

Selected Recent LLC Cases

ALI CLE
Limited Liability Entities 2014 Update
Video Webcast
March 24, 2014

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Standing/Authority to Sue

Turner v. Andrew, 413 S.W.3d 272 (Ky. 2013).

A truck owned by Billy Andrew and operated by Andrew's LLC was damaged in an accident, and Andrew sued to recover for damage to the truck as well as loss of income derived from use of the truck in Andrew's business. The LLC was not named as a plaintiff, and the Kentucky Supreme Court determined that Andrew had no standing to assert the claim for lost income if the LLC was conducting the business in which the truck was being used at the time of the accident. The court noted that Andrew could personally recover for the property damage to the truck since he personally owned the truck. The court explained that an LLC is a legal entity distinct from its members and pointed out that courts across the country have uniformly recognized the separateness of an LLC from its members. The court rejected the reasoning of the court of appeals that Andrew was the real party in interest since he was the sole owner of the LLC, pointing out that cases in the sole-owner corporation context had rejected that reasoning and stating that the same conclusion was mandated here. The court stated that the LLC and its sole member are not "interchangeable" and that "an LLC is not a legal coat that one slips on to protect the owner from liability but then discards or ignores altogether when it is time to pursue a damage claim." The court acknowledged that there are circumstances when the LLC's separate existence can be disregarded in the interest of equity but stated this was not such a case because the facts here bore no resemblance to the traditional veil-piercing situation where an unpaid LLC creditor seeks to pierce the veil of an LLC to reach the personal assets of the member. Further, this case was not even an "outsider reverse" piercing case where the creditor of a member seeks to pierce the LLC veil to reach assets of the LLC to satisfy the member's personal debt. The court acknowledged that there is an "insider reverse" piercing theory adopted by a very few states and employed when strong policy considerations are involved. Here, the only appropriate plaintiff to assert the lost damages claim was the LLC if, as it appeared, the trucking business was being conducted by the LLC at the time of the accident.

Williams v. Charles, 996 N.E.2d 475 (Mass. App. 2013).

Three members of an LLC brought a derivative suit on behalf of the LLC against the LLC's managing member. The court of appeals held that the complaint was properly dismissed because the plaintiffs did not have the requisite vote required by the Massachusetts LLC statute for standing to sue. The court of appeals also concluded that the managing member's mother, who was also a member of the LLC, did not necessarily have an adverse interest in the outcome based on the familial relationship.

The Massachusetts LLC statute provides that suit may be brought in the name of the LLC, whether or not management is vested in managers, by members who are authorized to sue by the vote of members who own more than 50% of the unreturned contributions of the LLC determined in

accordance with another provision of the LLC statute; provided, however, that the vote of any member who has an interest in the outcome of the suit adverse to the LLC is excluded from the vote. The operating agreement did not address authorization of members to bring suit, so the court looked to the statute to apply this provision and calculate the percentages of members' unreturned capital contributions. The statutory provision addressing unreturned contributions provided that a member receives a return of his contribution to the extent a distribution reduces his share of the fair value of the net assets of the LLC below the value, as set in the records of the LLC, of his contribution which has not been distributed to him. The reference to contributions in this provision points to the agreed value of the members' contributions in the LLC's records. Exhibit A to the operating agreement set out an amount of cash contribution for each of the six members except Williams, one of the plaintiffs. Exhibit A showed Williams' cash contribution as zero. Treating Williams' contribution as zero, the trial judge determined that the plaintiffs together did not have more than 50% of the contributions to authorize the derivative suit. The plaintiffs argued that Williams contributed services, and the court of appeals acknowledged that the statute allows a contribution to consist of services, but the court of appeals concluded that absent an agreed value placed on services, there was no basis to include his contribution in the member vote to authorize the suit. Because Exhibit A set forth percentage interests and the operating agreement allocated profits and losses in proportion to the members' percentage interests, the plaintiffs argued the members' percentages should be used to determine their standing. The court concluded, however, that the statute expressly tied standing to the percentage of members' unreturned contributions unless the operating agreement specified a different manner of determining standing.

The court also addressed whether the mother of the defendant/manager had an interest adverse to the outcome of the suit such that her vote should be excluded from the vote needed to determine standing. The court declined to extend Connecticut case law regarding the treatment of spouses to the parent-child relationship, at least without more particularized allegations. The court held that the particularity requirement applicable to derivative actions under Massachusetts Rule 23.1 of the Rules of Civil Procedure applied to allegations regarding familial relationships, and the allegation that a member was the mother of the defendant managing member was insufficient to show that the mother's interest was adverse to the LLC's regarding the outcome of the suit. The additional allegations that the mother voted in alliance with her son at one meeting, along with another unrelated member, and failed to respond to the plaintiff's concerns also fell short of particularized facts required to show that the mother had significant contrary personal interests to those of the LLC in the lawsuit.

Finally, the court addressed the plaintiffs' attempts to recast some of their claims as direct rather than derivative claims. The plaintiffs argued that their claims were based on the managing member's breach of the operating agreement, and that they were entitled to enforce them as parties to the operating agreement because the operating agreement provided that it was binding on and inured to the benefit of the parties and afforded any party the right to injunctive relief. However, the recovery sought by the plaintiffs arose from the managing member's alleged self-dealing and excessive compensation, and the court held that it belonged to the LLC. The plaintiffs also argued that their claim of a minority freeze-out by the managing member should have been treated as direct. The court acknowledged that a minority freeze-out claim need not be brought derivatively where the wrongs were done to the individual plaintiffs, but the court concluded that this claim was moot because the remedy sought in their freeze-out claim was essentially granted in the judgment entered

on the plaintiffs' claim for an accounting, under which they were granted access to LLC information and an accounting.

Zimmerman v. Crothall, C.A. No. 6001-VCP, 2013 WL 5630992 (Del. Ch. Oct. 14, 2013).

After the trial of this derivative action, the court issued an opinion holding that the defendants breached the operating agreement of a Delaware LLC by entering into certain transactions without approval of the Class A unitholders of the LLC. The court found, however, that the breach caused no damage to the LLC and ordered the parties to submit a final, post-trial order. The parties failed to agree on a final order, and the plaintiff sought entry of his proposed final order. The plaintiff sold all of his units in the LLC before the court ruled on his motion, and the defendants moved to dismiss the action, arguing that the plaintiff's sale of all of his interest in the LLC prior to the entry of a final judgment extinguished his standing to prosecute claims derivatively on behalf of the LLC. The defendants requested that the court apply, by analogy, the "continuous ownership rule" found in corporate law, which requires a plaintiff stockholder suing derivatively on behalf of the corporation to own stock in the corporation throughout the litigation. The court stated that the continuous ownership rule is embodied in the Delaware General Corporation Law and Court of Chancery Rule 23.1. While the court acknowledged that the Delaware General Corporation Law was not directly applicable, the court found no reason not to apply the contemporaneous ownership rule in this LLC case. The court noted that Rule 23.1, to which this action was subject, embodies the spirit of the contemporaneous ownership rule, and further noted that the standing provision of the Delaware LLC statute sufficiently tracks its corporate counterpart as to suggest that the General Assembly intended that the continuous ownership rule would apply in the LLC context. Thus, the court granted the defendants' motion to dismiss for lack of standing.

418 Meadow Street Associates, LLC v. One Solution Services, LLC, 73 A.3d 780 (Conn. App. 2013).

The question in this appeal was whether the trial court properly applied the appropriate standard in determining that two members who jointly owned 50% of an LLC had standing to initiate this action on behalf of the LLC without the consent of the third member, who owned the remaining 50%. Weinshel and Wynnich together owned 50% of an LLC, and Levine owned the other 50%. Weinshel and Wynnich brought this action on the LLC's behalf to recover damages for breach of the LLC's lease agreement with the defendant, and the defendant claimed that Weinshel and Wynnich were without authority to bring the action. After a previous appeal of a default judgment against the defendant and remand of the case, the trial court rejected the defendant's argument that Weinshel and Wynnich lacked standing. The operating agreement required a majority of the ownership to authorize legal expenditures, and the Connecticut LLC statute provides that approval of a majority in interest is required to make business decisions unless otherwise provided by the operating agreement. The Connecticut LLC statute also provides, however, that the vote of any member who has an interest in the outcome of the suit that is adverse to the LLC shall be excluded. There was no dispute that the dispositive issue in this case was whether Levine had an interest in the outcome of the suit that was adverse to the LLC. The trial court found that Levine had an adverse interest in the outcome of the suit although she did not have a proprietary interest in the defendant. Based on Levine's adverse interest, the trial court found that Weinshel and Wynnich had standing to bring the action without Levine's consent. On appeal, the court of appeals agreed with the defendant that the trial court erred in its analysis of whether Levine's interest was adverse. The trial

court focused on evidence of animosity between Levine and the other members rather than on whether Levine's interest in the outcome of the present litigation was adverse to the LLC. The court of appeals thus remanded for the trial court to use the appropriate standard, which required the trial court to focus on whether Levine's interest in the outcome of the present suit was adverse to the LLC.

Maya I-215, LLC v. Moore, No. 60095, 2013 WL 3833280 (Nev. July 18, 2013).

Maya I-215, LLC ("Maya") and Screaming Eagle, LLC ("Screaming Eagle") sued the managers of Screaming Eagle. Screaming Eagle was the manager of Maya, and the two LLCs alleged that the managers of Screaming Eagle received unauthorized fees to the detriment of Maya. The issue on appeal was whether Screaming Eagle, as Maya's manager, was authorized to initiate the litigation. The district court dismissed the litigation on the basis of member votes based on the interestedness test set forth by the Nevada Supreme Court in *In re AMERCO Derivative Litigation*. The supreme court held that the district court misread *AMERCO*, which did not apply, and that the manager had the unambiguous authority to initiate the lawsuit. Thus, the member vote was irrelevant. *AMERCO* involved the interestedness of corporate officers in declining to institute derivative litigation, and the court held that the corporation's shareholder could proceed with a derivative action without making demand on the corporations's officers because a demand would have been futile. The court explained that the *AMERCO* test did not apply in this case where the district court considered the opposite, i.e., the interestedness of the members in authorizing or discontinuing litigation initiated by the LLC's manager. Applying contract principles to the interpretation of the operating agreement, the court found clear and unambiguous provisions authorizing the manager of Maya to do all things necessary or convenient to carrying out the LLC's business, including instituting, prosecuting, and defending actions in the LLC's name. Except for certain specified matters, the authority to act for the LLC was vested in the manager. Certain decisions were reserved to the members or required member consent, but nothing in the operating agreement allowed members to override the decision of the manager to institute a lawsuit. One of the defendants also argued that the law firm representing Maya in the case could not do so because the members of Maya voted to terminate the LLC's relationship with the law firm, but the court stated that Screaming Eagle's authority to initiate the law suit included the authority to choose counsel.

Kohanim v. Katoli, __ S.W.3d __, 2013 WL 3943078 (Tex. App. 2013).

A member's 50% interest in an LLC was awarded to his wife in their divorce. Before the divorce, the other member closed an LLC bank account and transferred \$160,000 in the account to another account as a "payment to owner." After the divorce, the other member caused the LLC to make payments to him for services provided to the LLC. The ex-wife, now an assignee of her husband's 50% interest, sued the other member and the LLC, asserting claims that included unjust enrichment. The court of appeals agreed with the other member's challenge to the trial court's finding on the ex-wives's unjust enrichment claim. The trial court found that the other member wrongfully utilized funds and assets of the LLC for his own use and unilaterally obligated the LLC to pay himself for management services that were not performed at all or were performed in a manner that damaged the LLC. A claim for unjust enrichment on these facts belonged to the LLC rather than the ex-wife.

United States v. ADT Security Services, LLC, 522 Fed. App'x 480 (11th Cir. 2013).

In this civil forfeiture action, an LLC asserted a claim for a 10% interest in several properties owned by other LLCs in which the claimant held a 10% interest. The claimant also asserted a claim for a 10% interest in escrowed lease payments collected with respect to the properties. The district court granted the government summary judgment on the basis that the claimant lacked standing to assert the claim. The government's challenge to the claimant's standing rested in part on the fact that the claimant did not exist as a jural entity. The court discussed the formation and structure of LLCs under Pennsylvania and Florida law, described the history and existence of certain other entities with similar names, and explained that the evidence showed the claimant was never properly formed as an LLC. The claimant argued that it existed as a de facto LLC or an LLC by estoppel, but this argument was not properly briefed and thus was not considered by the court of appeals. The court of appeals next considered whether the claimant was an entity that could make an appearance despite not being properly formed as an LLC. The court concluded that the claimant could make an appearance but lacked standing. Whether the claimant as a non-existent legal entity could assert a valid claim was a question of "substantive standing jurisprudence." To have standing, the claimant must have an ownership interest in the subject properties as determined by the law of the jurisdiction creating the asserted interest. The properties at issue were owned by Florida and Pennsylvania LLCs in which the claimant claimed to be a member. Under Florida and Pennsylvania LLC law, property acquired by an LLC is property of the LLC, and the claimant thus could not assert a claim on its own behalf. The court next analyzed whether the claimant could assert a claim on behalf of the LLCs in which it claimed to be a member. The operating agreements of the LLCs at issue provided that the LLCs were manager-managed. A member of a manager-managed LLC under the Florida and Pennsylvania statutes does not have authority to act solely by reason of being a member. The claimant argued that it had been elected as a manager, but the court explained that the claimant failed to satisfy its evidentiary burden on this point and thus failed to show it had authority to file a claim on behalf of the LLCs that owned the property. Finally, the court addressed a provision of the Pennsylvania LLC statute that provides that the lack of authority of a member or manager to sue on behalf of an LLC may not be asserted as a defense to an action by the LLC. The court acknowledged that the statute appeared at first glance to bar the government from challenging the claim, but the court concluded that the statute was inapplicable. The court distinguished the filing of an "action" from the filing of a "claim" such as the claim in this forfeiture action. The court relied on commentary to the Pennsylvania statute and to applicable procedural rules allowing the government to challenge the claimant's standing.

Klingelhoef v. Parker, Grossart, Bahensky & Beucke, L.L.P., 834 N.W.2d 249 (Neb. App. 2013).

The plaintiff was one of 11 children of Constance Klingelhoef, and the plaintiff sued the law firm hired by his mother to develop and implement an estate plan. As part of her estate plan, the plaintiff's mother formed an LLC, transferred her real estate to the LLC, and gave interests in the LLC to her 11 children. The plaintiff's mother also created a trust to which she transferred her personal property. After the plaintiff's mother died, the plaintiff brought a professional negligence action against the law firm hired by his mother. The law firm filed a motion to dismiss based primarily on the plaintiff's lack of standing to bring an action in his own name for injuries he allegedly suffered as a member of the LLC and beneficiary of the trust. The plaintiff filed an amended complaint in which he changed the caption of the suit to reflect he was suing individually

and as beneficiary of the trust and representative of the LLC. He inserted an allegation that he did not secure initiation of the action against the LLC by the manager and certain other members because it would be futile since the manager and other members were beneficiaries of the misconduct and previously represented by the law firm. The plaintiff did not include an allegation that he had requested that the LLC file the action or why such request would be futile. After the plaintiff filed the amended complaint, the trial court granted the summary judgment in favor of the law firm on the basis that the plaintiff lacked standing to maintain a professional negligence action against the law firm as an heir of his mother or member of the LLC and that the law firm owed no duty to the plaintiff as a beneficiary of the trust. The court of appeals affirmed the trial court's judgment. The court of appeals first determined that the plaintiff did not plead a derivative action. The Nebraska LLC statute allows for a member derivative action if the member makes a demand on the manager or a demand is futile. A member bringing a derivative action must set forth in the complaint what actions were taken to comply with the statute. The plaintiff did not allege that he requested the manager to institute a professional negligence action but rather stated that it would have been futile to request the manager to initiate an action against the LLC. Even construing the pleading as an attempt to comply with the statute, the plaintiff did not allege that he brought his claims on behalf of the LLC. Further, the complaint here sought damages based on an interpretation of the trust and LLC that was rejected by the court in a prior suit brought by the plaintiff; therefore, this action reflected a position adverse to the established intent of the trust and LLC. It was clear to the court that the plaintiff's personal interests rather than the entity's interests were at the forefront of the litigation. The court went on to analyze the nature of the harm alleged by the plaintiff in light of principles applicable to corporate derivative suits applied by the Nebraska Supreme Court in the LLC context. The court concluded that the plaintiff did not allege any injury separate and distinct from the harm allegedly suffered by other non-farming members of the LLC. Neither did the plaintiff show any special duty was owed to him separate and distinct from the duty owed to the LLC. The court explained that this case was distinguishable from a case in which the Nebraska Supreme Court held that an attorney's duty extended to two shareholders of a closely held corporation that hired the attorney. In that case, the shareholders were a husband and wife who communicated directly with the attorney and whose interests were profoundly affected by whatever affected the corporation. Also, the corporation joined in the action against the attorney. Here, the plaintiff's mother was the sole founder of the LLC and trust, she hired the attorney and communicated with the attorney, and it was the mother's interests that the attorney was representing, not necessarily the interests of the plaintiff or his siblings (as evidenced by the fact that the plaintiff's mother included special provisions for her farming sons). Furthermore, extension of the attorney's duty to the plaintiff as a member of the LLC and beneficiary of the trust would necessarily extend the duty to the plaintiff's siblings, thus creating conflicting loyalties. The plaintiff complained of the attorney's actions that benefitted three of his siblings to the detriment of others, but the attorney was charged with drafting and carrying out the provisions of the documents through representation of the plaintiff's mother, regardless of the beneficial or detrimental effect it had on the individual beneficiaries of the trust or members of the LLC. In sum, the plaintiff did not have standing to bring the action, and legal representation of the plaintiff's mother did not equate to protection of the plaintiff and his siblings.

Painter's Mill Grille, LLC v. Brown, 716 F.3d 342 (4th Cir. 2013).

An LLC and its owners alleged that the LLC's landlord and its agents, motivated by racial animus, interfered with the LLC's restaurant business and the LLC's opportunity to sell the

restaurant in violation of federal anti-discrimination laws (42 U.S.C. §§ 1981, 1982, and 1985) and state law tort principles. The plaintiffs alleged that the defendants spoke about the LLC's clientele using racial slurs and engaged in various acts of harassment after the LLC's clientele became predominantly African American. The court of appeals affirmed the district court's dismissal of the LLC's owners as plaintiffs based on lack of standing. The appellate court pointed out the individual plaintiffs chose to conduct their business as an LLC, which provided them liability protection and resulted in their becoming agents of the LLC. In doing so, they gave up standing to claim damages for the LLC, even if they also suffered personal damages as a consequence. The court relied on the United States Supreme Court's decision in *Domino's Pizza, Inc. v. McDonald*, 546 U.S. 470 (2006). In that case, the sole shareholder and president of a corporation alleged that Domino's breached its contract with the shareholder's corporation based on racial animus toward the shareholder and that Domino's injured him personally. The Ninth Circuit recognized the shareholder's claim, but the Supreme Court held that a plaintiff cannot state a claim under 42 U.S.C. § 1981 unless the plaintiff would have rights under the contract at issue; § 1981 plaintiffs must identify injuries flowing from a racially motivated breach of their own contractual relationship, not of someone else's. Thus, *Domino's* directly foreclosed the individual plaintiffs' § 1981 claim, and the court of appeals held that the same principles applied to the §§ 1982 and 1985 claims. For similar reasons, the court held that the individual plaintiffs did not have standing to assert claims based on state law tortious interference with contract and economic relationships.

Padawer v. Yur, 66 A.3d 931 (Conn. App. 2013).

The defendants in an action brought by the sole member of an LLC appealed the judgment against them on the basis that the plaintiff did not have standing to assert the claims on which the judgment was based. The plaintiff sued for breach of contract and unjust enrichment based on the defendants' breach of an oral agreement to purchase a retail women's clothing store after taking over operation of the store. The store was owned by Clare Jones, LLC, and the plaintiff's evidence included various documents and proposed drafts of sales contracts, all of which indicated the plaintiff was acting as an agent of Clare Jones, LLC, rather than as an individual. There was no evidence or testimony that the plaintiff individually owned the store or that any of the assets located in the boutique belonged to the plaintiff individually. The court cited statutory provisions regarding the separate legal existence of an LLC and its power to sue and be sued. The court concluded that any harm caused by the alleged breach was to Clare Jones, LLC, and the plaintiff's status as sole member did not impute ownership of the LLC's assets to the plaintiff since property acquired by an LLC is property of the LLC rather than its members, and a member has no interest in specific LLC property. The plaintiff thus did not have standing, and the trial court erred in denying the defendants' motion to dismiss.

Zeigler v. Housing Authority of New Orleans, 118 So.3d 442 (La. App. 2013).

Zeigler and his LLC, an inspection company, alleged a scheme on the part of the defendants to take control of a housing program for victims of natural disasters and drive the LLC out of business with the New Orleans Housing Authority. Aside from a claim for intentional infliction of emotional distress, Zeigler only alleged causes of action related to the LLC's business dealings, and the court of appeals held that the trial court correctly dismissed Zeigler's claims because he had no standing to sue personally and recover damages suffered by his LLC. The court pointed out that a member of a Louisiana LLC has no interest in LLC property, and members of an LLC thus have no

right to sue personally for damages to LLC property. With respect to the intentional infliction of emotional distress claim, the court held that Zeigler failed to state a cause of action because, although both the LLC and Zeigler were negatively affected by the alleged acts, the perceived target as alleged by the pleadings was the LLC rather than Zeigler.

Damon v. Groteboer, 937 F.Supp.2d 1048 (D. Minn. 2013).

Mr. and Mrs. Damon sought to recover damages incurred in connection with the purchase of a commercial office building. The defendants argued that the Damons could not recover individually because they formed an LLC to own the building and limit their personal liability and they sought as individuals to recover damages that were incurred by the LLC. The court stated that it understood the economic reality that the Damons, as sole members, contributed the funds at issue, but the court would “not allow the Damons to take advantage of the corporate form to limit personal liability while simultaneously ignoring the corporate form when doing so allows them to profit personally.” The court concluded that the Damons could properly seek to recover the damages incurred personally before they created the LLC and transferred the building to the LLC, and the court allowed further briefing to address the possibility that it would not work an injustice if the LLC were added as a party.

Pro Se Representation

Smith v. Rustic Home Builders, LLC, 826 N.W.2d 357 (S.D. 2013).

The South Dakota Supreme Court held, as a matter of first impression, that an individual who is not a licensed attorney may not appear to represent an LLC pro se. The court followed many other federal and state courts that have extended the rule that a corporation must be represented by a licensed attorney to LLCs and thus dismissed an LLC’s appeal because it was filed by the LLC’s manager, a non-lawyer.

Personal Jurisdiction

Florida R&D Fund Investors, LLC v. Florida BOCA/Deerfield R&D Investors, LLC, C.A. No. 8400-VCN, 2013 WL 4734834 (Aug. 30, 2013).

A member of a joint venture Delaware LLC brought a books and records action under the Delaware Limited Liability Company Act and the LLC agreement. The plaintiff sought information for the purposes of appointing a new asset manager and investigating possible mismanagement of the LLC. The plaintiff sued the LLC, its former asset manager, the other members of the LLC and certain other affiliated parties. The defendants other than the LLC moved to dismiss for lack of personal jurisdiction and failure to state a claim.

The plaintiff alleged the court had personal jurisdiction over the former asset manager, an Indiana corporation with an Indiana address, pursuant to the Delaware long-arm statute or the implied consent provision of the Delaware LLC statute. The court declined to exercise jurisdiction over the former asset manager under the Delaware long-arm statute because mere participation in the management of a Delaware entity without allegations of extensive and continuing contacts with Delaware does not subject a party to the court’s long-arm jurisdiction. The plaintiff failed to allege that the former asset manager took any actions within Delaware or that the former asset manager was involved in the formation of the LLC or any related Delaware entities. The court next addressed

whether the former asset manager was subject to the court's jurisdiction under the implied consent provision of the Delaware LLC statute, under which service as a manager of a Delaware LLC constitutes implied consent to the court's jurisdiction. For purposes of the implied consent provision, the term "manager" means a person defined as a "manager" in the Delaware LLC statute and a person who participates materially in the management of the LLC even though the person is not a manager as defined in the statute; provided, however, that the power to choose or participate in choosing a manager does not alone constitute participation in the management of the LLC. The LLC agreement explicitly provided that the board of directors of the LLC was the manager of the LLC for purposes of the Delaware LLC statute, and the LLC agreement did not name or designate the former asset manager as a manager of the LLC. Therefore, the court held that the former asset manager was not a manager of the LLC as defined in the Delaware LLC statute, and the court turned to the question of whether the former asset manager had participated materially in the management of the LLC. The asset management agreement with the LLC specified that the former asset manager was an independent contractor and was not acting as an agent. Further, the role of the former asset manager was confined to acting as the asset manager and providing specified services in compliance with the LLC's business plan and budget. The court stated that the management of the underlying assets of an LLC is analytically distinct from management of the LLC itself for purposes of the implied consent provision of the LLC statute. The court did not determine whether the former asset manager's authority was sufficient to constitute material participation in the management of the LLC because the plaintiff did not allege that the former asset manager actually engaged in any of its contractually authorized conduct. The court stated that merely having the capacity to participate in management does not constitute material participation in management. Thus, the court dismissed the plaintiff's claim against the former asset manager for lack of personal jurisdiction.

Derivative Suits

Williams v. Charles, 996 N.E.2d 475 (Mass. App. 2013).

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The Massachusetts LLC statute provides that suit may be brought in the name of the LLC, whether or not management is vested in managers, by members who are authorized to sue by the vote of members who own more than 50% of the unreturned contributions of the LLC determined in accordance with another provision of the LLC statute; provided, however, that the vote of any member who has an interest in the outcome of the suit adverse to the LLC is excluded from the vote. The operating agreement did not address authorization of members to bring suit, so the court looked to the statute to apply this provision and calculate the percentages of members' unreturned capital contributions. The statutory provision addressing unreturned contributions provided that a member receives a return of his contribution to the extent a distribution reduces his share of the fair value of the net assets of the LLC below the value, as set in the records of the LLC, of his contribution which has not been distributed to him. The reference to contributions in this provision points to the agreed value of the members' contributions in the LLC's records. Exhibit A to the operating agreement set

out an amount of cash contribution for each of the six members except Williams, one of the plaintiffs. Exhibit A showed Williams' cash contribution as zero. Treating Williams' contribution as zero, the trial judge determined that the plaintiffs together did not have more than 50% of the contributions to authorize the derivative suit. The plaintiffs argued that Williams contributed services, and the court of appeals acknowledged that the statute allows a contribution to consist of services, but the court of appeals concluded that absent an agreed value placed on services, there was no basis to include his contribution in the member vote to authorize the suit. Because Exhibit A set forth percentage interests and the operating agreement allocated profits and losses in proportion to the members' percentage interests, the plaintiffs argued the members' percentages should be used to determine their standing. The court concluded, however, that the statute expressly tied standing to the percentage of members' unreturned contributions unless the operating agreement specified a different manner of determining standing.

The court also addressed whether the mother of the defendant/manager had an interest adverse to the outcome of the suit such that her vote should be excluded from the vote needed to determine standing. The court declined to extend Connecticut case law regarding the treatment of spouses to the parent-child relationship, at least without more particularized allegations. The court held that the particularity requirement applicable to derivative actions under Massachusetts Rule 23.1 of the Rules of Civil Procedure applied to allegations regarding familial relationships, and the allegation that a member was the mother of the defendant managing member was insufficient to show that the mother's interest was adverse to the LLC's regarding the outcome of the suit. The additional allegations that the mother voted in alliance with her son at one meeting, along with another unrelated member, and failed to respond to the plaintiff's concerns also fell short of particularized facts required to show that the mother had significant contrary personal interests to those of the LLC in the lawsuit.

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Zimmerman v. Crothall, C.A. No. 6001-VCP, 2013 WL 5630992 (Del. Ch. Oct. 14, 2013).

After the trial of this derivative action, the court issued an opinion holding that the defendants breached the operating agreement of a Delaware LLC by entering into certain transactions without approval of the Class A unitholders of the LLC. The court found, however, that the breach caused no damage to the LLC and ordered the parties to submit a final, post-trial order. The parties failed to agree on a final order, and the plaintiff sought entry of his proposed final order. The plaintiff sold all of his units in the LLC before the court ruled on his motion, and the defendants moved to dismiss

the action, arguing that the plaintiff's sale of all of his interest in the LLC prior to the entry of a final judgment extinguished his standing to prosecute claims derivatively on behalf of the LLC. The defendants requested that the court apply, by analogy, the "continuous ownership rule" found in corporate law, which requires a plaintiff stockholder suing derivatively on behalf of the corporation to own stock in the corporation throughout the litigation. The court stated that the continuous ownership rule is embodied in the Delaware General Corporation Law and Court of Chancery Rule 23.1. While the court acknowledged that the Delaware General Corporation Law was not directly applicable, the court found no reason not to apply the contemporaneous ownership rule in this LLC case. The court noted that Rule 23.1, to which this action was subject, embodies the spirit of the contemporaneous ownership rule, and further noted that the standing provision of the Delaware LLC statute sufficiently tracks its corporate counterpart as to suggest that the General Assembly intended that the continuous ownership rule would apply in the LLC context. Thus, the court granted the defendants' motion to dismiss for lack of standing. The court went on to consider the petition of the plaintiff's counsel for attorney's fees, and the court awarded fees based on the corporate benefit doctrine.

Najjar Group, LLC v. West 56th Hotel LLC, 974 N.Y.S.2d 58 (App. Div. 1st Dept. 2013).

The court held that the plaintiff's claim under a provision of an LLC operating agreement requiring distribution of surplus revenue to the members pro rata in accordance with their equity interests could not be asserted derivatively because it was personal to the plaintiff rather than belonging to the LLC. The plaintiff also failed to adequately allege that a pre-suit demand was futile. A pre-suit demand is required in the LLC context as it is in the corporate context, and the plaintiff did not allege that a majority of the individual defendants controlling the managing member were interested in the challenged transaction. The plaintiff alleged that one individual controlled certain entities that owned and operated another hotel to which the LLC's funds were allegedly diverted but did not specify how the other individual defendants were involved.

Otto v. Otto, 974 N.Y.S.2d 54 (App. Div. 1st Dept. 2013).

The court disagreed with the motion court's ruling that the plaintiff had legal capacity to bring derivative claims on behalf of a dissolved Delaware LLC and dissolved Delaware limited partnerships. The court stated that the plaintiff was required to bring her derivative claims on behalf of the entities after or in conjunction with a successful action to nullify the certificates of cancellation. Rather than file a petition in the Delaware Chancery Court to have the certificates of cancellation annulled, the plaintiff improperly filed a motion in this action seeking nullification of the certificates. With regard to the demand requirement in derivative actions on behalf of LLCs and limited partnerships under Delaware and New York law, the court stated that the motion court's finding that demand was futile with respect to four of the limited partnerships was supported by allegations that the defendant controlling owner was interested in the sale transactions.

Cook v. Toidze, 950 F.Supp.2d 386 (D. Conn. 2013).

The plaintiffs, members of an LLC, sued the other members individually and derivatively on behalf of the LLC. The defendants attacked a default judgment taken against them, and the court raised *sua sponte* the issue of whether the court lacked subject matter jurisdiction. Because an LLC has the citizenship of each of its members, the LLC was a citizen of Canada and Connecticut. The court stated that if the action was a derivative action, the LLC was not a nominal party and its

citizenship could not be ignored. The court concluded that the plaintiff's claims were derivative in nature. The plaintiffs claimed that one of the defendants failed to transfer intellectual property to the LLC, which forced a joint venture to which the LLC was a party to fail to renew a consulting agreement. The plaintiffs also alleged that the defendants engaged in unauthorized travel to meetings that damaged the relationship between a third party and the joint venture to which the LLC was a party. Further, the plaintiffs alleged that the defendants failed to pay their share of a capital call, thereby causing a shortfall in the LLC's working capital. Finally, the plaintiffs alleged that the defendants continued their efforts to damage the value of the membership interests by interfering with the governance of the LLC. The court held that these allegations described harm to the LLC and were derivative in nature; therefore, the LLC was not merely a nominal party. The court further held that the LLC was an indispensable party (noting that the courts appear to be unanimous in concluding that the party on whose behalf a derivative claim is brought is an indispensable party) whose presence in the suit destroyed diversity jurisdiction, and the default judgment against the defendants was thus void due to lack of subject matter jurisdiction.

Klingelhofer v. Parker, Grossart, Bahensky & Beucke, L.L.P., 834 N.W.2d 249 (Neb. App. 2013).

The plaintiff was one of 11 children of Constance Klingelhofer, and the plaintiff sued the law firm hired by his mother to develop and implement an estate plan. As part of her estate plan, the plaintiff's mother formed an LLC, transferred her real estate to the LLC, and gave interests in the LLC to her 11 children. The plaintiff's mother also created a trust to which she transferred her personal property. After the plaintiff's mother died, the plaintiff brought a professional negligence action against the law firm hired by his mother. The law firm filed a motion to dismiss based primarily on the plaintiff's lack of standing to bring an action in his own name for injuries he allegedly suffered as a member of the LLC and beneficiary of the trust. The plaintiff filed an amended complaint in which he changed the caption of the suit to reflect he was suing individually and as beneficiary of the trust and representative of the LLC. He inserted an allegation that he did not secure initiation of the action against the LLC by the manager and certain other members because it would be futile since the manager and other members were beneficiaries of the misconduct and previously represented by the law firm. The plaintiff did not include an allegation that he had requested that the LLC file the action or why such request would be futile. After the plaintiff filed the amended complaint, the trial court granted the summary judgment in favor of the law firm on the basis that the plaintiff lacked standing to maintain a professional negligence action against the law firm as an heir of his mother or member of the LLC and that the law firm owed no duty to the plaintiff as a beneficiary of the trust. The court of appeals affirmed the trial court's judgment. The court of appeals first determined that the plaintiff did not plead a derivative action. The Nebraska LLC statute allows for a member derivative action if the member makes a demand on the manager or a demand is futile. A member bringing a derivative action must set forth in the complaint what actions were taken to comply with the statute. The plaintiff did not allege that he requested the manager to institute a professional negligence action but rather stated that it would have been futile to request the manager to initiate an action against the LLC. Even construing the pleading as an attempt to comply with the statute, the plaintiff did not allege that he brought his claims on behalf of the LLC. Further, the complaint here sought damages based on an interpretation of the trust and LLC that was rejected by the court in a prior suit brought by the plaintiff; therefore, this action reflected a position adverse to the established intent of the trust and LLC. It was clear to the court

that the plaintiff's personal interests rather than the entity's interests were at the forefront of the litigation. The court went on to analyze the nature of the harm alleged by the plaintiff in light of principles applicable to corporate derivative suits applied by the Nebraska Supreme Court in the LLC context. The court concluded that the plaintiff did not allege any injury separate and distinct from the harm allegedly suffered by other non-farming members of the LLC. Neither did the plaintiff show any special duty was owed to him separate and distinct from the duty owed to the LLC.

Arbitration

LJL 33rd Street Associates, LLC v. Pitcairn Properties Inc., 725 F.3d 184 (2d Cir. 2013).

The plaintiff and defendant were the sole equity owners of an LLC that owned a luxury high-rise apartment building. The detailed operating agreement of the LLC contained an arbitration clause of limited scope that related to a buyout provision that provided that the "Purchase Price" under the buyout provision was to be derived from the "Stated Value." After the plaintiff exercised its purchase option, the parties were not able to agree on the price, and the plaintiff filed an arbitration demand asking for determination of both the Stated Value and Purchase Price. The arbitrator determined the Stated Value but refused to exercise jurisdiction to determine the Purchase Price. The court concluded that the arbitrator acted properly because the operating agreement expressly provided for arbitration to determine Stated Value but nowhere suggested that the Purchase Price be determined by arbitration.

Li v. Standard Fiber, LLC, C.A. No. 8191-VCN, 2013 WL 1286202 (Del. Ch. March 28, 2013).

Li sought advancement of legal fees pursuant to an indemnification agreement between Li and an LLC after the LLC's controlling owners initiated an arbitration proceeding against Li for breach of fiduciary duties to the LLC. When the LLC failed to satisfy Li's demand for advancement, he brought this action to enforce his advancement rights, and the LLC sought to dismiss or stay the action in favor of arbitration. The indemnification agreement did not contain an arbitration provision but contained an integration clause and provided that the question of Li's right to indemnification "shall be for an arbitrator or court to decide" if the LLC contested Li's right. Several other agreements to which Li and the LLC were parties contained mandatory arbitration clauses and integration clauses. Li was the founder of the LLC's predecessor and became a 25% owner of the LLC when the predecessor's assets were sold to the LLC under an asset purchase agreement that contained a broad arbitration clause and an integration clause. The LLC agreement also contained an arbitration clause and an integration clause, as did Li's employment agreement with the LLC. The court applied the standard established in *Willie Gary LLC v. James & Jackson LLC*, under which the question of arbitrability is presumed to be a question for the court rather than arbitrators unless there is "clear and unmistakable" evidence that the parties agreed to arbitrate. *Willie Gary* held that such evidence is present if the arbitration clause either generally provides for arbitration of all disputes or incorporates a set of arbitration rules that empowers arbitrators to decide arbitrability. The *Willie Gary* "clear and unmistakable" test has been modified by subsequent case law in one respect. Even if the *Willie Gary* test is met, a court must still "make a preliminary evaluation of whether the party seeking to avoid arbitration of arbitrability has made a clear showing that its adversary has made essentially no non-frivolous argument about substantive arbitrability." The court here concluded, and Li did not dispute, that the asset purchase agreement, LLC agreement, and employment

agreement satisfied the two prongs of the *Willie Gary* test because the broad arbitration clauses in those agreements generally provided for arbitration of all disputes and referenced the rules of Judicial Arbitration and Mediation Services. However, Li argued that the *Willie Gary* test should only apply to the indemnification agreement because it was executed after the other agreements and contained an integration clause showing that the parties intended the agreement to be the entire agreement with respect to its subject matter. The court acknowledged that the integration clause was some evidence that the indemnification agreement was completely independent of the other agreements and might lead to the conclusion that the arbitration provisions in the prior agreements were nullified with respect to the matter of advancement and indemnification. However, in the context of the limited inquiry permitted under *Willie Gary* and its progeny, Li's integration argument fell short because the integration clause did not conclusively establish that the valid arbitration clauses in the prior agreements were terminated. Some cases have held that a standard integration clause in a later agreement with no arbitration clause does not overcome an earlier agreement with an arbitration clause. Li also relied on the provision of the indemnification agreement granting the parties the right to litigate in Delaware courts under certain circumstances. The court stated that by focusing solely on the indemnification agreement, Li was subtly asserting that the claims asserted in his complaint did not relate to the prior agreements. However, who decides the question of substantive arbitrability turned on whether Li could clearly show that the LLC had made no non-frivolous argument that the dispute relates to the asset purchase agreement, LLC agreement, or employment agreement. Although Li's claims were based solely on the indemnification agreement, he arguably could not have brought them absent the other prior agreements that made him a member and officer of the LLC. The LLC's advancement and indemnification obligations arguably would not have arisen absent the parties' execution of the prior agreements, and the indemnification agreement could even be viewed as supplementing various provisions of the LLC and employment agreements. Further, Li's claims for indemnification at least colorably related to the LLC agreement in that he sought adjudication of substantive rights that were also provided in the LLC agreement. Although these arguments might not be very persuasive, they met the low threshold the court was required to apply, and the court could not conclude that the LLC had no non-frivolous arguments in favor of arbitrability. Thus, the court granted the LLC's request to stay the action pending an arbitrator's determination of arbitrability.

Nature of LLC

SJ Medical Center, L.L.C. v. Estahbanati, ___ S.W. 3d ___, 2013 WL 6628628 (Tex. App. 2013).

A Texas LLC argued that it was a "hospital district management contractor" within the meaning of a provision of the Texas Health and Safety Code that treats a hospital district management contractor as a governmental unit for purposes of the Texas Tort Claims Act. The Health and Safety Code defines a "hospital district management contractor" as "a nonprofit corporation, partnership, or sole proprietorship that manages or operates a hospital or provides services under contract with a hospital district that was created by general or special law." The LLC admitted it was an LLC but argued that the undefined term "partnership" in the statute should be construed broadly to include LLCs that elect to be taxed as partnerships for tax purposes under Texas and federal law. The court concluded that an LLC does not fall within the ordinary meaning of "partnership" even if the LLC elects partnership tax treatment. The court explained that an LLC has

some characteristics of a partnership but also has some characteristics of a corporation. The legislature chose to make only nonprofit corporations, partnerships, and sole proprietorships eligible for the protections of a hospital district management contractor, and the court stated that it was not the role of the court to question the wisdom of the statute or rewrite it.

Town of Midland v. Wayne, 748 S.E.2d 35 (N.C. App. 2013).

Wayne, an individual who held record title to a tract, sought to treat his tract and an adjacent tract owned by an LLC in which he owned a 75% interest as a single tract on the basis of unity of ownership. The court held that there was no unity of ownership because Wayne had no interest in the tract owned by the LLC; rather, he only owned an interest in the LLC that owned the tract. The court concluded that case law from the corporate context was the appropriate analogy and rejected Wayne's claim that the court should look to partnership case law under which the court had found that separate tracts owned by different partnerships could be treated as having a unity of ownership based on the fact that some of the general partners were the same. In that case, the court stated that each general partner had an ownership interest in the partnership property along with the other partners. Here, the court stated that the LLC should be treated like a corporation, which is distinct from the shareholders that own it, and that, where persons have deliberately adopted the corporate form to secure its advantages, they will not be allowed to disregard the existence of the corporate entity when it benefits them to do so. Wayne argued that an LLC should be treated like a general partnership rather than a corporation for purposes of unity of title because partnerships and LLCs are taxed similarly. The court was unconvinced, pointing out that S corporations and partnerships are also taxed similarly.

Limited Liability of Members and Managers; Personal Liability under Agency or Other Principles

Nwokedi v. Unlimited Restoration Specialists, __ S.W.3d __, 2014 WL 258993 (Tex. App. 2014).

Nwokedi and an LLC appealed a judgment against them in favor of a company that provided restoration services to the LLC's property after it was damaged in Hurricane Ike. The plaintiff's claims included claims for fraud, breach of contract, and fraudulent transfer, and the jury found in favor of the plaintiff on all its theories. The judgment awarded compensatory and punitive damages, voided four fraudulent transfers by Nwokedi and the LLC, imposed a constructive trust on fraudulently transferred insurance proceeds, and enjoined Nwokedi and the LLC from transferring any assets not subject to execution.

The plaintiff's common-law fraud claim was based on the plaintiff's contention that Nwokedi and the LLC intended to keep the insurance proceeds for themselves when they promised to pay for the plaintiff's work with the insurance proceeds. The court of appeals concluded that the evidence supported the jury's finding that Nwokedi and the LLC did not intend to pay the plaintiff as promised. Nwokedi argued on appeal that the evidence was insufficient to support a finding of individual liability on his part. The court recited the rule that a corporate officer who knowingly participates in tortious or fraudulent acts may be held individually liable to third persons even though the officer was acting as an agent of the corporation. The evidence showed that Nwokedi, who owned a controlling interest in the LLC, knowingly participated in its fraud. Nwokedi participated in the contract negotiations with the plaintiff and personally reassured representatives of the plaintiff

that the insurance company was acting on the LLC's behalf and that the plaintiff would be receiving payments from the insurance company. Nwokedi sent several emails to the insurance company instructing it not to issue checks to the plaintiff. Thus, the court concluded there was evidence that Nwokedi knowingly participated in the fraud.

The fraudulent transfer claims were based on several transfers of funds from the LLC's bank account to various other accounts. The plaintiff alleged that these transfers were made with the intent to hinder, delay, or defraud the plaintiff. Nwokedi and the LLC argued on appeal that there was insufficient evidence to support the jury's finding that Nwokedi and the LLC fraudulently transferred property with the intent to hinder, delay, or defraud creditors. Based on the jury's finding, the trial court set aside four transfers of insurance proceeds, amounting to \$618,000, from the LLC's account to other accounts. The court of appeals discussed each transfer and concluded the evidence supported a finding that the transfers were fraudulent. The court pointed to evidence of several badges of fraud, including that Nwokedi was an "insider," that the accounts to which the transfers were made were held in the name of or controlled by Nwokedi, that Nwokedi attempted to conceal the transfers, and that the transfers were made after the plaintiff sued the LLC. The court also rejected the argument that a creditor is required to trace specific funds under the TUFTA. A constructive trust could only be imposed on traceable funds, but the other funds could be included in an award of damages. Nwokedi argued that he could not be held individually liable for the fraudulent transfers because there was no evidence that the assets transferred were his assets. The court rejected this argument on the basis that a corporate officer who knowingly participates in tortious or fraudulent conduct may be held individually liable to third persons even though the officer performed the act as an agent of the corporation.

Dass v. Yale, __ N.E.2d __, 2013 WL 6800983 (Ill. App. 2013).

The plaintiffs, purchasers of a condominium unit from an LLC, sued the LLC and Yale, the managing member of the LLC, for common law and statutory fraud based on misrepresentations made by the LLC through Yale regarding inspections and repairs of the unit. Yale argued that he was protected from personal liability by section 10-10 of the Illinois Limited Liability Company Act, which provides that the debts, obligations, and liabilities of an LLC are solely the debts, obligations, and liabilities of the LLC and that a member or manager is not liable for a debt, obligation, or liability of the LLC solely by reason of being or acting as a member or manager. The plaintiffs argued that this provision does not shield LLC members or managers from personal liability for torts or fraud committed in their capacity as members or managers of the LLC. The plaintiffs asserted that Yale would be liable for fraud based on the alleged misrepresentations if he acted individually and that defrauding the plaintiffs while acting as a member/manager should not provide protection. The court held that the plain language of the statute protected Yale from liability. Section 10-10 of the Illinois statute provides that a member is liable for a debt, obligation, or liability only if a provision to that effect is included in the articles of organization and the member has consented in writing to the provision, and the plaintiffs made no claim that Yale was liable under this exception to limited liability. The plaintiffs pointed to the official comment to section 303 of the Uniform Limited Liability Company Act (ULLCA) because section 10-10 of the Illinois statute is similar to section 303 of ULLCA, and the ULLCA comment is included in the "Historical and Statutory Notes" published by West with section 10-10 of the Illinois statute. The ULLCA comment states that a member or manager is not liable for the debts, obligations, and liabilities of the LLC simply because of the member's or manager's status as an agent of the LLC, but a member or manager is responsible

for acts or omissions that would be actionable in contract or tort against the member or manager if the person were acting in an individual capacity. The court refused to give the comment persuasive value because the ULLCA comments are not part of the statute and were not adopted by the Illinois legislature. The court contrasted the language of the prior Illinois LLC statute (which provided that a member or manager of an LLC was personally liable for an act, debt, obligation, or liability of the LLC to the extent that a shareholder or director, respectively, of an Illinois corporation is liable under analogous circumstances) to the current language and concluded the legislature intended to change the law by removing language that provided for personal liability. The court relied on other Illinois appellate decisions that stressed the statutory distinction between corporations and LLCs under section 10-10 in the context of an involuntarily dissolved LLC and an unformed LLC.

Ogea v. Merritt, __ So.3d __, 2013 WL 6439355 (La. 2013).

The Louisiana Supreme Court analyzed the statutory limitation of liability of LLC members and managers in the context of the plaintiff's attempt to hold a member of an LLC personally liable for the member's own actions in connection with the construction of a house that the LLC contracted to build. The member personally operated the bulldozer in preparing the dirt pad for the foundation and supervised the subcontractor that poured the concrete slab. The foundation was faulty beyond repair, and the lower courts held the member was liable as well as the LLC. The supreme court discussed the nature of an LLC and stressed that it is an entity separate from its members and that the liability of its members is governed "solely" and "exclusively" by the law of LLCs. The Louisiana LLC statute provides that a member or manager of an LLC is not liable for any debt, obligation, or liability of the LLC except where the member or manager has committed fraud, a breach of professional duty, or other negligent or wrongful act. The court noted that the statute provides that a member is not a proper party to a proceeding by or against the LLC except when the object is to enforce a person's rights against or liability to the LLC, but the court declined to address this argument because the member had waived it.

The supreme court first addressed the plaintiff's arguments that the member committed fraud or breached a professional duty. In the absence of a definition of "fraud" in the LLC statute, the court found that it was appropriate to draw from a longstanding definition in the Civil Code, which provides that fraud is misrepresentation or suppression of the truth, including silence or inaction, with the intent to obtain an unjust advantage or cause loss or inconvenience. The court concluded that the member's failure to provide proof of insurance until the day of trial did not constitute fraud. Next the court noted the professions for which the Louisiana legislature has made available professional corporations and pointed out that there was no evidence that the individual defendant was a member of any of these professions. The plaintiff suggested that the member's role as a contractor should equate to a professional role, but the plaintiff failed to offer any evidence to support the argument. To the extent there was evidence in the record of licensure, it appeared that the LLC rather than the member held the contractor's license. The court stated that it was not suggesting that a mere licensure results in professional status, but the court stated that it may be one factor to consider.

Next the court discussed the exception to limited liability where a claimant "by law" has a cause of action against a member for a "negligent or wrongful act." The court rejected the member's argument that the phrase "negligent or wrongful act" applies only to conduct that can be construed as a tort. Because the concept of a "negligent" or "wrongful" act can be found outside of tort law, such as in criminal law and certain more arcane areas of law, the court concluded that the phrase was

not limited to torts. The court stated that the following four factors should be considered in determining whether conduct of a member falls within the ambit of a “negligent or wrongful act” for which a member has personal liability under the LLC statute: (1) whether the member’s conduct can be fairly characterized as a traditionally recognized tort; (2) whether the member’s conduct can be fairly characterized as a crime for which a natural person can be held culpable; (3) whether the conduct at issue was required by or in furtherance of a contract with the LLC; and (4) whether the conduct at issue was done outside the member’s capacity as a member. The court discussed each factor as it related to the case before it.

If a traditional tort has been committed against a cognizable victim, such a situation weighs in favor of applying the “negligent or wrongful act” exception to allow the victim to recover against the tortfeasor. The court cited the rule that a corporate officer or agent is liable where the officer or agent is at fault in causing an injury to another to whom a personal duty is owed, whether or not the act inflicting the injury was committed on the corporation’s behalf. The court stated that LLCs were not different from corporations in any sense that would justify a different approach to this type of question of personal liability. In examining whether an LLC member can be personally liable for a tort, the threshold question is whether a duty is owed to the claimant. The duty must be a duty in the tort sense rather than the contract sense. Here, the duty must be more than the duty inherent in the LLC’s contract not to engage in poor workmanship. Otherwise, the general rule of limited liability would be negated in any case where an LLC had a contractual duty not to engage in poor workmanship.

If the conduct at issue constitutes a crime, that fact weighs in favor of applying the “negligent or wrongful act” exception to permit the victim to recover. The court stated that only crimes for which a natural person (as opposed to a juridical person such as an LLC) could be held culpable should be considered. In the instant case, the court recognized that engaging in the business of contracting without a valid contractor’s license is a crime in Louisiana. Thus, if an LLC member personally acts in the capacity as a contractor without proper licensing of the individual or LLC, that situation would weigh in favor of holding the member personally liable. The court stated that it was not necessary that the member actually be convicted of the crime to satisfy the criminal conduct factor. As in the tort context, the critical question regarding a member’s criminal conduct is whether the member breached a duty to the claimant. A court must focus on whether the statute was intended to protect a particular plaintiff from the types of harm that ensued.

The contract factor weighs against holding the member personally liable if the member’s conduct was required by, or in furtherance of, a contract between the claimant and the LLC. If the reason a member is engaged in the conduct at issue is to satisfy a contractual obligation of the LLC, the member will be more likely to qualify for the limitation on liability.

Acting outside the capacity as a member weighs in favor of removing an individual from the protection of limited liability. The court acknowledged that this inquiry may overlap with the tort and/or contract inquiry. As examples of acting “outside” the structure of the business entity, the court noted situations in which a member in his personal capacity becomes a mandatary (agent) for the claimant and breaches a duty, or a member or shareholder contracts on behalf of the LLC or corporation without disclosing the representative capacity in which the member or shareholder is acting.

When determining whether the exception for a member’s “negligent or wrongful act” overrides the general rule of limited liability, a court must evaluate each situation on a case-by-case basis and consider each of the four factors discussed above. The tort factor may be dispositive. In

other words, on a showing that a member owed a duty in tort to the claimant, the breach of duty could pave the way to a member's personal liability for the tort. The evidence here did not show that the member owed the plaintiff a tort duty. His conduct amounted to poor workmanship undertaken in furtherance of the legitimate goals of the LLC under its contract. The court pointed out that the conduct "stands in stark contrast to the oft-commented example of a contractor committing a personal injury while driving, which would present a far clearer justification for finding the existence of a tort duty." With respect to the criminal conduct factor, the record did not show that the member engaged in any criminal conduct, such as acting as a contractor without proper licensing. The third factor also weighed against imposing liability because the member's actions were in furtherance of the LLC's contract with the plaintiff. Finally, the record contained no evidence that the member acted "outside" as opposed to "inside" the structure of the LLC. The court stated that the limitation of liability of a member is a presumption, but the plaintiff failed to overcome the presumption in this case.

Kubican v. The Tavern, LLC, 752 S.E.2d 299 (W. Va. 2013).

The West Virginia Supreme Court held that the West Virginia Uniform Limited Liability Company Act does not preclude application of the equitable remedy of piercing the veil, and the court set forth a two-prong test and a non-exclusive list of factors that may be relevant in determining whether the test is met. The court addressed this issue based on a certified question from a circuit court in a case in which the plaintiff sought to pierce the veil of a West Virginia LLC to hold the two members of the LLC liable for tort claims against the LLC arising out of an altercation in a bar owned and operated by the LLC. The court noted that the type of liability presented to the court was distinguishable from holding an LLC member or manager personally liable based upon his or her own tortious actions and suggested that LLC managers may be held liable for their own participation in tortious or criminal activity even when performing their duties as managers.

Allain v. Tripple B Holding, LLC, __ So.3d __, 2013 WL 6492268 (La. App. 2013).

The plaintiff sued two individuals who contracted with the plaintiff in the name "Louisiana Work Release." The defendants argued that they were acting on behalf of Louisiana Work Release, L.L.C. and thus were not personally liable to the plaintiff. The trial court found that the two individual defendants never advised the plaintiff that they were employed by or acting on behalf of an LLC, and the evidence supported the trial court's finding. Because the individuals did not disclose their status as agents and the identity of the principal, they were personally liable for payment under the contract. Use of a trade name is not necessarily sufficient disclosure by an individual that he is contracting on behalf of a corporation or LLC. Thus, the appellate court found no error in the trial court's determination that the individual defendants were personally liable to the plaintiff.

Production Resource Group, L.L.C. v. Zanker, 976 N.Y.S.2d 75 (App. Div. 1st Dept. 2013).

The plaintiff sought to hold Zanker, the president of Learning Annex, LLC and LA Expo, LLC, personally liable for purchases approved by Cummings under the trade name "Learning Annex." The defendants argued that only LA Expo, LLC was liable for the purchases. The plaintiff claimed that "Learning Annex" was a well-known trade name used by Zanker and sought to recover against Zanker on that basis. The court acknowledged that an individual who acts on behalf of a nonexistent corporation can be held personally liable, but the court pointed out that Zanker did not

interact with the plaintiff; Cummings did. The plaintiff argued that Cummings was acting as Zanker's authorized representative, but the court stated that Cummings' claim that he was Zanker's agent could not be used to establish the fact of agency. Further, Cummings did not have apparent authority because the plaintiff did not interact with Zanker, and there was thus no conduct by Zanker toward the plaintiff that cloaked Cummings with apparent authority. In sum, there was no basis to hold Zanker personally liable to the plaintiff.

Wholesale Builders Supply, Inc. v. Green-Source Development, L.L.C., No. 9971, 2013 WL 6175210 (Ohio App. Nov. 21, 2013).

An individual signed a credit application on behalf of an LLC, and the LLC purchased goods on credit. Included in the credit application was the following language: "By signing this agreement you are both personally and corporately liable for the total of purchases by you or anyone designated to sign for your purchases on your account." The seller sought to hold the individual personally liable, and the court of appeals agreed with the trial court's conclusion that the individual agreed to be personally liable for the LLC's purchases by signing the credit application.

Weaver v. Tri-County Implement, Inc., 311 P.3d 808 (Mont. 2013).

Smith and Weaver formed an LLC. Smith opened a line of credit for the LLC with Tri-County Implements, Inc. ("Tri-County"), and requested that Tri-County perform certain work on a truck on the LLC's account. The truck was titled in the name of Weaver, and when the invoice was not paid and Tri-County would not release the truck, Weaver sought return of the truck. In the litigation that ensued, the trial court held Weaver personally liable to Tri-County for the charges owed for work on the truck. The Montana Supreme Court reviewed the statutory liability protection provided to members and managers of an LLC under the Montana LLC statute, which states that a member or manager is not liable for an LLC's debt, obligation, or liability solely by reason of being a member or manager. The court stated that this protection is not absolute in that it does not protect a member from liability for the member's own wrongful conduct. Relying on previous Montana case law in the LLC context, the court stated that Weaver's liability as a member depended on whether he engaged in conduct that would give rise to contract or tort liability if he were acting in his individual capacity. Although the trial court concluded that Weaver was liable on the contract with Tri-County, the supreme court found no basis on which to hold Weaver liable on the contract. The agreements with Tri-County for work on the truck were solely between Tri-County and the LLC, and Weaver did not guarantee the LLC's payments or make any other promises. That Weaver held title to the truck, sued Tri-County, knew about the LLC's transactions with Tri-County and failed to object, or arranged to make some payments was immaterial. Conflating the LLC's failure to pay its own debt and Weaver's failure to pay the LLC's debt would eviscerate the statutory liability protection provided LLC members. Turning to a tort analysis, the allegation that the LLC was unable to pay its debts did not of itself amount to wrongful conduct that imposes liability on Weaver. It was also immaterial to the tort analysis that Weaver held title to the truck, sued Tri-County, knew about the LLC's transactions with Tri-County and failed to object, or arranged for some payments to be made. Weaver's conduct did not amount to an actionable tort. If a member or manager operates an LLC as an empty shell to perpetuate fraud and avoid personal liability, the court said the situation would be different, but those facts were not present here.

JSA, LLC v. Golden Gaming, Inc., No. 58074, 2013 WL 5437333 (Nev. Sept. 25, 2013).

The appellants negotiated a lease with Golden Gaming, Inc. (“Golden Gaming”), and Golden Gaming executed the lease on behalf of a subsidiary, Golden Tavern Group (“Golden Tavern”), the manager of Sparky’s South Carson 7, LLC (the “LLC”), which was listed as the tenant on the lease. The lease did not list Golden Gaming as a tenant, and Golden Gaming refused to guarantee the lease when asked. Golden Gaming provided the LLC’s initial capitalization and recapitalized the LLC on a frequent basis, but the LLC operated in accordance with Nevada gaming law using its own on-site managers. The on-site managers would report to a regional manager at Golden Tavern who would report to Golden Gaming. Upper-level management and operations occurred at Golden Gaming’s offices. Golden Gaming accounted for the LLC through the use of consolidated bank accounts with separate accounting through a coding system. Golden Gaming kept separate books and records for the LLC and filed independent sales tax returns but filed a single consolidated tax return. The LLC did not have an operating agreement, “as one was not required under Nevada law.” The LLC failed, and the appellants sued Golden Gaming alleging various claims and causes of actions. The trial court entered judgment in favor of Golden Gaming on all counts. On appeal, the appellants argued that the trial court erred in concluding that Golden Gaming was not a party to the lease, did not fraudulently or negligently misrepresent its status as guarantor or tenant, and was not the alter ego of the LLC. The Nevada Supreme Court first discussed the appellants’ argument that it should be able to hold Golden Gaming liable as a party to the lease due to its failure to disclose its alleged agency status and as a “dba” of the LLC. The court concluded that Golden Gaming was not liable on the lease because the LLC was listed on the signature line as the tenant, and the signature line clearly indicated that the lease was being signed by Golden Gaming on behalf of the LLC. Golden Gaming was not an undisclosed or partially disclosed agent and was not liable on the lease under agency principles. The appellants argued that Golden Gaming repeatedly used various LLCs as dba’s for its business operations so that it was rational for the appellants to assume that it was doing so in this case. The court stated that this argument failed when put in the context of the plain language of the lease, which clearly stated that the LLC was the tenant and that Golden Gaming was not signing for itself. The court rejected the fraudulent misrepresentation claim because there was substantial evidence supporting the trial court’s determination that Golden Gaming did not fraudulently misrepresent the identity of the tenant. A purported fraudulent inducement cannot be something that conflicts with the contract’s express terms. The identity of the tenant as the LLC was clear in the written lease. It was undisputed that Golden Gaming never told the appellants that it would be the tenant, and Golden Gaming was never listed as the tenant on the lease. The court characterized the appellants’ predicament as resulting from a lack of due diligence and erroneous assumptions rather than any action by Golden Gaming. Finally, the court concluded that substantial evidence supported the trial court’s determination that imposing alter ego liability on Golden Gaming was inappropriate.

Chen v. Yan, 971 N.Y.S.2d 519 (App. Div. 1st Dept. 2013).

The court held that an LLC’s owner was not liable as guarantor of an LLC’s promissory note, but the court could not determine as a matter of law that the owner was not primarily liable on the note. The note recited that “the undersigned hereby jointly and severally promise to pay” the amount owed under the promissory note, and the signature page had two signature lines, each next to the word “Borrower,” one on top of the other. Underneath the top line the words “Tony Yan (Owner)” were typed, and Yan’s signature appeared on that line. Stamped immediately below the typed words

“Tony Yan (Owner),” and covering the area above and below the second signature line, was a stamp with the employer ID number, name, and address of the LLC. Yan claimed he signed only in his capacity as the manager of the LLC and was not personally liable, but the court concluded that the lower court erred in dismissing the complaint against Yan because it could not be determined as a matter of law that he was not primarily liable based on the language in the note and extrinsic evidence. The court pointed out that the express “joint and several liability” of “the undersigned” would make no sense if the LLC were the sole obligor. Further, the signature page raised questions as to whether Yan signed in his individual capacity. It was possible to conclude that Yan intended to sign strictly on behalf of the entity, but it was also reasonable to interpret the signature section containing Yan’s signature on one line and the LLC’s stamp on the other as indicating that each was intended to be a borrower. Further clouding the intentions was the fact that the notary did not indicate Yan’s capacity. Next to the words “Notarized by:” appeared the words “For Tony Yan.” Looking to extrinsic evidence to resolve the ambiguities did not eliminate the possibility that Yan had borrowed the funds in his personal capacity. The loan proceeds were paid by a check payable to both the LLC and Yan as payees, and both parties pointed to aspects of their email communications supporting their arguments. In sum, it was error for the trial court to dismiss the claim against Yan individually.

Hooper v. Wisteria Lakes Subdivision, __ So.3d __, 2013 WL 5016455 (La. App. 2013).

Landowners who prevailed in a boundary dispute sought to hold two individuals personally liable for removing trees from the plaintiffs’ property. The individuals were members of an LLC, and the evidence indicated that all their actions took place in their capacities as members or agents of the LLC. Thus, the court concluded they were not personally liable for any liability of the LLC. The court stated that the plaintiffs offered no evidence that the individuals engaged in any fraudulent or ultra vires acts or otherwise acted in a manner that would warrant piercing the corporate veil. Thus, the trial court properly refused to hold the individuals liable with the LLC for the damages.

16 Jade Street, LLC v. R. Design Construction Co., LLC, 747 S.E.2d 770 (S.C. 2013).

The plaintiff sought to hold an LLC member liable for negligent supervision of subcontractors in a construction project of the LLC. In a previous opinion, a majority of the South Carolina Supreme Court held that the provisions of the South Carolina Uniform Limited Liability Company Act do not shield a member of an LLC from personal liability for his own torts committed while working in furtherance of the LLC’s business. The supreme court withdrew its previous opinion and substituted this opinion in which the court concluded that it need not reach the question of whether the Uniform Limited Liability Company Act shields an LLC member from personal liability for his own torts because the member in question did not commit an actionable tort. The circuit court concluded that the Residential Home Builders Act imposed a legal duty on the member based on his status as a the holder of a residential builder license. The supreme court examined the language of the statute and determined that the Residential Home Builders Act did not create such a legal duty.

In re Simerlein (First National Bank v. Simerlein), 497 B.R. 525 (Bankr. E.D. Tenn. 2013).

A creditor of an LLC sought to establish a nondischargeable debt on the part of the LLC’s member in the member’s bankruptcy. Although the transaction that formed the context for the creditor’s claim was with the LLC, the court stated that it had jurisdiction and authority to adjudicate

the plaintiff's claim and award damages. The court pointed out that the member could be liable to the plaintiff under Tennessee law. The court quoted the Tennessee LLC statute, which provides that a member, employee, or agent of an LLC does not have personal liability for the acts, debts, and obligations of the LLC or for the acts or omissions of others, but may become personally liable in contract, tort, or otherwise by reason of such person's own acts. Relying on agency law principles, the court stated that the debtor, the managing member of the LLC, was liable for any tortious or fraudulent conduct perpetrated against the plaintiffs in that role.

Estate of Hurst v. Moorehead, LLC, 748 S.E.2d 568 (N.C. App. 2013).

The plaintiffs entered into an agreement to sell a tract of land to Cramer Mountain Development, LLC ("Cramer"), which was owned by Desimone. The agreement was later assigned by Cramer to a newly formed LLC, Moorehead I, LLC ("Moorehead"), whose sole member was Blackmon. On the date the agreement was assigned, the plaintiffs met with Desimone and two real estate brokers and executed various documents, including a deed to Moorehead, prepared by Moorehead's closing attorney. The plaintiffs brought a lawsuit in which they alleged that Desimone and the real estate brokers made misrepresentations to them about what they were signing and that they were defrauded into closing the transaction under terms different than those agreed upon. The plaintiffs also alleged that Moorehead was in default on a \$4.5 million note payable to the plaintiffs. The plaintiffs sought to pierce the veil of Cramer and Moorehead on the basis that Desimone, Blackmon, and the real estate brokers exercised complete domination and control over the entities involved in the transaction. Based on the jury verdict, the plaintiffs obtained a judgment that concluded, *inter alia*, that Blackmon was the alter ego of Moorehead and was liable for \$4.9 million for Moorehead's breach of contract and that Blackmon was liable for nominal damages of \$1.00 for unfair and deceptive trade practices. Blackmon appealed the part of the judgment holding him personally liable.

The court of appeals discussed the statutory liability protection provided to members and managers under the North Carolina LLC statute and the circumstances under which a member can be held personally liable, including veil piercing. The LLC statute provides that a member or manager is not liable for the obligations of the LLC solely by reason of that status and that a member or manager does not become liable by participating, in whatever capacity, in the management and control of the business. The statute goes on, however, to state that a member or manager may become personally liable by reason of that person's own acts or conduct. The court explained that members of an LLC have the same liability protection as corporate shareholders and may not be held liable based merely on their participation in the LLC's business affairs, but an LLC member may be held individually liable for the LLC's obligations if the member engages in individual conduct that subjects the member to liability. In addition, the court explained that LLC members, like corporate shareholders, may be held individually liable for the LLC's obligations through the doctrine of piercing the corporate veil. In North Carolina, the instrumentality rule forms the basis for disregarding the corporate entity or piercing the veil. The court set forth the three elements of the instrumentality rule and listed numerous factors that may be considered in evaluating liability under the instrumentality rule. In this case, the plaintiffs presented evidence of multiple factors, the trial court properly instructed the jury regarding the instrumentality rule, and the jury returned a verdict based on which the trial court entered a judgment decreeing that Blackmon was the alter ego of Moorehead and that Blackmon and his entity were jointly and severally liable for all awards against either of them. Blackmon argued on appeal that he could not be held personally liable on

Moorehead's promissory note because the jury failed to find him liable for fraud or to award actual damages for fraud or unfair or deceptive practices. The court of appeals stated that Blackmon's argument completely misapprehended the law with respect to the instrumentality rule. The court stated that a finding that an individual member of an LLC personally engaged in fraud or misrepresentation is necessary to hold a member liable under the LLC statute for the member's own conduct but is not required to support alter ego liability under the instrumentality rule. The court of appeals next discussed Blackmon's challenge to the judgment insofar as it held him individually liable for unfair and deceptive trade practices. The court of appeals explained that fraud is not a required element of an unfair or deceptive trade practices claim, and an award of actual damages is not required to support a finding that the plaintiffs were injured by the acts complained of. The jury awarded nominal damages to the plaintiffs to compensate for the injuries found by the jury to be proximately caused by the various defendants' unfair and deceptive acts. The jury's findings were sufficient to support the trial court's judgment against both Blackmon and Moorehead for unfair and deceptive trade practices.

Joseph General Contracting, Inc. v. Couto, 72 A.3d 413 (Conn. App. 2013).

The Coutos obtained a judgment holding Anthony Silvestri personally liable for breach of contract, trespass, and violations of the Connecticut Unfair Trade Practices Act (CUTPA) based on actions of Silvestri and a corporation and LLC owned by Silvestri in connection with the construction and purchase of a home by the Coutos. The Coutos initially contracted with Silvestri's corporation, Joseph General Contracting, Inc. ("Joseph General"), for the purchase and construction of a home and carriage house. Various problems arose, and the original agreement was orally amended and essentially replaced by terms negotiated with Silvestri. Two additional written agreements pertaining to financial arrangements were executed by the Coutos and Silvestri, individually and on behalf of his LLC, Landel Realty, LLC ("Landel"). The Coutos testified that they were confused throughout this process as to whom they were dealing with. Problems and setbacks continued, and the Coutos eventually had to hire a new contractor to complete their home. The new contractor discovered various problems, including a zoning restriction that Silvestri did not disclose and a large quantity of debris that had been buried under, and caused damage to, the foundation of the carriage house. On appeal, Silvestri argued that the evidence did not support holding him personally liable on the Coutos' claims. Throughout the court of appeals' opinion Silvestri's corporation and LLC are referred to as "corporations." In a couple of instances, his entities are referred to as "limited liability corporations." The LLC statute and case law interpreting it are cited in some portions of the opinion, but most of the opinion speaks solely in corporate terms.

With respect to the breach of contract claim against Silvestri, he argued that he was not liable because "he was acting at all times as an authorized corporate officer of one of his two limited liability corporations" and that he therefore was protected from liability by the Connecticut LLC statute. The court responded that the provision of the LLC statute limiting liability of members and managers is "favorable to common-law exceptions" because of the statute's use of the word "solely." By stating that a member or manager of an LLC is not liable for the LLC's liabilities "solely" by reason of being a member or manager, the statute "plainly provides that a limited liability company member cannot be held liable for the malfeasance of a limited liability company by virtue of his membership alone; in other words, he must do more than merely be a member in order to be liable personally for an obligation of the limited liability company. The statute thus *does not* preclude individual liability for members of a limited liability company if that liability is not based simply on

the member's affiliation with the company." The court stated that the evidence supported the trial court's findings that the subsequent actions of the parties after the signing of the original contract were the joint actions of Silvestri, Joseph General, and Landel. Over time, Silvestri's actions muddied the waters so that it became unclear to the Coutos with whom they were dealing. The Coutos were reasonably entitled to infer from Silvestri's conduct that he had personally become a party to the contract. The court cited agency principles for the proposition that it was not enough for the Coutos to know of the existence of Joseph General and Landel for Silvestri to avoid personal liability. An agent must disclose both his representative capacity and the identity of the principal to avoid liability. Although Silvestri disclosed the identity of the principals at the outset, he did not clearly inform the Coutos that he continued at all times to be acting in a representative rather than individual capacity.

Silvestri next claimed that he was improperly held liable for tortiously causing debris to be buried on the Coutos' property. He claimed that all times he was acting as an agent of his two corporations and maintained that he could not be held personally liable because he did not personally bury the debris. The court stated that the uncertainty of whom the Coutos were dealing with in regard to various elements of the construction contract also supported the trial court's finding in this context. Further, the court cited "black letter law that an officer of a corporation who commits a tort is personally liable to the victim regardless of whether the corporation itself is liable." Having found that Silvestri caused the debris to be placed on the Coutos' property, the trial court found him liable not for the tortious conduct of his businesses, but for his own tort. The court of appeals cited Connecticut case law affirming the imposition of tort liability on an agent or officer who commits or participates in the commission of a tort, whether or not he acts on behalf of his principal or corporation. The court quoted the Connecticut Supreme Court's holding that the provision of the LLC statute that describes the liability protection of a member or manager "evinces no legislative intent to eliminate the right to impose liability on a member or manager of a limited liability company who has engaged in or participated in the commission of tortious conduct. Rather the statute clearly codifies the well established principle that an officer of a corporation does not incur personal liability for its torts merely because of his official position." Silvestri argued he could not be held liable because there was no evidence he personally ordered the debris to be buried under the carriage house foundation, but the court concluded the evidence supported a reasonable inference that Silvestri ordered or negligently caused the debris to be buried under the carriage house foundation and that the debris damaged the property; therefore, he could be held personally liable for the damage from the trespass.

Finally, the court of appeals rejected Silvestri's argument that he could not be held personally liable for violations of CUTPA because he was acting as an officer of his businesses. The trial court found that Silvestri personally engaged in tortious conduct directed at the Coutos and held him liable for his own actions, which the trial court described as "unscrupulous, oppressive, unfair and deceptive." The trial court's findings, which were supported by the record, justified the trial court's determination of personal liability under CUTPA. Although CUTPA is primarily a statutory cause of action, it is also recognized that claims under the statute may arise from underlying contract and tort actions. The Connecticut Supreme Court has recognized that individual tort liability can be imposed on a corporate officer who directly participates in tortious conduct regardless of whether the statutory basis for the claim expressly allows liability to be imposed on corporate officers. Therefore, the trial court did not err in finding Silvestri was liable under CUTPA.

Primary Investments, LLC v. Wee Tender Care III, Inc., 746 S.E.2d 823 (Ga. App. 2013).

When the members/managers of an LLC that sold its day care facility formed a new LLC and opened a new day care facility within three years after the sale, the purchaser sued the selling LLC, its members/managers, and the new LLC for breach of a noncompetition clause. The court of appeals held that the selling LLC did not violate the noncompetition provision, and the members/managers and their new LLC were not bound by the provision. Primary Prep Academy, LLC (“Primary LLC”) sold its childcare facility to the plaintiff pursuant to the terms of an asset purchase agreement (“APA”) that contained a noncompetition clause. The noncompetition clause provided that “Seller agrees that neither Seller nor its agents will” take certain acts within three years after the closing. The parties to the APA were the plaintiff and Primary LLC, and the APA was signed by Marguerite O’Brien in her capacity as a manager of Primary LLC. Within three years after the sale, Marguerite O’Brien and her two daughters (the “O’Briens”), who were the members and managers of Primary LLC, formed East Cobb Children’s Academy, LLC (“East Cobb”) to operate a new child care facility within the ten-mile radius in which the noncompetition clause prohibited the “Sellers or its agents” from opening a child care facility. The trial court granted summary judgment in favor of the defendants, and the plaintiff appealed. The court of appeals first noted that the parties did not contend, and there was no evidence indicating, that Primary LLC was involved in opening the East Cobb facility. Nor was there any evidence that the O’Briens were acting as agents for Primary LLC when they opened the new facility. The key issue was whether the APA barred the O’Briens individually from opening the East Cobb facility. Since Marguerite O’Brien executed the APA in her representative capacity for a disclosed principal, the APA was Primary LLC’s contract and not that of Marguerite O’Brien or of her two daughters, none of whom were even mentioned by name in the agreement. The plaintiffs argued that the words “its agents” unambiguously referred to the O’Briens, relying on the provision of the Georgia LLC statute that every manager is an agent of the LLC for the purpose of its business and affairs. The court acknowledged that the statute so provides, but this general statement that an agent is one who acts for another does not authorize the LLC to bind its agents for the LLC’s contractual obligations. To the contrary, the statute protects the members and agents of an LLC from liability for the LLC’s obligations. Under the statute, a member of an LLC is separate from the LLC and is not a proper party to a proceeding against the LLC solely by reason of being a member. Primary LLC had no authority to bind the O’Briens individually to the noncompetition clause, and merely including the term “its agents” in a contract with an LLC does not bind the members or managers individually under the LLC statute. If the buyer desired to bind the O’Briens individually it should have made them parties to the APA and required their signatures in their individual capacities. In a footnote, the court mentioned that the plaintiffs did not argue, and there was no evidence, that the existence of Primary LLC should be ignored. The court stated that the same recognition of a corporation’s separate existence “so long as the corporate forms are maintained” applies to an LLC, and courts must exercise great caution in disregarding the legal distinction.

Garber v. STS Concrete Co., LLC, 991 N.E.2d 1225 (Ohio App. 2013).

Suglio, the owner of an LLC that performed concrete work on a driveway for Garber, appealed a judgment holding Suglio personally liable for violations of the Ohio Consumer Sales Practices Act (CSPA) and Ohio Home Solicitation Sales Act (HSSA). Suglio argued that Garber knew that he was dealing with an LLC. The court of appeals acknowledged that employees and proprietors of corporations and LLCs are not generally answerable for the debts or responsibilities

of the company. In some situations, however, including violations of the CSPA, individuals can be liable for the actions of the company. Ohio courts have held that officers or shareholders who take part in or direct actions that constitute violations of the CSPA or HSSA may be held individually liable. In this case, the failure of Suglio and his LLC to provide Garber a cancellation notice when contracting for the work on the driveway was a violation of the HSSA and CSPA for which Suglio could be held individually liable.

Lone Star Air Systems, Ltd. v. Powers, 401 S.W.3d 855 (Tex. App. 2013).

The plaintiff operated a heating and air conditioning business and entered into a master purchase order agreement providing for the sale and purchase of goods with David Powers Homes, the assumed name of DJPH, LLC. Several business entities were associated with this LLC. Between 2000 and 2009, it was undisputed that a corporation affiliated with the LLC paid the plaintiff for hundreds of jobs. In 2008, the plaintiff sued the corporation and David Powers individually for unpaid balances from approximately 50 jobs involving the sale of air conditioning equipment and labor. The LLC and its affiliated entities ceased operating in 2009. The affiliated corporation sued by the plaintiff in this case filed a sworn pleading confessing judgment in 2010, and the plaintiff nonsuited the corporation, but the plaintiff continued to sue David Powers individually to recover payment and alleged that Powers was individually liable for breach of contract, fraud, and alter ego. Powers filed a motion for summary judgment, which the trial court granted. On appeal, the plaintiff argued that the trial court erred in granting summary judgment. The court of appeals first rejected the plaintiff's contract claim. The plaintiff argued that the true identity of David Powers Homes was Powers, or that there at least was a fact question, and that the plaintiff presented evidence establishing an exception to the statute of frauds. Powers argued that he was not a party to the agreement and that the actual party was the LLC for which David Powers Homes was an assumed name. Both parties acknowledged that the contract was subject to the statute of frauds as a contract for the sale of goods over \$500 and, as such, not enforceable unless signed by the person against whom enforcement is sought. The court rejected the plaintiff's arguments that two exceptions applied here: (1) that Powers admitted he had a contract with the plaintiff, and (2) partial performance. The court of appeals examined the evidence and concluded that there were no admissions by Powers that he had a contract with the plaintiff and that the evidence did not show Powers, as opposed to a business entity, performed under the agreement. Summary judgment was thus proper on the breach of contract claim because there was no enforceable agreement against Powers as a matter of law. With respect to the trial court's summary judgment on the fraud claim, Powers argued that the plaintiff did not plead or offer evidence that the fraud was perpetrated primarily for Powers' direct, personal benefit, as required under Texas law to pierce the LLC veil. The plaintiff countered that it was seeking to hold Powers individually liable for common law fraud rather than seeking to pierce the LLC veil. The appellate court concluded that the only theory of fraud available to the plaintiff was one characterized as piercing the LLC veil based on the plaintiff's pleadings, summary judgment response, and evidence. The plaintiff alleged that Powers was individually liable because he used the corporate fiction to commit fraud and further alleged that David Powers Homes and Powers were inextricably tied together under an alter ego theory. The court of appeals examined the summary judgment evidence and concluded that there was no evidence supporting the type of fraud required to pierce the veil.

Burnette v. Valero Refining–Maraux LLC, 950 F.Supp.2d 920 (E.D. La. 2013).

The court granted summary judgment to the parent company of the sole member of an LLC because a member of an LLC is not liable under Louisiana law for a debt, obligation, or liability of the LLC. The refining facility at which the plaintiff was injured was owned by the LLC, and there was no dispute that the parent did not own or operate the refinery and could not be liable for any debts of the owner or operator of the facility.

Cook v. Patient Edu, LLC, 989 N.E.2d 847 (Mass. 2013).

An employee of an LLC sued the LLC and two of its managers for unpaid wages under the Massachusetts Wage Act. The Massachusetts Supreme Court held that a manager, officer, or managerial agent of an LLC (as well as a manager, officer, or managerial agent of an LLP or other limited liability entity) may be a “person having employees in his service” within the meaning of a provision of the Wage Act that generally requires payment of wages on a weekly or bi-weekly basis and imposes personal liability for failure to do so. The Wage Act expressly deems the president and treasurer of a corporation, as well as an officer or agent having management of the corporation, to be “a person having employees in his service.” In a previous case, the court equated “management” to controlling, directing, or participating to a substantial degree in the formulation or determination of corporate policy. The Act also imposes individual liability for unpaid wages on each “public officer whose duty it is to pay money, approve, audit or verify pay rolls, or perform any other official act relative to payment of any public employees” and who fails to do so. However, the Act does not explicitly refer to managers of LLCs or managers of any other limited liability entity. When the provision of the Wage Act imposing individual liability on corporate officers was added in 1932, the LLC form of business did not exist. Formation of LLCs and LLPs in Massachusetts was not authorized in Massachusetts until 1996. The court did not view the provision imposing liability on corporate and public officers and managers as singling out officers and managers of those entities, but rather as illustrative of the circumstances in which an individual may be deemed a “person having employees in his service.” The court rejected the defendants’ argument that the provision implicitly excludes managers of LLCs and other limited liability entities from the category of persons having employees in their service. To the contrary, the court discerned a clear legislative intent to ensure that individuals with the authority to shape the employment and financial policies of an entity be liable for the obligations of the entity to its employees. The court refused to infer from various amendments and failures to amend the Wage Act over the years an intent to restrict the scope of a “person having employees in his service” to corporate and public officers and managers. The court also distinguished a previous decision involving criminal liability of a president of a corporation for another provision of the Wage Act. In sum, the claims against the LLC managers should not have been dismissed by the lower court because a manager or other officer or agent of an LLC, LLP, or other limited liability entity may be civilly or criminally liable for failure to pay wages as required by the Act if the manager or other person controls, directs, and participates to a substantial degree in formulating and determining policy of the entity.

American Arbitration Association v. Bowen, 743 S.E.2d 612 (Ga. App. 2013).

The American Arbitration Association sued the members of an LLC to collect unpaid arbitration fees. The court of appeals held that there was evidence that the members asserted individual claims through arbitration and were liable for the arbitration fees. The court acknowledged that the Georgia LLC statute protects members from liability for the debts of the LLC solely by

reason of being a member. Further, there was no evidence the members executed an agreement to guarantee the LLC's debts. However, the court concluded there was evidence that the members incurred personal debts in the arbitration by stating in a trial brief that they and the LLC were submitting their claims to binding arbitration. The arbitrator testified that the members were parties to the arbitration in their personal capacities, and the evidence from the arbitration showed that the members appeared in their personal capacities. Thus, the members were personally liable for any fees associated with their personal claims.

Tempay, Inc. v. Biltres Staffing of Tampa Bay, LLC, 945 F.Supp.2d 1321 (M.D. Fla. 2013).

The plaintiff, a company that engaged in payroll funding and accounts receivable factoring, entered into several Master Factoring Agreements with an LLC under which the plaintiff agreed to purchase and the LLC agreed to sell certain accounts receivable of the LLC. The plaintiff sued the LLC, the LLC's president, and the LLC's sole managing member for fraud and various other claims based on an alleged "ponzi-type" scheme whereby the defendants used the plaintiff's money from new factored invoices to pay older invoices as they became due. The plaintiff also contended that the defendants wrongfully converted to their own use payments that the plaintiff deposited into the managing member's personal bank account. The LLC and its president, who was responsible for the day-to-day management of the LLC, admitted that the undisputed evidence established that the plaintiff was entitled to summary judgment against them for liability for fraud, fraudulent inducement, violations of the Florida Deceptive and Unfair Trade Practices Act and Florida RICO, but the managing member argued that the summary judgment record did not support summary judgment against her based on either her personal involvement in the scheme or her role as managing member of the LLC. The court agreed with the managing member. The record contained no evidence of statements or misrepresentations by the managing member to the plaintiff or its agents and thus was insufficient to support summary judgment against the managing member based on her personal involvement in the fraudulent scheme. The plaintiff argued that the managing member was liable based on her role as managing and sole member of the LLC since she was the only individual entitled to share in the profits and losses of the LLC, the only individual with the right to receive distributions, and the only individual with voting and management rights. Under the Florida LLC statute, a member or manager does not have liability for a debt, obligation, or liability of the LLC solely by reason of being a member or serving as a manager or managing member, and a manager or managing member is not personally liable for monetary damages to the LLC, its members, or any other person for any statement, vote, decision, or failure to act regarding management or policy decisions unless the manager or managing member breached or failed to perform the duties as a manager or managing member and the breach resulted in a violation of criminal law or an improper personal benefit, or constituted recklessness or an act of bad faith. The court said that, at best, the record contained evidence sufficient to create an inference that the managing member breached one or more duties as managing member and that she knew or should have known that the LLC was engaged in criminal activity or that she acted with reckless indifference to the fraudulent scheme. Similarly, the record, at best, created an inference that the managing member derived a personal benefit since payments were deposited into her personal account. The evidence and inferences were insufficient, however, to establish the plaintiff's entitlement to summary judgment against the managing member. There were also disputed issues of material fact as to whether the managing member was a debtor (based on a guaranty executed in favor of the plaintiff by the managing

member) and intended to defraud the plaintiff with respect to the plaintiff's fraudulent transfer claim against the managing member.

Pazmino v. Bose McKinney & Evans, LLP, 989 N.E.2d 784 (Ind. App. 2013).

A law firm performed legal work for an LLC for several months at the request of Pazmino. The LLC was administratively dissolved during the period in which the law firm rendered services, and neither the LLC nor Pazmino paid the firm for its services. The firm sued the LLC for approximately \$12,500 plus interest and sued Pazmino for approximately \$9,600 plus interest (the amount for services performed after the LLC was dissolved). A default judgment was entered against the LLC. Both the firm and Pazmino sought summary judgment as to Pazmino's liability for the debts incurred after the LLC's dissolution. The trial court entered summary judgment in favor of the firm and against Pazmino for the amount sought from Pazmino, and Pazmino appealed. The first issue on appeal was on whose behalf Pazmino was acting. Pazmino contended that he was not personally liable for the LLC's obligations because he was an employee of the LLC. The firm alleged that even if Pazmino was an employee of the LLC, he was liable for his own acts of personally requesting the firm's services after the LLC dissolved. The appellate court was not convinced that the evidence established as a matter of law that Pazmino was only an employee of the LLC but declined to address the legal implications of Pazmino's liability if he was a member or manager of the LLC. The appellate court explained that if the evidence established that Pazmino requested the firm's services on his own behalf, he would be personally liable for that obligation under the Indiana LLC statute. However, if the evidence showed that Pazmino requested the services on behalf of the LLC such that normally he would not be personally liable for the debt, the firm argued that Pazmino was personally liable because he acted as an agent of a nonexistent principal and because he exceeded the scope of his authority. The firm presented affidavit evidence that Pazmino personally requested and directed the firm as to legal work not relating to the winding up of the LLC after it was administratively dissolved. However, billing records referred to the LLC as the client and the party being billed for the legal work. In addition, the billing records included only a brief description of the work performed and did not establish the services performed were outside the scope of winding up the LLC. The court held that the firm did not establish as a matter of law that Pazmino secured the legal services on his own behalf and thus the firm was not entitled to summary judgment on this issue. The evidence submitted by Pazmino to support his motion for summary judgment was an affidavit in which he claimed to be an employee of the LLC and that the firm did not inform him of the LLC's dissolution. The court found that a genuine issue of material fact existed as to whether Pazmino had notice of the dissolution, which impacted whether he secured the firm's services on behalf of the LLC or whether he was acting on his own behalf. The affidavit contained no information as to the work performed by the firm or the purpose of requesting the firm's services. Like the firm, Pazmino failed to establish as a matter of law that he acted on behalf of the LLC in requesting the legal services and therefore was not entitled to summary judgment on this basis. The next issue addressed by the court was whether after dissolution of the LLC Pazmino could act as an agent on behalf of the LLC because the LLC did not exist except to wind up its business. Generally, an agent who contracts for a nonexistent principal is personally liable on the contract made. The firm contended that Pazmino was personally liable for requesting services not associated with winding up the LLC. According to the Indiana LLC statute, an LLC continues to exist after dissolution to carry on business necessary to wind up and liquidate its business and affairs. Although neither party established as a matter of law whether the work performed by the firm was associated with winding

up the LLC, the LLC continued to exist as a principal that could be bound by the acts of its agents regardless of the nature of the work performed by the firm. Finally, the firm argued that Pazmino was not authorized by the LLC statute to wind up or bind the LLC following dissolution. Generally managers and/or members may wind up and bind an LLC after dissolution. The firm also maintained that the limitation on liability did not extend to employees after dissolution. The court agreed that the statute authorizes members to wind up and bind LLCs after dissolution while shielding them from personal liability; however, the court disagreed that an employee who continues to act on behalf of a dissolved LLC is always personally liable for that conduct. The firm specifically alleged that Pazmino was personally liable because he exceeded the scope of his authority under the statute when he, as an employee, requested the firm's services following dissolution of the LLC. The court stated that none of the cases cited by the firm suggested that an employee properly acting on behalf of a dissolved LLC was personally liable for such acts, and nothing in the statute suggests an intent by the legislature to expose employees of dissolved LLCs acting on behalf of the LLC to personal liability. The statute instead clarifies that even upon dissolution an LLC is responsible for its obligations. The court also reasoned that if the legislature intended to terminate the limitation on personal liability at the LLC's dissolution, the legislature would have included such a provision. Thus, when Pazmino acted within the scope of the authority conferred by the LLC, the firm's remedy was against the LLC and not Pazmino.

Kremer v. Sinopia LLC, 961 N.Y.S.2d 383 (App. Div. 1st Dept. 2013).

The plaintiff's claim for breach of a stock purchase agreement against the managing member of an LLC failed because the managing member signed the agreement only in his capacity as managing member of the LLC and could not be held liable for the LLC's breach. The plaintiff's fraudulent inducement claim against the managing member failed because the claim was based on a pre-contractual representation by the managing member that was barred by the merger/integration clause in the stock purchase agreement. A claim against the managing member for unjust enrichment, which was based on the LLC's failure to pay for goods received by the LLC, failed because the complaint did not contain allegations sufficient to pierce the LLC's veil.

Humphrey Industries, Ltd. v. Clay Street Associates, LLC, 295 P.3d 231 (Wash. 2013).

An LLC member who exercised its statutory dissenter's rights sought to hold other members of the LLC individually liable for the LLC's obligations to the dissenting member. The court recognized that members of an LLC generally are not personally liable for the LLC's debts, obligations, and liabilities. Under Washington law, a member may become liable to the LLC or its other members for an act or omission that constitutes gross negligence, intentional misconduct, or a knowing violation of the law. A member may become liable to the LLC if the member receives a distribution from the LLC knowing that the LLC would not be able to pay its debts or that the LLC's debts would exceed its assets. The dissenting member argued that the other members received distributions knowing the LLC would not be able to satisfy its obligations to the dissenting member. The court stated that the dissenting member did not support its argument and that the dissenting member's theories of liability would require the court to conduct factual inquiries that were beyond the scope of appellate review. Thus, the court held that the dissenting member did not establish the individual members were liable for the obligations owed to the dissenting member in the litigation.

LLC Veil Piercing

Turner v. Andrew, 413 S.W.3d 272 (Ky. 2013).

The court rejected the reasoning of the court of appeals that the sole member of an LLC was the real party in interest to sue for lost profits to the LLC, pointing out that cases in the sole-owner corporation context had rejected that reasoning and stating that the same conclusion was mandated here. The court stated that the LLC and its sole member are not “interchangeable” and that “an LLC is not a legal coat that one slips on to protect the owner from liability but then discards or ignores altogether when it is time to pursue a damage claim.” The court acknowledged that there are circumstances when the LLC’s separate existence can be disregarded in the interest of equity but stated this was not such a case because the facts here bore no resemblance to the traditional veil-piercing situation where an unpaid LLC creditor seeks to pierce the veil of an LLC to reach the personal assets of the member. Further, this case was not even an “outsider reverse” piercing case where the creditor of a member seeks to pierce the LLC veil to reach assets of the LLC to satisfy the member’s personal debt. The court acknowledged that there is an “insider reverse” piercing theory adopted by a very few states and employed when strong policy considerations are involved. Here, the only appropriate plaintiff to assert the lost damages claim was the LLC if, as it appeared, the trucking business was being conducted by the LLC at the time of the accident.

Kubican v. The Tavern, LLC, 752 S.E.2d 299 (W. Va. 2013).

The West Virginia Supreme Court held that the West Virginia Uniform Limited Liability Company Act does not preclude application of the equitable remedy of piercing the veil, and the court set forth a two-prong test and a non-exclusive list of factors that may be relevant in determining whether the test is met. The court addressed this issue based on a certified question from a circuit court in a case in which the plaintiff sought to pierce the veil of a West Virginia LLC to hold the two members of the LLC liable for tort claims against the LLC arising out of an altercation in a bar owned and operated by the LLC. (The court noted that the type of liability presented to the court was distinguishable from holding an LLC member or manager personally liable based upon his or her own tortious actions and suggested that LLC managers may be held liable for their own participation in tortious or criminal activity even when performing their duties as managers.) To answer the question before it, the supreme court first examined the statutory provision limiting liability of LLC members and managers. Applying maxims of statutory interpretation, the court concluded that the statute was unambiguous in declaring that a “member or manager is not personally liable for a debt, obligation, or liability of the company solely by reason of being or acting as a member or manager.” The court pointed out that the statute only allows a member or manager to be held liable based solely on that status if the articles of organization contain a provision to that effect, and a member who is liable on that basis has consented in writing to the provision. The court concluded that the legislature implicitly left intact the prospect that a member or manager could be held liable on grounds not based solely on the status of member or manager and cited case law from other jurisdictions illustrating that the court’s conclusion that the West Virginia statute does not preclude veil piercing is consistent with the manner in which other courts have interpreted similar statutes. The court next addressed the circumstances under which imposition of veil-piercing liability is appropriate since the legislature did not do so. The court discussed case law from other jurisdictions and concluded that most courts addressing the question apply the same test used to analyze piercing the corporate veil, while recognizing that certain elements of the test may

not apply at all or apply in a different manner than they would in the corporate context. The court thus considered West Virginia common law standards for piercing the corporate veil in order to establish guidance for lower courts faced with veil-piercing claims in the LLC context. The court set forth a list of 19 factors it had identified in a prior corporate veil-piercing case and stated that many of them may be relevant in the LLC context, but the court was hesitant to adopt a test that sets out specific factors since the court had previously stressed the case-by-case analysis that is required in determining whether to pierce the corporate veil. Consequently, the court held, as it has in the corporate context, that the following general test must be met to pierce the veil of an LLC: (1) there exists such unity of interest and ownership that the separate personalities of the business and the individual member(s) or manager(s) no longer exist, and (2) fraud, injustice, or an inequitable result would occur if the veil is not pierced. The court stated that this is a case-by-case, fact-driven analysis and that the failure of the LLC to observe usual company formalities or requirements relating to the exercise of its powers or management may not be a ground for imposing personal liability on members or managers.

Institutform Technologies, LLC v. Cosmic TopHat, LLC, __ F.Supp.2d __, 2013 WL 4038722 (N.D. Ga. 2013).

In this patent infringement suit, the plaintiffs sought summary judgment piercing the veil of a California LLC to hold the member liable for the LLC's infringement and vice versa. The court stated that, although the patent infringement claims arose under federal law, the veil-piercing issue was governed by Georgia law. Because the Georgia Supreme Court has rejected outsider reverse corporate veil piercing, i.e., piercing to allow a third-party creditor to reach a corporation's assets to satisfy the claims of an individual corporate insider, the court rejected the reverse piercing claim in this case and considered only the plaintiffs' arguments under a traditional piercing theory. The court recognized that a member of an LLC is considered separate from the LLC and is not a proper party to a proceeding by or against the LLC solely by reason of being a member. In order to pierce the veil of an LLC and hold a member personally liable under Georgia law, there must be evidence that the member abused the legal form by which the LLC is maintained as a separate entity from the member's personal business by showing that the member disregarded the separateness by commingling on an interchangeable or joint basis or confusing the otherwise separate properties, records, or control. The plaintiffs first argued that alter ego liability was appropriate because the LLC failed to observe formalities such as meeting and record keeping. However, the Georgia LLC statute provides that failure of an LLC to observe formalities is not a ground for imposing personal liability on a member, manager, or agent. Next the plaintiffs argued that alter ego liability was appropriate because the member failed to treat the LLC as a separate entity from himself. However, the evidence relied on by the plaintiff may have shown that the member failed to keep the LLC separate from another entity owned by the member but did not show that he failed to keep the LLC separate from himself. The mere fact that the member commonly controlled two entities did not support alter-ego liability. The plaintiffs also argued that alter-ego liability was appropriate because the LLC was undercapitalized. To justify piercing the veil based on undercapitalization, the plaintiffs had to show undercapitalization was coupled with an intent at the time of the capitalization to improperly avoid future debts. The plaintiffs identified no such evidence. Finally, the plaintiffs pointed to the member's prior conduct in the litigation as requiring piercing to prevent the injustice that would arise if he transferred or disposed of assets through or by means of the LLC in an effort to avoid collection activities. The court responded that this kind of misconduct could only be

combated through reverse piercing, which the Georgia Supreme Court has rejected on the basis that more traditional theories of conversion, fraudulent conveyance, and agency law are adequate to deal with the situation where one seeks to recover from the corporation for the wrongful conduct committed by a controlling shareholder. Even if the plaintiffs' fears were warranted, the court concluded that the plaintiffs had not shown as a matter of law that the member disregarded the separateness of the LLC by commingling on an interchangeable or joint basis or confusing the otherwise separate properties, records, or control.

Weaver v. Tri-County Implement, Inc., 311 P.3d 808 (Mont. 2013).

Smith and Weaver formed an LLC. Smith opened a line of credit for the LLC with Tri-County Implements, Inc. ("Tri-County"), and requested that Tri-County perform certain work on a truck on the LLC's account. The truck was titled in the name of Weaver, and when the invoice was not paid and Tri-County would not release the truck, Weaver sought return of the truck. In the litigation that ensued, the trial court held Weaver personally liable to Tri-County for the charges owed for work on the truck. The Montana Supreme Court reviewed the statutory liability protection provided to members and managers of an LLC under the Montana LLC statute, which states that a member or manager is not liable for an LLC's debt, obligation, or liability solely by reason of being a member or manager. The court stated that this protection is not absolute in that it does not protect a member from liability for the member's own wrongful conduct. Relying on previous Montana case law in the LLC context, the court stated that Weaver's liability as a member depended on whether he engaged in conduct that would give rise to contract or tort liability if he were acting in his individual capacity. Although the trial court concluded that Weaver was liable on the contract with Tri-County, the supreme court found no basis on which to hold Weaver liable on the contract. The agreements with Tri-County for work on the truck were solely between Tri-County and the LLC, and Weaver did not guarantee the LLC's payments or make any other promises. That Weaver held title to the truck, sued Tri-County, knew about the LLC's transactions with Tri-County and failed to object, or arranged to make some payments was immaterial. Conflating the LLC's failure to pay its own debt and Weaver's failure to pay the LLC's debt would eviscerate the statutory liability protection provided LLC members. Turning to a tort analysis, the allegation that the LLC was unable to pay its debts did not of itself amount to wrongful conduct that imposes liability on Weaver. It was also immaterial to the tort analysis that Weaver held title to the truck, sued Tri-County, knew about the LLC's transactions with Tri-County and failed to object, or arranged for some payments to be made. Weaver's conduct did not amount to an actionable tort. If a member or manager operates an LLC as an empty shell to perpetuate fraud and avoid personal liability, the court said the situation would be different, but those facts were not present here.

Fin & Feather Club v. Leander, 415 S.W.3d 548 (Tex. App. 2013)

The court relied on previous Texas case law for the proposition that the policies governing corporate veil piercing also apply to LLCs and held that there was no evidence of actual fraud, i.e., no evidence of dishonesty of purpose or intent to deceive, so as to hold a member or manager of the LLC liable. The court noted that the legislature specifically authorized single-member LLCs and limited the liability of a member or manager. The evidence did not establish who the principals of the LLC in this case were, but even if the evidence showed there was only one principal of the LLC, there was no evidence of actual fraud to support holding him liable and thus no basis to hold the sole principal liable for the LLC's debt.

Baker, Sanders, Barshay, Grossman, Fass, Muhlstock & Neuworth, LLC v. Comprehensive Mental Assessment & Medical Care, P.C., 974 N.Y.S.2d 93 (App. Div. 2d Dept. 2013) (holding claimant adequately pleaded allegations that individual dominated LLC and engaged in acts amounting to abuse of privilege of doing business in LLC form so as to perpetrate wrong or injustice and were thus sufficient to state claim under theory of piercing corporate veil).

501 Fifth Avenue Company LLC v. Alvona LLC, 973 N.Y.S.2d 137 (App. Div. 1st Dept. 2013).

The court affirmed the dismissal of a complaint because the plaintiff landlord's allegations of corporate domination and control were wholly conclusory and thus insufficient to support its claim to pierce the veil of the tenant LLC. The individual defendants were employees or officers rather than owners of the LLC, and the complaint provided no explanation as to how any domination was for their personal gain. Finally, failure to allege fraud or unjust conduct was fatal, especially since the tenant performed under the five-year lease for almost four years.

JSA, LLC v. Golden Gaming, Inc., No. 58074, 2013 WL 5437333 (Nev. Sept. 25, 2013).

The appellants negotiated a lease with Golden Gaming, Inc. ("Golden Gaming"), and Golden Gaming executed the lease on behalf of a subsidiary, Golden Tavern Group ("Golden Tavern"), the manager of Sparky's South Carson 7, LLC (the "LLC"), which was listed as the tenant on the lease. The lease did not list Golden Gaming as a tenant, and Golden Gaming refused to guarantee the lease when asked. Golden Gaming provided the LLC's initial capitalization and recapitalized the LLC on a frequent basis, but the LLC operated in accordance with Nevada gaming law using its own on-site managers. The on-site managers would report to a regional manager at Golden Tavern who would report to Golden Gaming. Upper-level management and operations occurred at Golden Gaming's offices. Golden Gaming accounted for the LLC through the use of consolidated bank accounts with separate accounting through a coding system. Golden Gaming kept separate books and records for the LLC and filed independent sales tax returns but filed a single consolidated tax return. The LLC did not have an operating agreement, "as one was not required under Nevada law." The LLC failed, and the appellants sued Golden Gaming alleging various claims and causes of actions. The trial court entered judgment in favor of Golden Gaming on all counts. On appeal, the appellants argued that the trial court erred in concluding that Golden Gaming was not a party to the lease, did not fraudulently or negligently misrepresent its status as guarantor or tenant, and was not the alter ego of the LLC. After concluding that Golden Gaming was not a party to the lease and did not misrepresent the identity of the tenant, the court concluded that substantial evidence supported the trial court's determination that imposing alter ego liability on Golden Gaming was inappropriate. The court assumed without deciding that the Nevada corporate alter ego statute applies to LLCs. Under the statute, a court may pierce the corporate veil only when three things are established: (1) the corporation is influenced and governed by the stockholder, director, or officer; (2) there is such unity of interest and ownership that the corporation and the stockholder, director, or officer are inseparable from each other; and (3) adhering to the corporate fiction would sanction fraud or promote manifest injustice. The court stated that the first prong was satisfied, but the second and third prongs were not. With respect to the second prong, the court stated that the use of a single cash management system was insufficient to establish commingling. The level of financial investment by Golden Gaming in the LLC did not even approach undercapitalization because Golden Gaming sustained approximately \$1.5 million in losses before closing the business. Finally, the LLC

observed all corporate formalities required of a Nevada LLC by filing its own state tax returns, possessing its own gaming license, managing its employees, and employing on-site managers. Furthermore, Golden Gaming separately accounted for and documented all the money it used to recapitalize the LLC. As to the final prong, the court found no fraud or manifest injustice because the appellants were responsible for the loss they suffered by not insisting that Golden Gaming guarantee the lease, and Golden Gaming did not misrepresent that it was the tenant on the lease.

Spring Street Partners-IV, L.P. v. Lam, 730 F.3d 427 (5th Cir. 2013).

The claimant in this case sought to recover based on a fraudulent transfer of assets to an LLC, and to hold the owners of the LLC personally liable for the value of the transfers. The claimant argued that it was not required to prove actual fraud to pierce the LLC veil because fraudulent transfer of assets is a tort under Texas law. The court pointed out that the Texas legislature specified that the statutory provisions regulating and restricting veil piercing of corporations in Texas are applicable to LLCs and their members and managers by virtue of an amendment to the LLC statute in 2011 and that a Texas court of appeals has held that a plaintiff seeking to pierce the veil of an LLC not covered by the amendment to the LLC statute must also meet the same requirements applicable to a corporation. These requirements differ depending upon whether a claimant is seeking to recover based on a tort or a contract. The court concluded that it did not have to determine whether the claimants were required to prove actual fraud or merely constructive fraud because there was “ample evidence” of the members’ actual fraud. This evidence included the formation of an LLC ten days after the members’ brother received notice that his debts were being accelerated, transfer of the brother’s interest in another LLC to the newly formed LLC for no consideration, signing a document transferring an asset of the newly formed LLC to another family member for no consideration, failing to disclose the transfer for over a year during the pendency of litigation against the newly formed entity, attempting to evade the Texas Uniform Fraudulent Transfer Act by allowing the new LLC’s charter to lapse, and attempting to evade individual liability by claiming the charter had been reinstated. The court stated that the members were acting for their direct personal benefit with respect to these actions because they had no other interest to serve.

Metroplex Mailing Services, L.L.C. v. RR Donnelly & Sons Company, 410 S.W.3d 889 (Tex. App. 2013).

The court held that there was no evidence to support piercing an LLC’s veil to hold the sole member liable for the return of a deposit owed by the LLC. The court noted that the Texas legislature specifically authorized single-member LLCs and that the statutory liability protection afforded members and managers only gives way when a plaintiff can show that the LLC was used for the purpose of perpetrating and did perpetrate an actual fraud for the member’s or manager’s direct personal benefit. The court relied on previous Texas case law for the proposition that the policies governing corporate veil piercing also apply to LLCs and equated actual fraud to dishonesty of purpose or intent to deceive. The court concluded that the member’s “use of a single-member LLC, as statutorily authorized by the legislature, combined with an ordinary personal loan to purchase equipment for the company’s use secured by that equipment, amounts to no evidence of actual fraud even in combination with” other facts in the case. Even assuming the evidence showed that the LLC used some of the deposit as operating funds in violation of its agreement with the plaintiff and without disclosing the fact to the plaintiff, the court stated that there was no evidence that this action resulted in any direct personal benefit to the LLC’s member. Additionally, although the member

shut down the LLC in the face of the plaintiff's demand for its deposit (which the LLC was not yet obligated to return), the evidence showed that the LLC shut down due to declining business and not to avoid returning the deposit.

Taurus IP, LLC v. Daimler-Chrysler Corporation, 726 F.3d 1306 (Fed. Cir. 2013).

The court affirmed the district court's exercise of personal jurisdiction over a Texas resident, Spangenberg, and his Texas LLC based on a two-step piercing analysis. First, the court held that Spangenberg, the individual managing member of a Wisconsin LLC, was the alter ego of that LLC, and then the court applied the alter ego theory in reverse to reach Spangenberg's Texas LLC. The court generally referred to both of the LLCs as "corporations" and applied corporate veil piercing principles. Pursuant to Wisconsin conflict-of-laws principles, the court applied Wisconsin veil-piercing principles to the Wisconsin LLC and Texas veil-piercing law to the Texas LLC. Applying Wisconsin law to the question of whether Spangenberg was the alter ego of his Wisconsin LLC, the court examined whether the evidence supported the first two requirements under Wisconsin law. The first element relates to the control exercised with regard to the transaction attacked. The court identified the relevant transactions as the formation of the Wisconsin LLC and its filing of a patent suit against Daimler-Chrysler in violation of a settlement agreement. These were the alleged unjust acts committed during Spangenberg's domination and control. Based on the record, the court determined that Spangenberg had complete domination and control over all aspects of the relevant transactions so that the Wisconsin LLC had no separate mind, will, or existence. Although the court stated that this level of control by a single manager is not itself improper, it is sufficient to satisfy the control element of the analysis. The second element of the analysis involves use of the control to commit an unjust act, and the court concluded that Spangenberg improperly sought to use the newly formed Wisconsin LLC to assert a patent claim assigned to it by the Texas LLC to circumvent a settlement agreement that arguably precluded assertion of the claim. Having found that the district court properly found personal jurisdiction over Spangenberg as alter ego of the Wisconsin LLC, the court turned to the reverse piercing analysis required to reach Spangenberg's Texas LLC. The court stated that Texas law permitted reverse piercing and that the Texas alter ego doctrine, as applied in reverse, requires a unity of interest such that the separateness of the corporation and individual has ceased, and asserting jurisdiction over only the individual would result in injustice. The court agreed with the parties that the Wisconsin and Texas tests are essentially identical, although the court noted that Texas case law has been superseded by statute insofar as failure to observe corporate formalities is no longer a factor in proving alter ego. The court found that Spangenberg, as manager of the Texas LLC, exercised control over the Texas LLC similar to that exercised over the Wisconsin LLC, and the court found that the injustice element was satisfied under Texas law by the possibility that a party would be unable to collect on a valid judgment. Without jurisdiction over the Texas LLC, the district court could not provide the remedy sought by the claimants on their counterclaim as the successor to the Wisconsin LLC under the settlement agreement. Thus, the requirements for the second step in the piercing analysis were met as well.

Estate of Hurst v. Moorehead, LLC, 748 S.E.2d 568 (N.C. App. 2013).

The plaintiffs entered into an agreement to sell a tract of land to Cramer Mountain Development, LLC ("Cramer"), which was owned by Desimone. The agreement was later assigned by Cramer to a newly formed LLC, Moorehead I, LLC ("Moorehead"), whose sole member was Blackmon. On the date the agreement was assigned, the plaintiffs met with Desimone and two real

estate brokers and executed various documents, including a deed to Moorehead, prepared by Moorehead's closing attorney. The plaintiffs brought a lawsuit in which they alleged that Desimone and the real estate brokers made misrepresentations to them about what they were signing and that they were defrauded into closing the transaction under terms different than those agreed upon. The plaintiffs also alleged that Moorehead was in default on a \$4.5 million note payable to the plaintiffs. The plaintiffs sought to pierce the veil of Cramer and Moorehead on the basis that Desimone, Blackmon, and the real estate brokers exercised complete domination and control over the entities involved in the transaction. Based on the jury verdict, the plaintiffs obtained a judgment that concluded, *inter alia*, that Blackmon was the alter ego of Moorehead and was liable for \$4.9 million for Moorehead's breach of contract and that Blackmon was liable for nominal damages of \$1.00 for unfair and deceptive trade practices. Blackmon appealed the part of the judgment holding him personally liable.

The court of appeals discussed the statutory liability protection provided to members and managers under the North Carolina LLC statute and the circumstances under which a member can be held personally liable, including veil piercing. The court explained that members of an LLC have the same liability protection as corporate shareholders and may not be held liable based merely on their participation in the LLC's business affairs, but an LLC member may be held individually liable for the LLC's obligations if the member engages in individual conduct that subjects the member to liability. In addition, the court explained that LLC members, like corporate shareholders, may be held individually liable for the LLC's obligations through the doctrine of piercing the corporate veil. In North Carolina, the instrumentality rule forms the basis for disregarding the corporate entity or piercing the veil. The court set forth the three elements of the instrumentality rule, which involve complete domination; use of that control to commit fraud or wrong, violate a duty, or dishonestly and unjustly violate a right; and injury proximately caused by the control and breach of duty. The court listed numerous factors that may be considered in evaluating liability under the instrumentality rule. In this case, the plaintiffs presented evidence of multiple factors, the trial court properly instructed the jury regarding the instrumentality rule, and the jury returned a verdict based on which the trial court entered a judgment decreeing that Blackmon was the alter ego of Moorehead and that Blackmon and his entity were jointly and severally liable for all awards against either of them.

Blackmon argued on appeal that he could not be held personally liable on Moorehead's promissory note because the jury failed to find him liable for fraud or to award actual damages for fraud or unfair or deceptive practices. The court of appeals stated that Blackmon's argument completely misapprehended the law with respect to the instrumentality rule. The court stated that a finding that an individual member of an LLC personally engaged in fraud or misrepresentation is necessary to hold a member liable under the LLC statute for the member's own conduct but is not required to support alter ego liability under the instrumentality rule. A showing of actual fraud in the legal sense is not required to pierce the corporate veil; piercing the veil under the instrumentality rule requires that a member used his control to commit fraud *or wrong*, to perpetrate the violation of a statutory or other positive or legal duty, *or a dishonest and unjust act in contravention of the plaintiff's legal rights*. Similarly, the fact that the jury found only nominal damages for unfair and deceptive trade practices had no bearing on the trial court's ability to pierce Moorehead's veil and hold Blackmon liable for Moorehead's breach of contract.

Primary Investments, LLC v. Wee Tender Care III, Inc., 746 S.E.2d 823 (Ga. App. 2013).

When the members/managers of an LLC that sold its day care facility formed a new LLC and opened a new day care facility within three years after the sale, the purchaser sued the selling LLC, its members/managers, and the new LLC for breach of a noncompetition clause. The court of appeals held that the selling LLC did not violate the noncompetition provision, and the members/managers and their new LLC were not bound by the provision. In a footnote, the court mentioned that the plaintiffs did not argue, and there was no evidence, that the existence of Primary LLC should be ignored. The court stated that the same recognition of a corporation's separate existence "so long as the corporate forms are maintained" applies to an LLC, and courts must exercise great caution in disregarding the legal distinction.

Thomas v. Bridges, 120 So.3d 338 (La. App. 2013).

The Louisiana Department of Revenue sought to hold Thomas, a Louisiana resident and sole member of a Montana LLC, liable for sales tax and penalties on the LLC's purchase of a recreational vehicle from a Louisiana seller. The Department acknowledged that LLC members and managers are not liable for the debts, obligations, and liabilities of the LLC under the Louisiana LLC statute, but contended that Thomas committed fraud in setting up an LLC in Montana for the sole purpose of avoiding Louisiana sales tax so that Thomas was individually liable for the sales tax in Louisiana. The Department argued that the LLC's veil should be pierced under the test for piercing the corporate veil supplied by the Louisiana Supreme Court. The court of appeals concluded that there was no evidence in the record that Thomas committed fraud even if he created the LLC to minimize tax liability. The court explained that tax avoidance, as opposed to tax evasion, is taking advantage of legally available tax-planning opportunities to minimize tax liability. Further, the court stated that the record did not establish the factors set forth by the Louisiana Supreme Court necessary to show the LLC was the alter ego of Thomas and should be pierced. Additionally, the court noted that the record showed that the vehicle was housed in Mississippi and was not being used or housed in Louisiana such that any other tax may be owed.

Lone Star Air Systems, Ltd. v. Powers, 401 S.W.3d 855 (Tex. App. 2013).

The plaintiff operated a heating and air conditioning business and entered into a master purchase order agreement providing for the sale and purchase of goods with David Powers Homes, the assumed name of DJPH, LLC. Several business entities were associated with this LLC. Between 2000 and 2009, it was undisputed that a corporation affiliated with the LLC paid the plaintiff for hundreds of jobs. In 2008, the plaintiff sued the corporation and David Powers individually for unpaid balances from approximately 50 jobs involving the sale of air conditioning equipment and labor. The LLC and its affiliated entities ceased operating in 2009. The affiliated corporation sued by the plaintiff in this case filed a sworn pleading confessing judgment in 2010, and the plaintiff nonsuited the corporation, but the plaintiff continued to sue David Powers individually to recover payment and alleged that Powers was individually liable for breach of contract, fraud, and alter ego. Powers filed a motion for summary judgment, which the trial court granted. On appeal, the plaintiff argued that the trial court erred in granting summary judgment. The court of appeals first rejected the plaintiff's contract claim. The plaintiff argued that the true identity of David Powers Homes was Powers, or that there at least was a fact question, and that the plaintiff presented evidence establishing an exception to the statute of frauds. Powers argued that he was not a party to the agreement and that the actual party was the LLC for which David Powers Homes was an assumed

name. Both parties acknowledged that the contract was subject to the statute of frauds as a contract for the sale of goods over \$500 and, as such, not enforceable unless signed by the person against whom enforcement is sought. The court rejected the plaintiff's arguments that two exceptions applied here: (1) that Powers admitted he had a contract with the plaintiff, and (2) partial performance. The court of appeals examined the evidence and concluded that there were no admissions by Powers that he had a contract with the plaintiff and that the evidence did not show Powers, as opposed to a business entity, performed under the agreement. Summary judgment was thus proper on the breach of contract claim because there was no enforceable agreement against Powers as a matter of law. With respect to the trial court's summary judgment on the fraud claim, Powers argued that the plaintiff did not plead or offer evidence that the fraud was perpetrated primarily for Powers' direct, personal benefit, as required under Texas law to pierce the LLC veil. The plaintiff countered that it was seeking to hold Powers individually liable for common law fraud rather than seeking to pierce the LLC veil. The appellate court concluded that the only theory of fraud available to the plaintiff was one characterized as piercing the LLC veil based on the plaintiff's pleadings, summary judgment response, and evidence. The plaintiff alleged that Powers was individually liable because he used the corporate fiction to commit fraud and contended that Powers misrepresented the identity of David Powers Homes, assured payment of debts, and used an assumed name as a mechanism to escape debt. The plaintiff further alleged that David Powers Homes and Powers were inextricably tied together under an alter ego theory. Together, the allegations were based on the premise that Powers used the LLC and its affiliates in a fraudulent manner, which required proof that Powers perpetrated fraud for his direct, personal benefit. The appellate court concluded that the plaintiff produced no evidence of any acts by Powers in his individual capacity distinct from the LLC and its affiliates, and there was no evidence that Powers abused the entities primarily for his direct, personal benefit. In addition, there was no evidence of acts by Powers to deceive or mislead explicitly or implicitly. The only evidence presented by the plaintiff was evidence that the plaintiff's employee worked directly with Powers as representative of "David Powers Homes" and that Powers did not volunteer that this was not an assumed name of Powers individually. The appellate court stated that even viewing this evidence in the light most favorable to the plaintiff, it was no evidence that Powers committed fraud so as to justify piercing the LLC veil.

In re Appalachian Fuels, LLC, 493 B.R. 1 (6th Cir (B.A.P.) 2013).

The court in this appeal addressed whether the bankruptcy court abused its discretion in denying the application for administrative expenses of the West Virginia Department of Environmental Protection (WVDEP) against two affiliated Chapter 11 debtors. The affiliated debtors were a Kentucky LLC and a West Virginia LLC, and the court first analyzed whether they had derivative liability for the expenses of a third affiliate, a West Virginia corporation. The court discussed the U.S. Supreme Court's decision in *United States v. Bestfoods* (which involved liability under CERCLA) as a helpful tool in analyzing liability for administrative expenses under the state environmental statutes at issue in this case. In *Bestfoods*, the Supreme Court did not answer the question of whether courts should borrow state law or apply a federal common law of veil piercing when enforcing CERCLA's derivative liability, but the Sixth Circuit has held that courts should borrow state law, and the court thought the same analysis should apply to derivative liability under the environmental statutes at issue in this case. The court then addressed the question of which state's law should apply here given that the three affiliates involved consisted of a West Virginia

corporation, a West Virginia LLC, and a Kentucky LLC; these affiliates filed bankruptcy in Kentucky; and the mining operations that caused the environmental damage took place in West Virginia. The court discussed veil piercing under Kentucky and West Virginia law and stated that West Virginia law is more favorable to parties seeking to establish the LLCs' derivative liability for the debts of its affiliated or sister corporation than Kentucky law since there is no reported decision in Kentucky recognizing the ability to pierce the veil of one corporation to reach its sister corporation. Ultimately, the court determined that the evidence was insufficient to pierce the corporate veil and impose liability on the two LLCs under either West Virginia or Kentucky law. Additionally, the court determined that substantive consolidation did not provide a basis to impose joint liability on the LLCs for the administrative expense claims because joint procedural administration of bankruptcy cases does not result in the same melding of estates as substantive consolidation. Finally, the court analyzed the direct liability of the LLCs under the environmental statutes at issue and concluded that the bankruptcy court abused its discretion when it denied the administrative expense claim of WVDEP against one of the LLCs based on the theory of direct liability.

Damon v. Groteboer, 937 F.Supp.2d 1048 (D. Minn. 2013).

Mr. and Mrs. Damon sought to recover damages incurred in connection with the purchase of a commercial office building. The defendants argued that the Damons could not recover individually because they formed an LLC to own the building and limit their personal liability and they sought as individuals to recover damages that were incurred by the LLC. The court stated that it understood the economic reality that the Damons, as sole members, contributed the funds at issue, but the court would “not allow the Damons to take advantage of the corporate form to limit personal liability while simultaneously ignoring the corporate form when doing so allows them to profit personally.” The court concluded that the Damons could properly seek to recover the damages incurred personally before they created the LLC and transferred the building to the LLC, and the court allowed further briefing to address the possibility that it would not work an injustice if the LLC were added as a party.

Provosty v. ARC Construction LLC, 119 So.3d 23 (La. App. 2013).

The plaintiffs sued an LLC and its members, seeking to hold the members liable for the breach of a construction contract with the LLC by piercing the veil of the LLC. The plaintiffs appealed the trial court's directed verdict in favor of one of the members and its judgment notwithstanding the verdict as to another. The court of appeals upheld the trial court's judgment as to both members. With respect to one of the members, Glasser, the plaintiffs argued that the trial court improperly removed him from the judgment despite the jury's finding him liable. Glasser argued that the jury did not find him liable and that the trial court merely entered judgment in accordance with the verdict. The court of appeals quoted extensively from the trial court's analysis regarding Glasser's liability and the trial court's reasoning for its judgment and agreed with the trial court that the jury did not find Glasser perpetrated fraud on the plaintiffs and that the evidence as to the non-exclusive factors considered in a veil piercing analysis did not support piercing the veil of the LLC as to Glasser. The trial court had no doubt that the jury found that other members were heavily involved in the LLC's shell game and in defrauding customers such that piercing the veil was warranted as to them, but the only evidence of the five factors enumerated by the Louisiana Supreme Court to be considered in a veil piercing case related to undercapitalization, and there was no

evidence that Glasser undercapitalized the LLC. There also was no evidence of any exceptional circumstances that would warrant piercing the veil as to Glasser with respect to any non-exclusive factor. As to whether Glasser had knowledge of the fraud being perpetrated such that he could be held liable without interaction with the plaintiffs, the trial court concluded that there was no evidence that Glasser, who was over a thousand miles away, had any participation or knowledge of what was going on in the business. The court of appeals, upon de novo review, found the trial court properly entered a judgment of dismissal of Glasser. Similarly, the court of appeals, after a de novo review, properly granted a directed verdict in favor of another defendant because the record lacked any evidence that this member perpetrated or was aware of any fraud against the plaintiffs, was involved in the operations and administration of the LLC, or knew of or was responsible for the alleged undercapitalization.

Ademiluyi v. PennyMac Mortgage Investment Trust Holdings I, LLC, 929 F.Supp.2d 502 ((D. Md. 2013).

The court analyzed whether the veil of a Delaware LLC (initially described by the court as a “Delaware corporation”) could be pierced so as to hold its sole member liable for unlawful debt collection activities. The court stated that Maryland courts have not hesitated to apply Maryland law where a plaintiff seeks to pierce the veil of an out-of-state corporation in connection with violations of a Maryland statute. Here, the parties relied upon Maryland law and did not identify any relevant legal principle that differed from other jurisdictions; therefore, the court applied Maryland law. The court stated that an LLC is treated as a corporation for liability purposes and noted the provision of the Maryland LLC statute providing that members of an LLC are not personally liable for the obligations of an LLC solely by reason of being a member. The court discussed Maryland case law addressing a parent company’s liability for actions of its subsidiaries. The court distinguished the case at hand from *Allen v. Dackman*, an LLC case in which the Maryland Court of Appeals stated that a member of an LLC is liable for torts personally committed because such liability is not based solely on status as a member. The court stated that the court in *Dackman* was addressing the situation in which corporate officials sought to rely on their status as LLC members to shield themselves from individual liability for acts taken in their official capacities. The court stated that the plaintiff here sought to hold the sole member liable based on its alleged control of the day-to-day operations but not because it personally committed the acts themselves. The court stated that the complaint did not allege facts that would establish the member’s liability for the acts of its subsidiary. The complaint alleged only conclusory assertions as to control allegedly asserted. A complaint seeking to pierce the corporate veil under Maryland law must allege more than general and conclusory allegations of fraud, undue control, or paramount equity. The complaint must allege facts that indicate fraud or from which fraud is necessarily implied. The court discussed various Maryland cases and concluded that the complaint did not allege facts to support a claim of fraud and had not shown that piercing the veil was necessary to enforce a paramount equity. The court dismissed the complaint with leave to amend.

Tyson Fresh Meats, Inc. v. Lauer Limited, L.L.C., 918 F.Supp.2d 835 (N.D. Iowa 2013).

The plaintiff sued an LLC, the LLC’s members, and several entities who shared some common ownership with the LLC. The LLC dissolved without performing on contracts entered into with the plaintiff, and the plaintiff sought to hold the defendants liable for breach of contract and related claims. The plaintiff argued that it had personal jurisdiction over the LLC as well as the other

defendants on the basis that the court was entitled to pierce the corporate veil of the LLC and/or the LLC was the alter ego of the other defendants. After determining that it had specific jurisdiction over the LLC based on the terms of its contract with the plaintiff, the court turned to the questions of whether piercing the LLC's veil and/or treating it as the alter ego of the other defendants allowed the court to treat the contacts of the LLC as the contacts of the other defendants and whether the plaintiff presented a prima facie case justifying piercing the LLC's veil or declaring the LLC the alter ego of the other defendants. As a threshold issue, the court determined that the internal affairs doctrine applies to piercing the corporate veil and/or alter ego theories and that Nebraska law thus governed whether the LLC's veil may be pierced or whether the LLC is the alter ego of the other defendants. Because the plaintiff did not allege and the record did not support fraud per se, the court examined the factors set forth by the Nebraska Supreme Court as furnishing a reasonable inference of fraud. First, the court explained that the facts strongly indicated that the LLC was grossly, inadequately capitalized because the five members' contributions of \$54,000 each paled in comparison to the operating costs of the LLC, the members were forced to pay a significant amount of company expenses out-of-pocket to keep the company afloat during the relevant time period, and the members had to take out a personal loan to pay company obligations upon dissolution. Next, the court concluded that the LLC was insolvent at the time it entered into its contracts with the plaintiff. The court then concluded that the members of the LLC, while they did not usurp its assets by ignoring the separateness of the LLC, used the dissolution process as an end run to divert what company funds were available to themselves and other entities of which they were part owners. The court was not persuaded that the final factor, i.e., that the LLC was a mere facade for the personal dealings of its members, was met, but the other factors were sufficient to make out a prima facie showing that the LLC was under the actual control of its members and that the members used their control to commit a wrong in contravention of the plaintiff's rights. The court next discussed the alter ego theory, stating that the plaintiff had treated piercing the corporate veil and alter ego theory as synonymous but that the term "alter ego" is often used by courts in two incompatible senses. According to the court, in one sense courts refer to a subject entity whose corporate veil has been pierced as the "alter ego" of the shareholders. The court distinguished this usage from a second sense in which courts refer to a subject entity as the "alter ego" of another entity or individual, regardless of whether or not the other entity or individual has an ownership interest in the subject entity. The court stated that this second sense is akin to a finding that the subject entity is acting as the mere agent or instrumentality of the individual or other entity at issue. The court viewed the distinction as important because piercing the corporate veil of a subject entity does not allow a court to impose liability on an individual or entity that is not an owner of the entity. Under the alter ego/instrumentality approach, the court stated that the emphasis is on whether a third party exercised sufficient control over the subject entity such that the subject entity is the mere agent or instrumentality of the third party's interests, regardless of whether the third party owned a controlling interest in the subject entity. Though the entity defendants other than the LLC had some owners in common with the LLC, the other entities did not own any interest in the LLC, and the plaintiff thus must establish that the LLC was organized, controlled, and conducted so as to make it merely the agency, instrumentality, or adjunct of the other entities. The court stated that a thorough review of the relevant case law in a number of jurisdictions revealed that it was quite rare for a plaintiff to argue, as in this case, that a subject entity that is not owned, at least in part, by a third party is actually the third party's alter ego. The court found a dearth of Nebraska law in this area and the court relied on factors set forth in Eighth Circuit case law for its analysis. The court stated that alter ego theory requires that the subject

entity, the LLC in this case, must be influenced and controlled by the third party entity and not vice versa. Analyzing the dealings between the LLC and the related third party entities, the court concluded that, to the extent the entities operated as a single entity, they did so because the LLC had control and influence over the other entities. Thus, if anything, the other entities were the alter egos of the LLC and not vice versa, and the court stressed that a third party sister or sibling entity controlled by a subject entity will generally not be held responsible for the subject entity's actions, especially when the third party sister or sibling entity involves minority owners who have no interest in the subject entity. The plaintiff therefore failed to make a prima facie showing that the exercise of personal jurisdiction over the related entities was appropriate based on the alter ego theory.

Authority of Member, Manager, or Agent

Stainless Valve Co. v. Safefresh Technologies, LLC, 753 S.E.2d 331 (N.C. App. 2013).

Anthony Garwood was an officer or manager of both Safefresh Technologies, LLC ("Safefresh") and American Beef Processing, LLC ("ABP"). In the early 2000s, Garwood, in his capacity as president of Safefresh, communicated with the plaintiff's president regarding the development of a specific type of valve for food processing, but no contract was entered into with the plaintiff at that time because the plaintiff's quoted cost for manufacturing the valve was too high. There were no further communications between Garwood and the plaintiff's president until 2008 when Garwood contacted the plaintiff regarding the production of two types of valves. At this time, the plaintiff's president that Garwood communicated with in the early 2000s had retired, and his son was president. In this suit against Safefresh by the plaintiff to enforce the 2008 contract, Safefresh claimed that Garwood was acting as president of ABP rather than Safefresh when the contract was entered into. All of the plaintiff's price quotes were addressed to Safefresh, and Garwood did not inform the plaintiff that he was acting on behalf of ABP rather than Safefresh during the price negotiations. In the email accepting the plaintiff's offer to manufacture the valves, Garwood did not identify himself as the agent of either Safefresh or ABP. He simply signed as "Tony." The court discussed basic agency principles and stated that the plaintiff had the burden to show that Garwood was acting as an agent of Safefresh at the time of the contract. A principal is liable on a contract made by its agent if the agent acts with actual authority, or if the agent acts with apparent authority when the third person is without notice that the agent is exceeding the agent's authority, or if the contract is ratified although it was unauthorized at the time. If the plaintiff raised a fact issue with respect to any of these bases for binding Safefresh, the trial court erred in rendering summary judgment in favor of Safefresh. The court concluded that there was a fact issue as to whether Garwood was acting within his actual authority as a manager of Safefresh when he contracted with the plaintiff. The court reviewed the provisions of the North Carolina Limited Liability Company Act under which, as a default rule, every manager is an agent of the LLC for the purpose of its business, and the act of a manager for apparently carrying on in the usual way the business of the LLC binds the LLC unless the manager in fact has no authority and the person with whom the manager is dealing has knowledge of the lack of authority. Thus, the court stated that Garwood as a manager of Safefresh had authority to bind Safefresh by default unless the articles of organization or operating agreement provided otherwise. The record contained evidence that Garwood had actual authority given that he had previously contacted the plaintiff regarding the manufacture of valves for Safefresh, and the silence on the email combined with that fact that he originally contacted the plaintiff as president of Safefresh was enough to create a genuine issue of material fact whether he

acted within the scope of his actual authority for Safefresh in 2008. The court noted that the record was not devoid of evidence suggesting that Garwood was acting in his capacity as manager of ABP, but the plaintiff produced sufficient evidence to create a fact issue as to his actual authority to act on behalf of Safefresh and thus preclude summary judgment in favor of Safefresh.

In re Collier (McGraw v. Collier), 497 B.R. 877 (Bankr. E.D. Ark. 2013).

An LLC sought to establish nondischargeability of debts owed by the debtor, who was an investment adviser with Stanford Group Company that sold the LLC uninsured CDs. As part of the court's analysis, it had to determine what the LLC knew in connection with its CD purchase. Although the LLC did not sign a subscription agreement, the court stated that it could be charged with knowledge based on what its managers learned when they signed subscription agreements in their individual capacities. Under the Arkansas LLC statute and agency principles, a manager is an agent of the LLC for the purpose of its business, and the knowledge acquired by a manager is charged to the LLC. Imputation of an agent's knowledge to the principal will not occur, however, when the agent acts for his own interests or where the agent is without sufficient control of the principal. This exception to imputation is not applicable if the agent is the sole representative of the principal and is not accountable to a superior. The LLC plaintiff in this case was family-owned and had only two adult members, Sutter and Pfeifer. Sutter was the managing member, and Pfeifer, his wife, did not know much about finances, did not see the documents related to the LLC until the litigation, and never participated in the business dealings of the LLC until the LLC's purchase of the CDs. The court concluded that Sutter controlled the LLC without accountability to a superior and that he was under a duty to consider the knowledge he acquired from the subscription agreement signed individually by Sutter and Pfeifer. Based on what he would have learned from the subscription agreement, the LLC knew it was not an accredited investor when it consummated the transaction by funding the CD purchase through its Stanford account. Thus, the LLC's role in the transaction called its credibility into account, which was one of the factors the court had to consider in the case.

Masterguard, L.P. v. Eco Technologies International, LLC, ___ S.W.3d ___, 2013 WL 4482976 (Tex. App. 2013).

An Iowa LLC challenged the trial court's exercise of personal jurisdiction over the LLC, and the court of appeals affirmed the trial court. The question was whether the actions of Cox, a Texas resident and member of the LLC, were attributable to the LLC for purposes of specific jurisdiction. Under the Iowa LLC statute, a person is not necessarily an agent simply because the person is a member, but the statute provides that a person's status as a member does not prevent other law from imposing liability on the LLC because of the person's conduct. The court of appeals relied heavily on an Iowa court of appeals decision, *Three Minnows, LLC v. CREAM, LLC*, which explained that an Iowa LLC is presumed to be managed by its members unless the members agree that the LLC will be managed by managers. As the court in *Three Minnows* further explained, the party asserting an agency relationship must prove its existence, and an agency results from manifestation of consent by a principal that an agent shall act on the principal's behalf and subject to the principal's control and consent by the agent to do so. In *Three Minnows*, where the LLC was manager-managed, a member did not have authority to bind the LLC to a contract. The LLC's articles of organization in that case expressly provided that no member, agent, or employee of the LLC had any power to bind the LLC unless authorized by the operating agreement or the managers of the LLC. Here, by

contrast, the LLC's operating agreement provided that the LLC's business and management was to be exercised by the members. Although the members were permitted to delegate to officers, the officers remained subject to the direction and control of the members. Thus, the court concluded that Cox had express authority to act on behalf of the LLC. The LLC argued that it did not control Cox and that Cox was not its agent for purposes of the jurisdictional analysis, but the operating agreement expressly provided that the management of its business would be conducted solely by its members. Cox was recruiting dealers to contract with the LLC, and the court relied on the general rule that the actions of a corporate agent are generally deemed the corporation's acts. As a member of a member-managed LLC with express authority to conduct the LLC's business, Cox was the LLC's agent. As an agent, he recruited dealers to contract with the LLC, and the LLC contracted with recruited dealers, evidencing both the LLC's consent for Cox to act and Cox's consent to do so. The LLC, not Cox, controlled the terms of the contractual relationships with the recruited dealers. Thus, the court concluded that Cox's contacts with Texas were attributable to the LLC for purposes of the specific jurisdiction analysis. The court went on to find the other requirements for the exercise of specific jurisdiction were met as well, i.e., that the contacts were purposeful and were done to obtain a benefit for the LLC, and the exercise of jurisdiction would not offend notions of fair play and substantial justice.

Cain Family Farm, L.P. v. Schrader Real Estate & Auction Company, Inc., 991 N.E.2d 971 (Ind. App. 2013).

A member of a member-managed LLC that was the general partner of a family limited partnership that owned certain real estate executed a contract of sale for several tracts of the real estate. The contract resulted from an auction at which the land was put up for bid pursuant to an auction contract under which the partnership had the right to reject any bid. The members of the LLC and the limited partners of the partnership were four siblings. The siblings met before the auction and discussed reserve or minimum prices for the land and agreed that unanimous consent was necessary to sell any of the land. At the auction, the bidding did not reach the minimum prices on which the siblings agreed. The siblings met privately during the auction and did not agree to accept a lower bid, but the auctioneer prepared a purchase contract for the purchase of the land to the high bidder, and one of the siblings, Candace, signed the contract in the name of the LLC in its capacity as general partner of the partnership. The partnership and LLC, through counsel, wrote a letter to the auctioneer demanding that the purchase contract be rescinded, and the partnership did not close on the sale. The partnership and LLC then sued the auctioneer for breach of contract, Candace for breach of fiduciary duty, and the purchaser to quiet title. The purchaser counterclaimed for specific performance and sought summary judgment. The trial court granted summary judgment in favor of the purchaser, and the court of appeals affirmed, concluding that Candace had the power to bind the partnership as a member of the LLC general partner under either common-law apparent authority or the provisions of the Indiana LLC statute.

The court of appeals first analyzed the situation applying common-law apparent authority principles. Apparent authority is the authority that a third person reasonably believes an agent to possess based on a manifestation by the principal. Manifestations made by the agent are not sufficient to create apparent authority. Candace and two of her siblings were present at the auction, and the purchaser knew that Candace and her siblings had met in private during the auction. After the siblings met in private, the auctioneer announced that one of the tracts would not be sold because the bid was too low, but the auctioneer commenced a two-minute countdown for final bidding on

the other tracts. The purchaser did not have any indication that the siblings had rejected the purchaser's bids on the remaining tracts, and the conduct of the siblings and their agent auctioneer thus indirectly communicated to the purchaser that they had accepted the remaining bids at the close of the auction. After the close of bidding, the auctioneer presented a contract to the purchaser and Candace. Candace had previously communicated with the purchaser that the consent of all the siblings was required to sell the property. Because three of the siblings attended the auction and did not indicate that they had rejected the purchaser's bid and because their auctioneer agent presented a purchase contract, it was reasonable for the purchaser to conclude that Candace had obtained the consent of her siblings and was authorized to sign the contract. As a matter of law, Candace had apparent authority to execute the purchase agreement.

The court of appeals next discussed the application of provisions of the Indiana LLC statute addressing a member's power to bind the LLC. Under the LLC statute, a member of a member-managed LLC is an agent of the LLC for the purpose of its business, and the act of a member, including execution of an instrument in the LLC's name for apparently carrying on in the usual way the business of the LLC binds the LLC unless the member does not have authority to act in the matter and the person with whom the member is dealing knows that the member lacks authority. An act that is not apparently carrying on in the usual way the business of the LLC does not bind the LLC unless authorized in accordance with the operating agreement or the unanimous consent of the members. The partnership and LLC argued that Candace's actions were not apparently for carrying on in the usual way the business of the LLC. The meaning of the statutory language at issue, i.e., "apparently carrying on in the usual way the business or affairs of the limited liability company," presented the court with a matter of first impression. The partnership and LLC argued that they were not in the business of selling real estate and that sale of the property was a major endeavor and a liquidation of assets. The court of appeals concluded that Candace was apparently carrying on in the usual way the business of the LLC. The business of the LLC was to act as general partner of the limited partnership, which owned the real estate. The limited partnership agreement gave the general partner the full and exclusive power to manage and operate the partnership's affairs, including the power to buy and sell real property. Thus, when Candace signed the purchase agreement, she was apparently carrying on in the usual way the business of the LLC, which was to act as general partner of the limited partnership. In addition, all the siblings agreed to sell the property at auction and authorized Candace to execute the contract with the auctioneer. The undisputed evidence showed that the purchaser had no knowledge or reason to believe that Candace did not have authority to bind the LLC; therefore, the purchase agreement was enforceable.

Primary Investments, LLC v. Wee Tender Care III, Inc., 746 S.E.2d 823 (Ga. App. 2013).

When the members/managers of an LLC that sold its day care facility formed a new LLC and opened a new day care facility within three years after the sale, the purchaser sued the selling LLC, its members/managers, and the new LLC for breach of a noncompetition clause. The court of appeals held that the selling LLC did not violate the noncompetition provision, and the members/managers and their new LLC were not bound by the provision. Primary Prep Academy, LLC ("Primary LLC") sold its childcare facility to the plaintiff pursuant to the terms of an asset purchase agreement ("APA") that contained a noncompetition clause. The noncompetition clause provided that "Seller agrees that neither Seller nor its agents will" take certain acts within three years after the closing. The parties to the APA were the plaintiff and Primary LLC, and the APA was signed by Marguerite O'Brien in her capacity as a manager of Primary LLC. Within three years after

the sale, Marguerite O'Brien and her two daughters (the "O'Briens"), who were the members and managers of Primary LLC, formed East Cobb Children's Academy, LLC ("East Cobb") to operate a new child care facility within the ten-mile radius in which the noncompetition clause prohibited the "Sellers or its agents" from opening a child care facility. The trial court granted summary judgment in favor of the defendants, and the plaintiff appealed. The court of appeals first noted that the parties did not contend, and there was no evidence indicating, that Primary LLC was involved in opening the East Cobb facility. Nor was there any evidence that the O'Briens were acting as agents for Primary LLC when they opened the new facility. The key issue was whether the APA barred the O'Briens individually from opening the East Cobb facility. Since Marguerite O'Brien executed the APA in her representative capacity for a disclosed principal, the APA was Primary LLC's contract and not that of Marguerite O'Brien or of her two daughters, none of whom were even mentioned by name in the agreement. The plaintiffs argued that the words "its agents" unambiguously referred to the O'Briens, relying on the provision of the Georgia LLC statute that every manager is an agent of the LLC for the purpose of its business and affairs. The court acknowledged that the statute so provides, but this general statement that an agent is one who acts for another does not authorize the LLC to bind its agents for the LLC's contractual obligations. To the contrary, the statute protects the members and agents of an LLC from liability for the LLC's obligations. Under the statute, a member of an LLC is separate from the LLC and is not a proper party to a proceeding against the LLC solely by reason of being a member. Primary LLC had no authority to bind the O'Briens individually to the noncompetition clause, and merely including the term "its agents" in a contract with an LLC does not bind the members or managers individually under the LLC statute. If the buyer desired to bind the O'Briens individually it should have made them parties to the APA and required their signatures in their individual capacities. In a footnote, the court mentioned that the plaintiffs did not argue, and there was no evidence, that the existence of Primary LLC should be ignored. The court stated that the same recognition of a corporation's separate existence "so long as the corporate forms are maintained" applies to an LLC, and courts must exercise great caution in disregarding the legal distinction.

Germano v. Beaujean, 997 N.E.2d 1238 (Ohio App. 2013).

Beaujean and Germano formed an LLC in 2007 to operate a pizza franchise. The two agreed that they would be equal owners, that Beaujean would provide financing for the LLC, and that Germano would provide on-site management. Other than the articles of organization, which listed both men as members, there was no written operating agreement. In 2010, Germano began paying himself a management fee retroactive to the beginning of the venture. He also began paying a bookkeeping fee to a restaurant supply company he owned as well as transferring LLC funds to a separate account accessible only to him. Beaujean objected to these expenditures, but Germano refused to return the funds. Beaujean sued Germano for breach of fiduciary duty. At trial, the parties agreed that their intent was for each of them to own 50% of the LLC and that Germano would earn his half through "sweat equity" while Beaujean would finance the company. They disagreed regarding Germano's right to compensation. Beaujean claimed that Germano's compensation would come through a distributive share of the profits and any value of the company, but Germano claimed it was never part of the agreement that he would manage the LLC without pay in perpetuity. The trial court found that Germano was not entitled to transfer funds outside the reach of Beaujean and that the parties had an agreement that Germano would not charge management fees. The court ordered Germano to return these amounts and also ordered that Germano stop paying his other

company bookkeeping fees and return fees paid in excess of \$15 per hour. On appeal, Germano argued that the trial court erred in finding him liable for breach of fiduciary duty, but the court of appeals stated that the judgment did not expressly hold him liable for breach of fiduciary duty, but rather for taking unauthorized actions. The Ohio LLC statute defines fiduciary duties of loyalty and care addresses the authority of members in the management of an LLC. A member or manager may act as an agent of the LLC, but a member's act must be authorized by the other members to be binding if it is not apparently for carrying on the business of the LLC in the usual way. The court of appeals concluded that Beaujean's testimony at trial could form the basis for the trier of fact to conclude that Germano's actions were unauthorized. Further, the court pointed out that the acts were patent departures from prior practice so that the trial court could conclude that Germano was not carrying on the business in the usual way. Since Germano was enriched by acts antithetical to the statute, the trial court could properly order the return of the money derived from the breach.

Maya I-215, LLC v. Moore, No. 60095, 2013 WL 3833280 (Nev. July 18, 2013).

Maya I-215, LLC ("Maya") and Screaming Eagle, LLC ("Screaming Eagle") sued the managers of Screaming Eagle. Screaming Eagle was the manager of Maya, and the two LLCs alleged that the managers of Screaming Eagle received unauthorized fees to the detriment of Maya. The issue on appeal was whether Screaming Eagle, as Maya's manager, was authorized to initiate the litigation. The district court dismissed the litigation on the basis of member votes based on the interestedness test set forth by the Nevada Supreme Court in *In re AMERCO Derivative Litigation*. The supreme court held that the district court misread *AMERCO*, which did not apply, and that the manager had the unambiguous authority to initiate the lawsuit. Thus, the member vote was irrelevant. *AMERCO* involved the interestedness of corporate officers in declining to institute derivative litigation, and the court held that the corporation's shareholder could proceed with a derivative action without making demand on the corporation's officers because a demand would have been futile. The court explained that the *AMERCO* test did not apply in this case where the district court considered the opposite, i.e., the interestedness of the members in authorizing or discontinuing litigation initiated by the LLC's manager. Applying contract principles to the interpretation of the operating agreement, the court found clear and unambiguous provisions authorizing the manager of Maya to do all things necessary or convenient to carrying out the LLC's business, including instituting, prosecuting, and defending actions in the LLC's name. Except for certain specified matters, the authority to act for the LLC was vested in the manager. Certain decisions were reserved to the members or required member consent, but nothing in the operating agreement allowed members to override the decision of the manager to institute a lawsuit. One of the defendants also argued that the law firm representing Maya in the case could not do so because the members of Maya voted to terminate the LLC's relationship with the law firm, but the court stated that Screaming Eagle's authority to initiate the law suit included the authority to choose counsel.

Ahmed v. Fulton Street Brothers Realty, LLC, 968 N.Y.S.2d 523 (App. Div. 2d Dept. 2013).

Lewis, the managing member and a 38% owner of an LLC, executed a deed conveying LLC property to another LLC also managed by Lewis. The two remaining members, who owned the remaining 62% of the LLC had a special meeting at which they voted to remove Lewis as managing member, and they then signed a contract of sale for the property to the plaintiffs. The plaintiffs filed

suit seeking specific performance of the contract of sale. The 62% members sought summary judgment vacating the deed executed by Lewis and directing specific performance of the contract with the plaintiffs. The court held that the lower court properly denied summary judgment vacating the deed and directing specific performance of the contract of sale. The New York LLC statute provides that the transfer of substantially all of the assets of an LLC requires the vote of at least a majority in interest of the members unless the operating agreement provides otherwise. Here, the operating agreement expressly authorized the managing member to make decisions relating to the sale or disposition of the property. Thus, there was no prima facie showing that the transfer by Lewis as the managing member was unauthorized under the operating agreement or LLC statute. Further, the 62% members did not establish as a matter of law that they complied with the provisions of the operating agreement when they called the meeting and replaced Lewis as managing member before entering into the contract with the plaintiffs.

Three Minnows, LLC v. CREAM, LLC, No. 12-0591, 2013 WL 1453246 (Iowa App. April 10, 2013).

The court of appeals upheld the trial court's directed verdict in favor of the defendant in this breach of contract case against a manager-managed LLC because no reasonable juror could find that the non-manager member who signed the contract on behalf of the LLC had actual or apparent authority to do so. The plaintiff operated a bar and sought to enter into a management agreement with an LLC that operated another bar. During the negotiations, before the terms of the management agreement were finalized, it was determined that the LLC needed a licensing agreement in order to open and operate its bar under the name used by the plaintiff, and Martin was given authority by the LLC to sign the licensing agreement on behalf of the LLC. He signed the licensing agreement in his capacity as member, and the agreement contained a termination clause that required notification of the LLC's registered agent to terminate. Later, a management agreement that purported to supersede and replace the previous licensing agreement was signed by Martin on behalf of the LLC. The agreement also recited that the LLC waived any notice of termination required by the previous agreement. Martin told the plaintiff's representative that he had no authority to sign the management agreement. A second management agreement that purported to replace the first management agreement was signed a little over a month later. Martin also signed that agreement on behalf of the LLC. Martin testified that the plaintiff's representative told Martin that signed agreements were needed for the plaintiff to obtain financing and would not be used to bind the LLC. The plaintiff's representative never inquired into Martin's authority to bind the LLC, and Martin never gave the management agreements to any other member of the LLC. The LLC first became aware of the management agreements when it received a demand letter from the plaintiff's attorney claiming the LLC was in breach of the management agreement and owed the plaintiff a large sum of money. The court of appeals analyzed the question of whether Martin had authority to bind the LLC on the management agreement based on the Iowa LLC statute and common-law agency principles and concluded he did not. The court pointed out that the Iowa LLC statute, effective January 1, 2011, provides that a member is not an agent solely by reason of being a member. Based on this provision, the court stated that generally only managers can bind an LLC unless another party, such as a member, is authorized to do so by a manager as a principal. The court noted in a footnote that the previous Iowa LLC statute, which was in effect when the LLC was formed, provided that a member, acting solely in the capacity as a member, is not an agent of the LLC. Also, the new statute allows the filing of a statement of authority with the secretary of state. The court stated that neither party

argued that the change in the law had any effect on this case, and the court thus did not address the change. The court stated that the party asserting an agency relationship has the burden to prove its existence and explained that agency results from the manifestation of consent by a principal that an agent shall act on the principal's behalf and subject to the principal's control, and consent by the agent to do so. The court stated that an agency can be established based on actual or apparent authority, and the court first addressed actual authority. Actual authority is composed of express and implied authority, and the articles of organization of the LLC in question recited that no member of the LLC had any power or authority to bind the LLC unless authorized by the operating agreement or the managers of the LLC. The court mentioned that the articles of organization were publicly available, but the plaintiff made no effort to access the articles or otherwise learn who had authority to bind the LLC. Since Martin was not a manager of the LLC when he negotiated the contract, he had no express authority to bind the LLC. The court next addressed apparent authority, which is authority the principal has knowingly permitted or held out the agent as possessing. The focus in determining whether apparent authority exists is the principal's communications to the third party. That is, apparent authority must be determined based on the acts of the principal rather than the acts of the agent. A principal may also be held liable based on the doctrines of estoppel and ratification. In this case, there was no representation by the LLC to the plaintiff that Martin had authority beyond the execution of the licensing agreement. The licensing agreement provided that notice to the LLC's registered agent must be given to terminate the licensing agreement, and no such notice was provided when the management agreements that superseded the licensing agreement were executed. Nothing in the record showed that the LLC gave the plaintiff any indication that Martin had authority to execute the management agreements. Martin told the plaintiff that he had no authority to bind the LLC and was told by the plaintiff that the agreements were only needed to obtain financing. Thus, the trial court correctly granted a directed verdict in favor of the LLC.

Pazmino v. Bose McKinney & Evans, LLP, 989 N.E.2d 784 (Ind. App. 2013).

A law firm performed legal work for an LLC for several months at the request of Pazmino. The LLC was administratively dissolved during the period in which the law firm rendered services, and neither the LLC nor Pazmino paid the firm for its services. The firm sued the LLC for approximately \$12,500 plus interest and sued Pazmino for approximately \$9,600 plus interest (the amount for services performed after the LLC was dissolved). A default judgment was entered against the LLC. Both the firm and Pazmino sought summary judgment as to Pazmino's liability for the debts incurred after the LLC's dissolution. The trial court entered summary judgment in favor of the firm and against Pazmino for the amount sought from Pazmino, and Pazmino appealed. The first issue on appeal was on whose behalf Pazmino was acting. Pazmino contended that he was not personally liable for the LLC's obligations because he was an employee of the LLC. The firm alleged that even if Pazmino was an employee of the LLC, he was liable for his own acts of personally requesting the firm's services after the LLC dissolved. The appellate court was not convinced that the evidence established as a matter of law that Pazmino was only an employee of the LLC but declined to address the legal implications of Pazmino's liability if he was a member or manager of the LLC. The appellate court explained that if the evidence established that Pazmino requested the firm's services on his own behalf, he would be personally liable for that obligation under the Indiana LLC statute. However, if the evidence showed that Pazmino requested the services on behalf of the LLC such that normally he would not be personally liable for the debt, the firm argued that Pazmino was personally liable because he acted as an agent of a nonexistent principal and because he

exceeded the scope of his authority. The firm presented affidavit evidence that Pazmino personally requested and directed the firm as to legal work not relating to the winding up of the LLC after it was administratively dissolved. However, billing records referred to the LLC as the client and the party being billed for the legal work. In addition, the billing records included only a brief description of the work performed and did not establish the services performed were outside the scope of winding up the LLC. The court held that the firm did not establish as a matter of law that Pazmino secured the legal services on his own behalf and thus the firm was not entitled to summary judgment on this issue. The evidence submitted by Pazmino to support his motion for summary judgment was an affidavit in which he claimed to be an employee of the LLC and that the firm did not inform him of the LLC's dissolution. The court found that a genuine issue of material fact existed as to whether Pazmino had notice of the dissolution, which impacted whether he secured the firm's services on behalf of the LLC or whether he was acting on his own behalf. The affidavit contained no information as to the work performed by the firm or the purpose of requesting the firm's services. Like the firm, Pazmino failed to establish as a matter of law that he acted on behalf of the LLC in requesting the legal services and therefore was not entitled to summary judgment on this basis. The next issue addressed by the court was whether after dissolution of the LLC Pazmino could act as an agent on behalf of the LLC because the LLC did not exist except to wind up its business. Generally, an agent who contracts for a nonexistent principal is personally liable on the contract made. The firm contended that Pazmino was personally liable for requesting services not associated with winding up the LLC. According to the Indiana LLC statute, an LLC continues to exist after dissolution to carry on business necessary to wind up and liquidate its business and affairs. Although neither party established as a matter of law whether the work performed by the firm was associated with winding up the LLC, the LLC continued to exist as a principal that could be bound by the acts of its agents regardless of the nature of the work performed by the firm. Finally, the firm argued that Pazmino was not authorized by the LLC statute to wind up or bind the LLC following dissolution. Generally managers and/or members may wind up and bind an LLC after dissolution. The firm also maintained that the limitation on liability did not extend to employees after dissolution. The court agreed that the statute authorizes members to wind up and bind LLCs after dissolution while shielding them from personal liability; however, the court disagreed that an employee who continues to act on behalf of a dissolved LLC is always personally liable for that conduct. The firm specifically alleged that Pazmino was personally liable because he exceeded the scope of his authority under the statute when he, as an employee, requested the firm's services following dissolution of the LLC. The court stated that none of the cases cited by the firm suggested that an employee properly acting on behalf of a dissolved LLC was personally liable for such acts, and nothing in the statute suggests an intent by the legislature to expose employees of dissolved LLCs acting on behalf of the LLC to personal liability. The statute instead clarifies that even upon dissolution an LLC is responsible for its obligations. The court also reasoned that if the legislature intended to terminate the limitation on personal liability at the LLC's dissolution, the legislature would have included such a provision. Thus, when Pazmino acted within the scope of the authority conferred by the LLC, the firm's remedy was against the LLC and not Pazmino.

In re Hari Aum, LLC (Hari Aum, LLC v. First Guaranty Bank), 714 F.3d 274 (5th Cir. 2013).

At issue in this adversary proceeding was the validity of a multiple indebtedness mortgage and whether the LLC's real property covered by that mortgage secured a subsequent loan made to

a second entity. A recorded acknowledgment signed by the LLC's sole member provided that the LLC was jointly and severally liable for the second entity's loan and that the multiple indebtedness mortgage secured the second entity's loan. As part of the court's analysis, the court discussed whether the member had authority to pledge the multiple indebtedness mortgage to secure the other entity's debt. Under the Louisiana LLC statute, a managing member of an LLC may act as an agent for all matters in the ordinary course of its business other than the alienation, lease, or encumbrance of the LLC's immovables. Unless otherwise provided in the LLC's articles of organization or a written operating agreement, a majority vote of the members is required to approve the alienation, lease, or encumbrance of any immovable of an LLC. The LLC argued that there was no valid written resolution authorizing the managing member to pledge the multiple indebtedness mortgage to secure the other entity's loan. The court concluded that the member was the sole managing member and that he had the authority to pledge the multiple indebtedness mortgage "based on the relevant law, and also based on common sense." The member signed a resolution granting himself the authority to pledge all of the LLC's real property as security for any indebtedness of the LLC to the lender, and the resolution thus comported with the requirement that a majority of an LLC's members approve a manager's pledge of the LLC's real property.

In re California TD Investments LLC (Golden State TD Investments, LLC v. Andrews Kurth LLP), 489 B.R. 124 (C.D. Cal. 2013).

A corporation engaged in the business of originating, servicing, buying, and selling sub-prime mortgages formed two LLC funds to fund its business. The funds had no employees, and the corporation was the sole manager of the funds. The operating agreements of the funds gave the manager authority to manage and direct the funds but required approval of a majority of member shares for certain transactions. The funds engaged in several transactions in which a law firm issued opinions on the transactions as special counsel to the manager and the funds, and the funds asserted malpractice and breach of fiduciary duty claims against the law firm in this adversary proceeding. The law firm sought summary judgment on *in pari delicto* grounds, arguing that the manager's wrongdoing (which was admitted by the funds) should be imputed to the funds under principles of corporate and agency law. The court stated that California courts follow the well-established principle that the acts and knowledge of an officer/agent can be attributed to a corporation/principal and that this principle could be applied to the LLC funds with respect to its manager because courts do not differentiate in this context between LLCs and "more traditional corporations." Furthermore, the court noted that imputation of an officer's acts to the corporation is simply an application of general agency law. The court then discussed the "adverse interest" exception to attribution or imputation of an agent's acts to the principal. The "adverse interest" exception is in turn subject to the "sole actor" exception. The court concluded that the manager did not have sole control over the transactions because the operating agreement required member consent to transactions presenting a conflict of interest for the manager. The court said that there was a material issue of fact whether the transactions benefitted the manager at the expense of the funds, and it was thus a disputed issue of fact whether the manager was the sole decision maker under the operating agreement. The court distinguished cases cited by the defendants for the proposition that the adverse interest exception should not be applied to this case because the cases relied on by the defendants involved corporations used by their principals to steal from outsiders, and the manager's wrongdoing was theft from the funds themselves. Furthermore, in addition to the adverse interest exception, the court stated that California courts refuse to impute the acts and knowledge of an officer in a situation where that

officer has no power to bind the corporation. The court stated that the manager's lack of authority under the operating agreements to bind the funds to the transactions also raised this exception. Because it was a disputed fact whether the manager had the sole authority or any authority at all to enter into the transactions, both the "adverse interest" and "no authority to act" exceptions precluded summary judgment in favor of the law firm. The court also examined the defendants' judicial estoppel argument and declined to invoke the doctrine on the record before it.

Bank of America, N.A. v. Keso Sagg, LLC, 960 N.Y.S.2d 135 (App. Div. 2d Dept. 2013).

By submitting the operating agreements of the LLC defendants, the plaintiff in this foreclosure action refuted the LLCs' allegations that the plaintiff knew or should have known that the LLCs' managing member lacked actual authority to mortgage the LLCs' property.

Carhart-Halaska International, LLC v. Carhart, Inc., 920 F.Supp.2d 971 (E.D. Wis. 2013).

The two members of a Wisconsin LLC, Halaska International, Inc. ("Halaska") and Carhart, Inc. ("Carhart"), had a contractual dispute, and Halaska sued Carhart and its owner in state court. Halaska named the LLC as a plaintiff in addition to Halaska. The defendants removed the case to federal court based on diversity of citizenship. Since the citizenship of an LLC is the citizenship of its members, citizens from the same state were on both sides of the case (i.e., defendant Carhart was a citizen of Illinois, which meant the plaintiff LLC was also a citizen of Illinois), thus destroying diversity of citizenship; however, the defendants alleged that the federal court should disregard the LLC's citizenship because it was an improper plaintiff. The defendants relied on the fraudulent joinder doctrine, which allows a court to disregard citizenship of a party joined to defeat diversity jurisdiction. The court noted that the Seventh Circuit has never endorsed the use of the fraudulent joinder doctrine to disregard a plaintiff's citizenship and that the burden to establish fraudulent joinder is very heavy. To prevail on the claim of fraudulent joinder, the defendants had to show that the plaintiff actually committed fraud in naming the LLC as a party or that there was no reasonable possibility that the LLC could prevail on any of its claims taking all inferences of fact and law in the LLC's favor. The defendants first argued that there was no reasonable possibility that the LLC could prevail because Halaska was not authorized to join the LLC as a plaintiff. The Wisconsin LLC statute provides that an action on behalf of an LLC may be brought in the name of the LLC by one or more of its members if the members are authorized to sue by the affirmative vote of a majority in interest of the members, except that the vote of any member who has an interest in the outcome of the action that is adverse to the interest of the LLC must be excluded. Wisconsin case law has held that an LLC's operating agreement must explicitly address voting to authorize an action on behalf of the LLC in order to override this statutory provision. The operating agreement between Halaska and Carhart prohibited a manager of the LLC from bringing suit on behalf of the LLC unless a certain procedure was followed, however it did not address member-initiated suits or voting to authorize such suits. Thus, the LLC's operating agreement did not override the statute governing the member's authority to sue on behalf of the LLC. The next issue was whether Halaska satisfied the governing statutory requirements, and specifically whether Halaska's interest was adverse to the LLC thus excluding Halaska from suing on the LLC's behalf. The defendants contended that Halaska's interest was adverse to that of the LLC because Halaska sought to compel the LLC to provide funds to pay tax obligations. Based on Halaska's complaint, the court could not say that Halaska's interest was adverse to the LLC because Halaska alleged that it sought to recover funds that were allegedly misappropriated by the defendants from the LLC. Halaska was thus authorized to join the LLC as

a plaintiff because it met the percentage of LLC ownership to satisfy the affirmative vote requirement. Finally, the defendants argued that Halaska failed to follow the appropriate procedure with respect to initiating the suit because Halaska did not seek a vote at a meeting of the LLC members and did not memorialize its consent in writing until after it filed suit. The Wisconsin statute does not require a formal vote or written consent; it requires a complaint to particularly describe the authorization for the member to bring the action. The court found that Halaska's complaint met the statutory requirement and that Halaska followed the appropriate procedure in initiating the suit. Thus, there was a reasonable possibility that the LLC could prevail on its claims against the defendants, and applying the fraudulent joinder doctrine would be improper. Since the citizenship of the LLC could not be disregarded, the court remanded the case to state court due to lack of subject matter jurisdiction.

Admission of Member/Issuance of Membership Interest

Germano v. Beaujean, 997 N.E.2d 1238 (Ohio App. 2013).

Beaujean and Germano formed an LLC in 2007 to operate a pizza franchise. The two agreed that they would be equal owners, that Beaujean would provide financing for the LLC, and that Germano would provide on-site management. Other than the articles of organization, which listed both men as members, there was no written operating agreement. In 2009, Beaujean and his wife divorced, and Beaujean's wife was awarded half of his membership interest in the LLC. The divorce decree was subsequently amended to provide that Beaujean was permitted to buy out the wife's share of the LLC. In 2010, Germano began paying himself a management fee retroactive to the beginning of the venture. He also began paying a bookkeeping fee to a restaurant supply company he owned as well as transferring LLC funds to a separate account accessible only to him. Beaujean objected to these expenditures, but Germano refused to return the funds. Beaujean sued Germano, and Germano counterclaimed. One of Germano's claims was for a declaratory judgment that Beaujean's ownership of the LLC was only 25%. At trial, Beaujean's ex-wife testified that by the time of trial Beaujean had completed the purchase of any interest she was granted in the divorce and that she never held a membership interest. The court denied Germano's counterclaims and issued a declaration that the parties were both 50% owners and that Beaujean's ex-wife did not have and never had any membership interest in the LLC. The court of appeals also upheld the trial court's declaration that Beaujean owned a 50% interest in the LLC. Germano argued on appeal that Beaujean's membership was divided between him and his ex-wife as a result of the divorce decree and that Beaujean's interest was thus reduced to 25%. The court of appeals noted that a "member" is defined in the Ohio LLC statute as a person whose name appears on the records of the LLC as an owner of a membership interest, and a "membership interest" is a member's share of the LLC's profits and losses and the right to receive distributions. The court set forth the provisions of the Ohio statute regarding admission of members after the filing of the articles of organization. The statute provides that a person acquiring an interest directly from the LLC can become a member only as provided by the operating agreement or if not provided by the operating agreement by written consent of all members, and an assignee can become a member if the transferring member has the power under a written operating agreement to admit the assignee as a member. The court stated that there was no written operating agreement and no written consent of all members for Beaujean's ex-wife to become a member. Further, her name did not appear in the LLC's records as having a membership interest, so she could not have become a member in that manner. The divorce was

granted in Michigan, but the court stated that Michigan law could not supersede Ohio business organizations law. Although Beaujean's ex-wife might have a claim under the decree, the court found it unnecessary to address it in this case because Beaujean's ex-wife "never became any part of a member" absent compliance with one of the statutory methods. Likewise, Beaujean's "membership was never diluted."

Sync Labs LLC v. Fusion Manufacturing, Civ. No. 2:11-0367 (WHW), 2013 WL 4776018 (D.N.J. Sept. 4, 2013), motion for reconsideration denied, 2014 WL 37124 (D.N.J. Jan. 6, 2014).

An LLC and its founder sued Ferchak, an individual who became involved in the LLC by contributing services and capital, for breach of contract and various other causes of action after Ferchak withdrew his pledge to invest \$250,000, demanded the return of \$20,000 he had already paid in exchange for units in the LLC, and resigned from the LLC. Ferchak counterclaimed for violations of the New Jersey Wage Payment Law and New Jersey Uniform Securities Law, and the LLC's founder sought summary judgment on the counterclaims (moving only on his own behalf because the court had disqualified him from representing the LLC pro se). The court granted summary judgment in favor of the plaintiffs (including the LLC even though its founder was not able to represent it) on the wage payment claim. According to the work for hire agreement Ferchak entered into, Ferchak agreed to work part-time and was entitled to a specified number of Class B Units of Profit Interest (BUPIs) in the LLC for each hour of work performed for the LLC. The summary judgment evidence established that Ferchak received the BUPIs to which he was entitled under his agreement; therefore, there was no genuine issue of material fact as to whether he received the compensation to which he was entitled. Although Ferchak made various demands for monetary compensation, he submitted no evidence to support a claim that he was entitled to any compensation other than the BUPIs. The court denied the plaintiff's motion for summary judgment on Ferchak's claim under the New Jersey Uniform Securities Law (NJUSL). Ferchak's claim for violation of the NJUSL was based on his purchase of 4,000 Class A Units of Profit Interest (AUPIs) for \$20,000. The court acknowledged that the sale of the units was exempt from registration under the NJUSL even if they were securities, but securities sold in exempt offerings are not exempt from the civil liability provisions, and the court concluded that there were fact issues as to whether the AUPIs were "stock" and thus securities under the NJUSL.

Fundamental Long Term Care Holdings, LLC v. Cammeby's Funding LLC, 985 N.E.2d 893 (N.Y. 2013).

In 2006, Fundamental Long Term Care Holdings, LLC ("Fundamental"), an LLC whose members were Grunstein and Forman, entered into an option agreement with Cammeby's Funding LLC ("Cam Funding"), an LLC wholly owned by Schron, under which Cam Funding was entitled to acquire one-third of Fundamental's membership units for a strike price of \$1,000, provided the option was exercised no later than June 9, 2011. Grunstein and Forman formed Fundamental for the purpose of owning companies that manage health care facilities, and they each contributed \$50 in equity for a half-interest in Fundamental and paid \$10 million, financed by debt, to purchase from an entity controlled by Schron the stock of 26 nursing home facilities. The option agreement provided that Cam Funding would be admitted as a member of Fundamental upon exercise of the option and that Fundamental would execute certificates for the acquired units and all other documents necessary to properly issue the acquired units, and Grunstein and Forman agreed, as the sole members of Fundamental, to consent to the issuance of the acquired units and the admission of

Cam Funding as a member and to execute and deliver amendments and schedules to the operating agreement of Fundamental to reflect the issuance of the acquired units. The option agreement also required Fundamental, Grunstein, and Forman to facilitate, and prohibited their interference with, the exercise of the option and provided that any conflicting agreement or commitment would be deemed void. Finally, the option agreement contained a standard merger clause. In late 2010, Cam Funding notified Fundamental that it was exercising the option and enclosed a \$1,000 certified check. Fundamental responded that its operating agreement provided that additional membership units could not be issued without a capital contribution equal to at least the fair market value of the proposed interest, which was estimated to be \$33 million. Fundamental sued for a declaration that Cam Funding was bound by the membership requirements in the operating agreement to make the requisite capital contribution, and Cam Funding counterclaimed for breach of contract. The trial court ruled that the option agreement unambiguously granted the right to acquire a one-third interest in Fundamental upon payment of \$1,000, and the appellate division affirmed. The New York Court of Appeals affirmed the appellate division. New York's high court rejected Fundamental's argument that the option agreement and operating agreement must be read together, stating that the two agreements were not inextricably intertwined. The court stated that the breach of one agreement would not undo the obligations imposed by the other, and an obligation for the fair market value to be due upon Cam Funding's exercise of the option was not the sort of term these sophisticated, counseled parties would have reasonably left out of the option agreement. Mere reference to the operating agreement in the option agreement was not enough to evidence clear intent for the two contracts to be read as one. Furthermore, whether payment of \$1,000 for a membership interest valued at \$33 million was commercially unreasonable was irrelevant. The court stated that an inquiry into commercial reasonableness is only justified when a contract is ambiguous, and the option here was unambiguous. The court noted that, in any event, parties enter into option agreements for all sorts of reasons, and this agreement was executed by sophisticated, counseled parties.

LLC Property/Interest of Member

Turner v. Andrew, 413 S.W.3d 272 (Ky. 2013).

A truck owned by Billy Andrew and operated by Andrew's LLC was damaged in an accident, and Andrew sued to recover for damage to the truck as well as loss of income derived from use of the truck in Andrew's business. The LLC was not named as a plaintiff, and the Kentucky Supreme Court determined that Andrew had no standing to assert the claim for lost income if the LLC was conducting the business in which the truck was being used at the time of the accident. The court noted that Andrew could personally recover for the property damage to the truck since he personally owned the truck. The court explained that an LLC is a legal entity distinct from its members and pointed out that courts across the country have uniformly recognized the separateness of an LLC from its members. The court rejected the reasoning of the court of appeals that Andrew was the real party in interest since he was the sole owner of the LLC, pointing out that cases in the sole-owner corporation context had rejected that reasoning and stating that the same conclusion was mandated here. The court stated that the LLC and its sole member are not "interchangeable" and that "an LLC is not a legal coat that one slips on to protect the owner from liability but then discards or ignores altogether when it is time to pursue a damage claim." The court acknowledged that there are circumstances when the LLC's separate existence can be disregarded in the interest of equity but stated this was not such a case because the facts here bore no resemblance to the traditional veil-

piercing situation where an unpaid LLC creditor seeks to pierce the veil of an LLC to reach the personal assets of the member. Further, this case was not even an “outsider reverse” piercing case where the creditor of a member seeks to pierce the LLC veil to reach assets of the LLC to satisfy the member’s personal debt. The court acknowledged that there is an “insider reverse” piercing theory adopted by a very few states and employed when strong policy considerations are involved. Here, the only appropriate plaintiff to assert the lost damages claim was the LLC if, as it appeared, the trucking business was being conducted by the LLC at the time of the accident.

In re Underhill, 498 B.R. 170 (6th Cir. (B.A.P.) 2013).

After the debtor received her discharge, her wholly-owned LLC filed an action for tortious interference and the lawsuit was settled. The settlement proceeds, net of attorney’s fees, went to the debtor rather than the LLC. A creditor moved to reopen the bankruptcy case so that the proceeds of the settlement could be administered as an asset of the estate. The court affirmed the bankruptcy court’s order reopening the case but remanded for the bankruptcy court to determine the value of the debtor’s interest in the LLC based on the LLC’s recovery in the lawsuit. The court held that it was not an abuse of discretion for the bankruptcy court to reopen the case because the settlement related to a prepetition cause of action held by the LLC, and the cause of action was not disclosed by the debtor in the bankruptcy. Thus, the settlement proceeds received post-discharge were sufficiently rooted in the debtor’s pre-bankruptcy past to require administration by the bankruptcy estate, and the cause of action was not abandoned when the bankruptcy case was closed. While the court agreed with the bankruptcy court that the bankruptcy case should be reopened, it found the record unclear as to what portion of the settlement proceeds belonged to the creditors of the LLC and what portion belonged to creditors of the debtor. Although the debtor listed her interest in the LLC as worth zero, that statement was not accurate because her membership interest had potential value if the LLC recovered on its cause of action. The unresolved issue was the value of the debtor’s membership interest after the LLC recovered on the settlement. The court looked to Ohio LLC law regarding the LLC’s and member’s rights and noted that the debtor’s membership interest was personal property representing her right to share in the profits and losses and right to receive distributions. The debtor had no specific interest in LLC property, and her interest only had value to the extent the assets of the LLC exceeded its liabilities. Under Ohio law, the settlement proceeds should have been paid to the LLC, and the debtor was required to pay creditors before making a distribution to herself. The court stated that if she had listed the LLC’s cause of action on her bankruptcy schedule, the cause of action would have been litigated for the benefit of the bankruptcy estate, and the settlement would have been applied to satisfy creditors of the LLC (including payment of attorney’s fees to the law firm that obtained the settlement for the LLC) and the balance distributed to the bankruptcy estate for payment of debtor’s creditors. With the case reopened, the court stated that the bankruptcy court should determine what portion of the settlement proceeds belong to creditors of the LLC under Ohio law and what portion should be paid into the bankruptcy estate on account of the debtor’s membership interest.

Town of Midland v. Wayne, 748 S.E.2d 35 (N.C. App. 2013).

Wayne, an individual who held record title to a tract, sought to treat his tract and an adjacent tract owned by an LLC in which he owned a 75% interest as a single tract on the basis of unity of ownership. The court held that there was no unity of ownership because Wayne had no interest in the tract owned by the LLC; rather, he only owned an interest in the LLC that owned the tract. The

court concluded that case law from the corporate context was the appropriate analogy and rejected Wayne's claim that the court should look to partnership case law under which the court had found that separate tracts owned by different partnerships could be treated as having a unity of ownership based on the fact that some of the general partners were the same. In that case, the court stated that each general partner had an ownership interest in the partnership property along with the other partners. Here, the court stated that the LLC should be treated like a corporation, which is distinct from the shareholders that own it, and that, where persons have deliberately adopted the corporate form to secure its advantages, they will not be allowed to disregard the existence of the corporate entity when it benefits them to do so. Wayne argued that an LLC should be treated like a general partnership rather than a corporation for purposes of unity of title because partnerships and LLCs are taxed similarly. The court was unconvinced, pointing out that S corporations and partnerships are also taxed similarly.

Peabody-Waterside Development, LLC v. Islands of Waterside, LLC, 995 N.E.2d 1021 (Ill. App. 2013).

The plaintiff sued for breach of contract and enforcement of a mechanic's lien to collect amounts owed by a defendant for grading and site development work the plaintiff performed on a Delaware LLC's property. The trial court concluded that the plaintiff, also a Delaware LLC, could not claim a lien against the defendant LLC's property because the plaintiff was a member of the defendant LLC and was therefore jointly interested in the property. The court of appeals began by stating that it was of little import whether the LLCs were formed in Delaware or Illinois. The court acknowledged that an owner or co-owner of property may not claim a lien against his or her own property, but the court pointed out that an LLC is a legal entity distinct from its members, and Illinois LLC law clearly states that membership in an LLC does not confer ownership of the LLC's property. An LLC member owns only its membership interest in the LLC, and for that reason a creditor of the member may not seize LLC property to satisfy the member's debt. Given that the plaintiff was a member of the defendant LLC, the plaintiff was not a co-owner of the defendant LLC's property, and its mechanic's lien was valid.

Ghosh v. Grover, 412 S.W.3d 749 (Tex. App. 2013).

Ghosh and Grover, through their respective entities of Cinemawalla, Inc. ("Cinemawalla") and 87 Minutes, LLC ("87 Minutes"), formed an LLC to produce a movie entitled *97 Minutes*. Ghosh and Grover orally agreed that Grover and 87 Minutes would contribute the rights to a screenplay and written commitments for the project along with \$600,000 in cash and \$400,000 of previous expenditures in exchange for 87 Minutes' membership interest, and Ghosh and Cinemawalla, in exchange for its membership interest, would obtain the release of \$4 million that had been placed in escrow under a contract between Cinemawalla and a third party ("San Luis Cine") for the production of another movie. Grover and 87 Minutes satisfied their obligations, and Ghosh repeatedly assured Grover that San Luis Cine had agreed to reallocate the escrowed funds to the production of *97 Minutes*, but San Luis Cine never released all the funds. After Ghosh offered various excuses and asserted that various actions needed to be taken before San Luis Cine would release the funds, Grover began to question Ghosh's credibility and demanded that their agreement be reduced to writing. Ghosh refused to do so, and Grover and 87 Minutes sued Ghosh and Cinemawalla. The plaintiffs' causes of action included breach of contract, conversion, and fraud, and the jury found in favor of the plaintiffs on each cause of action. On appeal, Ghosh and

Cinemawalla argued, *inter alia*, that the statute of frauds barred the breach of contract claim and that the evidence did not support the jury's verdict on the conversion claim. The court of appeals first addressed the enforceability of the oral agreement by the defendants to cause the \$4 million being held in escrow for production of another movie to be redirected to the LLC's movie project and concluded the agreement was unenforceable because the Texas LLC statute provides that a promise to make a contribution or otherwise pay cash or transfer property to an LLC is not enforceable unless the promise is in writing and signed by the person making the promise. The plaintiffs' conversion claim was based on checks Ghosh wrote to herself from the LLC's bank account. To recover for conversion, a plaintiff must have had legal possession or the right to possession of the money converted. The money in the LLC's bank account was deposited by 87 Minutes, but 87 Minutes no longer owned, possessed, or controlled the money once it was deposited in the LLC's account. Grover argued that he had the right to immediate possession of the money because he was entitled to rescind the fraudulently induced contract, but there was no legally enforceable contract due to the statute of frauds provision mentioned above, and thus this argument failed even assuming it otherwise had merit.

Kohannim v. Katoli, __ S.W.3d __, 2013 WL 3943078 (Tex. App. 2013).

A member's 50% interest in an LLC was awarded to his wife in their divorce. Before the divorce, the other member closed an LLC bank account and transferred \$160,000 in the account to another account as a "payment to owner." After the divorce, the other member caused the LLC to make payments to him for services provided to the LLC. The ex-wife, now an assignee of her husband's 50% interest, sued the other member and the LLC, asserting claims that included unjust enrichment. The court of appeals agreed with the other member's challenge to the trial court's finding on the ex-wife's unjust enrichment claim. The trial court found that the other member wrongfully utilized funds and assets of the LLC for his own use and unilaterally obligated the LLC to pay himself for management services that were not performed at all or were performed in a manner that damaged the LLC. A claim for unjust enrichment on these facts belonged to the LLC rather than the ex-wife.

United States v. ADT Security Services, LLC, 522 Fed. App'x 480 (11th Cir. 2013).

In this civil forfeiture action, an LLC asserted a claim for a 10% interest in several properties owned by other LLCs in which the claimant held a 10% interest. The claimant also asserted a claim for a 10% interest in escrowed lease payments collected with respect to the properties. The district court granted the government summary judgment on the basis that the claimant lacked standing to assert the claim. The government's challenge to the claimant's standing rested in part on the fact that the claimant did not exist as a jural entity. The evidence showed the claimant was never properly formed as an LLC, but the court of appeals went on to consider whether the claimant was an entity that could make an appearance despite not being properly formed as an LLC. The court concluded that the claimant could make an appearance but lacked standing. Whether the claimant as a non-existent legal entity could assert a valid claim was a question of "substantive standing jurisprudence." To have standing, the claimant must have an ownership interest in the subject properties as determined by the law of the jurisdiction creating the asserted interest. The properties at issue were owned by Florida and Pennsylvania LLCs in which the claimant claimed to be a member. Under Florida and Pennsylvania LLC law, property acquired by an LLC is property of the LLC, and the claimant thus could not assert a claim on its own behalf.

Padawer v. Yur, 66 A.3d 931 (Conn. App. 2013).

The defendants in an action brought by the sole member of an LLC appealed the judgment against them on the basis that the plaintiff did not have standing to assert the claims on which the judgment was based. The plaintiff sued for breach of contract and unjust enrichment based on the defendants' breach of an oral agreement to purchase a retail women's clothing store after taking over operation of the store. The store was owned by Clare Jones, LLC, and the plaintiff's evidence included various documents and proposed drafts of sales contracts, all of which indicated the plaintiff was acting as an agent of Clare Jones, LLC, rather than as an individual. There was no evidence or testimony that the plaintiff individually owned the store or that any of the assets located in the boutique belonged to the plaintiff individually. The court cited statutory provisions regarding the separate legal existence of an LLC and its power to sue and be sued. The court concluded that any harm caused by the alleged breach was to Clare Jones, LLC, and the plaintiff's status as sole member did not impute ownership of the LLC's assets to the plaintiff since property acquired by an LLC is property of the LLC rather than its members, and a member has no interest in specific LLC property. The plaintiff thus did not have standing, and the trial court erred in denying the defendants' motion to dismiss.

Zeigler v. Housing Authority of New Orleans, 118 So.3d 442 (La. App. 2013).

Zeigler and his LLC, an inspection company, alleged a scheme on the part of the defendants to take control of a housing program for victims of natural disasters and drive the LLC out of business with the New Orleans Housing Authority. Aside from a claim for intentional infliction of emotional distress, Zeigler only alleged causes of action related to the LLC's business dealings, and the court of appeals held that the trial court correctly dismissed Zeigler's claims because he had no standing to sue personally and recover damages suffered by his LLC. The court pointed out that a member of a Louisiana LLC has no interest in LLC property, and members of an LLC thus have no right to sue personally for damages to LLC property.

In re Blue Ridge Housing of Bakersville LLC, 738 S.E.2d 802 (N.C. App. 2013).

In the course of discussing whether a housing development qualified for ad valorem tax exemption as a low-income housing development owned by a nonprofit corporation, the court quoted a description by the U.S. Department of Housing and Urban Development of the use of LLCs as a common ownership structure for low income housing developments. The structure in this case involved ownership of the housing development by an LLC with a .1% managing member that was a nonprofit corporation and a 99.9% investor member that was a limited partnership. The court concluded that the housing complex qualified for the tax exemption. The court relied in part on its conclusion that the managing member was, by virtue of North Carolina LLC law and the managing member's management of the LLC's operations and property, trustee of the LLC property under an "active trust." The court also relied on a provision of the LLC operating agreement that gave the managing member a right of first refusal to purchase the investor member's interest at the end of a 15-year term. The likelihood of a buyout was one factor suggesting ownership. The court said that the evidence suggested that the investor member did not seek a typical goal of ownership in that it sought to obtain tax credits rather than obtain profits. On balance, notwithstanding the managing member's small ownership percentage, the court concluded that substantial factors indicated the managing member owned the housing complex for tax purposes.

In re Breece, No. 12-8018, 2013 WL 197399 (6th Cir. (B.A.P.) Jan. 18, 2013).

The debtor appealed the bankruptcy court's ruling that the debtor could not claim a homestead exemption in real property under Ohio law because the real property was owned by an LLC. The court cited case law and provisions of the Ohio LLC statute distinguishing between a member's membership interest in the LLC and property of the LLC. In attempting to predict what the Ohio Supreme Court would rule if presented with the issue, the court relied on an unpublished decision from the Northern District of Ohio and a Massachusetts bankruptcy court decision in which the courts concluded that the debtors did not have an exemptible interest in property owned by a wholly owned LLC. The court rejected the debtor's argument that the most important element under the Ohio homestead exemption statute is "use" of the property and that it trumps all other elements, including holding an "interest" in the property. Because the residence at issue was the LLC's property, the debtor held no specific interest in the LLC's property under Ohio LLC law. Because the Ohio exemption statute allows the debtor to exempt the debtor's interest in the property used as a residence, the debtor could not claim an exemption. Further, the debtor could not claim a homestead exemption because the property was not property of the bankruptcy estate. Property of the estate consists of the legal or equitable interests of the debtor in property at the time of the commencement of the case. Property cannot be exempted unless it first falls within the property of the bankruptcy estate, and the debtor's membership interest in the LLC gave her no specific or cognizable legal interest in the real property at issue. Accordingly, the property was not property of the estate, and she was not entitled to claim an exemption in it.

In re Kuiken, 484 B.R. 766 (9th Cir. (B.A.P.) 2013).

The debtor could not avoid a judgment lien on his homestead under the exemption impairment provision of the Bankruptcy Code where the debtor acquired the homestead, transferred it to an LLC, and later reacquired it from the LLC. The debtor had no interest in the property in the interim while it was owned by the LLC and he thus acquired a different interest to which a lien had attached when he reacquired the property.

Fiduciary Duties of Members and Managers

Phillips Brothers v. Winstead, __ So.3d __, 2014 WL 68814 (Miss. 2014).

Winstead, Simmons, and Phillips Brothers, LP ("Phillips") formed an LLC to operate a catfish hatchery and farm. The LLC operating agreement provided that Winstead, Simmons, and Phillips each had a 1/3 ownership interest and that Simmons was the manager. The members agreed that Winstead would be the hatchery operator and would receive a salary and certain other benefits. The LLC was funded with bank loans. The LLC was profitable only two of the eight years that Winstead was the hatchery operator, and Simmons fired Winstead in 2007. In 2009, Winstead sued the LLC, Simmons, and Phillips alleging various causes of action. Winstead obtained a judgment from the trial court for compensatory and punitive damages. The issues raised in this appeal to the Mississippi Supreme Court included the following: whether there was sufficient evidence to support Winstead's award for fraud; whether there was sufficient evidence to support Winstead's award for corporate freeze-out; and whether there was sufficient evidence to support Winstead's award for breach of fiduciary duty.

Winstead's fraud claim was based on a purchase by Simmons and Phillips of an adjacent catfish farm and withholding pay from Winstead's salary. Winstead alleged that LLC funds were

used to purchase the adjacent catfish farm and that Simmons led Winstead to believe that the LLC acquired it. The adjacent catfish farm was actually acquired in the name of Simmons and Phillips, who then allowed the LLC to use it as part of the hatchery operation rent-free. Simmons testified that Winstead was unwilling to join in the purchase because he did not feel the bank would lend him more money. The supreme court concluded that the evidence was insufficient to prove that the funds used to purchase the adjacent catfish farm came from the LLC and that Winstead's mere assertion that he thought the LLC owned it was not enough to carry his burden that he was defrauded. The court also examined the evidence regarding Winstead's claim that Simmons and Phillips fraudulently withheld pay from Winstead's salary and concluded the evidence did not support the finding on the amount Winstead alleged was withheld. It was undisputed that Winstead was aware deductions were being made from his salary. Although Winstead disagreed as to whether some of the charges were personal in nature, there was no evidence that Phillips ever made any representation to Winstead regarding his pay and no evidence that any shortage was caused by Winstead's reliance on any fraudulent representation by Simmons.

The court next discussed in depth the freeze-out cause of action recognized in Mississippi and concluded that Winstead had failed to prove that he was frozen out of the LLC by Simmons. Relying on traditional elements for an intentional tort claim and Mississippi case law involving closely held corporations and LLCs, the court stated that a plaintiff asserting a corporate (or LLC) freeze-out must establish: (1) the existence of a legally defined duty owed to or right of a minority shareholder arising out of the shareholder's ownership interest in the corporation; (2) the intentional or willful breach of that duty by the majority or controlling shareholder(s); (3) that the breach proximately caused plaintiff's direct injury; and (4) the fact and extent of injury. In evaluating the duties and alleged breach, the court will look to the parties' agreement and applicable state law. In this case, the court looked at applicable case law, the LLC operating agreement, and Mississippi LLC statute in effect at the time. Winstead alleged that Simmons and Phillips took actions to exclude Winstead from his ownership interest without justification and in willful disregard of Winstead's rights. In support of his claim, Winstead argued Simmons and Phillips did not make required cash contributions to start the LLC and misappropriated funds from the LLC, but the court had already held in earlier portions of the opinion that the alleged oral agreement to make cash contributions was inadmissible and that the evidence did not support Winstead's allegations that Simmons or Phillips committed fraud by misappropriating LLC funds. Winstead also argued that Simmons made detrimental loans to the LLC without Winstead's consent, did not allow Winstead to inspect the books and records, and mismanaged the LLC after Winstead was fired. Because the operating agreement gave Simmons full and complete authority to manage the LLC, including the power to borrow money and make all other decisions, the court rejected Winstead's arguments that he was denied participation as a "true managing shareholder." Winstead's approval was not required for the actions Simmons took, and the evidence showed that the LLC would have ceased operating without the loans made to the LLC by Simmons' other entities. The court concluded that termination of Winstead's employment was not evidence of a freeze-out because Mississippi is an employment-at-will state, there was nothing in the operating agreement that guaranteed employment, and there was evidence that Simmons was acting pursuant to a legitimate business purpose in firing Winstead. With respect to Winstead's claim regarding inspection of the LLC's books and records, there was no evidence to show that Winstead was denied access to the LLC's offices or that he even attempted to inspect the records as he had a right to do under the operating agreement; however, the operating agreement also required Simmons to furnish each member a balance sheet for each accounting

period, which Simmons failed to do after Winstead was fired. Although Simmons arguably breached a duty to Winstead by not providing balance sheets, Winstead did not show how this damaged him. Simmons eventually delivered voluminous financial records to Winstead, and the court found this claim had no merit. Finally, the court reviewed the evidence regarding mismanagement and concluded that there was no evidence of willful or wanton mismanagement damaging Winstead alone. In sum, the court concluded that Winstead failed to prove he was frozen out of the LLC. Simmons did not use his control to breach a duty to Winstead by denying Winstead his proportional share of any LLC benefits. None of the actions taken by Simmons circumvented the powers given him by the operating agreement, and neither Simmons nor Phillips ever received any payment from the LLC in the form of salary, dividends, or any other distribution. The court thus reversed and rendered the judgment of corporate freeze-out.

The court next discussed Winstead's breach of fiduciary duty claim as distinct from his corporate freeze-out claim. Winstead asserted that Simmons and Phillips negligently, carelessly, and intentionally failed to perform their duties as managing officers of the LLC so that the assets of the LLC were mismanaged, wasted, and diverted to Simmons and Phillips in 2008 after Winstead was fired. The court noted that Winstead's freeze-out claim was an individual claim stemming from an intentional breach of a duty owed directly to Winstead that caused him personal damages separate and apart from damages to the LLC. By contrast, a claim that Simmons breached his duty through mismanagement or dissipation of assets belongs to the LLC because the wrong damages the LLC and damages Winstead only derivatively. (Earlier in the opinion, when discussing the mismanagement allegations as they related to the freeze-out claim, the court noted that the defendants never challenged whether Winstead should be permitted to bring the derivative claims of mismanagement in a direct action; therefore, the derivative claims were tried by consent, and the pre-trial procedural requisites applicable to derivative actions were waived.) The court noted its holdings in previous cases that directors and officers in a closely held corporation stand in a fiduciary relationship with the corporation and its shareholders and that this rationale applies equally to LLCs. Before looking to any common-law standards of care, the court looked to the agreement of the parties, i.e., the LLC operating agreement. The operating agreement led the court to conclude that Simmons, as a manager, owed a fiduciary duty to the members, but the operating agreement also indemnified Simmons from any actions he took on behalf of the LLC as long as he conducted himself in good faith and reasonably believed his conduct was in the LLC's best interest. To prevail on his breach of fiduciary duty claim, the court stated that Winstead must at the very least prove that Simmons breached the operating agreement. Because there was no evidence that Phillips ever took part in the day-to-day operations of the LLC or was involved in the alleged acts of mismanagement, the court reversed and rendered the trial court's judgment that Phillips breached a duty by mismanaging the LLC's assets. Although Simmons, as manager of the LLC, owed a duty to Winstead even after Winstead was fired, the court found numerous problems with Winstead's evidence on damages and held that Simmons was entitled to a new trial on Winstead's breach of fiduciary duty claim against him.

Touch of Italy Salumeria & Pasticceria, LLC v. Bascio, Civil Action No. 8602-VCG, 2014 WL 108895 (Del. Ch. Jan. 13, 2014).

Four individuals formed an LLC to operate an Italian grocery. A couple years later, two of the original members left, and an additional member was admitted. The three members executed an amended and restated LLC agreement. Although the business operated successfully and

profitably after that, one of the original members eventually decided to withdraw from the LLC and gave notice pursuant to the LLC agreement, which permitted any member to withdraw by giving written notice to the other members. The withdrawing member told the remaining members that he intended to move to Pennsylvania and possibly start a new business there, but he and his brother opened a competing Italian grocery on the same block as the LLC's store ten weeks after he withdrew. The LLC and the two remaining members sued the withdrawing member and his brother (who was one of the original members that had withdrawn a couple years earlier), and the defendants filed a motion to dismiss. With respect to the plaintiffs' breach of contract claim, the court concluded that the LLC agreement provided a mechanism for voluntary withdrawal and did not contain a non-compete provision. Furthermore, the plaintiffs did not refer to any specific provision of the LLC agreement in support of their allegation that the withdrawing member breached the agreement. The court also dismissed the plaintiffs' claims of fraud and misrepresentation because the plaintiffs did not adequately plead any reliance on the withdrawing member's representations to their detriment. The court next addressed the plaintiffs' allegation that the withdrawing member breached the implied covenant of good faith and faith dealing. The implied covenant prevents a party from denying his or her contractual partners the benefit of their bargain based on circumstances that the parties did not anticipate, but withdrawal of a member was specifically anticipated by the parties inasmuch as the parties provided in their LLC agreement for voluntary member withdrawal. Additionally, the parties did not include a covenant not to compete, a standard provision in employee contracts, in their LLC agreement. The court stated that the plaintiffs obviously regretted not including a non-compete provision, but the court refused to use the implied covenant to "shoehorn" a covenant not to compete into the parties' contract, and the court dismissed the implied covenant claim. The court also dismissed the plaintiffs' claim that the withdrawing member breached his fiduciary duty to the LLC by making arrangements to open a competing business while he was still employed by the LLC. The plaintiffs did not plead any facts supporting an inference that the withdrawing member breached his fiduciary duty by making plans or arrangements to open the competing business while he was still a member of the LLC. Further, the withdrawing member owed no duties to the LLC in the ten-week period after he left the LLC and before he opened his competing business. Finally, the court dismissed the plaintiffs' conversion claim because the plaintiffs failed to identify any specific property that the withdrawing member converted.

AM General Holdings LLC v. The Renco Group, Inc., C.A. No. 7639-VCN, 2013 WL 5863010 (Del. Ch. Oct. 31, 2013).

In this direct and derivative action by the nonmanaging member of a Delaware LLC against the managing member and its affiliates, the court addressed a partial motion for summary judgment by the plaintiff and a motion by the defendants to dismiss numerous claims by the plaintiff. The court dismissed a number of the plaintiff's claims, including the plaintiff's claims that the defendants breached fiduciary duties of loyalty and care. The court point out that fiduciary claims that arise from facts underlying obligations addressed by a contract are foreclosed subject to a narrow exception. Under this exception, fiduciary duty claims can survive even though they share "a common nucleus of operative facts" with the underlying contract claims where the fiduciary duty claims depend on additional facts, are broader in scope, and involve different considerations in terms of a potential remedy. Because the plaintiff's claims that the defendants breached their duties of loyalty and care arose out of obligations the defendants owed under the LLC agreement and a contribution agreement, and the plaintiff failed to allege distinct harms outside of the scope of those

contractual agreements, the court dismissed the plaintiff's breach of fiduciary duty claims as duplicative of contractual claims against the managing member. Dismissal of the breach of fiduciary duty claims necessitated dismissal of the plaintiff's related aiding and abetting claims as well.

Stewart v. BF Bolthouse Holdco, LLC, C.A. No. 8119-VCP, 2013 WL 5210220 (Del. Ch. Aug. 30, 2013).

Former employees of an LLC sued the LLC and its board of managers for breach of contract, breach of fiduciary duty, and breach of the implied covenant of good faith and fair dealing in connection with the LLC's exercise of its right to repurchase the plaintiffs' membership units in the LLC when the plaintiffs voluntarily terminated their employment. Based on the board's valuation of the units at \$0.00, the LLC cancelled the plaintiffs' units without paying any consideration. The plaintiffs claimed that the board of managers acted in bad faith in valuing the units at \$0.00 and that such action violated both the purchase agreement that governed the repurchase of the units (which required the board of managers to determine the value in good faith) and the LLC agreement (which provided that the board owed to the LLC and its members the duties owed by corporate directors to the corporation and its shareholders). The relief sought by the plaintiffs included a declaratory judgment invalidating the repurchase and an order restoring their ownership of units in the LLC. The court denied in part and granted in part the defendants' motion to dismiss the breach of contract claims, and the court granted the motion to dismiss the claims for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing because the latter claims were duplicative of the breach of contract claims.

The court first addressed the plaintiffs' breach of contract claims and concluded that the plaintiffs' factual allegations were sufficient for the court to conclude that it was reasonably conceivable that the "Fair Market Value" of the units was greater than \$0.00 and that the board acted in bad faith in determining the value in breach of the purchase agreement. The purchase agreement provided that "Fair Market Value" of the units was to be "determined in good faith by the Board in its sole discretion after taking into account all factors determinative of value including, but not limited to, the lack of a readily available market to sell such units, but without regard to minority discounts." The court held that allegations of appraisals by a third party in 2008 for a contemplated acquisition and in 2012 for a completed acquisition bore little if any relationship to the Fair Market Value of the units in 2010 when they were repurchased because the third-party valuations were based on the terms of the LLC agreement rather than the Fair Market Value provision of the purchase agreement and were too long before or after the repurchase valuation date in 2010. The court nevertheless held that it was reasonably conceivable that the Fair Market Value of the units was greater than \$0.00 based on an e-mail from the president and CEO of the LLC valuing the units at \$200 per unit three weeks after the board determined the Fair Market Value was \$0.00. The court noted that the defendants did not argue that any material event occurred during those three weeks that affected the valuation. The court further held that the plaintiffs sufficiently pled that the defendants' valuation of \$0.00 was determined in bad faith based on allegations that the plaintiffs purchased units for \$25 per unit on several occasions between 2005 and 2008; there was no indication the LLC's financial condition was materially worse in 2010 than it was in 2005-2008; shortly before the plaintiffs quit their jobs, the CEO conveyed to LLC managers that the LLC had bright prospects; shortly before the plaintiffs quit their jobs, the CEO expressed his belief that the units were worth roughly \$200; plaintiffs quit their jobs; and shortly before the LLC would otherwise have had to deliver financial information to the plaintiffs, the plaintiffs were told without explanation

that their units had a Fair Market Value of \$0.00 on the date of termination of their employment. Furthermore, the plaintiffs pled a plausible motivation on the part of the defendants to increase the majority owner's interest in the LLC or to exact retribution for the plaintiffs' unexpected departure from the LLC at a time when the plaintiffs were important to the future success of the LLC. The court noted that a claim of wrongful inducement, trickery, or deception is not necessary to establish bad faith under Delaware law. The court thus denied the defendants' motion to dismiss plaintiffs' breach of contract claim that the board determined the Fair Market Value of the Units in bad faith.

The court next addressed the plaintiffs' claim that the board's failure to determine the Fair Market Value in good faith constituted a breach of the LLC agreement. The court concluded that the purchase agreement and LLC agreement were related and intended to be read in tandem and that the fiduciary duty provision of the LLC agreement, which provided that the managers owed the same fiduciary duties as the directors of a corporation, applied to the board's valuation of the units. A director is liable for breach of the fiduciary duty of care under Delaware law when the director's actions are grossly negligent. The focus of a duty of care analysis is the process undertaken by directors in making a decision. The plaintiffs made no allegations regarding the board's valuation process, and the court thus held that the plaintiffs failed to state a claim for breach of the contractual duty of care. The plaintiffs also failed to state a claim of breach of the duty of loyalty on the basis of an interested transaction because the plaintiffs did not allege that the defendants stood on both sides of the repurchase transaction, nor did they allege that the defendants were in a position to benefit from an unfairly low repurchase in a manner not shared equally by all owners of the LLC. However, the duty of loyalty in Delaware encompasses actions taken in bad faith in addition to interested transactions. Thus, the court held that the plaintiffs stated a claim for breach of the contractual duty of loyalty under the LLC agreement by acting in bad faith in determining the Fair Market Value of the units based on the allegations supporting the contractual bad faith claim under the purchase agreement.

The court dismissed the plaintiffs' breach of fiduciary duty claim because it was duplicative of and foreclosed by the breach of contract claim. Under Delaware law, a fiduciary duty claim that depends on the same nucleus of operative facts as a breach of contract claim only survives where the fiduciary duty claim depends on additional facts, is broader in scope, and involves different considerations in terms of potential remedies, i.e., where the breach of fiduciary duty claim may be maintained independently of the breach of contract claim. The court rejected the plaintiffs' effort to distinguish their breach of fiduciary duty claim from their breach of contract claim on the basis that the board's conduct should be assessed under the entire fairness standard for purposes of the breach of fiduciary duty claim. Because the plaintiffs did not allege that the defendants stood on both sides of the repurchase transaction or that the defendants were in a position to benefit from an unfairly low repurchase in a manner not shared equally by all owners of the LLC, the court held that the plaintiffs failed to articulate a basis to employ the entire fairness standard. The plaintiffs' claim that the defendants breached their fiduciary duties to plaintiffs when they declared that the units had no value and cancelled them arose from the dispute relating to the contractual repurchase right under the purchase agreement, thus making the case similar to *Nemec v. Schrader*, in which the Delaware Supreme Court affirmed the dismissal of a fiduciary duty claim arising from a corporation's exercise of its right to redeem shares of retired nonworking shareholders. The plaintiffs here argued that the facts fit the narrow exception to the general principle that a breach of contract and breach of fiduciary duty claim based on the same facts are duplicative, but the court concluded that the plaintiffs alleged essentially identical facts in support of both their breach of fiduciary duty claim and

their claim for breach of the purchase agreement and LLC agreement. Similarly, the breach of fiduciary duty claim was no broader in scope than the breach of contract claim. Finally, the breach of fiduciary duty claim did not implicate potentially different remedies because the requested relief (a declaration that the repurchase of the plaintiffs' units was invalid and that they still owned their units) was available to the plaintiffs with respect to their breach of contract claim.

Finally, the court dismissed the plaintiffs' claim that the defendants violated the implied covenant of good faith and fair dealing by failing to act in good faith when valuing the units. The plaintiffs did not allege a specific implied contractual obligation that was breached, but instead focused on the express contractual requirement in the purchase agreement that the board value the units in good faith. Thus, the court concluded that the claim was duplicative of the breach of contract claim. The court explained that its conclusion was consistent with the Delaware Supreme Court's decision in *Gerber v. Enterprise Products Holdings, LLC* because the limited partnership agreement in that case arguably had a contractual "gap" in that the duty of a party seeking the benefits of the "safe harbor" or "conclusive presumption" provided by the agreement was not specified. The court stated that the purchase agreement in this case did not have a "gap" for the implied covenant to fill. The plaintiffs' claim was based on a single clause of the purchase agreement that expressly required the LLC to act in good faith. The plaintiffs essentially contended that the LLC had an implied duty to act in good faith in complying with its contractual duty to act in good faith. The express requirement of good faith did not provide a basis for a valid claim for a breach of the implied covenant. Furthermore, there was no credible basis to reasonably infer the purchase agreement failed to reflect the parties' expectation at the time of bargaining. The parties obviously foresaw the potential issues with allowing the Fair Market Value of the units to be determined by the board in its sole discretion and addressed the issue by explicitly requiring good faith. The court went on to state that the more significant distinction between *Gerber* and this case related to the "discretionary rights" at issue. In *Gerber*, the "safe harbor" and "conclusive presumption" provisions were discretionary rights that the defendants could use to limit or avoid liability, but the contract did not specify any standard for evaluating the defendants' exercise of the rights. In the absence of a contractual standard, the supreme court determined that the defendants were required to use their discretion in conformity with the implied covenant. By contrast, in the purchase agreement in this case, the parties agreed to a good faith standard to evaluate the reasonableness of the defendants' exercise of discretion. Thus, in this case, the parties's express agreement superseded the implied covenant and precluded its application. The court acknowledged that *Gerber* held that a showing of compliance with a contractual duty of good faith does not automatically extinguish all implied covenant claims, but it does not relieve a plaintiff from the burden of pleading a cognizable claim, and the plaintiffs here did not sufficiently allege a claim because they did not show how the express terms of the purchase agreement failed to account for their legitimate expectations at the time they entered into the contract.

McColl Farms, LLC v. Pflaum, 837 N.W.2d 359 (N.D. 2013).

An LLC brought various claims against the ex-wife of a member. One of the claims was for misappropriation of a large sum of money. The trial court dismissed the claim on the basis that misappropriation is a statutory cause of action that relates only to the wrongful acquisition or disclosure of a trade secret, that the allegations were the same as the plaintiff's conversion claim and were redundant, and that North Dakota does not recognize a claim for misappropriation. The plaintiffs argued that there was a cause of action for misappropriation and that courts have broad

equitable powers to remedy it. However, the supreme court pointed out that the case relied on by the plaintiffs involved shareholders of a corporation suing the controlling shareholder and director for misappropriation of corporate funds and seeking relief under a provision of the North Dakota Business Corporation Act that authorizes equitable remedies when a corporation or officer or director violates the Act. The court stated that the LLC statute authorizes equitable remedies when an LLC member brings an action against the LLC or a manager or governor for violating the statute, but the defendant was not an officer, director, manager, or governor of the LLC. Thus, this case was distinguishable from the case on which the plaintiffs relied, and the lower court did not err in dismissing the misappropriation claim.

LJL 33rd Street Associates, LLC v. Pitcairn Properties Inc., 725 F.3d 184 (2d Cir. 2013).

The plaintiff and defendant were the sole equity owners of an LLC that owned a luxury high-rise apartment building. The detailed operating agreement of the LLC contained an arbitration clause of limited scope that related to a buyout provision that provided that the “Purchase Price” under the buyout provision was to be derived from the “Stated Value.” After the plaintiff exercised its purchase option, the parties were not able to agree on the price, and the plaintiff filed an arbitration demand asking for determination of both the Stated Value and Purchase Price. The arbitrator determined the Stated Value but refused to exercise jurisdiction to determine the Purchase Price. The court concluded that the arbitrator acted properly because the operating agreement expressly provided for arbitration to determine Stated Value but nowhere suggested that the Purchase Price be determined by arbitration. The court also addressed a claim by the defendant against the plaintiff for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing. The defendant argued the plaintiff’s failure to disclose its intent to exercise the buyout option upon the discharge of the defendant’s CEO (an event which triggered the right of the plaintiff to exercise the option under the agreement) was a breach of fiduciary duty and that exercise of the buyout option violated the implied covenant of good faith and fair dealing. The court rejected both claims. The purchase option upon defendant’s discharge of its CEO was the contractual right of the plaintiff, and the plaintiff did not ever make any false representations about the CEO or state that it would not exercise its purchase option if the CEO were terminated. The agreement contained a fair mechanism (arbitration) for resolving a dispute over the price of the buyout, and the plaintiff had no obligation to agree to the defendant’s plea to market the property in an illusory auction to third parties to help determine value. Thus, there was no breach of fiduciary duty. As for the implied covenant of good faith and fair dealing, the operating agreement conferred on the plaintiff the right to buy out the defendant if the defendant’s CEO ceased to be employed by the defendant. The implied covenant cannot create duties that negate explicit rights under the contract. The implied covenant bars a party from taking actions that so impair the value of the contract for another party that it may be assumed the parties did not intend the actions. The mere fact of the plaintiff’s exercise of its contractual buyout right, absent bad faith conduct, could not be deemed a breach of the duty to deal with the defendant in good faith.

Otto v. Otto, 974 N.Y.S.2d 54 (App. Div. 1st Dept. 2013).

The court disagreed with the motion court’s ruling that the plaintiff had legal capacity to bring derivative claims on behalf of a dissolved Delaware LLC and dissolved Delaware limited partnerships. The court stated that the motion court properly applied a six-year statute of limitations to the breach of fiduciary duty claim since the derivative action was equitable in nature. The plaintiff

continued to be in a fiduciary relationship with the defendant controlling owner and the other limited partners and members, and the statute of limitations thus did not begin to run until the relationship terminated.

Germano v. Beaujean, 997 N.E.2d 1238 (Ohio App. 2013).

Beaujean and Germano formed an LLC in 2007 to operate a pizza franchise. The two agreed that they would be equal owners, that Beaujean would provide financing for the LLC, and that Germano would provide on-site management. Other than the articles of organization, which listed both men as members, there was no written operating agreement. In 2010, Germano began paying himself a management fee retroactive to the beginning of the venture. He also began paying a bookkeeping fee to a restaurant supply company he owned as well as transferring LLC funds to a separate account accessible only to him. Beaujean objected to these expenditures, but Germano refused to return the funds. Beaujean sued Germano for breach of fiduciary duty. At trial, the parties agreed that their intent was for each of them to own 50% of the LLC and that Germano would earn his half through “sweat equity” while Beaujean would finance the company. They disagreed regarding Germano’s right to compensation. Beaujean claimed that Germano’s compensation would come through a distributive share of the profits and any value of the company, but Germano claimed it was never part of the agreement that he would manage the LLC without pay in perpetuity. The trial court found that Germano was not entitled to transfer funds outside the reach of Beaujean and that the parties had an agreement that Germano would not charge management fees. The court ordered Germano to return these amounts and also ordered that Germano stop paying his other company bookkeeping fees and return fees paid in excess of \$15 per hour. On appeal, Germano argued that the trial court erred in finding him liable for breach of fiduciary duty, but the court of appeals stated that the judgment did not expressly hold him liable for breach of fiduciary duty, but rather for taking unauthorized actions. The Ohio LLC statute defines fiduciary duties of loyalty and care addresses the authority of members in the management of an LLC. A member or manager may act as an agent of the LLC, but a member’s act must be authorized by the other members to be binding if it is not apparently for carrying on the business of the LLC in the usual way. The court of appeals concluded that Beaujean’s testimony at trial could form the basis for the trier of fact to conclude that Germano’s actions were unauthorized. Further, the court pointed out that the acts were patent departures from prior practice so that the trial court could conclude that Germano was not carrying on the business in the usual way. Since Germano was enriched by acts antithetical to the statute, the trial court could properly order the return of the money derived from the breach.

Holladay v. Storey, 307 P.3d 584 (Utah 2013).

In 2000, Storey, Holladay, Woodcock, and several other individuals formed an LLC to construct and operate an inn. Storey was appointed manager of the LLC. After the withdrawal of some of the members in early 2003, Storey, Holladay, and Woodcock executed an amended operating agreement under which Storey remained as manager and Storey, Holladay, and Woodcock each held a one-third interest in the LLC. In June 2003, Holladay and Woodcock took over Storey’s management duties, and later in 2003 litigation between the parties ensued. Storey asserted derivative claims and a demand for judicial accounting and dissolution or purchase of his interest. Holladay and Woodcock asserted claims against Storey for breach of fiduciary duty and other causes of action and sought Storey’s expulsion as a member and removal as a manager and a judicial accounting and dissolution of the LLC. The case was governed by the Utah Revised Limited

Liability Company Act in effect at the time. Initially, the court granted a motion by Storey for a partial summary judgment declaring that Storey could not be removed as a manager based on the terms of the operating agreement, noting that Holladay and Woodcock had not expressly invoked the provisions of the LLC statute providing for judicial removal of a manager. The court stayed implementation of the judgment to allow Holladay and Woodcock to request an injunction removing Storey under the statutory provision, and the court later issued a preliminary injunction removing Storey as manager on a motion by Holladay and Woodcock in 2005 invoking the statutory removal provision. Based on a stipulation of the parties in December 2003, the trial court permitted Holladay and Woodcock to enter into a franchise agreement for the sale of the inn. Following a bench trial in 2009, the trial court removed Storey as the manager of the LLC, expelled Storey as a member effective December 31, 2005, and valued Storey's interest as of December 31, 2005. Storey's removal as a manager was based on the trial court's findings of numerous instances of mismanagement and misconduct. The trial court ordered Storey's expulsion as a member for the same reasons as his removal as a manager and based on his unlawful conduct that adversely and materially affected the LLC's business or conduct making it not reasonably practicable to carry out business with the members. The trial court also found Storey breached his fiduciary duties to the members. The court made the expulsion and valuation of Storey's interest retroactive to December 31, 2005, based on the parties' conduct. The court found this date was appropriate because of Storey's mismanagement, misconduct, dishonesty, breach of fiduciary duty, and lack of success as a manager on that date. The trial court also justified the valuation date on the failure of Holladay and Woodcock to adhere to the amended operating agreement and timely access the court to implement their decisions and pursue their remedies. The trial court also found that the decision to convert to a franchise was a substantial reason for the success of the LLC during and after 2005.

On appeal, Storey argued that the statute did not authorize the trial court to backdate his expulsion and the valuation of his interest. The court of appeals discussed in detail the statutory provisions and the Utah Supreme Court's decision in *CCD, LC v. Millsap* and concluded that the trial court correctly determined that it had authority to make the expulsion of Storey and valuation of his interest retroactive. The court of appeals stated that the trial court could have chosen to backdate the expulsion to as early as 2003 based on his misconduct, but the trial court also appropriately took into account the delay by Holladay and Woodcock in complying with the amended operating agreement and LLC statute until 2005. Storey argued that he became an assignee under the statute when he ceased to be a member upon his expulsion and that he retained his interest until the judicial determination of dissolution in 2009. The court reconciled the provisions of the Utah statute by concluding that an expelled member becomes an assignee upon expulsion but that the assignee status continues only until valuation of the interest and does not preclude the retroactive valuation of the expelled member's interest when appropriate. Thus, the trial court had the discretion to set the valuation based on the equities of the case, and the evidence supported the valuation date chosen by the trial court.

The court of appeals also addressed a few other issues, including whether the trial court properly declined to award punitive damages against Storey. The trial court concluded that it did not have the authority to award punitive damages because that would result in "double punishment" inasmuch as the trial court had chosen a retroactive date of expulsion and valuation. The court of appeals held that the retroactive date served the purpose of compensating Holladay and Woodcock and pointed out that breach of fiduciary duty is an independent tort that can serve as the basis for punitive damages. Thus, the court remanded for the trial court to properly evaluate whether punitive

damages should be awarded. Finally, the court of appeals held that the trial court erroneously failed to grant a request for attorney's fees because Holladay and Woodcock prevailed on their breach of fiduciary duty claim, and "breach of a fiduciary obligation is a well-established exception to the American rule precluding attorney fees in tort cases generally."

Grove v. Brown, C.A. No. 6793-VCG, 2013 WL 4041495 (Del. Ch. Aug. 8, 2013).

In 2010, the Groves and the Browns started a successful home health care agency, Heartfelt Home Health, LLC ("Heartfelt"). After the first year, the relationship between the Groves and the Browns began to deteriorate when it was discovered that not all four members had made their requisite initial \$10,000 capital contributions. The Groves established their own home health agencies in Maryland and Delaware without telling the Browns, and the Browns attempted to remove the Groves by creating another LLC owned solely by the Browns and merging Heartfelt with that company. The Groves sued the Browns for breach of fiduciary duty, and the Browns counterclaimed for breach of fiduciary duty. The Browns also brought claims against family members and friends of the Groves for aiding and abetting the Groves' breach of fiduciary duty. After trial, the court rendered this opinion. The first issue addressed by the court was the percentage of the parties' ownership interests in Heartfelt. The Groves argued that the Browns only owned 50% of Heartfelt and thus lacked the legal authority to merge Heartfelt, but the Browns argued that the failure of the Groves to make the required capital contributions resulted in the Browns owning a majority interest in the LLC. The court examined the provisions in the Heartfelt LLC agreement and concluded that the agreement unambiguously provided that each member was required to contribute \$10,000 and that each member had a 25% ownership interest. The court further stated its conclusion would not change if it considered extrinsic evidence. Because the Browns owned only 50% of the LLC, the court held that the purported merger was a legal nullity. Unless otherwise provided by the LLC agreement, the Delaware Limited Liability Company Act requires a merger to be approved by members who own more than 50% of the then current percentage in the profits of the LLC, and the Heartfelt LLC agreement did not address mergers. The court next discussed the Browns' counterclaims that the Groves violated their fiduciary duties by taking corporate opportunities from Heartfelt. All four members played a role in the management of Heartfelt, and none of the members disputed that they were all managing members. The court noted that managing members of an LLC owe default fiduciary duties to the other members absent contrary language in the LLC agreement. The court held that the Groves violated their fiduciary duties by forming a Maryland LLC, which operated fewer than ten miles from the offices of Heartfelt, and a Delaware LLC with an office in the same building as Heartfelt, each of which engaged in the same business as Heartfelt. Relying on the corporate opportunity doctrine, the court held that the Groves had wrongfully taken for themselves the business opportunities of Heartfelt. Under the corporate opportunity doctrine, a corporate officer or director may not take a business opportunity as his own if: (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimicable to his duties to the corporation. However, a director or officer may take personal advantage of a corporate opportunity if: (1) the opportunity is presented to the director or officer in his individual rather than corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity. Because the

corporate opportunity doctrine stems from a director's duty of loyalty to the corporation, the burden is on the director to show that there was no breach. The evidence at trial showed that the business of the Maryland and Delaware LLCs would clearly qualify as a business opportunity of Heartfelt absent a waiver or disclaimer by Heartfelt of its interest in the opportunity, and the court concluded that the Groves did not satisfy their burden of demonstrating its right to pursue the opportunity. Though the court found all the testimony on the issue to be of questionable credibility, the weight of the evidence favored the Browns' position that there was no express grant of permission for competing businesses in any location. To the extent there was testimony that the Groves invited the Browns to join them in the competing entities, the court stated that presenting an opportunity to other members is not the same as presenting it to the LLC. As to the aiding and abetting counterclaims against family and friends of the Groves who worked for the competing entities, the court found there was no evidence that these other parties knowingly participated in the Groves' breach of fiduciary duty. The court determined that the appropriate remedy was for both the Browns and the Groves to account to Heartfelt for profits that they wrongfully kept, i.e., the profits made by the Browns after the invalid merger and the profits made by the Groves in the competing entities. The court commented that, given the bitterness and acrimony between the parties, it was not reasonably practicable to carry on the business of Heartfelt in conformity with its LLC agreement. The court expressed its hope that the parties, in the interest of economy, would present a petition for dissolution to be considered with the accounting.

Kohannim v. Katoli, __ S.W.3d __, 2013 WL 3943078 (Tex. App. 2013).

In 1996, Jacob Kohannim ("Jacob") and Mike Khosravikatoli ("Mike") formed an LLC to purchase and hold real property on which a corporation owned by them operated a restaurant. Jacob and Mike were the managers and each owned a 50% interest in the LLC. The member agreement contained transfer restrictions that provided the LLC and the other member the opportunity to purchase a member's interest in the event of a proposed sale of the interest or a transfer to a member's spouse in a divorce. In 2003, Mike's wife, Parvenah, filed for divorce, and the divorce court issued temporary orders prohibiting Mike and Parvenah from transferring assets. During the pendency of the divorce, Mike purported to transfer a 5% interest in the LLC to Jacob. In 2005, the divorce decree was entered. In the divorce decree, the district court found the transfer was void because it was an attempt to transfer community property in violation of the court's order enjoining such a transfer. The divorce decree further awarded to Parvenah "[o]ne hundred percent (100%) of the husband's interest" in the LLC, "which interest is equivalent to a fifty percent (50%) interest in such company." The decree required the husband to execute and deliver to the wife's attorney a stock transfer certificate and/or assignment of interest. Before the divorce decree was entered, Jacob closed an LLC bank account and transferred \$160,000 in the account to the restaurant's bank account as a "payment to owner." After the divorce decree was entered, Parvenah's attorney raised with Jacob the issue of the \$160,000 payment and demanded a meeting for an accounting and to discuss management of the LLC. The following month, Jacob advised Parvenah that he intended to start the process of determining the value of the LLC for purposes of the buyout provision in the member agreement. Jacob never consented to Parvenah's admission as a member. At the end of 2005, Jacob's attorney informed Parvenah that she had no right to vote at an upcoming meeting regarding Jacob's compensation and that Jacob intended to vote his 55% interest in favor of a \$50,000 payment to him as compensation for his services in 2005. Jacob received the \$50,000 payment over Parvenah's objections. In 2006, Parvenah sued Jacob and the LLC, seeking a declaration of her rights with

respect to the LLC and the validity of the member agreement and asserting claims based on constructive fraud, breach of fiduciary duty, oppression, waste, gross mismanagement and abuse of control, and unjust enrichment. The trial court appointed a receiver for the LLC and ordered the receiver to sell the LLC's assets. The trial court eventually approved a sale of the LLC's property for \$1,300,100. The trial court's final judgment contained findings as to the amount of assets held by the receiver and how the assets should be divided based on the court's finding that Jacob and Parvenah each held a 50% beneficial interest in the assets. The trial court also found that Jacob, with malice and intent to defraud, engaged in wrongful acts and omissions that damaged Parvenah by decreasing the value of Parvenah's interest in the LLC, and the trial court awarded Parvenah actual and punitive damages based on the wrongful acts and omissions. Jacob appealed on numerous issues but did not challenge the trial court's division of the LLC's assets.

The court of appeals sustained Jacob's challenge to Parvenah's recovery for breach of fiduciary duty. Although the trial court's conclusions of law stated that Jacob owed a fiduciary duty to the LLC and breached that duty, the trial court did not make Parvenah's requested findings that Jacob owed Parvenah a fiduciary duty or that he breached that duty. Thus, the court of appeals held that Parvenah could not recover for her breach of fiduciary duty cause of action.

The court of appeals also held that Parvenah could not recover on her fraud and constructive fraud claims. She failed to plead a cause of action for actual fraud, and the court concluded the issue of actual fraud was not tried by consent. With respect to Parvenah's constructive fraud claim, the court of appeals held that Parvenah could not recover because constructive fraud is premised upon the existence of a breach of fiduciary duty, and the trial court refused to find that Jacob owed Parvenah a fiduciary duty and that he breached that duty.

The court of appeals rejected Jacob's challenge to the legal sufficiency of the evidence to support Parvenah's oppression claim. The court of appeals stated that "a member oppression claim may exist when: (1) a majority shareholder's conduct substantially defeats the minority's expectations that objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture; or (2) burdensome, harsh, or wrongful conduct, a lack of probity and fair dealing in the company's affairs to the prejudice of some members, or a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely." Jacob contended that an oppression claim can only be asserted by a minority member or shareholder, and Jacob conceded that Parvenah owned a 50% interest. The court of appeals rejected the argument that only a minority owner may assert an oppression claim because the Texas receivership provisions provide for appointment of a receiver for a Texas entity based on oppression by the directors or "those in control" of the entity. The court of appeals went on to examine whether there was any evidence of oppressive acts. Jacob argued that there was no evidence that he oppressed Parvenah's rights by refusing to allow her to participate in management given that she was not a member. The court explained that a membership interest is personal property and that Mike's 50% membership interest was community property awarded in its entirety to Parvenah under the divorce decree. Mike executed a document transferring and assigning the membership interest to Parvenah as required by the divorce decree, but the assignment of the interest did not include the right to participate in management under the Texas LLC statute. Under the statute, the right to participate in management is not community property, and assignment of a membership interest does not entitle the assignee to participate in the management and affairs of the LLC, become a member, or exercise any rights of a member. An assignee is entitled to become a member only with the approval of all of the

members, and Jacob never consented to Parvenah becoming a member. Thus, she did not have any right to participate in the management of the LLC. Jacob next contended that there was no evidence that he oppressed Parvenah's rights by failing to make distributions to her. The LLC's regulations (i.e., operating agreement) provided for quarterly distributions to members of "available cash" provided available cash was not needed for reasonable working capital reserves. The Texas LLC statute provides that an assignee is entitled to receive any distribution the assignor is entitled to receive to the extent the distribution is assigned. Because the district court awarded the entire community interest to Parvenah, she had a right to receive distributions. The district court found that Jacob paid himself for services that were not performed and that he failed to make any distributions to Mike or Parvenah even though \$250,000 in undistributed profits had accumulated since the mortgage on the LLC's property was paid off. The court of appeals concluded this was some evidence supporting the trial court's finding that Jacob failed to make profit distributions. The court also agreed that the established facts demonstrated that Jacob engaged in wrongful conduct and exhibited a lack of fair dealing to the prejudice of Parvenah.

Jacob challenged the legal sufficiency of the evidence to support the actual and punitive damages award. Because the court of appeals sustained Jacob's challenges to Parvenah's other causes of action, the only viable cause of action to support a damage award was the shareholder/member oppression claim. The court of appeals stated that the standard of review on this issue was not the traditional sufficiency analysis as asserted by Jacob, but rather was abuse of discretion because the receivership provision of the Texas Business Organizations Code that provides for an oppression action authorizes a court to fashion an equitable remedy if the acts of those in control of an entity are oppressive. The court of appeals concluded that the trial court's methodology for finding actual damages was not an abuse of discretion. The trial court calculated Parvenah's damages by calculating the difference between the value of the LLC's assets at the time of the trial court's judgment in this case and the value of the LLC at the time of the divorce, increased by the amount taken from the LLC's bank account by Jacob before the divorce decree. The court of appeals rejected Jacob's argument that the trial court erred by adding back the amount taken from the LLC's bank account prior to the divorce. Because Jacob's removal of the LLC's funds reduced the value of Parvenah's interest, the court of appeals concluded the trial court did not err by adding that amount back into the value of the LLC. Next the court of appeals rejected the argument that the member agreement required the LLC to be valued as of the date of the divorce petition. The court of appeals stated that the trial court found that the member agreement did not apply to Parvenah. Assuming it did apply to Parvenah, the court of appeals stated that it was inapplicable here because Jacob did not comply with the provision addressing a buyout on divorce by intervening in the divorce proceeding to enforce the provision. Mike had agreed to the intervention, but Jacob did not do so. Jacob next argued that the LLC regulations provided that the valuation of Parvenah's interest must be based on book value because the regulations contained a provision for purchase of a member's interest at book value or appraised value on request of a party who deems the book value to vary from market value by more than 20%. The provision of the regulations relied upon by Jacob addressed death, dissolution, retirement, or bankruptcy of a member. The court stated that the provision did not address how damages are calculated in a lawsuit based on oppression, and the court relied on other case law in which the court in an oppression action concluded that it was not an abuse of discretion to order a buyout for fair value when a buy-sell agreement provided for redemption at book value. The court of appeals pointed out that receivership is one remedy for shareholder/member oppression and that the trial court ordered a receivership and authorized a sale of the LLC's assets.

Jacob did not complain concerning the receivership or sale. However, the court concluded that Parvenah was not limited to a recovery of her proportionate share of the sale proceeds and that courts have equitable powers to fashion appropriate remedies for oppressive conduct, including a buyout. Here, the court concluded that sufficient evidence supported the values found by the trial court and that Jacob did not argue, and the court of appeals did not perceive, that the trial court's methodology constituted an abuse of discretion. The court of appeals sustained Jacob's challenge to punitive damages because the only causes of action that could support a punitive damages award were actual fraud and breach of fiduciary duty.

Weinstein v. Colborne Foodbotics, LLC, 302 P.3d 263 (Colo. 2013).

A creditor of an LLC obtained an arbitration award in federal court against an LLC with two members who were also the only shareholders of the LLC's two managers. The managers authorized a distribution of the LLC's assets to the members, which the creditor alleged made the LLC insolvent and unable to pay the award owed to the creditor. The creditor filed suit against the members and managers claiming that the members violated the Colorado Limited Liability Company Act by accepting unlawful distributions and that the managers breached their fiduciary duty to the LLC's creditors by authorizing the distributions to its members. The defendants filed a motion to dismiss. In the motion, the members argued the plaintiff lacked authority to bring an action under the LLC statute because the statute provided only that members were liable to the LLC for an unlawful distribution. The managers argued that Colorado law did not recognize a common law fiduciary duty owed by managers of an LLC to an LLC's creditors and that case law allowing creditors of a corporation to recover against the corporation's shareholders did not apply to LLCs. The trial court agreed with the defendants and granted their motion to dismiss. The court of appeals reversed, holding that the plaintiff had a viable claim for an unlawful distribution against the LLC's members under the LLC statute because a similar provision of the Colorado Business Corporation Act had been interpreted to provide a cause of action for unlawful distributions to a corporation's creditors. The court of appeals also held that the plaintiff had stated a proper claim for breach of fiduciary duty against the managers based on prior case law that held an insolvent LLC's managers owed the same duty to the LLC's creditors that the directors of an insolvent corporation owe to the corporation's creditors. The Colorado Supreme Court granted the defendants' petition for certiorari on two issues: (1) whether the creditors had standing under the LLC statute to sue the members of an LLC who allegedly received an unlawful distribution, and (2) whether the court of appeals erred in extending the common law fiduciary duty an insolvent corporation's directors owe its creditors to the managers of an LLC. The supreme court generally discussed the LLC statute and the nature of LLCs and pointed out that an LLC is distinct from a corporation, which is governed by corporate law. As to the first issue, the supreme court agreed with the trial court that the LLC statute allows an LLC to state a claim against any member who knowingly receives a distribution that renders the LLC insolvent (i.e., an unlawful distribution) but does not provide for a cause of action for LLC creditors against LLC members. The court then addressed the question of whether the LLC's managers owed a common law fiduciary duty to the creditors similar to the fiduciary duty an insolvent corporation's directors owe its creditors. The creditor argued that the common law fiduciary duty exists in the LLC context and that the managers here breached that fiduciary duty by putting their own interests above the creditor's by authorizing unlawful distributions. This was a question of first impression for the Colorado Supreme Court. The court had previously held that the directors of an insolvent corporation owe the creditors of the corporation a limited fiduciary duty that requires the directors to avoid

favoring their own interests over creditors' claims; however, the insolvent corporation's directors do not owe a general fiduciary duty to its creditors. A Colorado court of appeals applied the ruling that a corporation's directors owe a common law fiduciary duty to the corporation's creditors to the managers of an LLC in *Sheffield Servs. Co. v. Trowbridge*, 211 P.3d 714, 723-24 (Colo. App. 2009). The supreme court disagreed with the appellate court. The Colorado LLC statute contains a provision specifying that corporation common law applies to a veil-piercing claim (not alleged here) but not to any other common law claim. The LLC statute extends no fiduciary duty to the LLC's creditors owed by the managers. Because the LLC statute did not extend corporation common law to an LLC in any instance except a veil-piercing claim, the court of appeals in *Sheffield* erred in extending the fiduciary duty of an insolvent corporation's directors to the managers of an LLC, and the court overruled *Sheffield* to the extent it held that an LLC's managers have a fiduciary duty to the LLC's creditors. The court held that absent statutory authority the managers of an insolvent LLC do not owe the LLC's creditors the same fiduciary duty that an insolvent corporation's directors owe the corporation's creditors. Thus, the creditor could not assert a claim of breach of fiduciary duty against the managers.

Patin v. Ferguson, 115 So.3d 1204 (La. App. 2013).

The plaintiff and defendant formed an LLC that acquired scrap metal, baled and compacted the scrap, and then re-sold the baled scrap at a profit. The LLC was member-managed, and its only members were the plaintiff and the defendant. The LLC's articles of organization provided that once each member had been reimbursed for his capital contributions, profits and losses would be divided equally between the members. The parties orally agreed that the defendant's capital contribution to the LLC would consist of the purchase of a baler, the LLC's primary piece of equipment, which was crucial to the business's operation, and other start-up costs. The plaintiff's capital contribution would consist of his personal services in the daily operation of the LLC and extensive expertise in the scrap metal business. Although the defendant purchased the baler in his name, it was dedicated to the LLC's operations. The defendant was paid money toward the cost of the baler, and the plaintiff received a monthly salary. After two profitable years, the defendant decided he no longer wanted to operate a business with the plaintiff due to the plaintiff's failure to repay a personal loan. The defendant demanded possession of the baler and an audit of the business records, and the plaintiff complied. The defendant offered to sell the baler to the plaintiff, but the plaintiff could not afford to buy it, and the defendant would not agree to provide owner financing. The defendant sold the baler to a third party, closed the LLC's bank account, and retained the proceeds of a workers' compensation premium refund. Without the baler, the LLC shut down. The plaintiff filed suit seeking damages on a claim of breach of fiduciary duties by the defendant. The trial court found that the baler was a capital contribution to the LLC rather than equipment that was the defendant's own property rented to the LLC and that the defendant breached his fiduciary duties to the LLC and the plaintiff. The trial court entered judgment in favor of the plaintiff and awarded damages. On appeal, the court first upheld the trial court's judgment that the baler was a capital contribution to the LLC. The evidence showed that the baler was not, as the defendant argued, the defendant's individually owned property leased to the LLC. Under the Louisiana LLC statute, a capital contribution is anything of value that a person contributes to the LLC as a prerequisite for or in connection with membership, and a capital contribution does not have to take the form of cash. The record was replete with evidence that the parties agreed the defendant would contribute the baler as capital to the LLC, and the existence of a rental agreement was unsubstantiated by any credible evidence. The

appellate court next explained that members entrusted with managing an LLC have a fiduciary relationship with the LLC and its members such that the fiduciary shall act in good faith with the diligence, care, judgment, and skill an ordinary prudent person in a like position would exercise under similar circumstances. The fiduciary obligations include a duty of care and a duty of loyalty such that a fiduciary may not take even the slightest advantage of the principal but must zealously, diligently, and honestly guard the rights of the principal. Fiduciary duties include obligations of utmost good faith, fairness, and honesty in dealing with matters relating to the business. A member has a right of action against other members for breach of fiduciary duties when such breach was grossly negligent and the member was directly damaged. Gross negligence is defined in the Louisiana LLC statute as a reckless disregard or a carelessness amounting to indifference to the best interests of the LLC or its members. The court of appeals concluded that the trial court correctly held that the defendant breached his fiduciary duties to the LLC and to the plaintiff. In reckless disregard of his duties of good faith and loyalty, and without notice to the plaintiff, the defendant sold the baler to a third party and retained the entire purchase price. The defendant emptied the LLC's banking account and transferred all assets to his own account, and he took possession of the money paid to the LLC by its workers' compensation insurer. It was undisputed that the baler was the crucial piece of equipment and the heart and soul of the business. The court stated that the defendant's actions were blatant, malicious, and grossly negligent, and his actions effectively dissolved the LLC and ended the plaintiff's livelihood. Furthermore, the court concluded that the defendant's unilateral actions conflicted with Louisiana LLC law, which requires a majority vote of the members to approve a transfer of all or substantially all of the assets of the LLC as well as to approve the dissolution and winding up of the LLC, unless otherwise provided in the LLC's articles of organization or a written operating agreement. The court characterized the defendant's actions as selfish and without regard for the plaintiff or the LLC, grossly negligent, and in breach of his fiduciary duties to the plaintiff and the LLC. The court also affirmed the award of damages granted to the plaintiff in the trial court's judgment.

Senior Housing Capital, LLC v. SHP Senior Housing Fund, LLC, C.A. No. 4586-CS, 2013 WL 1955012 (Del. Ch. May 13, 2013).

The plaintiffs in this case were investors in a Delaware LLC fund formed to invest in retirement homes. Two of the plaintiffs, the former manager of the LLC and the manager's affiliate, held a 5% ownership interest in the LLC, and the main defendant, the California Public Employee's Retirement System ("CalPERS"), held the remaining 95% ownership interest in the LLC. The manager and its affiliate claimed that the LLC agreement required CalPERS to make certain payments to them after their withdrawal from the LLC. CalPERS challenged appraisals of certain assets of the LLC that were used to calculate the payments, and the parties disagreed with regard to the interpretation of the LLC agreement in a number of respects affecting the calculation of the amounts owed. After finding in favor of the manager and its affiliate on their claims, the court ruled against CalPERS on its counterclaims, including breach of fiduciary claims asserted by CalPERS against the manager. The court stated that the breach of fiduciary duty claims arose out of the same facts as alleged breach of contract claims against the manager. The court pointed out that the Delaware Supreme Court has held that a dispute will be treated as a breach of contract claim where it arises from obligations that are expressly addressed by contract, and any fiduciary claims arising out of the same facts that underlie the contract obligations are foreclosed as superfluous.

Imbert v. LCM Interest Holding LLC, C.A. No. 7845-ML, 2013 WL 1934563 (Del. Ch. May 7, 2013).

Imbert sought advancement from two LLCs of fees and expenses he was incurring in his defense of a New York lawsuit filed against him by the LLCs after he was terminated from his position as manager of the LLCs. The LLC agreements required tax distributions to the members, and the LLCs alleged that Imbert had been inflating his tax liability so that he would receive disproportionately large distributions. In the New York lawsuit, the LLCs alleged, among other claims, that Imbert breached fiduciary duties owed as a manager and committed fraud when he approved and accepted the allegedly improper distributions. The LLC agreements contained mandatory indemnification and advancement provisions, and the court analyzed whether the claims in the New York action arose “by reason of the fact” that Imbert was a manager of the LLCs in accordance with Delaware case law stating that a proceeding is “by reason of the fact” that one is a corporate officer if there is a nexus or causal connection between any of the underlying proceedings and one’s official capacity. The nexus is established if the “corporate powers were used or necessary for the commission of the alleged misconduct,” which includes all actions brought against an officer or director “for wrongdoing that he committed in his official capacity” and all misconduct allegedly occurring “in the ordinary course of performing his day-to-day managerial duties.” The court found that the LLCs’ breach of fiduciary duty and fraud claims against Imbert related to acts in his capacity as a manager rather than as a member and that the nexus was thus sufficiently established as to those claims. The breach of fiduciary duty claim rested on Imbert’s capacity as a manager because the LLC agreement did not impose fiduciary duties on members, and Delaware law imposes no default fiduciary duties on non-managing, non-controlling members. As in the case of the breach of fiduciary duty claim, the fraud claim depended on Imbert’s role as a manager because the LLC agreement imposed no obligation on a member to make disclosures, and simply receiving distributions as a member without revealing that he had received tax refunds for the years at issue involved no deception.

Wiggs v. Summit Midstream Partners, LLC, C.A. No. 7801-VCN, 2013 WL 1286180 (Del. Ch. March 28, 2013).

The plaintiffs, former employees of the defendant LLCs and Class B members of defendant DFW Midstream Management, LLC (“Management”), sued Management, DFW Midstream Services LLC (“Services”), Summit Midstream Partners, LLC (“Summit”), and Summit Midstream Holdings, LLC (“Summit Holdings”). The members of Services were Management and Summit Holdings, and the sole manager of Management was Summit. The plaintiffs asserted various claims against the defendant LLCs in connection with an amendment to the LLC agreement of Services. Among the plaintiffs’ claims were a claim that Summit and Summit Holdings breached their fiduciary duties under the Services LLC agreement. This claim failed because the plaintiffs were not members of Services and thus were not owed any fiduciary duties under the agreement. Further, the agreement unambiguously eliminated fiduciary duties of the managers. The plaintiffs’ claim for breach of fiduciary duties under Management’s LLC agreement also failed because the agreement specifically eliminated any fiduciary duties of Summit.

North American Steel Connection, Inc. v. Watson Metal Products Corporation, 515 Fed. App'x 176 (3rd Cir. 2013).

North American Steel Connection, Inc. (“NASCO”), a Louisiana corporation, entered into a joint venture with Watson Metal Products Corporation (“Watson”), a New Jersey corporation, and another corporation. The joint venture was structured as a Delaware LLC. No formal contract memorializing the terms of the joint venture was executed, and the parties established by informal conversations and emails the roles of the three corporate members. When the joint venture was established, Ostermueller was Watson’s president and majority shareholder. After the joint venture began, accounting disagreements arose between NASCO and Watson. Watson and NASCO entered into an agreement requiring Watson to make certain payments to NASCO to rectify errors involving the misuse of joint venture funds. Eventually, the members of the LLC signed an agreement providing that the members other than NASCO would withdraw, leaving NASCO as the only member of the LLC. After Watson defaulted in the payment of funds owed NASCO, NASCO sued Watson and Ostermueller alleging various causes of action. After determining that there was insufficient evidence to support piercing Watson’s corporate veil to hold Ostermueller liable for Watson’s acts as well as insufficient evidence to show that Ostermueller personally participated in Watson’s mishandling of the LLC’s funds, the court turned to NASCO’s argument that Ostermueller was a manager of the LLC and was liable as such to NASCO for breach of fiduciary duty. The court of appeals agreed with the district court that there was no evidence that Ostermueller was in fact a manager of the LLC. The court stated that, under Delaware law, a manager must be named as a manager in an LLC agreement or similar instrument. Once so designated, a manager has the authority to bind the LLC and owes the traditional fiduciary duties of loyalty and care to the members of the LLC unless those duties are modified or eliminated in the LLC agreement. According to the court, a manager of an LLC is not simply someone who assumes management responsibilities. NASCO pointed to only two instances in which Ostermueller was referred to as a “manager:” an email in which he offered to resign as manager, and a reference in his affidavit to being the manager. The court stated that Ostermueller could not have unilaterally established himself as manager under Delaware law through such statements, and there was no evidence presented that the members of the LLC agreed that he would occupy that position or in fact exercised management authority. Thus, no reasonable jury could find that he was in a fiduciary relationship with NASCO, much less that he was liable for breach of a fiduciary duty, and the district court did not err in granting summary judgment to Ostermueller on the breach of fiduciary duty claim.

In re Hardee, Bankr. No. 11-60242, Adv. No. 11-6011, 2013 WL 1084494 (Bankr. E.D. Tex. March 14, 2013).

In this adversary proceeding, an LLC and two of its members sought a determination that debts to them arising from activities of the debtor, Hardee, while he was managing member of the LLC were nondischargeable in Hardee’s bankruptcy. The plaintiffs alleged that Hardee’s debts to them were nondischargeable on the basis that the debts were obtained by actual fraud or false representations or as debts arising from a defalcation by a fiduciary and/or embezzlement. The court granted a partial summary judgment in favor of the LLC on the basis that the summary judgment evidence established that Hardee owed a debt to the LLC arising from the unauthorized diversion of corporate funds and that the debt was nondischargeable as a debt arising out of a defalcation by a fiduciary or embezzlement. The court’s opinion consists of findings of fact and conclusions of law after the trial in the adversary proceeding. The parties agreed to the basic facts of the case. ETRG

Investments, LLC was a Texas limited liability company formed in 2005 for the purpose of owning and operating restaurants in Arkansas. Tomlin and Scott were individuals who resided in Georgia and invested as members in the LLC. Hardee, the debtor in this bankruptcy proceeding, was also a member of the LLC and resided in Texas. Although Hardee invested no money in the LLC, he held the title of “Managing Member” of the LLC from its inception until December 2008. Hardee sent falsified financial statements via email to the LLC investors to conceal his taking of LLC funds in excess of his compensation for personal purposes. Hardee admitted that he was responsible for the LLC’s tax matters, wrote checks on behalf of the LLC, and sent letters to potential investors of the LLC, and that the LLC’s regulations (i.e., company agreement) required him to obtain unanimous consent from the LLC’s members prior to incurring any indebtedness of \$100,000 on behalf of the LLC. The court determined that Hardee embezzled significant sums of money from the LLC and that his breaches of fiduciary duty included entering into an unauthorized lending relationship, not properly managing the LLC’s affairs by diverting funds, and not tendering required tax payments to the IRS on behalf of the LLC. The failure to tender the required tax payments also clearly breached the regulations (i.e., company agreement) of the LLC. The court determined the amount of the debt arising from Hardee’s embezzlement of money from the LLC to pay personal expenses, obtain excessive expense reimbursements, and otherwise receive compensation in amounts in excess of what he was authorized to receive was \$253,331. The court found that the tax debt owed by the LLC to the IRS remained in flux but was at least \$248,000. The court found that Hardee, as the sole person authorized to transact business and direct the financial activities of the LLC, including the payment of tax obligations, acted as an agent of the LLC and as such had a formal fiduciary relationship. The failure to tender the tax payments was a willful breach of duty and thus a defalcation while acting in a fiduciary capacity. As for Hardee’s relationship to the other plaintiffs, Tomlin and Scott, the court found that these members failed to establish that Hardee had a formal fiduciary relationship with them. The company agreement governing the LLC did not impose or even address any fiduciary duties owed by and among the LLC members. Furthermore, the court found that Tomlin and Scott failed to establish that Hardee had an informal fiduciary relationship with them or a trust relationship that existed prior to the creation of the tax obligations at issue that would create fiduciary duties to the members.

In its conclusions of law, the court addressed the nondischargeability of debts arising from breach of fiduciary duties. The court addressed the concept of a fiduciary under federal bankruptcy law and the requirement that the relationship amount to a “technical” or “express” trust. The court then proceeded to set forth numerous conclusions of law regarding fiduciary duties as they related to this proceeding. The Texas LLC statute does not directly address or define the duties owed by managers and members but implies that certain duties may be owed and allows the contracting parties to specify the breadth of those duties in the LLC agreement. One type of fiduciary relationship recognized under Texas law is a formal fiduciary relationship that arises as a matter of law and includes relationships between principal and agent. An agent has authority to transact business or manage some affair for another person or entity and owes a duty of care. Texas law also recognizes that a fiduciary relationship exists between corporate officers or directors and the corporation they serve, and one of the duties imposed on corporate management is a duty of care that requires diligence and prudence in the management of the corporation’s affairs. Although LLCs are not corporations in the strictest sense, Texas law implies that the fiduciary status of corporate officers and directors and their corresponding duties of care, loyalty, and obedience apply to managers and/or members governing the activities of an LLC. Thus, imposition of fiduciary duties on the

management of an LLC under Texas law is appropriate and warranted, and Hardee acted in a fiduciary capacity as to the LLC. Breach of Hardee's fiduciary duties required a willful neglect of duties owed, which is measured objectively by reference to what a reasonable person in the debtor's position knew or reasonably should have known and charges the debtor with knowledge of the law without regard to actual intent or motive. Hardee was charged with insuring that all required payments of employment taxes were made by the LLC to the appropriate taxing authorities, and Hardee's failure in each instance to make the tax payments on behalf of the LLC constituted a breach of the fiduciary duties he owed the LLC. Therefore, the debt owed by the LLC to the IRS to satisfy its tax obligations for the period in which the defendant was the managing member of the LLC constituted a defalcation by a fiduciary and was excepted from discharge in Hardee's bankruptcy proceeding. As for the individual members' request that any amount they were required to pay to satisfy the accrued IRS tax liabilities should also be a nondischargeable debt, the court noted a significant difference between a manager's fiduciary relationship to the LLC and the manager's relationship to fellow members. Case law has recognized that there is no formal fiduciary relationship created as a matter of law between members of an LLC. The designation of Hardee in the LLC agreement as the "Tax Matters Member" had no legal significance in the absence of a demonstration that the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) applied to this LLC—the small partnership exception might well have exempted the members of the LLC from the application of TEFRA. Thus, Hardee had no formal fiduciary relationship with either Tomlin or Scott. An informal fiduciary relationship is a confidential relationship arising from moral, social, domestic, or personal relationships in which one person trusts in and relies on another. The effect of imposing a fiduciary duty is to require the fiduciary party to place another's interest above its own, and a fiduciary relationship is thus not one that is created lightly. Hardee had no informal fiduciary relationship with either Tomlin or Scott. Any liability of Hardee to either Tomlin or Scott created by Hardee's failure to render tax payments on behalf of the LLC was not excepted from discharge as a result of a breach of fiduciary duties because the debtor owed no fiduciary duties to the members.

Ross Holding and Management Co. v. Advance Realty Group LLC, C.A. No. 4113-VCN, 2013 WL 764688 (Del. Ch. Feb. 28, 2013).

The plaintiffs complained of an LLC's failure to repurchase the plaintiffs' units when the plaintiffs were terminated and the LLC's adoption of a conversion and exchange agreement that involved a capital restructuring of the LLC. The plaintiffs alleged that the capital restructuring adversely affected the value of the plaintiffs' holdings because the defendants diverted the LLC's assets for their benefit. The court granted the defendants' motion for summary judgment on the breach of contract claims stemming from the failure to repurchase their units as well as breach of fiduciary duty claims against Rayevich, a member of the LLC's managing board, and Sheridan, the LLC's Chief Financial Officer, in connection with their alleged involvement with the LLC's adoption of the conversion and exchange agreement, but civil conspiracy claims under New Jersey law against some of the defendants survived summary judgment. The court applied Delaware law to the breach of fiduciary duty claims against Rayevich and Sheridan. The LLC agreement required Rayevich, as a member of the LLC's managing board, to manage the LLC reasonably and in good faith, and the agreement exculpated him from liability absent willful misconduct or bad faith. Although Rayevich was a member of the LLC's managing board, he had no discretion in how to vote because he was required to vote as directed by another individual. Although Rayevich had no

discretionary voting power, the court stated that his fiduciary duties extended beyond voting and could involve studying the proposed transaction, determining its appropriateness, expressing dissenting views to fellow board members and, under proper circumstances, informing unit holders about potential adverse effects. Plaintiffs failed, however, to allege any facts that demonstrated Rayevich's conduct was willful or in bad faith in connection with the conversion and exchange agreement, and he was entitled to summary judgment. Sheridan, the CFO of the LLC, did not dispute that she owed fiduciary duties to the plaintiffs. The plaintiffs alleged various acts of wrongdoing related to the conversion and exchange agreement. The court extended to the LLC context the principle that corporate fiduciaries may breach their general fiduciary duty to shareholders if the fiduciaries make misleading disclosures even though the disclosures do not relate to a specific request for shareholder action. When no shareholder or unit holder action is sought, the plaintiff must prove that the fiduciary knowingly disseminated materially false information and must prove reasonable reliance, causation, and damages. Here, the court concluded that the plaintiffs failed to demonstrate that Sheridan's alleged statements caused them any damage or that they relied on any of her alleged misrepresentations. Thus, the court granted summary judgment in her favor on this claim. The court also addressed claims of civil conspiracy under New Jersey law. The plaintiffs alleged that individual and entity defendants engaged in a civil conspiracy to harm the plaintiffs by depriving them of their Class A units pursuant to the restructuring under the conversion and exchange agreement. The defendants primarily challenged the sufficiency of the element of an agreement. Some of the alleged conspirators were equity holders, and some were debt holders. Some of the parties to the conversion and exchange agreement agreed to its terms, and the court posed the question whether that sort of written confirmation of a business transaction satisfies the agreement element for a conspiracy. The court concluded that there was a disputed issue of material fact as to whether the defendants other than Rayevich and Sheridan reached an agreement to pursue the conversion and exchange agreement and thus, according to the plaintiffs, to harm the plaintiffs for the benefit of the defendants. The court granted summary judgment in favor of Rayevich on the civil conspiracy claim because the plaintiffs identified no overt action on his part. The court concluded that Sheridan's actions leading up to the conversion and exchange agreement could support a reasonable inference that she agreed to the alleged purpose of the agreement (i.e., to inflict a wrong on the plaintiffs), and the court thus concluded that summary judgment in her favor on the conspiracy claim was precluded.

Fancher v. Prudhome, 112 So.3d 909 (La. App. 2013).

In this action by a withdrawn member to determine the value of his interest in a Louisiana LLC, the withdrawn member claimed that the remaining members were personally liable to him on the basis that they were grossly negligent in entering into a loan agreement that assigned 50% of the LLC's profits to the lender. Citing the Louisiana LLC statute, the court stated that a member who is a manager has a fiduciary duty to the LLC and its members and that members and managers are not personally liable to the LLC or its members unless they acted with gross negligence, which is a reckless disregard of or carelessness amounting to indifference to the best interests of the LLC or its members. Based on the evidence presented, the appellate court found that the trial court was not clearly wrong in finding that the members did not act with reckless disregard of the LLC's best interest by agreeing to a loan that was necessary to keep the LLC operating. Thus, the withdrawn member's argument that the members were personally liable based on gross negligence lacked merit.

Humphrey Industries, Ltd. v. Clay Street Associates, LLC, 295 P.3d 231 (Wash. 2013).

An LLC member who exercised its statutory dissenter's rights in the context of a merger of the LLC sought to recover attorney's fees in litigation to enforce its dissenter's rights. The dissenting member relied on the fiduciary duty owed among partners to argue that the members were liable for fees for breach of fiduciary duty, but the court pointed out that this argument assumed that the same duty exists among members, and the court refused to consider the issue.

Lakes Region Gaming v. Miller, 62 A.3d 838 (N.H. 2013).

In 2005, Gistis and Johnston agreed to purchase a greyhound race track through a court-approved bidding process. The two formed a joint venture in which Johnston's development company ("Johnston Development") would bid on the race track and Gistis would provide the required deposit. Johnston Development successfully bid over \$4 million to buy the race track, and Gistis provided the \$205,000 deposit in connection with the purchase. Shortly thereafter, Johnston Development and Gistis formed an LLC to own and manage the race track. The other members of the LLC were Miller and two other individuals. The parties agreed Johnston Development would contribute its right to purchase the race track to the LLC as part of the company's capitalization, and the LLC would own the race track. Johnston Development and the seller entered a purchase and sale agreement with a two-month period for Johnston Development to conduct its due diligence. If the seller was not notified of an intent to proceed with the transaction by July 18, the deposit would be forfeited. In June, a New Hampshire grand jury indicted a dozen people involved with the track, and the LLC members decided to try to sell their right to purchase the track and recoup expenses rather than to close on the transaction. Without the knowledge of the other members of the LLC, Miller and Johnston had been negotiating the right to purchase the track with numerous potential buyers. On July 17, Torguson Gaming Group, Inc. ("Torguson") agreed to pay \$5 million to Johnston for the right to purchase the race track. In addition, Miller paid the seller \$50,000 to extend the due diligence period and have the deposit remain in the escrow account. Torguson then replaced the deposit made by Gistis, and the seller returned Gistis's deposit. Johnston Development made a profit of almost \$900,000 in its sale to Torguson, and Johnston transferred \$445,000 of the profit to Miller. The LLC and its members (other than Miller and Johnston Development) filed suit against Johnston, Johnston Development, and Miller alleging, among other causes of action, breach of fiduciary duty. A default judgment was entered against Johnston and Johnston Development, and the claim against Miller proceeded to trial. The trial court found that Miller breached his fiduciary duties to the plaintiffs by using the original deposit made by Gistis and belonging to the LLC to appropriate the opportunity to sell the purchase rights to Torguson. Miller appealed alleging that the plaintiffs did not have standing to sue for breach of fiduciary duty and that the LLC's operating agreement allowed his actions in connection with the sale to Torguson. First, Miller argued that the assets at issue, which were the right to purchase the race track and the deposit, did not belong to the LLC and that the plaintiffs lacked standing to bring an action based on them. Although this issue was not raised at trial, the appellate court addressed it as it dealt with the trial court's subject matter jurisdiction. The trial court found that both the right to purchase the race track and the deposit held in escrow belonged to the LLC. The trial court found that Johnston had an obligation to transfer his rights at closing, which the LLC could have enforced. At the very least, the LLC had a cause of action for specific performance to require transfer of those rights so the closing could have occurred. In addition, the deposit, while in escrow, was to be used only for the benefit of the LLC. Therefore, the LLC and its members had standing to sue for breach of fiduciary duty. Next, the defendant contended

that the trial court erred when it failed to consider a paragraph in the LLC's operating agreement that allowed competition with the LLC with or without notice to or participation by the other LLC members without such conduct constituting a breach of fiduciary duty. Miller argued that his conduct involving negotiations with alternate buyers constituted competition, as allowed by the operating agreement. The plaintiffs countered that Miller was not merely competing with the LLC but rather sold the LLC's primary business asset (i.e., the right to purchase the race track) and secretly used Gistis's deposit to do so. The appellate court agreed with the plaintiffs that the LLC's operating agreement did not allow Miller to use the LLC's assets to enrich himself. Miller's argument mistakenly assumed that the purchase right and deposit did not belong to the LLC; however, as discussed above, the trial court found that both assets belonged to the LLC, and the appellate court upheld the finding on appeal. Therefore, Miller's actions constituted breach of the fiduciary duties he owed the plaintiffs, and the appellate court affirmed the trial court's judgment.

Information Rights

Stewart v. BF Bolthouse Holdco, LLC, C.A. No. 8119-VCP, 2013 WL 5210220 (Del. Ch. Aug. 30, 2013).

Former employees of an LLC sued the LLC and its board of managers for breach of contract, breach of fiduciary duty, and breach of the implied covenant of good faith and fair dealing in connection with the LLC's exercise of its right to repurchase the plaintiffs' membership units in the LLC when the plaintiffs voluntarily terminated their employment. Based on the board's valuation of the units at \$0.00, the LLC cancelled the plaintiffs' units without paying any consideration. The plaintiffs claimed that the board of managers acted in bad faith in valuing the units at \$0.00 and that such action violated both the purchase agreement that governed the repurchase of the units (which required the board of managers to determine the value in good faith) and the LLC agreement (which provided that the board owed to the LLC and its members the duties owed by corporate directors to the corporation and its shareholders). The relief sought by the plaintiffs included a declaratory judgment invalidating the repurchase and an order restoring their ownership of units in the LLC. The court denied in part and granted in part the defendants' motion to dismiss the breach of contract claims, and the court granted the motion to dismiss the claims for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing because the latter claims were duplicative of the breach of contract claims. Among the plaintiffs' breach of contract claims was claim that the LLC breached the LLC agreement by failing to provide the plaintiffs with year-end financial information. The court dismissed this claim. The LLC agreement provided that "[w]ithin one hundred twenty (120) days after the end of each Fiscal Year of the Company, the Company shall deliver to each Member the Company's annual financial statements." A "Member" was defined as "each Initial Member and each other Person who is hereafter admitted as a Member in accordance with the terms of this Agreement and the Act, in each case so long as such Person is shown on the Company's books and records as the owner of one or more Units." There was no dispute that the plaintiffs were members on March 31, 2010, the LLC's fiscal year end, but the plaintiffs' units were repurchased on July 22, 2010, seven days before the 120-day period expired on July 29, 2010. The question was whether membership on the date of the fiscal year end entitled them to the year-end financial information required to be delivered to members under the LLC agreement. The court concluded that the LLC agreement plainly required delivery of the information to anyone who was a member on the date of delivery. Since the LLC agreement defined a "Member" as a person with

a present ownership interest in the LLC, and there was no allegation that the LLC delivered financial information between March 31 and July 22, 2010, the court held that there were no alleged facts upon which the plaintiffs could conceivably prove a breach of the contract based on this provision of the LLC agreement.

Florida R&D Fund Investors, LLC v. Florida BOCA/Deerfield R&D Investors, LLC, C.A. No. 8400-VCN, 2013 WL 4734834 (Aug. 30, 2013).

A member of a joint venture Delaware LLC brought a books and records action under the Delaware Limited Liability Company Act and the LLC agreement. The plaintiff sought information for the purposes of appointing a new asset manager and investigating possible mismanagement of the LLC. The plaintiff sued the LLC, its former asset manager, the other members of the LLC and certain other affiliated parties. The defendants other than the LLC moved to dismiss for lack of personal jurisdiction and failure to state a claim. The court declined to exercise jurisdiction over the former asset manager under either the Delaware long-arm statute or the implied consent provision of the Delaware LLC statute. The court dismissed the plaintiff's books and records claim against other members of the LLC and their affiliates because the plaintiff failed to identify any source—either under the LLC agreement or the Delaware LLC statute—of a right to inspect books and records of other members or parties affiliated with other members.

Omes v. Ultra Enterprises, Inc., 116 So.3d 633 (Fla. App. 2013).

A minority owner of two corporations and two LLCs filed a complaint alleging unlawful denial of access to books and records under the corporate and LLC statutes. The court discussed whether a corporation or LLC that fails to maintain an accounting record specified to be accessible to a shareholder (in this case a statement of annual cash flows) can be ordered to prepare or produce the record or produce the source records that would be required to prepare the statement. The court discussed corporate case law and concluded that corporations are not obligated to prepare records that do not exist.

Interpretation of Operating Agreement

Phillips Brothers v. Winstead, __ So.3d __, 2014 WL 68814 (Miss. 2014).

Winstead, Simmons, and Phillips Brothers, LP (“Phillips”) formed an LLC to operate a catfish hatchery and farm. The LLC operating agreement provided that Winstead, Simmons, and Phillips each had a 1/3 ownership interest and that Simmons was the manager. The members agreed that Winstead would be the hatchery operator and would receive a salary and certain other benefits. The LLC was funded with bank loans. The LLC was profitable only two of the eight years that Winstead was the hatchery operator, and Simmons fired Winstead in 2007. In 2009, Winstead sued the LLC, Simmons, and Phillips alleging various causes of action. Winstead obtained a judgment from the trial court for compensatory and punitive damages. The issues raised in this appeal to the Mississippi Supreme Court included the following: (1) whether admission of testimony regarding an oral agreement for cash contributions violated the parol evidence rule; (2) whether there was sufficient evidence to support Winstead's award for fraud; (3) whether there was sufficient evidence to support Winstead's award for corporate freeze-out; and (4) whether there was sufficient evidence to support Winstead's award for breach of fiduciary duty.

First, the court considered whether the LLC operating agreement precluded admission of parol evidence regarding capital contribution obligations. The trial court allowed testimony by Winstead and Winstead's expert regarding an alleged oral agreement by Simmons and Phillips to provide \$600,000 in cash contributions for the purchase of startup equipment and fish inventory. The trial court allowed the testimony because the operating agreement was silent as to the contributions. Article VI of the operating agreement stated that the members shall contribute property more particularly described in Schedule A and that no member was required to make any capital contributions except as set forth in that provision. Schedule A was blank. The supreme court concluded that the "silence" in Schedule A did not create an ambiguity and that the agreement clearly provided that no member was required to make any capital contribution other than as provided in Schedule A, in which nothing was listed. Thus, it was error for the trial court to go outside the operating agreement to consider the intent of the parties.

After concluding the evidence did not support Winstead's fraud claims, the court discussed in depth the freeze-out cause of action recognized in Mississippi and concluded that Winstead had failed to prove that he was frozen out of the LLC by Simmons. Relying on traditional elements for an intentional tort claim and Mississippi case law involving closely held corporations and LLCs, the court stated that a plaintiff asserting a corporate (or LLC) freeze-out must establish: (1) the existence of a legally defined duty owed to or right of a minority shareholder arising out of the shareholder's ownership interest in the corporation; (2) the intentional or willful breach of that duty by the majority or controlling shareholder(s); (3) that the breach proximately caused plaintiff's direct injury; and (4) the fact and extent of injury. In evaluating the duties and alleged breach, the court will look to the parties' agreement and applicable state law. In this case, the court looked at applicable case law, the LLC operating agreement, and Mississippi LLC statute in effect at the time. Winstead alleged that Simmons and Phillips took actions to exclude Winstead from his ownership interest without justification and in willful disregard of Winstead's rights. In support of his claim, Winstead argued Simmons and Phillips did not make required cash contributions to start the LLC and misappropriated funds from the LLC. As discussed above, the court held that the alleged oral agreement to make cash contributions was inadmissible and that the evidence did not support Winstead's allegations that Simmons or Phillips committed fraud by misappropriating LLC funds. Winstead also argued that Simmons made detrimental loans to the LLC without Winstead's consent, did not allow Winstead to inspect the books and records, and mismanaged the LLC after Winstead was fired. Because the operating agreement gave Simmons full and complete authority to manage the LLC, including the power to borrow money and make all other decisions, the court rejected Winstead's arguments that he was denied participation as a "true managing shareholder." Winstead's approval was not required for the actions Simmons took, and the evidence showed that the LLC would have ceased operating without the loans made to the LLC by Simmons' other entities. The court concluded that termination of Winstead's employment was not evidence of a freeze-out because Mississippi is an employment-at-will state, there was nothing in the operating agreement that guaranteed employment, and there was evidence that Simmons was acting pursuant to a legitimate business purpose in firing Winstead. With respect to Winstead's claim regarding inspection of the LLC's books and records, there was no evidence to show that Winstead was denied access to the LLC's offices or that he even attempted to inspect the records as he had a right to do under the operating agreement; however, the operating agreement also required Simmons to furnish each member a balance sheet for each accounting period, which Simmons failed to do after Winstead was fired. Although Simmons arguably breached a duty to Winstead by not providing balance sheets, Winstead did not show how this damaged him.

Simmons eventually delivered voluminous financial records to Winstead, and the court found this claim had no merit. Finally, the court reviewed the evidence regarding mismanagement and concluded that there was no evidence of willful or wanton mismanagement damaging Winstead alone. In sum, the court concluded that Winstead failed to prove he was frozen out of the LLC. Simmons did not use his control to breach a duty to Winstead by denying Winstead his proportional share of any LLC benefits. None of the actions taken by Simmons circumvented the powers given him by the operating agreement, and neither Simmons nor Phillips ever received any payment from the LLC in the form of salary, dividends, or any other distribution. The court thus reversed and rendered the judgment of corporate freeze-out.

The court next discussed Winstead's breach of fiduciary duty claim as distinct from his corporate freeze-out claim. Winstead asserted that Simmons and Phillips negligently, carelessly, and intentionally failed to perform their duties as managing officers of the LLC so that the assets of the LLC were mismanaged, wasted, and diverted to Simmons and Phillips in 2008 after Winstead was fired. The court noted that Winstead's freeze-out claim was an individual claim stemming from an intentional breach of a duty owed directly to Winstead that caused him personal damages separate and apart from damages to the LLC. By contrast, a claim that Simmons breached his duty through mismanagement or dissipation of assets belongs to the LLC because the wrong damages the LLC and damages Winstead only derivatively. (Earlier in the opinion, when discussing the mismanagement allegations as they related to the freeze-out claim, the court noted that the defendants never challenged whether Winstead should be permitted to bring the derivative claims of mismanagement in a direct action; therefore, the derivative claims were tried by consent, and the pre-trial procedural requisites applicable to derivative actions were waived.) The court noted its holdings in previous cases that directors and officers in a closely held corporation stand in a fiduciary relationship with the corporation and its shareholders and that this rationale applies equally to LLCs. Before looking to any common-law standards of care, the court looked to the agreement of the parties, i.e., the LLC operating agreement. The operating agreement led the court to conclude that Simmons, as a manager, owed a fiduciary duty to the members, but the operating agreement also indemnified Simmons from any actions he took on behalf of the LLC as long as he conducted himself in good faith and reasonably believed his conduct was in the LLC's best interest. To prevail on his breach of fiduciary duty claim, the court stated that Winstead must at the very least prove that Simmons breached the operating agreement. Because there was no evidence that Phillips ever took part in the day-to-day operations of the LLC or was involved in the alleged acts of mismanagement, the court reversed and rendered the trial court's judgment that Phillips breached a duty by mismanaging the LLC's assets. Although Simmons, as manager of the LLC, owed a duty to Winstead even after Winstead was fired, the court found numerous problems with Winstead's evidence on damages and held that Simmons was entitled to a new trial on Winstead's breach of fiduciary duty claim against him.

Fillip v. Centerstone Linen Services, LLC, C.A. No. 8712-ML, 2013 WL 6671663 (Del. Ch. Dec. 3, 2013) (Master's report), *aff'd* in part and remanded for further proceedings, 2014 WL 793123 (Del Ch. Feb. 27, 2014).

Both the master and the vice chancellor concluded that the LLC agreement in this case provided for mandatory advancement and noted that the case illustrates the relatively common remorse experienced by an entity that has conferred broad advancement rights to an official or employee whom the entity later accuses of grievous wrongdoing. The plaintiff in this action sought

advancement for expenses in defending counterclaims and affirmative defenses asserted by the defendant LLC in an action brought by the plaintiff in Georgia to recover severance payments after the plaintiff resigned from his position as CEO of the LLC. The LLC's original counterclaims and affirmative defenses alleged various breaches of fiduciary duty and breaches of contract. In an effort to avoid advancement, the LLC dismissed its breach of fiduciary duty claims and argued that advancement was not required for the remaining breach of contract allegations. The indemnification provision of the LLC agreement provided as follows:

The Company shall indemnify, defend and hold harmless each Manager and Officer for all costs, losses, liability, and damages whatsoever paid or incurred by such Manager or Officer in the performance of his duties in such capacity, including, without limitations, reasonable attorney's fees, expert witness and court costs, to the fullest extent provided or permitted by the [Delaware Limited Liability Company Act] or other applicable laws. Further, in the event fraud or bad faith claims are asserted against such Manager or Officer, the Company shall nonetheless bear all of the aforesaid expenses subject to the obligation of such Manager or Officer to repay all such expenses if they are finally determined to have committed such fraud or bad faith acts.

The LLC argued that the plaintiff's advancement right was limited to expenses related to claims for fraud or bad faith, and in any event was not required because the breach of contract claims were personal and thus not taken "in the performance of his duties" as an officer of the LLC. Applying contract interpretation principles and reading the indemnification provision as a whole, the court held that the word "defend" in the first sentence of the indemnification provision created an advancement right. The court relied on case law holding that the word "defend" has a meaning distinct from the phrase "indemnify and hold harmless" and creates a duty to pay for expenses of defense on a current basis. The court concluded that the second sentence of the indemnification provision merely clarified the scope of the advancement rights created in the first sentence. According to the court, the LLC's position that the parties intended to limit advancement to circumstances in which an official was accused of fraud or bad faith was not a sensible interpretation of the agreement in this case. The court also rejected the LLC's argument that the phrase "in the performance of his duties in such capacity" created a narrower advancement right than the "by reason of the fact" standard found in the Delaware General Corporation Law, which is satisfied if there is a nexus or causal connection between the corporate actor's official capacity and the underlying proceedings. The court found no substantive distinction between the "performance of his duties" language used in the LLC agreement in this case and the "by reason of the fact" language in the corporate statute. The language used in the indemnification provision of the LLC agreement and the broad contractual freedom conferred under the LLC statute did not support the LLC's assertion that "in the performance of his duties in such capacity" should be read more narrowly than "by reason of the fact," both of which can be understood as encompassing wrongdoing committed by an officer in his official capacity and in the performance of his day-to-day duties. In arguing its exceptions to the master's report to the vice chancellor, the LLC conceded that the two standards are interchangeable but argued that the master's determination of the scope of advancement under either standard was incorrect. The vice chancellor found that the meaning of the phrase "in the performance of his duties" was controlled by case law explicating the "by reason of the fact" standard. The master evaluated the application of the advancement provision to the various claims asserted in the Georgia action, but the vice chancellor concluded that it would be premature to

address the master's findings in this regard due to the fluid nature of the Georgia action and information lacked by the master at the time of her report. The vice chancellor thus remanded to the master for further proceedings.

Touch of Italy Salumeria & Pasticceria, LLC v. Bascio, Civil Action No. 8602-VCG, 2014 WL 108895 (Del. Ch. Jan. 13, 2014).

Four individuals formed an LLC to operate an Italian grocery. A couple years later, two of the original members left, and an additional member was admitted. The three members executed an amended and restated LLC agreement. Although the business operated successfully and profitably after that, one of the original members eventually decided to withdraw from the LLC and gave notice pursuant to the LLC agreement, which permitted any member to withdraw by giving written notice to the other members. The withdrawing member told the remaining members that he intended to move to Pennsylvania and possibly start a new business there, but he and his brother opened a competing Italian grocery on the same block as the LLC's store ten weeks after he withdrew. The LLC and the two remaining members sued the withdrawing member and his brother (who was one of the original members that had withdrawn a couple years earlier), and the defendants filed a motion to dismiss. With respect to the plaintiffs' breach of contract claim, the court concluded that the LLC agreement provided a mechanism for voluntary withdrawal and did not contain a non-compete provision. Furthermore, the plaintiffs did not refer to any specific provision of the LLC agreement in support of their allegation that the withdrawing member breached the agreement. The plaintiffs appeared to argue that one of the original members was entitled to the return of his capital contribution under the LLC agreement, but the member was not yet entitled to the return of his contribution under the terms of the agreement and his claim would be against the LLC rather than the current or former members in any event. Thus, the court dismissed the breach of contract claim. The court also dismissed the plaintiffs' claims of fraud and misrepresentation because the plaintiffs did not adequately plead any reliance on the withdrawing member's representations to their detriment. The court next addressed the plaintiffs' allegation that the withdrawing member breached the implied covenant of good faith and faith dealing. The implied covenant prevents a party from denying his or her contractual partners the benefit of their bargain based on circumstances that the parties did not anticipate, but withdrawal of a member was specifically anticipated by the parties inasmuch as the parties provided in their LLC agreement for voluntary member withdrawal. Additionally, the parties did not include a covenant not to compete, a standard provision in employee contracts, in their LLC agreement. The court stated that the plaintiffs obviously regretted not including a non-compete provision, but the court refused to use the implied covenant to "shoehorn" a covenant not to compete into the parties' contract, and the court dismissed the implied covenant claim. The court also dismissed the plaintiffs' breach of fiduciary duty and conversion claims.

Grace v. Ashbridge LLC, C.A. No. 8348-VCN, 2013 WL 6869936 (Del. Ch. Dec. 31, 2013).

The plaintiff, a member, manager, and chairman of the defendant LLC, filed this action for advancement and indemnification for expenses incurred in the current action and a previously commenced action in Pennsylvania (the "Orphans' Court Proceeding") and failed mediation arising out of alleged breaches of fiduciary duty by the plaintiff in connection with the plaintiff's role as a trustee of a family trust. The trust owned shares in a corporation that merged into the defendant LLC, and the plaintiff was also a shareholder, director, and chairman of the corporate predecessor

of the LLC. The claims in the Orphan's Court Proceeding were based on various acts of mismanagement involving the corporation and an affiliate entity. The plaintiff argued in the current proceeding that he was entitled to advancement and indemnification under the LLC's operating agreement because the agreement required indemnification of losses and advancement of expenses for any person made a party to a proceeding by reason of being a member or manager of the LLC or an employee, officer, director, manager, shareholder, or partner of a member or manager of the LLC. The LLC sought to dismiss the current action because the plaintiff's acts relating to the Orphans' Court Proceeding were taken in the plaintiff's personal capacity or in his capacity as an officer of the predecessor corporation or its affiliate and not in any capacity relating to the LLC. The court analyzed the indemnification provision of the LLC operating agreement and concluded that its plain terms did not extend to predecessors or affiliates. The claims in the Orphans' Court Proceeding did not even mention the LLC, but rather were based on various acts of mismanagement related to the predecessor corporation and its affiliate. Thus, the LLC operating agreement did not require advancement and indemnification for that proceeding. The court stated that Delaware case law supported this result because successor entities are generally not liable for the actions of corporate officers of predecessor entities or affiliates when a fundamental change in identity has occurred. For purposes of advancement and indemnification, Delaware law considers a conversion from an LLC to a corporation to be a "fundamental change in identity." One of the ways in which LLCs and corporations differ is with respect to indemnification: indemnification is mandated when corporate directors and officers successfully defend themselves, but indemnification is left to the terms of the operating agreement in the case of LLCs. The indemnification rights in the LLC's operating agreement were different from those found in the predecessor corporation's bylaws, making this case similar to a previous Delaware case, *Bernstein v. Tractmanager, Inc.*, in which the chancery court had held that a former manager of an LLC and current director of a corporation was only entitled to indemnification under the corporate bylaws, which did not retroactively create a right for the person's tenure as a member of the LLC. The court expressed no opinion on whether a successor entity could be responsible for indemnifying or granting advancement based upon the bylaws or operating agreement of a predecessor entity because the plaintiff did not allege that the predecessor corporation's bylaws entitled him to indemnification and advancement. The court also held that no indemnification was due for expenses of the failed mediation because the plaintiff failed to plead any facts describing the mediation or the factual circumstances underlying it. Finally, because the plaintiff was not entitled to indemnification and advancement for the Orphan's Court Proceeding and mediation, he was not entitled to indemnification or advancement for the current action.

Graven v. Lucero, C.A. No. 8919-VCN, 2013 WL 6797566 (Del. Ch. Dec. 20, 2013).

Both the plaintiff and defendant claimed to be the managing principal of a Delaware LLC, and resolution of their disagreement depended on which members were the founding principals of the LLC. The plaintiff claimed that a vote by the LLC's founding principals removed the defendant from his position as managing principal and replaced him with the plaintiff. The LLC's operating agreement provided that two-thirds of the founding principals could remove and replace the managing principal, but the records of the LLC "had not been perfectly maintained," and the parties disagreed as to what version of the operating agreement was the final execution copy. The plaintiff relied on a version of the operating agreement circulated by e-mail to twenty individuals that was digitally executed by the plaintiff and defendant and listed three other individuals as founding principals, two of whom later resigned. The defendant argued that the version relied on by the

plaintiff was not the final executed version and that it took several months to obtain all the signatures for the fully executed version. Further, the defendant argued that the individual who voted with the plaintiff to remove the defendant as managing principal had declined to become a founding principal and executed the operating agreement in a different capacity. The court denied summary judgment based on a genuine issue of material fact as to which version of the operating agreement was the final executed version.

Huatuco v. Satellite Healthcare, Civil Action No. 8465-VCG, 2013 WL 6460898 (Del. Ch. Dec. 9, 2013).

A 50% LLC member sued the LLC and its other member, seeking judicial dissolution of the LLC on the basis of a deadlock between the plaintiff and the other member. The defendants moved to dismiss. Although the complaint alleged a breach of the LLC agreement, the court found that the parties had agreed that the motion to dismiss depended on whether the plaintiff would be entitled to judicial dissolution based on the interplay of the judicial dissolution provision of the Delaware LLC statute and certain provisions of the LLC agreement. The court held that the terms of the LLC agreement precluded the plaintiff from seeking judicial dissolution based on Delaware case law and the broad policy of freedom of contract underlying the LLC statute. As previously held in *R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, judicial dissolution is a default rule that may be displaced by contract. The LLC agreement in the instant case contained a provision specifying events causing dissolution, and judicial dissolution was not included among these events. The LLC agreement also included the following provision in a paragraph addressing distribution rights and denying preemptive rights with respect to additional membership interests: “Except as otherwise required by applicable law, the Members shall only have the power to exercise any and all rights expressly granted to the Members pursuant to the terms of this Agreement.” The court concluded that this provision applied to member rights generally, including the right to seek judicial dissolution. Because judicial dissolution is a default rule, and as such is not “required by applicable law,” the court concluded that judicial dissolution was intentionally excluded from the LLC agreement and was not available to the plaintiff. In a footnote, the court noted that it need not resolve the issue of whether the parties may, by contract, divest the court of “authority to order a dissolution in *all* circumstances, even where it appears manifest that equity so requires— leaving for instance, irreconcilable members locked away together forever like some alternative entity version of Sartre’s Huis Clois.”

Costantini v. Swiss Farm Stores Acquisition LLC, Civil Action No. 8613-VCG, 2013 WL 4758228 (Del. Ch. Sept. 5, 2013), modified on reargument, 2013 WL 6327510 (Del. Ch. Dec. 5, 2013).

Two individuals, Costantini and Kahn, sought indemnification for their fees and costs in underlying litigation brought against them by an LLC. In the underlying action, the LLC sued Costantini and Kahn for alleged breaches of fiduciary duty, but the action was dismissed based on laches. In this action, Costantini and Kahn sought judgment on the pleadings for indemnification for their fees and costs incurred in defending the fiduciary duty action. The court discussed the claims by Costantini and Kahn separately because Costantini was a member of the board of managers of the LLC and Kahn was not.

With respect to Costantini’s claim for indemnification, the court stated that the same policy reasons supporting indemnification of corporate actors apply to actors for other entities, including

LLCs. As creatures of contract, LLCs have broad latitude to allocate the rights and responsibilities of the members, but the LLC in this case chose to track the permissive and mandatory indemnification rights of the Delaware General Corporation Law for members of its board of managers, officers, employees, and agents. Costantini was sued in his capacity as a member of the LLC's board of managers, and the court held that the operating agreement unambiguously provided indemnification to Costantini under the undisputed facts. Thus, Costantini was entitled to judgment on the pleadings.

The parties had conceded that Kahn was not a member of the LLC's board of managers and was not an officer, employee, or agent of the LLC; Kahn was apparently sued for breach of fiduciary duty in his capacity as a partner of a partnership that was a member of the LLC. The partnership had the right as a member to appoint a member of the LLC's board of managers. The court held that, because Kahn was not an officer, employee, agent, or member of the board of managers of the LLC, he did not fall within the categories of persons granted indemnification under the LLC's operating agreement and was not entitled to indemnification. On reargument, Kahn submitted evidence claiming that he was an agent of the LLC based on brokerage and development management contracts between his corporation and the LLC. The court concluded that Kahn might be an agent or subagent of the LLC based on the agreements and his relationship with his corporation, but there were factual determinations that could not be made from the face of the complaint in that regard. Assuming Kahn was an agent of the LLC, he would be entitled to indemnification if the underlying action against him was brought by reason of the fact that he was an agent of the LLC. Because the indemnification clause in the operating agreement indemnified a person who was sued "by reason of the fact" that he as an agent, which was language borrowed from the Delaware General Corporation Law, the court looked to case law interpreting the corporate statute. Corporate precedent has established that a proceeding is "by reason of the fact" of a corporate position if there exists a causal connection or nexus with the corporate position. Case law in the corporate context further explains that a nexus exists where the corporate capacity is necessary or useful for committing the alleged misconduct. The court concluded that the pleadings were insufficient for the court to determine whether Kahn's alleged agent status was necessary or useful to commit the acts alleged in the underlying action. Thus, Kahn was not entitled to judgment on the pleadings.

CB3 Enterprises LLC v. Damas, 415 S.W.3d 163 (Mo. App. 2013).

Damas, the managing member of an LLC owned by Damas and his two brothers, sold his interest to one of his brothers, and his brothers then uncovered facts leading them to believe that Damas breached his fiduciary duty to the LLC. The LLC filed a lawsuit against Damas for breach of fiduciary duty, and Damas filed a counterclaim for indemnification from the LLC. The jury found for Damas on the breach of fiduciary duty claim and on his indemnification claim. The LLC argued that its articles of organization and operating agreement expressly barred the indemnification claim. The articles of organization contained indemnification provisions that were broken down into two paragraphs, one entitled "Direct Actions" and one entitled "Derivative Actions." The paragraph entitled "Direct Actions" required indemnification of any manager or officer who met specified standards and was a party to an action, suit, or proceeding "other than an action by or in the right of the Limited Liability Company," and the paragraph entitled "Derivative Actions" required indemnification of any manager or officer who met specified standards and was a party to an action, suit, or proceeding "by or in the right of the Limited Liability Company." The operating agreement provided that the manager shall be indemnified by the LLC to the fullest extent provided by Missouri

law. The LLC argued that the “Direct Actions” provision controlled because the LLC brought the action against Damas directly. Because the “Direct Actions” provision excluded any obligation to indemnify a manager or officer in an action brought by or in the right of the LLC, the LLC argued it had no obligation to indemnify Damas in this case. Construing the articles of organization according to general contract rules, the appellate court concluded that the LLC’s action against Damas fell within the scope of the “Derivative Actions” provision because that provision applied to an action “by or in the right of the Limited Liability Company.” Rather than being in conflict and ambiguous as the trial court found, the two indemnification provisions were harmonious and did not overlap. One provision applied to actions initiated by or in the right of the LLC, and the other did not. The court acknowledged that the LLC’s action could be characterized as a “direct” action under the dictionary definitions of “direct” and “derivative” actions, but parties to a contract are free to define terms as they see fit, and the court stated that it would not employ a dictionary definition that is contrary to the plain meaning of the contract. The court noted that the articles of organization did not contain a provision stating that headings are for convenience only and should not be used to interpret the contract. The operating agreement contained such a provision, and Damas argued that the provision in the operating agreement should be read to apply to the articles of organization as well since the two documents were executed at the same time. The court did not find it necessary to rely on any provision of the operating agreement because the court otherwise concluded that the articles of organization unambiguously required indemnification of Damas.

Iron Mound, LLC v. Nuterra Healthcare Management, 313 P.3d 808 (Kan. 2013).

An operating agreement for an LLC that was formed to develop and operate surgical and other healthcare facilities contained a provision regarding the division of fees for services performed by one of the members (Nuterra Healthcare Management, LLC or “Nuterra”) should Nuterra enter into management agreements with specified other surgical centers. Shortly after the LLC was formed, Nuterra entered into a management agreement with one of the specified surgical centers. The management agreement was to remain in effect for five-year terms unless either Nuterra or the surgical center elected not to renew the contract. Approximately two years after the LLC was formed, Nuterra’s co-member (Iron Mound, LLC or “Iron Mound”) exercised its right to dissolve the LLC. One of Iron Mound’s owners filed a certificate of cancellation for the LLC and conducted the winding up. At the time of dissolution, the only significant asset of the LLC was the interest in management fees generated from the surgical center with which Nuterra had contracted. The LLC’s operating agreement contained a provision addressing liquidation that provided that the members would continue to share in cash flow and profits and losses during the period of liquidation pursuant to the other provisions of the operating agreement. After dissolution of the LLC, Nuterra continued paying Iron Mound a percentage of the gross fee generated under Nuterra’s management agreement with the surgical center until the end of the first five-year term of the agreement. At that time, the surgical center exercised its right not to renew the management agreement but invited Nuterra to negotiate a new agreement. Nuterra and the surgical center entered into a second renegotiated management agreement. Nuterra did not pay Iron Mound any part of the fees from the second management agreement, and Iron Mound sued Nuterra to recover a percentage of the fees based on the provisions of the LLC operating agreement. The trial court concluded the operating agreement was unambiguous and granted summary judgment in favor of Nuterra. The court of appeals concluded that the operating agreement was ambiguous and that there were unresolved issues of fact. The supreme court, applying contract interpretation principles, concluded that the operating

agreement was unambiguous and that Iron Mound was not entitled to any of the fees from the second management agreement. The court stated that the operating agreement evidenced a clear intent that Iron Mound's right to a percentage of revenues was conditioned upon or derived from its membership in the LLC and the terms of the operating agreement. It was undisputed that when Nuterra entered into the second management agreement, the operating agreement had ceased to exist and there was no LLC to receive revenues and no members to whom such revenues could be allocated. It was further undisputed that the second management agreement was a new and separate contract rather than a renewal of the first management agreement. The parties conceded that the right to management fees received from the surgical center under the first management agreement was an asset of the LLC subject to liquidation or distribution in kind, but the court stated that this concession was not relevant to the second management agreement, which could not be an asset of the LLC that had ceased to exist at the time the contract was executed. A contrary conclusion would require a strained reading of the operating agreement and consideration of extrinsic matters. The supreme court stated that its conclusion made it unnecessary to consider the broader question of whether the dissolution of an LLC terminates its operating agreement absent express language to the contrary.

Ark-La-Tex Safety Showers, LLC v. Jorio, __ So.3d __, 2013 WL 6654373 (La. App. 2013).

After dissension developed between the 51% and 49% members of an LLC, the majority member filed suit against the minority member for declaratory relief alleging that the minority member had withdrawn and that the minority member's actions had breached his duties and the operating agreement. The minority member filed an answer and asserted various claims for relief himself. A "stipulated preliminary injunction" was issued under which the parties agreed that each of them would be enjoined from taking certain actions. A trial was held during which most of the evidence centered on the value of the LLC's assets. At the conclusion of the trial, the court reached a decision as to the value of the LLC's assets and the monetary interest of each member in the LLC. The court then scheduled an evidentiary hearing on issues limited to permanent injunctive relief, future participation in the LLC by the parties, dissolution of the LLC, attorney's fees, and assessment of costs. At this hearing, the parties conceded that they did not desire to continue to work together. The plaintiff opposed dissolution and continued to argue that the minority member had withdrawn, but the minority member asserted that he was still a 49% member. At the conclusion of the hearing, the trial court concluded that the plaintiff failed to prove the minority member had withdrawn. The trial court concluded both parties were "prevailing parties" under the provisions of the operating agreement and awarded each party attorney's fees as well as court costs from the assets of the LLC. On appeal, the plaintiff argued that counsel for both parties had stipulated that the minority member had withdrawn. The plaintiff argued that both sides operated under the assumption that the minority member had withdrawn and that the evidence thus centered around the value of the assets of the LLC. The court of appeals reviewed the record and found no express stipulation that the minority member had withdrawn as a member of the LLC. Further, the court of appeals agreed with the trial court that the evidence did not show any affirmative action on the minority member's part indicating an intent to withdraw from the LLC, nor did the record indicate that the minority member tacitly withdrew. The plaintiff also argued that neither party should have been considered a "prevailing party" and that the award of attorney's fees was erroneous. The court interpreted the operating agreement pursuant to principles of contract law and concluded that the minority member was a prevailing party, but the plaintiff was not. The operating agreement provided that the prevailing party in any litigation arising as a result of or by reason of the operating agreement shall be entitled

to reasonable attorney's fees. The plaintiff filed the initial petition seeking preliminary injunctive relief, damages, and a declaration that the minority member had withdrawn as a member of the LLC. The parties entered into stipulations with regard to the injunction, and the minority member was the prevailing party concerning damages and declaratory relief because the trial court did not award damages and found the minority member had not withdrawn. The minority member agreed to waive his claims with the exception of the valuation of assets and his interest in the LLC, and the court concluded that neither party was the "prevailing party" as to these claims. However, since the minority member prevailed with respect to the plaintiff's initial petition, the court affirmed the minority member's award of attorney's fees and reversed the award of attorney's fees to the plaintiff.

Barton v. Club Ventures Investments LLC, C.A. No. 8864-VCN, 2013 WL 6072249 (Del. Ch. Nov. 19, 2013).

The court resolved two threshold legal questions in this action by the plaintiff for a declaratory judgment that he was not subject to any non-competition agreement with the defendant LLC. The court concluded that (1) an amended and restated LLC agreement did not supersede a previously executed non-competition agreement between the plaintiff and the LLC, and (2) the LLC assumed and was reconstituted with the non-competition agreement under its Chapter 11 bankruptcy plan. In 2005, the plaintiff and the LLC entered into a non-competition agreement. In 2011, the LLC, the plaintiff, and several other parties entered into an amended and restated LLC agreement (the "LLC agreement"). The LLC executed the LLC agreement as the "Company," and the plaintiff and others executed the LLC agreement as "Members." The LLC agreement contained a provision purporting to restrict the activities of the plaintiff, but the LLC agreed after the initiation of this action that it would not enforce that provision. The LLC asserted, however, that the 2005 non-competition agreement was still effective, and the primary question before the court was whether the merger and integration clause of the LLC agreement superseded the earlier non-competition agreement. The last sentence of the integration clause stated: "All prior agreements among the Members are superseded by this Agreement, which integrates all promises, agreements, conditions, and understandings among the Members with respect to the Company and its property." The plaintiff argued that the integration clause unambiguously superseded the non-competition agreement. The court pointed out that the definition of a "Member" under the LLC agreement unambiguously included only those that executed the agreement as members. Further, the integration clause plainly superseded only prior agreements among members. The court held that the LLC did not sign the LLC agreement as a "Member," and the non-competition agreement, which was an agreement between a member (the plaintiff), and a non-member (the LLC), was not superseded. The court then analyzed whether the non-competition agreement was assumed and retained under the LLC's plan of reorganization when the LLC emerged from Chapter 11 bankruptcy. The non-competition agreement was not expressly identified in the plan as either an assumed or rejected executory contract, but the plan stated that the LLC assumed and was vested with all executory contracts that were not rejected. The plan also provided that the LLC assumed and was reconstituted with all non-executory contracts. Thus, without needing to resolve whether the non-competition agreement was an executory or non-executory contract, the court found that the LLC assumed and retained it under the plan.

AM General Holdings LLC v. The Renco Group, Inc., C.A. No. 7639-VCN, 2013 WL 5863010 (Del. Ch. Oct. 31, 2013).

In this direct and derivative action by the nonmanaging member of a Delaware LLC against the managing member and its affiliates, the court addressed a partial motion for summary judgment by the plaintiff and a motion by the defendants to dismiss numerous claims by the plaintiff. The plaintiff sought summary judgment on its claim that the managing member breached its obligations under the LLC agreement by transactions that violated a provision specifying “Prohibited Investments.” The defendants argued that the “Prohibited Investments” provision was not a strict prohibition in light of certain other language in the LLC agreement, but the court analyzed the provisions of the LLC agreement and concluded that the agreement unambiguously prohibited the managing member from acquiring or holding an interest in any entity in which The Renco Group, Inc. or any of its affiliates had an interest. The plaintiff argued that compliance certificates supplied by the defendants established that the defendants had violated the “Prohibited Investments” provision, but the court concluded that the plaintiff had not borne its summary judgment burden because the compliance certificates only characterized certain investments as “possible violations,” and thus were not an unqualified admission by the defendants, and the plaintiff submitted no additional evidence of a violation.

The court then addressed the defendants’ motion to dismiss numerous claims made by the plaintiff. The court dismissed the plaintiff’s claims that the defendants breached fiduciary duties of loyalty and care. The court point out that fiduciary claims that arise from facts underlying obligations addressed by a contract are foreclosed subject to a narrow exception. Under this exception, fiduciary duty claims can survive even though they share “a common nucleus of operative facts” with the underlying contract claims where the fiduciary duty claims depend on additional facts, are broader in scope, and involve different considerations in terms of a potential remedy. Because the plaintiff’s claims that the defendants breached their duties of loyalty and care arose out of obligations the defendants owed under the LLC agreement and a contribution agreement, and the plaintiff failed to allege distinct harms outside of the scope of those contractual agreements, the court dismissed the plaintiff’s breach of fiduciary duty claims as duplicative of contractual claims against the managing member. Dismissal of the breach of fiduciary duty claims necessitated dismissal of the plaintiff’s related aiding and abetting claims as well. The court also dismissed the plaintiff’s tortious interference, unjust enrichment, conversion, and indemnification claims. The court did not dismiss the plaintiff’s claim that it was entitled to certain distributions. Although the defendants suggested that the claim was moot due to the previous issuance of a preliminary injunction, the court pointed out that the preliminary injunction did not provide the plaintiff permanent relief.

Stewart v. BF Bolthouse Holdco, LLC, C.A. No. 8119-VCP, 2013 WL 5210220 (Del. Ch. Aug. 30, 2013).

Former employees of an LLC sued the LLC and its board of managers for breach of contract, breach of fiduciary duty, and breach of the implied covenant of good faith and fair dealing in connection with the LLC’s exercise of its right to repurchase the plaintiffs’ membership units in the LLC when the plaintiffs voluntarily terminated their employment. Based on the board’s valuation of the units at \$0.00, the LLC cancelled the plaintiffs’ units without paying any consideration. The plaintiffs claimed that the board of managers acted in bad faith in valuing the units at \$0.00 and that such action violated both the purchase agreement that governed the repurchase of the units (which required the board of managers to determine the value in good faith) and the LLC agreement (which

provided that the board owed to the LLC and its members the duties owed by corporate directors to the corporation and its shareholders). The relief sought by the plaintiffs included a declaratory judgment invalidating the repurchase and an order restoring their ownership of units in the LLC. The court denied in part and granted in part the defendants' motion to dismiss the breach of contract claims, and the court granted the motion to dismiss the claims for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing because the latter claims were duplicative of the breach of contract claims.

The court first addressed the plaintiffs' breach of contract claims and concluded that the plaintiffs' factual allegations were sufficient for the court to conclude that it was reasonably conceivable that the "Fair Market Value" of the units was greater than \$0.00 and that the board acted in bad faith in determining the value in breach of the purchase agreement. The purchase agreement provided that "Fair Market Value" of the units was to be "determined in good faith by the Board in its sole discretion after taking into account all factors determinative of value including, but not limited to, the lack of a readily available market to sell such units, but without regard to minority discounts." The court held that allegations of appraisals by a third party in 2008 for a contemplated acquisition and in 2012 for a completed acquisition bore little if any relationship to the Fair Market Value of the units in 2010 when they were repurchased because the third-party valuations were based on the terms of the LLC agreement rather than the Fair Market Value provision of the purchase agreement and were too long before or after the repurchase valuation date in 2010. The court nevertheless held that it was reasonably conceivable that the Fair Market Value of the units was greater than \$0.00 based on an e-mail from the president and CEO of the LLC valuing the units at \$200 per unit three weeks after the board determined the Fair Market Value was \$0.00. The court noted that the defendants did not argue that any material event occurred during those three weeks that affected the valuation. The court further held that the plaintiffs sufficiently pled that the defendants' valuation of \$0.00 was determined in bad faith based on allegations that the plaintiffs purchased units for \$25 per unit on several occasions between 2005 and 2008; there was no indication the LLC's financial condition was materially worse in 2010 than it was in 2005-2008; shortly before the plaintiffs quit their jobs, the CEO conveyed to LLC managers that the LLC had bright prospects; shortly before the plaintiffs quit their jobs, the CEO expressed his belief that the units were worth roughly \$200; plaintiffs quit their jobs; and shortly before the LLC would otherwise have had to deliver financial information to the plaintiffs, the plaintiffs were told without explanation that their units had a Fair Market Value of \$0.00 on the date of termination of their employment. Furthermore, the plaintiffs pled a plausible motivation on the part of the defendants to increase the majority owner's interest in the LLC or to exact retribution for the plaintiffs' unexpected departure from the LLC at a time when the plaintiffs were important to the future success of the LLC. The court noted that a claim of wrongful inducement, trickery, or deception is not necessary to establish bad faith under Delaware law. The court thus denied the defendants' motion to dismiss plaintiffs' breach of contract claim that the board determined the Fair Market Value of the Units in bad faith.

The court next addressed the plaintiffs' claim that the board's failure to determine the Fair Market Value in good faith constituted a breach of the LLC agreement. The court concluded that the purchase agreement and LLC agreement were related and intended to be read in tandem and that the fiduciary duty provision of the LLC agreement, which provided that the managers owed the same fiduciary duties as the directors of a corporation, applied to the board's valuation of the units. A director is liable for breach of the fiduciary duty of care under Delaware law when the director's actions are grossly negligent. The focus of a duty of care analysis is the process undertaken by

directors in making a decision. The plaintiffs made no allegations regarding the board's valuation process, and the court thus held that the plaintiffs failed to state a claim for breach of the contractual duty of care. The plaintiffs also failed to state a claim of breach of the duty of loyalty on the basis of an interested transaction because the plaintiffs did not allege that the defendants stood on both sides of the repurchase transaction, nor did they allege that the defendants were in a position to benefit from an unfairly low repurchase in a manner not shared equally by all owners of the LLC. However, the duty of loyalty in Delaware encompasses actions taken in bad faith in addition to interested transactions. Thus, the court held that the plaintiffs stated a claim for breach of the contractual duty of loyalty under the LLC agreement by acting in bad faith in determining the Fair Market Value of the units based on the allegations supporting the contractual bad faith claim under the purchase agreement.

The court dismissed the plaintiffs' claim that the defendants breached the LLC agreement by failing to deliver annual financial statements to the plaintiffs. The LLC agreement provided that "[w]ithin one hundred twenty (120) days after the end of each Fiscal Year of the Company, the Company shall deliver to each Member the Company's annual financial statements." A "Member" was defined as "each Initial Member and each other Person who is hereafter admitted as a Member in accordance with the terms of this Agreement and the Act, in each case so long as such Person is shown on the Company's books and records as the owner of one or more Units." There was no dispute that the plaintiffs were members on March 31, 2010, the LLC's fiscal year end, but the plaintiffs' units were repurchased on July 22, 2010, seven days before the 120-day period expired on July 29, 2010. The question was whether membership on the date of the fiscal year end entitled them to the year-end financial information required to be delivered to members under the LLC agreement. The court concluded that the LLC agreement plainly required delivery of the information to anyone who was a member on the date of delivery. Since the LLC agreement defined a "Member" as a person with a present ownership interest in the LLC, and there was no allegation that the LLC delivered financial information between March 31 and July 22, 2010, the court held that there were no alleged facts upon which the plaintiffs could conceivably prove a breach of the contract based on this provision of the LLC agreement.

The court also dismissed the plaintiffs' claim that the defendants breached the purchase agreement by "cancelling" the units rather than "repurchasing" them as provided in the purchase agreement. The court agreed with the LLC that it was immaterial whether the parties characterized their actions as a repurchase, cancellation, or both. Once the LLC elected to purchase the units, which it had a right to do under the purchase agreement, the court stated that the LLC was free to do with the units whatever it chose after tendering the required consideration. Here, the required consideration was \$0.00, and the LLC thus assumed complete control of the units upon informing the plaintiffs that it was exercising the purchase right. If the LLC breached the purchase agreement, it was because it failed to exercise good faith, not as a result of calling a repurchase a cancellation.

The court dismissed the plaintiffs' breach of fiduciary duty claim because it was duplicative of and foreclosed by the breach of contract claim. Under Delaware law, a fiduciary duty claim that depends on the same nucleus of operative facts as a breach of contract claim only survives where the fiduciary duty claim depends on additional facts, is broader in scope, and involves different considerations in terms of potential remedies, i.e., where the breach of fiduciary duty claim may be maintained independently of the breach of contract claim. The court rejected the plaintiffs' effort to distinguish their breach of fiduciary duty claim from their breach of contract claim on the basis that the board's conduct should be assessed under the entire fairness standard for purposes of the

breach of fiduciary duty claim. Because the plaintiffs did not allege that the defendants stood on both sides of the repurchase transaction or that the defendants were in a position to benefit from an unfairly low repurchase in a manner not shared equally by all owners of the LLC, the court held that the plaintiffs failed to articulate a basis to employ the entire fairness standard. The plaintiffs' claim that the defendants breached their fiduciary duties to plaintiffs when they declared that the units had no value and cancelled them arose from the dispute relating to the contractual repurchase right under the purchase agreement, thus making the case similar to *Nemec v. Schrader*, in which the Delaware Supreme Court affirmed the dismissal of a fiduciary duty claim arising from a corporation's exercise of its right to redeem shares of retired nonworking shareholders. The plaintiffs here argued that the facts fit the narrow exception to the general principle that a breach of contract and breach of fiduciary duty claim based on the same facts are duplicative, but the court concluded that the plaintiffs alleged essentially identical facts in support of both their breach of fiduciary duty claim and their claim for breach of the purchase agreement and LLC agreement. Similarly, the breach of fiduciary duty claim was no broader in scope than the breach of contract claim. Finally, the breach of fiduciary duty claim did not implicate potentially different remedies because the requested relief (a declaration that the repurchase of the plaintiffs' units was invalid and that they still owned their units) was available to the plaintiffs with respect to their breach of contract claim.

Finally, the court dismissed the plaintiffs' claim that the defendants violated the implied covenant of good faith and fair dealing by failing to act in good faith when valuing the units. The plaintiffs did not allege a specific implied contractual obligation that was breached, but instead focused on the express contractual requirement in the purchase agreement that the board value the units in good faith. Thus, the court concluded that the claim was duplicative of the breach of contract claim. The court explained that its conclusion was consistent with the Delaware Supreme Court's decision in *Gerber v. Enterprise Products Holdings, LLC* because the limited partnership agreement in that case arguably had a contractual "gap" in that the duty of a party seeking the benefits of the "safe harbor" or "conclusive presumption" provided by the agreement was not specified. The court stated that the purchase agreement in this case did not have a "gap" for the implied covenant to fill. The plaintiffs' claim was based on a single clause of the purchase agreement that expressly required the LLC to act in good faith. The plaintiffs essentially contended that the LLC had an implied duty to act in good faith in complying with its contractual duty to act in good faith. The express requirement of good faith did not provide a basis for a valid claim for a breach of the implied covenant. Furthermore, there was no credible basis to reasonably infer the purchase agreement failed to reflect the parties' expectation at the time of bargaining. The parties obviously foresaw the potential issues with allowing the Fair Market Value of the units to be determined by the board in its sole discretion and addressed the issue by explicitly requiring good faith. The court went on to state that the more significant distinction between *Gerber* and this case related to the "discretionary rights" at issue. In *Gerber*, the "safe harbor" and "conclusive presumption" provisions were discretionary rights that the defendants could use to limit or avoid liability, but the contract did not specify any standard for evaluating the defendants' exercise of the rights. In the absence of a contractual standard, the supreme court determined that the defendants were required to use their discretion in conformity with the implied covenant. By contrast, in the purchase agreement in this case, the parties agreed to a good faith standard to evaluate the reasonableness of the defendants' exercise of discretion. Thus, in this case, the parties's express agreement superseded the implied covenant and precluded its application. The court acknowledged that *Gerber* held that a showing of compliance with a contractual duty of good faith does not automatically extinguish all

implied covenant claims, but it does not relieve a plaintiff from the burden of pleading a cognizable claim, and the plaintiffs here did not sufficiently allege a claim because they did not show how the express terms of the purchase agreement failed to account for their legitimate expectations at the time they entered into the contract.

Magruder v. Pauley, 411 S.W.3d 323 (Mo. App. 2013).

Magruder, one of four equal members of an LLC realty agency, withdrew from the LLC. The remaining members refused to comply with the operating agreement, which required the LLC to obtain an appraisal of the business and pay the withdrawing member one-fourth of the appraised value. Magruder sued for specific performance, breach of contract, and prima facie tort. The court bifurcated the equitable claims from the remaining claims and found for Magruder after a bench trial on her claim for specific performance and the remaining members' counterclaim for declaratory judgment. A partial judgment for specific performance ordered the remaining members to commission and pay for an appraisal and to purchase Magruder's interest for one-fourth the appraised value. The parties agreed to a dismissal of Magruder's breach of contract claim because it was filed as an alternative to the specific performance claim, but the remaining claims were tried in the jury trial, which resulted in a judgment in favor of Magruder for compensatory and punitive damages. Over a period of five years, after the bench trial, jury trial, and at least 11 post-trial hearings, the specific performance ordered by the court still was not completed. During that time, an appraisal was eventually performed, but the appraiser failed to include the LLC's real estate and made certain other errors. Magruder supplied the court the missing information, and Magruder asked the court to exercise its equitable powers to include a final valuation in its final order because it had all the necessary information to do so. Magruder also moved to hold the remaining members in contempt and requested attorney's fees based on the operating agreement. The trial court denied the contempt motion, and the trial court's final order merely affirmed the jury verdict and attached the earlier partial judgment without reference to the disputed appraisal or attorney's fees. On appeal, Magruder argued that the trial court erred in failing to include a valuation, failing to hold the defendants in contempt, and not awarding Magruder attorney's fees. The court of appeals agreed with Magruder regarding the trial court's failure to render a valuation and award attorney's fees but held the trial court did not abuse its discretion on the contempt issue. With regard to the trial court's failure to include a valuation in the final order, the court of appeals held that the trial court should have acted in equity to do so for three reasons. First, there was sufficient evidence in the record for the court to determine the valuation. Second, specific performance constitutes a remedy for breach of contract. Although the remaining members argued that Magruder could not now ask for a remedy that required a finding of breach of contract, the court's order for specific performance implicitly found a breach of contract. Third, the trial court sitting in equity had the authority to do what was necessary to afford complete relief. With regard to the Magruder's contempt motion, the court of appeals recognized that the remaining members' conduct was egregious but concluded that the trial court's decision did not constitute a clear abuse of discretion given the subjective analysis of the parties' actions involved in the trial court's exercise of discretion. Finally, the court agreed with Magruder that she was entitled to attorney's fees based on the language of the operating agreement, which provided for recovery of reasonable attorney's fees by the LLC or any party who obtained a judgment against any other party "by reason of breach of the Agreement." The remaining members argued that the agreement only provided for attorney's fees in the case of a "breach of contract." Because Magruder prevailed on her specific performance claim, the court of appeals held she was

entitled to recover reasonable attorney's fees under the operating agreement. The court of appeals also noted that the trial court could have awarded fees on the basis of non-compliance with the court's order for specific performance.

Kaufman Development Partners, L.P. v. Eichenblatt, 749 S.E.2d 374 (Ga. App. 2013).

The court addressed the standing of a former member of an LLC who retained an economic interest in the LLC after his removal to sue for breach of the operating agreement and concluded the former member had standing to do so. Kaufman Development, L.P. ("Kaufman Development") and David Eichenblatt formed a real estate LLC and entered into an operating agreement identifying them as the members and addressing various governance, economic, and operational matters. A few years later, Eichenblatt and Kaufman Development agreed to part ways except for their agreement to continued joint ownership of certain entities. The two parties agreed to amend the operating agreement to remove Eichenblatt as a member in accordance with a particular provision of the operating agreement under which Eichenblatt would continue to receive allocations and distributions to which he would otherwise be entitled but would not have the other powers, rights, or privileges of a member. Accordingly, they amended the operating agreement to add a provision that specified the effective date of Eichenblatt's removal as a member, his right to receive allocations and distributions to which he would otherwise be entitled, and that he would have no other powers, rights, or privileges of a member, including authority to bind the LLC as a member or vote on any matter requiring member approval pursuant to the operating agreement or the Georgia LLC statute, except that Eichenblatt's consent was required to approve any amendment that would reduce the amount that would be paid or distributed to him. The amendment also addressed his access to LLC records and entitlement to receive certain fees, and a new provision addressing management of the LLC and transactions with affiliates was added. The amendment stated that it was binding upon and inured to the benefit of the parties and provided that except as expressly modified the operating agreement remained in full force and effect. Eichenblatt sued Kaufman Development for breach of the operating agreement, claiming that Kaufman Development failed to comply with certain provisions governing the management and dissolution resulting in diminished allocations and distributions to Eichenblatt under the agreement. The jury found in favor of Eichenblatt and awarded \$625,000 in compensatory damages for breach of the operating agreement. The trial court entered judgment on the jury verdict.

On appeal, the court of appeals addressed Kaufman Development's argument that Eichenblatt had no standing to sue for breach of the operating agreement since he was no longer a member. The court pointed out that both the operating agreement and the amendment identified Eichenblatt as a party. By expressly removing Eichenblatt as a member, the court said that the amendment modified the operating agreement to exclude him from the term "member" as used in the operating agreement but did not affect his identity as a party to the agreement. The court disagreed with Kaufman Development's argument that Eichenblatt could not sue for breach of any provision of the operating agreement other than those governing allocations and distributions. The amendment provided that the operating agreement remained in full force and effect except as altered by the amendment, and the provision that stated Eichenblatt had no rights as a member other than allocations and distributions merely prevented him from claiming other rights reserved to the members. Neither the amendment nor the operating agreement specified that standing to enforce their agreement was a "power, right or privilege" limited to the LLC's members. Further, the court stated that construing the agreement as argued by Kaufman Development would be inconsistent with the addition of a new

provision to the operating agreement addressing management and the provision of the amendment stating that the amendment was binding on and inured to the benefit of the parties. According to the court, these provisions made clear that Kaufman Development remained bound by and Eichenblatt continued to benefit from the terms other than those specifically related to allocations and distributions.

Ghosh v. Grover, 412 S.W.3d 749 (Tex. App. 2013).

Ghosh and Grover, through their respective entities of Cinemawalla, Inc. (“Cinemawalla”) and 87 Minutes, LLC (“87 Minutes”), formed an LLC to produce a movie entitled *97 Minutes*. Ghosh and Grover orally agreed that Grover and 87 Minutes would contribute the rights to a screenplay and written commitments for the project along with \$600,000 in cash and \$400,000 of previous expenditures in exchange for 87 Minutes’ membership interest, and Ghosh and Cinemawalla, in exchange for its membership interest, would obtain the release of \$4 million that had been placed in escrow under a contract between Cinemawalla and a third party (“San Luis Cine”) for the production of another movie. Grover and 87 Minutes satisfied their obligations, and Ghosh repeatedly assured Grover that San Luis Cine had agreed to reallocate the escrowed funds to the production of *97 Minutes*, but San Luis Cine never released all the funds. After Ghosh offered various excuses and asserted that various actions needed to be taken before San Luis Cine would release the funds, Grover began to question Ghosh’s credibility and demanded that their agreement be reduced to writing. Ghosh refused to do so, and Grover and 87 Minutes sued Ghosh and Cinemawalla. The plaintiffs’ causes of action included breach of contract, conversion, and fraud, and the jury found in favor of the plaintiffs on each cause of action. On appeal, Ghosh and Cinemawalla argued, *inter alia*, that the statute of frauds barred the breach of contract claim, and the court of appeals addressed the enforceability of the oral agreement by the defendants to cause the \$4 million being held in escrow for production of another movie to be redirected to the LLC’s movie project. The Texas LLC statute provides that a promise to make a contribution or otherwise pay cash or transfer property to an LLC is not enforceable unless the promise is in writing and signed by the person making the promise. “Contribution” is broadly defined in the statute to include any tangible or intangible benefit that a person transfers to an entity for an ownership interest or otherwise in the capacity as an owner or member. The benefit includes cash, services rendered, a contract for services to be performed, a promissory note or other obligation to pay cash or transfer property, or securities or other interests in or obligations of an entity. The plaintiffs argued that the defendants’ did not promise to contribute anything directly to the LLC, but rather to obtain the release of the escrowed funds to Cinemawalla, who would then use the funds to pay vendors and others providing services needed to make the movie *97 Minutes*. The court stated that the statutory language is not limited to direct contributions. Here it was clear that the oral agreement to access the \$4 million in escrow and invest it to fund the production of the LLC’s movie project constituted a promise to make a contribution to the LLC and was unenforceable because it was not in writing and signed as required by the statute. The defendants made several arguments attacking the damages awarded on the fraud claim. With respect to the measure of recovery, the court of appeals held that the plaintiffs were not permitted to recover based on the benefit of their bargain with the defendants because the oral agreement was unenforceable as discussed above. Thus, the plaintiffs could not recover the lost profits they sought. The plaintiffs could, however, recover out-of-pocket damages incurred as a result of the defendants’ misrepresentations. The evidence regarding the expenses incurred by the plaintiffs’ did not support the amount of expenses found by the jury, but there was evidence that the

plaintiffs suffered some out-of-pocket damages, and the court thus remanded for a new trial on the fraud claim.

LJL 33rd Street Associates, LLC v. Pitcairn Properties Inc., 725 F.3d 184 (2d Cir. 2013).

The plaintiff and defendant were the sole equity owners of an LLC that owned a luxury high-rise apartment building. The detailed operating agreement of the LLC contained an arbitration clause of limited scope that related to a buyout provision that provided that the “Purchase Price” under the buyout provision was to be derived from the “Stated Value.” After the plaintiff exercised its purchase option, the parties were not able to agree on the price, and the plaintiff filed an arbitration demand asking for determination of both the Stated Value and Purchase Price. The arbitrator determined the Stated Value but refused to exercise jurisdiction to determine the Purchase Price. The court concluded that the arbitrator acted properly because the operating agreement expressly provided for arbitration to determine Stated Value but nowhere suggested that the Purchase Price be determined by arbitration. The court also addressed a claim by the defendant against the plaintiff for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing. The defendant argued the plaintiff’s failure to disclose its intent to exercise the buyout option upon the discharge of the defendant’s CEO (an event which triggered the right of the plaintiff to exercise the option under the agreement) was a breach of fiduciary duty and that exercise of the buyout option violated the implied covenant of good faith and fair dealing. The court rejected both claims. The purchase option upon defendant’s discharge of its CEO was the contractual right of the plaintiff, and the plaintiff did not ever make any false representations about the CEO or state that it would not exercise its purchase option if the CEO were terminated. The agreement contained a fair mechanism (arbitration) for resolving a dispute over the price of the buyout, and the plaintiff had no obligation to agree to the defendant’s plea to market the property in an illusory auction to third parties to help determine value. Thus, there was no breach of fiduciary duty. As for the implied covenant of good faith and fair dealing, the operating agreement conferred on the plaintiff the right to buy out the defendant if the defendant’s CEO ceased to be employed by the defendant. The implied covenant cannot create duties that negate explicit rights under the contract. The implied covenant bars a party from taking actions that so impair the value of the contract for another party that it may be assumed the parties did not intend the actions. The mere fact of the plaintiff’s exercise of its contractual buyout right, absent bad faith conduct, could not be deemed a breach of the duty to deal with the defendant in good faith.

Grove v. Brown, C.A. No. 6793-VCG, 2013 WL 4041495 (Del. Ch. Aug. 8, 2013).

In 2010, the Groves and the Browns started a successful home health care agency, Heartfelt Home Health, LLC (“Heartfelt”). After the first year, the relationship between the Groves and the Browns began to deteriorate when it was discovered that not all four members had made their requisite initial \$10,000 capital contributions. The Groves established their own home health agencies in Maryland and Delaware without telling the Browns, and the Browns attempted to remove the Groves by creating another LLC owned solely by the Browns and merging Heartfelt with that company. The Groves sued the Browns for breach of fiduciary duty, and the Browns counterclaimed for breach of fiduciary duty. The Browns also brought claims against family members and friends of the Groves for aiding and abetting the Groves’ breach of fiduciary duty. After trial, the court rendered this opinion. The first issue addressed by the court was the percentage of the parties’ ownership interests in Heartfelt. The Groves argued that the Browns only owned 50% of Heartfelt

and thus lacked the legal authority to merge Heartfelt, but the Browns argued that the failure of the Groves to make the required capital contributions resulted in the Browns owning a majority interest in the LLC. The court examined the provisions in the Heartfelt LLC agreement, which stated that the members shall contribute a total of \$40,000 to the LLC capital and set forth each individual member's portion of this initial contribution as \$10,000 and 25%. The agreement also provided that profits and losses should be divided among the members "in proportion to each Member [sic] relative capital interest in the company." Thus, the court concluded that the agreement unambiguously provided that each member was required to contribute \$10,000 and that each member had a 25% ownership interest. The court further stated its conclusion would not change if it considered extrinsic evidence because there were membership certificates reflecting 25% ownership by each of the four members. The Browns disputed the validity of the membership certificates because they were undated and lacked the LLC seal, but the court considered the certificates to be overt statements demonstrating the understanding of the members of Heartfelt as opposed to contracts. Other extrinsic evidence consisted of representations by the members to a prospective lender that each was a 25% owner and the way members were treated before they had made their required capital contributions. The court noted that the LLC agreement could have been written to make each member's interest contingent on the amount of their capital contribution, but the agreement did not do so. It merely required a contribution of \$10,000 from each 25% owner. The Heartfelt LLC agreement did not address mergers, and the Delaware Limited Liability Company Act requires a merger to be approved by members who own more than 50% of the then current percentage in the profits of the LLC unless otherwise provided by the LLC agreement. Because the Browns owned only 50% of the LLC, the court held that the purported merger was a legal nullity.

Kohannim v. Katoli, __ S.W.3d __, 2013 WL 3943078 (Tex. App. 2013).

In 1996, Jacob Kohannim ("Jacob") and Mike Khosravikatoli ("Mike") formed an LLC to purchase and hold real property on which a corporation owned by them operated a restaurant. Jacob and Mike were the managers and each owned a 50% interest in the LLC. The member agreement contained transfer restrictions that provided the LLC and the other member the opportunity to purchase a member's interest in the event of a proposed sale of the interest or a transfer to a member's spouse in a divorce. In 2003, Mike's wife, Parvenah, filed for divorce, and the divorce court issued temporary orders prohibiting Mike and Parvenah from transferring assets. During the pendency of the divorce, Mike purported to transfer a 5% interest in the LLC to Jacob. In 2005, the divorce decree was entered. In the divorce decree, the district court found the transfer was void because it was an attempt to transfer community property in violation of the court's order enjoining such a transfer. The divorce decree further awarded to Parvenah "[o]ne hundred percent (100%) of the husband's interest" in the LLC, "which interest is equivalent to a fifty percent (50%) interest in such company." The decree required the husband to execute and deliver to the wife's attorney a stock transfer certificate and/or assignment of interest. After the divorce decree was entered, Jacob advised Parvenah that he intended to start the process of determining the value of the LLC for purposes of the buyout provision in the member agreement. In 2006, Parvenah sued Jacob and the LLC, seeking a declaration of her rights with respect to the LLC and the validity of the member agreement and asserting other claims based on constructive fraud, breach of fiduciary duty, oppression, waste, gross mismanagement and abuse of control, and unjust enrichment. The trial court appointed a receiver for the LLC and ordered the receiver to sell the LLC's assets. The trial court eventually approved a sale of the LLC's property for \$1,300,100. The trial court's final judgment

contained findings as to the amount of assets held by the receiver and how the assets should be divided based on the court's finding that Jacob and Parvenah each held a 50% beneficial interest in the assets. The trial court also found that Jacob, with malice and intent to defraud, engaged in wrongful acts and omissions that damaged Parvenah by decreasing the value of Parvenah's interest in the LLC, and the trial court awarded Parvenah actual and punitive damages based on the wrongful acts and omissions. Jacob appealed on numerous issues but did not challenge the trial court's division of the LLC's assets.

The court of appeals rejected Jacob's challenge to the legal sufficiency of the evidence to support Parvenah's oppression claim. Jacob contended that there was no evidence that he oppressed Parvenah's rights by failing to make distributions to her. The LLC's regulations (i.e., operating agreement) provided for quarterly distributions to members of "available cash" provided available cash was not needed for reasonable working capital reserves. The Texas LLC statute provides that an assignee is entitled to receive any distribution the assignor is entitled to receive to the extent the distribution is assigned. Because the district court awarded the entire community interest to Parvenah, she had a right to receive distributions. The district court found that Jacob paid himself for services that were not performed and that he failed to make any distributions to Mike or Parvenah even though \$250,000 in undistributed profits had accumulated since the mortgage on the LLC's property was paid off. The court of appeals concluded this was some evidence supporting the trial court's finding that Jacob failed to make profit distributions. The court also agreed that the established facts demonstrated that Jacob engaged in wrongful conduct and exhibited a lack of fair dealing to the prejudice of Parvenah.

The court addressed a challenge by Jacob to the legal sufficiency of the evidence to support the actual and punitive damages award. Because the court of appeals sustained Jacob's challenges to Parvenah's other causes of action, the only viable cause of action to support a damage award was the shareholder/member oppression claim. The court of appeals stated that the standard of review on this issue was not the traditional sufficiency analysis as asserted by Jacob, but rather was abuse of discretion because the receivership provision of the Texas Business Organizations Code that provides for an oppression action authorizes a court to fashion an equitable remedy if the acts of those in control of an entity are oppressive. The court of appeals concluded that the trial court's methodology for finding actual damages was not an abuse of discretion. The trial court calculated Parvenah's damages by calculating the difference between the value of the LLC's assets at the time of the trial court's judgment in this case and the value of the LLC at the time of the divorce. The court of appeals rejected the argument that the member agreement required the LLC to be valued as of the date of the divorce petition. The court of appeals stated that the trial court found that the member agreement did not apply to Parvenah. Assuming it applied to Parvenah, the court of appeals stated that it was inapplicable here because Jacob did not comply with the provision addressing a buyout on divorce by intervening in the divorce proceeding to enforce the provision. Mike had agreed to the intervention, but Jacob did not do so. Jacob next argued that the LLC regulations provided that the valuation of Parvenah's interest must be based on book value because the regulations contained a provision for purchase of a member's interest at book value or appraised value on request of a party who deems the book value to vary from market value by more than 20%. The provision of the regulations relied upon by Jacob addressed death, dissolution, retirement, or bankruptcy of a member. The court stated that the provision did not address how damages are calculated in a lawsuit based on oppression, and the court relied on other case law in which the court in an oppression action concluded that it was not an abuse of discretion to order a buyout for fair

value when a buy-sell agreement provided for redemption at book value. The court of appeals pointed out that receivership is one remedy for shareholder/member oppression and that the trial court ordered a receivership and authorized a sale of the LLC's assets. Jacob did not complain concerning the receivership or sale. However, the court concluded that Parvenah was not limited to a recovery of her proportionate share of the sale proceeds and that courts have equitable powers to fashion appropriate remedies for oppressive conduct, including a buyout. Here, the court concluded that sufficient evidence supported the values found by the trial court and that Jacob did not argue, and the court of appeals did not perceive, that the trial court's methodology constituted an abuse of discretion. The court of appeals sustained Jacob's challenge to punitive damages because the only causes of action that could support a punitive damages award were actual fraud and breach of fiduciary duty, and Jacob's challenges to these claims were sustained by the court of appeals.

Finally, the court concluded that Jacob's challenges to the trial court's declarations that the member agreement was void or inapplicable to Parvenah did not impact the judgment given that: Jacob did not challenge the declaration that Parvenah owned a 50% interest or the 50/50 allocation of the LLC's assets; the court of appeals sustained Jacob's contentions that an award of damages could not be based on Parvenah's breach of fiduciary duty, constructive fraud, and unjust enrichment claims; and attorney's fees under the Declaratory Judgment Act were supported by the unchallenged declarations of the trial court.

Grosvenor Orlando Associates v. HCP Grosvenor Orlando LLC, C.A. No. 7246-VCG, 2013 WL 3215704 (Del. Ch. June 26, 2013).

An LLC's agreement provided that the operating member "approved" of a payment of a monthly management fee of a specified amount to an affiliate of the other member. In another section, the LLC agreement provided that the operating member could amend property management, asset management, or other similar agreements without the consent of the other member "except ... with respect to the payment of the asset management fee to" the other member's affiliate. The plaintiffs argued that these provisions required payment of the specified asset management fee. The defendants argued that the provision approving of the asset management fee did not obligate the LLC to pay the fee and that the provision was merely a standard related-party-transaction provision under which the parties provided a prospective waiver of a potential conflict of interest if an asset management fee were agreed to in the future. The defendants argued that the provision approving the management fee was one of a series of waivers of conflicts of interests that must be read in context together. The court concluded that the provisions created an ambiguity and denied the parties' cross-motions for judgment on the pleadings.

Davies v. Jerry, 966 N.Y.S.2d 797 (App. Div. 4 Dept. 2013).

Rosenberg and Jerry entered into an LLC operating agreement in 2002. The LLC was formed for the purpose of acquiring underdeveloped real property and developing a commercial subdivision for the construction and operation of hotels. Rosenberg died in 2010, and the co-executors of his estate filed a suit for breach of contract, an accounting, and dissolution against Jerry and the LLC. The defendants asserted counterclaims, sought a declaration of the rights of the parties, and moved for summary judgment. The trial court granted the defendants' motions and denied the plaintiffs' cross motion. The appellate court found that the trial court properly determined the defendants were entitled to summary judgment but failed to declare the rights of the parties. The court modified the judgment by making the requisite declarations. First, the court addressed the plaintiffs' claim that

the decedent's estate was not required to give written notice of its intent to transfer the decedent's membership interest in the LLC. The court disagreed based on its interpretation of the operating agreement. The operating agreement clearly and unambiguously provided that if a member died, that member shall be deemed to have offered his or her membership interest to the other members for sale and shall give written notice to the other members of his, her, or its intention to transfer such membership interest. Thus, the plain language of the agreement provided for the decedent's estate to give written notice of its intent to sell. The court also found that the trial court properly interpreted the operating agreement in determining that the date of valuation of the decedent's interest was the date of his death. The operating agreement further provided that the purchase price of a membership interest shall be determined based on a fair market appraisal of the real property owned by the LLC and that the value of the LLC included goodwill. The plaintiffs contended that they would be entitled to essentially nothing under the provision because the LLC owned only a small vacant parcel of land since the LLC had transferred the real property it had owned in exchange for an interest in two entities that developed hotels on that property. However, the court pointed out that the defendants had admitted at oral argument that the value of the LLC included the appraised value of the hotels that currently existed on the real property in which the LLC had an interest. Therefore, the court modified the judgment to adjudge and declare that: the decedent was deemed to have offered his membership interest in the LLC to the defendants at his death; the estate of the decedent must give written notice of its intent to sell; and the purchase price of the membership interest was to be based on the appraised valuation of the commercial real property of the LLC as of the date of the decedent's death.

Treeline 990 Stewart Partners, LLC v. RAIT Atria, LLC, 967 N.Y.S.2d 119 (App. Div. 2d Dept. 2013).

Two entities executed an operating agreement governing an LLC formed for the purpose of purchasing and operating an office building. One party was designated the "common capital member" and "managing member," and the other was designated the "preferred capital member." The operating agreement contained a provision specifying that any modification of the operating agreement must be in writing. After economic conditions worsened and the building began losing tenants, the members began discussing potential transactions to restructure the LLC or sell the preferred member's interest to the managing member. After months of negotiations, the parties orally agreed that the managing member would purchase the preferred member's interest at a discounted price. The agreement was never reduced to writing, and the preferred member ultimately refused to go through with the alleged buyout agreement. The managing member sued the preferred member for breach of contract, fraud, and negligent misrepresentation. The preferred member argued that enforcement of the alleged oral buyout agreement was barred by the provision of the operating agreement requiring amendments to be in writing. The court held that the oral buyout agreement did not modify the terms of the conditions of the operating agreement, but was a separate additional agreement addressing a situation not covered by the operating agreement. The complaint alleged that the parties orally agreed on all of the material terms of the sale of the preferred member's interest and thus stated a cause of action for breach of contract. The court held that the fraud claim was properly dismissed because a fraud action does not lie where the only alleged fraud relates to an alleged breach of contract. Further, the court stated that a general allegation that a party entered into a contract with no intention to perform is insufficient to state a cause of action to recover damages for fraud. The negligent misrepresentation claim was also properly dismissed because the managing

member failed to allege any misrepresentation that was collateral or extraneous to the alleged contract.

Senior Housing Capital, LLC v. SHP Senior Housing Fund, LLC, C.A. No. 4586-CS, 2013 WL 1955012 (Del. Ch. May 13, 2013).

The plaintiffs in this case were investors in a Delaware LLC fund formed to invest in retirement homes. Two of the plaintiffs, the former manager of the LLC and the manager's affiliate, held a 5% ownership interest in the LLC, and the main defendant, the California Public Employee's Retirement System ("CalPERS"), held the remaining 95% ownership interest in the LLC. The manager and its affiliate claimed that the LLC agreement required CalPERS to pay it an incentive distribution, the value of their 5% membership interest upon their withdrawal as members of the LLC, and asset management fees. CalPERS challenged appraisals valuing the assets of the LLC that were used to calculate the payments. In essence, CalPERS sought a judicial determination of the value of the LLC's assets.

The court first addressed the threshold issue of what judicial standard of review to apply when a party disputes a value determined under a contractually specified appraisal process. The provisions of the LLC agreement governing the appraisal process were based on form contracts prepared by CalPERS, and the provisions gave CalPERS unilateral authority over the process, including the selection of the appraisers. The manager argued that the appraisal process was governed by the LLC agreement and that the court had no ability at all to review the appraisals. CalPERS argued that the court must independently review the appraisals and reach a *de novo* determination as to the matters assigned to the appraisers under the contract. Because Delaware respects freedom of contract, the court held that a court may not second-guess appraised values that have been determined by appraisers selected according to the terms of a contractual appraisal process unless the process has been tainted by a breach of the implied covenant of good faith and fair dealing, such as concerted bad faith action between the appraiser and the other party. Parties may agree in their LLC agreement to whatever level of judicial review they desire, but the parties here did not provide for any judicial review. CalPERS claimed that the manager breach the implied covenant of good faith and fair dealing in connection with the appraisal process by misleading an appraiser with bullish projections of the future performance of the LLC's investments, but the court concluded that the evidence showed that the appraiser made its own independent projections, and there was thus no breach of the implied covenant. Because the standard of judicial review was a relatively unique issue as to which the Delaware Supreme Court might differ, the chancery court went on, in the interest of judicial economy, to analyze CalPERS' arguments attacking the appraisers' valuation. The court concluded that, assuming it had the power to review the appraisals *de novo*, the court would reject CalPERS' attacks on the appraisals and would find that the substantive merits of the appraisals passed muster.

The next issue addressed by the court was a dispute between the parties regarding the calculation of cash "distributions" to CalPERS, which affected the incentive distribution payment owed to the manager. CalPERS argued that the calculation of "distributions" was incorrect because the manager included distributions in its calculation but had failed to transfer cash to CalPERS in accordance with the LLC agreement. A "distribution" was defined in the LLC agreement as any cash payment to a member. The LLC agreement provided that cash would be swept into a bank account daily, that the manager would instruct the bank to remit to CalPERS its portion of cash on a monthly basis, and that the funds in the cash management system remained property of the LLC. However,

the same section of the LLC agreement also provided that the manager was to manage cash in accordance with cash management policies established by CalPERS, and these policies defined distributions as “deposits made by the partners into the collection account for ordinary income.” The court found that this created an ambiguity in how distributions were to be made. Based on the parties’ course of performance, the court concluded that the parties understood that distributions could be made to CalPERS through the cash management system.

The court next addressed the claim of the manager and its affiliate for payment for their membership interests. The LLC agreement required CalPERS to purchase the membership interests when the manager withdrew from the LLC, and the LLC agreement required CalPERS to have the assets of the LLC appraised 120 days after the manager’s notice of intent to resign. CalPERS used one of its approved appraisers to do an appraisal and persuaded the appraiser to make certain adjustments to its original calculation before the report was issued and sent to the manager. When the manager objected to the appraisal, CalPERS triggered the LLC agreement’s appraisal arbitration process and ordered new appraisals from another appraiser, again pressuring the appraiser to deliver very low values. When the second appraisal was more than 5% lower than the first, CalPERS ordered a third set of appraisals from another appraiser, whom it also pressured to deliver a low value. Both sides agreed that the appraisal arbitration process was not used correctly, and at trial CalPERS abandoned its attempt to rely on the contractual appraisal process and argued under a new theory that the LLC had no equity and that nothing was owed for the membership interests. CalPERS later argued yet another theory for valuing the membership interests, but the court stated that the appraisers’ determinations could only be modified if there had been a breach of the implied covenant of good faith and fair dealing. The court focused on the original appraisal by the first appraiser and concluded that the pressure that CalPERS applied on the appraiser to make adjustments was a violation of the implied covenant of good faith and fair dealing. Thus, the court reinstated the original appraisal as it was calculated before the adjustments resulting from CalPERS’ improper pressure. The parties also disagreed on the date on which the payment for the membership interests would be calculated. The LLC agreement provided that upon a withdrawal, the “date of valuation for determining the purchase price of” the membership interests would be 120 days after the date of the manager’s notice of intent to withdraw. CalPERS argued that this provision referred only to the appraisal, which was only a part of the total calculation. (The appraisal determined the value of facilities invested in by the LLC but did not include the LLC’s financial assets.) The court found that the term “valuation” was used broadly to cover all kinds of assets; if the parties intended to refer only to the appraisal, they could have used the word “appraisal” as they did in other portions of the LLC agreement.

With regard to asset management fees, CalPERS claimed that the manager erroneously included leasehold interests in its calculation of these fees. The management fees were a percentage of the fair market value of the facilities in which the LLC invested. The LLC agreement was silent on whether leasehold interests should be included, and the court thus looked to extrinsic evidence to determine the parties’ intent in this regard. The court stated that the best extrinsic evidence was what the parties actually did. For five years, CalPERS paid the manager asset management fees based on fair market value that included the leasehold interest, and a representative of CalPERS specifically approved of the calculation of the fees. Thus, the court refused to deviate from the established course of dealing of the parties.

With regard to severance compensation that was due to the manager under the literal terms of management agreements with the manager, CalPERS argued that the management agreements

should be reformed based on the doctrines of mutual or unilateral mistake to provide that the manager was not due severance compensation where it chose to resign as the LLC manager. Although the court characterized CalPERS' argument as having "equitable force," the court rejected CalPERS' argument because CalPERS failed to meet its heavy burden of showing by clear and convincing evidence that the parties had a specific prior understanding that differed materially from the written agreement.

The court ruled against CalPERS on all of its counterclaims, including breach of fiduciary claims asserted by CalPERS against the manager. The court stated that the breach of fiduciary duty claims arose out of the same facts as alleged breach of contract claims against the manager. The court pointed out that the Delaware Supreme Court has held that a dispute will be treated as a breach of contract claim where it arises from obligations that are expressly addressed by contract, and any fiduciary claims arising out of the same facts that underlie the contract obligations are foreclosed as superfluous.

Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Estate Fund, 68 A.3d 665 (Del. 2013).

ASB Capital Management, LLC and pension funds advised by it (collectively, "ASB") entered into five joint ventures with The Scion Group, LLC ("Scion") for the ownership, operation, and development of student housing. The parties created a special purpose Delaware LLC for each project. ASB provided at least 99% of the capital and retained at least 99% of the equity of each joint venture, and Scion was the sponsor and invested no more than 1%. Scion was primarily compensated through an incentive payment known as a "promote." The LLC agreement for the parties' first venture contained a standard capital-event waterfall provision with a 20% promote provision. Then the parties discussed structuring their deals with lower fees but a higher promote, and the parties eventually agreed in an email exchange to the terms of a two-tier promote for future deals.

The first time the two-tier promote provision was placed in an LLC agreement between the parties, the first promote was placed after the first preferred return but before the return of capital, thus providing that ASB would begin to earn the promote before the parties received back their capital. The parties executed several more LLC agreements based on this form. When the mistake was discovered, ASB sought to reform all of the agreements to conform the two-tier promote provision to the terms set forth in the email. The chancery court reformed the agreements under the doctrine of unilateral mistake. The chancery court also awarded ASB attorneys' fees based on a fee-shifting provision in the LLC agreements.

The Delaware Supreme Court upheld the chancery court's reformation of the LLC agreements even though a senior individual at ASB failed to read the agreements. The court recognized that there was a lack of clarity in the case law and resolved the confusion by relying on the Restatement (Second) of Contracts, which provides that "[a] mistaken party's fault in failing to know or discover the facts before making the contract" does not bar a reformation claim "unless his fault amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing." The court overruled prior Delaware case law to the extent it was inconsistent with this standard but noted that the standard is limited to reformation claims and does not apply to avoidance or rescission cases. The failure to read the agreements did not bar ASB from seeking reformation of the agreements because the record supported the chancery court's finding that the senior individual at ASB read the first agreement and then relied on employees and advisors to alert him

of significant changes in subsequent agreements. The court said these actions were in good faith and in accordance with reasonable standards of fair dealing.

The court rejected Scion's argument that the chancery court erred in granting reformation based only on "knowing silence." The court recognized that the Delaware case law was contradictory as to whether reformation is available at all based on unilateral mistake or whether it is available, but only in "exceptional" cases. The record was clear that Scion did not engage in any fraud or trickery, but the court held that reformation based on a unilateral mistake is available where a party can show that it was mistaken and the other party knew of the mistake but remained silent. The court overruled prior cases to the extent they stated otherwise or imposed additional requirements.

The court also held that the court of chancery accurately stated Delaware law when the court held that ratification of a contract subject to reformation requires actual knowledge of the mistake and that imputed or constructive knowledge is not sufficient.

The court reversed the chancery court's fee award based on the fee-shifting provision in the LLC agreements and remanded for the chancery court to determine whether to exercise its equitable authority to award fees. The fee-shifting provision in the LLC agreements required the non-prevailing party to reimburse the prevailing party for reasonable costs and expenses incurred in an action to enforce the agreement. The court discussed the plain meaning of the words "incurred" and "reimburse" and concluded the terms of the provision did not extend to the situation at hand because DLA Piper agreed to represent ASB without charge. Because ASB did not "incur" liability for attorneys' fees and had no expense for which it needed to be "reimbursed," it was not entitled to fees under the fee-shifting provision. ASB argued in the alternative that it was entitled to fees under a Delaware statute providing for the chancery court to award costs. The court stated that the case law improperly conflates a chancery court's inherent equitable power to award fees with the authority provided in the statute. The court clarified that "costs" in the context of the Delaware statute is a term of art that does not include attorneys' fees, and the court overruled any prior inconsistent cases. However, the court recognized the chancery court's equitable power to shift attorneys' fees, and the court remanded the case for the chancery court to consider whether to do so.

Imbert v. LCM Interest Holding LLC, C.A. No. 7845-ML, 2013 WL 1934563 (Del. Ch. May 7, 2013).

Imbert sought advancement from two LLCs of fees and expenses he was incurring in his defense of a New York lawsuit filed against him by the LLCs after he was terminated from his position as manager of the LLCs. The LLC agreements required tax distributions to the members, and the LLCs alleged that Imbert had been inflating his tax liability so that he would receive disproportionately large distributions. In the New York lawsuit, the LLCs alleged that Imbert breached fiduciary duties owed as a manager and committed fraud when he approved and accepted the allegedly improper distributions, that Imbert was unjustly enriched by retaining the allegedly improper distributions, and that Imbert improperly charged personal expenses to a business expense account. The LLCs also sought in the New York action a declaratory judgment as to whether Imbert was still a member of the LLCs.

The LLC agreements provided that each LLC "shall indemnify" any person "made, or threatened to be made, a party to any action or proceeding by reason of the fact that he ... is or was a Manager, or an officer of the Company ..." and that the LLC must advance or promptly reimburse "[a]ll expenses reasonably incurred by an Indemnified Person in connection with a threatened or actual action or proceeding with respect to which such Person is or may be entitled to

indemnification” Because advancement and indemnification were mandatory under the LLC agreements, the burden was on the LLCs to prove that advancement was not required. The LLCs argued that Imbert was not entitled to advancement because the claims in the New York litigation involved wrongdoing by Imbert as a member and not as a manager. In focusing on whether the claims in the New York action arose “by reason of the fact” that Imbert was a manager of the LLCs, the court relied on Delaware case law stating that a proceeding is “by reason of the fact” that one is a corporate officer if there is a nexus or causal connection between any of the underlying proceedings and one’s official capacity. The nexus is established if the “corporate powers were used or necessary for the commission of the alleged misconduct,” which includes all actions brought against an officer or director “for wrongdoing that he committed in his official capacity” and all misconduct allegedly occurring “in the ordinary course of performing his day-to-day managerial duties.” The court found that the LLCs’ breach of fiduciary duty and fraud claims against Imbert related to acts in his capacity as a manager rather than as a member and that the nexus was thus sufficiently established as to those claims. The breach of fiduciary duty claim rested on Imbert’s capacity as a manager because the LLC agreement did not impose fiduciary duties on members, and Delaware law imposes no default fiduciary duties on non-managing, non-controlling members. As in the case of the breach of fiduciary duty claim, the fraud claim depended on Imbert’s role as a manager because the LLC agreement imposed no obligation on a member to make disclosures, and simply receiving distributions as a member without revealing that he had received tax refunds for the years at issue involved no deception. With respect to the LLCs’ unjust enrichment claim, however, the court concluded that Imbert was not entitled to advancement of fees. Retaining, as a member, the allegedly improper distribution, as alleged in the unjust enrichment claim, did not arise by “reason of the fact” that Imbert was a manager of the LLCs. The business expense claim had been dismissed from the New York case in anticipation of submission to mandatory arbitration, but the court addressed Imbert’s right to advancement in connection with this claim as well as the others. The court concluded that Imbert was entitled to advancement in connection with this dispute because it was rooted in the misuse of responsibility and trust given to Imbert as CEO of a subsidiary limited partnership of the LLCs, and the LLC agreements covered those who served at the request of the LLCs as an officer of any other enterprise. Further, the LLCs’ agreement that the claim should be withdrawn in favor of mandatory arbitration before FINRA confirmed that the claim related to Imbert’s role as CEO of the affiliate because a claim between the LLCs and a member of the LLCs would not be subject to mandatory arbitration before FINRA. The court concluded that Imbert was also entitled to advancement of fees in connection with the declaratory judgment sought by the LLCs in the New York action. The LLCs sought declaratory judgment that Imbert was not a member of the LLCs, which was a determination that depended on whether Imbert was properly removed as a manager because only a non-manager member could be expelled.

Finally, the court granted Imbert’s claim for advancement of fees incurred in a books and records request. The LLCs claimed this right belonged to Imbert by virtue of being a member because he invoked his statutory right as a member (as he was no longer a manager at the time he made his request) under the Delaware LLC statute. However, the court concluded that he exercised the right in order to defend claims asserted against him as a manager, and the court stated that certain offensive actions such as his books and records action can be a legitimate part of “defending” a suit.

The court granted Imbert an award of “fees on fees” to the extent the court granted Imbert’s contractual right to advancement.

Born to Build LLC v. 1141 Realty LLC, 963 N.Y.S.2d 29 (App. Div. 1st Dept. 2013).

Affidavits in which the affiants asserted that a former manager of an LLC told the affiants that the manager was actually an owner did not raise a fact issue as to the authenticity of the operating agreement where the operating agreement contradicted these assertions. Further, because this was a dissolution action and not an action for fraud, assertions that there were no documents in the manager's name because he used other people's names to conceal his holdings were insufficient to raise a fact question as to the authenticity of the operating agreement.

Li v. Standard Fiber, LLC, C.A. No. 8191-VCN, 2013 WL 1286202 (Del. Ch. March 28, 2013).

Li sought advancement of legal fees pursuant to an indemnification agreement between Li and an LLC after the LLC's controlling owners initiated an arbitration proceeding against Li for breach of fiduciary duties to the LLC. When the LLC failed to satisfy Li's demand for advancement, he brought this action to enforce his advancement rights, and the LLC sought to dismiss or stay the action in favor of arbitration. The indemnification agreement did not contain an arbitration provision but contained an integration clause and provided that the question of Li's right to indemnification "shall be for an arbitrator or court to decide" if the LLC contested Li's right. Several other agreements to which Li and the LLC were parties contained mandatory arbitration clauses and integration clauses. Li was the founder of the LLC's predecessor and became a 25% owner of the LLC when the predecessor's assets were sold to the LLC under an asset purchase agreement that contained a broad arbitration clause and an integration clause. The LLC agreement also contained an arbitration clause and an integration clause, as did Li's employment agreement with the LLC. The court applied the standard established in *Willie Gary LLC v. James & Jackson LLC*, under which the question of arbitrability is presumed to be a question for the court rather than arbitrators unless there is "clear and unmistakable" evidence that the parties agreed to arbitrate. *Willie Gary* held that such evidence is present if the arbitration clause either generally provides for arbitration of all disputes or incorporates a set of arbitration rules that empowers arbitrators to decide arbitrability. The *Willie Gary* "clear and unmistakable" test has been modified by subsequent case law in one respect. Even if the *Willie Gary* test is met, a court must still "make a preliminary evaluation of whether the party seeking to avoid arbitration of arbitrability has made a clear showing that its adversary has made essentially no non-frivolous argument about substantive arbitrability." The court here concluded, and Li did not dispute, that the asset purchase agreement, LLC agreement, and employment agreement satisfied the two prongs of the *Willie Gary* test because the broad arbitration clauses in those agreements generally provided for arbitration of all disputes and referenced the rules of Judicial Arbitration and Mediation Services. However, Li argued that the *Willie Gary* test should only apply to the indemnification agreement because it was executed after the other agreements and contained an integration clause showing that the parties intended the agreement to be the entire agreement with respect to its subject matter. The court acknowledged that the integration clause was some evidence that the indemnification agreement was completely independent of the other agreements and might lead to the conclusion that the arbitration provisions in the prior agreements were nullified with respect to the matter of advancement and indemnification. However, in the context of the limited inquiry permitted under *Willie Gary* and its progeny, Li's integration argument fell short because the integration clause did not conclusively establish that the valid arbitration clauses in the prior agreements were terminated. Some cases have held that a standard integration clause in a later agreement with no arbitration clause does not overcome an earlier agreement with

an arbitration clause. Li also relied on the provision of the indemnification agreement granting the parties the right to litigate in Delaware courts under certain circumstances. The court stated that by focusing solely on the indemnification agreement, Li was subtly asserting that the claims asserted in his complaint did not relate to the prior agreements. However, who decides the question of substantive arbitrability turned on whether Li could clearly show that the LLC had made no non-frivolous argument that the dispute relates to the asset purchase agreement, LLC agreement, or employment agreement. Although Li's claims were based solely on the indemnification agreement, he arguably could not have brought them absent the other prior agreements that made him a member and officer of the LLC. The LLC's advancement and indemnification obligations arguably would not have arisen absent the parties' execution of the prior agreements, and the indemnification agreement could even be viewed as supplementing various provisions of the LLC and employment agreements. Further, Li's claims for indemnification at least colorably related to the LLC agreement in that he sought adjudication of substantive rights that were also provided in the LLC agreement. Although these arguments might not be very persuasive, they met the low threshold the court was required to apply, and the court could not conclude that the LLC had no non-frivolous arguments in favor of arbitrability. Thus, the court granted the LLC's request to stay the action pending an arbitrator's determination of arbitrability.

Wiggs v. Summit Midstream Partners, LLC, C.A. No. 7801-VCN, 2013 WL 1286180 (Del. Ch. March 28, 2013).

The plaintiffs, former employees of the defendant LLCs and Class B members of defendant DFW Midstream Management, LLC ("Management"), asserted various claims against Management, DFW Midstream Services LLC ("Services"), Summit Midstream Partners, LLC ("Summit"), and Summit Midstream Holdings, LLC ("Summit Holdings"). The members of Services were Management, Summit, and Texas Competitive Electric Holdings Company, LLC ("TCEH") until 2010, when Summit purchased all of TCEH's membership interest in Services. In 2011, the defendants entered into a Second Amended and Restated Limited Liability Company Agreement of Services (the "2011 Amendment"), and Summit transferred its membership in Services to Summit Holdings. Summit was the sole manager of Management. The plaintiffs asserted that the changes effected by the 2011 Amendment were invalid without their consent. The plaintiffs brought several claims in connection with the 2011 Amendment. The court dismissed each of the plaintiffs' claims.

The plaintiffs sought a declaratory judgment that the 2011 Amendment was invalid and a breach of the Services LLC agreement in effect before the amendment (the "2009 Services LLC Agreement"). The plaintiffs argued that the defendants breached the 2009 Services LLC Agreement by amending the agreement in a way that materially affected the plaintiffs' interests without their consent. The 2009 Services LLC Agreement provided that no amendment, modification, or supplement to the agreement could adversely affect the interest of a member without that member's consent, but the plaintiffs were never members of Services. Thus, the court held that the plaintiffs did not plead a reasonably conceivable claim of breach of contract.

The court determined that the plaintiffs failed to adequately allege that various actions taken by the defendants violated the 2009 Services LLC Agreement or the 2011 Amendment, but the plaintiffs argued that even if the defendants' actions were technically permissible under those agreements, the defendants violated the implied covenant of good faith and fair dealing by repeatedly acting in bad faith to keep the plaintiffs from receiving the fruit of their bargain under the 2009 Services LLC Agreement, the Management LLC agreement, and award agreements entered into

between the plaintiffs and Services and Management. The defendants conceded that elimination of language regarding the duty of good faith and fair dealing from the 2009 Services LLC Agreement had no legal effect because Delaware law prohibits LLCs from eliminating this duty, but the defendants argued that the plaintiffs failed to state a claim for breach of the implied covenant. To state a claim for breach of the implied covenant, a plaintiff must allege a specific implied contractual obligation and how the violation of that obligation denied the plaintiff the fruit of the contract. The court rejected the plaintiffs' argument that the defendants needed plaintiffs' consent in order to amend the 2009 Services LLC Agreement in a way that essentially eliminated future payment for the plaintiffs because the 2009 Services LLC Agreement expressly set out an amendment process that did not require the plaintiffs' consent as non-members. Thus, an implied covenant was not appropriate. The plaintiffs' alternative formulation of the implied covenant was that the clear purpose of the parties' bargain was that the plaintiffs would receive a share of the profits in exchange for the plaintiffs' continued services after the defendants received their return of capital. This argument failed because the plaintiffs did not allege that this commitment was breached. The plaintiffs retained their rights to a share of the profits of Services as paid through Management. The plaintiffs took only an indirect interest in profits and did not acquire any corporate governance authority over Services. Though the plaintiffs may have been disappointed with what Summit did as manager of Services, the plaintiffs did not show that Summit acted outside of the business structure and management discretion to which they agreed.

The court next rejected the plaintiffs' claim that Summit and Summit Holdings breached their fiduciary duties under the 2009 Services LLC Agreement because the plaintiffs were not members of Services and thus were not owed any fiduciary duties under the agreement. Further, the agreement unambiguously eliminated fiduciary duties of the managers. The plaintiffs' claim for breach of fiduciary duties under Management's LLC agreement also failed because the agreement specifically eliminated any fiduciary duties of Summit.

The plaintiffs' fraud claim against the defendants was based on the theories of "active concealment" and "duty to speak." The plaintiffs argued that the defendants committed fraud by failing to inform plaintiffs of the 2011 Amendment and of the full scope and character of certain credit facilities and resulting encumbrances on Services. The "duty to speak" theory did not apply because the plaintiffs were not members of Services, and their consent to the 2011 Amendment was not required. Thus, the defendants did not have a duty to disclose the existence of the 2011 Amendment or the credit facilities to the plaintiffs. The "active concealment" theory did not apply because it requires more than mere silence under Delaware law. The plaintiffs claimed that active concealment took place because one of the plaintiffs sought a copy of the 2011 Amendment but was denied it, and another plaintiff asked but received no answer to the question of whether there had been any amendments to the 2009 Services LLC Agreement. However, the plaintiffs' lack of knowledge of the 2011 Amendment could not have been relied upon to their detriment because they could not challenge the adoption of the amendment.

Finally, the plaintiffs sought judicial dissolution of Services and Management under Sections 18-802 and 18-803 of the Delaware Limited Liability Company Act. Because the plaintiffs were not members or managers of Services, they could not apply for dissolution of Services under the statutory provisions on which they relied. With respect to the plaintiffs' claim for judicial dissolution of Management, the court looked to circumstances under which dissolution has been ordered under the analogous limited partnership dissolution statute. These circumstances are (1) where there is a "deadlock" that prevents the entity from operating, and (2) where the defined

purpose of the entity is fulfilled or impossible to carry out. The plaintiffs did not allege deadlock with respect to Management, and their disagreement with the credit facility entered into by the defendants and the initial public offering of Summit Holdings did not plead a reasonably conceivable claim that it was no longer reasonably practicable for Management to carry on in accordance with its LLC agreement because Management's LLC agreement contained a broad purpose clause allowing Management to engage in any lawful act or activity for which LLCs may be organized under the Delaware Limited Liability Company Act.

Xereas v. Heiss, 933 F.Supp.2d 1 (D.D.C. 2013).

The plaintiff registered a group of domain names using the "Riot Act" name, and he and two other individuals subsequently agreed to launch a comedy club in Washington, D.C. The three individuals executed an operating agreement forming an LLC and created a business plan. The plaintiff served as the general manager of the club and worked in a variety of roles for the club. The plaintiff completed paying his \$100,000 capital contribution, and the other two members agreed to compensate the plaintiff with an annual salary. Shortly after that, the other two members removed the plaintiff from his management role and arranged to revise the domain name registration information and transfer ownership of the domain names to the LLC. The plaintiff sued the other two members asserting numerous claims against them. The defendants sought to dismiss the plaintiff's claims. The plaintiff's breach of contract claim alleged that the defendants breached their duty of good faith and fair dealing by fraudulently inducing the plaintiff to enter into a business relationship with them and then terminating the plaintiff's participation shortly after the club's opening. The defendants argued that the plaintiff's allegations did not specify the express contractual duty owed or how the defendants breached the contract. The plaintiff argued that both the operating agreement and the business plan were contracts and that these contracts recognized his position as the general manager. The court stated that the complaint did not identify any express contractual duty allegedly breached by the defendants. The operating agreement vested broad authority in the managing members to engage and employ members and stated that any action must be approved by a majority of the managing members. The plaintiff's complaint confirmed that any management decision should be controlled by two-thirds of the Class A members. The plaintiff's allegations that the defendants terminated employees and removed the plaintiff as general manager did not state a claim for breach of the operating agreement because the defendants were empowered to do so as a majority of the managing members. Whether the business plan was a contract did not need to be resolved by the court because, assuming it was, the plaintiff did not identify any statement in the business plan that created a contractual duty regarding his trademarks that were violated. Thus, the plaintiff's claim of breach of an express contractual duty failed. The defendants also sought dismissal of the plaintiff's implied duty of good faith and fair dealing claim. The first portion of the plaintiff's implied duty claim failed because it alleged that the defendants caused the plaintiff to enter into a business relationship with them and sign the operating agreement, and the court stated that allegations regarding pre-contract negotiations cannot state an implied duty claim under D.C. law. The plaintiff also alleged that the defendants caused the plaintiff to contribute \$100,000 and his time, expertise, contacts, business plans, and the right to use the domain names. The defendants argued that the allegations supporting this claim were pre-contract actions of the defendants identical to the plaintiff's fraudulent inducement claim. The court stated that the allegations for an implied duty claim must have occurred after a contract is executed, but the court found that the plaintiff's claim for breach of implied duty of good faith and fair dealing survived because the plaintiff alleged that

the defendants induced him to contribute \$100,000 and continue his efforts in furtherance of the LLC by giving repeated assurances of their continued interest in the business. The assurances were allegedly given before the plaintiff paid his remaining \$50,000 contribution and continued to work for the club after execution of the operating agreement. The defendants then allegedly terminated the plaintiff's participation shortly after the club opened. According to the court, these allegations supported the claim that the defendants evaded the spirit of the contract and interfered with the plaintiff's performance and, if true, showed that the defendants violated the standard that neither party to a contract may do anything to destroy or injure the right of the other party to receive the fruits.

The plaintiff conceded that he had not stated an unjust enrichment claim against the other two members because the existence of an express contract between the managing members of the LLC precluded such a claim, but the plaintiff argued that his unjust enrichment claim against the LLC survived because there was no express contract between the plaintiff and the LLC. The operating agreement did not expressly state whether the LLC was a party, and the D.C. LLC statute in effect when the operating agreement was executed in 2010 did not specify whether an LLC is a party to its own operating agreement. The court noted the differing conclusions reached by the courts in the *Elf Atochem* decision in Delaware and the *Trover* decision in Illinois and concluded that, given the D.C. statute in effect at the time and the terms of the operating agreement at issue (which did not list the LLC as a party and provided that the managing members had the power to bind the LLC), the LLC was not a party to the operating agreement, as was the case in the *Trover* decision. Thus, the principle that a party to an express contract may not assert an unjust enrichment claim did not preclude an unjust enrichment claim against the LLC. Furthermore, because the LLC was not a party to the operating agreement, the court explained that case law precluding a litigant from asserting an unjust enrichment claim where there is an express contract that "governs the parties' conduct" did not apply either. The court concluded that the complaint's allegations of uncompensated efforts for the LLC before the agreement to compensate the plaintiff supported an unjust enrichment claim, but the unjust enrichment claim based on plaintiff's uncompensated efforts after he secured a salary agreement were barred by that agreement.

Mizrahi v. Cohen, 961 N.Y.S.2d 538 (App. Div. 2 Dept. 2013).

The plaintiff and defendant were the members of an LLC formed in 2000 for the purpose of the construction and operation of a mixed-use commercial and residential building. After formation of the LLC, the parties purchased real property on which to construct the LLC's building. The seller required an LLC agreement, which the parties did not execute initially when forming the LLC, so the attorney who represented both parties at the closing drafted an LLC agreement. The LLC agreement provided that each member owned a 50% membership interest in the LLC. The agreement did not state the amount of the parties' capital contributions but provided that after the initial capital contributions by the parties no member would be required to contribute additional capital unless required by a vote of all of the members of the LLC. The agreement also contained a provision that no member would have the right to receive any return of any capital contribution subject to certain exceptions not relevant to the litigation. According to the LLC agreement, the LLC could be dissolved only upon the occurrence of certain specified events, and at dissolution the assets were to be distributed first to the LLC creditors and then to the members in proportion to their respective ownership shares. The members contributed approximately equal funds toward the down payment on the LLC's property. The building's construction was financed largely by a construction loan,

which the parties refinanced into a mortgage loan. Through 2003, the parties made approximately equal capital contributions to the LLC. After that, the plaintiff contributed around \$1.4 million in capital to the LLC while the defendant contributed approximately \$317,000 in capital to the LLC. In 2006, the construction was complete and the parties moved their offices into the building. An accountant for the LLC testified at a hearing that the LLC experienced net operating losses in each year from 2006 through the first half of 2011 and that the LLC would have failed if not for the use of the proceeds of the mortgage loan and capital infusions by the plaintiff to cover the LLC's net operating expenses. The plaintiff filed suit to recover damages for breach of fiduciary duty and breach of contract, but the trial court granted the plaintiff's application for the judicial dissolution of the LLC. The plaintiff also sought an order authorizing him to purchase the defendant's interest in the LLC at dissolution. The appellate court reviewed the trial court's ruling and concluded that the trial court did not err in dismissing the plaintiff's cause of action to recover damages for breach of fiduciary duty because that cause of action was not properly brought in the plaintiff's individual capacity. Next, the court held that the trial court did not err in dismissing the cause of action to recover damages for breach of contract. Despite the defendant's protest, the trial court correctly found that the LLC agreement was ambiguous and that parol evidence of the parties' course of dealing was admissible to supplement and interpret the terms of the agreement. In addition, evidence of the parties' conduct with respect to capital contributions did not constitute a prior oral agreement or an impermissible oral modification of the contract. Even considering the evidence, the court found that the plaintiff failed to establish the existence of a binding agreement as to the parties' responsibility for capital contributions, and thus the plaintiff failed to show a breach of contract. The court next found that the trial court properly granted the plaintiff's application for judicial dissolution of the LLC because it was not reasonably practicable for the LLC to continue operating due to financial infeasibility. The court also held that the trial court did not err in determining that the capital contributions of the plaintiff were to be treated as loans to the LLC to the extent those contributions exceeded the contributions made by the defendant. The LLC agreement did contain a provision that a member did not have the right to receive any return of capital contributions, but the agreement also provided for the repayment of debts of the LLC upon dissolution. The agreement was silent as to the issue of equalization of capital contributions, and an affidavit submitted by the defendant established that the parties intended for the capital contributions contributed by the plaintiff to be treated as loans to the LLC to the extent the contributions exceeded those made by the defendant. Finally, the court held that the trial court should have granted the plaintiff's application for an order authorizing him to buy the defendant's interest in the LLC at its dissolution. The court stated that a buyout in dissolution proceedings can be an appropriate equitable remedy in certain circumstances. The court found that allowing the plaintiff to buy out the defendant's interest in the LLC upon dissolution was appropriate under the facts of the case. The LLC agreement did not contain provisions that precluded an order authorizing a buyout upon the judicial dissolution of the LLC despite the defendant's contentions to the contrary. The court remanded to the trial court for further proceedings to determine the value of the defendant's interest in the LLC for buyout purposes but otherwise affirmed the trial court's judgment.

Davis v. VCP South, LLC, 740 S.E.2d 410 (Ga. App. 2013).

The LLC operating agreement of an LLC formed by two doctors contained a provision that gave each member, following the other member's death, the option to purchase the deceased member's interest in the LLC, and the purchase price was to be determined by the LLC's certified

public account. Dr. Davis died, and his wife, Lori Davis (“Davis”), was appointed the administrator of his estate. The remaining member and the LLC sued the estate to enforce the LLC operating agreement provision authorizing the CPA to determine the purchase price of the deceased member’s interest in the LLC. The trial court entered partial summary judgment in favor of the plaintiffs, and Davis appealed. On appeal, Davis first argued that the trial court’s summary judgment finding that the LLC’s CPA was authorized to determine the purchase price was erroneous. The appellate court disagreed with Davis. The evidence showed that the LLC’s operating agreement expressly provided that “the purchase price for the membership units shall be their fair market value as determined in a commercially reasonable manner by or under the CPA regularly representing the LLC, whose decision in this matter shall be conclusive.” The court stated that the intent of the parties to the operating agreement was clear and unambiguous in authorizing the LLC’s CPA to determine the purchase price, and the trial court did not err in its construction of that portion of the operating agreement. Davis’s challenge to the propriety of such a provision failed to recognize the contractual flexibility afforded members of an LLC and the state policy to give maximum effect to the principle of freedom of contract and enforceability of operating agreements. Next, Davis contended that the trial court erred in granting partial summary judgment in favor of the plaintiffs because the plaintiffs waived the enforcement of the provision in the operating agreement authorizing the CPA to determine the purchase price by first obtaining a valuation of the deceased member’s interest from another accounting firm. The court found that Davis showed no evidence of waiver of the provision at issue. The alternate valuation was performed solely for the purpose of assisting the plaintiffs in negotiating with Davis. Once the negotiations ended unsuccessfully, the plaintiffs’ complaint sought to enforce the operating agreement provision authorizing the CPA to conclusively determine the fair market value and purchase price. Davis next alleged that the provision in the LLC’s operating agreement authorizing the appraisal by the CPA required a mandatory arbitration. The court again disagreed with Davis and explained that this case involved a contract provision concerning the method of appraising value. Appraisal involves an issue of value and does not constitute a common law or statutory arbitration, which would be invoked to resolve broader issues of liability. The court found that the provision in question was an appraisal clause set forth only to resolve an issue of value and not broader issues of liability, so Davis’s claim that the provision was an arbitration clause was without merit. Finally, Davis argued partial summary judgment in favor of the plaintiffs was erroneous because a genuine issue of material fact existed as to fraud and whether the CPA determined the fair market value in a commercially reasonable manner. However, Davis failed to indicate what specific facts showed fraud or a lack of commercial reasonableness. Although the court stated that it had no duty to go through the record in search of support for the contentions of the parties, the court reviewed the pages cited by Davis and found no evidence of fraud or that the appraisal by the CPA was not commercially reasonable. The cited pages critiqued the CPA’s appraisal methodology, but the appellate court agreed with the trial court’s finding that the facts did not rise to the level of showing fraud or that the appraisal was conducted in a commercially unreasonable manner. In sum, the court affirmed the trial court’s granting of partial summary judgment in favor of the plaintiffs and the ruling that the determination by the CPA, which the contracting parties expressly agreed would be conclusive, was binding.

Ross Holding and Management Co. v. Advance Realty Group LLC, C.A. No. 4113-VCN, 2013 WL 764688 (Del. Ch. Feb. 28, 2013).

The plaintiffs complained of an LLC's failure to repurchase the plaintiffs' units when the plaintiffs were terminated and the LLC's adoption of a conversion and exchange agreement that involved a capital restructuring of the LLC. The plaintiffs alleged that the capital restructuring adversely affected the value of the plaintiffs' holdings because the defendants diverted the LLC's assets for their benefit. The court granted the defendants' motion for summary judgment on the breach of contract claims stemming from the failure to repurchase their units as well as a breach of fiduciary duty claim against Rayevich, a member of the LLC's managing board.

The plaintiffs alleged that the LLC breached unit holder agreements with the plaintiffs by failing to repurchase their units when the plaintiffs were terminated. The agreements, which the parties agreed were governed by New Jersey law, provided that the LLC "may" purchase some or all of the units upon termination of an investor. The court stated that the use of the word "may" denoted a permissive standard and imposed no express duty to repurchase the plaintiffs' units. There is an implied covenant of good faith and fair dealing in every contract under New Jersey law, and the implied covenant may be breached where a party exercises its discretion under a contract with a dishonest purpose or intent to profit at the expense of another in violation of the spirit of the contract. The plaintiffs claimed that they expected their units to be acquired by the LLC if they were terminated, but their expectation was not incorporated into the contract, and the plaintiffs offered nothing to support their "reasonable expectation" when they entered into the contract in 2001 that they could force the LLC to purchase their units in the event they were terminated. The court recognized that the implied covenant might have required the LLC to act in good faith when it decided whether or not to purchase the units. The court could understand why the plaintiffs would not want to be minority unit holders in the enterprise, but the court found it hard to see why this would be an "inequitable" result. The plaintiffs pointed to another former employee whose units were purchased after termination, but the plaintiffs offered no cohesive theory to explain why the differential treatment was somehow proof that the implied covenant should be given effect. The LLC was entitled to summary judgment on this claim, and defendants against whom the plaintiffs asserted claims for tortious interference with the unit holder agreements were also entitled to summary judgment since the LLC did not breach the agreements.

The court applied Delaware law to the breach of fiduciary duty claim against Rayevich. The LLC agreement required Rayevich, as a member of the LLC's managing board, to manage the LLC reasonably and in good faith, and the agreement exculpated him from liability absent willful misconduct or bad faith. Although Rayevich was a member of the LLC's managing board, he had no discretion in how to vote because he was required to vote as directed by another individual. Although Rayevich had no discretionary voting power, the court stated that his fiduciary duties extended beyond voting and could involve studying the proposed transaction, determining its appropriateness, expressing dissenting views to fellow board members and, under proper circumstances, informing unit holders about potential adverse effects. Plaintiffs failed, however, to allege any facts that demonstrated Rayevich's conduct was willful or in bad faith in connection with the conversion and exchange agreement, and he was entitled to summary judgment.

Fundamental Long Term Care Holdings, LLC v. Cammeby's Funding LLC, 985 N.E.2d 893 (N.Y. 2013).

In 2006, Fundamental Long Term Care Holdings, LLC (“Fundamental”), an LLC whose members were Grunstein and Forman, entered into an option agreement with Cammeby’s Funding LLC (“Cam Funding”), an LLC wholly owned by Schron, under which Cam Funding was entitled to acquire one-third of Fundamental’s membership units for a strike price of \$1,000, provided the option was exercised no later than June 9, 2011. Grunstein and Forman formed Fundamental for the purpose of owning companies that manage health care facilities, and they each contributed \$50 in equity for a half-interest in Fundamental and paid \$10 million, financed by debt, to purchase from an entity controlled by Schron the stock of 26 nursing home facilities. The option agreement provided that Cam Funding would be admitted as a member of Fundamental upon exercise of the option and that Fundamental would execute certificates for the acquired units and all other documents necessary to properly issue the acquired units, and Grunstein and Forman agreed, as the sole members of Fundamental, to consent to the issuance of the acquired units and the admission of Cam Funding as a member and to execute and deliver amendments and schedules to the operating agreement of Fundamental to reflect the issuance of the acquired units. The option agreement also required Fundamental, Grunstein, and Forman to facilitate, and prohibited their interference with, the exercise of the option and provided that any conflicting agreement or commitment would be deemed void. Finally, the option agreement contained a standard merger clause. In late 2010, Cam Funding notified Fundamental that it was exercising the option and enclosed a \$1,000 certified check. Fundamental responded that its operating agreement provided that additional membership units could not be issued without a capital contribution equal to at least the fair market value of the proposed interest, which was estimated to be \$33 million. Fundamental sued for a declaration that Cam Funding was bound by the membership requirements in the operating agreement to make the requisite capital contribution, and Cam Funding counterclaimed for breach of contract. The trial court ruled that the option agreement unambiguously granted the right to acquire a one-third interest in Fundamental upon payment of \$1,000, and the appellate division affirmed. The New York Court of Appeals affirmed the appellate division. New York’s high court rejected Fundamental’s argument that the option agreement and operating agreement must be read together, stating that the two agreements were not inextricably intertwined. The court stated that the breach of one agreement would not undo the obligations imposed by the other and that an obligation for the fair market value to be due upon Cam Funding’s exercise of the option was not the sort of term these sophisticated, counseled parties would have reasonably left out of the option agreement. Mere reference to the operating agreement in the option agreement was not enough to evidence clear intent for the two contracts to be read as one. Furthermore, whether payment of \$1,000 for a membership interest valued at \$33 million was commercially unreasonable was irrelevant. The court stated that an inquiry into commercial reasonableness is only justified when a contract is ambiguous, and the option here was unambiguous. The court noted that, in any event, parties enter into option agreements for all sorts of reasons, and this agreement was executed by sophisticated, counseled parties.

Humphrey Industries, Ltd. v. Clay Street Associates, LLC, 295 P.3d 231 (Wash. 2013).

An LLC member who exercised statutory dissenter’s rights in the context of a merger of the LLC argued that it was entitled to recover attorney’s fees from the other members in litigation to enforce the member’s dissenter’s rights. One basis on which the dissenting member argued it was entitled to recover fees from the other members was a fee-shifting provision in the LLC operating

agreement. The court rejected the dissenting member's argument because the fee-shifting provision provided for fees incurred in enforcing the operating agreement, and the appeal did not concern enforcement of the operating agreement.

Carhart-Halaska International, LLC v. Carhart, Inc., 920 F.Supp.2d 971 (E.D. Wis. 2013).

The two members of a Wisconsin LLC, Halaska International, Inc. ("Halaska") and Carhart, Inc. ("Carhart"), had a contractual dispute, and Halaska sued Carhart and its owner in state court. Halaska named the LLC as a plaintiff in addition to Halaska. The defendants removed the case to federal court based on diversity of citizenship. Since the citizenship of an LLC is the citizenship of its members, citizens from the same state were on both sides of the case (i.e., defendant Carhart was a citizen of Illinois, which meant the plaintiff LLC was also a citizen of Illinois), thus destroying diversity of citizenship; however, the defendants alleged that the federal court should disregard the LLC's citizenship because it was an improper plaintiff. The defendants relied on the fraudulent joinder doctrine, which allows a court to disregard citizenship of a party joined to defeat diversity jurisdiction. The court noted that the Seventh Circuit has never endorsed the use of the fraudulent joinder doctrine to disregard a plaintiff's citizenship and that the burden to establish fraudulent joinder is very heavy. To prevail on the claim of fraudulent joinder, the defendants had to show that the plaintiff actually committed fraud in naming the LLC as a party or that there was no reasonable possibility that the LLC could prevail on any of its claims taking all inferences of fact and law in the LLC's favor. The defendants first argued that there was no reasonable possibility that the LLC could prevail because Halaska was not authorized to join the LLC as a plaintiff. The Wisconsin LLC statute provides that an action on behalf of an LLC may be brought in the name of the LLC by one or more of its members if the members are authorized to sue by the affirmative vote of a majority in interest of the members, except that the vote of any member who has an interest in the outcome of the action that is adverse to the interest of the LLC must be excluded. Wisconsin case law has held that an LLC's operating agreement must explicitly address voting to authorize an action on behalf of the LLC in order to override this statutory provision. The operating agreement between Halaska and Carhart prohibited a manager of the LLC from bringing suit on behalf of the LLC unless a certain procedure was followed, however it did not address member-initiated suits or voting to authorize such suits. Thus, the LLC's operating agreement did not override the statute governing the member's authority to sue on behalf of the LLC. The court went on to consider whether the requirements of the statute had been met, and the court found that Halaska's complaint met the statutory requirements and that Halaska followed the appropriate procedure in initiating the suit. Thus, there was a reasonable possibility that the LLC could prevail on its claims against the defendants, and applying the fraudulent joinder doctrine would be improper. Since the citizenship of the LLC could not be disregarded, the court remanded the case to state court due to lack of subject matter jurisdiction.

Woss, LLC v. 218 Eckford, LLC, 959 N.Y.S.2d 218 (App. Div. 2d Dept. 2013).

The plaintiff, an LLC that was a member of another LLC, was not a party to the 2006 operating agreement of the second LLC and thus could not assert claims for breach of that agreement where the plaintiff was not yet formed in 2006 and the agreement was signed only by the defendant. The plaintiff's affidavit advancing new causes of action based on a 2007 operating agreement without leave to replead or amend did not remedy the defect in pleading. The plaintiff's unjust

enrichment claim failed because the 2007 operating agreement was an express agreement between the parties.

Lakes Region Gaming v. Miller, 62 A.3d 838 (N.H. 2013).

In 2005, Gistis and Johnston agreed to purchase a greyhound race track through a court-approved bidding process. The two formed a joint venture in which Johnston's development company ("Johnston Development") would bid on the race track and Gistis would provide the required deposit. Johnston Development successfully bid over \$4 million to buy the race track, and Gistis provided the \$205,000 deposit in connection with the purchase. Shortly thereafter, Johnston Development and Gistis formed an LLC to own and manage the race track. The other members of the LLC were Miller and two other individuals. The parties agreed Johnston Development would contribute its right to purchase the race track to the LLC as part of the company's capitalization, and the LLC would own the race track. Johnston Development and the seller entered a purchase and sale agreement with a two-month period for Johnston Development to conduct its due diligence. If the seller was not notified of an intent to proceed with the transaction by July 18, the deposit would be forfeited. In June, a New Hampshire grand jury indicted a dozen people involved with the track, and the LLC members decided to try to sell their right to purchase the track and recoup expenses rather than to close on the transaction. Without the knowledge of the other members of the LLC, Miller and Johnston had been negotiating the right to purchase the track with numerous potential buyers. On July 17, Torguson Gaming Group, Inc. ("Torguson") agreed to pay \$5 million to Johnston for the right to purchase the race track. In addition, Miller paid the seller \$50,000 to extend the due diligence period and have the deposit remain in the escrow account. Torguson then replaced the deposit made by Gistis, and the seller returned Gistis's deposit. Johnston Development made a profit of almost \$900,000 in its sale to Torguson, and Johnston transferred \$445,000 of the profit to Miller. The LLC and its members (other than Miller and Johnston Development) filed suit against Johnston, Johnston Development, and Miller alleging, among other causes of action, breach of fiduciary duty. A default judgment was entered against Johnston and Johnston Development, and the claim against Miller proceeded to trial. The trial court found that Miller breached his fiduciary duties to the plaintiffs by using the original deposit made by Gistis and belonging to the LLC to appropriate the opportunity to sell the purchase rights to Torguson. Miller appealed alleging that the plaintiffs did not have standing to sue for breach of fiduciary duty and that the LLC's operating agreement allowed his actions in connection with the sale to Torguson. First, Miller argued that the assets at issue, which were the right to purchase the race track and the deposit, did not belong to the LLC and that the plaintiffs lacked standing to bring an action based on them. Although this issue was not raised at trial, the appellate court addressed it as it dealt with the trial court's subject matter jurisdiction. The trial court found that both the right to purchase the race track and the deposit held in escrow belonged to the LLC. The trial court found that Johnston had an obligation to transfer his rights at closing, which the LLC could have enforced. At the very least, the LLC had a cause of action for specific performance to require transfer of those rights so the closing could have occurred. In addition, the deposit, while in escrow, was to be used only for the benefit of the LLC. Therefore, the LLC and its members had standing to sue for breach of fiduciary duty. Next, the defendant contended that the trial court erred when it failed to consider a paragraph in the LLC's operating agreement that allowed competition with the LLC with or without notice to or participation by the other LLC members without such conduct constituting a breach of fiduciary duty. Miller argued that his conduct involving negotiations with alternate buyers constituted competition, as allowed by the operating

agreement. The plaintiffs countered that Miller was not merely competing with the LLC but rather sold the LLC's primary business asset (i.e., the right to purchase the race track) and secretly used Gistis's deposit to do so. The appellate court agreed with the plaintiffs that the LLC's operating agreement did not allow Miller to use the LLC's assets to enrich himself. Miller's argument mistakenly assumed that the purchase right and deposit did not belong to the LLC; however, as discussed above, the trial court found that both assets belonged to the LLC, and the appellate court upheld the finding on appeal. Therefore, Miller's actions constituted breach of the fiduciary duties he owed the plaintiffs, and the appellate court affirmed the trial court's judgment.

In re Batt (Apperson v. Bleckner), 485 B.R. 562 (Bankr. W.D. Ky. 2013).

The debtor and the defendants in this adversary proceeding were members of an LLC whose operating agreement provided that the LLC would indemnify any member that had to pay as a result of the member's status as a guarantor. The operating agreement further provided that the other members must pay their pro rata share to a paying member to the extent the LLC does not indemnify the paying member. A bank filed a proof of claim in the debtor's bankruptcy, and the debtor's trustee filed this adversary proceeding against the other members, alleging that, to the extent the debtor pays on his guarantee, the LLC will not indemnify him as required by the operating agreement. The defendants argued that the claim against them for indemnification was not ripe, and the trustee argued that Ohio law and the operating agreement allowed the debtor to bring an indemnity claim before making payment to the bank. The court examined the language of the operating agreement and concluded that it expressly authorized indemnification and did not authorize the debtor to make a claim for indemnification before suffering any loss. Furthermore, assuming the debtor made some pre-petition payments to the bank as contended by the trustee, the trustee was not entitled to seek indemnification because the trustee had not made a demand on the LLC seeking redress for the payments as required by the operating agreement. Even if such a demand would yield no results and would thus be futile as alleged by the trustee, the operating agreement required demand, and the claims for indemnity were not ripe until the demand was made.

Transfer of Interest/Buyout of Member

Kaufman Development Partners, L.P. v. Eichenblatt, 749 S.E.2d 374 (Ga. App. 2013).

The court addressed the standing of a former member of an LLC who retained an economic interest in the LLC after his removal to sue for breach of the operating agreement and concluded the former member had standing to do so. Kaufman Development, L.P. ("Kaufman Development") and David Eichenblatt formed a real estate LLC and entered into an operating agreement identifying them as the members and addressing various governance, economic, and operational matters. A few years later, Eichenblatt and Kaufman Development agreed to part ways except for their agreement to continued joint ownership of certain entities. The two parties agreed to amend the operating agreement to remove Eichenblatt as a member in accordance with a particular provision of the operating agreement under which Eichenblatt would continue to receive allocations and distributions to which he would otherwise be entitled but would not have the other powers, rights, or privileges of a member. After the operating agreement was amended to remove Eichenblatt as a member, Eichenblatt sued Kaufman Development for breach of the operating agreement, claiming that Kaufman Development failed to comply with certain provisions governing the management and dissolution resulting in diminished allocations and distributions to Eichenblatt under the agreement.

The jury found in favor of Eichenblatt and awarded \$625,000 in compensatory damages for breach of the operating agreement. The trial court entered judgment on the jury verdict and denied a motion by Kaufman Development to clarify the judgment to include a finding that Eichenblatt's interest in the LLC had been extinguished.

On appeal, the court of appeals first addressed Kaufman Development's argument that Eichenblatt had no standing to sue for breach of the operating agreement since he was no longer a member. The court pointed out that both the operating agreement and the amendment identified Eichenblatt as a party. By expressly removing Eichenblatt as a member, the court said that the amendment modified the operating agreement to exclude him from the term "member" as used in the operating agreement but did not affect his identity as a party to the agreement. According to the court, various provisions of the amendment made clear that Kaufman Development remained bound by and Eichenblatt continued to benefit from the terms other than those specifically related to allocations and distributions.

The court of appeals next rejected Kaufman Development's argument that the trial court should have clarified the judgment to specify that Eichenblatt's interest was extinguished. Kaufman Development argued that the jury's award represented the liquidated value of Eichenblatt's interest, but the court concluded that it was not at all clear that the jury intended for the damages award to represent the full value of Eichenblatt's interest in the LLC or for Eichenblatt to have no interest in the LLC going forward. The jury was not asked to make and did not make any findings about Eichenblatt's interest, and Kaufman Development was not entitled to rewrite the jury's verdict through a post-trial motion.

Stewart v. BF Bolthouse Holdco, LLC, C.A. No. 8119-VCP, 2013 WL 5210220 (Del. Ch. Aug. 30, 2013).

Former employees of an LLC sued the LLC and its board of managers for breach of contract, breach of fiduciary duty, and breach of the implied covenant of good faith and fair dealing in connection with the LLC's exercise of its right to repurchase the plaintiffs' membership units in the LLC when the plaintiffs voluntarily terminated their employment. Based on the board's valuation of the units at \$0.00, the LLC cancelled the plaintiffs' units without paying any consideration. The plaintiffs claimed that the board of managers acted in bad faith in valuing the units at \$0.00 and that such action violated both the purchase agreement that governed the repurchase of the units (which required the board of managers to determine the value in good faith) and the LLC agreement (which provided that the board owed to the LLC and its members the duties owed by corporate directors to the corporation and its shareholders). The relief sought by the plaintiffs included a declaratory judgment invalidating the repurchase and an order restoring their ownership of units in the LLC. The court denied in part and granted in part the defendants' motion to dismiss the breach of contract claims, and the court granted the motion to dismiss the claims for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing because the latter claims were duplicative of the breach of contract claims.

The court first addressed the plaintiffs' breach of contract claims and concluded that the plaintiffs' factual allegations were sufficient for the court to conclude that it was reasonably conceivable that the "Fair Market Value" of the units was greater than \$0.00 and that the board acted in bad faith in determining the value in breach of the purchase agreement. The purchase agreement provided that "Fair Market Value" of the units was to be "determined in good faith by the Board in its sole discretion after taking into account all factors determinative of value including, but not

limited to, the lack of a readily available market to sell such units, but without regard to minority discounts.” The court held that allegations of appraisals by a third party in 2008 for a contemplated acquisition and in 2012 for a completed acquisition bore little if any relationship to the Fair Market Value of the units in 2010 when they were repurchased because the third-party valuations were based on the terms of the LLC agreement rather than the Fair Market Value provision of the purchase agreement and were too long before or after the repurchase valuation date in 2010. The court nevertheless held that it was reasonably conceivable that the Fair Market Value of the units was greater than \$0.00 based on an e-mail from the president and CEO of the LLC valuing the units at \$200 per unit three weeks after the board determined the Fair Market Value was \$0.00. The court noted that the defendants did not argue that any material event occurred during those three weeks that affected the valuation. The court further held that the plaintiffs sufficiently pled that the defendants’ valuation of \$0.00 was determined in bad faith based on allegations that the plaintiffs purchased units for \$25 per unit on several occasions between 2005 and 2008; there was no indication the LLC’s financial condition was materially worse in 2010 than it was in 2005-2008; shortly before the plaintiffs quit their jobs, the CEO conveyed to LLC managers that the LLC had bright prospects; shortly before the plaintiffs quit their jobs, the CEO expressed his belief that the units were worth roughly \$200; plaintiffs quit their jobs; and shortly before the LLC would otherwise have had to deliver financial information to the plaintiffs, the plaintiffs were told without explanation that their units had a Fair Market Value of \$0.00 on the date of termination of their employment. Furthermore, the plaintiffs pled a plausible motivation on the part of the defendants to increase the majority owner’s interest in the LLC or to exact retribution for the plaintiffs’ unexpected departure from the LLC at a time when the plaintiffs were important to the future success of the LLC. The court noted that a claim of wrongful inducement, trickery, or deception is not necessary to establish bad faith under Delaware law. The court thus denied the defendants’ motion to dismiss plaintiffs’ breach of contract claim that the board determined the Fair Market Value of the Units in bad faith.

The court next addressed the plaintiffs’ claim that the board’s failure to determine the Fair Market Value in good faith constituted a breach of the LLC agreement. The court concluded that the purchase agreement and LLC agreement were related and intended to be read in tandem and that the fiduciary duty provision of the LLC agreement, which provided that the managers owed the same fiduciary duties as the directors of a corporation, applied to the board’s valuation of the units. A director is liable for breach of the fiduciary duty of care under Delaware law when the director’s actions are grossly negligent. The focus of a duty of care analysis is the process undertaken by directors in making a decision. The plaintiffs made no allegations regarding the board’s valuation process, and the court thus held that the plaintiffs failed to state a claim for breach of the contractual duty of care. The plaintiffs also failed to state a claim of breach of the duty of loyalty on the basis of an interested transaction because the plaintiffs did not allege that the defendants stood on both sides of the repurchase transaction, nor did they allege that the defendants were in a position to benefit from an unfairly low repurchase in a manner not shared equally by all owners of the LLC. However, the duty of loyalty in Delaware encompasses actions taken in bad faith in addition to interested transactions. Thus, the court held that the plaintiffs stated a claim for breach of the contractual duty of loyalty under the LLC agreement by acting in bad faith in determining the Fair Market Value of the units based on the allegations supporting the contractual bad faith claim under the purchase agreement.

The court dismissed the plaintiffs’ claim that the defendants breached the LLC agreement by failing to deliver annual financial statements to the plaintiffs. The LLC agreement provided that

“[w]ithin one hundred twenty (120) days after the end of each Fiscal Year of the Company, the Company shall deliver to each Member the Company’s annual financial statements.” A “Member” was defined as “each Initial Member and each other Person who is hereafter admitted as a Member in accordance with the terms of this Agreement and the Act, in each case so long as such Person is shown on the Company’s books and records as the owner of one or more Units.” There was no dispute that the plaintiffs were members on March 31, 2010, the LLC’s fiscal year end, but the plaintiffs’ units were repurchased on July 22, 2010, seven days before the 120-day period expired on July 29, 2010. The question was whether membership on the date of the fiscal year end entitled them to the year-end financial information required to be delivered to members under the LLC agreement. The court concluded that the LLC agreement plainly required delivery of the information to anyone who was a member on the date of delivery. Since the LLC agreement defined a “Member” as a person with a present ownership interest in the LLC, and there was no allegation that the LLC delivered financial information between March 31 and July 22, 2010, the court held that there were no alleged facts upon which the plaintiffs could conceivably prove a breach of the contract based on this provision of the LLC agreement.

The court also dismissed the plaintiffs’ claim that the defendants breached the purchase agreement by “cancelling” the units rather than “repurchasing” them as provided in the purchase agreement. The court agreed with the LLC that it was immaterial whether the parties characterized their actions as a repurchase, cancellation, or both. Once the LLC elected to purchase the units, which it had a right to do under the purchase agreement, the court stated that the LLC was free to do with the units whatever it chose after tendering the required consideration. Here, the required consideration was \$0.00, and the LLC thus assumed complete control of the units upon informing the plaintiffs that it was exercising the purchase right. If the LLC breached the purchase agreement, it was because it failed to exercise good faith, not as a result of calling a repurchase a cancellation.

The court dismissed the plaintiffs’ breach of fiduciary duty claim because it was duplicative of and foreclosed by the breach of contract claim. Under Delaware law, a fiduciary duty claim that depends on the same nucleus of operative facts as a breach of contract claim only survives where the fiduciary duty claim depends on additional facts, is broader in scope, and involves different considerations in terms of potential remedies, i.e., where the breach of fiduciary duty claim may be maintained independently of the breach of contract claim. The court rejected the plaintiffs’ effort to distinguish their breach of fiduciary duty claim from their breach of contract claim on the basis that the board’s conduct should be assessed under the entire fairness standard for purposes of the breach of fiduciary duty claim. Because the plaintiffs did not allege that the defendants stood on both sides of the repurchase transaction or that the defendants were in a position to benefit from an unfairly low repurchase in a manner not shared equally by all owners of the LLC, the court held that the plaintiffs failed to articulate a basis to employ the entire fairness standard. The plaintiffs’ claim that the defendants breached their fiduciary duties to plaintiffs when they declared that the units had no value and cancelled them arose from the dispute relating to the contractual repurchase right under the purchase agreement, thus making the case similar to *Nemec v. Schrader*, in which the Delaware Supreme Court affirmed the dismissal of a fiduciary duty claim arising from a corporation’s exercise of its right to redeem shares of retired nonworking shareholders. The plaintiffs here argued that the facts fit the narrow exception to the general principle that a breach of contract and breach of fiduciary duty claim based on the same facts are duplicative, but the court concluded that the plaintiffs alleged essentially identical facts in support of both their breach of fiduciary duty claim and their claim for breach of the purchase agreement and LLC agreement. Similarly, the breach of

fiduciary duty claim was no broader in scope than the breach of contract claim. Finally, the breach of fiduciary duty claim did not implicate potentially different remedies because the requested relief (a declaration that the repurchase of the plaintiffs' units was invalid and that they still owned their units) was available to the plaintiffs with respect to their breach of contract claim.

Finally, the court dismissed the plaintiffs' claim that the defendants violated the implied covenant of good faith and fair dealing by failing to act in good faith when valuing the units. The plaintiffs did not allege a specific implied contractual obligation that was breached, but instead focused on the express contractual requirement in the purchase agreement that the board value the units in good faith. Thus, the court concluded that the claim was duplicative of the breach of contract claim. The court explained that its conclusion was consistent with the Delaware Supreme Court's decision in *Gerber v. Enterprise Products Holdings, LLC* because the limited partnership agreement in that case arguably had a contractual "gap" in that the duty of a party seeking the benefits of the "safe harbor" or "conclusive presumption" provided by the agreement was not specified. The court stated that the purchase agreement in this case did not have a "gap" for the implied covenant to fill. The plaintiffs' claim was based on a single clause of the purchase agreement that expressly required the LLC to act in good faith. The plaintiffs essentially contended that the LLC had an implied duty to act in good faith in complying with its contractual duty to act in good faith. The express requirement of good faith did not provide a basis for a valid claim for a breach of the implied covenant. Furthermore, there was no credible basis to reasonably infer the purchase agreement failed to reflect the parties' expectation at the time of bargaining. The parties obviously foresaw the potential issues with allowing the Fair Market Value of the units to be determined by the board in its sole discretion and addressed the issue by explicitly requiring good faith. The court went on to state that the more significant distinction between *Gerber* and this case related to the "discretionary rights" at issue. In *Gerber*, the "safe harbor" and "conclusive presumption" provisions were discretionary rights that the defendants could use to limit or avoid liability, but the contract did not specify any standard for evaluating the defendants' exercise of the rights. In the absence of a contractual standard, the supreme court determined that the defendants were required to use their discretion in conformity with the implied covenant. By contrast, in the purchase agreement in this case, the parties agreed to a good faith standard to evaluate the reasonableness of the defendants' exercise of discretion. Thus, in this case, the parties' express agreement superseded the implied covenant and precluded its application. The court acknowledged that *Gerber* held that a showing of compliance with a contractual duty of good faith does not automatically extinguish all implied covenant claims, but it does not relieve a plaintiff from the burden of pleading a cognizable claim, and the plaintiffs here did not sufficiently allege a claim because they did not show how the express terms of the purchase agreement failed to account for their legitimate expectations at the time they entered into the contract.

Holladay v. Storey, 307 P.3d 584 (Utah 2013).

In 2000, Storey, Holladay, Woodcock, and several other individuals formed an LLC to construct and operate an inn. Storey was appointed manager of the LLC. After the withdrawal of some of the members in early 2003, Storey, Holladay, and Woodcock executed an amended operating agreement under which Storey remained as manager and Storey, Holladay, and Woodcock each held a one-third interest in the LLC. In June 2003, Holladay and Woodcock took over Storey's management duties, and later in 2003 litigation between the parties ensued. Storey asserted derivative claims and a demand for judicial accounting and dissolution or purchase of his interest.

Holladay and Woodcock asserted claims against Storey for breach of fiduciary duty and other causes of action and sought Storey's expulsion as a member and removal as a manager and a judicial accounting and dissolution of the LLC. The case was governed by the Utah Revised Limited Liability Company Act in effect at the time. Initially, the court granted a motion by Storey for a partial summary judgment declaring that Storey could not be removed as a manager based on the terms of the operating agreement, noting that Holladay and Woodcock had not expressly invoked the provisions of the LLC statute providing for judicial removal of a manager. The court stayed implementation of the judgment to allow Holladay and Woodcock to request an injunction removing Storey under the statutory provision, and the court later issued a preliminary injunction removing Storey as manager on a motion by Holladay and Woodcock in 2005 invoking the statutory removal provision. Based on a stipulation of the parties in December 2003, the trial court permitted Holladay and Woodcock to enter into a franchise agreement for the sale of the inn. Following a bench trial in 2009, the trial court removed Storey as the manager of the LLC, expelled Storey as a member effective December 31, 2005, and valued Storey's interest as of December 31, 2005. Storey's removal as a manager was based on the trial court's findings of numerous instances of mismanagement and misconduct. The trial court ordered Storey's expulsion as a member for the same reasons as his removal as a manager and based on his unlawful conduct that adversely and materially affected the LLC's business or conduct making it not reasonably practicable to carry out business with the members. The trial court also found Storey breached his fiduciary duties to the members. The court made the expulsion and valuation of Storey's interest retroactive to December 31, 2005, based on the parties' conduct. The court found this date was appropriate because of Storey's mismanagement, misconduct, dishonesty, breach of fiduciary duty, and lack of success as a manager on that date. The trial court also justified the valuation date on the failure of Holladay and Woodcock to adhere to the amended operating agreement and timely access the court to implement their decisions and pursue their remedies. The trial court also found that the decision to convert to a franchise was a substantial reason for the success of the LLC during and after 2005.

On appeal, Storey argued that the statute did not authorize the trial court to backdate his expulsion and the valuation of his interest. The court of appeals discussed in detail the statutory provisions and the Utah Supreme Court's decision in *CCD, LC v. Millsap* and concluded that the trial court correctly determined that it had authority to make the expulsion of Storey and valuation of his interest retroactive. The court of appeals stated that the trial court could have chosen to backdate the expulsion to as early as 2003 based on his misconduct, but the trial court also appropriately took into account the delay by Holladay and Woodcock in complying with the amended operating agreement and LLC statute until 2005. Storey argued that he became an assignee under the statute when he ceased to be a member upon his expulsion and that he retained his interest until the judicial determination of dissolution in 2009. The court reconciled the provisions of the Utah statute by concluding that an expelled member becomes an assignee upon expulsion but that the assignee status continues only until valuation of the interest and does not preclude the retroactive valuation of the expelled member's interest when appropriate. Thus, the trial court had the discretion to set the valuation based on the equities of the case, and the evidence supported the valuation date chosen by the trial court.

Kohannim v. Katoli, __ S.W.3d __, 2013 WL 3943078 (Tex. App. 2013).

In 1996, Jacob Kohannim ("Jacob") and Mike Khosravikatoli ("Mike") formed an LLC to purchase and hold real property on which a corporation owned by them operated a restaurant. Jacob

and Mike were the managers and each owned a 50% interest in the LLC. The member agreement contained transfer restrictions that provided the LLC and the other member the opportunity to purchase a member's interest in the event of a proposed sale of the interest or a transfer to a member's spouse in a divorce. In 2003, Mike's wife, Parvenah, filed for divorce, and the divorce court issued temporary orders prohibiting Mike and Parvenah from transferring assets. During the pendency of the divorce, Mike purported to transfer a 5% interest in the LLC to Jacob. In 2005, the divorce decree was entered. In the divorce decree, the district court found the transfer was void because it was an attempt to transfer community property in violation of the court's order enjoining such a transfer. The divorce decree further awarded to Parvenah "[o]ne hundred percent (100%) of the husband's interest" in the LLC, "which interest is equivalent to a fifty percent (50%) interest in such company." The decree required the husband to execute and deliver to the wife's attorney a stock transfer certificate and/or assignment of interest. After the divorce decree was entered, Jacob advised Parvenah that he intended to start the process of determining the value of the LLC for purposes of the buyout provision in the member agreement. In 2006, Parvenah sued Jacob and the LLC, seeking a declaration of her rights with respect to the LLC and the validity of the member agreement and asserting other claims based on constructive fraud, breach of fiduciary duty, oppression, waste, gross mismanagement and abuse of control, and unjust enrichment. The trial court appointed a receiver for the LLC and ordered the receiver to sell the LLC's assets. The trial court eventually approved a sale of the LLC's property for \$1,300,100. The trial court's final judgment contained findings as to the amount of assets held by the receiver and how the assets should be divided based on the court's finding that Jacob and Parvenah each held a 50% beneficial interest in the assets. The trial court also found that Jacob, with malice and intent to defraud, engaged in wrongful acts and omissions that damaged Parvenah by decreasing the value of Parvenah's interest in the LLC, and the trial court awarded Parvenah actual and punitive damages based on the wrongful acts and omissions. Jacob appealed on numerous issues but did not challenge the trial court's division of the LLC's assets.

The court of appeals rejected Jacob's challenge to the legal sufficiency of the evidence to support Parvenah's oppression claim. Jacob argued that there was no evidence that he oppressed Parvenah's rights by refusing to allow her to participate in management given that she was not a member. The court explained that a membership interest is personal property and that Mike's 50% membership interest was community property awarded in its entirety to Parvenah under the divorce decree. Mike executed a document transferring and assigning the membership interest to Parvenah as required by the divorce decree, but the assignment of the interest did not include the right to participate in management under the Texas LLC statute. Under the statute, the right to participate in management is not community property, and assignment of a membership interest does not entitle the assignee to participate in the management and affairs of the LLC, become a member, or exercise any rights of a member. An assignee is entitled to become a member only with the approval of all of the members, and Jacob never consented to Parvenah becoming a member. Thus, she did not have any right to participate in the management of the LLC. Jacob next contended that there was no evidence that he oppressed Parvenah's rights by failing to make distributions to her. The LLC's regulations (i.e., operating agreement) provided for quarterly distributions to members of "available cash" provided available cash was not needed for reasonable working capital reserves. The LLC statute provides that an assignee is entitled to receive any distribution the assignor is entitled to receive to the extent the distribution is assigned. Because the district court awarded the entire community interest to Parvenah, she had a right to receive distributions. The district court found that

Jacob paid himself for services that were not performed and that he failed to make any distributions to Mike or Parvenah even though \$250,000 in undistributed profits had accumulated since the mortgage on the LLC's property was paid off. The court of appeals concluded this was some evidence supporting the trial court's finding that Jacob failed to make profit distributions. The court also agreed that the established facts demonstrated that Jacob engaged in wrongful conduct and exhibited a lack of fair dealing to the prejudice of Parvenah.

The court addressed a challenge by Jacob to the legal sufficiency of the evidence to support the actual and punitive damages award. Because the court of appeals sustained Jacob's challenges to Parvenah's other causes of action, the only viable cause of action to support a damage award was the shareholder/member oppression claim. The court of appeals stated that the standard of review on this issue was not the traditional sufficiency analysis as asserted by Jacob, but rather was abuse of discretion because the receivership provision of the Texas Business Organizations Code that provides for an oppression action authorizes a court to fashion an equitable remedy if the acts of those in control of an entity are oppressive. The court of appeals concluded that the trial court's methodology for finding actual damages was not an abuse of discretion. The trial court calculated Parvenah's damages by calculating the difference between the value of the LLC's assets at the time of the trial court's judgment in this case and the value of the LLC at the time of the divorce. The court of appeals rejected the argument that the member agreement required the LLC to be valued as of the date of the divorce petition. The court of appeals stated that the trial court found that the member agreement did not apply to Parvenah. Assuming it applied to Parvenah, the court of appeals stated that it was inapplicable here because Jacob did not comply with the provision addressing a buyout on divorce by intervening in the divorce proceeding to enforce the provision. Mike had agreed to the intervention, but Jacob did not do so. Jacob next argued that the LLC regulations provided that the valuation of Parvenah's interest must be based on book value because the regulations contained a provision for purchase of a member's interest at book value or appraised value on request of a party who deems the book value to vary from market value by more than 20%. The provision of the regulations relied upon by Jacob addressed death, dissolution, retirement, or bankruptcy of a member. The court stated that the provision did not address how damages are calculated in a lawsuit based on oppression, and the court relied on other case law in which the court in an oppression action concluded that it was not an abuse of discretion to order a buyout for fair value when a buy-sell agreement provided for redemption at book value. The court of appeals pointed out that receivership is one remedy for shareholder/member oppression and that the trial court ordered a receivership and authorized a sale of the LLC's assets. Jacob did not complain concerning the receivership or sale. However, the court concluded that Parvenah was not limited to a recovery of her proportionate share of the sale proceeds and that courts have equitable powers to fashion appropriate remedies for oppressive conduct, including a buyout. Here, the court concluded that sufficient evidence supported the values found by the trial court and that Jacob did not argue, and the court of appeals did not perceive, that the trial court's methodology constituted an abuse of discretion. The court of appeals sustained Jacob's challenge to punitive damages because the only causes of action that could support a punitive damages award were actual fraud and breach of fiduciary duty, and Jacob's challenges to these claims were sustained by the court of appeals.

Davies v. Jerry, 966 N.Y.S.2d 797 (App. Div. 4 Dept. 2013).

Rosenberg and Jerry entered into an LLC operating agreement in 2002. The LLC was formed for the purpose of acquiring underdeveloped real property and developing a commercial subdivision

for the construction and operation of hotels. Rosenberg died in 2010, and the co-executors of his estate filed a suit for breach of contract, an accounting, and dissolution against Jerry and the LLC. The defendants asserted counterclaims, sought a declaration of the rights of the parties, and moved for summary judgment. The trial court granted the defendants' motions and denied the plaintiffs' cross motion. The appellate court found that the trial court properly determined the defendants were entitled to summary judgment but failed to declare the rights of the parties. The court modified the judgment by making the requisite declarations. First, the court addressed the plaintiffs' claim that the decedent's estate was not required to give written notice of its intent to transfer the decedent's membership interest in the LLC. The court disagreed based on its interpretation of the operating agreement. The operating agreement clearly and unambiguously provided that if a member died, that member shall be deemed to have offered his or her membership interest to the other members for sale and shall give written notice to the other members of his, her, or its intention to transfer such membership interest. Thus, the plain language of the agreement provided for the decedent's estate to give written notice of its intent to sell. The court also found that the trial court properly interpreted the operating agreement in determining that the date of valuation of the decedent's interest was the date of his death. The operating agreement further provided that the purchase price of a membership interest shall be determined based on a fair market appraisal of the real property owned by the LLC and that the value of the LLC included goodwill. The plaintiffs contended that they would be entitled to essentially nothing under the provision because the LLC owned only a small vacant parcel of land since the LLC had transferred the real property it had owned in exchange for an interest in two entities that developed hotels on that property. However, the court pointed out that the defendants had admitted at oral argument that the value of the LLC included the appraised value of the hotels that currently existed on the real property in which the LLC had an interest. Therefore, the court modified the judgment to adjudge and declare that: the decedent was deemed to have offered his membership interest in the LLC to the defendants at his death; the estate of the decedent must give written notice of its intent to sell; and the purchase price of the membership interest was to be based on the appraised valuation of the commercial real property of the LLC as of the date of the decedent's death.

Treeline 990 Stewart Partners, LLC v. RAIT Atria, LLC, 967 N.Y.S.2d 119 (App. Div. 2d Dept. 2013).

Two entities executed an operating agreement governing an LLC formed for the purpose of purchasing and operating an office building. One party was designated the "common capital member" and "managing member," and the other was designated the "preferred capital member." The operating agreement contained a provision specifying that any modification of the operating agreement must be in writing. After economic conditions worsened and the building began losing tenants, the members began discussing potential transactions to restructure the LLC or sell the preferred member's interest to the managing member. After months of negotiations, the parties orally agreed that the managing member would purchase the preferred member's interest at a discounted price. The agreement was never reduced to writing, and the preferred member ultimately refused to go through with the alleged buyout agreement. The managing member sued the preferred member for breach of contract, fraud, and negligent misrepresentation. The preferred member argued that enforcement of the alleged oral buyout agreement was barred by the provision of the operating agreement requiring amendments to be in writing. The court held that the oral buyout agreement did not modify the terms of the conditions of the operating agreement, but was a separate additional

agreement addressing a situation not covered by the operating agreement. The complaint alleged that the parties orally agreed on all of the material terms of the sale of the preferred member's interest and thus stated a cause of action for breach of contract. The court held that the fraud claim was properly dismissed because a fraud action does not lie where the only alleged fraud relates to an alleged breach of contract. Further, the court stated that a general allegation that a party entered into a contract with no intention to perform is insufficient to state a cause of action to recover damages for fraud. The negligent misrepresentation claim was also properly dismissed because the managing member failed to allege any misrepresentation that was collateral or extraneous to the alleged contract.

Davis v. VCP South, LLC, 740 S.E.2d 410 (Ga. App. 2013).

The LLC operating agreement of an LLC formed by two doctors contained a provision that gave each member, following the other member's death, the option to purchase the deceased member's interest in the LLC, and the purchase price was to be determined by the LLC's certified public accountant. Dr. Davis died, and his wife, Lori Davis ("Davis"), was appointed the administrator of his estate. The remaining member and the LLC sued the estate to enforce the LLC operating agreement provision authorizing the CPA to determine the purchase price of the deceased member's interest in the LLC. The trial court entered partial summary judgment in favor of the plaintiffs, and Davis appealed. On appeal, Davis first argued that the trial court's summary judgment finding that the LLC's CPA was authorized to determine the purchase price was erroneous. The appellate court disagreed with Davis. The evidence showed that the LLC's operating agreement expressly provided that "the purchase price for the membership units shall be their fair market value as determined in a commercially reasonable manner by or under the CPA regularly representing the LLC, whose decision in this matter shall be conclusive." The court stated that the intent of the parties to the operating agreement was clear and unambiguous in authorizing the LLC's CPA to determine the purchase price, and the trial court did not err in its construction of that portion of the operating agreement. Davis's challenge to the propriety of such a provision failed to recognize the contractual flexibility afforded members of an LLC and the state policy to give maximum effect to the principle of freedom of contract and enforceability of operating agreements. Next, Davis contended that the trial court erred in granting partial summary judgment in favor of the plaintiffs because the plaintiffs waived the enforcement of the provision in the operating agreement authorizing the CPA to determine the purchase price by first obtaining a valuation of the deceased member's interest from another accounting firm. The court found that Davis showed no evidence of waiver of the provision at issue. The alternate valuation was performed solely for the purpose of assisting the plaintiffs in negotiating with Davis. Once the negotiations ended unsuccessfully, the plaintiffs' complaint sought to enforce the operating agreement provision authorizing the CPA to conclusively determine the fair market value and purchase price. Davis next alleged that the provision in the LLC's operating agreement authorizing the appraisal by the CPA required a mandatory arbitration. The court again disagreed with Davis and explained that this case involved a contract provision concerning the method of appraising value. Appraisal involves an issue of value and does not constitute a common law or statutory arbitration, which would be invoked to resolve broader issues of liability. The court found that the provision in question was an appraisal clause set forth only to resolve an issue of value and not broader issues of liability, so Davis's claim that the provision was an arbitration clause was without merit. Finally, Davis argued partial summary judgment in favor of the plaintiffs was erroneous because a genuine issue of material fact existed as to fraud and whether the CPA

determined the fair market value in a commercially reasonable manner. However, Davis failed to indicate what specific facts showed fraud or a lack of commercial reasonableness. Although the court stated that it had no duty to go through the record in search of support for the contentions of the parties, the court reviewed the pages cited by Davis and found no evidence of fraud or that the appraisal by the CPA was not commercially reasonable. The cited pages critiqued the CPA's appraisal methodology, but the appellate court agreed with the trial court's finding that the facts did not rise to the level of showing fraud or that the appraisal was conducted in a commercially unreasonable manner. In sum, the court affirmed the trial court's granting of partial summary judgment in favor of the plaintiffs and the ruling that the determination by the CPA, which the contracting parties expressly agreed would be conclusive, was binding.

Fancher v. Prudhome, 112 So.3d 909 (La. App. 2013).

Robbins formed an LLC, and shortly after its formation, Prudhome and Fancher each acquired a one-third interest and became members of the LLC. Robbins retained a one-third interest. As consideration for his interest, Fancher paid \$10 and provided work and capital for the LLC. At the time, Fancher worked as a consultant for an oil company through which he performed consulting services, and Fancher directed that company's business to the LLC. This business was the LLC's primary source of business. The year following the LLC's formation, Fancher filed suit complaining he was denied access to the LLC's building and records. After filing suit, Fancher learned of a loan agreement and various leasing agreements that were done without his knowledge. Fancher withdrew from the LLC, asserting that the loan agreement was a breach of confidence. At trial, the main issue was the determination of the fair market value of Fancher's one-third interest in the LLC at the time of his withdrawal. Fancher's expert, a CPA, testified that the LLC's fair market value was \$2 million based on a "going concern" analysis, which assumed the business would continue, without a reduction for discounts. The trial court noted that Fancher was a minority interest holder in the LLC who could not make business decisions or require distributions. In addition, because Fancher occupied a unique role in providing the primary source of business to the LLC, the trial court stated that Fancher's interest was not marketable because its value was indistinguishable from Fancher himself. The trial court found that the fair market value of the plaintiff's interest was best determined by using the assets approach or book value of the LLC's equity, which Fancher's expert listed as almost \$38,000. The trial court awarded Fancher almost \$12,500 as the value of his share of the LLC at the time of his withdrawal. On appeal, Fancher first alleged that the trial court erred in valuing his interest in the LLC by failing to consider all of the LLC's assets at the time of his withdrawal. Under the Louisiana LLC statute, a withdrawing member of an LLC is entitled to receive the fair market value of the member's interest as of the date of withdrawal. The fair market value is generally the price a willing buyer would pay a willing seller in an arm's length transaction, and the determination may be subject to discounts when the facts support their use. The value of a withdrawing member's interest may be determined in a number of ways depending on the circumstances. The trial court determined that the income approach, which forecasts future earnings, was not applicable because the LLC's cash flow could not be assumed due to Fancher's role in providing most of the business. The market approach also did not apply because the LLC was a small, closely held company with profits tied to the skill of its members such that Fancher's interest was indistinguishable from himself. The appellate court concluded that the record did not show that the trial court erred in using the book value or assets approach to determine the value of the LLC.

Suresky v. Sweedler, 60 A.3d 358 (Conn. App. 2013).

The court of appeals concluded that the trial court's determination that a redeemed member did not receive less than he was entitled to receive under a letter agreement with the LLC was not clearly erroneous. Neither party provided expert testimony, and expecting the court to navigate five years of tax returns, payroll records, promissory notes, and repayment records and perform forensic accounting of capital accounts without expert assistance to conclude there were discrepancies would be unreasonable.

Indemnification

Fillip v. Centerstone Linen Services, LLC, C.A. No. 8712-ML, 2013 WL 6671663 (Del. Ch. Dec. 3, 2013) (Master's report), aff'd in part and remanded for further proceedings, 2014 WL 793123 (Del Ch. Feb. 27, 2014).

Both the master and the vice chancellor concluded that the LLC agreement in this case provided for mandatory advancement and noted that the case illustrates the relatively common remorse experienced by an entity that has conferred broad advancement rights to an official or employee whom the entity later accuses of grievous wrongdoing. The plaintiff in this action sought advancement for expenses in defending counterclaims and affirmative defenses asserted by the defendant LLC in an action brought by the plaintiff in Georgia to recover severance payments after the plaintiff resigned from his position as CEO of the LLC. The LLC's original counterclaims and affirmative defenses alleged various breaches of fiduciary duty and breaches of contract. In an effort to avoid advancement, the LLC dismissed its breach of fiduciary duty claims and argued that advancement was not required for the remaining breach of contract allegations. The indemnification provision of the LLC agreement provided as follows:

The Company shall indemnify, defend and hold harmless each Manager and Officer for all costs, losses, liability, and damages whatsoever paid or incurred by such Manager or Officer in the performance of his duties in such capacity, including, without limitations, reasonable attorney's fees, expert witness and court costs, to the fullest extent provided or permitted by the [Delaware Limited Liability Company Act] or other applicable laws. Further, in the event fraud or bad faith claims are asserted against such Manager or Officer, the Company shall nonetheless bear all of the aforesaid expenses subject to the obligation of such Manager or Officer to repay all such expenses if they are finally determined to have committed such fraud or bad faith acts.

The LLC argued that the plaintiff's advancement right was limited to expenses related to claims for fraud or bad faith, and in any event was not required because the breach of contract claims were personal and thus not taken "in the performance of his duties" as an officer of the LLC. Applying contract interpretation principles and reading the indemnification provision as a whole, the court held that the word "defend" in the first sentence of the indemnification provision created an advancement right. The court relied on case law holding that the word "defend" has a meaning distinct from the phrase "indemnify and hold harmless" and creates a duty to pay for expenses of defense on a current basis. The court concluded that the second sentence of the indemnification provision merely clarified the scope of the advancement rights created in the first sentence. According to the court, the LLC's position that the parties intended to limit advancement to circumstances in which an official was accused of fraud or bad faith was not a sensible interpretation

of the agreement in this case. The court also rejected the LLC's argument that the phrase "in the performance of his duties in such capacity" created a narrower advancement right than the "by reason of the fact" standard found in the Delaware General Corporation Law, which is satisfied if there is a nexus or causal connection between the corporate actor's official capacity and the underlying proceedings. The court found no substantive distinction between the "performance of his duties" language used in the LLC agreement in this case and the "by reason of the fact" language in the corporate statute. The language used in the indemnification provision of the LLC agreement and the broad contractual freedom conferred under the LLC statute did not support the LLC's assertion that "in the performance of his duties in such capacity" should be read more narrowly than "by reason of the fact," both of which can be understood as encompassing wrongdoing committed by an officer in his official capacity and in the performance of his day-to-day duties. In arguing its exceptions to the master's report to the vice chancellor, the LLC conceded that the two standards are interchangeable but argued that the master's determination of the scope of advancement under either standard was incorrect. The vice chancellor found that the meaning of the phrase "in the performance of his duties" was controlled by case law explicating the "by reason of the fact" standard. The master evaluated the application of the advancement provision to the various claims asserted in the Georgia action, but the vice chancellor concluded that it would be premature to address the master's findings in this regard due to the fluid nature of the Georgia action and information lacked by the master at the time of her report. The vice chancellor thus remanded to the master for further proceedings.

Grace v. Ashbridge LLC, C.A. No. 8348-VCN, 2013 WL 6869936 (Del. Ch. Dec. 31, 2013).

The plaintiff, a member, manager, and chairman of the defendant LLC, filed this action for advancement and indemnification for expenses incurred in the current action and a previously commenced action in Pennsylvania (the "Orphans' Court Proceeding") and failed mediation arising out of alleged breaches of fiduciary duty by the plaintiff in connection with the plaintiff's role as a trustee of a family trust. The trust owned shares in a corporation that merged into the defendant LLC, and the plaintiff was also a shareholder, director, and chairman of the corporate predecessor of the LLC. The claims in the Orphan's Court Proceeding were based on various acts of mismanagement involving the corporation and an affiliate entity. The plaintiff argued in the current proceeding that he was entitled to advancement and indemnification under the LLC's operating agreement because the agreement required indemnification of losses and advancement of expenses for any person made a party to a proceeding by reason of being a member or manager of the LLC or an employee, officer, director, manager, shareholder, or partner of a member or manager of the LLC. The LLC sought to dismiss the current action because the plaintiff's acts relating to the Orphans' Court Proceeding were taken in the plaintiff's personal capacity or in his capacity as an officer of the predecessor corporation or its affiliate and not in any capacity relating to the LLC. The court analyzed the indemnification provision of the LLC operating agreement and concluded that its plain terms did not extend to predecessors or affiliates. The claims in the Orphans' Court Proceeding did not even mention the LLC, but rather were based on various acts of mismanagement related to the predecessor corporation and its affiliate. Thus, the LLC operating agreement did not require advancement and indemnification for that proceeding. The court stated that Delaware case law supported this result because successor entities are generally not liable for the actions of corporate officers of predecessor entities or affiliates when a fundamental change in identity has occurred. For purposes of advancement and indemnification, Delaware law considers a conversion from an LLC

to a corporation to be a “fundamental change in identity.” One of the ways in which LLCs and corporations differ is with respect to indemnification: indemnification is mandated when corporate directors and officers successfully defend themselves, but indemnification is left to the terms of the operating agreement in the case of LLCs. The indemnification rights in the LLC’s operating agreement were different from those found in the predecessor corporation’s bylaws, making this case similar to a previous Delaware case, *Bernstein v. Tractmanager, Inc.*, in which the chancery court had held that a former manager of an LLC and current director of a corporation was only entitled to indemnification under the corporate bylaws, which did not retroactively create a right for the person’s tenure as a member of the LLC. The court expressed no opinion on whether a successor entity could be responsible for indemnifying or granting advancement based upon the bylaws or operating agreement of a predecessor entity because the plaintiff did not allege that the predecessor corporation’s bylaws entitled him to indemnification and advancement. The court also held that no indemnification was due for expenses of the failed mediation because the plaintiff failed to plead any facts describing the mediation or the factual circumstances underlying it. Finally, because the plaintiff was not entitled to indemnification and advancement for the Orphan’s Court Proceeding and mediation, he was not entitled to indemnification or advancement for the current action.

Costantini v. Swiss Farm Stores Acquisition LLC, Civil Action No. 8613-VCG, 2013 WL 4758228 (Del. Ch. Sept. 5, 2013), modified on reargument, 2013 WL 6327510 (Del. Ch. Dec. 5, 2013).

Two individuals, Costantini and Kahn, sought indemnification for their fees and costs in underlying litigation brought against them by an LLC. In the underlying action, the LLC sued Costantini and Kahn for alleged breaches of fiduciary duty, but the action was dismissed based on laches. In this action, Costantini and Kahn sought judgment on the pleadings for indemnification for their fees and costs incurred in defending the fiduciary duty action. The court discussed the claims by Costantini and Kahn separately because Costantini was a member of the board of managers of the LLC and Kahn was not.

With respect to Costantini’s claim for indemnification, the court stated that the same policy reasons supporting indemnification of corporate actors apply to actors for other entities, including LLCs. As creatures of contract, LLCs have broad latitude to allocate the rights and responsibilities of the members, but the LLC in this case chose to track the permissive and mandatory indemnification rights of the Delaware General Corporation Law for members of its board of managers, officers, employees, and agents. Costantini was sued in his capacity as a member of the LLC’s board of managers, and the court held that the operating agreement unambiguously provided indemnification to Costantini under the undisputed facts. Thus, Costantini was entitled to judgment on the pleadings.

The parties had conceded that Kahn was not a member of the LLC’s board of managers and was not an officer, employee, or agent of the LLC; Kahn was apparently sued for breach of fiduciary duty in his capacity as a partner of a partnership that was a member of the LLC. The partnership had the right as a member to appoint a member of the LLC’s board of managers. The court held that, because Kahn was not an officer, employee, agent, or member of the board of managers of the LLC, he did not fall within the categories of persons granted indemnification under the LLC’s operating agreement and was not entitled to indemnification. On reargument, Kahn submitted evidence claiming that he was an agent of the LLC based on brokerage and development management contracts between his corporation and the LLC. The court concluded that Kahn might be an agent

or subagent of the LLC based on the agreements and his relationship with his corporation, but there were factual determinations that could not be made from the face of the complaint in that regard. Assuming Kahn was an agent of the LLC, he would be entitled to indemnification if the underlying action against him was brought by reason of the fact that he was an agent of the LLC. Because the indemnification clause in the operating agreement indemnified a person who was sued “by reason of the fact” that he as an agent, which was language borrowed from the Delaware General Corporation Law, the court looked to case law interpreting the corporate statute. Corporate precedent has established that a proceeding is “by reason of the fact” of a corporate position if there exists a causal connection or nexus with the corporate position. Case law in the corporate context further explains that a nexus exists where the corporate capacity is necessary or useful for committing the alleged misconduct. The court concluded that the pleadings were insufficient for the court to determine whether Kahn’s alleged agent status was necessary or useful to commit the acts alleged in the underlying action. Thus, Kahn was not entitled to judgment on the pleadings.

CB3 Enterprises LLC v. Damas, 415 S.W.3d 163 (Mo. App. 2013).

Damas, the managing member of an LLC owned by Damas and his two brothers, sold his interest to one of his brothers, and his brothers then uncovered facts leading them to believe that Damas breached his fiduciary duty to the LLC. The LLC filed a lawsuit against Damas for breach of fiduciary duty, and Damas filed a counterclaim for indemnification from the LLC. The jury found for Damas on the breach of fiduciary duty claim and on his indemnification claim. The LLC argued that its articles of organization and operating agreement expressly barred the indemnification claim. The articles of organization contained indemnification provisions that were broken down into two paragraphs, one entitled “Direct Actions” and one entitled “Derivative Actions.” The paragraph entitled “Direct Actions” required indemnification of any manager or officer who met specified standards and was a party to an action, suit, or proceeding “other than an action by or in the right of the Limited Liability Company,” and the paragraph entitled “Derivative Actions” required indemnification of any manager or officer who met specified standards and was a party to an action, suit, or proceeding “by or in the right of the Limited Liability Company.” The operating agreement provided that the manager shall be indemnified by the LLC to the fullest extent provided by Missouri law. The LLC argued that the “Direct Actions” provision controlled because the LLC brought the action against Damas directly. Because the “Direct Actions” provision excluded any obligation to indemnify a manager or officer in an action brought by or in the right of the LLC, the LLC argued it had no obligation to indemnify Damas in this case. Construing the articles of organization according to general contract rules, the appellate court concluded that the LLC’s action against Damas fell within the scope of the “Derivative Actions” provision because that provision applied to an action “by or in the right of the Limited Liability Company.” Rather than being in conflict and ambiguous as the trial court found, the two indemnification provisions were harmonious and did not overlap. One provision applied to actions initiated by or in the right of the LLC, and the other did not. The court acknowledged that the LLC’s action could be characterized as a “direct” action under the dictionary definitions of “direct” and “derivative” actions, but parties to a contract are free to define terms as they see fit, and the court stated that it would not employ a dictionary definition that is contrary to the plain meaning of the contract. The court noted that the articles of organization did not contain a provision stating that headings are for convenience only and should not be used to interpret the contract. The operating agreement contained such a provision, and Damas argued that the provision in the operating agreement should be read to apply to the articles of organization as

well since the two documents were executed at the same time. The court did not find it necessary to rely on any provision of the operating agreement because the court otherwise concluded that the articles of organization unambiguously required indemnification of Damas.

Imbert v. LCM Interest Holding LLC, C.A. No. 7845-ML, 2013 WL 1934563 (Del. Ch. May 7, 2013).

Imbert sought advancement from two LLCs of fees and expenses he was incurring in his defense of a New York lawsuit filed against him by the LLCs after he was terminated from his position as manager of the LLCs. The LLC agreements required tax distributions to the members, and the LLCs alleged that Imbert had been inflating his tax liability so that he would receive disproportionately large distributions. In the New York lawsuit, the LLCs alleged that Imbert breached fiduciary duties owed as a manager and committed fraud when he approved and accepted the allegedly improper distributions, that Imbert was unjustly enriched by retaining the allegedly improper distributions, and that Imbert improperly charged personal expenses to a business expense account. The LLCs also sought in the New York action a declaratory judgment as to whether Imbert was still a member of the LLCs.

The LLC agreements provided that each LLC “shall indemnify” any person “made, or threatened to be made, a party to any action or proceeding ... by reason of the fact that he ... is or was a Manager, or an officer of the Company ...” and that the LLC must advance or promptly reimburse “[a]ll expenses reasonably incurred by an Indemnified Person in connection with a threatened or actual action or proceeding with respect to which such Person is or may be entitled to indemnification” Because advancement and indemnification were mandatory under the LLC agreements, the burden was on the LLCs to prove that advancement was not required. The LLCs argued that Imbert was not entitled to advancement because the claims in the New York litigation involved wrongdoing by Imbert as a member and not as a manager. In focusing on whether the claims in the New York action arose “by reason of the fact” that Imbert was a manager of the LLCs, the court relied on Delaware case law stating that a proceeding is “by reason of the fact” that one is a corporate officer if there is a nexus or causal connection between any of the underlying proceedings and one’s official capacity. The nexus is established if the “corporate powers were used or necessary for the commission of the alleged misconduct,” which includes all actions brought against an officer or director “for wrongdoing that he committed in his official capacity” and all misconduct allegedly occurring “in the ordinary course of performing his day-to-day managerial duties.” The court found that the LLCs’ breach of fiduciary duty and fraud claims against Imbert related to acts in his capacity as a manager rather than as a member and that the nexus was thus sufficiently established as to those claims. The breach of fiduciary duty claim rested on Imbert’s capacity as a manager because the LLC agreement did not impose fiduciary duties on members, and Delaware law imposes no default fiduciary duties on non-managing, non-controlling members. As in the case of the breach of fiduciary duty claim, the fraud claim depended on Imbert’s role as a manager because the LLC agreement imposed no obligation on a member to make disclosures, and simply receiving distributions as a member without revealing that he had received tax refunds for the years at issue involved no deception. With respect to the LLCs’ unjust enrichment claim, however, the court concluded that Imbert was not entitled to advancement of fees. Retaining, as a member, the allegedly improper distribution, as alleged in the unjust enrichment claim, did not arise by “reason of the fact” that Imbert was a manager of the LLCs. The business expense claim had been dismissed from the New York case in anticipation of submission to mandatory arbitration, but the court addressed Imbert’s

right to advancement in connection with this claim as well as the others. The court concluded that Imbert was entitled to advancement in connection with this dispute because it was rooted in the misuse of responsibility and trust given to Imbert as CEO of a subsidiary limited partnership of the LLCs, and the LLC agreements covered those who served at the request of the LLCs as an officer of any other enterprise. Further, the LLCs' agreement that the claim should be withdrawn in favor of mandatory arbitration before FINRA confirmed that the claim related to Imbert's role as CEO of the affiliate because a claim between the LLCs and a member of the LLCs would not be subject to mandatory arbitration before FINRA. The court concluded that Imbert was also entitled to advancement of fees in connection with the declaratory judgment sought by the LLCs in the New York action. The LLCs sought declaratory judgment that Imbert was not a member of the LLCs, which was a determination that depended on whether Imbert was properly removed as a manager because only a non-manager member could be expelled.

Finally, the court granted Imbert's claim for advancement of fees incurred in a books and records request. The LLCs claimed this right belonged to Imbert by virtue of being a member because he invoked his statutory right as a member (as he was no longer a manager at the time he made his request) under the Delaware LLC statute. However, the court concluded that he exercised the right in order to defend claims asserted against him as a manager, and the court stated that certain offensive actions such as his books and records action can be a legitimate part of "defending" a suit.

The court granted Imbert an award of "fees on fees" to the extent the court granted Imbert's contractual right to advancement.

Crossroads ABL LLC v. Canaras Capital Management, LLC, 963 N.Y.S.2d 645 (App. Div. 1st Dept. 2013).

The court explained the distinction between advancement of legal fees and indemnification and concluded that the broad language of a servicing agreement between the parties entitled the plaintiff member of an LLC to advancement of its legal fees for prosecuting its claims against the LLC and defending against the counterclaims asserted by the LLC. The provision applied to "any and all claims, demands, actions, suits or proceedings" so long as the plaintiff's involvement in the proceedings is by reason of its service to the LLC and the plaintiff provided a statement that it agreed to reimburse the LLC in the event it was ultimately determined that the plaintiff was not entitled to indemnity. The court rejected the argument that the provision did not include intra-party claims and held the lower court properly determined that the plaintiff was entitled to advancement of its legal fees until the question of the plaintiff's entitlement to indemnification was ultimately determined.

Li v. Standard Fiber, LLC, C.A. No. 8191-VCN, 2013 WL 1286202 (Del. Ch. March 28, 2013).

Li sought advancement of legal fees pursuant to an indemnification agreement between Li and an LLC after the LLC's controlling owners initiated an arbitration proceeding against Li for breach of fiduciary duties to the LLC. When the LLC failed to satisfy Li's demand for advancement, he brought this action to enforce his advancement rights, and the LLC sought to dismiss or stay the action in favor of arbitration. The indemnification agreement did not contain an arbitration provision but contained an integration clause and provided that the question of Li's right to indemnification "shall be for an arbitrator or court to decide" if the LLC contested Li's right. Several other agreements to which Li and the LLC were parties contained mandatory arbitration clauses and integration clauses. Li was the founder of the LLC's predecessor and became a 25% owner of the

LLC when the predecessor's assets were sold to the LLC under an asset purchase agreement that contained a broad arbitration clause and an integration clause. The LLC agreement also contained an arbitration clause and an integration clause, as did Li's employment agreement with the LLC. The court applied the standard established in *Willie Gary LLC v. James & Jackson LLC*, under which the question of arbitrability is presumed to be a question for the court rather than arbitrators unless there is "clear and unmistakable" evidence that the parties agreed to arbitrate. *Willie Gary* held that such evidence is present if the arbitration clause either generally provides for arbitration of all disputes or incorporates a set of arbitration rules that empowers arbitrators to decide arbitrability. The *Willie Gary* "clear and unmistakable" test has been modified by subsequent case law in one respect. Even if the *Willie Gary* test is met, a court must still "make a preliminary evaluation of whether the party seeking to avoid arbitration of arbitrability has made a clear showing that its adversary has made essentially no non-frivolous argument about substantive arbitrability." The court here concluded, and Li did not dispute, that the asset purchase agreement, LLC agreement, and employment agreement satisfied the two prongs of the *Willie Gary* test because the broad arbitration clauses in those agreements generally provided for arbitration of all disputes and referenced the rules of Judicial Arbitration and Mediation Services. However, Li argued that the *Willie Gary* test should only apply to the indemnification agreement because it was executed after the other agreements and contained an integration clause showing that the parties intended the agreement to be the entire agreement with respect to its subject matter. The court acknowledged that the integration clause was some evidence that the indemnification agreement was completely independent of the other agreements and might lead to the conclusion that the arbitration provisions in the prior agreements were nullified with respect to the matter of advancement and indemnification. However, in the context of the limited inquiry permitted under *Willie Gary* and its progeny, Li's integration argument fell short because the integration clause did not conclusively establish that the valid arbitration clauses in the prior agreements were terminated. Some cases have held that a standard integration clause in a later agreement with no arbitration clause does not overcome an earlier agreement with an arbitration clause. Li also relied on the provision of the indemnification agreement granting the parties the right to litigate in Delaware courts under certain circumstances. The court stated that by focusing solely on the indemnification agreement, Li was subtly asserting that the claims asserted in his complaint did not relate to the prior agreements. However, who decides the question of substantive arbitrability turned on whether Li could clearly show that the LLC had made no non-frivolous argument that the dispute relates to the asset purchase agreement, LLC agreement, or employment agreement. Although Li's claims were based solely on the indemnification agreement, he arguably could not have brought them absent the other prior agreements that made him a member and officer of the LLC. The LLC's advancement and indemnification obligations arguably would not have arisen absent the parties' execution of the prior agreements, and the indemnification agreement could even be viewed as supplementing various provisions of the LLC and employment agreements. Further, Li's claims for indemnification at least colorably related to the LLC agreement in that he sought adjudication of substantive rights that were also provided in the LLC agreement. Although these arguments might not be very persuasive, they met the low threshold the court was required to apply, and the court could not conclude that the LLC had no non-frivolous arguments in favor of arbitrability. Thus, the court granted the LLC's request to stay the action pending an arbitrator's determination of arbitrability.

Davis v. Winning Streak Sports, LLC, 301 P.3d 709 (Kan. App. 2013).

In this action, Davis sought indemnification of his attorney's fees under the indemnification provision of the Kansas LLC statute based on the outcome of previous litigation brought by Davis against an LLC and the other members of the LLC. In the litigation, the jury determined that Davis was a member of the LLC and was entitled to \$600,000 in damages for breaches of fiduciary duty by the other members. However, the jury also found that Davis was liable to the LLC for \$74,788 for breach of contract and was liable in the same amount to the LLC and the other members for negligent misrepresentation. Further, on a declaratory judgment claim by Davis that he held a 49% membership interest in the LLC, the district court determined that Davis's interest was only 0.96%. In a previous appeal, the court of appeals found that the record supported the findings in the litigation. Davis then brought this action seeking indemnification from the LLC of his attorney's fees incurred in the original action against the LLC. The Kansas LLC statute authorizes an LLC to indemnify a member subject to any standards and restrictions set forth in the operating agreement and requires indemnification of a member's reasonable expenses in an action, including attorney's fees, to the extent that the member has been successful on the merits or otherwise. The LLC argued that there could be only one prevailing party and that Davis was not the prevailing party because he lost on the issue of the extent of his membership interest and on the counterclaims against him for breach of contract and negligent misrepresentation, but Davis argued that he prevailed because he succeeded in establishing that he had an interest in the LLC and obtained a \$600,000 judgment for breach of fiduciary duty against the other members. The appellate court focused on the statutory language providing requiring indemnification "to the extent that" a member was successful and concluded that there was no doubt that Davis prevailed in part in the litigation. Davis was thus entitled to indemnification to the extent he was successful. Because the district court erroneously determined by summary judgment that Davis was not entitled to indemnification, it did not reach the question of the amount of fees to be awarded. The appellate court stated that the district court on remand would need to consider not only the extent to which Davis succeeded but the factors set forth in the Kansas Rules of Professional Conduct for use in assessing reasonable attorney's fees. The court discussed a Delaware case in which partial indemnification of attorney's fees was at issue in the corporate context. The court noted the similarity between the language used in the Delaware corporate statute and the Kansas LLC statute and pointed out that the factors used under the Delaware Lawyers' Rules of Professional Conduct and the Kansas Rules of Professional Conduct are the same. The appellate court commended to the district court on remand the Delaware court's discussion regarding the calculation of indemnifiable fees. Next, the court of appeals distinguished numerous cases relied upon by the LLC for the proposition that the court should apply an abuse-of-discretion standard of review. These cases were inapposite because they apply when an award of attorney's fees is discretionary and the statute here mandates indemnification. Only the "how much" issue remained discretionary in this case. The court of appeals also addressed other arguments by the LLC that were not reached by the district court. The LLC argued that Davis could not seek indemnification because there was no operating agreement providing for indemnification. According to the LLC, the reference to an operating agreement in the first subsection of the statutory indemnification provision, which permits indemnification subject to any standards and restrictions set forth in the operating agreement, extends to the second subsection mandating indemnification. The appellate court rejected this interpretation and concluded that the lack of an operating agreement did not render the mandatory indemnification provision of the statute inoperative. The court next rejected the LLC's argument that the LLC indemnification statute is unconstitutionally vague. The

statutory provision contains an obvious clerical error in that it first refers to “a member, manager, officer, employee or agent” and then later in the paragraph refers to “such director, officer, employee or agent.” Considering the statute in its entirety, the court was satisfied that the legislature intended the statute to require indemnity for LLC members to the extent they are successful in any suit or proceeding contemplated by the statute. Finally, the court of appeals rejected the LLC’s argument that the statute was not intended to reimburse Davis for prosecution of his personal claim of ownership since it advanced his private interest. The court distinguished a corporate whistle-blower suit in which a former employee was determined not to qualify for indemnification. The court pointed out that Davis’s claims brought to light improper conduct by the other members that affected both the interests of the LLC and Davis. Thus, the court could not conclude as a matter of law that Davis’s suit advanced only his private interest, and the LLC provided no support for the notion that indemnity is not required when the underlying action benefits both the LLC and the individual plaintiff. In sum, Davis was entitled to partial summary judgment on his claim for indemnification, and the district court must determine on remand an amount of recoverable reasonable attorney’s fees.

In re Batt (Apperson v. Bleckner), 485 B.R. 562 (Bankr. W.D. Ky. 2013).

The debtor and the defendants in this adversary proceeding were members of an LLC whose operating agreement provided that the LLC would indemnify any member that had to pay as a result of the member’s status as a guarantor. The operating agreement further provided that the other members must pay their pro rata share to a paying member to the extent the LLC does not indemnify the paying member. A bank filed a proof of claim in the debtor’s bankruptcy, and the debtor’s trustee filed this adversary proceeding against the other members, alleging that, to the extent the debtor pays on his guarantee, the LLC will not indemnify him as required by the operating agreement. The defendants argued that the claim against them for indemnification was not ripe, and the trustee argued that Ohio law and the operating agreement allowed the debtor to bring an indemnity claim before making payment to the bank. The court examined the language of the operating agreement and concluded that it expressly authorized indemnification and did not authorize the debtor to make a claim for indemnification before suffering any loss. Furthermore, assuming the debtor made some pre-petition payments to the bank as contended by the trustee, the trustee was not entitled to seek indemnification because the trustee had not made a demand on the LLC seeking redress for the payments as required by the operating agreement. Even if such a demand would yield no results and would thus be futile as alleged by the trustee, the operating agreement required demand, and the claims for indemnity were not ripe until the demand was made.

Capital Contributions

Phillips Brothers v. Winstead, ___ So.3d ___, 2014 WL 68814 (Miss. 2014).

Winstead, Simmons, and Phillips Brothers, LP (“Phillips”) formed an LLC to operate a catfish hatchery and farm. The LLC operating agreement provided that Winstead, Simmons, and Phillips each had a 1/3 ownership interest and that Simmons was the manager. The members agreed that Winstead would be the hatchery operator and would receive a salary and certain other benefits. The LLC was funded with bank loans. The LLC was profitable only two of the eight years that Winstead was the hatchery operator, and Simmons fired Winstead in 2007. In 2009, Winstead sued the LLC, Simmons, and Phillips alleging various causes of action. The issues raised in this appeal to the Mississippi Supreme Court included whether admission of testimony regarding an oral

agreement for cash contributions violated the parol evidence rule. The trial court allowed testimony by Winstead and Winstead's expert regarding an alleged oral agreement by Simmons and Phillips to provide \$600,000 in cash contributions for the purchase of startup equipment and fish inventory. The trial court allowed the testimony because the operating agreement was silent as to the contributions. Article VI of the operating agreement stated that the members shall contribute property more particularly described in Schedule A and that no member was required to make any capital contributions except as set forth in that provision. Schedule A was blank. The supreme court concluded that the "silence" in Schedule A did not create an ambiguity and that the agreement clearly provided that no member was required to make any capital contribution other than as provided in Schedule A, in which nothing was listed. Thus, it was error for the trial court to go outside the operating agreement to consider the intent of the parties.

Germano v. Beaujean, 997 N.E.2d 1238 (Ohio App. 2013).

Beaujean and Germano formed an LLC in to operate a pizza franchise. The two agreed that that they would be equal owners, that Beaujean would provide financing for the LLC, and that Germano would provide on-site management. Other than the articles of organization, which listed both men as members, there was no written operating agreement. Disputes arose, and one claim that was asserted by Germano was that Beaujean made no capital contribution and had no management rights. At trial, the parties agreed that their intent was for each of them to own 50% of the LLC and that Germano would earn his half through "sweat equity" while Beaujean would finance the company. The court of appeals held that the trial court did not err in refusing to declare that Beaujean made no capital contribution and had no management rights. The court pointed out that the Ohio LLC statute provides that a contribution may consist of services or any other benefit provided to an LLC. There was some testimony that the parties initially sought bank financing, but it was later decided that Beaujean would loan the start-up funds. Beaujean obtained financing for the LLC in any event, and the court stated that the source of the loan was not relevant. The initial agreement that the parties would each be a 50% owner reflected that Germano found Beaujean's services of obtaining financing constituted a sufficient contribution, and the trial court did not err in recognizing that fact.

Ghosh v. Grover, 412 S.W.3d 749 (Tex. App. 2013).

Ghosh and Grover, through their respective entities of Cinemawalla, Inc. ("Cinemawalla") and 87 Minutes, LLC ("87 Minutes"), formed an LLC to produce a movie entitled *97 Minutes*. Ghosh and Grover orally agreed that Grover and 87 Minutes would contribute the rights to a screenplay and written commitments for the project along with \$600,000 in cash and \$400,000 of previous expenditures in exchange for 87 Minutes' membership interest, and Ghosh and Cinemawalla, in exchange for its membership interest, would obtain the release of \$4 million that had been placed in escrow under a contract between Cinemawalla and a third party ("San Luis Cine") for the production of another movie. Grover and 87 Minutes satisfied their obligations, and Ghosh repeatedly assured Grover that San Luis Cine had agreed to reallocate the escrowed funds to the production of *97 Minutes*, but San Luis Cine never released all the funds. After Ghosh offered various excuses and asserted that various actions needed to be taken before San Luis Cine would release the funds, Grover began to question Ghosh's credibility and demanded that their agreement be reduced to writing. Ghosh refused to do so, and Grover and 87 Minutes sued Ghosh and Cinemawalla. The plaintiffs' causes of action included breach of contract, conversion, and fraud,

and the jury found in favor of the plaintiffs on each cause of action. On appeal, Ghosh and Cinemawalla argued, *inter alia*, that the statute of frauds barred the breach of contract claim and the court of appeals addressed the enforceability of the oral agreement by the defendants to cause the \$4 million being held in escrow for production of another movie to be redirected to the LLC's movie project. The Texas LLC statute provides that a promise to make a contribution or otherwise pay cash or transfer property to an LLC is not enforceable unless the promise is in writing and signed by the person making the promise. "Contribution" is broadly defined in the statute to include any tangible or intangible benefit that a person transfers to an entity for an ownership interest or otherwise in the capacity as an owner or member. The benefit includes cash, services rendered, a contract for services to be performed, a promissory note or other obligation to pay cash or transfer property, or securities or other interests in or obligations of an entity. The plaintiffs argued that the defendants' did not promise to contribute anything directly to the LLC, but rather to obtain the release of the escrowed funds to Cinemawalla, who would then use the funds to pay vendors and others providing services needed to make the movie *97 Minutes*. The court stated that the statutory language is not limited to direct contributions. Here it was clear that the oral agreement to access the \$4 million in escrow and invest it to fund the production of the LLC's movie project constituted a promise to make a contribution to the LLC and was unenforceable because it was not in writing and signed as required by the statute.

Grove v. Brown, C.A. No. 6793-VCG, 2013 WL 4041495 (Del. Ch. Aug. 8, 2013).

In 2010, the Groves and the Browns started a successful home health care agency, Heartfelt Home Health, LLC ("Heartfelt"). After the first year, the relationship between the Groves and the Browns began to deteriorate when it was discovered that not all four members had made their requisite initial \$10,000 capital contributions. The Groves established their own home health agencies in Maryland and Delaware without telling the Browns, and the Browns attempted to remove the Groves by creating another LLC owned solely by the Browns and merging Heartfelt with that company. The Groves sued the Browns for breach of fiduciary duty, and the Browns counterclaimed for breach of fiduciary duty. After trial, the court rendered this opinion. The first issue addressed by the court was the percentage of the parties' ownership interests in Heartfelt. The Groves argued that the Browns only owned 50% of Heartfelt and thus lacked the legal authority to merge Heartfelt, but the Browns argued that the failure of the Groves to make the required capital contributions resulted in the Browns owning a majority interest in the LLC. The court examined the provisions in the Heartfelt LLC agreement, which stated that the members shall contribute a total of \$40,000 to the LLC capital and set forth each individual member's portion of this initial contribution as \$10,000 and 25%. The agreement also provided that profits and losses should be divided among the members "in proportion to each Member [sic] relative capital interest in the company." Thus, the court concluded that the agreement unambiguously provided that each member was required to contribute \$10,000 and that each member had a 25% ownership interest. The court further stated its conclusion would not change if it considered extrinsic evidence because there were membership certificates reflecting 25% ownership by each of the four members. The Browns disputed the validity of the membership certificates because they were undated and lacked the LLC seal, but the court considered the certificates to be overt statements demonstrating the understanding of the members of Heartfelt as opposed to contracts. Other extrinsic evidence consisted of representations by the members to a prospective lender that each was a 25% owner and the way members were treated before they had made their required capital contributions. The court noted that the LLC agreement could have been

written to make each member's interest contingent on the amount of their capital contribution, but the agreement did not do so. It merely required a contribution of \$10,000 from each 25% owner. Because the Browns owned only 50% of the LLC, the court held that the purported merger was a legal nullity. Unless otherwise provided by the LLC agreement, the Delaware Limited Liability Company Act requires a merger to be approved by members who own more than 50% of the then current percentage in the profits of the LLC, and the Heartfelt LLC agreement did not address mergers.

Patin v. Ferguson, 115 So.3d 1204 (La. App. 2013).

The plaintiff and defendant formed an LLC that acquired scrap metal, baled and compacted the scrap, and then re-sold the baled scrap at a profit. The LLC was member-managed, and its only members were the plaintiff and the defendant. The LLC's articles of organization provided that once each member had been reimbursed for his capital contributions, profits and losses would be divided equally between the members. The parties orally agreed that the defendant's capital contribution to the LLC would consist of the purchase of a baler, the LLC's primary piece of equipment, which was crucial to the business's operation, and other start-up costs. The plaintiff's capital contribution would consist of his personal services in the daily operation of the LLC and extensive expertise in the scrap metal business. Although the defendant purchased the baler in his name, it was dedicated to the LLC's operations. The defendant was paid money toward the cost of the baler, and the plaintiff received a monthly salary. After two profitable years, the defendant decided he no longer wanted to operate a business with the plaintiff due to the plaintiff's failure to repay a personal loan. The defendant demanded possession of the baler and an audit of the business records, and the plaintiff complied. The defendant offered to sell the baler to the plaintiff, but the plaintiff could not afford to buy it, and the defendant would not agree to provide owner financing. The defendant sold the baler to a third party, closed the LLC's bank account, and retained the proceeds of a workers' compensation premium refund. Without the baler, the LLC shut down. The plaintiff filed suit seeking damages on a claim of breach of fiduciary duties by the defendant. The trial court found that the baler was a capital contribution to the LLC rather than equipment that was the defendant's own property rented to the LLC and that the defendant breached his fiduciary duties to the LLC and the plaintiff. The trial court entered judgment in favor of the plaintiff and awarded damages. On appeal, the court first upheld the trial court's judgment that the baler was a capital contribution to the LLC. The evidence showed that the baler was not, as the defendant argued, the defendant's individually owned property leased to the LLC. Under the Louisiana LLC statute, a capital contribution is anything of value that a person contributes to the LLC as a prerequisite for or in connection with membership, and a capital contribution does not have to take the form of cash. The record was replete with evidence that the parties agreed the defendant would contribute the baler as capital to the LLC, and the existence of a rental agreement was unsubstantiated by any credible evidence. The court of appeals also upheld the trial court's conclusion that the defendant's actions breached his fiduciary duty and affirmed the award of damages to the plaintiff.

Improper Distributions

Weinstein v. Colborne Foodbotics, LLC, 302 P.3d 263 (Colo. 2013).

A creditor of an LLC obtained an arbitration award in federal court against an LLC with two members who were also the only shareholders of the LLC's two managers. The managers authorized

a distribution of the LLC's assets to the members, which the creditor alleged made the LLC insolvent and unable to pay the award owed to the creditor. The creditor filed suit against the members and managers claiming that the members violated the Colorado Limited Liability Company Act by accepting unlawful distributions and that the managers breached their fiduciary duty to the LLC's creditors by authorizing the distributions to its members. The defendants filed a motion to dismiss. In the motion, the members argued the plaintiff lacked authority to bring an action under the LLC statute because the statute provided only that members were liable to the LLC for an unlawful distribution. The managers argued that Colorado law did not recognize a common law fiduciary duty owed by managers of an LLC to an LLC's creditors and that case law allowing creditors of a corporation to recover against the corporation's shareholders did not apply to LLCs. The trial court agreed with the defendants and granted their motion to dismiss. The court of appeals reversed, holding that the plaintiff had a viable claim for an unlawful distribution against the LLC's members under the LLC statute because a similar provision of the Colorado Business Corporation Act had been interpreted to provide a cause of action for unlawful distributions to a corporation's creditors. The court of appeals also held that the plaintiff had stated a proper claim for breach of fiduciary duty against the managers based on prior case law that held an insolvent LLC's managers owed the same duty to the LLC's creditors that the directors of an insolvent corporation owe to the corporation's creditors. The Colorado Supreme Court granted the defendants' petition for certiorari on two issues: (1) whether the creditors had standing under the LLC statute to sue the members of an LLC who allegedly received an unlawful distribution, and (2) whether the court of appeals erred in extending the common law fiduciary duty an insolvent corporation's directors owe its creditors to the managers of an LLC. The supreme court generally discussed the LLC statute and the nature of LLCs and pointed out that an LLC is distinct from a corporation, which is governed by corporate law. As to the first issue, the supreme court agreed with the trial court that the LLC statute allows an LLC to state a claim against any member who knowingly receives a distribution that renders the LLC insolvent (i.e., an unlawful distribution) but does not provide for a cause of action for LLC creditors against LLC members. The creditor relied on the similarity of the distribution provision in the corporate statute, which Colorado case law had held conferred standing on creditors to sue directors. The supreme court conducted a statutory construction analysis and concluded that the creditor's argument was incorrect. The language of the LLC statute creates a cause of action for the LLC against a member for accepting unlawful distributions but does not mention such a cause of action for the LLC's creditors. The legislature created remedies for an LLC's creditor in other sections of the LLC statute but not in the circumstances at issue here. The court pointed out that the LLC statute and the corporate statute are two different statutes with different schemes and purposes, and because a corporate shareholder is not equivalent to an LLC member, the legislature was free to choose a statutory limitation on an LLC's creditors different from what it chose for a corporation's creditors. Furthermore, because LLCs and corporations are different business entities, common law applicable to corporations does not apply to an LLC in the context of a claim for unlawful distribution. Thus, the supreme court concluded that the LLC statute only permits the LLC to assert a claim against its members for an unlawful distribution, and the creditor could not assert a claim against the members for unlawful distribution absent statutory authority.

The court next addressed the question of whether the LLC's managers owed a common law fiduciary duty to the creditors similar to the fiduciary duty an insolvent corporation's directors owe its creditors. The creditor argued that the common law fiduciary duty exists in the LLC context and that the managers here breached that fiduciary duty by putting their own interests above the creditor's

by authorizing unlawful distributions. This was a question of first impression for the Colorado Supreme Court. The court had previously held that the directors of an insolvent corporation owe the creditors of the corporation a limited fiduciary duty that requires the directors to avoid favoring their own interests over creditors' claims; however, the insolvent corporation's directors do not owe a general fiduciary duty to its creditors. A Colorado court of appeals applied the ruling that a corporation's directors owe a common law fiduciary duty to the corporation's creditors to the managers of an LLC in *Sheffield Servs. Co. v. Trowbridge*, 211 P.3d 714, 723-24 (Colo. App. 2009). The supreme court disagreed with the appellate court. The Colorado LLC statute contains a provision specifying that corporation common law applies to a veil-piercing claim (not alleged here) but not to any other common law claim. The LLC statute extends no fiduciary duty to the LLC's creditors owed by the managers. Because the LLC statute did not extend corporation common law to an LLC in any instance except a veil-piercing claim, the court of appeals in *Sheffield* erred in extending the fiduciary duty of an insolvent corporation's directors to the managers of an LLC, and the court overruled *Sheffield* to the extent it held that an LLC's managers have a fiduciary duty to the LLC's creditors. The court held that absent statutory authority the managers of an insolvent LLC do not owe the LLC's creditors the same fiduciary duty that an insolvent corporation's directors owe the corporation's creditors. Thus, the creditor could not assert a claim of breach of fiduciary duty against the managers.

Fancher v. Prudhome, 112 So.3d 909 (La. App. 2013).

In this action to determine the value of a withdrawn member's interest in a Louisiana LLC, the withdrawn member argued that the remaining two members were personally liable to him for the value of his interest based on a provision of the Louisiana LLC statute prohibiting distributions when the LLC would be unable to pay its debts as they became due in the usual course of business. Each member who knowingly assents to such a distribution is joint and severally liable to the LLC for the amount of the distribution that exceeds the amount which could have been lawfully distributed. However, the withdrawn member did not present evidence to support his assertion that the distributions made to the other members caused the LLC to be unable to pay its debts as they became due. Because the record did not contain evidence that the distributions violated the statute, the members were not personally liable for the amount owed to the withdrawn member for his interest.

Humphrey Industries, Ltd. v. Clay Street Associates, LLC, 295 P.3d 231 (Wash. 2013).

An LLC member who exercised its statutory dissenter's rights sought to hold other members of the LLC individually liable for the LLC's obligations to the dissenting member. The court recognized that members of an LLC generally are not personally liable for the LLC's debts, obligations, and liabilities. Under Washington law, a member may become liable to the LLC if the member receives a distribution from the LLC knowing that the LLC would not be able to pay its debts or that the LLC's debts would exceed its assets. The dissenting member argued that the other members received distributions knowing the LLC would not be able to satisfy its obligations to the dissenting member. The court stated that the dissenting member did not support its argument and that the dissenting member's theories of liability would require the court to conduct factual inquiries that were beyond the scope of appellate review. Thus, the court held that the dissenting member did not establish the individual members were liable for the obligations owed to the dissenting member in the litigation.

Withdrawal or Expulsion of Member

Ark-La-Tex Safety Showers, LLC v. Jorio, __ So.3d __, 2013 WL 6654373 (La. App. 2013).

After dissension developed between the 51% and 49% members of an LLC, the majority member filed suit against the minority member for declaratory relief alleging that the minority member had withdrawn and that the minority member's actions had breached his duties and the operating agreement. The minority member filed an answer and asserted various claims for relief himself. A "stipulated preliminary injunction" was issued under which the parties agreed that each of them would be enjoined from taking certain actions. A trial was held during which most of the evidence centered on the value of the LLC's assets. At the conclusion of the trial, the court reached a decision as to the value of the LLC's assets and the monetary interest of each member in the LLC. The court then scheduled an evidentiary hearing on issues limited to permanent injunctive relief, future participation in the LLC by the parties, dissolution of the LLC, attorney's fees, and assessment of costs. At this hearing, the parties conceded that they did not desire to continue to work together. The plaintiff opposed dissolution and continued to argue that the minority member had withdrawn, but the minority member asserted that he was still a 49% member. At the conclusion of the hearing, the trial court concluded that the plaintiff failed to prove the minority member had withdrawn. The trial court concluded both parties were "prevailing parties" under the provisions of the operating agreement and awarded each party attorney's fees as well as court costs from the assets of the LLC. On appeal, the plaintiff argued that counsel for both parties had stipulated that the minority member had withdrawn. The plaintiff argued that both sides operated under the assumption that the minority member had withdrawn and that the evidence thus centered around the value of the assets of the LLC. The court of appeals reviewed the record and found no express stipulation that the minority member had withdrawn as a member of the LLC. Further, the court of appeals agreed with the trial court that the evidence did not show any affirmative action on the minority member's part indicating an intent to withdraw from the LLC, nor did the record indicate that the minority member tacitly withdrew. The plaintiff also argued that neither party should have been considered a "prevailing party" and that the award of attorney's fees was erroneous. The court interpreted the operating agreement pursuant to principles of contract law and concluded that the minority member was a prevailing party, but the plaintiff was not.

Magruder v. Pauley, 411 S.W.3d 323 (Mo. App. 2013).

Magruder, one of four equal members of an LLC realty agency, withdrew from the LLC. The remaining members refused to comply with the operating agreement, which required the LLC to obtain an appraisal of the business and pay the withdrawing member one-fourth of the appraised value. Magruder sued for specific performance, breach of contract, and prima facie tort. The court bifurcated the equitable claims from the remaining claims and found for Magruder after a bench trial on her claim for specific performance and the remaining members' counterclaim for declaratory judgment. A partial judgment for specific performance ordered the remaining members to commission and pay for an appraisal and to purchase Magruder's interest for one-fourth the appraised value. The parties agreed to a dismissal of Magruder's breach of contract claim because it was filed as an alternative to the specific performance claim, but the remaining claims were tried in the jury trial, which resulted in a judgment in favor of Magruder for compensatory and punitive damages. Over a period of five years, after the bench trial, jury trial, and at least 11 post-trial hearings, the specific performance ordered by the court still was not completed. During that time,

an appraisal was eventually performed, but the appraiser failed to include the LLC's real estate and made certain other errors. Magruder supplied the court the missing information, and Magruder asked the court to exercise its equitable powers to include a final valuation in its final order because it had all the necessary information to do so. Magruder also moved to hold the remaining members in contempt and requested attorney's fees based on the operating agreement. The trial court denied the contempt motion, and the trial court's final order merely affirmed the jury verdict and attached the earlier partial judgment without reference to the disputed appraisal or attorney's fees. On appeal, Magruder argued that the trial court erred in failing to include a valuation, failing to hold the defendants in contempt, and not awarding Magruder attorney's fees. The court of appeals agreed with Magruder regarding the trial court's failure to render a valuation and award attorney's fees but held the trial court did not abuse its discretion on the contempt issue. With regard to the trial court's failure to include a valuation in the final order, the court of appeals held that the trial court should have acted in equity to do so for three reasons. First, there was sufficient evidence in the record for the court to determine the valuation. Second, specific performance constitutes a remedy for breach of contract. Although the remaining members argued that Magruder could not now ask for a remedy that required a finding of breach of contract, the court's order for specific performance implicitly found a breach of contract. Third, the trial court sitting in equity had the authority to do what was necessary to afford complete relief. With regard to the Magruder's contempt motion, the court of appeals recognized that the remaining members' conduct was egregious but concluded that the trial court's decision did not constitute a clear abuse of discretion given the subjective analysis of the parties' actions involved in the trial court's exercise of discretion. Finally, the court agreed with Magruder that she was entitled to attorney's fees based on the language of the operating agreement, which provided for recovery of reasonable attorney's fees by the LLC or any party who obtained a judgment against any other party "by reason of breach of the Agreement." The remaining members argued that the agreement only provided for attorney's fees in the case of a "breach of contract." Because Magruder prevailed on her specific performance claim, the court of appeals held she was entitled to recover reasonable attorney's fees under the operating agreement. The court of appeals also noted that the trial court could have awarded fees on the basis of non-compliance with the court's order for specific performance.

Kaufman Development Partners, L.P. v. Eichenblatt, 749 S.E.2d 374 (Ga. App. 2013).

The court addressed the standing of a former member of an LLC who retained an economic interest in the LLC after his removal to sue for breach of the operating agreement and concluded the former member had standing to do so. Kaufman Development, L.P. ("Kaufman Development") and David Eichenblatt formed a real estate LLC and entered into an operating agreement identifying them as the members and addressing various governance, economic, and operational matters. A few years later, Eichenblatt and Kaufman Development agreed to part ways except for their agreement to continued joint ownership of certain entities. The two parties agreed to amend the operating agreement to remove Eichenblatt as a member in accordance with a particular provision of the operating agreement under which Eichenblatt would continue to receive allocations and distributions to which he would otherwise be entitled but would not have the other powers, rights, or privileges of a member. Accordingly, they amended the operating agreement to add a provision that specified the effective date of Eichenblatt's removal as a member, his right to receive allocations and distributions to which he would otherwise be entitled, and that he would have no other powers, rights, or privileges of a member, including authority to bind the LLC as a member or vote on any

matter requiring member approval pursuant to the operating agreement or the Georgia LLC statute, except that Eichenblatt's consent was required to approve any amendment that would reduce the amount that would be paid or distributed to him. The amendment also addressed his access to LLC records and entitlement to receive certain fees, and a new provision addressing management of the LLC and transactions with affiliates was added. The amendment stated that it was binding upon and inured to the benefit of the parties and provided that except as expressly modified the operating agreement remained in full force and effect. Eichenblatt sued Kaufman Development for breach of the operating agreement, claiming that Kaufman Development failed to comply with certain provisions governing the management and dissolution resulting in diminished allocations and distributions to Eichenblatt under the agreement. The jury found in favor of Eichenblatt and awarded \$625,000 in compensatory damages for breach of the operating agreement. The trial court entered judgment on the jury verdict and denied a motion by Kaufman Development to clarify the judgment to include a finding that Eichenblatt's interest in the LLC had been extinguished.

On appeal, the court of appeals first addressed Kaufman Development's argument that Eichenblatt had no standing to sue for breach of the operating agreement since he was no longer a member. The court pointed out that both the operating agreement and the amendment identified Eichenblatt as a party. By expressly removing Eichenblatt as a member, the court said that the amendment modified the operating agreement to exclude him from the term "member" as used in the operating agreement but did not affect his identity as a party to the agreement. The court disagreed with Kaufman Development's argument that Eichenblatt could not sue for breach of any provision of the operating agreement other than those governing allocations and distributions. The amendment provided that the operating agreement remained in full force and effect except as altered by the amendment, and the provision that stated Eichenblatt had no rights as a member other than allocations and distributions merely prevented him from claiming other rights reserved to the members. Neither the amendment nor the operating agreement specified that standing to enforce their agreement was a "power, right or privilege" limited to the LLC's members. Further, the court stated that construing the agreement as argued by Kaufman Development would be inconsistent with the addition of a new provision to the operating agreement addressing management and the provision of the amendment stating that the amendment was binding on and inured to the benefit of the parties. According to the court, these provisions made clear that Kaufman Development remained bound by and Eichenblatt continued to benefit from the terms other than those specifically related to allocations and distributions.

The court of appeals next rejected Kaufman Development's argument that the trial court should have clarified the judgment to specify that Eichenblatt's interest was extinguished. Kaufman Development argued that the jury's award represented the liquidated value of Eichenblatt's interest, but the court concluded that it was not at all clear that the jury intended for the damages award to represent the full value of Eichenblatt's interest in the LLC or for Eichenblatt to have no interest in the LLC going forward. The jury was not asked to make and did not make any findings about Eichenblatt's interest, and Kaufman Development was not entitled to rewrite the jury's verdict through a post-trial motion.

Holladay v. Storey, 307 P.3d 584 (Utah 2013).

In 2000, Storey, Holladay, Woodcock, and several other individuals formed an LLC to construct and operate an inn. Storey was appointed manager of the LLC. After the withdrawal of some of the members in early 2003, Storey, Holladay, and Woodcock executed an amended

operating agreement under which Storey remained as manager and Storey, Holladay, and Woodcock each held a one-third interest in the LLC. In June 2003, Holladay and Woodcock took over Storey's management duties, and later in 2003 litigation between the parties ensued. Storey asserted derivative claims and a demand for judicial accounting and dissolution or purchase of his interest. Holladay and Woodcock asserted claims against Storey for breach of fiduciary duty and other causes of action and sought Storey's expulsion as a member and removal as a manager and a judicial accounting and dissolution of the LLC. The case was governed by the Utah Revised Limited Liability Company Act in effect at the time. Initially, the court granted a motion by Storey for a partial summary judgment declaring that Storey could not be removed as a manager based on the terms of the operating agreement, noting that Holladay and Woodcock had not expressly invoked the provisions of the LLC statute providing for judicial removal of a manager. The court stayed implementation of the judgment to allow Holladay and Woodcock to request an injunction removing Storey under the statutory provision, and the court later issued a preliminary injunction removing Storey as manager on a motion by Holladay and Woodcock in 2005 invoking the statutory removal provision. Based on a stipulation of the parties in December 2003, the trial court permitted Holladay and Woodcock to enter into a franchise agreement for the sale of the inn. Following a bench trial in 2009, the trial court removed Storey as the manager of the LLC, expelled Storey as a member effective December 31, 2005, and valued Storey's interest as of December 31, 2005. Storey's removal as a manager was based on the trial court's findings of numerous instances of mismanagement and misconduct. The trial court ordered Storey's expulsion as a member for the same reasons as his removal as a manager and based on his unlawful conduct that adversely and materially affected the LLC's business or conduct making it not reasonably practicable to carry out business with the members. The trial court also found Storey breached his fiduciary duties to the members. The court made the expulsion and valuation of Storey's interest retroactive to December 31, 2005, based on the parties' conduct. The court found this date was appropriate because of Storey's mismanagement, misconduct, dishonesty, breach of fiduciary duty, and lack of success as a manager on that date. The trial court also justified the valuation date on the failure of Holladay and Woodcock to adhere to the amended operating agreement and timely access the court to implement their decisions and pursue their remedies. The trial court also found that the decision to convert to a franchise was a substantial reason for the success of the LLC during and after 2005.

On appeal, Storey argued that the statute did not authorize the trial court to backdate his expulsion and the valuation of his interest. The court of appeals discussed in detail the statutory provisions and the Utah Supreme Court's decision in *CCD, LC v. Millsap* and concluded that the trial court correctly determined that it had authority to make the expulsion of Storey and valuation of his interest retroactive. The court of appeals stated that the trial court could have chosen to backdate the expulsion to as early as 2003 based on his misconduct, but the trial court also appropriately took into account the delay by Holladay and Woodcock in complying with the amended operating agreement and LLC statute until 2005. Storey argued that he became an assignee under the statute when he ceased to be a member upon his expulsion and that he retained his interest until the judicial determination of dissolution in 2009. The court reconciled the provisions of the Utah statute by concluding that an expelled member becomes an assignee upon expulsion but that the assignee status continues only until valuation of the interest and does not preclude the retroactive valuation of the expelled member's interest when appropriate. Thus, the trial court had the discretion to set the valuation based on the equities of the case, and the evidence supported the valuation date chosen by the trial court.

In re Tristar Esperanza Properties, LLC (O'Donnell v. Tristar Esperanza Properties, LLC), 488 B.R. 394 (9th Cir. (B.A.P.) 2013).

A member of a California LLC invoked a withdrawal provision of the LLC operating agreement, triggering a process in which the LLC and withdrawing member would use their best efforts to agree upon the fair market value of the member's interest. After an appraisal failed to result in a value to which the LLC agreed, the withdrawing member initiated an arbitration proceeding that resulted in a determination that the LLC was bound by the value determined by the appraiser. The arbitrator awarded the appraised value as damages, and the arbitration award was confirmed by a California court and reduced to judgment. An abstract of judgment was recorded. The LLC filed a Chapter 11 bankruptcy case, and the LLC filed this adversary proceeding seeking mandatory subordination of the withdrawn member's judgment under Section 510(b) of the Bankruptcy Code. Section 510(b) provides that a claim for damages arising from the purchase or sale of a security of the debtor or an affiliate of the debtor shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if the security is common stock, the claim has the same priority as common stock. The court determined that a membership interest in an LLC is a "security" for purposes of this provision although the Bankruptcy Code definition of a "security" does not mention a membership interest in an LLC. Since the fifteen-item list of what constitutes a security in the definition is not exclusive, the court looked for an analogous item in the list and determined that the inclusion of the interest of a limited partner in a limited partnership led to the conclusion that the interest of a member of an LLC is also a security based on the similarities between the two types of interests. The court next concluded that the confirmed arbitration award was "for damages" within the meaning of Section 510(b). The court examined the general meaning of "damages" and rejected the argument that "damages" must arise from wrongdoing or malfeasance. Because the arbitration award was an order to pay money as a matter of contractual right and achieved the status of judgment debt, the arbitration award and judgment qualified as "damages" under Section 510(b). The court next addressed the question of whether the withdrawn member's claim was a claim "arising from the purchase or sale" of the LLC's securities. The withdrawn member claimed that her claim was an ordinary debt obligation because she withdrew, shed her equity status, and became a general creditor before the bankruptcy proceedings. The court discussed the ambiguous nature of the phrase "arising from" and concluded the Ninth Circuit favors a broad reading of the phrase. The court examined the legislative history of Section 510(b) and concluded that two rationales underlying Section 510(b) supported mandatory subordination: (1) the dissimilar risk and return expectations of shareholders and creditors; and (2) the reliance of creditors on the equity cushion provided by shareholder investment. As to the first rationale, the withdrawn member was an equity holder before she withdrew, enjoyed a considerable return during her tenure as member, and received an arbitration award that was directly linked to her ownership of a membership interest because it constituted the cashing out of her equity. Second, the court presumed that creditors relied on the equity cushion created by contributions to capital, and the withdrawal of the member in this case and liquidation of her interest altered, or attempted to alter, the balance sheet by extracting her contribution and deflating the equity cushion. Even if the withdrawn member had argued that there was a lack of creditor reliance, the presence of the first rationale was sufficient to support a holding that Section 510(b) is broad enough to encompass a claim that arose from the withdrawal of an LLC member triggering a repurchase process by which the debtor was obligated to buy back the interest. The court rejected the argument that the withdrawal from the LLC and fixing of the claim before bankruptcy rendered the claim a "fixed debt" and

prevented mandatory subordination. The court noted that this was not a case involving “a transformation of equity into debt in a transaction that is old and cold and that has long been treated as a part of the enterprise’s debt.” Rather, “the dispute over the buy-back amount and the chapter 11 filing were sufficiently proximate in time to warrant the conclusion that this is an effort by equity to capture paper (and arguably mythical) profits via a judgment for money damages.” In sum, the court concluded that the claim was so firmly rooted in the withdrawn member’s equity status that subordination was mandatory.

Fancher v. Prudhome, 112 So.3d 909 (La. App. 2013).

Robbins formed an LLC, and shortly after its formation, Prudhome and Fancher each acquired a one-third interest and became members of the LLC. Robbins retained a one-third interest. As consideration for his interest, Fancher paid \$10 and provided work and capital for the LLC. At the time, Fancher worked as a consultant for an oil company through which he performed consulting services, and Fancher directed that company’s business to the LLC. This business was the LLC’s primary source of business. The year following the LLC’s formation, Fancher filed suit complaining he was denied access to the LLC’s building and records. After filing suit, Fancher learned of a loan agreement and various leasing agreements that were done without his knowledge. Fancher withdrew from the LLC, asserting that the loan agreement was a breach of confidence. At trial, the main issue was the determination of the fair market value of Fancher’s one-third interest in the LLC at the time of his withdrawal. Fancher’s expert, a CPA, testified that the LLC’s fair market value was \$2 million based on a “going concern” analysis, which assumed the business would continue, without a reduction for discounts. The trial court noted that Fancher was a minority interest holder in the LLC who could not make business decisions or require distributions. In addition, because Fancher occupied a unique role in providing the primary source of business to the LLC, the trial court stated that Fancher’s interest was not marketable because its value was indistinguishable from Fancher himself. The trial court found that the fair market value of the plaintiff’s interest was best determined by using the assets approach or book value of the LLC’s equity, which Fancher’s expert listed as almost \$38,000. The trial court awarded Fancher almost \$12,500 as the value of his share of the LLC at the time of his withdrawal. The trial court also found that Robbins and Prudhome were not personally liable for the debts of the LLC. On appeal, Fancher first alleged that the trial court erred in valuing his interest in the LLC by failing to consider all of the LLC’s assets at the time of his withdrawal. Under the Louisiana LLC statute, a withdrawing member of an LLC is entitled to receive the fair market value of the member’s interest as of the date of withdrawal. The fair market value is generally the price a willing buyer would pay a willing seller in an arm’s length transaction, and the determination may be subject to discounts when the facts support their use. The value of a withdrawing member’s interest may be determined in a number of ways depending on the circumstances. The trial court determined that the income approach, which forecasts future earnings, was not applicable because the LLC’s cash flow could not be assumed due to Fancher’s role in providing most of the business. The market approach also did not apply because the LLC was a small, closely held company with profits tied to the skill of its members such that Fancher’s interest was indistinguishable from himself. The appellate court concluded that the record did not show that the trial court erred in using the book value or assets approach to determine the value of the LLC. Next, Fancher contended that the trial court erred in not finding the other members personally liable for Fancher’s withdrawal distribution. Fancher argued that the members were liable because they were grossly negligent in entering into a loan agreement that assigned 50% of the LLC’s profits to

the lender. Citing the Louisiana LLC statute, the court stated that a member who is a manager has a fiduciary duty to the LLC and its members and that members and managers are not personally liable to the LLC or its members unless they acted with gross negligence, which is a reckless disregard of or carelessness amounting to indifference to the best interests of the LLC or its members. Based on the evidence presented, the appellate court found that the trial court was not clearly wrong in finding that the members did not act with reckless disregard of the LLC's best interest by agreeing to a loan that was necessary to keep the LLC operating. Thus, Fancher's argument that the members were personally based on gross negligence lacked merit. Fancher also argued that the members were personally liable for the withdrawal distribution because they accepted distributions knowing that the LLC was indebted to Fancher for his one-third interest. Fancher relied on the provision of the Louisiana LLC statute prohibiting distributions when the LLC would be unable to pay its debts as they became due in the usual course of business. Each member who knowingly assents to such a distribution is joint and severally liable to the LLC for the amount of the distribution that exceeds the amount which could have been lawfully distributed. Here, Fancher did not present evidence to support his assertion that the distributions made to the other members caused the LLC to be unable to pay its debts as they became due. Because the record did not contain evidence that the distributions violated the statute, the members were not personally liable for the withdrawal distribution.

Dissolution and Winding Up

Iron Mound, LLC v. Nuterra Healthcare Management, 313 P.3d 808 (Kan. 2013).

An operating agreement for an LLC that was formed to develop and operate surgical and other healthcare facilities contained a provision regarding the division of fees for services performed by one of the members (Nuterra Healthcare Management, LLC or "Nuterra") should Nuterra enter into management agreements with specified other surgical centers. Shortly after the LLC was formed, Nuterra entered into a management agreement with one of the specified surgical centers. The management agreement was to remain in effect for five-year terms unless either Nuterra or the surgical center elected not to renew the contract. Approximately two years after the LLC was formed, Nuterra's co-member (Iron Mound, LLC or "Iron Mound") exercised its right to dissolve the LLC. One of Iron Mound's owners filed a certificate of cancellation for the LLC and conducted the winding up. At the time of dissolution, the only significant asset of the LLC was the interest in management fees generated from the surgical center with which Nuterra had contracted. The LLC's operating agreement contained a provision addressing liquidation that provided that the members would continue to share in cash flow and profits and losses during the period of liquidation pursuant to the other provisions of the operating agreement. After dissolution of the LLC, Nuterra continued paying Iron Mound a percentage of the gross fee generated under Nuterra's management agreement with the surgical center until the end of the first five-year term of the agreement. At that time, the surgical center exercised its right not to renew the management agreement but invited Nuterra to negotiate a new agreement. Nuterra and the surgical center entered into a second renegotiated management agreement. Nuterra did not pay Iron Mound any part of the fees from the second management agreement, and Iron Mound sued Nuterra to recover a percentage of the fees based on the provisions of the LLC operating agreement. The trial court concluded the operating agreement was unambiguous and granted summary judgment in favor of Nuterra. The court of appeals concluded that the operating agreement was ambiguous and that there were unresolved issues of fact.

The supreme court, applying contract interpretation principles, concluded that the operating agreement was unambiguous and that Iron Mound was not entitled to any of the fees from the second management agreement. The court stated that the operating agreement evidenced a clear intent that Iron Mound's right to a percentage of revenues was conditioned upon or derived from its membership in the LLC and the terms of the operating agreement. It was undisputed that when Nuterra entered into the second management agreement, the operating agreement had ceased to exist and there was no LLC to receive revenues and no members to whom such revenues could be allocated. It was further undisputed that the second management agreement was a new and separate contract rather than a renewal of the first management agreement. The parties conceded that the right to management fees received from the surgical center under the first management agreement was an asset of the LLC subject to liquidation or distribution in kind, but the court stated that this concession was not relevant to the second management agreement, which could not be an asset of the LLC that had ceased to exist at the time the contract was executed. A contrary conclusion would require a strained reading of the operating agreement and consideration of extrinsic matters. The supreme court stated that its conclusion made it unnecessary to consider the broader question of whether the dissolution of an LLC terminates its operating agreement absent express language to the contrary.

Otto v. Otto, 974 N.Y.S.2d 54 (App. Div. 1st Dept. 2013).

The court disagreed with the motion court's ruling that the plaintiff had legal capacity to bring derivative claims on behalf of a dissolved Delaware LLC and dissolved Delaware limited partnerships. The court stated that the plaintiff was required to bring her derivative claims on behalf of the entities after or in conjunction with a successful action to nullify the certificates of cancellation. Rather than file a petition in the Delaware Chancery Court to have the certificates of cancellation annulled, the plaintiff improperly filed a motion in this action seeking nullification of the certificates.

Croteau v. National Better Living Association, Inc., 290 F.R.D. 521 (D. Mont. 2013).

One of the defendants, an administratively dissolved Tennessee LLC that had filed articles of termination stipulating that all assets had been distributed to creditors and members, argued that it lacked capacity to be sued and should be dismissed because its legal capacity had terminated and its had been assets distributed prior to the filing of the suit. The court concluded that the plaintiffs were entitled to proceed on a theory of successor liability based on Tennessee LLC law. The LLC argued that the plaintiffs' claims were barred because filing articles of termination demonstrates that all the LLC's assets have been distributed, and the general claim termination provision of the Tennessee LLC statute provides that creditors whose claims are not barred may proceed only against the dissolved LLC to the extent of its undistributed assets. The court stated that the LLC statute was phrased in the disjunctive so that if a dissolved LLC provides neither specific notice to creditors nor notice by publication, a creditor may proceed against *either* the dissolved LLC to the extent of its undistributed assets *or* against members or holders of financial rights of the dissolved LLC within three years after the filing of articles of termination. Thus, the court concluded that the LLC did not lack capacity to be sued because, even though its assets had been distributed, the plaintiffs might be able to proceed against members or holders of financial rights of the dissolved LLC. The LLC did not produce information regarding termination of creditors' claims by specific notice or publication, and the suit was filed within three years after the articles of termination were filed with the Tennessee Secretary of State. Thus, the court held that the plaintiffs' claims of successor liability

were legally sufficient under the LLC statute and were not barred as a matter of law for lack of capacity of the LLC. The court commented that joinder of individuals or entities might be required if discovery revealed information supporting claims against members or holders of financial rights of the dissolved LLC.

In re Aslansan (Commercial Properties, LLC v. Aslansan), 490 B.R. 675 (Bankr. E.D. Penn. 2013).

An LLC mortgagee objected to the discharge of the debtor's debt to the LLC and asserted claims under state law against the debtor. The LLC relied on an exception to discharge for certain types of debts when the creditor has no notice of the bankruptcy case. The debtor argued that the provision on which the LLC relied did not apply because the LLC had been dissolved before the debtor's Chapter 7 case and the LLC thus could not complain that it did not receive notice of the bankruptcy. The debtor provided evidence from the Corporation Division of the Commonwealth of Massachusetts of the LLC's administrative dissolution and argued that an administratively dissolved LLC is a legal nullity that can be disregarded by persons who had business relationships with it. The court stated that the evidence of the LLC's administrative dissolution did not aid the debtor because the Massachusetts LLC statute did not support the debtor's argument. The Massachusetts LLC statute provides that an administratively dissolved LLC continues in existence but shall not carry on any business except as necessary to wind up. Thus, the LLC continued to exist after its dissolution and was entitled to protect its interest in the debtor's Chapter 7 case and should have received notice of the bankruptcy.

Pazmino v. Bose McKinney & Evans, LLP, 989 N.E.2d 784 (Ind. App. 2013).

A law firm performed legal work for an LLC for several months at the request of Pazmino. The LLC was administratively dissolved during the period in which the law firm rendered services, and neither the LLC nor Pazmino paid the firm for its services. The firm sued the LLC for approximately \$12,500 plus interest and sued Pazmino for approximately \$9,600 plus interest (the amount for services performed after the LLC was dissolved). A default judgment was entered against the LLC. Both the firm and Pazmino sought summary judgment as to Pazmino's liability for the debts incurred after the LLC's dissolution. The trial court entered summary judgment in favor of the firm and against Pazmino for the amount sought from Pazmino, and Pazmino appealed. The first issue on appeal was on whose behalf Pazmino was acting. Pazmino contended that he was not personally liable for the LLC's obligations because he was an employee of the LLC. The firm alleged that even if Pazmino was an employee of the LLC, he was liable for his own acts of personally requesting the firm's services after the LLC dissolved. The appellate court was not convinced that the evidence established as a matter of law that Pazmino was only an employee of the LLC but declined to address the legal implications of Pazmino's liability if he was a member or manager of the LLC. The appellate court explained that if the evidence established that Pazmino requested the firm's services on his own behalf, he would be personally liable for that obligation under the Indiana LLC statute. However, if the evidence showed that Pazmino requested the services on behalf of the LLC such that normally he would not be personally liable for the debt, the firm argued that Pazmino was personally liable because he acted as an agent of a nonexistent principal and because he exceeded the scope of his authority. The firm presented affidavit evidence that Pazmino personally requested and directed the firm as to legal work not relating to the winding up of the LLC after it was administratively dissolved. However, billing records referred to the LLC as the client and the party

being billed for the legal work. In addition, the billing records included only a brief description of the work performed and did not establish the services performed were outside the scope of winding up the LLC. The court held that the firm did not establish as a matter of law that Pazmino secured the legal services on his own behalf and thus the firm was not entitled to summary judgment on this issue. The evidence submitted by Pazmino to support his motion for summary judgment was an affidavit in which he claimed to be an employee of the LLC and that the firm did not inform him of the LLC's dissolution. The court found that a genuine issue of material fact existed as to whether Pazmino had notice of the dissolution, which impacted whether he secured the firm's services on behalf of the LLC or whether he was acting on his own behalf. The affidavit contained no information as to the work performed by the firm or the purpose of requesting the firm's services. Like the firm, Pazmino failed to establish as a matter of law that he acted on behalf of the LLC in requesting the legal services and therefore was not entitled to summary judgment on this basis. The next issue addressed by the court was whether after dissolution of the LLC Pazmino could act as an agent on behalf of the LLC because the LLC did not exist except to wind up its business. Generally, an agent who contracts for a nonexistent principal is personally liable on the contract made. The firm contended that Pazmino was personally liable for requesting services not associated with winding up the LLC. According to the Indiana LLC statute, an LLC continues to exist after dissolution to carry on business necessary to wind up and liquidate its business and affairs. Although neither party established as a matter of law whether the work performed by the firm was associated with winding up the LLC, the LLC continued to exist as a principal that could be bound by the acts of its agents regardless of the nature of the work performed by the firm. Finally, the firm argued that Pazmino was not authorized by the LLC statute to wind up or bind the LLC following dissolution. Generally managers and/or members may wind up and bind an LLC after dissolution. The firm also maintained that the limitation on liability did not extend to employees after dissolution. The court agreed that the statute authorizes members to wind up and bind LLCs after dissolution while shielding them from personal liability; however, the court disagreed that an employee who continues to act on behalf of a dissolved LLC is always personally liable for that conduct. The firm specifically alleged that Pazmino was personally liable because he exceeded the scope of his authority under the statute when he, as an employee, requested the firm's services following dissolution of the LLC. The court stated that none of the cases cited by the firm suggested that an employee properly acting on behalf of a dissolved LLC was personally liable for such acts, and nothing in the statute suggests an intent by the legislature to expose employees of dissolved LLCs acting on behalf of the LLC to personal liability. The statute instead clarifies that even upon dissolution an LLC is responsible for its obligations. The court also reasoned that if the legislature intended to terminate the limitation on personal liability at the LLC's dissolution, the legislature would have included such a provision. Thus, when Pazmino acted within the scope of the authority conferred by the LLC, the firm's remedy was against the LLC and not Pazmino.

Sealy v. Clifton, 966 N.Y.S.2d 454 (App. Div. 2d Dept. 2013).

The plaintiff and Alston formed an LLC in which each owned a 50% interest. After Alston's death, the plaintiff commenced an action for partition against the LLC and the administrator of Alston's estate. After proceedings in which the supreme court and appellate court determined that the LLC had not been dissolved six years before Alston's death by the plaintiff's alleged expulsion from the LLC, the action was transferred to the surrogate's court, which granted summary judgment to the plaintiff on the basis that the LLC was dissolved by Alston's death. The appellate court held

that the surrogate court properly determined that the LLC was dissolved by Alston's death. The previous appeal rejecting the defendants' argument that the action was time-barred by dissolution of the LLC six years before Alston's death by the alleged expulsion of the plaintiff was the law of the case and precluded re-examination of that issue.

Judicial or Administrative Dissolution

Huatuco v. Satellite Healthcare, Civil Action No. 8465-VCG, 2013 WL 6460898 (Del. Ch. Dec. 9, 2013).

A 50% LLC member sued the LLC and its other member, seeking judicial dissolution of the LLC on the basis of a deadlock between the plaintiff and the other member. The defendants moved to dismiss. Although the complaint alleged a breach of the LLC agreement, the court found that the parties had agreed that the motion to dismiss depended on whether the plaintiff would be entitled to judicial dissolution based on the interplay of the judicial dissolution provision of the Delaware LLC statute and certain provisions of the LLC agreement. The court held that the terms of the LLC agreement precluded the plaintiff from seeking judicial dissolution based on Delaware case law and the broad policy of freedom of contract underlying the LLC statute. As previously held in *R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, judicial dissolution is a default rule that may be displaced by contract. The LLC agreement in the instant case contained a provision specifying events causing dissolution, and judicial dissolution was not included among these events. The LLC agreement also included the following provision in a paragraph addressing distribution rights and denying preemptive rights with respect to additional membership interests: "Except as otherwise required by applicable law, the Members shall only have the power to exercise any and all rights expressly granted to the Members pursuant to the terms of this Agreement." The court concluded that this provision applied to member rights generally, including the right to seek judicial dissolution. Because judicial dissolution is a default rule, and as such is not "required by applicable law," the court concluded that judicial dissolution was intentionally excluded from the LLC agreement and was not available to the plaintiff. In a footnote, the court noted that it need not resolve the issue of whether the parties may, by contract, divest the court of "authority to order a dissolution in *all* circumstances, even where it appears manifest that equity so requires— leaving for instance, irreconcilable members locked away together forever like some alternative entity version of Sartre's Huis Clois."

Grove v. Brown, C.A. No. 6793-VCG, 2013 WL 4041495 (Del. Ch. Aug. 8, 2013).

In 2010, the Groves and the Browns started a successful home health care agency, Heartfelt Home Health, LLC ("Heartfelt"). After the first year, the relationship between the Groves and the Browns began to deteriorate when it was discovered that not all four members had made their requisite initial \$10,000 capital contributions. The Groves established their own home health agencies in Maryland and Delaware without telling the Browns, and the Browns attempted to remove the Groves by creating another LLC owned solely by the Browns and merging Heartfelt with that company. The Groves sued the Browns for breach of fiduciary duty, and the Browns counterclaimed for breach of fiduciary duty. The court found that the merger attempted by the Browns was invalid, and the new home health businesses established by the Groves were a usurpation of Heartfelt's business opportunities. The court determined that the appropriate remedy was for both the Browns and the Groves to account to Heartfelt for profits that they wrongfully kept, i.e., the profits made by

the Browns after the invalid merger and the profits made by the Groves in the competing entities. The court commented that, given the bitterness and acrimony between the parties, it was not reasonably practicable to carry on the business of Heartfelt in conformity with its LLC agreement. The court expressed its hope that the parties, in the interest of economy, would present a petition for dissolution to be considered with the accounting.

Croteau v. National Better Living Association, Inc., 290 F.R.D. 521 (D. Mont. 2013).

One of the defendants, an administratively dissolved Tennessee LLC that had filed articles of termination stipulating that all assets had been distributed to creditors and members, argued that it lacked capacity to be sued and should be dismissed because its legal capacity had terminated and its had been assets distributed prior to the filing of the suit. The court concluded that the plaintiffs were entitled to proceed on a theory of successor liability based on Tennessee LLC law. The LLC argued that the plaintiffs' claims were barred because filing articles of termination demonstrates that all the LLC's assets have been distributed, and the general claim termination provision of the Tennessee LLC statute provides that creditors whose claims are not barred may proceed only against the dissolved LLC to the extent of its undistributed assets. The court stated that the LLC statute was phrased in the disjunctive so that if a dissolved LLC provides neither specific notice to creditors nor notice by publication, a creditor may proceed against *either* the dissolved LLC to the extent of its undistributed assets *or* against members or holders of financial rights of the dissolved LLC within three years after the filing of articles of termination. Thus, the court concluded that the LLC did not lack capacity to be sued because, even though its assets had been distributed, the plaintiffs might be able to proceed against members or holders of financial rights of the dissolved LLC. The LLC did not produce information regarding termination of creditors' claims by specific notice or publication, and the suit was filed within three years after the articles of termination were filed with the Tennessee Secretary of State. Thus, the court held that the plaintiffs' claims of successor liability were legally sufficient under the LLC statute and were not barred as a matter of law for lack of capacity of the LLC. The court commented that joinder of individuals or entities might be required if discovery revealed information supporting claims against members or holders of financial rights of the dissolved LLC.

In re Aslansan (Commercial Properties, LLC v. Aslansan), 490 B.R. 675 (Bankr. E.D. Penn. 2013).

An LLC mortgagee objected to the discharge of the debtor's debt to the LLC and asserted claims under state law against the debtor. The LLC relied on an exception to discharge for certain types of debts when the creditor has no notice of the bankruptcy case. The debtor argued that the provision on which the LLC relied did not apply because the LLC had been dissolved before the debtor's Chapter 7 case and the LLC thus could not complain that it did not receive notice of the bankruptcy. The debtor provided evidence from the Corporation Division of the Commonwealth of Massachusetts of the LLC's administrative dissolution and argued that an administratively dissolved LLC is a legal nullity that can be disregarded by persons who had business relationships with it. The court stated that the evidence of the LLC's administrative dissolution did not aid the debtor because the Massachusetts LLC statute did not support the debtor's argument. The Massachusetts LLC statute provides that an administratively dissolved LLC continues in existence but shall not carry on any business except as necessary to wind up. Thus, the LLC continued to exist after its dissolution and was entitled to protect its interest in the debtor's Chapter 7 case and should have received notice

of the bankruptcy. The court noted in a footnote that the debtor's evidence of administrative dissolution also showed that the LLC was reinstated. The court commented that reinstatement of a Massachusetts corporation may be retroactive but that the Massachusetts LLC statute has no analogous provision. The court offered an opinion as to whether the Massachusetts courts would read retroactivity into the LLC statute.

Wiggs v. Summit Midstream Partners, LLC, C.A. No. 7801-VCN, 2013 WL 1286180 (Del. Ch. March 28, 2013).

The plaintiffs, former employees of the defendant LLCs and Class B members of defendant DFW Midstream Management, LLC ("Management"), asserted various claims against Management, DFW Midstream Services LLC ("Services"), Summit Midstream Partners, LLC ("Summit"), and Summit Midstream Holdings, LLC ("Summit Holdings"). The members of Services were Management and Summit Holdings, and the sole manager of Management was Summit. The plaintiffs brought claims against the defendant LLCs in connection with an amendment of the LLC agreement of Services and sought judicial dissolution of Services and Management under Sections 18-802 and 18-803 of the Delaware Limited Liability Company Act. Because the plaintiffs were not members or managers of Services, they could not apply for dissolution of Services under the statutory provisions on which they relied. With respect to the plaintiffs' claim for judicial dissolution of Management, the court looked to circumstances under which dissolution has been ordered under the analogous limited partnership dissolution statute. These circumstances are (1) where there is a "deadlock" that prevents the entity from operating, and (2) where the defined purpose of the entity is fulfilled or impossible to carry out. The plaintiffs did not allege deadlock with respect to Management, and their disagreement with actions taken by the defendants did not plead a reasonably conceivable claim that it was no longer reasonably practicable for Management to carry on in accordance with its LLC agreement because Management's LLC agreement contained a broad purpose clause allowing Management to engage in any lawful act or activity for which LLCs may be organized under the Delaware Limited Liability Company Act.

Mizrahi v. Cohen, 961 N.Y.S.2d 538 (App. Div. 2 Dept. 2013).

The plaintiff and defendant were the members of an LLC formed in 2000 for the purpose of the construction and operation of a mixed-use commercial and residential building. After formation of the LLC, the parties purchased real property on which to construct the LLC's building. The seller required an LLC agreement, which the parties did not execute initially when forming the LLC, so the attorney who represented both parties at the closing drafted an LLC agreement. The LLC agreement provided that each member owned a 50% membership interest in the LLC. The agreement did not state the amount of the parties' capital contributions but provided that after the initial capital contributions by the parties no member would be required to contribute additional capital unless required by a vote of all of the members of the LLC. The agreement also contained a provision that no member would have the right to receive any return of any capital contribution subject to certain exceptions not relevant to the litigation. According to the LLC agreement, the LLC could be dissolved only upon the occurrence of certain specified events, and at dissolution the assets were to be distributed first to the LLC creditors and then to the members in proportion to their respective ownership shares. The members contributed approximately equal funds toward the down payment on the LLC's property. The building's construction was financed largely by a construction loan, which the parties refinanced into a mortgage loan. Through 2003, the parties made approximately

equal capital contributions to the LLC. After that, the plaintiff contributed around \$1.4 million in capital to the LLC while the defendant contributed approximately \$317,000 in capital to the LLC. In 2006, the construction was complete and the parties moved their offices into the building. An accountant for the LLC testified at a hearing that the LLC experienced net operating losses in each year from 2006 through the first half of 2011 and that the LLC would have failed if not for the use of the proceeds of the mortgage loan and capital infusions by the plaintiff to cover the LLC's net operating expenses. The plaintiff filed suit to recover damages for breach of fiduciary duty and breach of contract, but the trial court granted the plaintiff's application for the judicial dissolution of the LLC. The plaintiff also sought an order authorizing him to purchase the defendant's interest in the LLC at dissolution. The appellate court reviewed the trial court's ruling and concluded that the trial court did not err in dismissing the plaintiff's cause of action to recover damages for breach of fiduciary duty because that cause of action was not properly brought in the plaintiff's individual capacity. Next, the court held that the trial court did not err in dismissing the cause of action to recover damages for breach of contract. Despite the defendant's protest, the trial court correctly found that the LLC agreement was ambiguous and that parol evidence of the parties' course of dealing was admissible to supplement and interpret the terms of the agreement. In addition, evidence of the parties' conduct with respect to capital contributions did not constitute a prior oral agreement or an impermissible oral modification of the contract. Even considering the evidence, the court found that the plaintiff failed to establish the existence of a binding agreement as to the parties' responsibility for capital contributions, and thus the plaintiff failed to show a breach of contract. The court next found that the trial court properly granted the plaintiff's application for judicial dissolution of the LLC because it was not reasonably practicable for the LLC to continue operating due to financial infeasibility. The court also held that the trial court did not err in determining that the capital contributions of the plaintiff were to be treated as loans to the LLC to the extent those contributions exceeded the contributions made by the defendant. The LLC agreement did contain a provision that a member did not have the right to receive any return of capital contributions, but the agreement also provided for the repayment of debts of the LLC upon dissolution. The agreement was silent as to the issue of equalization of capital contributions, and an affidavit submitted by the defendant established that the parties intended for the capital contributions contributed by the plaintiff to be treated as loans to the LLC to the extent the contributions exceeded those made by the defendant. Finally, the court held that the trial court should have granted the plaintiff's application for an order authorizing him to buy the defendant's interest in the LLC at its dissolution. The court stated that a buyout in dissolution proceedings can be an appropriate equitable remedy in certain circumstances. The court found that allowing the plaintiff to buy out the defendant's interest in the LLC upon dissolution was appropriate under the facts of the case. The LLC agreement did not contain provisions that precluded an order authorizing a buyout upon the judicial dissolution of the LLC despite the defendant's contentions to the contrary. The court remanded to the trial court for further proceedings to determine the value of the defendant's interest in the LLC for buyout purposes but otherwise affirmed the trial court's judgment.

Doyle v. Icon, LLC, 959 N.Y.S.2d 200 (App. Div. 1st Dept. 2013).

The plaintiff's allegations that he was systematically excluded from an LLC were insufficient to establish that it was not reasonably practicable to carry on the LLC's business as required for judicial dissolution. The allegations did not show unwillingness of management to reasonably permit or promote the stated purpose of the entity or that continuing the entity was financially infeasible.

According to the court, the allegation that the defendants failed to pay the plaintiff his share of the profits and make distributions to the plaintiff showed that the LLC had been able to carry on its business since the plaintiff's alleged expulsion and that the LLC was financially feasible.

Foreign LLCs: Failure to Qualify to Do Business

Conseco Marketing, LLC v. IFA Insurance Services, Inc., 164 Cal.Rptr.3d 788 (Cal. App. 2013).

The court held that a judgment creditor that is a foreign LLC does not have to qualify to do business in California in order to enforce a sister-state judgment under the Sister-State and Foreign Money Judgments Act. A foreign LLC is not considered to be transacting intrastate business in California solely by reason of maintaining or defending an action or suit or securing or collecting debts.

Wagner Equipment Co. v. Wood, 938 F.Supp.2d 1203 (D.N.M. 2013).

The plaintiff in an action against a Washington LLC argued that the LLC could not assert its counterclaim because it was barred from maintaining an action in New Mexico by its failure to register to transact business in New Mexico at the time it filed its counterclaim. The LLC argued that its subsequent registration allowed it to maintain its counterclaim. The court held that the LLC's previously unregistered status was not a bar to maintaining its counterclaim since the LLC was now properly registered.

Foreign LLCs: Governing Law

Alphonse v. Arch Bay Holdings, L.L.C., __ Fed. App'x __, 2013 WL 6490229 (5th Cir. 2013).

The court discussed the question of whether a series of a Delaware LLC is a separate juridical entity in this wrongful foreclosure action arising out of a judgment of foreclosure obtained in Louisiana by a series of a Delaware LLC that was not named as a defendant in the wrongful foreclosure action. After the series, which was the holder of the note secured by Alphonse's home, obtained the judgment of foreclosure, Alphonse brought this action in federal court asserting claims under Louisiana law and the Federal Fair Debt Collection Practices Act. Alphonse sued the mortgage servicing company and the Delaware parent LLC of the series. On appeal, the parties agreed that the district court erred in its analysis of the *Rooker-Feldman* doctrine, but the defendants argued that dismissal was proper on res judicata grounds and because of the separate juridical status of the series. The success of the res judicata argument turned on whether there was an identity of parties between the series and the defendants. The court of appeals held that the defendants did not meet their burden of showing an identity of parties at the motion to dismiss stage. The analysis of this question depended on fact-bound issues involving control and virtual representation, and the court held that the district court's decision to dismiss before discovery was erroneous. In the course of its discussion, the court of appeals acknowledged that the series that obtained the judgment of foreclosure "is a Series LLC [noting by way of footnote that '[a] "Series LLC" is basically a business entity within a business entity'], and Series LLCs only exist to represent the interest of the parent LLC," but the court characterized the question of the legal separation of the series and its parent as a fact-bound question under Louisiana law. The court next discussed the question of whether

dismissal could be upheld on the basis that Alphonse sued the wrong party when it sued the parent LLC rather than the series. Alphonse argued that the series and its parent LLC are not legally distinct entities and that the district court erred in relying on the statutory limitation of liability and capacity and power of a series to sue and be sued in its own name to conclude that the series in this case was a separate juridical entity from its parent LLC and thus responsible for the trade violations alleged in the complaint. The court of appeals took issue with the district court's conclusion that Delaware law applied under the applicable Louisiana conflict-of-laws provision, which states that "[t]he laws of the state or other jurisdiction under which a foreign limited liability company is organized shall govern its organization, its internal affairs, and the liability of its managers and members that arise solely out of their positions as managers and members." The court of appeals discussed the distinction between internal and external affairs and stated that it is not clear whether the liability of an LLC, or its series, to third parties like Alphonse is internal or external. Because the district court apparently did not consider "whether the liability as between a third-party plaintiff with respect to a holding company LLC or its Series LLC constitutes internal or external affairs," the court of appeals remanded the case for consideration of the question. The court suggested that factual development might be necessary to resolve the question.

Institutform Technologies, LLC v. Cosmic TopHat, LLC, __ F.Supp.2d __, 2013 WL 4038722 (N.D. Ga. 2013).

In this patent infringement suit, the plaintiffs sought summary judgment piercing the veil of a California LLC to hold the member liable for the LLC's infringement and vice versa. The court stated that, although the patent infringement claims arose under federal law, the veil-piercing issue was governed by Georgia law. Because the Georgia Supreme Court has rejected outsider reverse corporate veil piercing, i.e., piercing to allow a third-party creditor to reach a corporation's assets to satisfy the claims of an individual corporate insider, the court rejected the reverse piercing claim in this case and considered only the plaintiffs' arguments under a traditional piercing theory.

Taurus IP, LLC v. Daimler-Chrysler Corporation, 726 F.3d 1306 (Fed. Cir. 2013).

The court affirmed the district court's exercise of personal jurisdiction over a Texas resident, Spangenberg, and his Texas LLC based on a two-step piercing analysis. First, the court held that Spangenberg, the individual managing member of a Wisconsin LLC, was the alter ego of that LLC, and then the court applied the alter ego theory in reverse to reach Spangenberg's Texas LLC. The court generally referred to both of the LLCs as "corporations" and applied corporate veil piercing principles. Pursuant to Wisconsin conflict-of-laws principles, the court applied Wisconsin veil-piercing principles to the Wisconsin LLC and Texas veil-piercing law to the Texas LLC.

In re Appalachian Fuels, LLC, 493 B.R. 1 (6th Cir (B.A.P.) 2013).

The court in this appeal addressed whether the bankruptcy court abused its discretion in denying the application for administrative expenses of the West Virginia Department of Environmental Protection (WVDEP) against two affiliated Chapter 11 debtors. The affiliated debtors were a Kentucky LLC and a West Virginia LLC, and the court first analyzed whether they had derivative liability for the expenses of a third affiliate, a West Virginia corporation. The court discussed the U.S. Supreme Court's decision in *United States v. Bestfoods* (which involved liability under CERCLA) as a helpful tool in analyzing liability for administrative expenses under the state environmental statutes at issue in this case. In *Bestfoods*, the Supreme Court did not answer the

question of whether courts should borrow state law or apply a federal common law of veil piercing when enforcing CERCLA's derivative liability, but the Sixth Circuit has held that courts should borrow state law, and the court thought the same analysis should apply to derivative liability under the environmental statutes at issue in this case. The court then addressed the question of which state's law should apply here given that the three affiliates involved consisted of a West Virginia corporation, a West Virginia LLC, and a Kentucky LLC; these affiliates filed bankruptcy in Kentucky; and the mining operations that caused the environmental damage took place in West Virginia. The court discussed veil piercing under Kentucky and West Virginia law and stated that West Virginia law is more favorable to parties seeking to establish the LLCs' derivative liability for the debts of its affiliated or sister corporation than Kentucky law since there is no reported decision in Kentucky recognizing the ability to pierce the veil of one corporation to reach its sister corporation. Ultimately, the court determined that the evidence was insufficient to pierce the corporate veil and impose liability on the two LLCs under either West Virginia or Kentucky law.

Tyson Fresh Meats, Inc. v. Lauer Limited, L.L.C., 918 F.Supp.2d 835 (N.D. Iowa 2013).

The plaintiff sued an LLC, the LLC's members, and several entities who shared some common ownership with the LLC. The LLC dissolved without performing on contracts entered into with the plaintiff, and the plaintiff sought to hold the defendants liable for breach of contract and related claims. The plaintiff argued that it had personal jurisdiction over the LLC as well as the other defendants on the basis that the court was entitled to pierce the corporate veil of the LLC and/or the LLC was the alter ego of the other defendants. After determining that it had specific jurisdiction over the LLC based on the terms of its contract with the plaintiff, the court turned to the questions of whether piercing the LLC's veil and/or treating it as the alter ego of the other defendants allowed the court to treat the contacts of the LLC as the contacts of the other defendants and whether the plaintiff presented a prima facie case justifying piercing the LLC's veil or declaring the LLC the alter ego of the other defendants. As a threshold issue, the court determined that the internal affairs doctrine applies to piercing the corporate veil and/or alter ego theories and that Nebraska law thus governed whether the LLC's veil may be pierced or whether the LLC is the alter ego of the other defendants. Although neither the Iowa courts nor the Eighth Circuit has determined which state's law applies to questions of piercing the corporate veil or alter ego theories in cases involving an Iowa plaintiff and an out-of-state entity defendant, the court was persuaded that Nebraska law applied because the LLC was a Nebraska entity. The court noted that most jurisdictions recognize the internal affairs doctrine whereby the law of the state of incorporation is used to determine issues relating to the internal affairs of a corporation. The court stated that the internal affairs doctrine applied even though the parties' contract called for delivery in Iowa because whether or not the independence of an out-of-state entity will be respected is collateral to and not part of the parties' negotiations or expectations under the contract. The court said the internal affairs doctrine also has the benefit of recognizing that the state of organization generally has the greater interest in determining when or if limited liability may be stripped away from an entity organized under its laws. Finally, the internal affairs doctrine provides consistency and predictability to an entity; consistency and predictability would be eviscerated, rendering investment prohibitive, if an entity were subject to piercing or alter ego theories of each and every state.

Charging Order

Southlake Equipment Company, Inc. v. Henson Gravel & Sand, LLC, 313 P.3d 289 (Okla. App. 2013).

A judgment creditor that received a judgment in Texas filed a notice of foreign judgment in Oklahoma and sought a writ of special execution for seizure of the debtor's units, both economic and voting interest, in an LLC. The Oklahoma trial court granted the writ and ordered the debtor to assign his entire membership interest, both economic and voting, in his units of the LLC. On appeal, the debtor argued that the trial court erred in ordering him to transfer both his economic and voting interest, and the court of appeals agreed. The court of appeals relied on the charging order provision of the Oklahoma LLC statute, which allows a court to charge the membership interest of a judgment debtor, but provides that the judgment creditor has only the rights of an assignee of the membership interest. The charging order provision further provides that a charging order cannot be converted into a membership interest through foreclosure or otherwise and the charging order provision is the exclusive remedy of a judgment creditor with respect to the judgment debtor's membership interest. Although the Oklahoma LLC statute defines a "membership interest" to include both economic and voting/management rights, the court stated that the charging order provision narrows the meaning of a membership interest to the flow of profits and surplus from the member's economic interest. Further, the statute specifically states that the judgment creditor has only the rights of an assignee, which are limited under the LLC statute to economic rights. The court of appeals thus concluded that the trial court erred in charging the debtor to transfer both economic and voting rights. The court went on to further discuss the trial court's order as it pertained to transfer of the debtor's voting interest in the LLC. With respect to transfer of a member's membership interest, the Oklahoma LLC statute provides that a member may assign the economic rights associated with the membership interest, but an assignment of the economic rights does not entitle the assignee to participate in the management of the LLC or become or exercise the rights and powers of a member unless otherwise provided in the operating agreement. Because the operating agreement determines if and how a membership interest other than economic rights is transferred, the court examined the operating agreement of the LLC at issue. The operating agreement required the written consent of all remaining members for a transfer of units to a non-member. The LLC (which had filed a special appearance in favor of the judgment creditor's writ) submitted to the trial court a resolution containing the written consent of two of the three members other than the debtor, but the debtor's wife, who was also a member, did not consent in writing. Thus, the court stated that the terms of the operating agreement were not satisfied, and the trial court erred in ordering the debtor to assign his voting interest in the LLC.

Scheel v. Alfaro, 406 S.W.3d 216 (Tex. App. 2013).

The court of appeals affirmed an order of the trial court's order setting aside a receiver's sale and sanctioned the judgment creditor's attorney given circumstances that included the following: the sale occurred without notice to the judgment debtor while a motion for new trial was pending and the parties were in settlement negotiations; the sales price appeared to be grossly inadequate; the sale covered LLC interests without obtaining a charging order; and, after the receiver's sale, the judgment debtors entered into a settlement in full satisfaction of the judgment without knowledge that all of their property had been sold in the receiver's sale. Nearly two months after the judgment creditor's attorney filed a satisfaction of judgment based on the settlement, the judgment creditor's attorney

filed a motion for approval of the receiver's sale. The court of appeals discussed the legal requirements and circumstances surrounding the turnover orders and receiver's sale and concluded that the trial court did not abuse its discretion by setting aside the receiver's sale. The trial court also did not err in setting aside the turnover orders because the turnover orders had no further force or effect once the judgment was satisfied. In its order sanctioning the judgment creditor's attorney for filing groundless or bad faith pleadings, the trial court listed, *inter alia*, the turnover order that ordered the judgment debtors "to turn over their interests in various L.L.C.s, which is prohibited by statute," and the motion to approve the receiver's sale even though the judgment creditor's attorney "was aware that the sale was held without notice, purported to convey L.L.C. interests which were prohibited by statute and that the judgment had already been satisfied." In the course of analyzing whether the trial court's order of sanctions was an abuse of discretion, the court of appeals pointed out that the judgment creditor's attorney sought the sale of interests in numerous LLCs and that he "asked for a turnover order as to these interests, but he did not do so via a charging order." The court of appeals cited the Texas limited partnership charging order provision and parenthetically quoted the portion that reads: "The entry of a charging order is the exclusive remedy by which a judgment creditor of a partner or of any other owner of a partnership interest may satisfy a judgment out of the judgment debtor's partnership interest."

Kriti Ripley, LLC v. Emerald Investments, LLC, 746 S.E.2d 26 (S.C. 2013).

The present action was the culmination of a long and contentious dispute between two members of an LLC. Kriti Ripley, LLC ("Kriti") and Emerald Investments, LLC ("Emerald") formed an LLC to develop property. Emerald and its sole member, Longman, decided to develop condominiums and a marina on a piece of property in Charleston. When experiencing financial difficulties, Emerald and Longman turned to Kriti, an outside investor. Emerald and Kriti formed the LLC, and under the operating agreement, Emerald made in-kind contributions of the property for its 70% share in the LLC, and Kriti contributed \$1.25 million for its 30% share in the LLC. Emerald and Longman diverted and misappropriated Kriti's funds and took actions prohibited by the operating agreement. Kriti and the LLC obtained a judgment against Emerald and Longman based on an arbitration award. Emerald was stripped of its voting rights and management of the LLC. Emerald and Longman refused to pay any amount toward the judgment obtained by the plaintiffs and instead engaged in a pattern of abusive litigation to delay and avoid payment. The plaintiffs obtained a charging order against Emerald's interest and moved to foreclose on that interest. The trial court denied the motion for foreclosure explaining that foreclosure was a drastic remedy and that South Carolina courts had a long-standing judicial policy to avoid forfeiture. The trial court held that foreclosure was not the appropriate remedy and that the charging order was sufficient to protect the plaintiffs' interest. The South Carolina Supreme Court reversed and remanded, holding that the trial court committed several errors in denying the motion to foreclose and that foreclosure and sale of Emerald's interest in the LLC was warranted. The plaintiffs had obtained a charging order and sought foreclosure under the South Carolina Uniform Limited Liability Company Act, which allowed the court to charge the distributional interest of the judgment debtor to satisfy the judgment. The statute provides that a charging order constitutes a lien on the judgment debtor's distributional interest and that the court may order foreclosure of a lien on a distributional interest subject to the charging order at any time. The plaintiffs first argued that the trial court erred by considering other provisions of the LLC statute providing alternative remedies weighing against foreclosure on the charging order. The supreme court concluded that the trial court improperly considered unavailable

remedies (e.g., forced dissolution or the compelled purchase of the member's interest) as weighing against foreclosure. The court stated that the plaintiffs confirmed their judgment, obtained a charging order, and sought foreclosure not as members of an LLC but as judgment creditors. The plaintiffs' status as judgment creditors did not give them the legal right to seek dissolution or other relief under the LLC statute, and the charging order provision states that it is the exclusive remedy for a judgment creditor seeking to satisfy a judgment through the debtor's interest in an LLC. The court held that there were no other available remedies, and the trial court's conclusion that the availability of other remedies weighed against ordering foreclosure was in error. Next, the plaintiffs contended that the trial court erred when it considered foreclosure to be a "drastic remedy." The court agreed that the trial court incorrectly characterized the seriousness of foreclosure. The court acknowledged that foreclosure is more drastic than simply charging a member's distributional interest in an LLC but stated that foreclosure is a remedy commonly used when a charging order on a debtor's interest alone will not result in payment of a judgment or more generally to satisfy a debt. In addition, the LLC statute provides no indication that foreclosure is "drastic" or only to be used in extreme circumstances. The court stated that a judgment creditor has a right to collect on a judgment, and characterizing the remedy of foreclosure as drastic wrongly implied that to foreclose on a charging order a debtor must make a showing beyond the simple necessity of foreclosure. The plaintiffs also argued that the trial court erred when it considered foreclosure to be a form of forfeiture. Again, the supreme court agreed. Forfeiture, according to the court, is a penalty. However, foreclosure is the ultimate remedy for collection of a debt owed rather than a penalty. Foreclosure does not divest the member of his or her interest in an LLC without compensation or cause a loss of the interest. The member simply has a debt that must be paid, and the debtor could avoid foreclosure by paying the judgment. Finally, setting aside the trial court's errors, the plaintiffs asserted that the trial court erred in denying foreclosure. The supreme court agreed and held that foreclosure was warranted. The court stated that the decision whether to grant foreclosure requires consideration of the totality of the circumstances. Here, the court said that the trial court failed to consider and make findings as to the likelihood of the judgment being satisfied through distributions within a reasonable amount of time, a primary and typically determinative factor. Therefore, the trial court erred in denying foreclosure. According to the supreme court, had the trial court considered whether the judgment would be satisfied through distributions, it could only have found that distributions would not be made in the foreseeable future. Specifically, the charging order had existed almost three years without satisfaction, the LLC's equity was shrinking each year as the liabilities steadily grew, and the LLC could only pay its debts due to loans made by Kriti and affiliated entities. Distributions under such circumstances were not permitted under the operating agreement. In addition, Kriti could not be expected to make a capital contribution when Emerald continued to impede the LLC's business, and there was no evidence that Kriti engaged in misconduct, mismanaged the LLC to avoid making distributions, or acted outside its business judgment. Finally, Kriti attempted to give Emerald a way out of the LLC without the loss of its capital contribution by offering to purchase Emerald's interest, but Emerald refused. Emerald and Longman were in the position they were in because of their wrongful acts, and to the extent the parties' conduct was relevant to the decision of whether to grant foreclosure, the court found the evidence weighed against the defendants. Thus, the court remanded for the foreclosure on the sale of Emerald's interest in the LLC through the normal foreclosure process and without further delay.

Series LLCs

Alphonse v. Arch Bay Holdings, L.L.C., __ Fed. App'x __, 2013 WL 6490229 (5th Cir. 2013).

The court discussed the question of whether a series of a Delaware LLC is a separate juridical entity in this wrongful foreclosure action arising out of a judgment of foreclosure obtained in Louisiana by a series of a Delaware LLC that was not named as a defendant in the wrongful foreclosure action. After the series, which was the holder of the note secured by Alphonse's home, obtained the judgment of foreclosure, Alphonse brought this action in federal court asserting claims under Louisiana law and the Federal Fair Debt Collection Practices Act. Alphonse sued the mortgage servicing company and the Delaware parent LLC of the series. On appeal, the parties agreed that the district court erred in its analysis of the *Rooker-Feldman* doctrine, but the defendants argued that dismissal was proper on res judicata grounds and because of the separate juridical status of the series. The success of the res judicata argument turned on whether there was an identity of parties between the series and the defendants. The court of appeals held that the defendants did not meet their burden of showing an identity of parties at the motion to dismiss stage. The analysis of this question depended on fact-bound issues involving control and virtual representation, and the court held that the district court's decision to dismiss before discovery was erroneous. In the course of its discussion, the court of appeals acknowledged that the series that obtained the judgment of foreclosure "is a Series LLC [noting by way of footnote that "[a] 'Series LLC' is basically a business entity within a business entity'], and Series LLCs only exist to represent the interest of the parent LLC," but the court characterized the question of the legal separation of the series and its parent as a fact-bound question under Louisiana law. The court next discussed the question of whether dismissal could be upheld on the basis that Alphonse sued the wrong party when it sued the parent LLC rather than the series. Alphonse argued that the series and its parent LLC are not legally distinct entities and that the district court erred in relying on the statutory limitation of liability and capacity and power of a series to sue and be sued in its own name to conclude that the series in this case was a separate juridical entity from its parent LLC and thus responsible for the trade violations alleged in the complaint. The court of appeals took issue with the district court's conclusion that Delaware law applied under the applicable Louisiana conflict-of-laws provision, which states that "[t]he laws of the state or other jurisdiction under which a foreign limited liability company is organized shall govern its organization, its internal affairs, and the liability of its managers and members that arise solely out of their positions as managers and members." The court of appeals discussed the distinction between internal and external affairs and stated that it is not clear whether the liability of an LLC, or its series, to third parties like Alphonse is internal or external. Because the district court apparently did not consider "whether the liability as between a third-party plaintiff with respect to a holding company LLC or its Series LLC constitutes internal or external affairs," the court of appeals remanded the case for consideration of the question. The court suggested that factual development might be necessary to resolve the question.

Dissenter's Rights

Humphrey Industries, Ltd. v. Clay Street Associates, LLC, 295 P.3d 231 (Wash. 2013).

In 1997, Humphrey Industries Ltd. ("Humphrey"), Scott Rogel, Joseph and Lee Ann Rogel, and ABO Investments formed Clay Street Associates LLC ("the LLC") to purchase and manage a

piece of real property in Washington. A dispute arose in 2004 when Scott Rogel sought to sell the LLC's property and dissolve the LLC to satisfy his divorce settlement. The LLC's operating agreement required unanimous consent to sell the property, and Humphrey refused to consent to the sale. The other members circumvented the unanimity requirement by forming a new LLC, which they merged with the original LLC. Humphrey received notice of his statutory right to dissent, which it exercised, and Humphrey demanded payment of the fair value of its interest in the LLC. The parties disagreed on the fair value of the property and the time in which the LLC paid Humphrey for its interest, and Humphrey filed suit. The trial court found the value of the LLC as of the date of the merger and the amount that Humphrey was owed. The trial court denied Humphrey's request for attorney fees, holding that the LLC substantially complied with the statutory deadline for payment of fair value; however, the trial court did award fees and expenses to the LLC and Joseph and Lee Ann Rogel ("the Rogels") based on its finding that Humphrey acted arbitrarily, vexatiously, and not in good faith in pursuing its dissenter's rights claim. The court of appeals affirmed. The Washington Supreme Court reversed the award of attorney fees imposed on Humphrey because the record did not establish that Humphrey acted arbitrarily, vexatiously, and not in good faith, and the court remanded to determine whether Humphrey was entitled to attorney fees for the LLC's failure to meet the statutory deadline. On remand, the trial court awarded Humphrey part of its attorney fees but also reinstated part of the attorney fees awarded against Humphrey that the court had reversed. Humphrey appealed directly to the supreme court arguing that the trial court erred in not following the supreme court's ruling and imposing attorney fees against Humphrey in favor of the LLC and the Rogels. Humphrey argued the trial court was only to consider whether the LLC owed Humphrey attorney fees for failure to substantially comply with the statutory provisions regarding payment of fair value. The supreme court agreed and found that the law of the case precluded the trial court from revisiting issues that it found supported the award of attorney fees against Humphrey because the issues had been resolved by the supreme court. The supreme court held that it was error for the trial court not to apply the supreme court's holding that Humphrey's conduct did not meet the standard to support and impose attorney fees on Humphrey. The trial court was not authorized to reconsider imposing attorney fees against Humphrey, and the supreme court reversed the attorney fees that the trial court awarded the LLC and the Rogels on the previous remand. Furthermore, the trial court abused its discretion by denying Humphrey the prejudgment interest it sought on the reversed attorney fees award Humphrey originally satisfied. The court rejected Humphrey's argument that the individual members of the LLC should be held liable for the LLC's obligations to Humphrey. Humphrey did not support its argument that the LLC's individual members were liable for receiving improper distributions, and Humphrey's theories of liability would require the court to conduct factual inquiries that were beyond the scope of appellate review. Finally, the court held that Humphrey was entitled by statute to recover fees from the LLC for this appeal because the LLC failed to substantially comply with the LLC statute. The court declined to award fees for the trial court proceedings on remand. The court rejected other arguments by Humphrey for recovery of fees from the members. Humphrey argued that he was entitled to recover fees from the other members under a fee-shifting provision in the LLC operating agreement, but that provision provided for fees incurred in enforcing the operating agreement, and the appeal did not concern enforcement of the operating agreement. Humphrey also argued that the LLC's members were liable for attorney's fees under other exceptions to the American Rule. Humphrey argued that the members were liable due to their bad faith, but the court stated that bad faith had not been established. Humphrey relied on the fiduciary duty owed among partners to argue that the members were liable for fees for breach of

fiduciary duty, but the court pointed out that this argument assumed that the same duty exists among members, and the court refused to consider that issue.

Bankruptcy

Barton v. Club Ventures Investments LLC, C.A. No. 8864-VCN, 2013 WL 6072249 (Del. Ch. Nov. 19, 2013).

The court resolved two threshold legal questions in this action by the plaintiff for a declaratory judgment that he was not subject to any non-competition agreement with the defendant LLC. The court concluded that (1) an amended and restated LLC agreement did not supersede a previously executed non-competition agreement between the plaintiff and the LLC, and (2) the LLC assumed and was revested with the non-competition agreement under its Chapter 11 bankruptcy plan. The non-competition agreement was not expressly identified in the plan as either an assumed or rejected executory contract, but the plan stated that the LLC assumed and was vested with all executory contracts that were not rejected. The plan also provided that the LLC assumed and was revested with all non-executory contracts. Thus, without needing to resolve whether the non-competition agreement was an executory or non-executory contract, the court found that the LLC assumed and retained it under the plan.

In re Underhill, 498 B.R. 170 (6th Cir. (B.A.P.) 2013).

After the debtor received her discharge, her wholly-owned LLC filed an action for tortious interference and the lawsuit was settled. The settlement proceeds, net of attorney's fees, went to the debtor rather than the LLC. A creditor moved to reopen the bankruptcy case so that the proceeds of the settlement could be administered as an asset of the estate. The court affirmed the bankruptcy court's order reopening the case but remanded for the bankruptcy court to determine the value of the debtor's interest in the LLC based on the LLC's recovery in the lawsuit. The court held that it was not an abuse of discretion for the bankruptcy court to reopen the case because the settlement related to a prepetition cause of action held by the LLC, and the cause of action was not disclosed by the debtor in the bankruptcy. Thus, the settlement proceeds received post-discharge were sufficiently rooted in the debtor's pre-bankruptcy past to require administration by the bankruptcy estate, and the cause of action was not abandoned when the bankruptcy case was closed. While the court agreed with the bankruptcy court that the bankruptcy case should be reopened, it found the record unclear as to what portion of the settlement proceeds belonged to the creditors of the LLC and what portion belonged to creditors of the debtor. Although the debtor listed her interest in the LLC as worth zero, that statement was not accurate because her membership interest had potential value if the LLC recovered on its cause of action. The unresolved issue was the value of the debtor's membership interest after the LLC recovered on the settlement. The court looked to Ohio LLC law regarding the LLC's and member's rights and noted that the debtor's membership interest was personal property representing her right to share in the profits and losses and right to receive distributions. The debtor had no specific interest in LLC property, and her interest only had value to the extent the assets of the LLC exceeded its liabilities. Under Ohio law, the settlement proceeds should have been paid to the LLC, and the debtor was required to pay creditors before making a distribution to herself. The court stated that if she had listed the LLC's cause of action on her bankruptcy schedule, the cause of action would have been litigated for the benefit of the bankruptcy estate, and the settlement would have been applied to satisfy creditors of the LLC (including payment of attorney's fees to the law

firm that obtained the settlement for the LLC) and the balance distributed to the bankruptcy estate for payment of debtor's creditors. With the case reopened, the court stated that the bankruptcy court should determine what portion of the settlement proceeds belong to creditors of the LLC under Ohio law and what portion should be paid into the bankruptcy estate on account of the debtor's membership interest.

In re B&M Land and Livestock, LLC, 498 B.R. 262 (Bankr. D. Nev. 2013).

Two and half years after filing her own Chapter 7 petition, the debtor filed a Chapter 11 petition for a Nevada member-managed LLC of which she was the sole member. The debtor took this action without the knowledge or consent of her Chapter 7 trustee. The debtor listed her LLC in her Chapter 7 petition, and the bankruptcy trustee did not abandon the bankruptcy estate's interest in the LLC. Between the two bankruptcies, the trustee took no action to remove or replace the debtor as manager of the LLC. The court concluded that the LLC's bankruptcy filing was not authorized because the trustee controlled the LLC and the debtor lacked standing to file the petition for the LLC. Upon the filing of the debtor's bankruptcy petition, all her legal and equitable interests became property of the bankruptcy estate. Relying on *In re First Protection, Inc.*, 440 B.R. 821 (9th Cir. BAP 2010), and other cases that have favorably cited *In re Albright*, the court held that the Chapter 7 trustee automatically succeeds to all the rights of a debtor who is the single member of an LLC without having to take any further actions under state law before exercising management rights. Should any state law provision conflict with this result, the court held that Section 541 trumps state law. The debtor argued that the Nevada Supreme Court's decision in *Weddell v. H2O*, a charging order case, compelled a different outcome, but the court stated that the rights provided to a trustee under Section 541 trump the approach taken by the court in that case. A bankruptcy trustee's powers are broader than those of a judgment creditor. Because the debtor did not have authority to file the bankruptcy petition for her LLC, the court dismissed the LLC's bankruptcy.

In re Virginia Broadband (Official Committee of Unsecured Creditors v. Virginia Broadband, LLC), 498 B.R. 90 (Bankr. W.D. Va. 2013).

The authorization of a Virginia LLC's bankruptcy filing by a majority of the managers of the LLC depended on whether the removal and replacement of certain managers was valid, which depended on whether one of the members, Chapman, who voted for the removal and appointment of the managers in question had the right to vote at the time the members took such action or at the time of a later ratification of such action. The Unsecured Creditors' Committee argued that Chapman's bankruptcy filing resulted in his dissociation and transformation of his interest into that of an assignee. If Chapman was only an assignee at the time he voted to remove and replace the managers, he was not entitled to participate in the management and affairs of the LLC, and his vote would not have counted. The analysis was complicated by the fact that Chapman filed bankruptcy before the original vote to remove and replace the managers (the "August Consent"), but his bankruptcy was dismissed before a later ratification of the August Consent (the "October Consent"). The October Consent was made retroactively effective as of the date of the August Consent. The question addressed by the court was whether Chapman's noneconomic rights as a member were property of the bankruptcy estate that reverted upon the dismissal of the bankruptcy such that Chapman was entitled to vote on the October Consent.

The bankruptcy court held that Chapman's noneconomic rights along with his economic rights became property of the estate when he filed bankruptcy and that they reverted when the

bankruptcy was dismissed. The court first distinguished the economic rights associated with a member's membership interest, which are transferable under the Virginia LLC statute, from the noneconomic governance rights, which are not transferable. Under the Bankruptcy Code, property of the estate includes all legal and equitable interests a debtor has in property at the commencement of the case. The Virginia LLC statute purports to strip the member of his noneconomic rights on the filing of bankruptcy, and the court concluded that this provision of the statute is an unenforceable ipso facto clause. The Unsecured Creditors' Committee argued that *In re Garrison-Ashburn, L.C.*, 253 B.R. 700 (Bankr. E.D. 2000), supported its position that the Virginia statute was effective to strip Chapman of his management rights, but the court pointed out that the question in *In re Garrison-Ashburn* was whether a member could invoke a provision in the LLC operating agreement to prevent the LLC from selling property where the signature of the debtor, who was manager of the LLC, was required for the sale. The court concluded that the operating agreement was not an executory contract so that the ipso facto prohibition of the Bankruptcy Code did not apply. The court here was only concerned with determining whether Chapman's noneconomic rights became property of the estate, and the court stated that *In re Garrison-Ashburn* supported the court's conclusion that Section 541(c)(1) makes Chapman's noneconomic interest property of the estate. According to the court, to say that Section 541(c)(1) makes only the economic interest property of the estate confuses the issue of what becomes property of the estate with what rights and powers the debtor has in that property upon the commencement of the case. The court recognized in a footnote that its conclusion that a member's noneconomic rights become property of the estate conflicted with the bankruptcy court's conclusion in *In re Williams*, 455 B.R. 485 (Bankr. E.D. Va. 2011), but the court stated that the holding in that case should be confined as much as possible to the "unique circumstances" in that case. Having found that Chapman's noneconomic rights became property of the estate when he filed bankruptcy, the court concluded that the dismissal of his case caused the noneconomic interest to revert in Chapman pursuant to Section 349(b)(3). Thus, Chapman had the right to vote his interest at the time of the October Consent ratifying the August Consent, and the managers' authorization of the LLC bankruptcy was valid because the action of the members removing and appointing managers under the August Consent was valid.

In re Quad-C Funding LLC, 496 B.R. 135 (S.D.N.Y. 2013).

A member of the LLC debtor filed a motion to dismiss the Chapter 11 bankruptcy petition filed by the debtor. The member, Crossroads ABL, LLC ("Crossroads"), asserted that the vote to authorize the filing of the Chapter 11 petition did not satisfy the debtor's operating agreement. Crossroads was one of the original two members and owned a 40% interest. Under the operating agreement, a supermajority of 62.5% of the common units was required to authorize the filing of a bankruptcy petition, and Crossroads thus had sufficient ownership to block such a decision. However, the operating agreement permitted the manager to raise additional capital by issuing additional common units that could result in impairment of Crossroads' blocking position. Additional common units were issued to investors who, in accordance with the private placement memorandum, were required to be accredited investors under SEC Rule 501 and who represented in subscription agreements that they were accredited investors. At a members' meeting, 63.5% of the common units (but not Crossroads) voted to authorize the LLC's manager to file a Chapter 11 petition. Crossroads argued that the vote was not valid because the debtor LLC had not shown that the additional investors were accredited investors. Crossroads argued that the court must hold an evidentiary hearing to establish whether each of the individuals was an accredited investor when the

units were purchased three years earlier. The debtor LLC argued that it was Crossroads' burden to show the investors were not accredited. The bankruptcy court noted that there is conflicting case law on the burden in a motion to dismiss a petition for lack of authority to file. The court was not persuaded by the cases holding that the burden should initially be on the debtor or should shift to the debtor. The court found the record adequate to sustain the petition and that Crossroads did not sustain its burden to justify the relief it sought. The validity of the issuance of the new units had been argued previously in state court litigation, and Crossroads was unable to convince the state court that there was a substantial likelihood of success on the merits to support a preliminary injunction. Further, Crossroads learned of the purchase by 2011, at the latest, and cited no "state authority that would permit a minority shareholder to challenge a corporate action on such technical grounds years after the fact." In any event, the court stated it would be wrong as a matter of federal policy to allow additional investigation of this matter to permit the obstruction of the bankruptcy proceeding. Further, the court stated that the controverted issue of whether the investors were accredited investors for purposes of the securities laws was an issue extraneous to the bankruptcy filing. In light of its holding, the court commented that it need not determine the validity of clauses such as the one at bar, that may, in some cases, purport to give minority owners a veto over a Chapter 11 filing. The court recognized that some courts have not hesitated to apply supermajority and other clauses designed to impede a debtor's entry into bankruptcy. The court characterized such clauses as permitting minority equity holders "to hold a bankruptcy filing hostage even where there is no dispute that there should be a judicial dissolution or reorganization of the debtor." The court stated that the "mischief" of such clauses was readily illustrated by the present case in which Crossroads, if it obtained dismissal, might be able to continue to burden creditors with its own litigation and prevent the debtor from engaging in legitimate operations and avoid the risk of a potentially meritorious preference suit against Crossroads. The court stated that there was no reason to treat bankruptcy as a "bogeyman," "fate worse than death," or "penalty," and the court found no reason to compound the problem of supermajority clauses, whatever their validity, and create a whole new method of obstructing a bankruptcy filing, by holding that the court must investigate the authority of each LLC member to vote.

In re Hardee, Bankr. No. 11-60242, Adv. No. 11-6011, 2013 WL 1084494 (Bankr. E.D. Tex. March 14, 2013).

In this adversary proceeding, an LLC and two of its members sought a determination that debts to them arising from activities of the debtor, Hardee, while he was managing member of the LLC were nondischargeable in Hardee's bankruptcy. The plaintiffs alleged that Hardee's debts to them were nondischargeable on the basis that the debts were obtained by actual fraud or false representations or as debts arising from a defalcation by a fiduciary and/or embezzlement. The court granted a partial summary judgment in favor of the LLC on the basis that the summary judgment evidence established that Hardee owed a debt to the LLC arising from the unauthorized diversion of corporate funds and that the debt was nondischargeable as a debt arising out of a defalcation by a fiduciary or embezzlement. The issue of the amount of the debt was reserved for trial. After the trial, the court concluded that a debt to the LLC representing over \$250,000 in embezzled funds was nondischargeable as a debt arising from a defalcation by a fiduciary and embezzlement, and a debt to the LLC of approximately \$248,000 arising from Hardee's failure to tender employment taxes owed to the IRS was nondischargeable as a debt arising from a defalcation by a fiduciary. The court concluded, however, that the two members who sought an exception to Hardee's discharge failed

to establish that Hardee was in a formal or informal fiduciary relationship with them as would be required to render the debt to them for the unpaid tax liabilities nondischargeable as arising out of a defalcation by a fiduciary, and the members failed to establish that their initial investments in the LLC were procured by actual fraud or false representations so as to support an exception to discharge with respect to the amount of their investments.

The court's opinion consists of findings of fact and conclusions of law after the trial in the adversary proceeding. The parties agreed to the basic facts of the case. ETRG Investments, LLC was a Texas limited liability company formed in 2005 for the purpose of owning and operating restaurants in Arkansas. Tomlin and Scott were individuals who resided in Georgia and invested as members in the LLC. Hardee, the debtor in this bankruptcy proceeding, was also a member of the LLC and resided in Texas. Although Hardee invested no money in the LLC, he held the title of "Managing Member" of the LLC from its inception until December 2008. Hardee sent falsified financial statements via email to the LLC investors to conceal his taking of LLC funds in excess of his compensation for personal purposes. Hardee admitted that he was responsible for the LLC's tax matters, wrote checks on behalf of the LLC, and sent letters to potential investors of the LLC, and that the LLC's regulations (i.e., company agreement) required him to obtain unanimous consent from the LLC's members prior to incurring any indebtedness of \$100,000 on behalf of the LLC.

In additional findings of fact, the court determined that Hardee embezzled significant sums of money from the LLC and that his breaches of fiduciary duty included entering into an unauthorized lending relationship, not properly managing the LLC's affairs by diverting funds, and not tendering required tax payments to the IRS on behalf of the LLC. The failure to tender the required tax payments also clearly breached the regulations (i.e., company agreement) of the LLC. The court determined the amount of the debt arising from Hardee's embezzlement of money from the LLC to pay personal expenses, obtain excessive expense reimbursements, and otherwise receive compensation in amounts in excess of what he was authorized to receive was \$253,331. The court found that the tax debt owed by the LLC to the IRS remained in flux but was at least \$248,000. The court found that Hardee, as the sole person authorized to transact business and direct the financial activities of the LLC, including the payment of tax obligations, acted as an agent of the LLC and as such had a formal fiduciary relationship. The failure to tender the tax payments was a willful breach of duty and thus a defalcation while acting in a fiduciary capacity. As for Hardee's relationship to the other plaintiffs, Tomlin and Scott, the court found that these members failed to establish that Hardee had a formal fiduciary relationship with them. The company agreement governing the LLC did not impose or even address any fiduciary duties owed by and among the LLC members. Furthermore, the court found that Tomlin and Scott failed to establish that Hardee had an informal fiduciary relationship with them or a trust relationship that existed prior to the creation of the tax obligations at issue that would create fiduciary duties to the members. Tomlin and Scott also failed to show that the amounts they invested in the LLC were paid due to false representation, false pretenses, or actual fraud. A plea of guilt to a wire fraud charge did not establish that Hardee induced the original investment of Tomlin and Scott by actual fraud. The evidence showed Hardee devised his embezzlement scheme subsequent to the original investment solicitations and made no false representations at the time of the investment solicitation.

In its conclusions of law, the court addressed the nondischargeability of debts arising from breach of fiduciary duties. The court addressed the concept of a fiduciary under federal bankruptcy law and the requirement that the relationship amount to a "technical" or "express" trust. The court then proceeded to set forth numerous conclusions of law regarding fiduciary duties as they related

to this proceeding. The Texas LLC statute does not directly address or define the duties owed by managers and members but implies that certain duties may be owed and allows the contracting parties to specify the breadth of those duties in the LLC agreement. One type of fiduciary relationship recognized under Texas law is a formal fiduciary relationship that arises as a matter of law and includes relationships between principal and agent. An agent has authority to transact business or manage some affair for another person or entity and owes a duty of care. Texas law also recognizes that a fiduciary relationship exists between corporate officers or directors and the corporation they serve, and one of the duties imposed on corporate management is a duty of care that requires diligence and prudence in the management of the corporation's affairs. Although LLCs are not corporations in the strictest sense, Texas law implies that the fiduciary status of corporate officers and directors and their corresponding duties of care, loyalty, and obedience apply to managers and/or members governing the activities of an LLC. Thus, imposition of fiduciary duties on the management of an LLC under Texas law is appropriate and warranted, and Hardee acted in a fiduciary capacity as to the LLC. Breach of Hardee's fiduciary duties required a willful neglect of duties owed, which is measured objectively by reference to what a reasonable person in the debtor's position knew or reasonably should have known and charges the debtor with knowledge of the law without regard to actual intent or motive. Hardee was charged with insuring that all required payments of employment taxes were made by the LLC to the appropriate taxing authorities, and Hardee's failure in each instance to make the tax payments on behalf of the LLC constituted a breach of the fiduciary duties he owed the LLC. Therefore, the debt owed by the LLC to the IRS to satisfy its tax obligations for the period in which the defendant was the managing member of the LLC constituted a defalcation by a fiduciary and was excepted from discharge in Hardee's bankruptcy proceeding. As for the individual members' request that any amount they were required to pay to satisfy the accrued IRS tax liabilities should also be a nondischargeable debt, the court noted a significant difference between a manager's fiduciary relationship to the LLC and the manager's relationship to fellow members. Case law has recognized that there is no formal fiduciary relationship created as a matter of law between members of an LLC. The designation of Hardee in the LLC agreement as the "Tax Matters Member" had no legal significance in the absence of a demonstration that the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) applied to this LLC—the small partnership exception might well have exempted the members of the LLC from the application of TEFRA. Thus, Hardee had no formal fiduciary relationship with either Tomlin or Scott. An informal fiduciary relationship is a confidential relationship arising from moral, social, domestic, or personal relationships in which one person trusts in and relies on another. The effect of imposing a fiduciary duty is to require the fiduciary party to place another's interest above its own, and a fiduciary relationship is thus not one that is created lightly. Hardee had no informal fiduciary relationship with either Tomlin or Scott. Any liability of Hardee to either Tomlin or Scott created by Hardee's failure to render tax payments on behalf of the LLC was not excepted from discharge as a result of a breach of fiduciary duties because the debtor owed no fiduciary duties to the members.

The court next set forth conclusions of law relating to nondischargeability of debts arising from false representation, false pretenses, or actual fraud. Tomlin and Scott argued that the amounts each of them invested in the LLC as a result of the solicitations by Hardee should be declared nondischargeable debts on these bases. The Fifth Circuit has distinguished actual fraud from false representations and false pretenses, and the distinction rests upon whether a debtor's representation is made with reference to a future event or to a past or existing fact. That is, a debtor's promise

related to a future action may be actual fraud, while a debtor's promise related to past or current fact may be a false representation (e.g., involving an express statement) or false pretense (e.g., misleading conduct without an explicit statement). Any representations made by Hardee that may have induced the members into investing in the LLC must have pertained to a future event as the LLC had not yet been engaged in the restaurant business at the time of the solicitation. Thus, the members' claims related to a future event, and their claim required proof that the debt was obtained by actual fraud. Failure to perform the terms of a contract is a breach of contract, and a debt arising from a breach of contract is not normally sufficient to make a debt nondischargeable. Likewise, future predictions and opinions of the profitability of a business cannot form the basis of fraud as a matter of law. Tomlin and Scott failed to prove actual fraud on the part of Hardee.

In sum, the managing member's debt to the LLC based on his embezzlement of LLC property for his personal use was nondischargeable as a debt arising from a defalcation by a fiduciary and from embezzlement. In addition, the debt owed by the managing member to the LLC to fulfill the LLC's employment tax obligations was excepted from discharge as a debt arising from a defalcation by a fiduciary. However, the individual investor members did not prove by a preponderance of the evidence that the managing member owed them a fiduciary duty or committed actual fraud against them. Thus, the debts owing by the managing member to the other members were dischargeable in the bankruptcy proceeding.

In re Tristar Esperanza Properties, LLC (O'Donnell v. Tristar Esperanza Properties, LLC), 488 B.R. 394 (9th Cir. (B.A.P.) 2013).

A member of a California LLC invoked a withdrawal provision of the LLC operating agreement, triggering a process in which the LLC and withdrawing member would use their best efforts to agree upon the fair market value of the member's interest. After an appraisal failed to result in a value to which the LLC agreed, the withdrawing member initiated an arbitration proceeding that resulted in a determination that the LLC was bound by the value determined by the appraiser. The arbitrator awarded the appraised value as damages, and the arbitration award was confirmed by a California court and reduced to judgment. An abstract of judgment was recorded. The LLC filed a Chapter 11 bankruptcy case, and the LLC filed this adversary proceeding seeking mandatory subordination of the withdrawn member's judgment under Section 510(b) of the Bankruptcy Code. Section 510(b) provides that a claim for damages arising from the purchase or sale of a security of the debtor or an affiliate of the debtor shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if the security is common stock, the claim has the same priority as common stock. The court determined that a membership interest in an LLC is a "security" for purposes of this provision although the Bankruptcy Code definition of a "security" does not mention a membership interest in an LLC. Since the fifteen-item list of what constitutes a security in the definition is not exclusive, the court looked for an analogous item in the list and determined that the inclusion of the interest of a limited partner in a limited partnership led to the conclusion that the interest of a member of an LLC is also a security based on the similarities between the two types of interests. The court next concluded that the confirmed arbitration award was "for damages" within the meaning of Section 510(b). The court examined the general meaning of "damages" and rejected the argument that "damages" must arise from wrongdoing or malfeasance. Because the arbitration award was an order to pay money as a matter of contractual right and achieved the status of judgment debt, the arbitration award and judgment qualified as "damages" under Section 510(b). The court next addressed the question of whether the

withdrawn member's claim was a claim "arising from the purchase or sale" of the LLC's securities. The withdrawn member claimed that her claim was an ordinary debt obligation because she withdrew, shed her equity status, and became a general creditor before the bankruptcy proceedings. The court discussed the ambiguous nature of the phrase "arising from" and concluded the Ninth Circuit favors a broad reading of the phrase. The court examined the legislative history of Section 510(b) and concluded that two rationales underlying Section 510(b) supported mandatory subordination: (1) the dissimilar risk and return expectations of shareholders and creditors; and (2) the reliance of creditors on the equity cushion provided by shareholder investment. As to the first rationale, the withdrawn member was an equity holder before she withdrew, enjoyed a considerable return during her tenure as member, and received an arbitration award that was directly linked to her ownership of a membership interest because it constituted the cashing out of her equity. Second, the court presumed that creditors relied on the equity cushion created by contributions to capital, and the withdrawal of the member in this case and liquidation of her interest altered, or attempted to alter, the balance sheet by extracting her contribution and deflating the equity cushion. Even if the withdrawn member had argued that there was a lack of creditor reliance, the presence of the first rationale was sufficient to support a holding that Section 510(b) is broad enough to encompass a claim that arose from the withdrawal of an LLC member triggering a repurchase process by which the debtor was obligated to buy back the interest. The court rejected the argument that the withdrawal from the LLC and fixing of the claim before bankruptcy rendered the claim a "fixed debt" and prevented mandatory subordination. The court noted that this was not a case involving "a transformation of equity into debt in a transaction that is old and cold and that has long been treated as a part of the enterprise's debt." Rather, "the dispute over the buy-back amount and the chapter 11 filing were sufficiently proximate in time to warrant the conclusion that this is an effort by equity to capture paper (and arguably mythical) profits via a judgment for money damages." In sum, the court concluded that the claim was so firmly rooted in the withdrawn member's equity status that subordination was mandatory.

In re Pickel, 487 B.R. 289 (Bankr. D.N.M. 2013).

In the course of addressing whether the automatic stay in this bankruptcy applied to an action pending in a Virgin Islands court against the wholly owned Virgin Islands LLC of the debtor, the court addressed the question of the effect of the member's bankruptcy on his ownership interest and management rights. Under the Virgin Islands LLC statute, an LLC member becomes dissociated when the member files bankruptcy. Upon dissociation, a member is no longer a member and can no longer participate in the management and conduct of the company. The court stated that this provision, which is taken from the Uniform Limited Liability Company Act (1996), conflicts with Section 541(c)(1) of the Bankruptcy Code, which provides that an interest of the debtor in property becomes property of the estate notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law that restricts or conditions transfer of the interest or that is conditioned on the commencement of a bankruptcy case. The court cited cases addressing the conflict that have held that state law provisions like the Virgin Islands provision are preempted by Section 541(c)(1) and noted that some cases have held that such state law provisions make little sense in the case of a single-member LLC. Based on these authorities, the court held that the debtor's bankruptcy filing did not diminish the debtor's membership or management rights and that the debtor continued as the sole member and manager of the LLC. The court also discussed a dispute as to the effect of the member's post-petition dissolution of the LLC and purported transfer of shares of a

corporation purchased by the LLC under an agreement entered into before the bankruptcy. The seller of the shares argued that the transfer of the shares was ineffective based on the seller's alleged pre-petition termination of the share purchase agreement after the LLC's default in payment of the purchase price. Alternatively, the seller argued that the transfer of the shares violated the winding up provisions of the LLC statute because the LLC did not pay the balance of the purchase price for the shares owed by the LLC to the seller of the shares. The debtor argued that the share transfer in the dissolution was proper because the seller was the only creditor and the LLC's claims and defenses against the seller reduced the seller's claim to zero. The court stated that it need not resolve the dispute because the law was clear that the transfer was not void even if it violated the statute but rather would give rise to additional claims against the debtor and the LLC, including potential trust fund and fraudulent transfer claims. The court also noted that the transfer of the shares may not have been properly authorized by the court as a transaction not in the ordinary course of the debtor's business. Such an action would be potentially voidable and was effective to bring the shares into the estate assuming the LLC had anything to transfer. Finally, the court addressed the application of the automatic stay to the litigation brought by the seller in the Virgin Islands action. The court acknowledged that the automatic stay ordinarily does not apply to the assets of a debtor's subsidiary, even a wholly owned subsidiary like the LLC here. Because there was a bona fide dispute as to the effectiveness of the seller's attempted pre-petition termination of the purchase agreement and the consequences of the attempted termination, the court determined that the estate, post-transfer, had a sufficient interest in the shares for the automatic stay to apply. The court commented that it was not condoning the eleventh-hour upstreaming of the shares without court approval and with the obvious goal of obtaining the benefit of the automatic stay, and the court set forth a number of considerations underlying its decision in the case.

In re Breece, No. 12-8018, 2013 WL 197399 (6th Cir. (B.A.P.) Jan. 18, 2013).

The debtor appealed the bankruptcy court's ruling that the debtor could not claim a homestead exemption in real property under Ohio law because the real property was owned by an LLC. The court cited case law and provisions of the Ohio LLC statute distinguishing between a member's membership interest in the LLC and property of the LLC. In attempting to predict what the Ohio Supreme Court would rule if presented with the issue, the court relied on an unpublished decision from the Northern District of Ohio and a Massachusetts bankruptcy court decision in which the courts concluded that the debtors did not have an exemptible interest in property owned by a wholly owned LLC. The court rejected the debtor's argument that the most important element under the Ohio homestead exemption statute is "use" of the property and that it trumps all other elements, including holding an "interest" in the property. Because the residence at issue was the LLC's property, the debtor held no specific interest in the LLC's property under Ohio LLC law. Because the Ohio exemption statute allows the debtor to exempt the debtor's interest in the property used as a residence, the debtor could not claim an exemption. Further, the debtor could not claim a homestead exemption because the property was not property of the bankruptcy estate. Property of the estate consists of the legal or equitable interests of the debtor in property at the time of the commencement of the case. Property cannot be exempted unless it first falls within the property of the bankruptcy estate, and the debtor's membership interest in the LLC gave her no specific or cognizable legal interest in the real property at issue. Accordingly, the property was not property of the estate, and she was not entitled to claim an exemption in it.

In re Kuiken, 484 B.R. 766 (9th Cir. (B.A.P.) 2013).

The debtor could not avoid a judgment lien on his homestead under the exemption impairment provision of the Bankruptcy Code where the debtor acquired the homestead, transferred it to an LLC, and later reacquired it from the LLC. The debtor had no interest in the property in the interim while it was owned by the LLC and he thus acquired a different interest to which a lien had attached when he reacquired the property.

Securities Laws

Sync Labs LLC v. Fusion Manufacturing, Civ. No. 2:11-0367 (WHW), 2013 WL 4776018 (D.N.J. Sept. 4, 2013), motion for reconsideration denied, 2014 WL 37124 (D.N.J. Jan. 6, 2014).

An LLC and its founder sued Ferchak, an individual who became involved in the LLC by contributing services and capital, for breach of contract and various other causes of action after Ferchak withdrew his pledge to invest \$250,000 and demanded the return of \$20,000 he had paid in exchange for units in the LLC. Ferchak counterclaimed for violations of the New Jersey Wage Payment Law and New Jersey Uniform Securities Law, and the plaintiff sought summary judgment on the counterclaims.

The court denied the plaintiff's motion for summary judgment on Ferchak's claim under the New Jersey Uniform Securities Law (NJUSL). Ferchak's claim for violation of the NJUSL was based on his purchase of 4,000 Class A Units of Profit Interest (AUPIs) for \$20,000. The court acknowledged that the sale of the units was exempt from registration under the NJUSL even if the units were securities, but securities sold in exempt offerings are not exempt from the civil liability provisions, and the court concluded that there were fact issues as to whether the AUPIs were "stock" and thus securities under the NJUSL. Because the issuer of the AUPIs was an LLC, the court analyzed the AUPIs as membership interests in an LLC. The definition of "securities" in the NJUSL is essentially identical to the federal securities laws, and the court thus relied on case law applying the federal securities laws. The court first analyzed whether the AUPIs were "investment contract" securities. The court focused on the prong of the *Howey* test that requires the profits of the investment to be dependent "solely" on the efforts of others, and the court concluded that Ferchak's involvement in the management of the LLC was sufficient to preclude his AUPIs from constituting an investment contract. Ferchak's work for hire agreement gave him extensive management responsibilities, and he was not a passive investor, but rather a member-manager of the LLC. The court concluded, however, that the possibility remained that Ferchak's AUPIs might be "stock" and thus "securities" under the NJUSL. Under the Supreme Court's two-part test for whether an investment is "stock," a court should first determine whether the investment is labeled as "stock." If it is, the court must then determine whether the investment possesses significant characteristics typically associated with stock, i.e., (1) the right to receive an apportionment of profits, (2) negotiability, (3) the ability to be pledged or hypothecated, (4) voting rights in proportion to the number of shares owned, and (5) the capacity to increase in value. The court described the Fourth Circuit's application of this analysis in *Robinson v. Glynn* to an LLC interest as follows: "this test is a one-way ratchet: if an investment is labeled a 'stock,' it may not be, but if the investment is not labeled a stock, the analysis is over." The court stated that the nomenclature issue in *Robinson v. Glynn* was dispositive because the membership interest was not labeled as "stock" although it had some characteristics of stock. Here, the court stated that the parties disagreed over what "unit of profit interest" meant, but the court pointed out that the plaintiff referred to the interest as "stock"

in one of his submissions to the court. Assuming *arguendo* that the AUPIs are stock, the court next considered whether the AUPIs shared the five characteristics of stock outlined by the United States Supreme Court. The court stated that the first, fourth, and fifth factors were satisfied, but there was nothing in the record to show whether the second and third factors were satisfied. The court stated that these facts were material and genuinely disputed, thus precluding summary judgment. On the plaintiff's motion to reconsider, the court stated that nothing in the NJUSL explicitly states that LLC membership interests can never be "stock," and the court cited the Fourth Circuit's opinion in *Robinson v. Glynn* and the District of Delaware's decision in *Great Lakes Chemical Corp. v. Monsanto* in support of its assertion that "courts routinely consider the possibility that LLC membership interests might fall under the protection of state and federal securities laws, not only as 'investment contracts' but also as 'stock.'" The court stated that the courts in those cases determined that the LLC interests in those cases were not stock, not that an LLC interest can never be stock.

Archer Well Company, Inc. v. GW Holdings I LLC, No. 12 Civ. 6762(JSR), 2013 WL 2314271 (S.D.N.Y. May 21, 2013).

The plaintiff, an oil field services provider, contracted with a holding company to pay \$630 million for all of the equity interests in four LLCs and a corporation. The plaintiff sued the holding company and its parent/manager based on allegedly false representations and warranties in the purchase agreement. The plaintiff's claims included securities fraud claims under Sections 10b and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5. The defendants sought dismissal of the claims as to the LLC interests on the basis that the interests were not "securities" within the meaning of the Exchange Act. The court granted the motion to dismiss on the basis that the plaintiff's purchase of 100% of the interests of each of the four LLCs was not a purchase of securities. The court set forth the criteria of the *Howey* test, which applies to investments such as LLC interests that are not explicitly covered by the Exchange Act. Under the *Howey* test, an interest in an entity is a security if it is (1) an investment in a common venture, (2) premised on a reasonable expectation of profits, (3) to be derived from the entrepreneurial or managerial efforts of others. In analyzing what is a "security," substance prevails over form, and the "economic reality" should be the focus. Because the plaintiff bought the entirety of the membership interests in the LLCs, its investment failed to satisfy both the first and third prongs of the *Howey* test, and the purchase of the interests thus did not constitute the purchase of securities. The plaintiff asserted three arguments in an attempt to avoid this result. First, the plaintiff argued that, even if it did not purchase securities, the defendant sold securities when it sold its equity interests in the LLCs. The plaintiff based this argument on the fact that the plaintiff was simply a holding company through which numerous passive investors invested in the LLCs. The court distinguished case law involving sellers of limited partnership interests to a general partner and concluded that the economic reality of the purchaser's purchase of the entirety of the membership interests in this case did not meet the *Howey* test. Plaintiff's second argument was that the court should look to the period between the signing of the purchase agreement and the closing of the transaction because the seller was obligated to operate and manage the LLCs for the benefit of the purchaser during that period. The court rejected this argument as well, concluding that the relevant perspective for the economic reality of the transaction was what the plaintiff in fact purchased. Finally, the plaintiff argued that the LLC interests should be treated as securities because the LLCs were identical in form to the corporation purchased by the plaintiff at the same time, and the defendants conceded that the stock in the corporation was covered by the Exchange Act. The court also rejected this argument, pointing out that stock is expressly covered

by the Exchange Act regardless of the economic reality or circumstances of the transaction. The court stated that LLC membership interests cannot be “bootstrapped into becoming ‘securities’” merely because the plaintiff also purchased other securities.

Contempt

Magruder v. Pauley, 411 S.W.3d 323 (Mo. App. 2013).

Magruder, one of four equal members of an LLC realty agency, withdrew from the LLC. The remaining members refused to comply with the operating agreement, which required the LLC to obtain an appraisal of the business and pay the withdrawing member one-fourth of the appraised value. Magruder sued for specific performance, breach of contract, and prima facie tort. The court bifurcated the equitable claims from the remaining claims and found for Magruder after a bench trial on her claim for specific performance and the remaining members’ counterclaim for declaratory judgment. A partial judgment for specific performance ordered the remaining members to commission and pay for an appraisal and to purchase Magruder’s interest for one-fourth the appraised value. The parties agreed to a dismissal of Magruder’s breach of contract claim because it was filed as an alternative to the specific performance claim, but the remaining claims were tried in the jury trial, which resulted in a judgment in favor of Magruder for compensatory and punitive damages. Over a period of five years, after the bench trial, jury trial, and at least 11 post-trial hearings, the specific performance ordered by the court still was not completed. During that time, an appraisal was eventually performed, but the appraiser failed to include the LLC’s real estate and made certain other errors. Magruder supplied the court the missing information, and Magruder asked the court to exercise its equitable powers to include a final valuation in its final order because it had all the necessary information to do so. Magruder also moved to hold the remaining members in contempt and requested attorney’s fees based on the operating agreement. The trial court denied the contempt motion, and the trial court’s final order merely affirmed the jury verdict and attached the earlier partial judgment without reference to the disputed appraisal or attorney’s fees. On appeal, Magruder argued that the trial court erred in failing to include a valuation, failing to hold the defendants in contempt, and not awarding Magruder attorney’s fees. The court of appeals agreed with Magruder regarding the trial court’s failure to render a valuation and award attorney’s fees but held the trial court did not abuse its discretion on the contempt issue. With regard to the Magruder’s contempt motion, the court of appeals recognized that the remaining members’ conduct was egregious but concluded that the trial court’s decision did not constitute a clear abuse of discretion given the subjective analysis of the parties’ actions involved in the trial court’s exercise of discretion.

Moultrie v. Wall, __ So.3d __, 2013 WL 4873073 (Ala. 2013).

Wall and Moultrie, the members of an LLC that owned and operated a Ford automobile dealership, got in a dispute after Moultrie proposed removing Wall as manager of the LLC and general manager of the dealership and selling the LLC or its assets. Moultrie and Wall disagreed over who had the controlling interest in the LLC. Wall and the LLC filed suit against Moultrie, and Moultrie asserted counterclaims. Wall sought and obtained a TRO preventing Moultrie from taking various actions. Based on actions taken by Moultrie after entry of the TRO, Wall filed a petition to hold Moultrie in contempt. By agreement of the parties, the court entered an amended TRO that left in place the original terms of the TRO and prohibited the plaintiffs from taking various actions.

Over the next few weeks, Wall filed a second petition to hold Moultrie in contempt for violating the TRO and amended TRO, and Moultrie filed two petitions seeking to hold Wall in contempt for violating the amended TRO. The court conducted a hearing and found Moultrie in contempt for violating the TROs based on his entering into a sales agreement to sell the LLC, removing documents from the dealership, and causing Ford to conduct an audit that resulted in a penalty due in part to the missing documents. The court entered a judgment against Moultrie for contempt and a few weeks later entered a second judgment assessing over \$132,000 in attorney's fees and costs against Moultrie. The court denied Moultrie's motions seeking return of certain funds from Wall and denied Moultrie's petitions to hold Wall in contempt. On appeal, the Alabama Supreme Court declined to address the merits of the contempt judgment against Moultrie because his appeal of the contempt judgment was untimely. Moultrie's appeal of the judgment for attorney's fees was timely, and the supreme court addressed Moultrie's argument that the trial court assessed an unreasonable amount of attorney's fees against him. The court discussed the evidence considered by the trial court and the process the trial court followed and concluded that the trial court did not abuse its discretion in the award of attorney's fees. In response to Wall's argument on appeal that Moultrie's "bad acts" further supported the trial court's award of fees and costs, Moultrie argued that his actions did not merit such a sanction. However, the contempt judgment found Moultrie guilty of what amounted to flagrant violations of the TROs entered by the trial court. Based on the argument presented by Moultrie on appeal, Moultrie did not affirmatively demonstrate that the trial court exceeded its discretion with respect to the award of attorney's fees and costs.

Intracorporate Conspiracy

Painter's Mill Grille, LLC v. Brown, 716 F.3d 342 (4th Cir. 2013).

The court dismissed the plaintiff's conspiracy claim because it was based on the wrongful acts of individuals who were employees of an LLC and its parent. The plaintiff alleged that the defendants conspired to deprive it of equal protection in violation of 42 U.S.C. § 1985(3). The court applied the intracorporate conspiracy doctrine, which provides that a corporation cannot conspire with its agents because the agents' acts are the corporation's own acts. Given that the complaint alleged that the three conspirators were also agents of the LLC and its parent, it could not allege a conspiracy between two or more persons unless an exception to the intracorporate conspiracy doctrine applied. The court rejected the plaintiff's argument that it sufficiently alleged an exception, i.e., that the individual defendants had an independent personal stake in achieving the corporation's objective, which was racial animus. The court concluded that the plaintiff did not allege that the individual defendants had a personal stake independent of their relationship to their employer or that they were acting outside the scope of their employment.

Attorney Disqualification

Maya I-215, LLC v. Moore, No. 60095, 2013 WL 3833280 (Nev. July 18, 2013).

Maya I-215, LLC ("Maya") and Screaming Eagle, LLC ("Screaming Eagle") sued the managers of Screaming Eagle. Screaming Eagle was the manager of Maya, and the two LLCs alleged that the managers of Screaming Eagle received unauthorized fees to the detriment of Maya. The issue on appeal was whether Screaming Eagle, as Maya's manager, was authorized to initiate the litigation. Applying contract principles to the interpretation of the operating agreement, the court

found clear and unambiguous provisions authorizing the manager of Maya to do all things necessary or convenient to carrying out the LLC's business, including instituting, prosecuting, and defending actions in the LLC's name. Except for certain specified matters, the authority to act for the LLC was vested in the manager. Certain decisions were reserved to the members or required member consent, but nothing in the operating agreement allowed members to override the decision of the manager to institute a lawsuit. One of the defendants also argued that the law firm representing Maya in the case could not do so because the members of Maya voted to terminate the LLC's relationship with the law firm, but the court stated that Screaming Eagle's authority to initiate the law suit included the authority to choose counsel. Another issue raised in the appeal was whether the law firm that represented Maya had a conflict of interest because of its previous representation of one of the defendants in a related case. The supreme court was not in a position to address this issue because of its fact-bound nature, but the court stated that this issue of professional ethics merited review by the district court on remand.

Attorney Sanctions

Scheel v. Alfaro, 406 S.W.3d 216 (Tex. App. 2013).

The court of appeals affirmed an order of the trial court's order setting aside a receiver's sale and sanctioned the judgment creditor's attorney given circumstances that included the following: the sale occurred without notice to the judgment debtor while a motion for new trial was pending and the parties were in settlement negotiations; the sales price appeared to be grossly inadequate; the sale covered LLC interests without obtaining a charging order; and, after the receiver's sale, the judgment debtors entered into a settlement in full satisfaction of the judgment without knowledge that all of their property had been sold in the receiver's sale. Nearly two months after the judgment creditor's attorney filed a satisfaction of judgment based on the settlement, the judgment creditor's attorney filed a motion for approval of the receiver's sale. The court of appeals discussed the legal requirements and circumstances surrounding the turnover orders and receiver's sale and concluded that the trial court did not abuse its discretion by setting aside the receiver's sale. The trial court also did not err in setting aside the turnover orders because the turnover orders had no further force or effect once the judgment was satisfied. In its order sanctioning the judgment creditor's attorney for filing groundless or bad faith pleadings, the trial court listed, *inter alia*, the turnover order that ordered the judgment debtors "to turn over their interests in various L.L.C.s, which is prohibited by statute," and the motion to approve the receiver's sale even though the judgment creditor's attorney "was aware that the sale was held without notice, purported to convey L.L.C. interests which were prohibited by statute and that the judgment had already been satisfied." In the course of analyzing whether the trial court's order of sanctions was an abuse of discretion, the court of appeals pointed out that the judgment creditor's attorney sought the sale of interests in numerous LLCs and that he "asked for a turnover order as to these interests, but he did not do so via a charging order." The court of appeals cited the Texas limited partnership charging order provision and parenthetically quoted the portion that reads: "The entry of a charging order is the exclusive remedy by which a judgment creditor of a partner or of any other owner of a partnership interest may satisfy a judgment out of the judgment debtor's partnership interest."