Selected Recent LLC Cases

ALI CLE
Limited Liability Entities 2015 Update
Video Webcast
March 26, 2015

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by Elizabeth S. Miller

Standing

See also cases below under the heading "Derivative Suits."

In re Galaz (Galaz v. Galaz), 765 F.3d 426 (5th Cir. 2014).

Lisa Galaz brought an adversary proceeding against her ex-husband, Raul Galaz, for fraudulently transferring the assets of an LLC in which Lisa owned a 25% economic interest. In Lisa and Raul's divorce, they executed a divorce decree under which Raul assigned half of his LLC 50% interest to Lisa. The transfer occurred in violation of the operating agreement without the other member's consent, and Lisa therefore received a 25% economic interest with no management or voting rights. Raul, as manager of the LLC, transferred the assets of the LLC to another entity that he formed with his father. The bankruptcy court found that the transfer was invalid under the Texas Uniform Fraudulent Transfer Act and awarded Lisa a judgment for damages against the defendants. The court of appeals clarified that Lisa was a "creditor" under the Texas Uniform Fraudulent Transfer Act because she had a right to payment or property that existed at the time of the fraudulent transfer or that arose within a reasonable time after the transfer. The court reasoned that, as an economic interest holder of the LLC, "a creature of California corporate law," she had a right to payment and was entitled to distributions before the LLC was dissolved and Raul transferred its assets. Because the California LLC statute provides that an economic interest includes a person's right to receive distributions from the LLC and an economic interest constitutes personal property of an assignee, Lisa had standing to bring her fraudulent transfer claim.

Chou v. Chilton, 2014 WL 2154087, __ S.W.3d __ (Ky. App. 2014).

Richard Chilton, Mark Chilton, and William Chilton formed an LLC with Li An Chou. In order to qualify the LLC as a minority owned business (MBE), Chou was granted a 51% interest and was appointed the president and managing member. The Chiltons owned the remaining 49% among them. The Chiltons had a construction company that operated in the same environment as the LLC, and the LLC was eventually decertified as an MBE, in part because of lack of documentation that it was a separate entity and not merely a conduit for transactions of the Chiltons' company. The Chiltons blamed Chou, claiming he was not capable of running the business and did not want to learn, and Chou argued he was shut out of the operations and existed only as a figurehead for the Chiltons to secure MBE-related contracts. Chou brought an action in his individual capacity against the Chiltons and sought judicial dissolution of the LLC, an accounting of the financial transactions of the LLC, and recovery for breach of loyalty, breach of fiduciary duty, breach of the duty of good faith and fair dealing implied in the LLC operating agreement, misappropriation, and misrepresentation. The trial court dismissed Chou's complaint on the basis that the LLC rather than Chou was the real party in interest and that Chou lacked standing to bring the claims. The court of appeals held that Chou, as a member, had standing under the Kentucky LLC statute to bring an action for dissolution of the LLC. The court further held that the claim for an accounting was a

natural next step of the dissolution that Chou as a member could assert. The court held that Chou did not have standing to bring the claims for breach of loyalty and breach of fiduciary duty. The court disagreed with Chou's reading of Kentucky case law and stated that the case relied on by Chou did not hold that every member of an LLC owes every other member a duty of loyalty and fiduciary duty. The court stated that the case relied on by Chou held that managing members owed a duty to the other members, and Chou was the managing member. Thus, the court held that the Chiltons did not owe a fiduciary duty to Chou, and Chou had no standing to assert such a claim against them. The court also held that the claim for misappropriation of funds and opportunities alleged a wrong by the Chiltons against the LLC, and Chou thus lacked standing to bring this claim individually. The court stated that the claim for breach of the covenant of good faith and fair dealing related to the operating agreement, which was an agreement among Chou and the Chiltons, and their agreement specifically allowed members to sue other members for fraud, gross negligence, or an intentional breach of the agreement. The court stated that whether the claim for breach of the covenant of good faith and fair dealing was intentional was a question for the trier of fact, but Chou had standing to bring the claim against the Chiltons since they were all parties to the agreement. Finally, the claim for misrepresentation was a claim for fraud, and since the operating agreement allowed members to bring claims against other members for fraud, the court concluded that Chou had standing to assert this claim.

Capano v. Capano, C.A. No. 8721-VCN, 2014 WL 2964071 (Del. Ch. June 30, 2014).

Two brothers, Louis and Joseph, owned or controlled identical interests in a family owned LLC that held real estate assets. The brothers' mother transferred a portion of an interest to a Delaware business trust ("CI Trust") for the benefit of a third brother, Gerry. CI Trust held the swing vote in the event of a deadlock among the members of the LLC, and Gerry had voting control over the trust. In 2000, Gerry executed several documents purporting to grant Louis a voting proxy and an option to purchase Gerry's interest in CI Trust. In 2001, Gerry executed documents purporting to transfer all of Gerry's interest in CI Trust to Louis. In 2013, after the mother's death, Louis exercised the rights purportedly transferred to him to cash Joseph out of the LLC through a merger of the LLC with an entity controlled by Louis. Gerry and Joseph brought lawsuits asserting various claims, including challenges to the transfers by Gerry and to the merger. The defendants argued that Joseph lacked standing to challenge the transfer documents relating to the CI Trust because he was not an intended beneficiary of those documents. Joseph argued that because the CI Trust held an interest in the LLC and essentially functioned as a tie-breaking voter, Joseph was an intended beneficiary of the documents. The court rejected Joseph's argument based on the text of the trust agreement of the CI Trust, which did not identify Joseph as a party or as a third-party beneficiary. The court noted, however, that Joseph would have standing to challenge a transfer of interest in the CI Trust to the extent it violated the operating agreement of the LLC.

Kelly v. Smith, 134 So.3d 644 (La. App. 2014).

Kelly and Smith formed an LLC for the purpose of acquiring residential properties that would be leased to persons under rent-to-own contracts. The parties agreed to split the profits equally, including commissions that Smith received from her employment with a real estate brokerage firm. Kelly alleged that Smith caused the LLCs to default on a real estate purchase agreement and forfeit its deposit and that Smith also failed to deposit her sales commissions into the LLC's bank account. After Smith decided that she no longer wanted to be part of the LLC, the articles of organization were amended to allow her to surrender her interest and transfer her rights in the LLC to Kelly.

Smith relinquished future involvement in the LLC other than retaining the right as agent to collect rental payments from current lessees. Kelly alleged that Smith misappropriated funds from the LLC's bank account and sued Smith for breach of fiduciary duty to Kelly and the LLC and asserted that Smith was liable to him for misappropriation, breach of fiduciary duty, and breach of contract. The trial court awarded Kelly recovery of the funds misappropriated from the LLC's bank account. On appeal, Smith argued that the trial court erred in awarding Kelly recovery in his individual capacity because he had no right of recovery on behalf of the LLC. The court of appeals stated that Kelly was the sole member of the LLC after Smith surrendered her interest and pointed to examples of cases where an individual has been allowed to bring or defend in the individual's capacity an action by or against an LLC. The court stated that it appeared that the LLC ceased to do business and that Kelly and Smith had separate and personal interests in three shared properties. The court stated that the LLC's license was revoked by the Secretary of State, and the court found no error in the trial court's award of funds to Kelly in his individual capacity. In addition to Smith's appeal of the judgment, she asserted a peremptory exception of no right of action questioning Kelly's interest in judicially enforcing the right asserted against her. The court stated that Kelly alleged that Smith owed a fiduciary duty to both Kelly and the LLC and that Kelly thus had a right of action to bring the suit. The court noted that the LLC statute states that a member of an LLC is not a proper party to a proceeding by or against an LLC unless the object is to enforce the member's rights against or liability to the LLC. The court stated that an analogous argument could be made that "the same should apply where a member, who is left as the sole member of an LLC, is bringing an action regarding the LLC against a former member of the LLC; it would make no difference if he brought the action on behalf of the LLC or in his individual capacity."

Personal Jurisdiction

2009 Caiola Family Trust v. PWA, LLC, C.A. No. 8028-VCP, 2014 WL 7232276 (Del. Ch. Dec. 18, 2014).

The non-managing members of Dunes Point West, LLC ("Dunes Point"), a Delaware LLC that owned an apartment complex in Kansas, sued PWA, LLC ("PWA"), a Kansas LLC that served as managing member of Dunes Point, and Katz, the managing member of PWA. The plaintiffs alleged that the actions of Katz and PWA breached Dunes Point's operating agreement and fiduciary duties owed by PWA and Katz. Katz also sought dismissal on the basis that the Delaware court lacked personal jurisdiction over him, and the court concluded that it could exercise personal jurisdiction. The court first concluded that Katz "transacted business" in Delaware within the meaning of the Delaware long-arm statute. Katz controlled and managed PWA, which managed Dunes Point, as shown by the following actions: Katz executed multiple documents relating to Dunes Point, was listed as its principal manager, had sole authority to draw checks on its bank account, mailed its Delaware partnership returns, signed checks for its Delaware franchise tax payments, and signed and filed its tax returns. The fact that neither Katz nor PWA filed the documents related to Dunes Point's formation did not place them outside the court's jurisdiction. Next the court found that exercising jurisdiction over Katz comported with due process. Since Katz expected a significant monetary return from his management of Dunes Point, it was reasonable to require him to answer in Delaware for alleged wrongdoing relating to his management.

VTB Bank v. Navitron Projects Corp., C.A. No. 8514-VCN, 2014 WL 1691250 (Del. Ch. Apr. 28, 2014).

The plaintiff made loans to two Ukrainian entities that were part of a corporate family ("AIS Group") owned and controlled by a Delaware LLC. The AIS Group sold cars in Ukraine and pledged to the plaintiff real and personal property in Ukraine. The plaintiff alleged that the AIS Group fraudulently transferred cars it purchased with proceeds of the loans to shell companies. The AIS Group eventually defaulted on the loans, and the plaintiff brought suit in Ukraine to foreclose on the collateral. The defendants allegedly facilitated the fraudulent transfer of the collateral to the defendants while the litigation in Ukraine was pending. The plaintiff brought suit in Delaware alleging fraudulent transfer and unjust enrichment and seeking a constructive trust and equitable appointment of a receiver. Navitron sought dismissal of the plaintiff's claims against it for lack of personal jurisdiction. The plaintiff relied on the Delaware long-arm statute and the Delaware LLC statute. The court concluded that the plaintiff waived its argument under the long-arm statute by failing to brief or argue it. The court analyzed whether the implied consent provision of the Delaware Limited Liability Company Act supported the exercise of personal jurisdiction and concluded it did not. Section 18-109 of the Delaware LLC statute authorizes service of process on managers of Delaware LLCs in actions "involving or relating to the business of the limited liability company or a violation of the manager . . . of a duty to the limited liability company or any member of the limited liability company." Consistent with constitutional due process and Delaware precedent, the court stated that this provision does not establish a basis for personal jurisdiction over a manager where claims do not relate to the "rights, duties and responsibilities" that the manager owes to the LLC or to the manager's involvement in the LLC's "internal business affairs" or "day-to-day operations." The plaintiff argued that a party subjects itself to the court's jurisdiction generally when it becomes the managing member of a Delaware LLC, but the court granted the motion to dismiss because the plaintiff asserted it was harmed by the defendants' conduct independent of their corporate structure, and the claim thus was not related to Navitron's rights, duties, or responsibilities as a managing member of the Delaware LLC.

Venue

VTB Bank v. Navitron Projects Corp., C.A. No. 8514-VCN, 2014 WL 1691250 (Del. Ch. Apr. 28, 2014).

The plaintiff made loans to two Ukrainian entities that were part of a corporate family ("AIS Group") owned and controlled by a Delaware LLC. The AIS Group sold cars in Ukraine and pledged to the plaintiff real and personal property in Ukraine. The plaintiff alleged that the AIS Group fraudulently transferred cars it purchased with proceeds of the loans to shell companies. The AIS Group eventually defaulted on the loans, and the plaintiff brought suit in Ukraine to foreclose on the collateral. The defendants allegedly facilitated the fraudulent transfer of the collateral to the defendants while the litigation in Ukraine was pending. The plaintiff brought suit in Delaware alleging fraudulent transfer and unjust enrichment and seeking a constructive trust and equitable appointment of a receiver. After dismissing a manager based on the absence of personal jurisdiction, the court addressed the LLC's motion to dismiss the complaint on forum non conveniens grounds. The LLC asserted that it would face an overwhelming hardship in defending itself in Delaware. The court analyzed the factors that are considered in a forum non conveniens analysis and found that (i) most of the evidence and witnesses were based in Ukraine, (ii) the matter involved Ukrainian law, (iii) the parties had pending litigation in Ukraine, and (iv) there were significant practical difficulties

in maintaining this litigation in Delaware. Despite these findings, the court denied the motion to dismiss. The court emphasized that the remedy of equitable receivership sought by the plaintiff implicated the court's fundamental and immutable responsibility to supervise Delaware entities. Given the allegation of systematic fraudulent conduct, the court concluded this responsibility outweighed any hardship on the defendant in litigating in Delaware.

Derivative Suits

Northwest Wholesale, Inc. v. Pac Organic Fruit, LLC, 334 P.3d 63 (Wash. App. 2014).

Harold and Shirley Ostenson and Greg Holzman formed an LLC in 1998 to operate an orchard packing facility. The Ostensons and Greg Holzman, Inc. ("GHI") became the members of the LLC, and both the Ostensons and GHI were active in the business. The Ostensons owned 49% of the LLC, and GHI owned the remaining 51%, thus giving GHI control of the business decisions. The LLC began as a seasonal business but expanded to operate year-round. The members' versions of the decline of the LLC differed, but in any event the LLC financially collapsed in 2005. The Ostensons accused Holzman of wrongdoing, and Holzman claimed that the Ostensons were uncooperative and caused stored fruit to sit past its prime, which caused the LLC to lose revenue. Holzman fired the Ostensons from their positions with the LLC after the LLC defaulted on its operating line of credit and lease. The Ostensons filed for bankruptcy protection under Chapter 11 in early 2007. Later in 2007, a creditor of the LLC filed this lawsuit in state court against the LLC, GHI, and the Ostensons. The Ostensons filed cross claims and a third party complaint against Holzman, GHI, and another entity of Holzman's. These claims were in the nature of a derivative action on behalf of the LLC. In 2008, the bankruptcy court approved a "stipulation" that addressed claims among the Ostensons, Holzman, and Holzman's affiliated entities. Under the stipulation, the Ostensons agreed to arbitrate some claims and litigate others. The stipulation stated that any claims of the LLC against Holzman and his entities would be litigated in this lawsuit. In 2010, Holzman filed a motion in the bankruptcy proceeding in which he argued for the first time that the Ostensons were no longer members of the LLC because the Washington LLC statute dissociated them from the LLC when they filed for bankruptcy. The bankruptcy court did not rule on this motion. This case went to trial in 2011, and Holzman and his entities moved to dismiss the Ostensons' derivative action after the Ostensons rested their case. The Holzman defendants argued that the Ostensons were no longer members of the LLC and lacked authority to bring their derivative action. Eventually, the trial court ruled that the Ostensons relinquished their membership in the LLC when they filed bankruptcy and could not maintain a derivative action on the LLC's behalf. The Ostensons appealed.

The court of appeals examined the standing of the Ostensons under state law to bring a derivative action on behalf of the LLC and agreed with the trial court that the Ostensons did not have standing. Under the Washington LLC statute, a derivative plaintiff must be a member at the time of the bringing of the action. The Washington LLC statute also provides that, unless otherwise provided in the LLC agreement, a person ceases to be a member, and attains the status of an assignee, of an LLC when the person files a voluntary petition in bankruptcy. The LLC agreement in this case provided that a person became dissociated upon any event of dissociation specified in the Washington LLC statute. Under Washington law, the Ostensons thus forfeited their right to bring a derivative action on behalf of the LLC when they filed for bankruptcy. As an assignee, a dissociated member retains the right to share in profits but loses any management rights. The court rejected the Ostensons' argument that Holzman consented in the bankruptcy stipulation to the continued membership of the Ostensons. While the stipulation preserved claims of the LLC against

the Holzman defendants, it did not address whether the Ostensons could assert those claims. Even though unlikely, the LLC itself could assert those claims. Long before the stipulation, the membership of the Ostensons had ceased, and the stipulation did not indicate that it resurrected the membership of the Ostensons and their ability to file a derivative action on behalf of the LLC. Absent consent in writing to the Ostensons' continued membership in the LLC, the Ostensons lacked statutory authority and standing under state law to bring their derivative action.

The court next turned to the Ostensons' argument that federal bankruptcy law, specifically Section 541(c)(1) or Section 365 of the Bankruptcy Code, preempted the Washington LLC statute from dissociating them as members of the LLC. The court analyzed these provisions and concluded that they did not preempt state law. Because bankruptcy law did not preempt the provisions of Washington law that removed the Ostensons as members of the LLC when they filed bankruptcy, they did not have standing to assert their derivative claims.

Crothall v. Zimmerman, 94 A.3d 733 (Del. 2014).

The defendants appealed the court of chancery's award of attorney's fees to the plaintiff's attorney for allegedly creating a corporate benefit. After trial, the court of chancery ruled in favor of the plaintiff on one of his derivative claims, i.e., that the LLC's operating agreement had been violated by the issuance of units without an amendment approved by the common unitholders. Before the form of a final judgment was agreed upon, the plaintiff sold his units, thus losing standing to pursue his derivative claims, and the suit was dismissed. The plaintiff's attorney was granted leave to intervene to seek recovery of attorney's fees, and the court of chancery awarded $300,000 in attorney's fees for conferring a corporate benefit by successfully arguing that the operating agreement had been violated. The supreme court declined to address the merits of the court of chancery's ruling on the breach of contract claim since it was moot, and the court concluded that attorney's fees were improperly awarded. Since no final judgment was ever rendered, the plaintiff's attorney never obtained an authoritative ruling of the court of chancery and did not create a corporate benefit. The supreme court distinguished cases relied upon by the plaintiff's attorney because the claims in those cases were mooted by actions taken by the defendants rather than the plaintiffs. The court characterized the plaintiff's action of obtaining a favorable trial court decision on a closely contested issue of corporate governance and then rendering the decision moot by abandoning the claim as merely causing uncertainty rather than a corporate benefit. The court stated that ruling otherwise would come close to rendering an advisory opinion and would devote judicial resources to a claim that a plaintiff voluntarily withdrew.

Dinuro Investments, LLC v. Camacho, 141 So.3d 731 (Fla. App. 2014).

The court of appeals reviewed Florida law on the question of when a member of an LLC has standing to bring a claim individually as opposed to derivatively against a fellow member and concluded that the plaintiff's claims in this case must be brought derivatively. The plaintiff alleged violations of the operating agreement of the LLC that left the LLC worthless and deprived the plaintiff of the value of his investment. In essence, the plaintiff alleged that the other two members and their individual owners intentionally allowed the LLC to default on its indebtedness so that they could purchase the loans at a discount and foreclose on the mortgaged properties, thus depriving the LLC of its sole assets.

The court characterized the question of when a particular action may be brought directly rather than derivatively as a complicated and confusing inquiry, particularly in the case of a closely held entity, and the court stated that the matter was further confounded by the lack of clarity in

Florida case law. The court's review of the scholarly literature and case law around the country revealed three approaches to determining whether an action may be brought directly or derivatively: (1) the "direct harm" test; (2) the "special injury" test; and (3) the "duty owed" test. The court stated that a majority of courts around the country appear to apply the "direct harm" test, under which the harm is examined to see if it flows first to the company and only damages the owners due to the loss in value of their ownership interests or whether the harm flows directly to the owner in a way that is not secondary to the company's loss. The court characterized this approach as likely the simplest approach but noted that it may be especially harsh in small company settings. The "special injury" test requires the court to determine whether the plaintiff's injury is distinct from that of other owners. The court noted that this test provides more flexibility but can be difficult to apply because the "special" nature of the injury can be a nebulous inquiry. The "duty owed" test examines the statutory and contractual terms to determine whether the duty at issue is owed to the individual owner or whether the duty is owed to the company generally. This approach allows for the greatest freedom of contract, but the court noted that many operating agreements and statutes do not specify who owes a particular duty and to whom the duty is owed. For example, the court pointed out that the Florida LLC statute states that all managing members owe a duty of loyalty and care to the LLC and all the members of the LLC. Thus, the court said that the "duty owed" test may provide little guidance or can be interpreted to allow either a direct or derivative suit.

The court reviewed Florida case law and attempted to synthesize 50 years of case law in the courts of appeals in the absence of an established rule by the Florida Supreme Court. The court characterized the case law as "opaque," "varying," and "divergent" and concluded that the only way to reconcile the case law was to hold that an action may be brought directly only if both the direct harm and special injury tests are met, i.e., only if (1) there is a direct harm to the shareholder or member such that the alleged injury does not flow subsequently from an initial injury to the company, and (2) there is a special injury to the shareholder or member that is separate and distinct from those sustained by the other shareholders or members. However, the court also concluded that there was an exception to this rule under Florida law so that a member or shareholder need not satisfy this two-pong test if there is a separate statutory or contractual duty owed by the defendant to the plaintiff.

Applying Florida law to the facts of this case, the court concluded that the plaintiff did not allege a direct harm and thus did not satisfy the two-prong test. The plaintiff sought to establish that the separate duty exception was met based on the operating agreement. The court noted that an operating agreement is a more complicated and nuanced set of contractual rights and duties than a typical bilateral contract. The LLC statute provides that the operating agreement governs the relations among the members, managers, and company, and the precise terms of the agreement are important in determining whether an individual member owes the other members any duties or merely owes the company duties. The operating agreement in this case contained a provision outlining certain conduct that constitutes a default under the agreement and the effects of a default. The agreement specified certain remedies for a member's default and also provided that the members and company could elect to pursue remedies provided under the agreement "or any other remedies available at law or in equity." The plaintiff argued that this language provided for a direct action by a member against another member for breach of the agreement. The court disagreed. The specific remedies provided by the agreement were termination of a defaulting member's interest and a preemptive right to buy out the member's interest. The court said that the ability to pursue other remedies simply allowed pursuit of additional remedies consistent with Florida statutory and common law but did not expand the member's rights beyond the rights currently available under

Florida law. The court found it significant that a provision stating that members are directly liable to one another was conspicuously missing from the operating agreement. According to the court, the statutory limitation on a member's liability for involvement with the LLC precluded a member from suing another member directly for breach of the agreement.

In sum, Florida law does not permit an LLC member to sue individually for damages arising out of its status as a member unless (1) the damages arise from a direct harm and special injury, or (2) there is a separate duty owed by the defendant to the plaintiff. The plaintiff did not satisfy either of these tests. Thus, the remedy available to the plaintiff was a derivative suit, which the plaintiff did not bring, and the trial court did not err by dismissing the plaintiff's complaint.

Muccio v. Hunt, No. CV-11-1273, 2014 Ark. 35 (Ark. 2014).

The Arkansas Supreme Court characterized claims for fraud, breach of duty to disclose company information, and conversion asserted by members of a bankrupt LLC as direct rather than derivative claims. The court relied on corporate and partnership case law regarding derivative and direct claims to conclude that the fraud claim, which was based on misrepresentations that allegedly deprived the members of their membership interests, were direct claims. Similarly, the court characterized the conversion claim, which was based on the defendants' alleged exercise of dominion over the members' membership interests through the defendants' fraudulent misrepresentations, as a direct claim. The court relied on provisions of the Arkansas LLC statute to conclude that the members' claim that managers, officers, and board members of the LLC withheld company information stated a direct claim. The court pointed out that the Arkansas LLC statute requires managers to "render, to the extent the circumstances render it just and reasonable, true and full information of all things affecting the members to any member." The court held that this statutory information right of members constitutes an individual claim running to the individual member. Further, the court concluded that the statute contemplates a manager's liability to a member in the provision that states that a manager is not liable "to the limited liability company or to the members" for any act or failure to act unless the act or omission constitutes gross negligence or willful misconduct.

Arbitration

In re Galaz (Galaz v. Galaz), 765 F.3d 426 (5th Cir. 2014).

Lisa Galaz brought an adversary proceeding against her ex-husband, Raul Galaz, for fraudulently transferring the assets of an LLC in which Lisa owned a 25% economic interest. In Lisa and Raul's divorce, they executed a divorce decree under which Raul assigned half of his LLC 50% interest to Lisa. The transfer occurred in violation of the operating agreement without the other member's consent, and Lisa therefore received a 25% economic interest with no management or voting rights. Raul, as manager of the LLC, transferred the assets of the LLC to another entity that he formed with his father. The bankruptcy court found that the transfer was invalid under the Texas Uniform Fraudulent Transfer Act and awarded Lisa a judgment for damages against the defendants. One of the contentions in this appeal by Raul and the transferee entity was that the bankruptcy court should have referred Lisa's claims to arbitration pursuant to a provision in the LLC operating agreement. The court rejected this argument because Lisa was not a party to the operating agreement. The operating agreement referred to the "parties" as the LLC's "Members," and Lisa held only an economic interest. The court stated that the Fifth Circuit has recognized limited circumstances in which a nonsignatory may be bound by an arbitration agreement, but there was no

argument or evidence suggesting how Lisa, neither a member nor a party, was bound by the arbitration provision.

Seven Hills Commercial, LLC v. Mirabal Custom Homes, Inc., 442 S.W.3d 706 (Tex. App. 2014).

Five entities entered into an amended and restated LLC operating agreement that listed three of the entities as members and identified one of the entities as a former member and one of the entities as a former manager. One of the member entities was named as manager of the LLC. Three individuals signed the agreement one or more times in representative capacities for the five entities. The LLC sued the three entity members and two individuals whom the LLC alleged participated in one member's breach of fiduciary duty and tortious interference with the operating agreement. The defendants and other parties and signatories to the operating agreement asserted various cross claims and counterclaims. Some of the parties to the lawsuit sought arbitration pursuant to an arbitration clause in the LLC operating agreement, and the parties disputed whether the arbitration clause was binding on all the parties to the lawsuit, whether the claims asserted fell within the scope of the arbitration clause, and who could enforce the arbitration clause.

The court of appeals held that a member and former manager who were parties to the operating agreement, as well as a nonparty individual, could compel arbitration of another member's claim for money had and received against them. The individual who was not a party to the operating agreement was entitled to compel arbitration of the claim against him because he signed the operating agreement as an agent for a party. Based on the language of the arbitration clause, the court concluded that the members had agreed to delegate arbitrability to the arbitrator. Thus, the arbitrator would make the primary determination of whether this claim for money had and received based on alleged improper distributions fell within the scope of the arbitration clause.

The court analyzed claims by an individual and his entity (the former member) against an individual and two of that individual's entities (one of whom was the former manager), and the court concluded that the latter could not compel the claims to arbitration. The individuals had signed the operating agreement only in their capacities as representatives of their respective entities, and one of the entities involved in these claims did not sign the operating agreement at all. The claims arose out of a contract separate and apart from the operating agreement and thus did not arise out of or relate to the operating agreement. The claims by the individual representative of the former member were based on alleged acts involving injury to the individual personally. None of these claims appeared to arise out of or related to the operating agreement.

The court of appeals next addressed the LLC's claims against one of the members and an individual who signed the operating agreement as representative of that member and allegedly participated in the member's breach of fiduciary duty and tortious interference with the operating agreement. The court determined that the member and the individual (whose acts at issue were taken in a representative capacity for the member) clearly agreed to allow the arbitrator to decide the arbitrability of the claims and that the LLC could compel arbitration of its claims even though it was not a signatory to the operating agreement. The court relied on a case involving a law firm partnership agreement in deciding that the LLC could enforce the arbitration clause in the operating agreement even though it was not a signatory. The operating agreement, like the law firm partnership agreement in the other case, created an ongoing relationship between the signatories and the entity and governed the operation and existence of the entity. The court pointed out that the Texas Business Organizations Code provides that the company agreement of an LLC governs "the relations among members, managers, and officers of the company, assignees of membership interests

in the company, and the company itself." The court interpreted this provision to mean that the company agreement governs the relationships between the LLC and its members, and the court did not believe that the LLC was required to sign the operating agreement in order to enforce the arbitration provision in the agreement.

Preformation Transactions

Hansen v. Fields Company, LLC, 763 S.E.2d 31 (S.C. 2014).

The court applied principles of corporate law to conclude that an LLC was not liable for breach-of-contract and tort claims based on the activities of a promoter and his various entities. The plaintiff, Hansen, worked with another individual, Fields, to assist Fields in procuring capital to purchase a water bottling business, and Hansen sued Fields after Fields cut Hansen out of the deal, found investors, and acquired the business. One of the defendants Hansen sued was an LLC formed by Fields during the course of Fields's structuring of the deal to acquire the water bottling business. The court recited the rule that a corporation is not initially liable for a promoter's preincorporation contract but may become liable by expressly or implicitly adopting the contract. Here there was no evidence that the LLC expressly ratified any contract with Hansen or benefitted from or accepted any benefits from any contract with Hansen. As for the tort claims, the court stated that the rule among jurisdictions that have considered the issue is that a corporation is not liable for torts of its promoters committed before the corporation came into existence. Three policy considerations led the court to conclude that this is the proper rule. First, there is no agency relationship between a promoter and a non-existent corporate entity. Second, the individual tortfeasor/promoter is still liable for any tort committed. To the extent the promoter owns a portion of the corporate entity, the injured party could use that interest to satisfy a judgment against the promoter, and other owners potentially could be held liable under a conspiracy theory if they knew of and aided in the commission of the tort. Finally, a contrary rule would permit innocent investors to be harmed by tortious conduct of which they were not aware and thus might stifle investment.

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

Heaps v. Nuriche, LLC, 2015 WL 404572, __ P.3d __ (Utah 2015).

Employees of a Nevada LLC sought to hold the managers of the LLC personally liable for unpaid wages under the Utah Payment of Wages Act (UPWA), which provides for civil and criminal liability on the part of employers for unpaid wages and defines an "employer" as "every person, firm, partnership, association, corporation, receiver or other officer of a court of this state, and any agent or officer of the above-mentioned classes, employing any person in this state."

The court first rejected the managers' argument that Nevada law applied to their liability under the Utah Revised Uniform Limited Liability Company Act, which provides that the law of the jurisdiction of formation of a foreign LLC governs "the liability of a member as member and a manager as manager for a debt, obligation, or other liability of the company." The managers argued that unpaid wages are like any other debt of an LLC and that Nevada law should be applied to determine the managers' liability for the unpaid wages. The court responded that the employees were not seeking to hold the managers liable for an obligation of the LLC but were arguing that UPWA imposed direct liability on the managers. Because the employees' theory was premised on direct liability, and the conflict-of-laws provision in the Utah LLC statute applied to liability for

obligations of the LLC, the conflict provision did not apply to this case. Further, the court pointed out that the Utah LLC statute provides that registration of a foreign LLC to do business in Utah does not authorize the foreign LLC to engage in activities or exercise any power that a Utah LLC may not engage in or exercise in Utah. Because a foreign LLC that employs employees in Utah is required to follow Utah wage law, any claim of illegal wage practice by a Utah employee will be governed by Utah wage law.

The court next analyzed the UPWA and concluded that it did not impose personal liability for unpaid wages on managers of an LLC employer. Although the definition of an employer includes "any agent or officer" of the entities listed in the statute, the court stated that the phrase is qualified by the clause "employing any person in this state." The LLC rather than the managers employed the employees, and the court stated that the conclusion that the managers were not liable was buttressed by long-accepted principles of corporate law that recognize the separate legal existence of a corporation from its officers, shareholders, and directors. Where the legislature has imposed personal liability on business officers and agents, it has done so expressly, such as in the Insurer Receivership Act and the Alcoholic Beverage Control Act. Further, the imposition of criminal liability on employers under the UPWA weighs against imposing personal liability on corporate officers and agents because "fair warning" of conduct constituting a crime is required, and the UPWA is not clear enough to meet that standard. The court rejected two alternative constructions of the UPWA raised by the employees. The employees argued that the definition of "employer" rendered the managers liable as "agents and officers" of the LLC under the language of the definition, but the court stated that this construction would lead to the absurd result that all employees would be personally liable for unpaid wages because all employees are agents of their employer. The second construction argued by the employees would limit the types of agents and officers who qualify as employers to those who exercise some control over the payment of wages. This approach has been used in Pennsylvania in interpreting a wage statute that defines an employer in a manner similar to the UPWA. The court concluded that the Pennsylvania approach was arguably consistent with public policy but was not consistent with the language of the UPWA. This approach would require courts to "engage in a free-standing public policy analysis to determine precisely which agents of an employer should be held liable for unpaid wages," and the court characterized the role of drawing such lines as one for the legislature. Since the employees' first argument would lead to absurd results by imposing civil and criminal liability on all employees, and the second argument required drawing policy-based lines not supported by the statutory language, the court held that the LLC managers could not be held personally liable for the unpaid wages under the UPWA.

Daniel v. Ripoli, 2015 IL App (1st) 122607, __ N.E.3d __ (Ill. App. 2015).

A general partnership accounting firm with two partners, Ripoli and Daniel, converted to an LLC effective January 1, 1999, and a third individual, Grieco, became a member of the firm and entered into an operating agreement with the two other members a few months later. The three members approved and ratified the articles of organization and agreed to operate under the articles and the operating agreement. Several years later, the members met to discuss concerns regarding the disparity between Daniel's profit-sharing percentage and the actual income generated from Daniel's clients. Daniel's profit-sharing percentage under the operating agreement was significantly higher than the income generated by his clients, and Greico's profit-sharing percentage was significantly lower than the income produced by his clients. Eventually, in December of 2003, the members signed an agreement that they would not follow the profit-sharing percentages in the operating

agreement for 2003 and would determine the profit-sharing percentages for 2003 based on the financial statements for 2003. In January of 2004, the members signed an agreement adjusting the members' capital accounts in 2003 and specifying a method of determining Daniel's distributions in 2004. The members abided by the 2004 agreement until Daniel died in 2006. Daniel's estate sued Ripoli, Greico, the partnership, and the LLC seeking payment of the amount the estate claimed was owed for Daniel's capital account under the operating agreement. The estate argued that the January 2004 agreement did not permanently change the profit-sharing percentages because it did not expressly refer to future years. The court examined the terms of the 2004 agreement and the course of conduct of the parties and concluded that the 2004 agreement amended the operating agreement and established a permanent change in Daniel's capital account.

The court rejected an argument by Daniel's estate on appeal that the trial court erred in determining that Ripoli and Greico had no individual liability for breach of contract. First, the court pointed out that the LLC statute at one time allowed LLC members to be held personally liable to the same extent as shareholders of a corporation. That provision was removed by the legislature effective January 1, 1998, and the statute has provided that a member or manager is not personally liable for a debt, obligation, or liability of the LLC solely by reason of being or acting as a member or manager for the entire time period since the conversion in this case of the partnership to an LLC. The LLC statute provides for an exception to the liability protection of LLC members to the extent the articles of organization provide for personal liability in a provision to which a member has consented in writing, but this exception did not apply because there was no such provision in the LLC's articles of organization. Next the court rejected various attacks by Daniel's estate on the validity of the conversion. The court stated that the fact that the LLC members continued to treat certain aspects of the business as a partnership (giving as an example the filing of K-1 partnership tax statements) did not change the legal status of the business as an LLC, pointing to the provision of the LLC statute that provides that an LLC's failure to observe usual company formalities is not a ground for imposing personal liability on the members. Next the court described the conversion process. The only two partners at the time of the conversion filed a statement of conversion and articles of organization with the Illinois Secretary of State. The statement of conversion recited that each partner voted for the conversion, which satisfied the statutory requirement that all partners approve a conversion. Under the Illinois LLC statute, upon the filing of the articles of organization there is a presumption that all prerequisites to formation have been satisfied, and the LLC's existence begins. The court stated that the estate's argument that the partnership's assets did not vest in the LLC was entirely refuted by the statutory conversion provisions, which provide that the converted entity is the same entity that existed before the conversion for all purposes and that the assets of a converting partnership automatically become assets of the LLC. Finally, the court rejected the estate's argument that it could sue the other members to enforce Daniel's rights under a provision of the LLC statute that provides a member may maintain an action against the LLC or another member to enforce the member's rights under the operating agreement or under the statute. The court stated that the plain language of the statute expressly provides only for an action by a "member." On a member's death, the member becomes dissociated, and the estate cited no authority allowing a member's estate to bring an action against individual LLC members. In sum, the court stated that the Illinois LLC statute was clear on both of the following points: (1) once a partnership converts to an LLC, it legally becomes an LLC, and inconsistent actions by the members cannot change that legal fact; and (2) LLC members have no individual liability to nonmembers. Thus, Daniel's estate was not entitled to a judgment against the members.

Nunez v. Pinnacle Homes, L.L.C., 2014 WL 7154101, __ So.3d __ (La. App. 2014).

A homeowner sought to hold the owner of an LLC liable in connection with the faulty construction of a home that the LLC contracted to build for the homeowner. The home was built below the required elevation level, and the plaintiff sought to hold the LLC's owner liable for professional negligence. The court of appeals considered this matter in light of the Louisiana Supreme Court's decision in *Ogea v. Merritt*. In *Ogea*, the supreme court set forth factors to be used to determine if an LLC member, manager, employee, or agent is personally liable in light of the provisions of the Louisiana LLC statute that provide liability protection to such persons for the liabilities of the LLC subject to certain exceptions. One of the exceptions under the statute is breach of a professional duty. The court in *Ogea* did not reach the question whether a licensed contractor is a professional for purposes of this exception. Because a licensed building contractor is not one of the "legislatively recognized professions" identified in *Ogea*, the court in this case looked to other sources to make this determination. Based on the definition of a "professional" in Black's Law Dictionary and certain provisions of the Louisiana statutes addressing professions or professional services, the court concluded that professional status may extend beyond the narrow scope of professions enumerated in *Ogea*. The court's analysis of the record and the statutes regarding licensing and regulation of contractors convinced the court that the LLC's owner was acting as a professional with regard to the construction contract with the plaintiff. The owner was acting with special knowledge as distinguished from mere skill, as evidenced by his having passed tests and obtaining a license from the state. The court stated that there was no question that his failure to elevate the house as required by the permit was a defect, and his own testimony indicated that it was his negligence that caused the defect. This negligence resulted in a breach of professional duty for which he was personally liable for damages.

Syzygy Construction, LLC v. McKey, 2014 WL 6982462, __ So.3d __ (La. App. 2014).

The plaintiff contracted with an LLC to build a home for the plaintiff. Mason and Marking were the sole managers and members of the LLC, and Marking served as the qualifying party on the LLC's contractor's license. The plaintiff asserted that Mason's acts of fraud and professional negligence subjected Mason to personal liability as provided by the Louisiana LLC statute, which provides a member liability protection with respect to the liabilities of the LLC unless the member: (1) commits fraud, (2) breaches a professional duty, or (3) performs a negligent or wrongful act against another. The trial court granted summary judgment in favor of Mason, and the plaintiff appealed. The court of appeals first examined whether there was any evidence of fraud on the part of Mason. The plaintiff alleged that Mason fraudulently induced her to enter into a contract with the LLC by misrepresenting the LLC's expertise and knowledge in home construction of the type involved in this case. Relying on the supreme court's discussion of the meaning of fraud in *Ogea v. Merritt*, the court found no evidence that Mason intentionally misrepresented or suppressed the truth regarding his knowledge and expertise in construction. Although the plaintiff did not raise the third exception for negligent or wrongful acts, the court noted that her fraud claim was based on allegations of poor workmanship. Under the rationale of *Ogea*, which states that poor workmanship in and of itself does not establish a negligent or wrongful act, the court said that poor workmanship does not establish fraud on the part of the LLC member. The court also rejected the plaintiff's argument that Mason could be personally liable for breaching his professional duty because the work on her home fell below construction industry standards. Mason argued that he did not fit the definition of "professional" as contemplated by the LLC statute and the supreme court in *Ogea*. The court compared this case to the situation in *Ogea*, in which it appeared that the LLC that contracted

to build the home at issue held a contractor's license but there was no evidence that the individual member defendant held a license. In the absence of proof that the individual member was licensed, the court in *Ogea* did not reach the issue of whether such licensing elevates an individual to the status of "professional" for purposes of the LLC statute. The court in *Ogea* did not suggest that mere licensure results in one being a professional but stated that it may be a factor. In the instant case, the record demonstrated that Mason was not the qualifying party on the LLC's contractor's license, and he held no license in his name. Applying the reasoning in *Ogea*, the court held that Mason was not a professional within the meaning of the LLC statute and could not be personally liable for breach of a professional duty.

Cortez v. Nacco Material Handling Group, Inc., 337 P.3d 111 (Or. 2014).

The plaintiff was injured at his job at a lumber mill and, after receiving workers' compensation benefits, sued the owner of the lumber mill for negligence and under the Oregon Employer Liability Law. The lumber mill was a member-managed LLC of which Swanson Group, Inc. ("Swanson") was the sole member. Swanson provided the LLC with a safety manual, but the LLC had its own employees who were responsible for the day-to-day operation of the mill. Swanson delegated responsibility for carrying out the safety program to the LLC's mill manager and HR director, who were supervised by officers of Swanson.

The court first addressed Swanson's arguments regarding the liability protection provided by the Oregon LLC statute. The court examined the text and legislative history of the statutory immunity provided LLC members and managers under the Oregon LLC statute, which currently provides that the debts, obligations, and liabilities of an LLC, whether arising in contract, tort, or otherwise, are solely the debts, obligations, and liabilities of the LLC. The statute goes on to state that a member or manager is not personally liable for a debt, obligation, or liability of the LLC solely by reason of being or acting as a member or member or manager. The court discussed the meaning of the words "being" and "acting" in the second sentence of the provision and noted that the word "acting" was added several years after the statute's enactment. The court examined testimony given before a House subcommittee when the original statute was enacted as well as commentary given when the statute was amended to add the word "acting." The court also examined the official comments to the comparable provisions of the Uniform Limited Liability Company Act, which were adopted by Oregon verbatim. The court concluded that the statute was intended to protect members and managers from vicarious liability but not to immunize them from personal liability for their own actions. Members and managers remain liable for actions they take on behalf of an LLC to the same extent that they would be liable if they were acting in an individual capacity. As indicated in the official comment to the Uniform Limited Liability Company Act, consistent with the common law regarding liability of directors and officers in the corporate context, a member or manager will not ordinarily be personally liable for the negligence of a subordinate.

With respect to the application of the common-law negligence standard in Oregon in this case, Swanson argued, and the plaintiff did not dispute, that the court has recognized that a director or officer of a corporation is not liable for the tort of a subordinate agent in which the director or officer did not participate. The court agreed with Swanson that its status as a member-manager was comparable to that of a corporate officer and should be judged by the same standard. The court stated that Swanson had adopted a corporate model of management in which Swanson acted in the same way an officer of a corporation would. The court noted that it has held that an officer of a corporation will be liable for a subordinate's tortious acts if the officer knew of those acts or participated in them. The court stated that Swanson participated in worksite safety in several general respects, but there

was no evidence that Swanson negligently formulated the general safety plan, negligently delegated responsibility for safety to the HR director and mill manager, or negligently exercised the oversight authority it retained. The court explained that the "participation" doctrine that applied in this case rested on a distinction between misfeasance and nonfeasance. The court stated that one potential problem with the participation doctrine is that it can be difficult to characterize a specific instance of negligence as either nonfeasance or misfeasance. Another potential problem is the doctrine may foreclose inquiry into an officer's negligent failure to carry out an assigned task. The court stated that some jurisdictions have rejected or modified the participation doctrine so as to recognize that an officer or manager whose assigned task is the supervision of others will be liable for the negligent failure to carry out the task even though the failure could be characterized as nonfeasance. Neither party in this case argued for a standard other than participation or knowledge on Swanson's part in order to hold Swanson liable for negligence, and the court thus left the issue for another day.

The court next addressed the plaintiff's claim under the Employer Liability Law (ELL), which imposes a heightened standard of care on a person or entity who is in charge of, or responsible for, work involving risk or danger. The question on which the plaintiff's ELL claim turned was whether Swanson was a person "having charge of, or responsibility for" the work. Although Swanson was not the plaintiff's direct employer, the court held that it was not entitled to summary judgment because a reasonable juror could infer that Swanson retained the right to control the method or manner in which the risk-producing activity was performed. As the sole member-manager of the LLC employer, the Oregon LLC statute gave Swanson the right to manage the LLC's business. Although Swanson chose to delegate responsibility for day-to-day decisions to the LLC's mill manager and HR director, Swanson retained the right under the LLC statute to manage all aspects of the LLC's operation, including the way that the equipment operated and the safety conditions in the area of operation. In addition, the court stated that there was evidence from which a reasonable juror could infer that Swanson retained the right to operate the mill and regulate the way the equipment was used even though it had chosen to delegate primary authority for such matters.

Because Swanson was not entitled to summary judgment on the plaintiff's ELL claims, the court turned to Swanson's argument that the exclusive remedy provision of the workers' compensation statute shielded Swanson from liability under the ELL. Before 2013, the Oregon workers' compensation statute provided immunity to "employers" and their employees, officers, directors, and insurers. In 2013, the legislature amended the statute to include LLC members and managers, but the claim in this case arose before the amendment and was thus governed by prior law. The court acknowledged the policy reasons for Swanson's argument that the legislature must have intended that the immunity enjoyed by an LLC employer would extend to those who manage LLCs, and the court recognized that the omission may have been an oversight, but the court hesitated to insert language in the statute based on an unsupported belief regarding what the legislature must have meant. Further, the court pointed out that the legislature provided in the LLC statute a "key" to determining when other statutes would apply to LLCs. This provision of the LLC statute specifies that when another statute applies both to partners and directors, the other statute will apply to members in member-managed LLCs and managers of manager-managed LLCs. Because the exclusive remedy provision of the workers' compensation statute did not refer to both partners and directors, the LLC statute indicated that members and managers did not qualify for the immunity provided to directors. In sum, the pre-2013 exclusive remedy provision of the workers' compensation statute did not shield Swanson, the managing member of an LLC employer, from the plaintiff's ELL claim.

Landstar Inway, Inc. v. Samrow, 325 P.3d 327 (Wash. App. 2014).

A trucking company's truck was involved in an accident allegedly caused by the negligence of a pilot car operator dispatched through an LLC. The plaintiff sued Samrow, a member of the LLC, and the trial court granted Samrow summary judgment. The plaintiff argued that there were fact questions as to whether Samrow was (1) personally liable for the LLC's obligations under the doctrine of corporate disregard, (2) personally liable as a partner in an unnamed partnership with the LLC, and (3) personally liable for his own tortious acts.

With regard to the claim against Samrow based on veil piercing, the court of appeals stated that courts may disregard the LLC entity to impose personal liability on the LLC's members based on the same test used to determine the propriety of piercing the veil of a corporation, and the court held that there were material issues of fact regarding the elements of a veil piercing claim. The court of appeals rejected the plaintiff's argument that Samrow might be personally liable to the plaintiff because Samrow signed the pilot services contract with the plaintiff as a "Partner" of the LLC. The court stated that nothing in the terms or purposes of the applicable statutes suggested that the protections of an LLC are lost by signing as a partner instead of a member. Further, the court concluded that the inference of an unnamed partnership between Samrow and the LLC was unreasonable because all of the provisions of the contract at issue indicated that the contract was between the plaintiff and the LLC and that Samrow signed on behalf of the LLC. The court of appeals held that the plaintiff failed to plead its fraud claim against Samrow with the required particularity, and the court thus did not reach the merits of the plaintiff's claim that Samrow was liable for his own tortious acts based on alleged fraudulent statements by Samrow.

Stewart v. Bureaus Investment Group #1, LLC, 24 F.Supp.3d 1142 (M.D. Ala. 2014).

The plaintiff, on behalf of herself and other potential class members, sued a non-existent LLC, related existent and non-existent entities, and several individuals, for violation of the Federal Fair Debt Collection Practices Act and state law torts. Assuming the plaintiff amended her complaint to provide more detail about the alleged fraudulent acts or omissions of individual defendants who allegedly committed or participated in FDCPA violations and state law torts as "central figures," the court concluded that personal liability of these defendants was plausible on this basis.

Llewellyn-Jones v. Metro Property Group, LLC, 22 F.Supp.3d 760 (E.D. Mich. 2014).

The plaintiff sued numerous Michigan LLCs and individual officers for fraud and other causes of action. The individual defendants sought dismissal of counts that were based on "corporate officer responsibility/liability." The court acknowledged that Michigan law permits corporate officials to be held liable for their individual tortious acts done in the course of business or for personally causing their corporation to act unlawfully, but the court stated that "corporate officer responsibility/liability" is not a cause of action or theory of liability. The vague allegations in the complaint did not contain facts supporting an inference of joint enterprise liability pursuant to which the conduct of any corporate or individual defendant could be imputed to the other defendants.

Empire Office Machines, Inc. v. Aspen Trails Associates LLC, 322 P.3d 424 (Mont. 2014).

The lessor of copy machines sought to hold Demaray, the majority member of Aspen Trails Associates, LLC, personally liable on the lease because Demaray signed the lease without specifying his representative capacity and because the lease identified the LLC by a trade name– "Windermere"– rather than the actual name of the LLC. An agent is not personally liable on a contract made on behalf of the principal if the agent disclosed the principal's identity and made the

engagement for the principal. An agent is a party to the contract if the principal is unidentified, or "partially disclosed," unless the third party agrees otherwise. The court held that Demaray satisfied his burden of showing that, at the time the contract was entered into, the lessor had notice that Demaray was acting as an agent. The lease executed by Demaray was the third lease in a series of copier leases with Windermere over a period of four years. The prior two leases had been executed on behalf of Windermere by a different individual. At the time Demaray signed the third lease, the lessor had reason to know Demaray was signing as an agent for a principal in light of the longstanding business relationship between the parties, the payments received by the lessor from the LLC doing business as Windermere, and the terms of the prior contracts. The court also concluded that the evidence showed that the lessor had notice of the LLC's identity as the principal. The court acknowledged that an agent's use of a trade name under which the principal transacts business is not alone a sufficient identification of the principal to protect the agent from liability, but the court concluded that the longstanding business relationship between the lessor and the LLC doing business as Windermere gave the lessor reason to know that the LLC was Demaray's principal.

Pannell v. Shannon, 425 S.W.3d 58 (Ky. 2014).

The sole member of an LLC executed a lease identifying the LLC as the tenant. At the time the lease was signed, the LLC had been administratively dissolved, but the LLC was subsequently reinstated. The lessor argued that the member was personally liable on the lease based on the manner in which she signed the lease and because the LLC was not in existence at the time of the lease. The court concluded that the lease unambiguously indicated that the member signed the lease in her representative capacity on behalf of the LLC and that the retroactive effect of the reinstatement of the LLC under Kentucky law precluded the member from being liable as a member or under agency principles for actions taken on behalf of the LLC while the LLC was administratively dissolved.

Pannell, the owner of the property, first argued that Shannon, the sole member of Elegant Interiors, LLC, was personally liable based on the manner in which Shannon signed the lease. The lease stated on its cover page that it was "for Ann Shannon," but the lease defined the "Tenant" as Elegant Interiors, LLC, and referred to the "Tenant" as the party to the lease throughout the lease. The court stated that the cover page was introductory and was not an essential part of the operative terms of the lease. Although Shannon did not include her title or otherwise indicate her representative capacity along with her signature, her signature line was preceded by the word "By," which indicated she was signing in a representative capacity. The court stated that the failure of an officer to add the title of the office is not fatal, although it is the better practice to include the title. The court saw no reason to depart from the rule that an officer or agent has not signed in an individual capacity and is not personally liable on a contract if the body of the contract states it is with a corporation or other entity. The court concluded that the reference to the member on the cover page and failure to specify her representative capacity did not create an ambiguity in the lease. The court also rejected the argument that a release of a prior lease between the LLC and Pannell created an ambiguity by referring to Ann Shannon as the bound party. The parties to the first lease were the LLC and Pannell, and that lease had a no-oral-modification clause. The court stated that the release was entered into because of that provision and could not be read in a vacuum to be an independent agreement personally obligating Shannon. The court stated that the release and second lease must be read in light of the statutory preference for liability protection of LLC members. Further, the court relied on the integration clause in the second lease to conclude that the second lease controlled over the release with regard to who was bound under the lease.

The court next considered the effect of the administrative dissolution and subsequent reinstatement of the LLC with regard to Shannon's statutory protection from liability as a member of the LLC. The court concluded that a member of an LLC is protected by the Kentucky LLC statute from liability for actions taken during a period of administrative dissolution so long as the LLC is reinstated before a final judgment is rendered against the member. The court analyzed the relevant statutory provisions at length and concluded that the relation-back language in the statute and the cancellation of the certificate of dissolution by the secretary of state in a reinstatement result in a retroactive undoing of the dissolution as if the administrative dissolution never took place.

The court next addressed the effect of the administrative dissolution and subsequent reinstatement of the LLC with regard to Shannon's potential liability based on agency principles. This analysis involved two sub-questions. First, could Shannon be personally liable merely by reason of being an agent of a dissolved LLC? Second, could Shannon be personally liable as an agent who acted without authority? With respect to the first question, the court noted that the statutory protection from liability for the debts, obligations, and liabilities of an LLC extends to managers and agents as well as LLC members. Thus, the analysis above as to why a member of an administratively dissolved LLC is protected from liability by the retroactive effect of reinstatement would also apply to the extent liability was predicated solely on Shannon's status as a manager or agent. The court went on to address Pannell's argument that Kentucky should follow the majority rule that reinstatement of a corporation does not shield officers from personal liability for debts incurred after dissolution. The court stated that the existence of a majority rule was only persuasive if the rule is based on statutes like those in Kentucky, and the court stated that many of the cases in other jurisdictions proclaiming the majority rule depended on statutes different from Kentucky's and may not even reflect the current statutory law in those jurisdictions. Under the Kentucky statutory provisions regarding dissolution, reinstatement, and liability protection of agents of LLCs, Shannon was not personally liable based merely on her status as an agent of an administratively dissolved LLC. Likewise, the court concluded that the retroactive effect of reinstatement meant there was never a failure of Shannon's authority as an agent of the LLC. Pannell argued that Shannon lacked authority to act on behalf of the LLC because there was no LLC in existence when the second lease was signed and the dissolution statute limited the LLC's permitted activities to winding up its business. But the court noted that a dissolved LLC continues to exist under the Kentucky LLC statute, and the retroactive effect of reinstatement creates a "seamless existence and functionality for the LLC" so that there was never a failure of Shannon's authority. Pannell complained that the LLC's reinstatement occurred only after he filed suit, and Pannell suggested that the court's reading of the statute had an inequitable effect, but the court characterized reinstatement as a matter between the state and the LLC and pointed out that Pannell received what he expected in the transaction.

LLC Veil Piercing

Greenhunter Energy, Inc. v. Western Ecosystems Technology, Inc., 337 P.3d 454 (Wyo. 2014).

The plaintiff entered into a contract with Greenhunter Wind Energy, LLC under which the plaintiff provided consulting services related to potential development of a wind turbine farm. The LLC, a wholly owned subsidiary of Greenhunter Energy, Inc., failed to pay for the plaintiff's services, and the plaintiff sought to recover from the corporate parent as the alter ego of the LLC. The district court found in favor of the plaintiff, and the corporate parent appealed. On appeal, the Wyoming Supreme Court concluded that the 2010 Wyoming Limited Liability Company Act

provides LLCs with even more flexibility than the previous Wyoming LLC statute, but the statute still recognizes that an LLC's veil may be pierced in certain circumstances. After discussing the standard for piercing the veil of an LLC under current law, the court examined the evidence with respect to the LLC at issue and concluded that the district court correctly applied the law when it pierced the LLC's veil in this case.

The supreme court discussed the development of LLCs in general and the Wyoming case law addressing LLC veil piercing in particular. The supreme court stated that the 2010 Wyoming Limited Liability Company Act, which was signed into law five days after a supreme court opinion refining the rules governing LLC veil piercing, recognizes that the veil of an LLC may be pierced under certain circumstances but makes clear that failure of an LLC to adhere to formalities required for a corporation is not a basis for disregarding the LLC in an action to pierce its veil. The court proceeded to address what test should be applied under the 2010 statute and what factors may be considered in determining whether to pierce the veil of an LLC. The court concluded that a refinement of its previously articulated test was in order and set forth the following fact-driven, flexible test: An LLC's veil may be pierced under exceptional circumstances when: (1) in addition to being owned, influenced, and governed by its members, the LLC has ceased to exist as a separate entity due to misuse of the LLC; and (2) the facts are such that adherence to the fiction of its separate existence would lead to injustice, fundamental unfairness, or inequity. The court stated that the factors that usually can be applied in determining both prongs are (1) fraud (actual or constructive), (2) inadequate capitalization, and (3) the degree to which the business and finances of the LLC and its member are intermingled. The court elaborated on each of these factors and stressed that courts must be mindful of the manner in which LLCs are commonly operated in Wyoming, noting that many cases do not legitimately require more than a single member with little capital. The court then reviewed the evidence in this case and concluded that this was one of the rare cases in which exceptional circumstances supported piercing the LLC veil.

First, with respect to undercapitalization, the court stated that the record confirmed the accuracy of the district court's finding that the LLC often had no money in its operating account during the periods when the plaintiff's invoices were submitted to the LLC. The corporate parent decided the timing and amount of money transferred to the LLC to pay specific bills the parent decided to pay. The court acknowledged that new businesses often lack sufficient capital or income to meet expenses and require capital infusions from members, but the court stated that the evidence supported the district court's finding that the LLC had inadequate capital due to manipulation by its member, a publicly traded corporation. The court characterized the continual undercapitalization as occurring by choice rather than by external forces.

With respect to intermingling of business and finances, the court recognized that the LLC and it corporate parent maintained separate bank accounts and business records but pointed out other facets of this factor that must be considered. The court stated that the following aspects of the relationship between the LLC and its parent, among other evidence in the record, showed that the entities had ceased to be separate due to misuse of the LLC: performance of all of the functions of the LLC by employees of the corporate parent, direct payment of the parent's employees for work performed for the LLC (although the parent charged the LLC for the labor performed by its employees), absence of any revenue on the part of the LLC other than funds passed through to the LLC from the parent for bills the parent chose to pay, the parent's use of deductions and losses from the wind energy project to which the plaintiff's services related on the parent's tax return, and the parent's manipulation of the LLC's assets and liabilities in such a manner as to reap the rewards while saddling the LLC with the burdens including the plaintiff's unpaid bill. The court stated that

this evidence showed that adherence to the fiction of the separate existence would lead to an unjust and inequitable result. The court responded to the corporate parent's "reasonable observations" that the LLC could be properly treated as a disregarded entity under the federal income tax classification rules. The court stated that the amount of weight given to the tax return and use of the LLC's losses in this case must be balanced against the fact that the practice is permitted by federal tax law, but the supreme court stated that the district court's consideration did not indicate that advantages of federal tax law must be foregone to preserve limited liability. The court stated that the district court's consideration of the tax filings as only one of many relevant pieces of evidence was not error. The court recognized that single-member LLCs may be used in many situations, ranging from an individual starting a business out of her home to a large corporation, and the court stated that use of a sole member's home address for a business and a sole member's management of the LLC's finances as well as her own would not be uncommon. However, the court stated that the district court did not give undue weight to the fact that the LLC's address was the same as the parent's and evidence that all finances and negotiations of the LLC were handled by the parent. The corporate parent argued that the plaintiff should have protected itself by obtaining a guarantee from the parent, but the court stated that not all contract creditors are in a competitive or economic position to insist on guarantees, and the court declined the invitation to find piercing inappropriate in this case based on the plaintiff's failure to attempt to obtain a guarantee or other security.

Finally, the court reiterated its pronouncement in prior case law that a showing of fraud or an intent to defraud is not required to disregard the legal fiction of a separate entity. While fraud is not required to pierce an LLC's veil, fraud can be a powerful reason to do so. The supreme court agreed that the plaintiff failed to present any evidence of fraud, and the district court erred by inferring fraud. The court stated that facts supporting the elements of fraud must be proved by clear and convincing evidence, and there was no evidence of false statements or partially truthful statements relied on by the plaintiff, nor was there any evidence that the LLC or its corporate parent assumed a fiduciary relationship that might support a claim of constructive fraud. Nevertheless, even though there was no fraud in the classic sense, the district court's decision to pierce the LLC's veil was supported by its findings that the corporate parent misused the LLC in order to manipulate the situation to avoid paying for the plaintiff's services and failed to maintain adequate separation between it and the LLC, and that allowing the corporate parent to rely on the separate existence of the LLC would be unjust and inequitable.

In re Howland (Spradlin v. Beads and Steeds Inns, LLC), 516 B.R. 163 (Bankr. E.D. Ky. 2014).

The defendant in this action by a bankruptcy trustee to avoid a conveyance of property from an LLC to the defendant as a fraudulent conveyance sought dismissal of the action on the basis that the trustee failed to state a claim. The trustee's claim hinged on being able to characterize the transfer by the LLC as a transfer by the debtor members of the LLC under a reverse veil-piercing theory. The court explained that there are two types of reverse veil piercing: (1) outsider reverse veil piercing, in which a third-party creditor pierces the corporate veil in reverse to reach the assets of a corporation to satisfy the debt of a corporate insider, and (2) insider reverse veil piercing, in which an insider of the corporation seeks to disregard the corporate form for his own benefit. The court stated that it was not clear which type of reverse piercing was involved here due to the trustee's unique position of being able to assert causes of action belonging to the debtors as well as asserting causes of action that belong to the bankruptcy estate. In either event, however, the court stated that the trustee's claim failed. The court pointed out that Kentucky courts have neither accepted nor

rejected reverse veil piercing, but the court acknowledged that it was not unreasonable to conclude that Kentucky might ultimately adopt the doctrine in the right circumstances based on its adoption of traditional veil piercing. The court commented in a footnote that the defendant's argument that veil piercing is limited to corporations and does not apply to LLCs was not persuasive. Even assuming Kentucky courts would accept either of the two types of reverse veil piercing, the court stated that the trustee's attempted use of it was not consistent with Kentucky's treatment of veil piercing as a remedy rather than a cause of action. The court stated that the trustee needed more from reverse veil piercing than merely the right to pursue the LLC's assets; the trustee sought to consolidate the debtor members and the LLC to pursue federal and state fraudulent conveyance claims. The trustee's attempt to treat the transfer by the LLC as occurring by the debtor members directly was not based on whether the debtors or LLC committed alleged wrongdoing, but would simply treat the assets of both as merged both prospectively and retroactively in order to give rise to a fraudulent transfer claim. Consistent with traditional veil piercing under Kentucky law, which requires that a corporation commit wrongdoing before allowing the injured party to recover for that harm from the shareholders, officers, or directors, the court stated that it was reasonable to conclude that Kentucky would treat reverse veil piercing as an equitable remedy that requires wrongdoing by the corporation's shareholders, officers, or directors before considering whether justice requires piercing the veil to recover from the corporation's assets. The court distinguished cases from other jurisdictions relied on by the trustee as inconsistent with Kentucky law. In sum, the court held that Kentucky law does not recognize reverse veil piercing as a means to consolidate owners and their company to allow pursuit of federal and state fraudulent conveyance claims. During oral argument, the trustee sought leave to amend the complaint to add a count addressing substantive consolidation, and the court granted the trustee an opportunity to memorialize the request to amend, which the defendant would have an opportunity to oppose.

Tayloe v. Sellco Two Corporation, 2014 WL 3674252, __ S.W.3d __ (Ky. App. 2014).

The plaintiff sued an LLC to collect on a debt arising out of the sale of fuel to the LLC, and the plaintiff and the LLC entered into an agreed judgment. Tayloe, the managing member of the LLC, executed the agreed judgment on behalf of the LLC, and the plaintiff did not obtain a personal guarantee from Tayloe. During post-judgment discovery, the LLC produced bank records that revealed Tayloe took over $6,000,000 in the LLC's moneys for himself. The plaintiff filed this action to hold Tayloe personally liable for the LLC's debt. The plaintiff argued that Tayloe should be held liable based on his breach of duties as a manager and that Tayloe owed a duty to the plaintiff to conduct the LLC's business in a manner so as not to leave it with inadequate capital to conduct its business or prevent it from paying the judgment. The plaintiff also argued that Tayloe used the LLC's assets as his own. The trial court entered summary judgment in favor of the plaintiff piercing the veil and holding Tayloe personally liable. On appeal, Tayloe first argued that a provision of the LLC's sales contract with the plaintiff precluded holding Tayloe liable. The provision stated that neither party would pursue any claim against any member, manager, shareholder, officer, employee, agent, or representative of the buyer or seller with respect to the buyer's or seller's obligations under the sales agreement. The court agreed with the plaintiff and the trial court that this provision of the contract did not apply to the extra-contractual fraud, tort, or equitable claims being asserted against Tayloe in the instant action. The court further stated that Tayloe could not contract away his responsibility for his intentional and fraudulent misappropriation of the LLC's assets. Tayloe next argued that the trial court's decision to pierce the LLC's veil violated the language of the Kentucky LLC statute providing liability protection to LLC members and managers. Tayloe argued that the

absence of a provision in the Kentucky LLC statute specifically allowing for the piercing of the LLC's veil demonstrates the legislature's intent to provide extremely broad protections to members and managers of Kentucky LLCs. The court agreed with the plaintiff that Kentucky law does not distinguish between corporations and LLCs with respect to limited liability or piercing the veil. Tayloe argued that the trial court's summary judgment did not comply with the requirements for corporate veil piercing pronounced by the Kentucky Supreme Court in the 2012 case of *Inter-Tel Technologies, Inc. v. Linn Station Properties, LLC*. The court of appeals concluded that the trial court considered the expanded list of factors set forth by the Kentucky Supreme Court with respect to the element of domination and lack of separateness, and the trial court also identified the fraud or injustice that would occur if the veil were not pierced – the unjust enrichment of Tayloe to the prejudice of the LLC's creditors. The court thus affirmed the trial court's summary judgment piercing the LLC's veil to hold Tayloe liable to the plaintiff.

Wandering Trails, LLC v. Big Bite Excavation, Inc., 329 P.3d 368 (Idaho 2014).

The plaintiffs sought to pierce the veil of an LLC and hold its two individual members liable for the LLC's failure to perform a contract. The court discussed the application of the corporate alter-ego doctrine to LLCs and held that the plaintiffs' veil-piercing claim failed because the plaintiffs did not raise a genuine issue of material fact demonstrating the unity of interest required to establish alter ego. The court noted that factors considered in corporate veil piercing include the level of control the shareholder exercises over the corporation, the lack of corporate formalities, the failure to operate corporations separately, whether separate books are kept, and the decision-making process of the entity. The court pointed out that the Idaho LLC statute specifically provides that the failure of an LLC to observe particular formalities related to exercise of the LLC's powers or management activities is not a ground for imposing liability on members or managers for the liabilities of the LLC. Thus, the court stated that the validity of its holdings with respect to corporate veil piercing were questionable in the LLC context. The court also stated that the exercise of full control by owners of a corporation is a relevant inquiry but that such an inquiry in the LLC context would be contrary to express statutory provisions permitting "individual LLCs and member-managed LLCs" and providing that LLCs are entities distinct from their members. The plaintiffs argued that the LLC's bank account was not formal enough, that decisions were not made by resolutions, and that the LLC was capitalized by capital calls. The court stated that these facts did not demonstrate unity of interest because the lack of such corporate formalities is not fatal to an LLC's status, and there is no requirement that an LLC make decisions by resolution or be capitalized other than by capital calls. Further, there was evidence that demonstrated a distinction between the LLC and its members in the form of checks in the LLC's name, the absence of any evidence of deposits of the members' own money into the LLC bank account other than capital contributions, and the absence of evidence of payment of the member's obligations with LLC funds. The members also recognized the distinction between themselves and their LLC when they requested that the LLC be named in an assignment agreement that was executed in connection with the LLC's contract with the plaintiff. Although the members issued a check from the LLC's account for legal services rendered to another entity owned by the members, the other entity later reimbursed the LLC for this expense, and the court characterized this as an oversight that was a reasonable mistake amounting to no more than a scintilla of evidence of unity of interest.

Landstar Inway, Inc. v. Samrow, 325 P.3d 327 (Wash. App. 2014).

A trucking company's truck was involved in an accident allegedly caused by the negligence of a pilot car operator dispatched through an LLC. The plaintiff sued Samrow, a member of the LLC, and the trial court granted Samrow summary judgment. The plaintiff argued that there were fact questions as to whether Samrow was (1) personally liable for the LLC's obligations under the doctrine of corporate disregard, (2) personally liable as a partner in an unnamed partnership with the LLC, and (3) personally liable for his own tortious acts. With regard to the claim against Samrow based on veil piercing, the court of appeals stated that courts may disregard the LLC entity to impose personal liability on the LLC's members based on the same test used to determine the propriety of piercing the veil of a corporation. Under this test, the plaintiff must show an abuse of the corporate form, which typically involves some manner of fraud, misrepresentation, or manipulation of the corporate form to the benefit of the shareholder. The plaintiff must also show that disregarding the corporate form is necessary to avoid the consequences of intentional misconduct harmful to the plaintiff. The court held that there were material issues of fact regarding whether Samrow committed fraud. As a threshold issue, the court held that the plaintiff need not satisfy the heightened pleading requirement applicable to a fraud claim because the doctrine of corporate disregard is an equitable remedy rather than an independent claim. Turning to the merits of the claim, the court concluded that a reasonable inference could be drawn that Samrow fraudulently misled the plaintiff with regard to whether the LLC had satisfied its contractual obligation to the plaintiff with respect to insurance coverage. The court also concluded that there were material issues of fact as to whether disregard of the LLC was necessary to avoid injustice. The court rejected an argument by the plaintiff that Samrow abused the corporate form by causing the LLC to evade a legal duty to provide pilot car services in a reasonable manner that existed independently of the LLC's contract with the plaintiff. The plaintiff relied on a statute that imposed detailed requirements on the operation of pilot cars, but Samrow did not himself provide the pilot car services at issue, and the agent who provided the services was an agent of the LLC rather than Samrow. The court rejected the argument that Samrow owed a personal duty under the LLC's contract with the plaintiff as well as the argument that Samrow owed a non-delegable duty under the statute regulating pilot car operators.

Stewart v. Bureaus Investment Group #1, LLC, 24 F.Supp.3d 1142 (M.D. Ala. 2014).

The plaintiff, on behalf of herself and other potential class members, sued a non-existent LLC, related existent and non-existent entities, and several individuals, for violation of the Federal Fair Debt Collection Practices Act and state law torts. The court discussed the alter ego doctrine as it related to the plaintiff's standing to sue the various entities. The plaintiff alleged that she had standing to sue all the entities because they were all alter egos of one of the individual defendants. The court stated that Alabama law allows veil piercing of an LLC but stated that the alter ego doctrine would only confer standing to sue all the entities if they were all the alter egos of the one entity that pursued the plaintiff, and they were not. The court concluded, however, that the plaintiff had standing to sue the entities under the "juridical link" theory. The court also addressed the viability of the alter ego claims as a basis to impose liability on certain defendants and concluded that the plaintiff's allegations were sufficient to avoid dismissal of the veil-piercing claims.

Kosanovich v. 80 Worcester Street Associates, LLC, No. 201201 CV 001748, 2014 WL 2565959, 2014 Mass.App.Div. 93 (Mass. App. May 28, 2014).

The plaintiff purchased a condominium from 80 Worcester Street Associates, LLC, and the purchase and sale agreement required the seller to make certain repairs and improvements to the

condominium. (The court never specifically stated that 80 Worcester Street Associates, LLC, was a limited liability company, but the entity's name indicates it was an LLC, and the court identified the individual defendant as its "manager and sole member.") The purchase and sale agreement was signed on behalf of the LLC by its sole member and manager, Feuerman. After the plaintiff identified various defects in the property that were not rectified by the LLC, the plaintiff sued the LLC and Feuerman for breach of contract and breach of implied warranty of habitability. The trial court found for the plaintiff on these claims and awarded damages. The trial court imposed liability against Feuerman as well as the LLC on the basis that the evidence supported piercing the veil of the LLC to hold Feuerman personally liable. The court of appeals concluded that the evidence supported the trial judge's decision to pierce the "corporate veil." The court of appeals cited Massachusetts case law regarding corporate veil piercing and noted that courts should look beyond the corporate form only to defeat fraud or wrong or remedy injustice. The court listed twelve factors that should be examined in order to determine whether veil piercing is justified and stated that the result is "not a simple exercise in counting." It was undisputed that Feuerman had sole ownership and pervasive control of the LLC, but the court stated that pervasive control is not alone sufficient to pierce the corporate veil. The court relied on evidence that corporate records did not exist or were not properly kept in addition to pervasive control to uphold the decision to pierce the veil. Feuerman testified that he turned over any documents he had to his attorney, but the only evidence submitted by his counsel was the "article of incorporation." Feuerman testified that he ran the business out of his house and car and kept the books and handled whatever paper work or legal work needed to be handled. When specifically asked about records, he testified that his ex-partner disappeared and may have had records. When asked about tax records and whether he sought records from his accountant, Feuerman testified that he did not remember. When asked if he kept any records, such as checkbooks, regarding payments to any subcontractors, Feuerman stated that he had no knowledge of any such records. He characterized his relationship with his ex-partner as "a bit informal," and he did not know whether his partner received a W-2 or 1099 or something else from the accountant for tax purposes. The court of appeals stated that Feuerman's failure to maintain or produce records hindered the court's ability to establish the twelve factors, including intermingling of assets, thin capitalization, and insolvency. According to the court, Feuerman's failure could not be excused based on naivety or inexperience because Feuerman testified he had been in the renovation business for more than 20 years and had established LLCs for 15 to 20 projects. The court stated that "Feuerman's failure to maintain business records in light of potential litigation unjustifiably hindered the court's ability to exercise its oversight role over [the LLC's] corporate affairs," and Feuerman's failure to maintain business records along with his sole ownership and pervasive control supported the trial judge's decision to pierce the corporate veil.

Llewellyn-Jones v. Metro Property Group, LLC, 22 F.Supp.3d 760 (E.D. Mich. 2014).

The plaintiff sued numerous Michigan LLCs and individual officers for fraud and other causes of action. The plaintiffs alleged that the individual defendants were the alter egos of the LLCs and thus liable for the obligations of the LLCs. The court discussed Michigan law on piercing the corporate veil and held that the plaintiffs' pleadings alleged insufficient facts to support a claim to pierce the veil. The allegations in this regard were largely a conclusory recitation of factors considered in an alter ego claim, and these bare assertions without factual support were insufficient. In connection with allegations regarding the sole membership of a PLLC law firm, the court noted that the separate existence of a corporation is generally recognized even if a single shareholder owns all the stock, and the court stated that the same holds true for professional corporations.

Hibbs v. Berger, 430 S.W.3d 296 (Mo. App. 2014).

The plaintiff was employed by an LLC as a salesperson and later obtained a 5% non-voting economic interest in the LLC. At the time the plaintiff obtained his interest, the LLC's founder (Taylor) sold half of his interest to Wood Nuts, Inc. ("Wood Nuts"). Thus, Taylor and Wood Nuts each owned 47.5% of the economic interest in the LLC and 50% of the voting interest in the LLC. Wood Nuts was owned by another individual (Berger) and his sister. The LLC was governed by a board of two managers, one appointed by Taylor and one by Wood Nuts. Taylor appointed himself, and Wood Nuts appointed Berger. The LLC encountered financial difficulty, and Wood Nuts made several secured loans to the LLC. The LLC defaulted on the loans and voluntarily surrendered the collateral. Wood Nuts accepted the collateral in satisfaction of the LLC's indebtedness although the amount of indebtedness exceeded the value of the collateral. The plaintiff eventually terminated his employment and sued the LLC for commissions, salary, and benefits that he alleged he was owed. The plaintiff obtained a judgment against the LLC and then filed a lawsuit against Wood Nuts, Berger, and Taylor alleging, inter alia, veil-piercing and breach-of-fiduciary-duty claims. The plaintiff settled with Taylor. The trial court granted summary judgment in favor of the remaining defendants, and the plaintiff appealed. With respect to the veil-piercing claim, the court of appeals acknowledged that members of an LLC and shareholders of a corporation are generally protected from liability, but the court then described the circumstances under which courts will pierce the corporate veil or disregard the business entity. In this instance, the court first addressed whether a minority member or shareholder may pierce the entity veil to impose liability on the majority shareholders or other insiders. The court reviewed case law from other jurisdictions because this was a question of first impression in Missouri, and the court concluded that fairness precluded a per se rule that minority shareholders cannot pierce their own corporate veil. The court discussed outside and insider reverse piercing and noted that a number of jurisdictions permit reverse piercing. While offering no guidance on the availability of reverse veil piercing in Missouri, the court concluded that minority shareholders should be able to pierce the veil in "appropriate circumstances" since the trend in other jurisdictions is to permit majority shareholders themselves to pierce the veil in appropriate circumstances. The court proceeded to analyze whether the facts of this case constituted appropriate circumstances. The plaintiff alleged that the defendants used their complete domination and control to: transfer money to themselves in the form of repayment of loans and salary increases; forego repayment of commissions allegedly due the plaintiff; secretly amend the operating agreement to permit fraudulent transfers; and fraudulently transfer assets resulting in the LLC' undercapitalization. The court examined the evidence and concluded that it was reflective of the downturn in the economy rather than a scheme to defraud. The court saw no evidence that the operating agreement was amended secretly or in bad faith. The court agreed that the LLC had financial difficulties and may have been poorly managed, but the plaintiff did not show a genuine issue of material fact that the LLC was undercapitalized or that the defendants perpetrated fraud to hide assets or used their limited liability for improper purposes. Thus, veil piercing was not warranted.

Thomas v. Bridges, 144 So.3d 1001 (La. 2014).

Thomas, a Louisiana resident, formed a Montana LLC solely to avoid the Louisiana sales tax on a recreational vehicle. Montana is the only state that does not impose sales tax on the purchases of vehicles by its residents, including resident LLCs, and Montana LLCs are commonly formed for the sole purpose of avoiding sales tax. The purchase of the RV was the only business conducted by the LLC, and the RV was kept in Mississippi. The Louisiana Department of Revenue assessed sales tax against Thomas on the RV, and Thomas appealed the assessment to the Board of Tax Appeals,

which affirmed the assessment. The district court reversed the assessment, and the court of appeals upheld the reversal. The Louisiana Supreme Court concluded that the Department did not establish a basis to assess Thomas individually for the tax and affirmed the lower courts' reversal of the assessment. The supreme court acknowledged that the purpose of forming an LLC is to protect the LLC's members from personal liability, and the court stated that the Department erred in ignoring the LLC's separate existence and assessing Thomas individually before establishing any basis for doing so. After Thomas appealed the assessment, the Department contended that the veil of the LLC should be pierced, but the supreme court stated that "this after-the-fact appraisal the veil should be pierced does not change the fact the existence of [the LLC], a validly formed Montana LLC, was ignored in derogation of Louisiana's statutory protections for LLCs, Louisiana's obligation under the United States constitution to provide full faith and credit to the laws of Montana, and Thomas's constitutional right to due process." Instead of pursuing Thomas individually, the court stated that the Department should have first assessed the LLC. Under the Louisiana LLC statute, the question of whether the LLC was validly formed and the extent of personal liability of the members are governed by the law of the jurisdiction of organization of the LLC, but the Department never applied Montana law in determining whether to pierce the LLC's veil. Beyond concluding that the LLC would have been the proper party against whom to assess the tax, the court did not speculate how the legal error of neglecting to examine Montana law might have affected the outcome. The court went on to note that the Department could still have assessed Thomas individually, even if no personal liability existed under Montana law, if the Department established fraud on the part of Thomas, relying on a provision of the Louisiana LLC statute that provides that nothing in the statute shall be in derogation of any rights a person may have against a member of an LLC because of any fraud practiced on the person. There was no evidence, however, of any fraud on Thomas's part. The court stated that taking actions to avoid sales tax does not constitute fraud. Specifically, "[u]se of particular entities to avoid taxes and other liabilities, far from being fraudulent, is a common and legal practice." LLCs may be formed for "any lawful purpose" under both Louisiana and Montana law, and the court stated that a finding that formation of an LLC solely for tax avoidance constitutes fraud would potentially destabilize Louisiana law. The court refused to consider other theories of legal liability made by the Department for the first time on appeal, and the court stated that policy arguments made by the Department and amici were better directed to the legislature.

GE Mobile Water, Inc. v. Red Desert Reclamation, LLC, 6 F.Supp.3d 195 (D.N.H. 2014).

The plaintiff sued an LLC and its parent corporation for the LLC's failure to fulfill its obligations under a contract with the plaintiff. The parties cited both New Hampshire and Virginia law, and the court stated that neither party made a serious attempt to analyze the choice-of-law issues or claimed that its argument on any issue depended upon how choice-of-law questions were resolved. The court thus applied New Hampshire law without any choice-of-law analysis. The court stated that it followed the New Hampshire Supreme Court's practice of assuming without deciding that members and managers of LLCs may be held liable based on veil-piercing theory in an appropriate case, and the court expressed no view as to whether veil-piercing principles as applied to LLCs differ from veil-piercing principles as applied to corporations. The plaintiff alleged that the LLC and its parent operated out of the same business address and that the entities had common officers. In addition, the plaintiff alleged that the LLC was severely undercapitalized and that the parent offered to pay a portion of the LLC's debt, which the plaintiff argued permitted an inference of intermingling of funds. The pleadings described the LLC's winding up of operations after six months, not even one-third of the way through a $3.2 million contract. The plaintiff alleged that the LLC paid only

$20,000 on more than $1 million owed to the plaintiff, that the manager made promises about payment that were not kept, and that the parent made misrepresentations about the funding for the project. The court concluded that the facts alleged by the plaintiff were sufficient to show that the LLC and its parent "bent the rules regarding corporate formalities and failed to adequately capitalize [the LLC] so as to cover its prospective debts." The court also concluded that the plaintiff sufficiently alleged that the actions were taken to promote an injustice on the LLC's creditors. Thus, the court denied the parent entity's motion to dismiss the veil-piercing claim.

Trinity Industries Leasing Company v. Midwest Gas Storage, Inc., 33 F.Supp.3d 947 (N.D. Ill. 2014).

The plaintiff obtained a default judgment in Texas state court for breach of contract against a Delaware LLC headquartered in Illinois. In this case, the plaintiff sued the judgment debtor LLC's president and CEO, O'Malley, alleging that O'Malley schemed to defraud the plaintiff by causing the LLC to lease railcars from the plaintiff and sublease those railcars to other companies and then funneling the payments from the other companies to himself and other entities under his control. The plaintiff claimed that O'Malley misrepresented the financial condition of the LLC when it entered into the lease with the plaintiff and that the LLC was in the process of selling its business at that time. In this case, the plaintiff asserted claims based on fraud, veil piercing, and fraudulent transfer. Because the judgment debtor LLC was organized in Delaware, the parties agreed that Delaware law controlled the plaintiff's alter-ego claim against O'Malley. The court stated that the same rules that apply to corporate veil piercing apply to LLCs under Delaware law, and the court held that the plaintiff pled facts sufficient to state a claim to disregard the LLC's organizational structure and hold O'Malley liable under an alter-ego theory. The court stated that the plaintiff need not plead that the corporate form itself was a fraud but need only plead an injustice in the use of the corporate form. The plaintiff alleged that O'Malley used the LLC's organizational form to perpetrate a scheme to defraud by leasing railcars on behalf of the LLC, subleasing them to a third party, and keeping the proceeds. The court stated that the plaintiff also alleged facts to support the factors relevant to piercing the veil. In addition to facts regarding the LLC's undercapitalization and insolvency, the court pointed out that the plaintiff pled the following facts showing a failure to observe corporate formalities: the LLC did not maintain accurate financial records, including an account of members' capital contributions; the LLC failed to properly file tax returns or declare dividends; the board of directors failed to approve the lease; and the defendants had no meeting minutes or articles of organization for the LLC. The plaintiff also alleged that O'Malley diverted the sublease proceeds from the LLC to other entities in which he had an interest and that these transactions were not properly documented or approved by the LLC's board of directors. The plaintiff alleged that O'Malley dominated and controlled the LLC and related entities and used his control to intermingle the cash, employees, and assets of these entities. The court concluded that the allegations of a scheme to defraud the plaintiff and factors evidencing the misuse of the LLC's form stated a claim for veil piercing under an alter-ego theory.

Hector v. Mo-Dad Environmental Serv., LLC, 134 So.3d 133 (La. App. 2014).

Shermane Hector, an employee of Mo-Dad Global Environmental Systems, LLC ("Global"), was injured while working for Global, and Global settled with Hector. The settlement was reduced to judgment, but Global did not pay the judgment. Hector sued to enforce the judgment and also sought to pierce Global's veil to hold William Stegall, Sr. ("Sr.") and William Stegall, Jr. ("Jr.") personally liable. The trial court rendered judgment piercing Global's veil and holding Sr. and Jr.

liable with Global for the judgment. The defendants argued that the trial court erred in finding that Jr. was a member of Global and that the trial court erred in piercing the LLC's veil. The court of appeals affirmed the trial court in both respects.

The defendants argued that the trial court erred in finding that Jr. was a member of Global. They argued that Sr. and his wife were each 50% members. The court of appeals stated that the determination of who was a member was a question of fact subject to a manifest-error standard of review. The defendants argued that Jr. never made a capital contribution, never received a K-1, and never received a distribution. The court reviewed the statutory definitions of a "member" and "membership interest" and noted that Global's articles of organization provided that the LLC was member-managed and listed Jr. as the first and only member. The annual reports filed with the secretary of state also identified Jr. as the only member. The Louisiana LLC statute provides that a person registered in the LLC's records as a member may be treated as such for all purposes by the LLC, and its members, managers, and agents. The evidence indicated that Sr. could use the losses generated by Global for income tax purposes, and Jr. did not need the losses. The court concluded that Jr.'s services constituted a capital contribution because he managed Global without receiving a salary. The court of appeals also noted the trial court's finding that Jr. was nervous and evasive in his testimony and thus not a credible witness.

The court of appeals next addressed whether the evidence supported the trial court's conclusion that Global's veil should be pierced to hold Sr. and Jr. personally liable to Hector. The court of appeals noted that the Louisiana Supreme Court has recognized that Louisiana law permits the veil of an LLC to be pierced but has not further addressed the application of the doctrine to LLCs. The court discussed corporate veil-piercing principles and stated that the courts allow piercing of the corporate veil in two exceptional situations: (1) where the corporation is an alter ego of the shareholders, and the shareholders have used the corporation to defraud a third party, and (2) where the shareholders have failed to conduct the business on a "corporate footing" to such an extent that the corporation ceases to be distinguishable from its shareholders. The court listed various factors that are relevant in applying the alter-ego doctrine and discussed the fraudulent intent required to establish fraud for purposes of veil piercing. Finally, the court stated that the Louisiana LLC statute provides for piercing the LLC veil to impose liability on a member to prevent the use of the LLC to defraud creditors. Whether the LLC is an alter ego of its members is a fact determination reviewed by the court of appeals under the manifest-error standard. The court discussed the fact that the Stegalls set up numerous LLCs to shield themselves from liability, and described evidence showing that these LLCs commingled funds and operations. The companies were totally funded by Sr., who never received any distributions or profits from Global. The account receivable earmarked to pay Global's judgment to Hector was not collected, and the judgment was not paid. Sr. would advance money to Global to pay other debts but chose not to advance money to pay the debt to Hector. Sr. testified that he owned the assets of the various companies and that "[t]he bad times stayed with the company, and the good times came to [him]." Shortly after Global's settlement with Hector was reduced to judgment, Sr. and Jr. testified that they decided to shut down Global because Hurricanes Katrina and Rita had destroyed the business. Based on this evidence, the court of appeals found no manifest error in the trial court's decision to pierce the LLC veil of Global and hold Sr. and Jr. personally liable to Hector.

Lopes v. JetSetDC, LLC, 994 F.Supp.2d 135 (D.D.C. 2014).

The plaintiff relied on veil-piercing theory as a basis to hold two individual members of an LLC liable for tort claims against the LLC, and the members sought dismissal of the claims on the

basis that the plaintiff did not plead facts sufficient to pierce the veil of the LLC. The court noted that there was a question as to whether the veil-piercing doctrine of the District of Columbia (where the events occurred) or Maryland (the jurisdiction in which the LLC was organized and its principal office was located) applied in this case. The court stated that the District of Columbia choice-of-law rules required the court to conduct an "interest analysis" to determine which jurisdiction's underlying policy would be most advanced by having its law applied. The court concluded that no real conflict existed between the veil-piecing doctrines of the District of Columbia and Maryland in that both doctrines are firmly grounded in equity and recognize the alter-ego theory as a means to pierce the corporate veil. The court then proceeded to apply the law of the District of Columbia. The court listed several factors as to which courts generally inquire under D.C.'s veil-piercing test but stated that "the inquiry ultimately rests on whether 'the corporation is, in reality, an alter ego or business conduit of the person in control.'" The plaintiff pled that the individual members were the "'owners and operators,'" of the LLC, were "'alter egos of the corporation,'" that "'substantial ownership of corporate stock is concentrated in one person or a few persons, corporate formalities have been disregarded, and other factors support disregarding the corporate entity.'" The court characterized the facts pled by the plaintiff as "minimal" and concluded that the plaintiff had met, "albeit barely," the plaintiff's pleading burden. The court thus denied the defendants' motion to dismiss for failure to state a claim upon which relief can be granted.

Authority of Member, Manager, or Agent

Montana Food, LLC v. Todosijevic, 2015 WL 779688, __ P.3d __ (Wyo. 2015).

Todosijevic and Vukov each owned a 50% interest in a Wyoming LLC, and after Vukov discovered he had made significantly greater capital contributions over time than Todosijevic, Vukov called a meeting and adopted resolutions increasing his ownership interest to 99.72% and decreasing Todosijevic's interest to .28% to reflect the amounts of the members' capital contributions. The articles of organization provided for initial contributions of $10,000 and additional contributions at such times and in such amounts as agreed by the members. Over time, Vukov became concerned that he was the only member making additional capital contributions and that Todosijevic misrepresented that he was contributing additional funds. Vukov's investigation showed that he had contributed 1,260,00 Euros and that Todosijevic had made no additional contributions, prompting Vukov to hold a meeting at which he voted to adjust the ownership interests. Todosijevic did not attend the meeting. (Interestingly, the members were Serbian residents, and the LLC's business was in Belgrade; the LLC had no connection with Wyoming other than being organized under Wyoming law.) Todosijevic sued the LLC and Vukov claiming that the adjustments to the members' ownership percentages were improper. The articles of organization and written operating agreement provided that the LLC was manager-managed and named an individual who was not a member as manager, but Vukov and the LLC claimed that the LLC had no active manager and was in reality member-managed and that provisions of the Wyoming LLC statute suggested that management of a member-managed LLC is proportionate to each member's capital contribution. The court first examined the provisions of the current LLC statute to determine whether the current or prior statute applied to the question of whether the LLC was manager-managed or member-managed. Because the LLC in this case was organized in 2007, the prior statute applied to this question. Under that statute, an LLC is member-managed unless the articles of organization provide that the LLC is manager-managed. The court rejected the argument that it should look beyond the language of the Wyoming LLC statute and the organizational documents to the realities of how the LLC was managed. The court stated that the

statute did not permit the court to ignore the LLC's designation of itself as manager-managed. Next the court addressed whether a member has the authority in a manager-managed LLC to adjust the members' ownership interests. The current statute specifies certain provisions of the prior statute that continue to apply to LLCs formed before adoption of the new statute, but none of the specified provisions addressed this question. Thus, the court applied the current statute to this question. Under the statute, a manager in a manager-managed LLC has the exclusive authority to decide any matter relating to the activities of the LLC, and the consent of all members is required to undertake any act outside the ordinary course of the company's activities, unless otherwise provided by the articles of organization or operating agreement. The LLC's articles of organization stated that the manager was authorized to act for and bind the LLC by his individual signature, and the operating agreement gave broad authority to the managers and provided that members who are not managers shall take no part in the management or control of the LLC and have no power to bind the LLC. The court concluded that the changing of ownership interests was action outside the ordinary course of the LLC's activities and required the consent of all members under the clear language of the statute. Thus, Vukov did not have the authority to unilaterally change the members' ownership interests. The court recognized that this left the members deadlocked. Only the manager had authority to sell or transfer the LLC's assets, but the LLC claimed there was in reality no manager. The remedy of judicial dissolution was foreclosed because the district court's ruling granting the LLC's motion for summary judgment on Todosijevic's dissolution claim was not appealed. Under these circumstances, the court stated that Todosijevic's only remedy if Vukov had illegally transferred LLC assets was to sue for monetary damages.

Zions Gate R.V. Resort, LLC v. Oliphant, 326 P.3d 118 (Utah App. 2014).

Sorpold was one of two managers of a Utah LLC, and Sorpold signed a 99-year lease on behalf of the LLC in which the LLC conveyed rights to a recreational vehicle pad and lot to Oliphant as payment for work Oliphant performed for the LLC at Sorpold's direction. The other manager of the LLC did not consent to the lease, and the articles of organization expressly required acts of the LLC to be approved by both managers; therefore, the LLC disputed the validity of the lease. The parties did not dispute that Sorpold lacked actual authority, but Oliphant argued that Sorpold had statutory authority under the Utah Revised Limited Liability Company Act (applicable to LLCs formed on or before December 31, 2013) or apparent authority under common-law agency principles. If Sorpold lacked statutory or apparent authority, then Oliphant argued that the LLC ratified Sorpold's otherwise unauthorized act. The court held that Sorpold did not have statutory or common-law apparent authority, but there were fact questions that remained on the issue of ratification.

The court of appeals first held that Sorpold lacked statutory authority because the Utah LLC statute applicable in this case provides that an act of a manager for apparently carrying on in the ordinary course the company business binds the LLC unless the manager has no authority to act for the LLC in the particular matter and the lack of authority was expressly described in the articles of organization or the person with whom the manager was dealing knew or otherwise had notice that the manager lacked authority. Because the articles of organization expressly required the consent or approval of both managers for acts of the LLC, Sorpold lacked authority under the statute to enter into the lease. Oliphant argued that a manager's act was ineffective under the statute only if the manager was without any authority to act for the LLC and not merely limited in his authority, but the court pointed out that the plain language of the statute provided that a manager's act was not binding when the manager lacked authority to act for the LLC "in the particular matter,"and Sorpold

lacked authority to unilaterally bind the LLC on the lease in question because the other manager did not consent.

The court next rejected Oliphant's argument that Sorpold had common-law apparent authority to bind the LLC on the lease. The court explained that apparent authority exists where conduct of the principal causes a third party to reasonably believe that a person has authority to act on the principal's behalf and the third party relies on this appearance of authority and will suffer loss if an agency relationship is not found. The court held that Oliphant had notice of the limitation on Sorpold's authority based on the Utah LLC statute, which provides that articles of organization that have been filed with the Utah division of corporations constitute notice to third persons of all statements that are expressly permitted to be included by the statute. The statute permits the articles of organization to include any provision not inconsistent with law, including a statement of whether there are limitations on the authority of a manager or member and what the limitations are. Because the statute provided that Oliphant had notice of the limitation on Sorpold's authority, he could not reasonably believe Sorpold had authority to act, nor could he reasonably rely on any perceived authority. Oliphant argued that it is unreasonable and unrealistic to expect persons dealing with an LLC to acquire the articles of organization to determine if the signatory for the LLC has authority to act on behalf of the LLC, but the court stated that it was not the prerogative of the court to question the wisdom of the statutory scheme.

Although the court held that Sorpold lacked statutory or apparent authority to bind the LLC on the lease, the court concluded that there were fact questions that remained as to whether the LLC had ratified the lease. Ratification is based on the principal's knowledge of all material facts and express or implied intention to ratify. An intent to ratify may be implied where the principal knows that another has purported to act as its agent and the principal fails to object within a reasonable time. An agent's knowledge obtained within the scope of authority is imputed to the principal. The LLC could not be charged with Sorpold's knowledge of the lease because Sorpold acted without authority in entering into the lease, but it was unclear when the other manager or the LLC became aware of Sorpold's unauthorized acts. Furthermore, the court stated that the question of whether the LLC disaffirmed Sorpold's actions within a reasonable time itself presented an issue of fact. Finally, the court pointed out that the Utah statute of frauds requires an agent executing an agreement conveying an interest in land to be authorized by the principal in writing, and Utah case law states that ratification of an act requiring written authorization must also generally be in writing. Because neither party addressed this issue below, the record was not adequately developed for the court to consider the effect of this rule.

Pannell v. Shannon, 425 S.W.3d 58 (Ky. 2014).

Shannon, the sole member of Elegant Interiors, LLC, executed a lease identifying the LLC as the tenant. At the time the lease was signed, the LLC had been administratively dissolved, but the LLC was subsequently reinstated. Pannell, the lessor, argued that Shannon was liable under agency principles for actions taken on behalf of the LLC while the LLC was administratively dissolved. This analysis involved two sub-questions. First, could Shannon be personally liable merely by reason of being an agent of a dissolved LLC? Second, could Shannon be personally liable as an agent who acted without authority? With respect to the first question, the court held that the retroactive effect of reinstatement under the Kentucky LLC statute along with the statutory protection of managers and agents from liability for the debts, obligations, and liabilities of an LLC precluded holding Shannon liable based solely on her status as a manager or agent. The court went on to address Pannell's argument that Kentucky should follow the majority rule that reinstatement of a corporation does not

shield officers from personal liability for debts incurred after dissolution. The court stated that the existence of a majority rule was only persuasive if the rule is based on statutes like those in Kentucky, and the court stated that many of the cases in other jurisdictions proclaiming the majority rule depended on statutes different from Kentucky's and may not even reflect the current statutory law in those jurisdictions. Under the Kentucky statutory provisions regarding dissolution, reinstatement, and liability protection of agents of LLCs, Shannon was not personally liable based merely on her status as an agent of an administratively dissolved LLC. Likewise, the court concluded that the retroactive effect of reinstatement meant there was never a failure of Shannon's authority as an agent of the LLC. Pannell argued that Shannon lacked authority to act on behalf of the LLC because there was no LLC in existence when the lease was signed and the dissolution statute limited the LLC's permitted activities to winding up its business. But the court noted that a dissolved LLC continues to exist under the Kentucky LLC statute, and the retroactive effect of reinstatement creates a "seamless existence and functionality for the LLC" so that there was never a failure of Shannon's authority. Pannell complained that the LLC's reinstatement occurred only after he filed suit, and Pannell suggested that the court's reading of the statute had an inequitable effect, but the court characterized reinstatement as a matter between the state and the LLC and pointed out that Pannell received what he expected in the transaction.

Admission of Member/Issuance of Membership Interest

L.B. Whitfield, III Family LLC v. Whitfield, 150 So.3d 171 (Ala. 2014).

L.B. Whitfield III ("L.B.") formed the L.B. Whitfield, III Family LLC (the "Family LLC") in 1998 and contributed to it shares of stock in a corporation that had been owned by at least four generations of the Whitfield family. L.B. was the father of three daughters ("the sisters") and a son ("Louie"). L.B. was the sole member of the Family LLC, and L.B. and Louie were the managers. On the same date on which the Family LLC was formed, L.B. executed his will, which made specific bequests of certain property and provided that the residue of his property was to be divided in four equal shares to Louie and the sisters. In 2000, L.B. died, and Louie took various actions as executor of L.B.'s estate and manager of the Family LLC in an effort to continue the Family LLC in the wake of L.B.'s death. Capital accounts in the LLC were established for Louie and the sisters. In 2005, the sisters signed a consent to the settlement of L.B.'s estate, and Louie filed a petition for final settlement of L.B.'s estate that listed the Family LLC as an asset "on hand" in the estate. Following the closing of the estate, Louie and the sisters began receiving a 25% share of the dividends produced by the shares held in the Family LLC. The distribution checks were deposited in capital accounts for each individual, and K-1 tax forms were issued with respect to the receipt of the dividends. In 2010, the sisters wrote letters to Louie requesting that he return certain shares of stock held by the LLC to which they claimed they were entitled. The Family LLC filed a complaint against the sisters seeking a judgment declaring that the sisters had no right to the shares they sought. The sisters filed various counterclaims and a third party complaint against Louie. Eventually, the sisters filed an amended complaint in which they requested a permanent injunction against the Family LLC to take only those actions necessary and appropriate to wind up the Family LLC and distribute the assets. The request was based on the contention that the Family LLC was dissolved as a matter of law and pursuant to the terms of the operating agreement and was only permitted to take actions necessary and appropriate to wind up the affairs of the LLC. The trial court decided that the Alabama Limited Liability Company Law dictated that the LLC was dissolved, either as of the date of L.B.'s death or the date of the entry of the decree of final settlement of L.B.'s estate, and was not extended by an

agreement in writing among all the owners. Thus, the trial court found that the affairs of the Family LLC must be promptly wound up.

On appeal, the court addressed the Family LLC's contention that the trial court erred in concluding that the Family LLC was dissolved in 2000 when L.B. died, and the court concluded that the trial court reached the correct conclusion. The Family LLC argued that Louie and the sisters became members of the Family LLC, but the sisters contended that they and Louie merely inherited the financial rights associated with the membership L.B. held in the Family LLC before his death. The sisters contended that they never agreed to become, and did not become members, of the Family LLC. The articles of organization listed only L.B. as a member, and the Family LLC did not contend that anyone else became a member before L.B.'s death. The Family LLC argued that Louie and the sisters became members of the LLC as a result of a transfer of membership made by Louie as personal representative of L.B.'s estate. Under the Alabama LLC statute, an LLC is dissolved and must be wound up when there is no remaining member unless (1) all of the holders of financial rights in the LLC agree in writing, within 90 days after the cessation of the membership of the last remaining member, to continue the legal existence and business of the LLC and to appoint one or more new members, or (2) the LLC's legal existence and business is continued and one or more new members are appointed as provided in the governing documents. The Family LLC relied on a provision of the LLC statute that gives a personal representative the power to exercise a deceased member's financial rights, including the power to transfer the membership interest, for the purpose of settling the member's estate or administering the member's property, but the court pointed out that this provision does not state that a personal representative of a member becomes a member. It only provides for the exercise of the deceased member's financial rights, including the transfer of those rights, for a limited purpose. The court pointed out that the commentary to the predecessor provision of this portion of the statute stated that the personal representative of a member may only exercise financial rights and does not have the right to participate in management of the LLC. The LLC statute only specifies two exceptions to the general rule that an LLC is dissolved and must wind up on the death of the last remaining member, and the Family LLC relied only on the exception that requires the holders of all financial rights to agree in writing to continue the legal existence and business of the LLC and to appoint one or more new members. The Family LLC contended that this requirement was met when Louie probated L.B.'s will, established a new employer identification number for the LLC, opened a bank account, and worked with the sisters to establish capital accounts for himself and his sisters. The court did not see in those actions an "agreement in writing" of the nature contemplated by the statute. Even if these actions were an agreement in writing, they were undertaken by Louie in his capacity as personal representative when it was Louie in his individual capacity as well as his sisters that would have had to enter into the agreement. The court also rejected the Family LLC's argument that the final settlement of the estate constituted such an agreement. Further, the actions of the sisters with regard to matters such as accepting dividends did not constitute an agreement in writing as contemplated by the statute. The court stated that the nature of LLCs does not allow for the possibility that the sisters somehow could agree to the continuation of the Family LLC or become members of it by implication or by Louie's actions rather than their own actions and consent. The court stressed that the law requires written documentation of consent to membership by all members of an LLC, and the court agreed with the trial court's comment that the statutory scheme does not provide that people who do not desire to be in business together can be made to do so without their consent. Because there was no agreement in writing by all of the holders of the financial rights in the Family LLC to continue its business, it dissolved and must be wound up.

Hector v. Mo-Dad Environmental Serv., LLC, 134 So.3d 133 (La. App. 2014).

Shermane Hector, an employee of Mo-Dad Global Environmental Systems, LLC ("Global"), was injured while working for Global, and Global settled with Hector. The settlement was reduced to judgment, but Global did not pay the judgment. Hector sued to enforce the judgment and also sought to pierce Global's veil to hold William Stegall, Sr. ("Sr.") and William Stegall, Jr. ("Jr.") personally liable. The trial court rendered judgment piercing Global's veil and holding Sr. and Jr. liable with Global for the judgment. The defendants first argued that the trial court erred in finding that Jr. was a member of Global. They argued that Sr. and his wife were each 50% members. The court of appeals stated that the determination of who was a member was a question of fact subject to a manifest-error standard of review. The defendants argued that Jr. never made a capital contribution, never received a K-1, and never received a distribution. The court reviewed the statutory definitions of a "member" and "membership interest" and noted that Global's articles of organization provided that the LLC was member-managed and listed Jr. as the first and only member. The annual reports filed with the secretary of state also identified Jr. as the only member. The Louisiana LLC statute provides that a person registered in the LLC's records as a member may be treated as such for all purposes by the LLC, and its members, managers, and agents. The evidence indicated that Sr. could use the losses generated by Global for income tax purposes, and Jr. did not need the losses. The court concluded that Jr.'s services constituted a capital contribution because he managed Global without receiving a salary. The court of appeals also noted the trial court's finding that Jr. was nervous and evasive in his testimony and thus not a credible witness. After concluding that the trial court did not err in finding that Jr. was a member of Global, the court of appeals examined the evidence relating to the trial court's conclusion that Global's veil should be pierced to hold Sr. and Jr. personally liable to Hector, and the court of appeals found no manifest error in the trial court's decision.

Fiduciary Duties of Members and Managers

LaFond v. Sweeney, 2015 WL 333701, __ P.3d __ (Col. 2015).

This dispute over the distribution of attorney's fees from a contingent-fee case pending at the time of the dissolution of a two-member LLC law firm presented the Colorado Supreme Court with a matter of first impression in Colorado. LaFond and Sweeney formed a law firm as an LLC, and the oral profit-sharing agreement that was in effect at the time of the firm's dissolution was that they shared equally in the profits of the firm without regard to their actual workloads. LaFond represented a client in a whistle-blower action on a contingency fee basis. After a considerable amount of work was done on the case, the firm dissolved. Once the firm dissolved, LaFond continued to represent the client in the action. At the time of the dissolution, there was no written agreement describing how the firm's assets should be distributed, and no written agreement existed regarding how the contingent fee generated by the case would be distributed. LaFond and Sweeney were unable to reach an agreement as to the division of the fees that were potentially going to be earned from the whistle-blower case, and LaFond filed a declaratory judgment action seeking a determination by the court as to how the potential fee should be distributed. The trial court determined that the whistle-blower case had been an asset of the law firm, and the value of the case as an asset of the firm was its value at the time the firm dissolved. The oral agreement between LaFond and Sweeney required any profit from the whistle-blower case to be divided equally, so if LaFond recovered a contingent fee from the case, the trial court held that Sweeney would be entitled to one half of the recovery up to a ceiling of an amount calculated based on the work done and costs

advanced as of the date of the dissolution. Sweeney appealed the trial court's order, and the court of appeals reversed, holding that the trial court should have awarded LaFond and Sweeney each one half of the profits from the case and that LaFond was not entitled to any additional compensation for his post-dissolution work on the case. The supreme court affirmed. The court explained that the unfinished business rule is based on the continued existence of a dissolved LLC law firm through the winding-up period and the fiduciary duties owed by the members and managers of the LLC. The court looked to the Colorado LLC statute to determine whether it required application of the unfinished business doctrine and concluded that it did. Here, a contingent-fee case was brought into the law firm before it dissolved, and LaFond continued to handle the case after dissolution until the case was resolved. Dissolution did not terminate the LLC law firm. Instead, the entity continued as to all existing matters for the purpose of winding up its unfinished business. The pending whistle-blower case was unfinished business to be completed in the process of winding up the LLC. The client agreed to have LaFond continue the representation, and this choice did not alter the contingent-fee agreement or the rights and duties that LaFond and Sweeney owed each other under their business arrangement. The fiduciary duties of members and mangers of an LLC continue to apply during the winding up process, and LaFond was required to hold as trustee for the LLC any profit derived in the winding up of the business. The profits from the whistle-blower case thus belonged to the firm to be distributed in accordance with the profit-sharing agreement that existed at the time of dissolution. The court relied on the California case of *Jewel v. Boxer* and other out-of-state cases that have held that completing an executory contract is part of winding up a firm's business. The court rejected the argument that adopting the unfinished business rule violates a client's right to counsel of his choice, and the court noted compelling reasons to apply the unfinished business rule over the quantum meruit approach advocated by LaFond. The court stated that the unfinished business rule prevents members and managers from competing for the most lucrative cases during the life of the LLC in hopes of retaining them if the LLC dissolves and also discourages members and managers of a dissolved LLC from scrambling to seize client files and solicit clients. The court found nothing fundamentally unfair about the effect of the unfinished business rule and pointed out that members and managers may alter the rule in the LLC operating agreement if they desire.

Feresi v. The Livery, LLC, 182 Cal.Rptr.3d 169 (Cal. App. 2014).

In 2006, Feresi was awarded one-half of a 25% LLC interest acquired during her marriage to Mesa. Feresi also obtained a security interest in Mesa's remaining 12.5% interest to secure payment obligations imposed on Mesa in the divorce. Feresi did not file a UCC-1 financing statement to perfect her security interest in Mesa's interest, but she gave the LLC's president and managing member, Hartley, and the other members written notice that the divorce decree gave her one-half of Mesa's share of the LLC and that Mesa pledged his remaining share as security for his financial obligations to her. According to the court, amendments to the LLC's books and records showed Feresi as a member with a 12.5% ownership interest, and "corporate" tax returns identified her as a member. In 2008, when Mesa got in financial difficulty, Hartley made a loan to Mesa, and Mesa pledged his 12.5% interest to Hartley to secure that loan. Hartley did not disclose these transactions to Feresi. Later in 2008, Feresi filed an action to foreclose her lien and compel Mesa to convey his 12.5% interest to her. Hartley learned of Feresi's action and, having determined that Feresi had not filed a UCC-1, Hartely filed a UCC-1 perfecting the security interest taken to secure the loan made by Hartley to Mesa. In January of 2009, Feresi obtained a judgment requiring Mesa to convey his remaining 12.5% interest to her, and she notified the LLC that the records should be amended to identify her as the owner of a 25% membership interest. Later in 2009, Mesa failed to

repay the loan from Hartley, and Hartley gave notice that Mesa's 12.5% interest would be sold to satisfy the debt. Feresi filed an action for injunctive and declaratory relief. The trial court found that Feresi was a member of the LLC and that Hartley breached a fiduciary duty to Feresi such that the security interest created in favor of Hartley was null and void. Thus, the trial court declared that Feresi had a 25% membership interest unencumbered by Hartley's claims. Hartley appealed, and the court of appeals affirmed the trial court's judgment.

On appeal, the court first rejected Hartley's argument that Feresi was not a member of the LLC and thus was not a person to whom he owed a duty of good faith and fair dealing. The court stated that substantial evidence supported the trial court's finding that Feresi was a member. The court stated that the other LLC members acknowledged that she was a member "by, for example, identifying her as a member on the LLC's tax returns." Under the California LLC statute, a manager of an LLC owes the members of an LLC the same duties of loyalty and good faith as a partner owes to the partnership and the partners. Thus, Hartley was obligated to act with the utmost loyalty and highest good faith in his dealings with Feresi. Citing *Meinhard v. Salmon*, the court held that Hartley breached his fiduciary duty to Feresi by surreptitiously perfecting his conflicting security interest in Mesa's ownership share, thus destroying the value of Feresi's security interest to advance his own. Hartley argued that his filing of the UCC-1 financing statement was not a breach of fiduciary duty because the partnership statute provides that a partner does not breach a duty merely because the partner's conduct furthers the partner's own interest. The court explained that the apparent purpose of this provision is to excuse partners from accounting for incidental benefits obtained in the course of partnership activities without detriment to the partnership, and the court stated that the provision did not apply in these circumstances where Hartley acted with actual knowledge of Feresi's pre-existing security interest and acted to render her security interest worthless. The court said that Feresi had no reason to protect the priority of her own interest since she was not aware of Hartley's conflicting interest. By concealing his interest and perfecting his interest ahead of Feresi's, Hartley betrayed her trust, and "[t]he primacy of Hartley's security interest in Mesa's share must succumb to the infection of his duplicity and silence." Hartley contended that the UCC draws a bright line and requires courts to disregard equities and accept "harsh results," but the court concluded that the doctrine of equitable subordination could be invoked. The court identified three conditions for invocation of equitable subordination that were met here: (1) the fiduciary engaged in inequitable conduct; (2) the misconduct resulted in injury to the petitioner or conferred unfair advantage on the fiduciary; and (3) invocation of the remedy will not be inconsistent with the Commercial Code. The court noted that the UCC itself provides that its provisions are to be supplemented by "principles of law and equity." The court concluded that "[t]he application of equitable principles in this case strengthens the statutory scheme" because "[n]ot rewarding the product of sharp practices in the creation of a security interest lends stability and security in commercial transactions among fiduciaries."

2009 Caiola Family Trust v. PWA, LLC, C.A. No. 8028-VCP, 2014 WL 7232276 (Del. Ch. Dec. 18, 2014).

The non-managing members of Dunes Point West, LLC ("Dunes Point"), a Delaware LLC that owned an apartment complex in Kansas, sued PWA, LLC ("PWA"), a Kansas LLC that served as managing member of Dunes Point, and Katz, the managing member of PWA. The plaintiffs alleged that the actions of Katz and PWA breached Dunes Point's operating agreement and fiduciary duties owed by PWA and Katz. PWA and Katz moved to dismiss for failure to state a claim. The plaintiffs moved for summary judgment, arguing that the defendants' actions justified removal of

PWA from its position as managing member. The court denied the defendant's motion to dismiss with respect to four of the plaintiffs' claims but granted the motion on the plaintiff's claim for waste. The court found that the complaint contained sufficient facts from which it could be inferred that PWA breached the operating agreement by allegedly paying management fees in violation of the agreement, by providing misleading financial reports, and by mismanaging Dunes Point. The complaint also contained facts supporting a claim that the defendants breached their fiduciary duties by engaging in self dealing and mismanagement. The defendants argued that the fiduciary-duty claims should be dismissed because they were essentially contract claims, but the court found that the fiduciary duty claims were broader in scope than the contract claims. The court pointed out that Katz was not a party to the operating agreement so that the claims against him could not constitute breach of contract claims. The court also found that PWA's duty of loyalty could be implicated by alleged self dealing and that allegations of mismanagement could amount to gross negligence such that non-exculpated breaches of the duty of care could be implicated. The court dismissed the waste claim because the standard for waste is very high and was not satisfied by the plaintiffs' allegation that the defendants charged somewhat lower rent than the alleged market rate for comparable apartments. The court denied the plaintiffs' motion for summary judgment because there were genuine issues of material fact as to whether the defendants improperly commingled tenant security deposits or whether the "key person" provision was violated by Katz's failure to remain actively involved in the management of the apartment complex.

Matthew v. Laudamiel, C.A. No. 5957-VCN, 2014 WL5904716 (Del. Ch. Nov. 12, 2014).

Fläkt Woods Group SA ("FW") moved for summary judgment on the plaintiff's claims of aiding and abetting breach of fiduciary duties, tortious interference with contractual relations, unjust enrichment, and civil conspiracy. The plaintiff's claims were premised upon FW's role in the efforts of defendants Laudamiel and Capua to oust the plaintiff from Aeosphere LLC, a Delaware LLC (the "LLC"). The plaintiff's allegations focused on the actions of Yule, who represented FW in its dealings with the LLC. The court commented that Yule's desire for the LLC to resolve its internal disputes and to do business with Laudamiel were unobjectionable, and there was only scant evidence of wrongful conduct on Yule's part. Nevertheless, the record suggested Yule engaged in behavior that could support an inference that he developed and implemented the strategy to force the plaintiff out of the LLC. For example, Yule created scheduling conflicts to keep Matthew from attending potentially important meetings, participated in meetings between Laudamiel and Capua allegedly to discuss how to exclude Matthew from the LLC, made statements to the effect that any contact he had with Matthew was for the sole purpose of helping Laudamiel and Capua, offered to threaten that FW would discontinue its relationship with the LLC, and took the position that DreamAir, the new entity formed by Laudamiel after the LLC was dissolved, would succeed to the agreement in place between the LLC and FW. Although these facts were not dispositive, they presented considerable obstacles to granting FW's motion for summary judgment. In light of these facts, the court discussed the plaintiff's claims against FW. FW argued that the fiduciary-duty claims should be dismissed because they were based on the plaintiff's breach-of-contract claims related to the dissolution of the LLC and were therefore duplicative. The court acknowledged that fiduciary-duty claims cannot proceed in parallel with contract claims based on the same conduct. While the plaintiff's harm primarily arose from the dissolution and winding up of the LLC, which were topics addressed in the LLC agreement, the court found that the plaintiff presented facts that could support claims independent of the contract. For instance, the plaintiff's allegation that FW was conducting the LLC's business with DreamAir raised issues about the scope of FW's violations and the resulting

harm in view of the plaintiff's contentions that Laudamiel and Capua engaged in a scheme with FW to exploit the LLC's assets. The dissolution of the LLC was only a part of this scheme; therefore, the court denied summary judgment on the claim for aiding and abetting breach of fiduciary duty. Similarly, the court denied FW's motion for summary judgment on the civil conspiracy claim.

Simulis, L.L.C. v. General Electric Capital Corporation, 439 S.W.3d 571 (Tex. App. 2014).

In the course of protracted litigation between Simulis, L.L.C. ("Simulis") and General Electric Capital Corporation ("GE Capital"), the claims asserted by Simulis against GE Capital included a claim for breach of fiduciary duty. The parties agreed that Simulis was a Delaware LLC and that the Texas Business Organizations Code required the application of Delaware law to Simulis's claim that GE Capital breached a fiduciary duty to Simulis. Under the operating agreement of Simulis, GE Capital was a member of the LLC holding 20% of its units. Simulis alleged that GE Capital owed a fiduciary duty to Simulis as a member of the LLC and that it breached this duty through its agents and employees. GE Capital contended that it was entitled to summary judgment because it owed no fiduciary duty under Delaware law. GE Capital argued that it had contractual investor rights as a member but was not a manager of the LLC under the board structure of the LLC and had no authority to bind or manage the LLC. Further, GE Capital contended that it was not a controlling member because it owned only 20% of the LLC and appointed only one of four board members. Simulis argued that GE Capital was itself a member of the board and owed a fiduciary duty to the LLC because the operating agreement appointed a GE Capital officer as a member of the LLC's board. The court held that GE Capital did not owe a fiduciary duty to the LLC solely by virtue of its officer's position on the board of directors. The court based this conclusion on Delaware case law rejecting the proposition that a stockholder would automatically acquire the fiduciary obligations of a director when the director is affiliated with the stockholder. According to Delaware case law, the notion that a stockholder could become a fiduciary by attribution (similar to the tort doctrine of respondeat superior) would work an unprecedented, revolutionary change in Delaware law and would cause investors to be hesitant about seeking representation on a corporation's board of directors. The court stated that the reasoning from this case law applied in this context and foreclosed Simulis's claim for breach of fiduciary duty against GE Capital.

Capano v. Capano, C.A. No. 8721-VCN, 2014 WL 2964071 (Del. Ch. June 30, 2014).

Two brothers, Louis and Joseph, owned or controlled identical interests in a family owned LLC that held real estate assets. The brothers' mother transferred a portion of an interest to a Delaware business trust ("CI Trust") for the benefit of a third brother, Gerry. CI Trust held the swing vote in the event of a deadlock among the members of the LLC, and Gerry had voting control over the trust. In 2000, Gerry executed several documents purporting to grant Louis a voting proxy and an option to purchase Gerry's interest in CI Trust. In 2001, Gerry executed documents purporting to transfer all of Gerry's interest in CI Trust to Louis. In 2013, after the mother's death, Louis exercised the rights purportedly transferred to him to cash Joseph out of the LLC through a merger of the LLC with an entity controlled by Louis. Gerry and Joseph brought lawsuits asserting various claims, including challenges to the transfers by Gerry and to the merger. The defendants sought dismissal of claims by Joseph against entities owned or controlled by Louis. Joseph alleged that these entities aided and abetted breaches of fiduciary duty by Louis to Joseph, and the defendants argued that a corporation cannot conspire with its wholly owned subsidiary or its officers or agents. The court stated that there were exceptions to this rule and relied on case law for the proposition that parent corporations may be subjected to claims for aiding and abetting breaches of fiduciary duty

committed by directors of their subsidiaries. The defendants argued in the alternative that an agent cannot aid and abet its principal and that Louis, acting in his capacities as trustee of the CI Trust and general partner of his limited partnership, was acting as an agent of Louis in his capacity as a fiduciary of the LLC. The court found that the defendants mischaracterized these relationships because Louis in his capacities as trustee of the CI Trust and general partner of the limited partnership was not an agent of the LLC. Thus, the court denied the defendants' motion to dismiss the aiding and abetting claim.

Chou v. Chilton, 2014 WL 2154087, __ S.W.3d __ (Ky. App. 2014).

Richard Chilton, Mark Chilton, and William Chilton formed an LLC with Li An Chou. In order to qualify the LLC as a minority owned business (MBE), Chou was granted a 51% interest and was appointed the president and managing member. The Chiltons owned the remaining 49% among them. The Chiltons had a construction company that operated in the same environment as the LLC, and the LLC was eventually decertified as an MBE, in part because of lack of documentation that it was a separate entity and not merely a conduit for transactions of the Chiltons' company. The Chiltons blamed Chou, claiming he was not capable of running the business and did not want to learn, and Chou argued he was shut out of the operations and existed only as a figurehead for the Chiltons to secure MBE-related contracts. Chou brought an action in his individual capacity against the Chiltons asserting various claims, including claims for breach of loyalty, breach of fiduciary duty, breach of the duty of good faith and fair dealing implied in the LLC operating agreement, misappropriation, and misrepresentation. The trial court dismissed Chou's complaint on the basis that the LLC rather than Chou was the real party in interest and that Chou lacked standing to bring the claims. The court of appeals held that Chou did not have standing to bring the claims for breach of loyalty and breach of fiduciary duty. The court disagreed with Chou's reading of Kentucky case law and stated that the case relied on by Chou did not hold that every member of an LLC owes every other member a duty of loyalty and fiduciary duty. The court stated that the case relied on by Chou held that managing members owed a duty to the other members, and Chou was the managing member. Thus, the court held that the Chiltons did not owe a fiduciary duty to Chou, and Chou had no standing to assert such a claim against them. The court also held that the claim for misappropriation of funds and opportunities alleged a wrong by the Chiltons against the LLC, and Chou thus lacked standing to bring this claim individually. The court stated that the claim for breach of the covenant of good faith and fair dealing related to the operating agreement, which was an agreement among Chou and the Chiltons, and their agreement specifically allowed members to sue other members for fraud, gross negligence, or an intentional breach of the agreement. The court stated that whether the claim for breach of the covenant of good faith and fair dealing was intentional was a question for the trier of fact, but Chou had standing to bring the claim against the Chiltons since they were all parties to the agreement. Finally, the claim for misrepresentation was a claim for fraud, and since the operating agreement allowed members to bring claims against other members for fraud, the court concluded that Chou had standing to assert this claim.

TM2008 Investments, Inc. v. ProCon Capital Corporation, 323 P.3d 704 (Ariz. App. 2014).

In litigation between the two members of a real estate development LLC, the trial court determined that the members of an Arizona LLC necessarily owe each other fiduciary duties based on principles applicable to closely held corporations and/or partnerships, and the trial court instructed the jury that the members owed each other a fiduciary duty that required the members to deal in utmost good faith with each other and fully disclose to each other all material facts relating to the

LLC. The jury found that the defendant breached its fiduciary duty to the plaintiff, and the defendant argued on appeal that the trial court erred in imputing common-law fiduciary duties to the members of the LLC. The court of appeals held that the trial court erred in failing to consider the LLC operating agreement and imputing common-law fiduciary duties based solely on principles applicable to closely held corporations and/or partnerships. The court explained that, unlike other statutorily based business structures such as corporations and partnerships, the Arizona LLC statute does not refer to any baseline fiduciary duties that members owe to an LLC or to one another. The court declined in this case to mechanically apply fiduciary duty principles from the law of closely held corporations or partnerships, but looked instead to the operating agreement for guidance. The court stated that a provision of the operating agreement stating that the entity was an LLC and not a general partnership (while acknowledging that the LLC would be operated consistent with its treatment as a partnership for Arizona and federal income tax purposes) did not preclude the court from determining whether and to what extent the agreement established that the members owed each other a fiduciary duty. Another provision of the agreement stated that the members shall direct, manage, and control the business of the LLC subject only to the restrictions set forth in the operating agreement, and the operating agreement further provided that a member would not be liable to the LLC or another member for damages if the member acted in good faith and with reasonable business judgment including the care of an ordinarily prudent person in similar circumstances and in a manner believed to be in the best interest of the LLC. The court stated that this provision unquestionably established the existence and scope of the duties owed by and between the members. The court stated that it need not reach the issue of whether these duties were "fiduciary" in nature. The court noted, however, that the agreement obligated members to: (1) act in good faith, thus explicitly acknowledging what is generally implied in any contractual relationship; (2) utilize reasonable business judgment and ordinary care, thus seemingly establishing an applicable standard of care; and (3) act in a manner believed to be in the best interest of the LLC, which appears to be consistent with the general concept of a duty of loyalty to the entity. Because the trial court instructed the jury based on a comparison with other business forms and common law rather than the operating agreement, the court reversed and remanded for a new trial.

Hibbs v. Berger, 430 S.W.3d 296 (Mo. App. 2014).

The plaintiff was employed by an LLC as a salesperson and later obtained a 5% non-voting economic interest in the LLC. At the time the plaintiff obtained his interest, the LLC's founder (Taylor) sold half of his interest to Wood Nuts, Inc. ("Wood Nuts"). Thus, Taylor and Wood Nuts each owned 47.5% of the economic interest in the LLC and 50% of the voting interest in the LLC. Wood Nuts was owned by another individual (Berger) and his sister. The LLC was governed by a board of two managers, one appointed by Taylor and one by Wood Nuts. Taylor appointed himself, and Wood Nuts appointed Berger. The LLC encountered financial difficulty, and Wood Nuts made several secured loans to the LLC. The LLC defaulted on the loans and voluntarily surrendered the collateral. Wood Nuts accepted the collateral in satisfaction of the LLC's indebtedness although the amount of indebtedness exceeded the value of the collateral. The plaintiff eventually terminated his employment and sued the LLC for commissions, salary, and benefits that he alleged he was owed. The plaintiff obtained a judgment against the LLC and then filed a lawsuit against Wood Nuts, Berger, and Taylor alleging, inter alia, claims based on veil piercing and breach of fiduciary duty. The plaintiff settled with Taylor. The trial court granted summary judgment in favor of the remaining defendants, and the plaintiff appealed. With respect to the plaintiff's claim for breach of fiduciary duty against the defendants, the court stated that the critical issues were "what, if any, fiduciary

duties are established by virtue of creation of a limited liability company, and to whom do members and managers of limited liability companies owe a fiduciary duty." The court characterized these issues as "uncharted waters." Specifically, the inquiry in this case boiled down to whether Wood Nuts, a member but not a manager, and Berger, a manager but not a member, owed fiduciary duties to the plaintiff. The court started by reviewing the provisions of the Missouri LLC statute, the plain language of which evidences that managers (member or non-member) of an LLC owe fiduciary duties to the LLC itself. What remains unsettled is whether managers of an LLC owe fiduciary duties to members of the LLC. The court stated that a review of case law from other jurisdictions, the statutes interpreted in those cases, and commentary on the subject revealed that Missouri's statute was most analogous to jurisdictions that impose fiduciary duties upon managers to members of the LLC. Further, the court said this conclusion was consistent with the articulation of the statutory standard of care ("with the care of a corporate officer of like position...") and the statutory directive to apply the rules of equity in a case not provided for. Because Missouri imposes on corporate directors fiduciary duties to the corporation and its shareholders, the court concluded the statute envisioned that managers owe fiduciary duties to members. The court then proceeded to analyze the operating agreement because the LLC statute permits fiduciary duties to be defined or limited in the operating agreement. The court pointed out that a provision of the operating agreement stated that a member shall have no fiduciary duty not to declare a default or initiate enforcement or collection of a loan. In addition, the operating agreement limited the liability of managers and members acting in good faith and in a manner reasonably believed to be within the scope of the operating agreement. Based on these provisions, the court concluded that the fiduciary duties Berger owed by statute were abridged by the operating agreement so that Berger did not owe the plaintiff fiduciary duties. With respect to Wood Nuts, the court pointed out that the Missouri LLC statute provides that one who is a member of a manager-managed LLC owes no duties to the LLC or other members solely by reason of acting in his capacity as a member. The court observed that some jurisdictions have found that controlling members owe fiduciary duties to minority members, but the court did not address this argument because the plaintiff did not raise it. In the course of addressing a claim for tortious interference with business relationship by the plaintiff against Berger, the court addressed the plaintiff's argument that amendments to the LLC operating agreement were unfair and illegal. The court acknowledged that Missouri law implies a covenant of good faith and fair dealing in every contract, but the court said the plaintiff proffered no evidence of any illegal or unfair conduct by the defendants. The court commented that the plaintiff seemed to have forgotten that he had little control over the operations of the LLC as a 5% economic owner, which was the bargain he agreed to.

Trinity Industries Leasing Company v. Midwest Gas Storage, Inc., 33 F.Supp.3d 947 (N.D. Ill. 2014).

The plaintiff obtained a default judgment in Texas state court for breach of contract against a Delaware LLC headquartered in Illinois. In this case, the plaintiff sued the judgment debtor LLC's president and CEO, O'Malley, alleging that O'Malley schemed to defraud the plaintiff by causing the LLC to lease railcars from the plaintiff and sublease those railcars to other companies and then funneling the payments from the other companies to himself and other entities under his control. The plaintiff claimed that O'Malley misrepresented the financial condition of the LLC when it entered into the lease with the plaintiff and that the LLC was in the process of selling its business at that time. In this case, the plaintiff asserted claims based on fraud, veil piercing, and fraudulent transfer. The parties agreed that Texas law applied to the plaintiff's fraud claim, and the court held, under Indiana choice-of-law rules, that Texas law applied to the extent that the plaintiff's fraud claim rested

on breach of fiduciary duty as well. The court rejected the plaintiff's argument that Delaware law governed the question of whether O'Malley owed the plaintiff a duty under the trust fund doctrine because Indiana choice-of-law rules do not permit different issues within the same claim to be governed by different laws. The plaintiff did not rely on the trust fund doctrine as a separate basis of recovery but sought to extrapolate a fiduciary duty to creditors pursuant to the trust fund doctrine. The court noted that Texas had slowly abrogated the trust fund doctrine by the enactment of remedial statutes, and the parties disputed whether the doctrine remained viable in Texas. Although the court recognized that Indiana choice-of-law rules required the application of Texas law to each element of the plaintiff's fraud claims, the court also stated that whether the trust fund doctrine imposes a fiduciary duty on directors and officers of a corporation or LLC is a matter of internal affairs governed by the law of the state of formation under Indiana corporate and LLC choice-of-law laws. While the scope of the trust fund doctrine was uncertain in Texas, it has clearly been rejected in the LLC context in Delaware so that creditors of a Delaware LLC have no claim for breach of fiduciary duty under the trust fund doctrine. Because the judgment debtor LLC was a Delaware LLC, the court stated that the plaintiff could not rely on the trust fund doctrine to establish that O'Malley owed the plaintiff a fiduciary duty.

Kalikow v. Shalik, 986 N.Y.S.2d 762 (N.Y. Sup. 2014).

Kalikow and Shalik, each 50% members of an LLC that owned an office building and ground lease, guaranteed a loan to the LLC to refinance the building. Under the operating agreement, Kalikow was the sole managing member of the LLC with sole discretion to manage the business and affairs of the LLC. The principal subtenants in the building were an accounting firm in which Shalik was a partner and a business of Kalikow's. To obtain an extension on the loan after it matured, Kalikow paid down the amount requested by the bank as a condition to the extension. Kalikow sued Shalik for contribution, and the court determined that Shalik was not obligated to contribute toward the payment made by Kalikow because the bank had not yet demanded payment of the loan or declared it in default, and Kalikow was thus not obligated to make the payment. Kalikow also sued Shalik for breach of fiduciary duty asserting damages from Shalik's failure to inform Kalikow and the LLC of Shalik's intention not to have his accounting firm renew its sublease, refusing to allow Kalikow and the LLC to show the lease space to potential tenants, and damaging the premises by replacing glass doors with a wooden door. The court stated that New York case law is replete with cases demonstrating that a managing member of an LLC owes the LLC and the other members a fiduciary duty, and the court pointed out that the New York LLC statute provides for duties of managers. The court found it significant that the New York LLC statute contains no provisions imposing any duties on non-managing members. Given the legislature's omission of any duty of good faith or loyalty on the part of a non-managing member and the fact that Kalikow was the sole managing member, the court held that the LLC and Kalikow failed to stated a cause of action for breach of fiduciary duty against Shalik, a non-managing member.

Pokoik v. Pokoik, 982 N.Y.S.2d 67 (App. Div. 1st Dept. 2014).

The court held that the plaintiff, a nonmanaging member of an LLC, was entitled to summary judgment against the managing member on the plaintiff's claims for breach of fiduciary duty. To settle a dispute, the plaintiff and the managing member had agreed that "discrepancies" in payments made by the plaintiff would be written off upon payment by the plaintiff of $2.2 million. Both parties knew that the amounts at issue were more than the $2.2 million amount agreed upon to settle the discrepancies. The managing member contended that he was then informed by the accountant

that the written-off funds would have to be accounted for and that the managing member followed the accountant's instructions to place the entire burden on the plaintiff. Neither the operating agreement nor the settlement agreement provided for a unilateral reduction of the plaintiff's account, and the managing member did not inform the plaintiff of the accountant's recommendation or notify the plaintiff that his capital account, and no one else's, was reduced to address the tax situation. Later, also without notice to the plaintiff, the managing member discontinued distributions to the plaintiff. The managing member claimed that the plaintiff was not singled out for harmful treatment because the distributions were made in proportion to capital accounts, but the plaintiff was the only member whose capital account was written down.

The court stated that the managing member owed the nonmanaging member an undivided duty of loyalty that barred not only blatant self dealing but also avoidance of situations in which the managing member's personal interest would possibly conflict with the interest of the nonmanaging member. The court rejected the managing member's reliance on the statutory defense of reliance on outside professionals and the business judgment rule because the managing member did not meet his initial burden of showing that he acted in good faith and with undivided loyalty. The court stated that the managing member had an interest in reducing the plaintiff's capital account, as opposed to charging certain amounts to the LLC, because charging the LLC would have had a negative financial impact on the managing member. The managing member's failure to make truthful and complete disclosures and his conflict of interest in choosing to burden only the plaintiff did not show undivided loyalty. The court rejected all of the managing member's affirmative defenses. The first defense was based on the provision of the LLC operating agreement governing distributions, but the court stated that the managing member's lack of good faith was revealed by the fact that distributions were made for three years after the plaintiff's capital account was emptied and then suddenly discontinued without explanation. The second defense was rejected because the plaintiff refuted the contention that the settlement agreement required a general reconciliation that was performed by the accountant and revealed fraudulent entries of expenses by the plaintiff. The court rejected the defense of the business judgment rule because of the evidence of lack of good faith on the managing member's part. The managing member alleged that the nonmanaging member had unclean hands based on certain disbursements, but that claim was released by the settlement agreement. The court rejected the managing member's defense of waiver based on the plaintiff's K-1s (which showed a negative capital account balance for several years) because the plaintiff was never alerted by the accountant of the change to his account or that his accounts were treated differently from those of other members. The court stated that the nonmanaging member's claims were not released by the settlement agreement and that the nonmanaging member could assert his breach of fiduciary duty claim against the managing member without joining the LLC as a party. In sum, while the managing member may have relied on the accountant's opinion in reducing the plaintiff's capital account, the court concluded that the failure of the managing member and the accountant to inform the plaintiff of the decision and of the subsequent elimination of distributions established the plaintiff's claim that the managing member was not acting in the plaintiff's best interest and breached his fiduciary duty of care.

Kyle v. Apollomax, LLC, 987 F.Supp.2d 519 (D. Del. 2013).

O'Neill and Kyle formed a Delaware LLC in which O'Neill was an 85% member and Kyle was a 15% member. Under the written operating agreement for the LLC, O'Neill guaranteed that a substantial portion of his time would be spent on the day-to-day execution of business plans and growth, and Kyle guaranteed that a substantial portion of his time would be spent raising capital.

The operating agreement provided for the removal of a member if the member was not substantially performing the promised services and a supermajority in interest of the members voted for removal. The relationship between O'Neill and Kyle deteriorated, and O'Neill sent Kyle a notice of failure to perform services as required by the operating agreement before a vote for removal could take place. After the sixty-day cure period required by the operating agreement elapsed, O'Neill, who held the requisite supermajority in interest voted to remove Kyle. Kyle's actions and his efforts to cure his deficiency were heavily disputed. Kyle brought suit alleging breach of fiduciary duty, conversion, breach of the operating agreement, and breach of the implied covenant of good faith and fair dealing, and the court granted summary judgment against Kyle on his claims for conversion and breach of the implied covenant but concluded that there was sufficient evidence for a jury to reasonably find for Kyle on the other claims and denied summary judgment on those claims.

Kyle's claim for breach of fiduciary duty was based on allegations that O'Neill excluded Kyle from the opportunity to participate in the formation of a new venture that supplanted the LLC as the supplier for the LLC's major customer. The court discussed the sufficiency of Kyle's complaint and concluded that, while not a model of clarity, allegations regarding diversion of business opportunities and assets put the defendants on notice of the breach of fiduciary duty claim. The court then discussed the application of Delaware law to the fiduciary duty claim. The court noted that the Delaware LLC statute places a premium on freedom of contract and allows the parties to expand, restrict, or eliminate fiduciary duties. Because the operating agreement did not address fiduciary duties, default fiduciary duties of care and loyalty applied. The defendants conceded that the duty of loyalty applied, but they argued that the record did not contain evidence to support a breach. The defendants argued that Kyle precluded himself from participating in the new venture by failing to fulfill his obligations under the operating agreement. The court acknowledged that this might turn out to be true, but the court pointed out that Kyle was still a member during part of the discussions and Kyle put forth evidence that he was not offered the opportunity to participate in the new venture. Interpreting the facts most favorably to Kyle, O'Neill's decision not to include Kyle could have denied Kyle an opportunity he was owed and thereby resulted in a breach of the duty of loyalty. The defendants' motion for summary judgment was denied on this claim.

Information Rights

Prokupek v. Consumer Capital Partners LLC, C.A. No. 9918-VCN, 2014 WL 7452205 (Del. Ch. Dec. 30, 2014).

The plaintiff sought to inspect financial documents of Smashburger Master LLC ("Smashburger") in connection with a dispute over the amount Smashburger owed the plaintiff for the redemption of his units. The plaintiff was the chairman and CEO of Smashburger and was granted restricted equity units of Smashburger as a term of employment. Most of the units did not vest unless Smashburger met certain "performance hurdles." After Smashburger terminated the plaintiff and redeemed his vested units pursuant to the LLC agreement at a price it determined to be fair market value, the plaintiff demanded certain of Smashburger's business records under Section 18-305(a) of the Delaware Limited Liability Company Act for the stated purpose of evaluating Smashburger's financial performance to determine whether it manipulated its financials to make it appear that it fell short of some of the performance hurdles. Smashburger refused the plaintiff's demand on the basis that Smashburger had redeemed all of his units, thus terminating his status as a member, and that former members have no standing to demand inspection under either the Delaware LLC statute or Smashburger's LLC agreement. The plaintiff petitioned the court for

inspection, arguing that he retained equity in Smashburger because it paid him too little for his units and because it did not call all of his units in any event. Alternatively, he argued that he retained inspection rights by virtue of his status as a former member of Smashburger. Smashburger moved to dismiss the plaintiff's claim, and the court granted the motion. The court first determined that the plaintiff was no longer a member because all of his units had been redeemed. Then the court addressed the plaintiff's argument that he retained inspection rights even if he was no longer a member. Section 18-305(a) of the Delaware Limited Liability Company Act provides inspection rights to "[e]ach member" of an LLC. The court looked to the corporate analogue for guidance on the scope of the LLC provision. Section 220 of the Delaware General Corporation Law unambiguously limits inspection rights to current stockholders and directors and has been narrowly construed by the court. The plain language of Section 18-305(a) of the Delaware Limited Liability Company Act confers inspection rights only on current members, and the plaintiff cited no Delaware authority holding that former members retain residual inspection rights. Given that the LLC statute permits LLC agreements to grant members inspection rights that exceed those provided by statute, the court found no reason to expand the plain language of the statute when the parties did not choose to do so.

Muccio v. Hunt, No. CV-11-1273, 2014 Ark. 35 (Ark. 2014).

The Arkansas Supreme Court characterized claims for fraud, breach of duty to disclose company information, and conversion asserted by members of a bankrupt LLC as direct rather than derivative claims. The court relied on provisions of the Arkansas LLC statute to conclude that the members' claim that managers, officers, and board members of the LLC withheld company information stated a direct claim. The court pointed out that the Arkansas LLC statute requires managers to "render, to the extent the circumstances render it just and reasonable, true and full information of all things affecting the members to any member." The court held that this statutory information right of members constitutes an individual claim running to the individual member. Further, the court concluded that the statute contemplates a manager's liability to a member in the provision that states that a manager is not liable "to the limited liability company or to the members" for any act or failure to act unless the act or omission constitutes gross negligence or willful misconduct.

Capano v. Capano, C.A. No. 8721-VCN, 2014 WL 2964071 (Del. Ch. June 30, 2014).

Two brothers, Louis and Joseph, owned or controlled identical interests in a family owned LLC that held real estate assets. The brothers' mother transferred a portion of an interest to a Delaware business trust ("CI Trust") for the benefit of a third brother, Gerry. CI Trust held the swing vote in the event of a deadlock among the members of the LLC, and Gerry had voting control over the trust. In 2000, Gerry executed several documents purporting to grant Louis a voting proxy and an option to purchase Gerry's interest in CI Trust. In 2001, Gerry executed documents purporting to transfer all of Gerry's interest in CI Trust to Louis. In 2013, after the mother's death, Louis exercised the rights purportedly transferred to him to cash Joseph out of the LLC through a merger of the LLC with an entity controlled by Louis. Gerry and Joseph brought lawsuits asserting various claims, including challenges to the transfers by Gerry and to the merger. The defendants sought dismissal of a request by Joseph for access to the books and records of the LLC that was the surviving entity in the merger. The court found that Joseph did not have any rights to books and records of entities of which he was not a member, but if Joseph prevailed in unwinding the merger, he could separately request the LLC's books and records at that time.

Interpretation of Operating Agreement

Montana Food, LLC v. Todosijevic, 2015 WL 779688, __ P.3d __ (Wyo. 2015).

Todosijevic and Vukov each owned a 50% interest in a Wyoming LLC, and after Vukov discovered he had made significantly greater capital contributions over time than Todosijevic, Vukov called a meeting and adopted resolutions increasing his ownership interest to 99.72% and decreasing Todosijevic's interest to .28% to reflect the amounts of the members' capital contributions. The articles of organization provided for initial contributions of $10,000 and additional contributions at such times and in such amounts as agreed by the members. Over time, Vukov became concerned that he was the only member making additional capital contributions and that Todosijevic misrepresented that he was contributing additional funds. Vukov's investigation showed that he had contributed 1,260,00 Euros and that Todosijevic had made no additional contributions, prompting Vukov to hold a meeting at which he voted to adjust the ownership interests. Todosijevic did not attend the meeting. (Interestingly, the members were Serbian residents, and the LLC's business was in Belgrade; the LLC had no connection with Wyoming other than being organized under Wyoming law.) Todosijevic sued the LLC and Vukov claiming that the adjustments to the members' ownership percentages were improper. The articles of organization and written operating agreement provided that the LLC was manager-managed and named an individual who was not a member as manager, but Vukov and the LLC claimed that the LLC had no active manager and was in reality member-managed and that provisions of the Wyoming LLC statute suggested that management of a member-managed LLC is proportionate to each member's capital contribution. The court first examined the provisions of the current LLC statute to determine whether the current or prior statute applied to the question of whether the LLC was manager-managed or member-managed. Because the LLC in this case was organized in 2007, the prior statute applied to this question. Under that statute, an LLC is member-managed unless the articles of organization provide that the LLC is manager-managed. The court rejected the argument that it should look beyond the language of the Wyoming LLC statute and the organizational documents to the realities of how the LLC was managed. The court stated that the statute did not permit the court to ignore the LLC's designation of itself as manager-managed. Next the court addressed whether a member has the authority in a manager-managed LLC to adjust the members' ownership interests. The current statute specifies certain provisions of the prior statute that continue to apply to LLCs formed before adoption of the new statute, but none of the specified provisions addressed this question. Thus, the court applied the current statute to this question. Under the statute, a manager in a manager-managed LLC has the exclusive authority to decide any matter relating to the activities of the LLC, and the consent of all members is required to undertake any act outside the ordinary course of the company's activities, unless otherwise provided by the articles of organization or operating agreement. The LLC's articles of organization stated that the manager was authorized to act for and bind the LLC by his individual signature, and the operating agreement gave broad authority to the managers and provided that members who are not managers shall take no part in the management or control of the LLC and have no power to bind the LLC. The court concluded that the changing of ownership interests was action outside the ordinary course of the LLC's activities and required the consent of all members under the clear language of the statute. Thus, Vukov did not have the authority to unilaterally change the members' ownership interests. The court recognized that this left the members deadlocked. Only the manager had authority to sell or transfer the LLC's assets, but the LLC claimed there was in reality no manager. The remedy of judicial dissolution was foreclosed because the district court's ruling granting the LLC's motion for summary judgment on Todosijevic's dissolution claim was not appealed. Under these circumstances, the court

stated that Todosijevic's only remedy if Vukov had illegally transferred LLC assets was to sue for monetary damages.

Moultrie v. Wall, 2015 WL 480828, __ So.3d __ (Ala. 2015).

In this dispute regarding the ownership of an LLC Ford automobile dealership, Moultrie appealed from a judgment that determined Moultrie's interest was reduced from 51% to 10% pursuant to an amendment of the operating agreement and that Moultrie was divested of that interest because he failed to pay a required capital contribution. The first issue addressed by the supreme court was whether the evidence was sufficient for the trial court to find that the members of the LLC amended an LLC operating agreement that specified the ownership interests in the LLC as Moultrie 51% and Wall 49%. The original members of the LLC were Wall and Mariner, but they approached Moultrie to help them with the dealership application process and offered him a 10% interest in the LLC. Based on Mariner's background, Ford rejected a dealership application that reflected 45% ownership interests by Wall and Mariner and a 10% ownership interest by Moultrie. In July 2009, after rejection of the dealership application that reflected Mariner as an owner, Mariner, Wall, and Moultrie signed an amended operating agreement that specified the ownership of the LLC as Moultrie 51% and Wall 49%. An amended dealership application that specified this ownership was approved by Ford. In August 2009, Wall, Mariner, and Moultrie signed an agreement that provided that Moultrie was to retain a 10% interest in the LLC and participate in profit distributions as a 10% owner. The trial court found that the parties agreed to amend the July 2009 operating agreement based on the August 2009 agreement and other evidence, such as Moultrie's acceptance of only 10% of the profits during a 2009 tax-planning meeting and K-1 schedules for 2009 and 2010. Under the Alabama LLC statute, the written agreement of all of the members was required to amend the operating agreement unless otherwise provided by the operating agreement, and Moultrie argued that the evidence relied on by the trial court did not satisfy the statutory requirement. Moultrie argued that the supreme court's strict application of the phrase "agree in writing" in *L.B. Whitfield, III Family LLC v. Whitfield* should be applied in this case. In *Whitfield*, the court considered whether the statutory requirement of a written agreement by the holders of all financial rights in an LLC to the continuation of the LLC after the death of the sole member could be satisfied by implication based on the actions of the heirs of the sole member. The court agreed that Moultrie's oral agreement to accept 10% of the profits at a tax-planning meeting and the accountant's preparation of tax documents reflecting that agreement would not alone be sufficient to meet the statutory requirement that an amendment of the operating agreement be in writing. But the court stated that the "glaring difference" between the facts in this case and the *Whitfield* case was the August 2009 agreement signed by Moultrie and Wall in this case. Moultrie pointed out that the copy of the August 2009 agreement submitted into evidence was unsigned, but the court stated that it was undisputed that a signed copy was kept in Wall's office and was stolen while the litigation was pending. Moultrie argued that it was not clear that the terms of the August 2009 agreement were intended to be an amendment of the operating agreement. The court concluded that the terms were sufficient to constitute an amendment even though the word "amendment" was not used and there was no specific reference to the operating agreement. The court also rejected Moultrie's argument that the agreement should have been filed with the probate court to have operative effect. The Alabama LLC statute required amendments to an LLC's certificate of formation to be delivered to the probate court but not amendments to the operating agreement.

The court next addressed Moultrie's challenge to the trial court's conclusion that he was divested of his membership interest in the LLC based on his failure to comply with a capital call

made by Wall. The court examined the provisions of the operating agreement and concluded that the decision to make a capital call was subject to the general requirement that LLC decisions and actions be approved by a majority in interest of the members at a meeting called with notice to all members. The court rejected Wall's argument that this general provision did not require a meeting because a provision of the operating agreement that controlled Wall's request of capital from Moultrie did not specifically require a meeting. Wall contended that the decision to contribute capital was not a company decision but rather one left to the members. The court stated that nothing in the agreement precluded an individual member from contributing additional capital if the member desired, but a decision that the LLC needed a substantial capital contribution and that all members were required to contribute in order to maintain their ownership interest was a company decision or action that required a meeting. Although Wall argued that the urgency of the situation excused him from calling a meeting, the court pointed out that a formal meeting was not required, and Wall failed to show that in the 12-day time frame involved he did not have even a few minutes to schedule an informal meeting such as a conference call. The court also rejected Wall's argument that no meeting was required because it would have been "fruitless." Neither the hostility between the parties nor the fact that Wall owned the majority interest required to make the decision overrode the requirement in the operating agreement that all members had a right to a meeting before company decisions and actions were decided by a majority in interest of the members. Finally, the court could not conclude that anything in the operating agreement allowed Wall as the manager of the LLC to make a unilateral demand for capital. Because Wall did not comply with the terms of the operating agreement requiring a meeting when he made the capital call, the court reversed the trial court's judgment insofar as it held that Moultrie was divested of his 10% interest by failing to contribute additional capital.

Daniel v. Ripoli, 2015 IL App (1st) 122607, __ N.E.3d __ (Ill. App. 2015).

A general partnership accounting firm with two partners, Ripoli and Daniel, converted to an LLC effective January 1, 1999, and a third individual, Grieco, became a member of the firm and entered into an operating agreement with the two other members a few months later. The three members approved and ratified the articles of organization and agreed to operate under the articles and the operating agreement. Several years later, the members met to discuss concerns regarding the disparity between Daniel's profit-sharing percentage and the actual income generated from Daniel's clients. Daniel's profit-sharing percentage under the operating agreement was significantly higher than the income generated by his clients, and Greico's profit-sharing percentage was significantly lower than the income produced by his clients. Eventually, in December of 2003, the members signed an agreement that they would not follow the profit-sharing percentages in the operating agreement for 2003 and would determine the profit-sharing percentages for 2003 based on the financial statements for 2003. In January of 2004, the members signed an agreement adjusting the members' capital accounts in 2003 and specifying a method of determining Daniel's distributions in 2004. The members abided by the 2004 agreement until Daniel died in 2006. Daniel's estate sued Ripoli, Greico, the partnership, and the LLC seeking payment of the amount the estate claimed was owed for Daniel's capital account under the operating agreement. The estate argued that the January 2004 agreement did not permanently change the profit-sharing percentages because it did not expressly refer to future years. The court examined the terms of the 2004 agreement and the course of conduct of the parties and concluded that the 2004 agreement amended the operating agreement and established a permanent change in Daniel's capital account.

Prokupek v. Consumer Capital Partners LLC, C.A. No. 9918-VCN, 2014 WL 7452205 (Del. Ch. Dec. 30, 2014).

The plaintiff sought to inspect financial documents of Smashburger Master LLC ("Smashburger") in connection with a dispute over the amount Smashburger owed the plaintiff for the redemption of his units. The plaintiff was the chairman and CEO of Smashburger and was granted restricted equity units of Smashburger as a term of employment. Most of the units did not vest unless Smashburger met certain "performance hurdles." After Smashburger terminated the plaintiff and redeemed his vested units pursuant to the LLC agreement at a price it determined to be fair market value, the plaintiff demanded certain of Smashburger's business records under Section 18-305(a) of the Delaware Limited Liability Company Act for the stated purpose of evaluating Smashburger's financial performance to determine whether it manipulated its financials to make it appear that it fell short of some of the performance hurdles. Smashburger refused the plaintiff's demand on the basis that Smashburger had redeemed all of his units, thus terminating his status as a member, and that former members have no standing to demand inspection under either the Delaware LLC statute or Smashburger's LLC agreement. The plaintiff petitioned the court for inspection, arguing that he retained equity in Smashburger because it paid him too little for his units and because it did not call all of his units in any event. Alternatively, he argued that he retained inspection rights by virtue of his status as a former member of Smashburger. Smashburger moved to dismiss the plaintiff's claim, and the court granted the motion on the basis that he was no longer a member and that only members have statutory inspection rights.

The court first addressed the issue of whether plaintiff was a member of Smashburger at the time of his demand. The plaintiff essentially claimed that he still owned units based on his contention that Smashburger improperly calculated the number of units that had vested. The purchase price tendered by Smashburger and the number of units that it called were undisputed facts. Under the redemption provision of the LLC agreement, Smashburger's manager was to determine the number of vested units by certifying whether Smashburger achieved the applicable performance hurdles. Since the manager decided Smashburger did not meet the performance hurdles, Smashburger complied with the agreement, and the plaintiff was no longer a member. Whether the EBITDA numbers the manager used to determine compliance with the performance hurdles were unreliable was a separate factual question that could support a breach of contract action but did not change the fact that the plaintiff was no longer a member at the time of the demand for inspection.

The court next addressed the plaintiff's argument that he retained equity pursuant to a dispute mechanism in the LLC agreement. The dispute mechanism allowed former employees to object to Smashburger's determination of fair market value within 30 days of receiving a call notice and provided for subsequent steps to resolve the valuation issue. The plaintiff contended this mechanism required Smashburger to determine a fair price for his units prior to redeeming his units. The court rejected this argument because the plain language of the redemption provision provided that all redemptions shall close within 60 days of the notice of termination and contained no exception for ongoing disputes covered by the dispute mechanism. In addition, the dispute mechanism contemplated a period of up to 75 days from the date of Smashburger's determination of fair market value to resolve disputes, whereas the redemption provision required closing to occur within 60 days. The only way to give effect to both provisions without altering the express terms of the agreement was to recognize that valuation disputes may continue after a member's units have been validly called. Thus, the court concluded that the plaintiff may have had damages claims related to the redemption, but he was not entitled to the restoration of an equity interest.

2009 Caiola Family Trust v. PWA, LLC, C.A. No. 8028-VCP, 2014 WL 7232276 (Del. Ch. Dec. 18, 2014).

The non-managing members of Dunes Point West, LLC ("Dunes Point"), a Delaware LLC that owned an apartment complex in Kansas, sued PWA, LLC ("PWA"), a Kansas LLC that served as managing member of Dunes Point, and Katz, the managing member of PWA. The plaintiffs alleged that the actions of Katz and PWA breached Dunes Point's operating agreement and fiduciary duties owed by PWA and Katz. PWA and Katz moved to dismiss for failure to state a claim. The plaintiffs moved for summary judgment, arguing that the defendants' actions justified removal of PWA from its position as managing member. The court denied the defendant's motion to dismiss with respect to four of the plaintiffs' claims but granted the motion on the plaintiff's claim for waste. The court found that the complaint contained sufficient facts from which it could be inferred that PWA breached the operating agreement by allegedly paying management fees in violation of the agreement, by providing misleading financial reports, and by mismanaging Dunes Point. The complaint also contained facts supporting a claim that the defendants breached their fiduciary duties by engaging in self dealing and mismanagement. The defendants argued that the fiduciary-duty claims should be dismissed because they were essentially contract claims, but the court found that the fiduciary duty claims were broader in scope than the contract claims. The court pointed out that Katz was not a party to the operating agreement so that the claims against him could not constitute breach of contract claims. The court also found that PWA's duty of loyalty could be implicated by alleged self dealing and that allegations of mismanagement could amount to gross negligence such that non-exculpated breaches of the duty of care could be implicated. The court dismissed the waste claim because the standard for waste is very high and was not satisfied by the plaintiffs' allegation that the defendants charged somewhat lower rent than the alleged market rate for comparable apartments. The court denied the plaintiffs' motion for summary judgment because there were genuine issues of material fact as to whether the defendants improperly commingled tenant security deposits or whether the "key person" provision was violated by Katz's failure to remain actively involved in the management of the apartment complex.

Seaport Village Ltd v. Seaport Village Operating Company, LLC, C.A. No. 8841-VCL, 2014 WL 4782817 (Del. Ch. Sept. 24, 2014).

An LLC prevailed in an action brought against it by a member, and the LLC sought to enforce a fee-shifting provision in the LLC agreement. The LLC agreement provided for the recovery of reasonable attorney's fees, costs, and expenses by the prevailing party in an action arising out of the agreement brought by a party to the agreement against another party to the agreement. It was undisputed that the LLC was the prevailing party, that the action arose out of the agreement, and that the amount requested was reasonable. The only defense asserted was that the LLC was not a "party" to the agreement because it did not sign the agreement. This defense failed as a matter of law. Section 18-101(7), which was added to the Delaware Limited Liability Company Act in 2002, provides that an LLC is not required to execute its LLC agreement and is bound by its LLC agreement whether or not it executes the agreement. This provision of the LLC statute codified the Delaware Supreme Court's 1999 decision in *Elf Atochem North America, Inc. v. Jaffari*. In 2005, the Delaware General Assembly added language to the LLC statute clarifying that members are also bound by the LLC agreement regardless of whether they execute the operating agreement. These amendments make clear that the LLC and its members are parties to the LLC agreement whether or not they sign it. Since the LLC in this case was a party to its LLC agreement, it could enforce the fee-shifting provision.

Gagne v. Gagne, 338 P.3d 1152 (Col. App. 2014).

Paula and Richard Gagne, mother and son, were the members of four LLCs, each of which owned apartment complexes. Richard filed an action for judicial dissolution of the LLCs, declaratory relief, and appointment of a receiver, and Paula asserted numerous counterclaims. The trial court granted partial summary judgment against Richard on his judicial dissolution claim on the basis that the LLC agreements provided a means of navigating around membership deadlock and the purpose of the LLCs, i.e., to operate apartment complexes, could profitably continue in accordance with the LLC agreements even in the absence of cooperation between the parties. The case proceeded to trial on the merits, and both parties appealed.

The court of appeals agreed with Richard that the trial court erred in granting summary judgment on his claim for judicial dissolution. The Colorado LLC statute provides that an LLC may be dissolved in a proceeding by or for a member or manager "if it is established that it is not reasonably practicable to carry on the business of the limited liability company in conformity with the operating agreement" of the LLC. As a matter of first impression in Colorado, the court of appeals determined that this standard requires a party seeking judicial dissolution to "establish that the managers and members of the company are unable to pursue the purposes for which the company was formed in a reasonable, sensible, and feasible manner." The test is whether it is "reasonably practicable to carry on the business of the LLC, not whether it is impossible to do so." Factors to be considered– no one of which is necessarily dispositive, and all of which are not required– include: (1) whether the management is unable or unwilling to reasonably permit or promote the purposes for which the company was formed; (2) whether a member or manager has engaged in misconduct; (3) whether the members have clearly reached an inability to work with one another to pursue the company's goals; (4) whether there is deadlock between the members; (5) whether the agreement provides a means of navigating around the deadlock; (6) whether, due to the company's financial position, there is still a business to operate; and (7) whether continuing the company is financially feasible. The court pointed out that the language in the LLC statute is not the same as that in the corporate and limited partnership statutes, and the court thus rejected the argument that LLCs may be dissolved solely based on oppressive conduct, like corporations, or solely based on substantial misconduct, like partnerships. Applying this standard to the case at hand, the court of appeals concluded that there were genuine issues of material fact precluding summary judgment on Richard's judicial dissolution claim. The court acknowledged that there was no evidence that the LLCs were financially unfeasible, but there was nevertheless substantial evidence raising a genuine issue of material fact as to whether Paula and Richard could pursue the purposes for which the LLCs were formed in a reasonable, sensible, and feasible manner. There was evidence of misconduct on the part of Paula and extreme dysfunction between the parties, including physical altercations. The evidence also raised fact issues as to whether there was a deadlock and whether the LLC agreements provided a mechanism for navigating a deadlock. The LLC agreements provided for mediation in certain circumstances, but mediation had already failed. Although Paula was Chief Executive Manager and had a 51% voting interest and the undisputed right to sell the assets, it was not clear that the LLC agreements gave Paula the unilateral right to control all management of the properties. For example, the agreements required unanimous agreement to hire and fire a new property manager. The court of appeals thus reversed and remanded for further consideration of the judicial dissolution claim under the standard pronounced by the court.

Richard and Paula each appealed aspects of a declaratory judgment entered by the trial court regarding a provision of the LLC operating agreement that addressed the rights and obligations of Paula, Richard, and a property management company owned and operated by Richard and his wife.

The court of appeals concluded that the provision was ambiguous and that further findings were necessary regarding the parties' intent. Under the provision, Richard's company was responsible for property management of the LLCs' assets for a period of 24 months at a stated rate of compensation, and there were provisions regarding extension and renewal and a right of first refusal by Richard's company. The court of appeals agreed with the trial court that the provision at issue was "difficult, poorly drafted and to some extent contradictory" and stated that various parts of the provision lent themselves to "a myriad of reasonable interpretations" such that remand was necessary so that evidence could be offered to allow the trial court to determine the parties' intent. The court also addressed Richard's contention that minutes of a week-long meeting between him and Paula replaced all or part of the provision at issue. The court of appeals agreed with the trial court that at most the minutes reflected an amendment to the rate of compensation to be paid to Richard's company after expiration of the initial 24-month term and that the minutes did not reflect an intent to effect a wholesale amendment to central aspects of the LLC agreements.

In re Marriage of Schlichting, 19 N.E.3d 1055 (Ill. App. 2014).

In the divorce of Larisa and Bruce Schlichting, Larisa appealed the trial court's order disposing of Larisa's 20% membership interest in an LLC of which she and other family members of Bruce were members but Bruce was not. The operating agreement had a buyout procedure in the event of a member's divorce under which the LLC would purchase a divorcing member's interest at a valuation that involved a determination by the LLC's accountant. The trial court determined that Larisa's membership interest was marital property and divided and awarded "the potential cash distribution" from Larisa's interest in the LLC 65% to Larisa and 35% to Bruce, which was in accordance with the 65/35 split applied to the entire marital estate. Larisa moved to set the value of the LLC based on deposition testimony of the LLC's accountant. Based on the accountant's $150,000 valuation, Larisa's cash distribution would be $19,500, and Bruce's would be $10,500. Bruce believed the value of the LLC was significantly higher, and he thus requested that the court order Larisa to sell her interest to Bruce for $19,500 so that he could then pursue litigation with the LLC and establish a higher value. Larisa opposed Bruce's request, arguing that it would violate the operating agreement, which contained a provision prohibiting Larisa or any other member from transferring a membership interest without unanimous written consent of the other members. Larisa testified that the other members did not want Bruce to be part of the LLC and did not approve of her transferring rights to Bruce. Because Larisa was already a 20% member, Larisa argued that she could pay Bruce for his share of the cash distribution from her interest without having to get approval from the other members. Larisa proposed that she rather than the LLC should provide Bruce with the $10,500 payment, thus allowing her to retain her 20% membership interest. The trial court ultimately ordered that Larisa sell her membership interest to Bruce for $19,500. Upon payment by Bruce to Larisa, the order awarded all of Larisa's membership interest and rights and responsibilities under the LLC operating agreement to Bruce so that he could pursue litigation with the LLC over the value of the interest.

On appeal, the court first determined that the trial court ordered Larisa to violate the operating agreement when it ordered her to sell her membership interest to Bruce without the unanimous consent of the other members. Contrary to the transfer restriction in the operating agreement and the provision requiring the LLC to buy out a divorcing member's interest, the trial court ordered Larisa to sell her membership interest to Bruce without consent of the other members. The court also addressed a misinterpretation by Bruce and the trial court of the buyout provision of the operating agreement that applied in the divorce context. The LLC operating agreement provided

for a buyout of the divorcing member's interest at the greater of the value established by the LLC's accountant or the value determined by the divorce court. If the divorce court set a value higher than the accountant's value, the divorcing member was required to pay the LLC the difference in the valuation. The court of appeals explained that this provision required the divorce court to make a valuation determination and required payment by the LLC for Larisa's membership interest based on the greater of the court's valuation or the LLC accountant's valuation. When the divorce court divided the cash distribution for Larisa's membership interest, Bruce would receive payment for his share based on the higher valuation, but the divorcing member (i.e., Larisa) would be required to pay the LLC the difference between the court's valuation and the accountant's valuation if the court's valuation was higher. Bruce mistakenly believed that it would be futile to provide evidence of a higher valuation in the divorce proceeding because he believed he would be required to reimburse the LLC for a payment in excess of the accountant's valuation, but the operating agreement imposed that obligation on Larisa as the divorcing member. Thus, the trial court did not need to require Larisa to sell her membership interest to Bruce to allow Bruce to pursue a higher valuation.

Having determined that the trial court ordered Larisa to violate the operating agreement and that it was not necessary to do so to allow Bruce to pursue a higher valuation, the court of appeals explained that the trial court's order was an abuse of discretion. The court stated that no Illinois case requires a court to distribute marital property in accordance with an operating agreement binding on one or both parties in their business activities, but the court stated that case law establishes that failure to do so when compliance is easily possible is an abuse of discretion. The court discussed the nature and role of buy-sell agreements and discussed developing case law within and outside Illinois concerning the avoidance of potential conflict between marital dissolution orders and business operating agreements. The court saw no reason in this case to enter an order conflicting with the terms of the operating agreement when the agreement specified the valuation process in the event of a divorce and allowed for a nonmember spouse to contest the valuation during the divorce proceeding. Bruce was entitled to a portion of the cash value of the membership interest, but not an actual membership interest. Because the trial court's order was stayed during appeal, the court of appeals did not have to order the "undoing" of any transaction. The court of appeals concluded that the most efficient way to compensate Bruce for his 35% interest under the circumstances of this case was to order Larisa to pay Bruce $10,500 for his claim with respect to Larisa's membership interest. Bruce was bound by the accountant's valuation because he chose not to offer any evidence of valuation. The court stated that Larisa could accomplish the payment to Bruce with personal funds or by forcing the LLC to buy her out under the terms of the operating agreement.

In re Galaz (Galaz v. Galaz), 765 F.3d 426 (5th Cir. 2014).

Lisa Galaz brought an adversary proceeding against her ex-husband, Raul Galaz, for fraudulently transferring the assets of an LLC in which Lisa owned a 25% economic interest. In Lisa and Raul's divorce, they executed a divorce decree under which Raul assigned half of his LLC 50% interest to Lisa. The transfer occurred in violation of the operating agreement without the other member's consent, and Lisa therefore received a 25% economic interest with no management or voting rights. Raul, as manager of the LLC, transferred the assets of the LLC to another entity that he formed with his father. The bankruptcy court found that the transfer was invalid under the Texas Uniform Fraudulent Transfer Act and awarded Lisa a judgment for damages against the defendants. One of the contentions in this appeal by Raul and the transferee entity was that the bankruptcy court should have referred Lisa's claims to arbitration pursuant to a provision in the LLC operating agreement. The court rejected this argument because Lisa was not a party to the operating

agreement. The operating agreement referred to the "parties" as the LLC's "Members," and Lisa held only an economic interest. The court stated that the Fifth Circuit has recognized limited circumstances in which a nonsignatory may be bound by an arbitration agreement, but there was no argument or evidence suggesting how Lisa, neither a member nor a party, was bound by the arbitration provision.

Levy v. Carolinian, LLC, 763 S.E.2d 594 (S.C. 2014).

After obtaining a $2.5 million judgment against an LLC member, the judgment creditors obtained a charging order against the member's interest and purchased the interest at a foreclosure sale for $215,000. The LLC was represented at the foreclosure sale, but the judgment creditors outbid the LLC. The South Carolina LLC statute provides that a charging order is the exclusive remedy by which a judgment creditor may satisfy a judgment out of the judgment debtor's distributional interest, and a charging order constitutes a lien that may be foreclosed at any time by order of a court. Both the South Carolina statute and the operating agreement provided that the LLC had the right to redeem the judgment debtor's interest at any time prior to foreclosure. The operating agreement also provided that a creditor who obtained any part of a member's interest by charging order could only become a member with the written consent of all members after the transfer and that such a transferee had no right to vote or participate in the management of the LLC. These provisions were consistent with the provisions of the South Carolina statute regarding a distributional interest and the rights of a transferee. Neither the LLC nor its members redeemed the judgment debtor's interest before the foreclosure sale, and the judgment creditors did not seek to be admitted as members of the LLC. After the foreclosure sale, the LLC asserted that provisions of the operating agreement gave the LLC the right to force the judgment creditor to sell the interest to the LLC. The LLC relied on Article 11 of the operating agreement, which contained restrictions on transfer of a member's interest. Section 11.1 of the operating agreement contained a provision that prohibited a member from voluntarily or involuntarily selling, transferring, hypothecating, or otherwise conveying any portion of the member's interest without the prior written consent of members having 67% of the voting rights. Section 11.1 also stated that any attempted conveyance or encumbrance by a member without the required consent was null and void. Section 11.2 provided that a member who attempted to transfer all or a portion of his interest without obtaining the other members' consent was deemed to have offered to the LLC all of the member's interest. The judgment creditors argued that the ability of the LLC to redeem the judgment debtor's interest was extinguished by the foreclosure sale and that Article 11 did not compel the judgment creditors to sell their interest to the LLC. The supreme court agreed with the judgment creditors. The court pointed out that, consistent with the LLC statute, the operating agreement provided that a member's interest may be redeemed at any time prior to the foreclosure sale, and the court reviewed the provisions of the South Carolina LLC statute relating to transfer of a distributional interest and the rights of a transferee. The court noted that the operating agreement is the essential contract governing the affairs of an LLC, but the operating agreement may not restrict the rights of a person other than a manager, member, and transferee of a member's distributional interest. The supreme court concluded that Article 11 did not apply to the judgment creditors before they became transferees and did not restrict them from foreclosing their charging order lien. The court pointed out that the transfer restrictions in Section 11.1 applied only to "members," and the judgment creditors merely became transferees. Further, they were not even transferees until after the foreclosure sale. Thus, the court stated that the operating agreement could not restrict the statutory rights of the judgment creditors by requiring consent of the LLC or its members before the foreclosure sale, and the restrictions of Section 11.1

did not apply to the judgment creditors at the time they foreclosed their charging order lien. Further, because they were not required to obtain consent under Section 11.1, the court concluded that the LLC could not invoke a right to purchase under Section 11.2. In sum, the court held that the LLC's ability to purchase the judgment debtor's interest was not controlled by any part of Article 11, but rather by Section 3.5, which provided the opportunity to purchase the interest before the foreclosure sale. The court noted that the LLC also had the opportunity to obtain the interest at the foreclosure sale itself, and this opportunity was limited only by the LLC's decision not to outbid the judgment creditor.

Seven Hills Commercial, LLC v. Mirabal Custom Homes, Inc., 442 S.W.3d 706 (Tex. App. 2014).

Five entities entered into an amended and restated LLC operating agreement that listed three of the entities as members and identified one of the entities as a former member and one of the entities as a former manager. One of the member entities was named as manager of the LLC. Three individuals signed the agreement one or more times in representative capacities for the five entities. The LLC sued the three entity members and two individuals whom the LLC alleged participated in one member's breach of fiduciary duty and tortious interference with the operating agreement. The defendants and other parties and signatories to the operating agreement asserted various cross claims and counterclaims. Some of the parties to the lawsuit sought arbitration pursuant to an arbitration clause in the LLC operating agreement, and the parties disputed whether the arbitration clause was binding on all the parties to the lawsuit, whether the claims asserted fell within the scope of the arbitration clause, and who could enforce the arbitration clause. The court of appeals held that a member and former manager who were parties to the operating agreement, as well as a nonparty individual, could compel arbitration of another member's claim for money had and received against them. The individual who was not a party to the operating agreement was entitled to compel arbitration of the claim against him because he signed the operating agreement as an agent for a party. The court analyzed claims by an individual and his entity (the former member) against an individual and two of that individual's entities (one of whom was the former manager), and the court concluded that the latter could not compel the claims to arbitration. The court of appeals next addressed the LLC's claims against one of the members and an individual who signed the operating agreement as representative of that member and allegedly participated in the member's breach of fiduciary duty and tortious interference with the operating agreement. The court determined that the member and the individual (whose acts at issue were taken in a representative capacity for the member) clearly agreed to allow the arbitrator to decide the arbitrability of the claims and that the LLC could compel arbitration of its claims even though it was not a signatory to the operating agreement. The court relied on a case involving a law firm partnership agreement in deciding that the LLC could enforce the arbitration clause in the operating agreement even though it was not a signatory. The operating agreement, like the law firm partnership agreement in the other case, created an ongoing relationship between the signatories and the entity and governed the operation and existence of the entity. The court pointed out that the Texas Business Organizations Code provides that the company agreement of an LLC governs "the relations among members, managers, and officers of the company, assignees of membership interests in the company, and the company itself." The court interpreted this provision to mean that the company agreement governs the relationships between the LLC and its members, and the court did not believe that the LLC was required to sign the operating agreement in order to enforce the arbitration provision in the agreement.

Chou v. Chilton, 2014 WL 2154087, __ S.W.3d __ (Ky. App. 2014).

Richard Chilton, Mark Chilton, and William Chilton formed an LLC with Li An Chou. In order to qualify the LLC as a minority owned business (MBE), Chou was granted a 51% interest and was appointed the president and managing member. The Chiltons owned the remaining 49% among them. The Chiltons had a construction company that operated in the same environment as the LLC, and the LLC was eventually decertified as an MBE, in part because of lack of documentation that it was a separate entity and not merely a conduit for transactions of the Chiltons' company. The Chiltons blamed Chou, claiming he was not capable of running the business and did not want to learn, and Chou argued he was shut out of the operations and existed only as a figurehead for the Chiltons to secure MBE-related contracts. Chou brought an action in his individual capacity against the Chiltons and sought various remedies, including relief for breach of the duty of good faith and fair dealing implied in the LLC operating agreement, misappropriation, and misrepresentation. The trial court dismissed Chou's complaint on the basis that the LLC rather than Chou was the real party in interest and that Chou lacked standing to bring the claims. The court of appeals stated that the claim for breach of the covenant of good faith and fair dealing related to the operating agreement, which was an agreement among Chou and the Chiltons, and their agreement specifically allowed members to sue other members for fraud, gross negligence, or an intentional breach of the agreement. The court stated that whether the claim for breach of the covenant of good faith and fair dealing was intentional was a question for the trier of fact, but Chou had standing to bring the claim against the Chiltons since they were all parties to the agreement. The claim for misrepresentation was a claim for fraud, and since the operating agreement allowed members to bring claims against other members for fraud, the court concluded that Chou had standing to assert this claim.

Dinuro Investments, LLC v. Camacho, 141 So.3d 731 (Fla. App. 2014).

The issue in this case was whether the plaintiff, an LLC member, had standing to bring a claim individually as opposed to derivatively against two other members for alleged violations of the LLC operating agreement that left the LLC worthless and deprived the plaintiff of the value of the plaintiff's investment. In essence, the plaintiff alleged that the other two members and their individual owners intentionally allowed the LLC to default on its indebtedness so that they could purchase the loans at a discount and foreclose on the mortgaged properties, thus depriving the LLC of its sole assets. The court reviewed Florida case law and attempted to synthesize 50 years of case law in the courts of appeals in the absence of an established rule by the Florida Supreme Court for determining when an entity's owner may sue directly versus derivatively. The court characterized the case law as "opaque," "varying," and "divergent" and concluded that the only way to reconcile the case law was to hold that an action may be brought directly only if (1) there is a direct harm to the shareholder or member such that the alleged injury does not flow subsequently from an initial injury to the company, and (2) there is a special injury to the shareholder or member that is separate and distinct from those sustained by the other shareholders or members. However, the court also concluded that there was an exception to this rule under Florida law so that a member or shareholder need not satisfy this two-pong test if there is a separate statutory or contractual duty owed by the defendant to the plaintiff. Applying Florida law to the facts of this case, the court concluded that the plaintiff did not allege a direct harm and thus did not satisfy the two-prong test. The plaintiff sought to establish that the separate duty exception was met based on the operating agreement. The court noted that an operating agreement is a more complicated and nuanced set of contractual rights and duties than a typical bilateral contract. The LLC statute provides that the operating agreement governs the relations among the members, managers, and company, and the precise terms of the

agreement are important in determining whether an individual member owes the other members any duties or merely owes the company duties. The operating agreement in this case contained a provision outlining certain conduct that constitutes a default under the agreement and the effects of a default. The agreement specified certain remedies for a member's default and also provided that the members and company could elect to pursue remedies provided under the agreement "or any other remedies available at law or in equity." The plaintiff argued that this language provided for a direct action by a member against another member for breach of the agreement. The court disagreed. The specific remedies provided by the agreement were termination of a defaulting member's interest and a preemptive right to buy out the member's interest. The court said that the ability to pursue other remedies simply allowed pursuit of additional remedies consistent with Florida statutory and common law but did not expand the member's rights beyond the rights currently available under Florida law. The court found it significant that a provision stating that members are directly liable to one another was conspicuously missing from the operating agreement. According to the court, the statutory limitation on a member's liability for involvement with the LLC precluded a member from suing another member directly for breach of the agreement.

MPT of Hoboken TRS, LLC v. HUMC Holdco, LLC, C.A. No. 8442-VCN, 2014 WL 3611674 (Del. Ch. July 22, 2014).

MPT of Hoboken TRS, LLC ("MPT Hoboken") and HUMC Holdco, LLC ("Holdco") were the sole members of an LLC governed by an LLC agreement under which Holdco was the "General Manager" charged with management of the business and operations of the LLC. In certain events, MPT Hoboken or its designee, as "Special Manager," could assume certain powers. Holdco caused the LLC to establish a board of directors, and the board adopted bylaws granting the board purported management rights over the LLC. These actions were not reviewed or approved by MPT Hoboken, and MPT Hoboken (and related entities) sued Holdco and the LLC seeking a declaratory judgment that Holdco violated the LLC agreement by creating the board when the LLC agreement vested management in a manager. Holdco designees comprised nine of the fourteen board votes, and the bylaws provided that Holdco could modify or reject any action proposed by the board and could compel the board to take action. The court stated that the bylaws facially conflicted with the LLC agreement because the LLC agreement vested exclusive management authority in Holdco as the General Manager while the bylaws gave the board certain managerial rights. However, the facial conflict was not dispositive because there was an issue as to whether the board structure could fall within the LLC agreement provision permitting "advisory committees." The court found that the board structure could fall within one meaning of the term "advisory committee" because Holdco maintained management authority through its majority voting representation on the board and its ability to veto, modify, or compel board actions. On the other hand, requiring Holdco to compel the board to act or modify the board's actions could also exceed a reasonable interpretation of an "advisory committee." Because the pleadings and incorporated documents did not contain dispositive evidence of the parties' intent with regard to an "advisory committee," the court held that the meaning of "advisory committee" was an issue of material fact, and the court denied MPT Hoboken's motion for judgment. The defendants claimed that Holdco still exclusively managed the LLC and that the plaintiffs' claim was not ripe because they did not allege any current or imminent harm due to the board structure or the bylaws. The court has authority pursuant to the Delaware LLC statute to determine the right of a person to become or continue to be a manager of an LLC. In addition to other requirements for a declaratory judgment action, the court must find the issue is ripe for judicial determination. The court found that the dispute over whether the bylaws granted the

board managerial rights beyond those of an advisory committee put a "cloud" over the LLC's management, and the court noted that the bylaws did not address how the LLC would be governed if MPT Hoboken exercised the power it had under certain circumstances to remove Holdco as General Manager. The court held that the risk of future harm was sufficient to warrant a resolution, and the claim was ripe for judicial determination. Because the meaning of "advisory committee" remained an issue of material fact, the court denied the defendants' motion to dismiss.

Comerica Bank v. Global Payments Direct, Inc., C.A. No. 9707-CB, 2014 WL 3567610 (Del. Ch. July 21, 2014).

The parties, a bank and a payment processor, formed a Delaware LLC to process credit and debit card transactions. The bank owned a 49% membership interest, and the processor owned a 51% membership interest, and their relationship was governed by several related agreements executed when the venture began. The bank, which was a member of the Visa and MasterCard associations, agreed to refer merchants exclusively to the LLC, and the processor was to be the exclusive processor for the LLC. Upon the expiration of the service agreement, the bank elected not to renew the service agreement, and the processor elected to dissolve the LLC, as it had a right to do in the event of termination of the service agreement. The parties agreed to an extension of certain services under the service agreement to aid in the transition of the merchant portfolio, but disputes arose in connection with the winding up of the LLC. The bank filed suit seeking a declaration that the bank's exclusivity obligations terminated upon termination of the service agreement and that non-competition obligations contained in contribution agreements between the parties ended upon the LLC's dissolution or termination of the service agreement. Despite an integration clause in the service agreement, the court concluded that the service agreement should be read together with the LLC agreement and contribution agreements between the parties based on the rule that contemporaneous contracts between the same parties concerning the same subject matter should be read together. The court discussed the terms of the agreements in detail and rejected the processor's argument that the exclusivity obligations survived termination of the service agreement and applied during the transition period. The court held that the terms and conditions of the service agreement that were necessary to perform services during the transition period and were requested to be extended by the bank would be extended, but terms and conditions that would hinder the transition of services terminated with the service agreement. Additionally, as provided by the contribution agreements, the non-competition obligations ended upon termination of the service agreement.

Branin v. Stein Roe Investment Counsel, LLC, C.A. No. 8481-VCN, 2014 WL 2961084 (Del. Ch. June 30, 2014).

An employee of the defendants sought indemnification under the LLC agreement of one of the defendants, Stein Roe Investment Counsel LLC ("Stein Roe"). Before joining Stein Roe, the plaintiff was a principal/owner and the CEO of another investment management firm. During that time, the plaintiff's firm was acquired by Bessemer Trust, N.A. ("Bessemer"). This acquisition was governed by a doctrine of New York law that prevented the plaintiff from soliciting his former clients (the "*Mohawk* Doctrine"), although the plaintiff could accept business from former clients if they approached him. At Stein Roe the plaintiff managed 30 clients that he previously managed while at Bessemer, and Bessemer sued the plaintiff under the *Mohawk* Doctrine. When the plaintiff joined Stein Roe, and at the time Bessemer sued the plaintiff, Stein Roe's LLC agreement provided broad indemnification rights that applied to employees of Stein Roe. This indemnification provision provided indemnification "[t]o the full extent permitted by applicable law" for acts or omissions

taken on behalf of Stein Roe in "good faith" and "in a manner reasonably believed to be within the scope of the authority conferred" by the LLC agreement. After Bessemer sued the plaintiff, Stein Roe amended the indemnification provision of its LLC agreement to exclude claims based on actions by an employee that may have breached a contract between the employee and a third party that predated the employee's employment with Stein Roe. The defendants asserted that the amended indemnification provision applied and precluded the plaintiff's claim. The court analyzed when an indemnification cause of action accrues, whether it accrues irrevocably even though an indemnitee is on notice that the agreement providing for indemnification may be modified, and whether the defendants could defeat the plaintiff's indemnification claim by later amending the LLC agreement if the plaintiff had a valid claim for indemnification when Bessemer sued him. Although the court recognized that Stein Roe could amend its LLC agreement, the court concluded that the plaintiff became entitled to indemnification under the indemnification provision in effect at the time Bessemer sued him, and the subsequent amendment of the indemnification provision did not operate to unilaterally rescind this matured liability to the plaintiff. The court noted that the Delaware LLC statute establishes no criteria governing indemnification by LLCs and provides broad contractual freedom to define indemnification rights. The indemnification provision in effect when the plaintiff was hired gave no indication of how to treat a claim that arose under that provision but that might be precluded under a subsequent amendment. The court discussed policies justifying indemnification as set forth in several corporate cases, and the court identified circumstances in this case consistent with the policy behind the earlier, broader indemnification provision. Before being hired by Stein Roe, the plaintiff had discussed with Stein Roe's president and CEO the possibility of bringing over the plaintiff's former clients and the possible impacts of the *Mohawk* Doctrine, and, as anticipated, Stein Roe benefitted from the plaintiff's clients. Furthermore, at the time of the plaintiff's conduct giving rise to Bessemer's claim, the plaintiff reasonably anticipated he would have the protection of the indemnification provision despite the language in the LLC agreement allowing for modification of the LLC agreement. The court also noted that the amended LLC agreement did not purport to modify or eliminate any liability that already existed. In light of the language of the indemnification provision and case law that generally protects indemnitees and looks to the indemnification provisions in effect when the events giving rise to the claim occurred or the time when the lawsuit on the claim is filed, the court held that the plaintiff established a right to pursue a claim for indemnification. Thus, if the plaintiff satisfied the other substantive requirements of the indemnification provision (acting in good faith and in a manner reasonably believed to be within the scope of his authority), Stein Roe's liability for the claim was fixed before the amendment of the indemnification provision, which did not modify or eliminate any liability that already existed. The court rejected the defendants' claim that the plaintiff was sued in his personal capacity or by reason of his employment with Bessemer, relying on corporate case law in which the Delaware Supreme Court has stated that "'proceedings are 'by reason of the fact' that one was a corporate officer'" if there is a "'nexus or causal connection'" between the proceedings and a person's official capacity. The plaintiff, as an employee of Stein Roe, created tangible benefits for Stein Roe because of his contacts and client accounts. Thus, a "nexus or causal connection" existed. Nevertheless, the court dismissed the plaintiff's motion for judgment on the pleadings because the parties disputed the fact question of whether the plaintiff acted in good faith and in a manner he reasonably believed to be within the scope of his authority.

Durham v. Grapetree, LLC, C.A. No. 7325-VCG, 2014 WL 1980335 (Del. Ch. May 16, 2014).

An LLC member, one of five siblings who owned equal interests in the LLC and the only non-managing member, sued the LLC for reimbursement of expenses allegedly incurred for the benefit of the LLC. The plaintiff and the LLC disagreed as to whether the plaintiff was entitled to reimbursement for certain expenses incurred by the plaintiff for maintaining the landscaping of vacation rental properties owned by the LLC. Both parties contended that the language of the LLC agreement governed their dispute. According to the court, the language of the LLC agreement, which stated that "[f]or all routine operational issues[,] the majority vote of (3/5) [sic] of the managing members may make all decisions," was ambiguous when applied to the plaintiff's claim for reimbursement. The court thus examined the course of dealing in order to determine the parties' intent. Because some of the expenditures made by the plaintiff were routinely made by other members and reimbursed by the LLC without any vote of the managing members, the court concluded that the plaintiff was entitled to seek reimbursement for those types of expenses.

Thomas v. Bozick, 92 A.3d 614 (Md. App. 2014).

Thomas was the managing member of an architectural firm (George, Miles & Buhr, LLC or "GMB") as well as a member of an LLC that owned and leased the property occupied by the architectural firm (GMB Plaza, LLC or "GMB Plaza"). On December 31, 2010, Thomas retired as managing member of GMB, thus triggering his involuntary withdrawal from GMB Plaza under the GMB Plaza operating agreement as well as a provision in the operating agreement that gave GMB Plaza an option to purchase Thomas's membership interest within 60 days at a formula set by the operating agreement. The remaining members of GMB Plaza met in February 2011 and decided that the value of the property as determined by the formula under the operating agreement (approximately $1.2 million) was no longer representative of the fair market value of the property. This conclusion was based on two appraisals obtained in September 2010 when Thomas was still managing member of GMB Plaza. Using the sales approach and the income approach, the September 2010 appraisals valued the property at $875,000 and $760,000, respectively. As a result of these appraisals, GMB Plaza declined to exercise its option to purchase Thomas's interest in GMB Plaza. In addition, the new managing member of GMB requested that GMB Plaza reduce the rent it was charging GMB retroactive to the beginning of 2011. The members of GMB Plaza unanimously approved the request for a reduction in rent at the February 2011 meeting. In order to determine the true value of GMB Plaza, the members commissioned a second set of appraisals. Using the sales approach and the income approach, these appraisals valued the property at $830,000 and $700,000, respectively. In July 2011, GMB Plaza offered to purchase Thomas's interest based on a property value of $760,000, slightly less than the averages of the valuations under the sales and income approaches. Thomas rejected this offer. In October 2011, the members of GMB Plaza voted to dissolve GMB Plaza and sell the property to a newly formed entity, GMB Properties, for $765,000, the average of the valuations under the sales and income approaches. The members of GMB Properties were the remaining members of GMB Plaza and an additional member who did not own an interest in GMB Plaza. After the sale of the property by GMB Plaza to GMB Properties, Thomas was notified of the sale and the dissolution of GMB Plaza. He received a distribution check for his share of the liquidation proceeds based on his interest in GMB Plaza. Upon receiving the notice and liquidating distribution, Thomas filed suit against the members of GMB Plaza alleging that they breached the operating agreement by failing to include Thomas in meetings and decisions concerning the sale of the property, changing the valuation method and selling the property, and reducing the rent. The trial

court granted summary judgment in favor of the defendants on the basis that Thomas ceased to be a member of GMB Plaza upon his retirement and thus was not entitled to notice of member meetings, that the remaining members could determine the value of the property without Thomas's consent, and that there was no genuine dispute as to the fair market or fair rental value of the property. Thomas appealed.

On appeal, the court first addressed Thomas's argument that he retained all of his membership rights in GMB Plaza after GMB Plaza declined to exercise the purchase option. The court analyzed the language of the operating agreement along with provisions of the Maryland LLC statute and concluded that Thomas's membership in GMB Plaza ceased upon his retirement and that his status became one of an assignee of an economic interest. Under GMB Plaza's operating agreement, Thomas's retirement from GMB caused an involuntary withdrawal of Thomas from GMB Plaza (no member had the power to voluntarily withdraw from GMB Plaza), and an involuntary withdrawal triggered GMB Plaza's option to purchase a member's interest on an involuntary withdrawal. Because GMB Plaza's operating agreement was silent as to what happens if GMB Plaza elects not to purchase an involuntarily withdrawn member's interest, the court looked to the Maryland LLC statute, which provides that a person who ceases to be a member of an LLC is deemed to be an assignee of the person's membership interest if the LLC elects not to completely liquidate the member's interest. Thomas argued that he necessarily owned and retained his voting and participation rights because the operating agreement required that he offer to sell his "Membership Rights" and defined "Membership Rights" as including the right to vote and participate in management of the LLC. The court concluded, however, that to retain his membership rights, Thomas would have to continue to be a member, and the operating agreement clearly provided that Thomas ceased to be a member of GMB Plaza when he ceased to be employed by GMB. Further, the provision specifying the purchase price referred to the purchase and sale of the "Member's Interest," which the operating agreement defined as a member's share of the profits and losses of, and right to receive distributions from, GMB Plaza. Thus, reading the provisions of the operating agreement together, the court concluded that it was clear that the 'Membership Rights owned of record and beneficially by the withdrawn Member" referred only to Thomas's "Interest" in GMB Plaza, which was defined as the economic interest. Thomas argued that the operating agreement superseded the provisions of the Maryland LLC statute that address liquidation of the interest of a person who ceases to be a member and the assignee status of a former member whose interest is not completely liquidated, but the court concluded that the operating agreement superseded only the statutory provision governing an LLC's election to purchase a withdrawn member's interest, not the provision that applies when an LLC declines to purchase the withdrawn member's interest. In sum, Thomas retained only his economic interest in GMB Plaza when he retired, and he thus had no right to vote on or participate in the management of GMB Plaza, including the decision to sell the property or to decide on the property's value.

The court next addressed Thomas's claim that the members of GMB Plaza breached the operating agreement by reducing the rent charged to GMB soas to decrease the property's appraised value under the income approach. Thomas argued that the rent reduction was intended to defraud him by artificially lowering the valuation of the property so that the payout to Thomas would be less than agreed under the operating agreement. The members contended that the operating agreement permitted the managing member to set the rent and that they relied on appraisals of the property performed in 2010 and 2011. The 2010 appraisal was performed while Thomas was still managing member of GMB Plaza and revealed that GMB's rental payments were 60% higher than market rates. Thomas offered no evidence to demonstrate that the rent reduction violated the operating

agreement or was not reflective of market rates. Thomas also offered no factual basis to support his assertion that the rent reduction was intended to defraud him or reduce the value of the property under the income approach. Thus, the trial court properly determined that the lowered rental rate was not a disputed material fact and that the rent reduction was appropriate.

The court of appeals also rejected Thomas's contention that the fair market value of the property was a disputed material fact. Thomas argued that the members of GMB Plaza breached the operating agreement by disregarding the previously agreed upon formula to determine fair market value of the property. The court of appeals pointed out that the previously agreed upon formula in the operating agreement applied to the purchase of Thomas's interest if the LLC elected to purchase Thomas's interest under the purchase option. After the LLC declined to exercise the purchase option, the remaining members complied with the provisions of the operating agreement that governed transactions such as the sale of the property. The members presented sufficient evidence of the property's fair market value to meet their initial burden as the party moving for summary judgment, and Thomas produced no evidence to the contrary. Thus, the court of appeals affirmed the trial court's summary judgment.

2009 Caiola Family Trust v. PWA, LLC, C.A. No. 8028-VCP, 2014 WL 1813174 (Del Ch. April 30, 2014).

The non-managing members of an LLC that owned and operated an apartment complex claimed that they had the right under the LLC agreement to terminate and replace the property manager. The non-managing members owned 90% of the LLC, and the managing member owned the other 10%. The non-managing members attempted to replace the property manager based on a majority vote of the non-managing members, but the managing member claimed that the non-managing members lacked the authority to replace the property manager. The applicable provision of the LLC agreement provided that the "prior written approval" of a majority of the non-managing members was required for a list of actions, including termination or retention of a property manager, and that the managing member of the LLC was required to "use all commercially reasonable efforts to carry out and implement" any of the listed decisions approved by the non-managing members. The non-managing members argued that the duty of the managing member to carry out and implement decisions approved by the non-managing members under this provision provided the non-managing members with the right to vote for the LLC to take such actions and obligated the managing member to implement the outcome of that vote. Applying Delaware contract interpretation principles, the court found that the provision at issue gave the non-managing members only a veto right over such actions. According to the court, the provision could not reasonably be read to give the non-managing members affirmative authority to mandate unilaterally that any of the listed actions be taken by the LLC. In support of its interpretation, the court pointed out that other provisions of the LLC agreement that gave the non-managing members the affirmative right to take action were worded differently. The court also explained how the non-managing members' interpretation conflicted with the general management scheme under the LLC agreement, which conferred broad authority on the managing member to manage the LLC. In addition, applying the non-managing members' interpretation of the provision at issue to a similarly worded provision that required prior written approval of all members for certain listed actions would lead to arguably absurd results, such as the unilateral ability of the non-managing members to modify the operating agreement. Finally, the court addressed a provision of the LLC agreement that specified that any provision of the agreement that would create any exposure to liability with respect to a non-managing member must be deemed stricken from the agreement. The court noted that if the

provision relied upon by the non-managing members gave them the ability to unilaterally dictate that the LLC take the listed actions, then the provision would likely have to be deemed stricken since the Delaware LLC statute characterizes a person who materially participates in the management of an LLC as a manager and such status could expose them to liability.

BUKE, LLC v. Cross Country Auto Sales, LLC, 331 P.3d 942 (N.M. App. 2014).

BUKE, LLC (BUKE) bought a GM car dealership and had access to GM credentials, known as a "badge," which allowed BUKE to purchase low-mileage GM vehicles at closed GM auctions. BUKE also had a GMAC credit line, also known as a "floor plan," that allowed BUKE to finance vehicles it purchased at low interest rates. Eastburg, the manager of BUKE and a 32.5% member, also managed and owned interests in other car dealerships. All of BUKE's members knew of Eastburg's involvement in the other car dealerships. Eastburg openly used the GM badges and credit line to purchase and finance vehicles for all of the dealerships he operated. BUKE sued Eastburg's other dealerships after late payments on the credit line caused GMAC to increase BUKE's interest rates. The trial court granted summary judgment in favor of the defendant dealerships on the basis that a majority of BUKE's members consented to Eastburg's use of BUKE's badge and credit line, and the court of appeals affirmed.

The court of appeals first analyzed the terms of BUKE's operating agreement and concluded that it permitted Eastburg to use the badge and credit line for the other dealerships with the consent of a majority of BUKE's members. The court stressed that the New Mexico LLC statute states a policy of giving maximum effect to freedom of contract. The statute states that a manager has the power to manage the LLC as provided in the articles of organization or operating agreement and requires a manager to account to the LLC for the use of LLC property absent consent of a majority of disinterested managers or disinterested members "[u]nless otherwise provided by the articles of organization or an operating agreement." BUKE's operating agreement gave the manager the exclusive right to control and manage BUKE but prohibited a manager from possessing or assigning BUKE's assets without the consent of a majority of the members. BUKE argued that the statutory requirement that a majority of disinterested managers approve a manager's "use" of LLC property governed rather than the provision of the operating agreement that required consent of a majority of BUKE's members for a manager to "possess" or "assign" BUKE's assets. The court was not persuaded by BUKE's argument, and, in any event, BUKE conceded that the operating agreement addressed the manager's "use" of BUKE assets by providing that "consent of a majority of BUKE's members is required to use the company assets for other than a company purpose." Given the provisions of the operating agreement, the court rejected BUKE's arguments that the "more specific" statutory provision requiring an affirmative vote of a majority of disinterested members applied and that the statute's default provisions applied unless "repugnant" to the terms of the operating agreement.

After concluding that Eastburg's use of the badge and credit line were authorized if he had the consent of a majority of BUKE's members as required by the operating agreement, the court proceeded to examine the summary judgment record to see if it established consent as a matter of law. The court pointed out that, unlike the statutory requirement BUKE had sought to invoke, the operating agreement did not provide specific requirements by which a manager must obtain member consent, such as prior, written, or express consent. Absent any modifier, the court concluded that "consent" simply means agreement, approval, or permission. The parties did not dispute that the question of whether a "majority" of the members consented was determined based on the members' ownership percentages. BUKE's four members and their ownership percentages were as follows:

Eastburg (32.5%), Urlacher (32.5%), Branch (20%), and Karger (15%). Based on the other members' knowledge that Eastburg was involved in the other dealerships, his open use of the badge and credit line, his discussion of the relationship between the dealerships and his use of the badge and credit line with the media, the knowledge of BUKE's staff and others of the arrangement, and the failure of any of BUKE's members to object for three years until the late payments on the credit line, the court concluded that a presumption of consent by a majority of BUKE's members arose. The only direct evidence BUKE relied upon to refute consent was Branch's deposition testimony that he did not know about or consent to Eastburg's use of the badge and credit line to purchase vehicles for other dealerships. BUKE did not present any affidavit or deposition testimony of Urlacher but simply asserted that it should be inferred based on Branch's testimony that Urlacher did not consent. BUKE did not refute the evidence that Eastburg was open about his use of the badge and credit line, and BUKE did not address the fact that Urlacher, along with Eastburg and Karger, was a member of another (non-defendant) car dealership that also benefitted from Eastburg's use of the badge and credit line. There was evidence that Karger consented to Eastburg's use of the badge and credit line for the defendant car dealerships, but the parties disputed whether this consent was conditioned on a promise by Eastburg to pay BUKE a fee for each vehicle bought at a closed GM auction. The court stated that this dispute was immaterial because, even assuming Karger consented only because of Eastburg's promise to pay the per vehicle fee, BUKE provided no summary judgment to support a reasonable inference that Eastburg and Urlacher, who together held a majority ownership interest, did not consent to Eastburg' use of BUKE's assets as he did.

LCM Holdings GP, LLC v. Imbert, 980 N.Y.S.2d 45 (App. Div. 1st Div. 2014).

The court held that the operating agreement of a Delaware LLC did not require the defendant to sell his membership interest to the plaintiffs. The plaintiffs relied on a provision that compelled the sale of a membership interest upon the termination of employment of an employee other than a manager. The defendant was a manager at the time of his termination, and the provision thus did not apply to him.

Kyle v. Apollomax, LLC, 987 F.Supp.2d 519 (D. Del. 2013).

O'Neill and Kyle formed a Delaware LLC in which O'Neill was an 85% member and Kyle was a 15% member. Under the written operating agreement for the LLC, O'Neill guaranteed that a substantial portion of his time would be spent on the day-to-day execution of business plans and growth, and Kyle guaranteed that a substantial portion of his time would be spent raising capital. The operating agreement provided for the removal of a member if the member was not substantially performing the promised services and a supermajority in interest of the members voted for removal. The relationship between O'Neill and Kyle deteriorated, and O'Neill sent Kyle a notice of failure to perform services as required by the operating agreement before a vote for removal could take place. After the sixty-day cure period required by the operating agreement elapsed, O'Neill, who held the requisite supermajority in interest voted to remove Kyle. Kyle's actions and his efforts to cure his deficiency were heavily disputed. Kyle brought suit alleging breach of fiduciary duty, conversion, breach of the operating agreement, and breach of the implied covenant of good faith and fair dealing, and the court granted summary judgment against Kyle on his claims for conversion and breach of the implied covenant but concluded that there was sufficient evidence for a jury to reasonably find for Kyle on the other claims and denied summary judgment on those claims.

Kyle's claim for breach of fiduciary duty was based on allegations that O'Neill excluded Kyle from the opportunity to participate in the formation of a new venture that supplanted the LLC as the

supplier for the LLC's major customer. The court discussed the sufficiency of Kyle's complaint and concluded that, while not a model of clarity, allegations regarding diversion of business opportunities and assets put the defendants on notice of the breach of fiduciary duty claim. The court then discussed the application of Delaware law to the fiduciary duty claim. The court noted that the Delaware LLC statute places a premium on freedom of contract and allows the parties to expand, restrict, or eliminate fiduciary duties. Because the operating agreement did not address fiduciary duties, default fiduciary duties of care and loyalty applied. The defendants conceded that the duty of loyalty applied, but they argued that the record did not contain evidence to support a breach. The defendants argued that Kyle precluded himself from participating in the new venture by failing to fulfill his obligations under the operating agreement. The court acknowledged that this might turn out to be true, but the court pointed out that Kyle was still a member during part of the discussions and Kyle put forth evidence that he was not offered the opportunity to participate in the new venture. Interpreting the facts most favorably to Kyle, O'Neill's decision not to include Kyle could have denied Kyle an opportunity he was owed and thereby resulted in a breach of the duty of loyalty. The defendants' motion for summary judgment was denied on this claim.

Kyle's claim for conversion failed because it arose solely from a breach of contract. Kyle based his conversion claim on the allegations that the defendants illegally froze Kyle out of the LLC's business operations, converted his interest in the LLC to their own personal use and benefit, excluded Kyle from the LLC's operations, and failed to pay Kyle for his ownership interest. These issues were covered by the operating agreement, and Kyle thus failed to allege an independent legal duty apart from the duty imposed by the operating agreement. Thus, the court granted the defendants summary judgment on the conversion claim.

Kyle's claim for breach of the operating agreement survived the defendants' motion for summary judgment. The parties disputed what actions Kyle performed and when he performed them relative to the process that resulted in his termination. The record showed that Kyle's performance fell somewhere between abject nonperformance and complete performance, and the operating agreement required substantial performance. Viewed most favorably to Kyle, a reasonable jury could conclude that Kyle had substantially performed, and these fact issues had to be determined at trial.

Kyle's claim for breach of the implied covenant of good faith and fair dealing did not survive summary judgment. A claim for breach of the implied covenant of good faith and fair dealing must be based on a specific implied contractual obligation to fill an unanticipated gap in the contract and a violation of the obligation that denied the plaintiff the fruits of the contract. Kyle's complaint alleged that the defendants alleged a failure to negotiate in good faith the fair market value of Kyle's interests, but his brief in opposition to summary judgment alleged instead that the breach resulted from the offer by the LLC's major customer to be purchased by the LLC and the formation of a new LLC that partnered with the LLC's customer. The operative theory appeared to be that neither party could have anticipated that the LLC's customer would seek to be bought out by the LLC or that O'Neill would form a new LLC to supply the customer's orders. To the extent that Kyle's claim was based on a failure to negotiate the fair market value of his interest, the claim failed because the operating agreement expressly covered valuation of a terminated member's interest. The implied covenant cannot override express language in the contract. Kyle's modified theory in his brief failed because general allegations of bad faith conduct are not sufficient to support a claim for breach of the implied covenant. Kyle identified neither a specific implied contractual obligation nor a subsequent breach. The court stated that it was pure conjecture that O'Neill would have agreed to limit his rights as majority owner of the LLC by including express language in the operating

agreement barring him from purchasing a customer of the LLC or form forming a new LLC. Kyle also did not specify how the customer's decisions in 2012 to purchase from the newly formed LLC and to dissolve its contract with the LLC breached an implied covenant owed to Kyle in 2010 at the time the operating agreement was entered into.

Transfer of Interest/Buyout of Member

Prokupek v. Consumer Capital Partners LLC, C.A. No. 9918-VCN, 2014 WL 7452205 (Del. Ch. Dec. 30, 2014).

The plaintiff sought to inspect financial documents of Smashburger Master LLC ("Smashburger") in connection with a dispute over the amount Smashburger owed the plaintiff for the redemption of his units. The plaintiff was the chairman and CEO of Smashburger and was granted restricted equity units of Smashburger as a term of employment. Most of the units did not vest unless Smashburger met certain "performance hurdles." After Smashburger terminated the plaintiff and redeemed his vested units pursuant to the LLC agreement at a price it determined to be fair market value, the plaintiff demanded certain of Smashburger's business records under Section 18-305(a) of the Delaware Limited Liability Company Act for the stated purpose of evaluating Smashburger's financial performance to determine whether it manipulated its financials to make it appear that it fell short of some of the performance hurdles. Smashburger refused the plaintiff's demand on the basis that Smashburger had redeemed all of his units, thus terminating his status as a member, and that former members have no standing to demand inspection under either the Delaware LLC statute or Smashburger's LLC agreement. The plaintiff petitioned the court for inspection, arguing that he retained equity in Smashburger because it paid him too little for his units and because it did not call all of his units in any event. Alternatively, he argued that he retained inspection rights by virtue of his status as a former member of Smashburger. Smashburger moved to dismiss the plaintiff's claim, and the court granted the motion on the basis that all of the plaintiff's units had been redeemed and that only members have statutory inspection rights.

The court first addressed the issue of whether plaintiff was a member of Smashburger at the time of his demand. The plaintiff essentially claimed that he still owned units based on his contention that Smashburger improperly calculated the number of units that had vested. The purchase price tendered by Smashburger and the number of units that it called were undisputed facts. Under the redemption provision of the LLC agreement, Smashburger's manager was to determine the number of vested units by certifying whether Smashburger achieved the applicable performance hurdles. Since the manager decided Smashburger did not meet the performance hurdles, Smashburger complied with the agreement, and the plaintiff was no longer a member. Whether the EBITDA numbers the manager used to determine compliance with the performance hurdles were unreliable was a separate factual question that could support a breach of contract action but did not change the fact that the plaintiff was no longer a member at the time of the demand for inspection.

The court next addressed the plaintiff's argument that he retained equity pursuant to a dispute mechanism in the LLC agreement. The dispute mechanism allowed former employees to object to Smashburger's determination of fair market value within 30 days of receiving a call notice and provided for subsequent steps to resolve the valuation issue. The plaintiff contended this mechanism required Smashburger to determine a fair price for his units prior to redeeming his units. The court rejected this argument because the plain language of the redemption provision provided that all redemptions shall close within 60 days of the notice of termination and contained no exception for ongoing disputes covered by the dispute mechanism. In addition, the dispute mechanism

contemplated a period of up to 75 days from the date of Smashburger's determination of fair market value to resolve disputes, whereas the redemption provision required closing to occur within 60 days. The only way to give effect to both provisions without altering the express terms of the agreement was to recognize that valuation disputes may continue after a member's units have been validly called. Thus, the court concluded that the plaintiff may have had damages claims related to the redemption, but he was not entitled to the restoration of an equity interest.

In re Marriage of Schlichting, 19 N.E.3d 1055 (Ill. App. 2014).

In the divorce of Larisa and Bruce Schlichting, Larisa appealed the trial court's order disposing of Larisa's 20% membership interest in an LLC of which she and other family members of Bruce were members but Bruce was not. The operating agreement had a buyout procedure in the event of a member's divorce under which the LLC would purchase a divorcing member's interest at a valuation that involved a determination by the LLC's accountant. The trial court determined that Larisa's membership interest was marital property and divided and awarded "the potential cash distribution" from Larisa's interest in the LLC 65% to Larisa and 35% to Bruce, which was in accordance with the 65/35 split applied to the entire marital estate. Larisa moved to set the value of the LLC based on deposition testimony of the LLC's accountant. Based on the accountant's $150,000 valuation, Larisa's cash distribution would be $19,500, and Bruce's would be $10,500. Bruce believed the value of the LLC was significantly higher, and he thus requested that the court order Larisa to sell her interest to Bruce for $19,500 so that he could then pursue litigation with the LLC and establish a higher value. Larisa opposed Bruce's request, arguing that it would violate the operating agreement, which contained a provision prohibiting Larisa or any other member from transferring a membership interest without unanimous written consent of the other members. Larisa testified that the other members did not want Bruce to be part of the LLC and did not approve of her transferring rights to Bruce. Because Larisa was already a 20% member, Larisa argued that she could pay Bruce for his share of the cash distribution from her interest without having to get approval from the other members. Larisa proposed that she rather than the LLC should provide Bruce with the $10,500 payment, thus allowing her to retain her 20% membership interest. The trial court ultimately ordered that Larisa sell her membership interest to Bruce for $19,500. Upon payment by Bruce to Larisa, the order awarded all of Larisa's membership interest and rights and responsibilities under the LLC operating agreement to Bruce so that he could pursue litigation with the LLC over the value of the interest.

On appeal, the court first determined that the trial court ordered Larisa to violate the operating agreement when it ordered her to sell her membership interest to Bruce without the unanimous consent of the other members. Contrary to the transfer restriction in the operating agreement and the provision requiring the LLC to buy out a divorcing member's interest, the trial court ordered Larisa to sell her membership interest to Bruce without consent of the other members. The court also addressed a misinterpretation by Bruce and the trial court of the buyout provision of the operating agreement that applied in the divorce context. The LLC operating agreement provided for a buyout of the divorcing member's interest at the greater of the value established by the LLC's accountant or the value determined by the divorce court. If the divorce court set a value higher than the accountant's value, the divorcing member was required to pay the LLC the difference in the valuation. The court of appeals explained that this provision required the divorce court to make a valuation determination and required payment by the LLC for Larisa's membership interest based on the greater of the court's valuation or the LLC accountant's valuation. When the divorce court divided the cash distribution for Larisa's membership interest, Bruce would receive payment for his

share based on the higher valuation, but the divorcing member (i.e., Larisa) would be required to pay the LLC the difference between the court's valuation and the accountant's valuation if the court's valuation was higher. Bruce mistakenly believed that it would be futile to provide evidence of a higher valuation in the divorce proceeding because he believed he would be required to reimburse the LLC for a payment in excess of the accountant's valuation, but the operating agreement imposed that obligation on Larisa as the divorcing member. Thus, the trial court did not need to require Larisa to sell her membership interest to Bruce to allow Bruce to pursue a higher valuation.

Having determined that the trial court ordered Larisa to violate the operating agreement and that it was not necessary to do so to allow Bruce to pursue a higher valuation, the court of appeals explained that the trial court's order was an abuse of discretion. The court stated that no Illinois case requires a court to distribute marital property in accordance with an operating agreement binding on one or both parties in their business activities, but the court stated that case law establishes that failure to do so when compliance is easily possible is an abuse of discretion. The court discussed the nature and role of buy-sell agreements and discussed developing case law within and outside Illinois concerning the avoidance of potential conflict between marital dissolution orders and business operating agreements. The court saw no reason in this case to enter an order conflicting with the terms of the operating agreement when the agreement specified the valuation process in the event of a divorce and allowed for a nonmember spouse to contest the valuation during the divorce proceeding. Bruce was entitled to a portion of the cash value of the membership interest, but not an actual membership interest. Because the trial court's order was stayed during appeal, the court of appeals did not have to order the "undoing" of any transaction. The court of appeals concluded that the most efficient way to compensate Bruce for his 35% interest under the circumstances of this case was to order Larisa to pay Bruce $10,500 for his claim with respect to Larisa's membership interest. Bruce was bound by the accountant's valuation because he chose not to offer any evidence of valuation. The court stated that Larisa could accomplish the payment to Bruce with personal funds or by forcing the LLC to buy her out under the terms of the operating agreement.

In re Denman, 513 B.R. 720 (Bankr. W.D. Tenn. 2014).

Denman, a 70% member of a Tennessee LLC, filed a Chapter 13 bankruptcy petition, thus triggering a provision under the LLC operating agreement that gave any member the option to purchase another member's interest in the LLC for an agreed value if the other member filed a petition under the Bankruptcy Code. Another member sought to exercise the option to purchase Denman's interest, and the court analyzed whether the operating agreement was an executory contract under Section 365(e)(1) or the Bankruptcy Code or whether Denman's interest became property of the estate under Section 541. The court concluded that the operating agreement was not an executory contract and that Denman's membership interest became property of the bankruptcy estate and was not subject to the purchase option because the provision was an unenforceable ipso facto clause.

In re Galaz (Galaz v. Galaz), 765 F.3d 426 (5th Cir. 2014).

Lisa Galaz brought an adversary proceeding against her ex-husband, Raul Galaz, for fraudulently transferring the assets of an LLC in which Lisa owned a 25% economic interest. In Lisa and Raul's divorce, they executed a divorce decree under which Raul assigned half of his LLC 50% interest to Lisa. The transfer occurred in violation of the operating agreement without the other member's consent, and Lisa therefore received a 25% economic interest with no management or voting rights. Raul, as manager of the LLC, transferred the assets of the LLC to another entity that

he formed with his father. The bankruptcy court found that the transfer was invalid under the Texas Uniform Fraudulent Transfer Act and awarded Lisa a judgment for damages against the defendants. One of the contentions in this appeal by Raul and the transferee entity was that the bankruptcy court should have referred Lisa's claims to arbitration pursuant to a provision in the LLC operating agreement. The court rejected this argument because Lisa was not a party to the operating agreement. The operating agreement referred to the "parties" as the LLC's "Members," and Lisa held only an economic interest. The court stated that the Fifth Circuit has recognized limited circumstances in which a nonsignatory may be bound by an arbitration agreement, but there was no argument or evidence suggesting how Lisa, neither a member nor a party, was bound by the arbitration provision. The court of appeals also clarified that Lisa was a "creditor" under the Texas Uniform Fraudulent Transfer Act because she had a right to payment or property that existed at the time of the fraudulent transfer or that arose within a reasonable time after the transfer. The court reasoned that, as an economic interest holder of the LLC, "a creature of California corporate law," she had a right to payment and was entitled to distributions before the LLC was dissolved and Raul transferred its assets. Because the California LLC statute provides that an economic interest includes a person's right to receive distributions from the LLC and an economic interest constitutes personal property of an assignee, Lisa had standing to bring her fraudulent transfer claim.

Levy v. Carolinian, LLC, 763 S.E.2d 594 (S.C. 2014)

After obtaining a $2.5 million judgment against an LLC member, the judgment creditors obtained a charging order against the member's interest and purchased the interest at a foreclosure sale for $215,000. The LLC was represented at the foreclosure sale, but the judgment creditors outbid the LLC. The South Carolina LLC statute provides that a charging order is the exclusive remedy by which a judgment creditor may satisfy a judgment out of the judgment debtor's distributional interest, and a charging order constitutes a lien that may be foreclosed at any time by order of a court. Both the South Carolina statute and the operating agreement provided that the LLC had the right to redeem the judgment debtor's interest at any time prior to foreclosure. The operating agreement also provided that a creditor who obtained any part of a member's interest by charging order could only become a member with the written consent of all members after the transfer and that such a transferee had no right to vote or participate in the management of the LLC. These provisions were consistent with the provisions of the South Carolina statute regarding a distributional interest and the rights of a transferee. Neither the LLC nor its members redeemed the judgment debtor's interest before the foreclosure sale, and the judgment creditors did not seek to be admitted as members of the LLC. After the foreclosure sale, the LLC asserted that provisions of the operating agreement gave the LLC the right to force the judgment creditor to sell the interest to the LLC. The LLC relied on Article 11 of the operating agreement, which contained restrictions on transfer of a member's interest. Section 11.1 of the operating agreement contained a provision that prohibited a member from voluntarily or involuntarily selling, transferring, hypothecating, or otherwise conveying any portion of the member's interest without the prior written consent of members having 67% of the voting rights. Section 11.1 also stated that any attempted conveyance or encumbrance by a member without the required consent was null and void. Section 11.2 provided that a member who attempted to transfer all or a portion of his interest without obtaining the other members' consent was deemed to have offered to the LLC all of the member's interest. The judgment creditors argued that the ability of the LLC to redeem the judgment debtor's interest was extinguished by the foreclosure sale and that Article 11 did not compel the judgment creditors to sell their interest to the LLC. The supreme court agreed with the judgment creditors. The court pointed

out that, consistent with the LLC statute, the operating agreement provided that a member's interest may be redeemed at any time prior to the foreclosure sale, and the court reviewed the provisions of the South Carolina LLC statute relating to transfer of a distributional interest and the rights of a transferee. The court noted that the operating agreement is the essential contract governing the affairs of an LLC, but the operating agreement may not restrict the rights of a person other than a manager, member, and transferee of a member's distributional interest. The supreme court concluded that Article 11 did not apply to the judgment creditors before they became transferees and did not restrict them from foreclosing their charging order lien. The court pointed out that the transfer restrictions in Section 11.1 applied only to "members," and the judgment creditors merely became transferees. Further, they were not even transferees until after the foreclosure sale. Thus, the court stated that the operating agreement could not restrict the statutory rights of the judgment creditors by requiring consent of the LLC or its members before the foreclosure sale, and the restrictions of Section 11.1 did not apply to the judgment creditors at the time they foreclosed their charging order lien. Further, because they were not required to obtain consent under Section 11.1, the court concluded that the LLC could not invoke a right to purchase under Section 11.2. In sum, the court held that the LLC's ability to purchase the judgment debtor's interest was not controlled by any part of Article 11, but rather by Section 3.5, which provided the opportunity to purchase the interest before the foreclosure sale. The court noted that the LLC also had the opportunity to obtain the interest at the foreclosure sale itself, and this opportunity was limited only by the LLC's decision not to outbid the judgment creditor.

Capano v. Capano, C.A. No. 8721-VCN, 2014 WL 2964071 (Del. Ch. June 30, 2014).

Two brothers, Louis and Joseph, owned or controlled identical interests in a family owned LLC that held real estate assets. The brothers' mother transferred a portion of an interest to a Delaware business trust ("CI Trust") for the benefit of a third brother, Gerry. CI Trust held the swing vote in the event of a deadlock among the members of the LLC, and Gerry had voting control over the trust. In 2000, Gerry executed several documents purporting to grant Louis a voting proxy and an option to purchase Gerry's interest in CI Trust. In 2001, Gerry executed documents purporting to transfer all of Gerry's interest in CI Trust to Louis. In 2013, after the mother's death, Louis exercised the rights purportedly transferred to him to cash Joseph out of the LLC through a merger of the LLC with an entity controlled by Louis. Gerry and Joseph brought lawsuits asserting various claims, including challenges to the transfers by Gerry and to the merger.

The court concluded that Gerry's fraud claims relating to the documents granting Louis a voting proxy and option to purchase Gerry's interest in the CI Trust were barred by laches; however, the court concluded that Gerry's challenge to the validity of the transfer of his interest in the CI Trust to Louis was not barred by laches. The defendants relied on signed documents under which Gerry purported to substitute himself as trustee of the CI Trust and assign all of his right, title, and interest in the trust, including his position as trustee, to Louis. Gerry claimed that the transfer was invalid based on a number of defects, including that Louis backdated the documents without Gerry's consent and that Gerry was inebriated when he signed the documents. The trust agreement of CI Trust contained a spendthrift provision requiring the written consent of the trustee for the beneficial owner, i.e., Gerry, to transfer his interest in the CI Trust. The court denied the defendants' motion to dismiss this claim because the alleged defects gave rise to a question as to who the trustee was at the time the transfer documents were effective, and there thus was a question as to whether consent was given by the trustee in accordance with the trust agreement of CI Trust.

The court next rejected the defendants's argument that Gerry lacked standing to challenge the merger of the LLC because Gerry had no rights in the CI Trust. The court found that if Gerry successfully demonstrated that the assignment of his interest in the CI Trust to Louis was invalid, then his remaining interest in the CI Trust would permit him to assert rights in the LLC to challenge the fairness of the merger. Thus, the court denied the defendants' motion to dismiss this claim.

The defendants also argued that Joseph lacked standing to challenge the transfer documents relating to the CI Trust because he was not an intended beneficiary of those documents. Joseph argued that because the CI Trust held an interest in the LLC and essentially functioned as a tie-breaking voter, Joseph was an intended beneficiary of the documents. The court rejected Joseph's argument based on the text of the trust agreement of the CI Trust, which did not identify Joseph as a party or as a third-party beneficiary. The court noted, however, that Joseph would have standing to challenge a transfer of interest in the CI Trust to the extent it violated the operating agreement of the LLC.

The court next addressed claims based on a transfer restriction in the LLC operating agreement. Relying on the transfer restriction in the operating agreement, Joseph contested the validity of the transfer of Gerry's interest in the CI Trust as well as a transfer by Louis of his interest in the LLC to a limited partnership Louis controlled. The defendants argued that these acts were ratified, but the court found that the power to wield a majority voting interest capable of ratifying the transfers was dependent upon compliance with the operating agreement of the LLC. If the transfer of interest in the CI Trust was invalid, a properly-constituted majority did not ratify such transfers. Similarly, the defendants argued that because they controlled a majority of the economic interest they "could" have consented. The court found that the factual issue of whether they actually did consent as a necessary precondition to Louis exercising the transferred interests under the terms of the LLC operating agreement must be resolved .

Finally, the defendants argued that Gerry and Joseph could not obtain rescission because the LLC had entered into numerous transactions with third parties that could not be undone. The court stated that the defendants' argument might prove compelling after additional factual development, but it was premature to conclude that there was no possibility of recovery that could include rescission.

LCM Holdings GP, LLC v. Imbert, 980 N.Y.S.2d 45 (App. Div. 1st Div. 2014).

The court held that the operating agreement of a Delaware LLC did not require the defendant to sell his membership interest to the plaintiffs. The plaintiffs relied on a provision that compelled the sale of a membership interest upon the termination of employment of an employee other than a manager. The defendant was a manager at the time of his termination, and the provision thus did not apply to him.

Indemnification or Contribution

Durham v. Grapetree, LLC, C.A. No. 7325-VCG, 2014 WL 3565980 (Del. Ch. July 21, 2014).

An LLC member, one of five siblings who owned equal interests in the LLC, sued the LLC for reimbursement of certain expenses incurred by the plaintiff allegedly for the benefit of the LLC. In a previous opinion, the court determined that the language of the LLC agreement regarding reimbursement was ambiguous with respect to the expenses at issue, but the plaintiff was entitled to seek reimbursement based on the course of dealing between the LLC and other members. In this

decision, the court addressed the plaintiff's attempt to authenticate documentation relating to the expenditures for which the court found the plaintiff was entitled to seek reimbursement. The plaintiff failed to substantiate the expenditures or explain how such expenditures benefitted the LLC. The court rejected the plaintiff's argument that the LLC agreement did not require the plaintiff to substantiate his expenditures. The plaintiff had the burden of proof to submit substantiation and failed to do so. Therefore, the court declined to award the plaintiff anything more than the amount that the LLC conceded it owed the plaintiff.

Branin v. Stein Roe Investment Counsel, LLC, C.A. No. 8481-VCN, 2014 WL 2961084 (Del. Ch. June 30, 2014).

An employee of the defendants sought indemnification under the LLC agreement of one of the defendants, Stein Roe Investment Counsel LLC ("Stein Roe"). Before joining Stein Roe, the plaintiff was a principal/owner and the CEO of another investment management firm. During that time, the plaintiff's firm was acquired by Bessemer Trust, N.A. ("Bessemer"). This acquisition was governed by a doctrine of New York law that prevented the plaintiff from soliciting his former clients (the "*Mohawk* Doctrine"), although the plaintiff could accept business from former clients if they approached him. At Stein Roe the plaintiff managed 30 clients that he previously managed while at Bessemer, and Bessemer sued the plaintiff under the *Mohawk* Doctrine. When the plaintiff joined Stein Roe, and at the time Bessemer sued the plaintiff, Stein Roe's LLC agreement provided broad indemnification rights that applied to employees of Stein Roe. This indemnification provision provided indemnification "[t]o the full extent permitted by applicable law" for acts or omissions taken on behalf of Stein Roe in "good faith" and "in a manner reasonably believed to be within the scope of the authority conferred" by the LLC agreement. After Bessemer sued the plaintiff, Stein Roe amended the indemnification provision of its LLC agreement to exclude claims based on actions by an employee that may have breached a contract between the employee and a third party that predated the employee's employment with Stein Roe. The defendants asserted that the amended indemnification provision applied and precluded the plaintiff's claim. The court analyzed when an indemnification cause of action accrues, whether it accrues irrevocably even though an indemnitee is on notice that the agreement providing for indemnification may be modified, and whether the defendants could defeat the plaintiff's indemnification claim by later amending the LLC agreement if the plaintiff had a valid claim for indemnification when Bessemer sued him. Although the court recognized that Stein Roe could amend its LLC agreement, the court concluded that the plaintiff became entitled to indemnification under the indemnification provision in effect at the time Bessemer sued him, and the subsequent amendment of the indemnification provision did not operate to unilaterally rescind this matured liability to the plaintiff. The court noted that the Delaware LLC statute establishes no criteria governing indemnification by LLCs and provides broad contractual freedom to define indemnification rights. The indemnification provision in effect when the plaintiff was hired gave no indication of how to treat a claim that arose under that provision but that might be precluded under a subsequent amendment. The court discussed policies justifying indemnification as set forth in several corporate cases, and the court identified circumstances in this case consistent with the policy behind the earlier, broader indemnification provision. Before being hired by Stein Roe, the plaintiff had discussed with Stein Roe's president and CEO the possibility of bringing over the plaintiff's former clients and the possible impacts of the *Mohawk* Doctrine, and, as anticipated, Stein Roe benefitted from the plaintiff's clients. Furthermore, at the time of the plaintiff's conduct giving rise to Bessemer's claim, the plaintiff reasonably anticipated he would have the protection of the indemnification provision despite the language in the LLC agreement

allowing for modification of the LLC agreement. The court also noted that the amended LLC agreement did not purport to modify or eliminate any liability that already existed. In light of the language of the indemnification provision and case law that generally protects indemnitees and looks to the indemnification provisions in effect when the events giving rise to the claim occurred or the time when the lawsuit on the claim is filed, the court held that the plaintiff established a right to pursue a claim for indemnification. Thus, if the plaintiff satisfied the other substantive requirements of the indemnification provision (acting in good faith and in a manner reasonably believed to be within the scope of his authority), Stein Roe's liability for the claim was fixed before the amendment of the indemnification provision, which did not modify or eliminate any liability that already existed. The court rejected the defendants' claim that the plaintiff was sued in his personal capacity or by reason of his employment with Bessemer, relying on corporate case law in which the Delaware Supreme Court has stated that "'proceedings are 'by reason of the fact' that one was a corporate officer'" if there is a "'nexus or causal connection'" between the proceedings and a person's official capacity. The plaintiff, as an employee of Stein Roe, created tangible benefits for Stein Roe because of his contacts and client accounts. Thus, a "nexus or causal connection" existed. Nevertheless, the court dismissed the plaintiff's motion for judgment on the pleadings because the parties disputed the fact question of whether the plaintiff acted in good faith and in a manner he reasonably believed to be within the scope of his authority.

Durham v. Grapetree, LLC, C.A. No. 7325-VCG, 2014 WL 1980335 (Del. Ch. May 16, 2014).

An LLC member, one of five siblings who owned equal interests in the LLC and the only non-managing member, sued the LLC for reimbursement of expenses allegedly incurred for the benefit of the LLC. The plaintiff and the LLC disagreed as to whether the plaintiff was entitled to reimbursement for certain expenses incurred by the plaintiff for maintaining the landscaping of vacation rental properties owned by the LLC. Both parties contended that the language of the LLC agreement governed their dispute. According to the court, the language of the LLC agreement, which stated that "[f]or all routine operational issues[,] the majority vote of (3/5) [sic] of the managing members may make all decisions," was ambiguous when applied to the plaintiff's claim for reimbursement. The court thus examined the course of dealing in order to determine the parties' intent. Because some of the expenditures made by the plaintiff were routinely made by other members and reimbursed by the LLC without any vote of the managing members, the court concluded that the plaintiff was entitled to seek reimbursement for those types of expenses.

Kalikow v. Shalik, 986 N.Y.S.2d 762 (N.Y. Sup. 2014).

Kalikow and Shalik, each 50% members of an LLC that owned an office building and ground lease, guaranteed a loan to the LLC to refinance the building. Under the operating agreement, Kalikow was the sole managing member of the LLC with sole discretion to manage the business and affairs of the LLC. The principal subtenants in the building were an accounting firm in which Shalik was a partner and a business of Kalikow's. To obtain an extension on the loan after it matured, Kalikow paid down the amount requested by the bank as a condition to the extension. Kalikow sued Shalik for contribution, and the court determined that Shalik was not obligated to contribute toward the payment made by Kalikow because the bank had not yet demanded payment of the loan or declared it in default, and Kalikow was thus not obligated to make the payment.

Capital Contributions

Montana Food, LLC v. Todosijevic, 2015 WL 779688, __ P.3d __ (Wyo. 2015).

Todosijevic and Vukov each owned a 50% interest in a Wyoming LLC, and after Vukov discovered he had made significantly greater capital contributions over time than Todosijevic, Vukov called a meeting and adopted resolutions increasing his ownership interest to 99.72% and decreasing Todosijevic's interest to .28% to reflect the amounts of the members' capital contributions. The articles of organization provided for initial contributions of $10,000 and additional contributions at such times and in such amounts as agreed by the members. Over time, Vukov became concerned that he was the only member making additional capital contributions and that Todosijevic misrepresented that he was contributing additional funds. Vukov's investigation showed that he had contributed 1,260,00 Euros and that Todosijevic had made no additional contributions, prompting Vukov to hold a meeting at which he voted to adjust the ownership interests. Todosijevic did not attend the meeting. (Interestingly, the members were Serbian residents, and the LLC's business was in Belgrade; the LLC had no connection with Wyoming other than being organized under Wyoming law.) Todosijevic sued the LLC and Vukov claiming that the adjustments to the members' ownership percentages were improper. The articles of organization and written operating agreement provided that the LLC was manager-managed and named an individual who was not a member as manager, but Vukov and the LLC claimed that the LLC had no active manager and was in reality member-managed and that provisions of the Wyoming LLC statute suggested that management of a member-managed LLC is proportionate to each member's capital contribution. The court first examined the provisions of the current LLC statute to determine whether the current or prior statute applied to the question of whether the LLC was manager-managed or member-managed. Because the LLC in this case was organized in 2007, the prior statute applied to this question. Under that statute, an LLC is member-managed unless the articles of organization provide that the LLC is manager-managed. The court rejected the argument that it should look beyond the language of the Wyoming LLC statute and the organizational documents to the realities of how the LLC was managed. The court stated that the statute did not permit the court to ignore the LLC's designation of itself as manager-managed. Next the court addressed whether a member has the authority in a manager-managed LLC to adjust the members' ownership interests. The current statute specifies certain provisions of the prior statute that continue to apply to LLCs formed before adoption of the new statute, but none of the specified provisions addressed this question. Thus, the court applied the current statute to this question. Under the statute, a manager in a manager-managed LLC has the exclusive authority to decide any matter relating to the activities of the LLC, and the consent of all members is required to undertake any act outside the ordinary course of the company's activities, unless otherwise provided by the articles of organization or operating agreement. The LLC's articles of organization stated that the manager was authorized to act for and bind the LLC by his individual signature, and the operating agreement gave broad authority to the managers and provided that members who are not managers shall take no part in the management or control of the LLC and have no power to bind the LLC. The court concluded that the changing of ownership interests was action outside the ordinary course of the LLC's activities and required the consent of all members under the clear language of the statute. Thus, Vukov did not have the authority to unilaterally change the members' ownership interests. The court recognized that this left the members deadlocked. Only the manager had authority to sell or transfer the LLC's assets, but the LLC claimed there was in reality no manager. The remedy of judicial dissolution was foreclosed because the district court's ruling granting the LLC's motion for summary judgment on Todosijevic's dissolution claim was not appealed. Under these circumstances, the court

stated that Todosijevic's only remedy if Vukov had illegally transferred LLC assets was to sue for monetary damages.

Moultrie v. Wall, 2015 WL 480828, __ So.3d __ (Ala. 2015).

In this dispute regarding the ownership of an LLC Ford automobile dealership, Moultrie appealed from a judgment that determined Moultrie's interest was reduced from 51% to 10% pursuant to an amendment of the operating agreement and that Moultrie was divested of that interest because he failed to pay a required capital contribution. After concluding that the evidence supported the trial court's determination that the operating agreement was amended to provide that Moultrie owned a 10% interest in the LLC, the court addressed Moultrie's challenge to the trial court's conclusion that he was divested of his membership interest in the LLC based on his failure to comply with a capital call made by Wall. The court examined the provisions of the operating agreement and concluded that the decision to make a capital call was subject to the general requirement that LLC decisions and actions be approved by a majority in interest of the members at a meeting called with notice to all members. The court rejected Wall's argument that this general provision did not require a meeting because a provision of the operating agreement that controlled Wall's request of capital from Moultrie did not specifically require a meeting. Wall contended that the decision to contribute capital was not a company decision but rather one left to the members. The court stated that nothing in the agreement precluded an individual member from contributing additional capital if the member desired, but a decision that the LLC needed a substantial capital contribution and that all members were required to contribute in order to maintain their ownership interest was a company decision or action that required a meeting. Although Wall argued that the urgency of the situation excused him from calling a meeting, the court pointed out that a formal meeting was not required, and Wall failed to show that in the 12-day time frame involved he did not have even a few minutes to schedule an informal meeting such as a conference call. The court also rejected Wall's argument that no meeting was required because it would have been "fruitless." Neither the hostility between the parties nor the fact that Wall owned the majority interest required to make the decision overrode the requirement in the operating agreement that all members had a right to a meeting before company decisions and actions were decided by a majority in interest of the members. Finally, the court could not conclude that anything in the operating agreement allowed Wall as the manager of the LLC to make a unilateral demand for capital. Because Wall did not comply with the terms of the operating agreement requiring a meeting when he made the capital call, the court reversed the trial court's judgment insofar as it held that Moultrie was divested of his 10% interest by failing to contribute additional capital.

<u>Improper Distributions</u>

CB Richard Ellis, Inc. v. Terra Nostra Consultants, 230 Cal.App.4th 405 (Cal. App. 2014).

A creditor of an LLC obtained a judgment against the members of the LLC on the basis that the members had been distributed assets of the LLC upon dissolution of the LLC. The creditor relied on a provision of the California LLC statute that provides that a cause of action against a dissolved LLC, whether arising before or after dissolution, may be enforced against members of the dissolved LLC to the extent of the LLC's assets distributed to the members upon dissolution. Thus, a key issue in the case was when the LLC dissolved and whether assets were distributed to the members upon dissolution. The members complained that the trial court erred in instructing the jury as follows: "'Dissolution of a limited liability company occurs when it ceases operating in the ordinary course

of its business, with the intention, on the part of its members, not to resume the ordinary course of its business. Dissolution of a limited liability company is not the same as cessation of all business activity. A limited liability company may continue to do business after it has dissolved for the purpose of winding up its affairs, paying its creditors and distributing its remaining assets. In determining whether a dissolution of [the LLC] ... occurred, you may consider all evidence bearing on that issue, including; for example, the ordinary business of the limited liability company, the assets of the limited liability company both before and after a distribution, the continuation of the ordinary business and the cessation of its ordinary business activities.'" The members argued that the jury should have been limited to inquiring whether one of the three specified causes of dissolution under the statute had occurred. According to the members, so long as a distribution occurs before the de jure dissolution of the LLC, the distribution is not "upon dissolution" for purposes of imposing liability on the members. The court analyzed the statutory scheme and concluded that "de facto" dissolution is an acceptable predicate to a claim of the type asserted against the members in this case, i.e., a claim based on distribution of assets of the LLC "upon dissolution." This approach allows a jury to find that an LLC has actually dissolved at the time of the distribution based on the reality of the LLC's finances and operations. Thus, the jury was correctly instructed in this case.

Dissociation of Member

Northwest Wholesale, Inc. v. Pac Organic Fruit, LLC, 334 P.3d 63 (Wash. App. 2014).

Harold and Shirley Ostenson and Greg Holzman formed an LLC in 1998 to operate an orchard packing facility. The Ostensons and Greg Holzman, Inc. ("GHI") became the members of the LLC, and both the Ostensons and GHI were active in the business. The Ostensons owned 49% of the LLC, and GHI owned the remaining 51%, thus giving GHI control of the business decisions. The LLC began as a seasonal business but expanded to operate year-round. The members' versions of the decline of the LLC differed, but in any event the LLC financially collapsed in 2005. The Ostensons accused Holzman of wrongdoing, and Holzman claimed that the Ostensons were uncooperative and caused stored fruit to sit past its prime, which caused the LLC to lose revenue. Holzman fired the Ostensons from their positions with the LLC after the LLC defaulted on its operating line of credit and lease. The Ostensons filed for bankruptcy protection under Chapter 11 in early 2007. Later in 2007, Northwest Wholesale, Inc., a creditor of the LLC, filed this lawsuit in state court against the LLC, GHI, and the Ostensons. The Ostensons filed cross claims and a third party complaint against Holzman, GHI, and another entity of Holzman's. These claims were in the nature of a derivative action on behalf of the LLC. In 2008, the bankruptcy court approved a "stipulation" that addressed claims among the Ostensons, Holzman, and Holzman's affiliated entities. Under the stipulation, the Ostensons agreed to arbitrate some claims and litigate others. The stipulation stated that any claims of the LLC against Holzman and his entities would be litigated in this lawsuit. In 2010, Holzman filed a motion in the bankruptcy proceeding in which he argued for the first time that the Ostensons were no longer members of the LLC because the Washington LLC statute dissociated them from the LLC when they filed for bankruptcy. The bankruptcy court did not rule on this motion. This case went to trial in 2011, and Holzman and his entities moved to dismiss the Ostensons' derivative action after the Ostensons rested their case. The Holzman defendants argued that the Ostensons were no longer members of the LLC and lacked authority to bring their derivative action. Eventually, the trial court ruled that the Ostensons relinquished their membership

in the LLC when they filed bankruptcy and could not maintain a derivative action on the LLC's behalf. The Ostensons appealed.

The court of appeals examined the standing of the Ostensons under state law to bring a derivative action on behalf of the LLC and agreed with the trial court that the Ostensons did not have standing. Under the Washington LLC statute, a derivative plaintiff must be a member at the time of the bringing of the action. The Washington LLC statute also provides that, unless otherwise provided in the LLC agreement, a person ceases to be a member, and attains the status of an assignee, of an LLC when the person files a voluntary petition in bankruptcy. The LLC agreement in this case provided that a person became dissociated upon any event of dissociation specified in the Washington LLC statute. Under Washington law, the Ostensons thus forfeited their right to bring a derivative action on behalf of the LLC when they filed for bankruptcy. As an assignee, a dissociated member retains the right to share in profits but loses any management rights. The court rejected the Ostensons' argument that Holzman consented in the bankruptcy stipulation to the continued membership of the Ostensons. While the stipulation preserved claims of the LLC against the Holzman defendants, it did not address whether the Ostensons could assert those claims. Even though unlikely, the LLC itself could assert those claims. Long before the stipulation, the membership of the Ostensons had ceased, and the stipulation did not indicate that it resurrected the membership of the Ostensons and their ability to file a derivative action on behalf of the LLC. Absent consent in writing to the Ostensons' continued membership in the LLC, the Ostensons lacked statutory authority and standing under state law to bring their derivative action.

The court next turned to the Ostensons' argument that federal bankruptcy law, specifically Section 541(c)(1) or Section 365 of the Bankruptcy Code, preempted the Washington LLC statute from dissociating them as members of the LLC. The court explained that the Washington LLC statute causes the dissociation of a member upon the member's filing of bankruptcy, but the dissociation of one member (assuming there is at least one remaining member) does not dissolve the LLC. The dissociated member assumes the status of an assignee and has no management rights in the LLC. Under Section 541(c)(1), an interest of the debtor becomes property of the estate notwithstanding any nonbankruptcy law restriction on transfer of that property. The Ostensons argued that their interest in the LLC became part of their bankruptcy estate. The court agreed but stated that this contention did not end the inquiry. The question was not whether the Ostensons retained some ownership interest but whether they retained management rights and the right to file a derivative action. While the Bankruptcy Code provides that a bankruptcy case creates an estate that includes all legal and equitable interests of the debtor in property, the Code also provides that a debtor's property rights are defined by state law. Thus, Washington law defines what property rights the Ostensons held upon filing bankruptcy. The Ostensons relied on *In re Daugherty Construction, Inc.*, 188 B.R. 607 (Bankr. D. Neb. 1995), to support their contention that they retained their membership and management rights in the LLC. The court did not find that case persuasive in view of differences between Washington and Nebraska LLC law. Because the dissociation of a member upon the member's bankruptcy under Washington law does not result in a dissolution of the LLC, and the dissociated member retains economic rights, the court found the Washington LLC statute to be similar to the Virginia statute and adopted the reasoning of *In re Garrison-Ashburn, L.C.*, 253 B.R 700 (Bankr. E.D. Va. 2000), in which the bankruptcy court held that the bankruptcy estate of a member of a Virginia LLC had only the rights of an assignee (and not the membership or management rights) despite Section 541(c)(1).

The court next addressed Section 365(a), (c), and (e) of the Bankruptcy Code, which address the trustee's ability to assume or reject an executory contract. Under these provisions, the first

question is whether an LLC agreement is an executory contract, and, if so, whether the applicable law excuses the other members from continuing to accept performance of the bankrupt member. These provisions are designed to protect nondebtor third parties whose rights may be prejudiced by having a contract performed by a party other than the one with which they originally contracted. If there are no material obligations that must be performed by the members of an LLC, then the contract is not executory and is not governed by Section 365. The Ostensons again relied on *Daugherty* and argued that their LLC agreement was executory based on provisions requiring the members to contribute capital at GHI's discretion, appointing GHI as the manager, and obligating Harold Ostenson to lease a packing facility to the LLC, obtain a loan towards improving the facility, and pay the loan. The court stated that these provisions may suffice to create an executory contract, but the court determined that it was not necessary to decide if the LLC agreement was an executory contract because Section 365 excused GHI from accepting or rendering performance under the agreement. Because of the similarities between LLCs and partnerships in this area of inquiry, the court looked to a Washington case that addressed the application of Section 365(e)(2) to a partnership. In that case, the court determined that partnership agreements are, at least in part, executory contracts, but the partners are not obligated to accept an assumption of the partnership agreement because partnerships are voluntary associations and partners are not obligated to accept a substitution for their choice of partner. Based on this conclusion, the provision of Section 365(e) invalidating ipso facto clauses did not apply, and state partnership law was not preempted. The debtor partner's economic interest was protected, but he was no longer entitled to be a partner. The same reasoning applied here, and bankruptcy law did not preempt the provisions of Washington law that removed the Ostensons as members of the LLC when they filed bankruptcy.

Thomas v. Bozick, 92 A.3d 614 (Md. App. 2014).

Thomas was the managing member of an architectural firm (George, Miles & Buhr, LLC or "GMB") as well as a member of an LLC that owned and leased the property occupied by the architectural firm (GMB Plaza, LLC or "GMB Plaza"). On December 31, 2010, Thomas retired as managing member of GMB, thus triggering his involuntary withdrawal from GMB Plaza under the GMB Plaza operating agreement as well as a provision in the operating agreement that gave GMB Plaza an option to purchase Thomas's membership interest within 60 days at a formula set by the operating agreement. The remaining members of GMB Plaza met in February 2011 and decided that the value of the property as determined by the formula under the operating agreement (approximately $1.2 million) was no longer representative of the fair market value of the property. This conclusion was based on two appraisals obtained in September 2010 when Thomas was still managing member of GMB Plaza. Using the sales approach and the income approach, the September 2010 appraisals valued the property at $875,000 and $760,000, respectively. As a result of these appraisals, GMB Plaza declined to exercise its option to purchase Thomas's interest in GMB Plaza. In addition, the new managing member of GMB requested that GMB Plaza reduce the rent it was charging GMB retroactive to the beginning of 2011. The members of GMB Plaza unanimously approved the request for a reduction in rent at the February 2011 meeting. In order to determine the true value of GMB Plaza, the members commissioned a second set of appraisals. Using the sales approach and the income approach, these appraisals valued the property at $830,000 and $700,000, respectively. In July 2011, GMB Plaza offered to purchase Thomas's interest based on a property value of $760,000, slightly less than the averages of the valuations under the sales and income approaches. Thomas rejected this offer. In October 2011, the members of GMB Plaza voted to dissolve GMB Plaza and sell the property to a newly formed entity, GMB Properties, for $765,000, the average of the

valuations under the sales and income approaches. The members of GMB Properties were the remaining members of GMB Plaza and an additional member who did not own an interest in GMB Plaza. After the sale of the property by GMB Plaza to GMB Properties, Thomas was notified of the sale and the dissolution of GMB Plaza. He received a distribution check for his share of the liquidation proceeds based on his interest in GMB Plaza. Upon receiving the notice and liquidating distribution, Thomas filed suit against the members of GMB Plaza alleging that they breached the operating agreement by failing to include Thomas in meetings and decisions concerning the sale of the property, changing the valuation method and selling the property, and reducing the rent. The trial court granted summary judgment in favor of the defendants on the basis that Thomas ceased to be a member of GMB Plaza upon his retirement and thus was not entitled to notice of member meetings, that the remaining members could determine the value of the property without Thomas's consent, and that there was no genuine dispute as to the fair market or fair rental value of the property. Thomas appealed.

On appeal, the court first addressed Thomas's argument that he retained all of his membership rights in GMB Plaza after GMB Plaza declined to exercise the purchase option. The court analyzed the language of the operating agreement along with provisions of the Maryland LLC statute and concluded that Thomas's membership in GMB Plaza ceased upon his retirement and that his status became one of an assignee of an economic interest. Under GMB Plaza's operating agreement, Thomas's retirement from GMB caused an involuntary withdrawal of Thomas from GMB Plaza (no member had the power to voluntarily withdraw from GMB Plaza), and an involuntary withdrawal triggered GMB Plaza's option to purchase a member's interest on an involuntary withdrawal. Because GMB Plaza's operating agreement was silent as to what happens if GMB Plaza elects not to purchase an involuntarily withdrawn member's interest, the court looked to the Maryland LLC statute, which provides that a person who ceases to be a member of an LLC is deemed to be an assignee of the person's membership interest if the LLC elects not to completely liquidate the member's interest. Thomas argued that he necessarily owned and retained his voting and participation rights because the operating agreement required that he offer to sell his "Membership Rights" and defined "Membership Rights" as including the right to vote and participate in management of the LLC. The court concluded, however, that to retain his membership rights, Thomas would have to continue to be a member, and the operating agreement clearly provided that Thomas ceased to be a member of GMB Plaza when he ceased to be employed by GMB. Further, the provision specifying the purchase price referred to the purchase and sale of the "Member's Interest," which the operating agreement defined as a member's share of the profits and losses of, and right to receive distributions from, GMB Plaza. Thus, reading the provisions of the operating agreement together, the court concluded that it was clear that the 'Membership Rights owned of record and beneficially by the withdrawn Member" referred only to Thomas's "Interest" in GMB Plaza, which was defined as the economic interest. Thomas argued that the operating agreement superseded the provisions of the Maryland LLC statute that address liquidation of the interest of a person who ceases to be a member and the assignee status of a former member whose interest is not completely liquidated, but the court concluded that the operating agreement superseded only the statutory provision governing an LLC's election to purchase a withdrawn member's interest, not the provision that applies when an LLC declines to purchase the withdrawn member's interest. In sum, Thomas retained only his economic interest in GMB Plaza when he retired, and he thus had no right to vote on or participate in the management of GMB Plaza, including the decision to sell the property or to decide on the property's value.

Marrara v. Ripley Associates, LLC, 755 S.E.2d 120 (W. Va. 2014).

A member dissociated from a family owned at-will LLC that did not have an operating agreement specifying how to value the distributional interest of a dissociating member. Under the West Virginia LLC statute, an at-will LLC is required to purchase the distributional interest of a dissociated member for the fair market value of the dissociated member's interest determined as of the date of dissociation. The dissociated member and the LLC were unable to agree on the value of the dissociated member's interest, and the dissociated member filed suit to enforce the purchase of its interest. The court determined the fair market value of the interest and entered an order providing for interest from the date the court made its determination of the value. The dissociated member claimed that it was entitled to interest from the date of its dissociation. On appeal, the court examined the language of the West Virginia statute and concluded that the dissociated member was entitled to interest from the date of dissociation. Section 7-702(e) of the statute requires that interest be paid "on the amount awarded from the fair market value determined under section 7-701(a) to the date of payment." The dissociated member argued that the requirement under section 7-701(a) that the interest be valued at its fair market value as of the date of dissociation suggests that the interest award should be calculated from the date of dissociation. The LLC relied on the language in section 7-702(e) that states interest is to be paid "on the amount awarded" and pointed out that the legislature rejected alternative language, adopted by other states that have also adopted the Uniform Limited Liability Company Act, under which calculation of interest from the date of dissociation is required. Reading section 7-702(e) in conjunction with section 7-701(a), the court concluded that section 7-702(e) requires the payment of interest upon a dissociated member's distributional interest in an at-will LLC from the date of dissociation. The court noted that it was not making any ruling on the operative date of commencement of interest in the case of dissociation from a term LLC.

Dissolution and Winding Up

LaFond v. Sweeney, 2015 WL 333701, __ P.3d __ (Col. 2015).

This dispute over the distribution of attorney's fees from a contingent-fee case pending at the time of the dissolution of a two-member LLC law firm presented the Colorado Supreme Court with a matter of first impression in Colorado. LaFond and Sweeney formed a law firm as an LLC, and the oral profit-sharing agreement that was in effect at the time of the firm's dissolution was that they shared equally in the profits of the firm without regard to their actual workloads. LaFond represented a client in a whistle-blower action on a contingency fee basis. After a considerable amount of work was done on the case, the firm dissolved. Once the firm dissolved, LaFond continued to represent the client in the action. At the time of the dissolution, there was no written agreement describing how the firm's assets should be distributed, and no written agreement existed regarding how the contingent fee generated by the case would be distributed. LaFond and Sweeney were unable to reach an agreement as to the division of the fees that were potentially going to be earned from the whistle-blower case, and LaFond filed a declaratory judgment action seeking a determination by the court as to how the potential fee should be distributed. The trial court determined that the whistle-blower case had been an asset of the law firm, and the value of the case as an asset of the firm was its value at the time the firm dissolved. The oral agreement between LaFond and Sweeney required any profit from the whistle-blower case to be divided equally, so if LaFond recovered a contingent fee from the case, the trial court held that Sweeney would be entitled to one half of the recovery up to a ceiling of an amount calculated based on the work done and costs advanced as of the date of the dissolution. Sweeney appealed the trial court's order, and the court

of appeals reversed, holding that the trial court should have awarded LaFond and Sweeney each one-half of the profits from the case and that LaFond was not entitled to any additional compensation for his post-dissolution work on the case. The court of appeals relied on three principles: (1) cases belong to clients, not to attorneys or law firms; (2) when attorneys handle contingent-fee cases to a successful resolution, they have enforceable rights to the contingent fee; and (3) a contingent fee may constitute an asset of a dissolved law firm organized as an LLC. Additionally, the court of appeals relied on the difference between the language of the Colorado Uniform Partnership Act of 1997 and the Colorado LLC statute to conclude that members or managers of an LLC that perform services in winding up the LLC are not entitled to additional compensation for their post-dissolution services. The supreme court affirmed the judgment of the court of appeals.

The supreme court first addressed the application of the unfinished business rule, which is based on the continued existence of a dissolved LLC law firm through the winding-up period and the fiduciary duties owed by the members and managers of the LLC. The court looked to the Colorado LLC statute to determine whether it required application of the unfinished business doctrine and concluded that it did. Here, a contingent-fee case was brought into the law firm before it dissolved, and LaFond continued to handle the case after dissolution until the case was resolved. Dissolution did not terminate the LLC law firm. Instead, the entity continued as to all existing matters for the purpose of winding up its unfinished business. The pending whistle-blower case was unfinished business to be completed in the process of winding up the LLC. The client agreed to have LaFond continue the representation, and this choice did not alter the contingent-fee agreement or the rights and duties that LaFond and Sweeney owed each other under their business arrangement. The fiduciary duties of members and mangers of an LLC continue to apply during the winding up process, and LaFond was required to hold as trustee for the LLC any profit derived in the winding up of the business. The profits from the whistle-blower case thus belonged to the firm to be distributed in accordance with the profit-sharing agreement that existed at the time of dissolution. The court relied on the California case of *Jewel v. Boxer* and other out-of-state cases that have held that completing an executory contract is part of winding up a firm's business. The court rejected the argument that adopting the unfinished business rule violates a client's right to counsel of his choice, and the court noted compelling reasons to apply the unfinished business rule over the quantum meruit approach advocated by LaFond. The court stated that the unfinished business rule prevents members and managers from competing for the most lucrative cases during the life of the LLC in hopes of retaining them if the LLC dissolves and also discourages members and managers of a dissolved LLC from scrambling to seize client files and solicit clients. The court found nothing fundamentally unfair about the effect of the unfinished business rule and pointed out that members and managers may alter the rule in the LLC operating agreement if they desire.

The court next addressed LaFond's argument that he was entitled to additional compensation for his services in winding up even if the unfinished business rule applied. Because the Colorado LLC statute requires a member or manager to account to the LLC for the profits derived in the winding up of the LLC's business and is silent on the issue of additional compensation in winding up, the court concluded that the statute does not provide for additional compensation. The court pointed to the legislature's inclusion of language in the Colorado Uniform Partnership Act of 1997 expressly providing for compensation of a partner for services in winding up as well as the inclusion of similar language in the Uniform Limited Liability Company Act. The court stated that the legislature's choice to include such language in Colorado's partnership statute, and its choice to amend the Colorado LLC statute to include some provisions of the Uniform Limited Liability Company Act but not the provision on compensation in winding up, indicated the legislature's intent

not to provide for compensation of an LLC member or manager in winding up absent a provision in the operating agreement.

CB Richard Ellis, Inc. v. Terra Nostra Consultants, 230 Cal.App.4th 405 (Cal. App. 2014).

A creditor of an LLC obtained a judgment against the members of the LLC on the basis that the members had been distributed assets of the LLC upon dissolution of the LLC. The creditor relied on a provision of the California LLC statute that provides that a cause of action against a dissolved LLC, whether arising before or after dissolution, may be enforced against members of the dissolved LLC to the extent of the LLC's assets distributed to the members upon dissolution. Thus, a key issue in the case was when the LLC dissolved and whether assets were distributed to the members upon dissolution. The members complained that the trial court erred in instructing the jury as follows: "'Dissolution of a limited liability company occurs when it ceases operating in the ordinary course of its business, with the intention, on the part of its members, not to resume the ordinary course of its business. Dissolution of a limited liability company is not the same as cessation of all business activity. A limited liability company may continue to do business after it has dissolved for the purpose of winding up its affairs, paying its creditors and distributing its remaining assets. In determining whether a dissolution of [the LLC] ... occurred, you may consider all evidence bearing on that issue, including; for example, the ordinary business of the limited liability company, the assets of the limited liability company both before and after a distribution, the continuation of the ordinary business and the cessation of its ordinary business activities.'" The members argued that the jury should have been limited to inquiring whether one of the three specified causes of dissolution under the statute had occurred. According to the members, so long as a distribution occurs before the de jure dissolution of the LLC, the distribution is not "upon dissolution" for purposes of imposing liability on the members. The court analyzed the statutory scheme and concluded that "de facto" dissolution is an acceptable predicate to a claim of the type asserted against the members in this case, i.e., a claim based on distribution of assets of the LLC "upon dissolution." This approach allows a jury to find that an LLC has actually dissolved at the time of the distribution based on the reality of the LLC's finances and operations. Thus, the jury was correctly instructed in this case.

Comerica Bank v. Global Payments Direct, Inc., C.A. No. 9707-CB, 2014 WL 3779025 (Del. Ch. Aug. 1, 2014).

The parties, a bank and a payment processor, formed a Delaware LLC to process credit and debit card transactions. The bank owned a 49% membership interest, and the processor owned a 51% membership interest, and their relationship was governed by several related agreements executed when the venture began. The bank, which was a member of the Visa and MasterCard associations, agreed to refer merchants exclusively to the LLC, and the processor was to be the exclusive processor for the LLC. Upon the expiration of the service agreement, the bank elected not to renew the service agreement, and the processor elected to dissolve the LLC, as it had a right to do in the event of termination of the service agreement. In a previous opinion, the court held that the terms and conditions of the service agreement that were necessary to perform services during the transition period and which were requested to be extended by the bank would be extended, but terms and conditions that would hinder the transition of services terminated with the service agreement. Additionally, as provided by the contribution agreements, the non-competition obligations ended upon termination of the service agreement. In this decision, the court ruled on two issues: (1) whether the bank was entitled to receive information and assistance from the processor in order to

transition to a new payment processor and whether the processor was required to incur the cost of this assistance; and (2) whether the court should intervene in the winding up of the LLC and appoint a liquidating trustee to oversee the process. The court held that the bank was entitled to the information and assistance relating to the transition to a new payment processor it requested but expenses relating to the transition should be borne by the LLC as a cost of winding up. The court also held that there was cause for the court to appoint a liquidating trustee. The processor argued that "cause," which is not defined in the LLC statute, does not exist unless there is a deadlock among the parties entitled to wind up the LLC. The court declined to take such a limited view. The court interpreted the statute to give the court discretion to make a fact-specific determination on a case-by-case basis. The parties here were deeply divided, and the processor had been unwilling to wind up the LLC in a timely and orderly manner. The default fiduciary duties owed by managers include a duty to promptly distribute assets in a winding up in a manner to maximize value. The processor approached the winding up in a confrontational manner and had acted in its own interest by delaying winding up. Under these circumstances, the court concluded there was cause to intervene in the winding up process and appoint a liquidating trustee.

Comerica Bank v. Global Payments Direct, Inc., C.A. No. 9707-CB, 2014 WL 3567610 (Del. Ch. July 21, 2014).

The parties, a bank and a payment processor, formed a Delaware LLC to process credit and debit card transactions. The bank owned a 49% membership interest, and the processor owned a 51% membership interest, and their relationship was governed by several related agreements executed when the venture began. The bank, which was a member of the Visa and MasterCard associations, agreed to refer merchants exclusively to the LLC, and the processor was to be the exclusive processor for the LLC. Upon the expiration of the service agreement, the bank elected not to renew the service agreement, and the processor elected to dissolve the LLC, as it had a right to do in the event of termination of the service agreement. The parties agreed to an extension of certain services under the service agreement to aid in the transition of the merchant portfolio, but disputes arose in connection with the winding up of the LLC. The bank filed suit seeking a declaration that the bank's exclusivity obligations terminated upon termination of the service agreement and that non-competition obligations contained in contribution agreements between the parties ended upon the LLC's dissolution or termination of the service agreement. Despite an integration clause in the service agreement, the court concluded that the service agreement should be read together with the LLC agreement and contribution agreements between the parties based on the rule that contemporaneous contracts between the same parties concerning the same subject matter should be read together. The court discussed the terms of the agreements in detail and rejected the processor's argument that the exclusivity obligations survived termination of the service agreement and applied during the transition period. The court held that the terms and conditions of the service agreement that were necessary to perform services during the transition period and were requested to be extended by the bank would be extended, but terms and conditions that would hinder the transition of services terminated with the service agreement. Additionally, as provided by the contribution agreements, the non-competition obligations ended upon termination of the service agreement.

In re Reinstatement of Southern Labor Services, L.L.C., 142 So.3d 60 (La. App. 2014).

In 2006, Stacey Roque and Joaquin Roque formed an LLC to provide contract labor for demolition and remediation projects. The Roques were the sole members of the LLC and in 2010, they filed an affidavit to dissolve its status pursuant to a provision of the Louisiana LLC statute that

provides for dissolution of an LLC by affidavit of the members if the LLC is no longer doing business and owes no debts. The statute provides that after such a dissolution the members are liable for any debts or other claims against the LLC in proportion to their ownership interest. In 2012, a former employee of the LLC filed a lawsuit against the LLC asserting a workers' compensation claim based on an injury in 2008. The LLC had reported this injury in 2008 to its workers' compensation carrier, which voluntarily initiated payments to the injured employee. In the employee's lawsuit, the Roques filed a petition for reinstatement of the LLC for purposes of defending against the employee's claims and the claims of another defendant against the LLC. Additionally, the LLC sought to pursue claims against its carrier. The carrier intervened in the lawsuit and opposed the LLC's reinstatement. At a hearing on the reinstatement at which no evidence was admitted, the court granted the reinstatement for the stated purpose of giving the parties their day in court to try the matter on the merits. The trial court granted the reinstatement retroactive to the date of the LLC's dissolution and ordered the secretary of state to retroactively reinstate the LLC. The carrier argued that the trial court erred in granting the reinstatement without receiving any evidence. On appeal, the parties disagreed as to whether an evidentiary hearing was required and what the Roques were required to establish in order to obtain reinstatement. The Louisiana statutory provision that permits dissolution by affidavit when an LLC is no longer doing business and has no debts provides that the secretary of state shall reinstate an LLC only upon receipt of an order of a court of competent jurisdiction, but the statute does not specify the procedural aspects of a reinstatement proceeding. The court of appeals concluded that evidence needs to be presented for an LLC to be reinstated, and the court thus vacated the trial court's order and remanded the matter for an evidentiary hearing for the Roques to prove that they were entitled to reinstatement of the LLC.

L.B. Whitfield, III Family LLC v. Whitfield, 150 So.3d 171 (Ala. 2014).

L.B. Whitfield III ("L.B.") formed the L.B. Whitfield, III Family LLC (the "Family LLC") in 1998 and contributed to it shares of stock in a corporation that had been owned by at least four generations of the Whitfield family. L.B. was the father of three daughters ("the sisters") and a son ("Louie"). L.B. was the sole member of the Family LLC, and L.B. and Louie were the managers. The stock L.B. contributed to the Family LLC included 22 voting shares that at one time were owned by the sisters but had been transferred by the sisters to L.B. in 1981 pursuant to an agreement under which they received 44 nonvoting shares in exchange for their 22 voting shares. The 1981 agreement gave the sisters certain rights to reacquire the 22 voting shares on the death of L.B. in exchange for their 44 nonvoting shares. In 1998, before L.B. formed the LLC, the sisters signed an agreement cancelling the 1981 agreement. On the same date on which the Family LLC was formed, L.B. executed his will, which made specific bequests of certain property and provided that the residue of his property was to be divided in four equal shares to Louie and the sisters. In 2000, L.B. died, and Louie took various actions as executor of L.B.'s estate and manager of the Family LLC in an effort to continue the Family LLC in the wake of L.B.'s death. Capital accounts in the LLC were established for Louie and the sisters. In 2005, the sisters signed a consent to the settlement of L.B.'s estate, and Louie filed a petition for final settlement of L.B.'s estate that listed the Family LLC as an asset "on hand" in the estate. Following the closing of the estate, Louie and the sisters began receiving a 25% share of the dividends produced by the shares held in the Family LLC. The distribution checks were deposited in capital accounts for each individual, and K-1 tax forms were issued with respect to the receipt of the dividends. In 2010, the sisters wrote letters to Louie requesting that he return the 22 shares to the sisters based on the 1981 agreement. The Family LLC

filed a complaint against the sisters seeking a judgment declaring that the sisters had no right to the 22 voting shares held by the Family LLC. The sisters filed various counterclaims and a third party complaint against Louie. Eventually, the sisters filed an amended complaint in which they requested a permanent injunction against the Family LLC to take only those actions necessary and appropriate to wind up the Family LLC and distribute the assets and to comply with the 1981 agreement by tendering the 22 shares of voting stock to the sisters. The request was based on the contention that the Family LLC was dissolved as a matter of law and pursuant to the terms of the operating agreement and was only permitted to take actions necessary and appropriate to wind up the affairs of the LLC. The trial court decided that the Alabama Limited Liability Company Law dictated that the LLC was dissolved, either as of the date of L.B.'s death or the date of the entry of the decree of final settlement of L.B.'s estate, and was not extended by an agreement in writing among all the owners. Thus, the trial court found that the affairs of the Family LLC must be promptly wound up. The trial court also concluded that the 1981 agreement had been voided and cancelled and that the sisters were entitled to the return of the 22 voting shares held by the LLC and must return the 44 nonvoting shares to the Family LLC to be distributed in four equal shares to Louie and the sisters.

On appeal, the Family LLC argued that the sisters' claim seeking dissolution of the Family LLC was barred by res judicata, laches, equitable estoppel, and judicial estoppel. The court rejected all these defenses. Initially, the court pointed out that the sisters' complaint did not ask the trial court to dissolve the Family LLC; it sought an injunction to require a winding up of the LLC in recognition of what they argued was the LLC's dissolution as a matter of law. With respect to the Family LLC's res judicata argument, the court stated that the decree of final settlement of L.B.'s estate did not adjudicate the continuation of the Family LLC. According to the court, whether the Family LLC continued its normal existence or was dissolved on L.B.'s death so that it was required to be wound up was not a central or even peripheral issue in the probate of L.B.'s estate. With respect to the Family LLC's laches argument, the court stated that no condition between the parties changed between 2000 and 2010 that would make raising the issue of dissolution of the Family LLC in 2010 inequitable. Likewise, the elements of equitable estoppel were not present. The Family LLC's "judicial estoppel" argument was essentially its res judicata argument by another name, and the court saw no basis for the defense of judicial estoppel.

The court next addressed the Family LLC's contention that the trial court erred in concluding that the Family LLC was dissolved in 2000 when L.B. died, and the court concluded that the trial court reached the correct conclusion. The Family LLC argued that Louie and the sisters became members of the Family LLC, but the sisters contended that they and Louie merely inherited the financial rights associated with the membership L.B. held in the Family LLC before his death. The sisters contended that they never agreed to become, and did not become members, of the Family LLC. The articles of organization listed only L.B. as a member, and the Family LLC did not contend that anyone else became a member before L.B.'s death. The Family LLC argued that Louie and the sisters became members of the LLC as a result of a transfer of membership made by Louie as personal representative of L.B.'s estate. Under the Alabama LLC statute, an LLC is dissolved and must be wound up when there is no remaining member unless (1) all of the holders of financial rights in the LLC agree in writing, within 90 days after the cessation of the membership of the last remaining member, to continue the legal existence and business of the LLC and to appoint one or more new members, or (2) the LLC's legal existence and business is continued and one or more new members are appointed as provided in the governing documents. The Family LLC relied on a provision of the LLC statute that gives a personal representative the power to exercise a deceased member's financial rights, including the power to transfer the membership interest, for the purpose

of settling the member's estate or administering the member's property, but the court pointed out that this provision does not state that a personal representative of a member becomes a member. It only provides for the exercise of the deceased member's financial rights, including the transfer of those rights, for a limited purpose. The court pointed out that the commentary to the predecessor provision of this portion of the statute stated that the personal representative of a member may only exercise financial rights and does not have the right to participate in management of the LLC. The LLC statute only specifies two exceptions to the general rule that an LLC is dissolved and must wind up on the death of the last remaining member, and the Family LLC relied only on the exception that requires the holders of all financial rights to agree in writing to continue the legal existence and business of the LLC and to appoint one or more new members. The Family LLC contended that this requirement was met when Louie probated L.B.'s will, established a new employer identification number for the LLC, opened a bank account, and worked with the sisters to establish capital accounts for himself and his sisters. The court did not see in those actions an "agreement in writing" of the nature contemplated by the statute. Even if these actions were an agreement in writing, they were undertaken by Louie in his capacity as personal representative when it was Louie in his individual capacity as well as his sisters that would have had to enter into the agreement. The court also rejected the Family LLC's argument that the final settlement of the estate constituted such an agreement. Further, the actions of the sisters with regard to matters such as accepting dividends did not constitute an agreement in writing as contemplated by the statute. The court stated that the nature of LLCs does not allow for the possibility that the sisters somehow could agree to the continuation of the Family LLC or become members of it by implication or by Louie's actions rather than their own actions and consent. The court stressed that the law requires written documentation of consent to membership by all members of an LLC, and the court agreed with the trial court's comment that the statutory scheme does not provide that people who do not desire to be in business together can be made to do so without their consent. Because there was no agreement in writing by all of the holders of the financial rights in the Family LLC to continue its business, it dissolved and must be wound up.

The court agreed with the Family LLC that the trial court erred in ordering the distribution of the 22 voting shares solely to the sisters. The trial court apparently concluded that the 1998 cancellation constituted a rescission of the 1981 agreement, but the supreme court examined the evidence and concluded that the 1998 cancellation was not intended to rescind the 1981 agreement. The language of the 1998 cancellation and the conduct of the parties indicated that the intent was simply to cancel and void any further rights or obligations under the 1981 agreement going forward. Thus, the 22 voting shares held by the Family LLC should be distributed in the winding up in four equal shares to Louie and the sisters, and the sisters were entitled to retain their 44 nonvoting shares.

Judicial or Administrative Dissolution

Beaudry v. Harding, 104 A.3d 134 (Me. 2014).

A member of an administratively dissolved LLC sued the LLC's attorney for malpractice. The member sued individually and derivatively, and the defendant sought and obtained summary judgment. The member appealed, and the court was not persuaded that he was authorized to bring a derivative claim or that he could bring an individual claim when the only harm he alleged was not a harm that was personal to him. The court focused on the member's argument that the Maine Limited Liability Company Act authorizes an administratively dissolved LLC to prosecute claims to collect the LLC's assets. The provision of the Maine LLC statute entitled "Procedure for and

effect of administrative dissolution of a limited liability company" provides that dissolution of an LLC does not impair the LLC's rights to *defend* an action. In contrast, the provision entitled "Effect of dissolution," which is located in the statute following the provision pertaining to voluntary and judicial dissolution, provides that the dissolution of an LLC does not prevent the commencement of a proceeding by or against the LLC. Reading the provisions in relation to the entire statutory scheme, the court concluded that the more specific provision governing the effect of an administrative dissolution controlled, and an administratively dissolved LLC may defend claims but is not authorized to prosecute claims.

Gagne v. Gagne, 338 P.3d 1152 (Col. App. 2014).

Paula and Richard Gagne, mother and son, were the members of four LLCs, each of which owned apartment complexes. Richard filed an action for judicial dissolution of the LLCs, declaratory relief, and appointment of a receiver, and Paula asserted numerous counterclaims. The trial court granted partial summary judgment against Richard on his judicial dissolution claim on the basis that the LLC agreements provided a means of navigating around membership deadlock and the purpose of the LLCs, i.e., to operate apartment complexes, could profitably continue in accordance with the LLC agreements even in the absence of cooperation between the parties. The case proceeded to trial on the merits, and both parties appealed. The court of appeals agreed with Richard that the trial court erred in granting summary judgment on his claim for judicial dissolution. The Colorado LLC statute provides that an LLC may be dissolved in a proceeding by or for a member or manager "if it is established that it is not reasonably practicable to carry on the business of the limited liability company in conformity with the operating agreement" of the LLC. As a matter of first impression in Colorado, the court of appeals determined that this standard requires a party seeking judicial dissolution to "establish that the managers and members of the company are unable to pursue the purposes for which the company was formed in a reasonable, sensible, and feasible manner." The test is whether it is "reasonably practicable to carry on the business of the LLC, not whether it is impossible to do so." Factors to be considered– no one of which is necessarily dispositive, and all of which are not required– include: (1) whether the management is unable or unwilling to reasonably permit or promote the purposes for which the company was formed; (2) whether a member or manager has engaged in misconduct; (3) whether the members have clearly reached an inability to work with one another to pursue the company's goals; (4) whether there is deadlock between the members; (5) whether the agreement provides a means of navigating around the deadlock; (6) whether, due to the company's financial position, there is still a business to operate; and (7) whether continuing the company is financially feasible. The court pointed out that the language in the LLC statute is not the same as that in the corporate and limited partnership statutes, and the court thus rejected the argument that LLCs may be dissolved solely based on oppressive conduct, like corporations, or solely based on substantial misconduct, like partnerships. Applying this standard to the case at hand, the court of appeals concluded that there were genuine issues of material fact precluding summary judgment on Richard's judicial dissolution claim. The court acknowledged that there was no evidence that the LLCs were financially unfeasible, but there was nevertheless substantial evidence raising a genuine issue of material fact as to whether Paula and Richard could pursue the purposes for which the LLCs were formed in a reasonable, sensible, and feasible manner. There was evidence of misconduct on the part of Paula and extreme dysfunction between the parties, including physical altercations. The evidence also raised fact issues as to whether there was a deadlock and whether the LLC agreements provided a mechanism for navigating a deadlock. The LLC agreements provided for mediation in certain circumstances, but mediation had already failed.

Although Paula was Chief Executive Manager and had a 51% voting interest and the undisputed right to sell the assets, it was not clear that the LLC agreements gave Paula the unilateral right to control all management of the properties. For example, the agreements required unanimous agreement to hire and fire a new property manager. The court of appeals thus reversed and remanded for further consideration of the judicial dissolution claim under the standard pronounced by the court.

Pannell v. Shannon, 425 S.W.3d 58 (Ky. 2014).

Shannon, the sole member of Elegant Interiors, LLC, executed a lease identifying the LLC as the tenant. At the time the lease was signed, the LLC had been administratively dissolved, but the LLC was subsequently reinstated. Pannell, the lessor, asserted several bases for holding Shannon personally liable, some of which hinged on the fact that the LLC was administratively dissolved when the lease was executed. The court concluded that the retroactive effect of the reinstatement of the LLC under Kentucky law precluded the member from being liable as a member or under agency principles for actions taken on behalf of the LLC while the LLC was administratively dissolved.

The court first considered the effect of the administrative dissolution and subsequent reinstatement of the LLC with regard to Shannon's statutory protection from liability as a member of the LLC. The court concluded that a member of an LLC is protected by the Kentucky LLC statute from liability for actions taken during a period of administrative dissolution so long as the LLC is reinstated before a final judgment is rendered against the member. The court analyzed the relevant statutory provisions at length and concluded that the relation-back language in the statute and the cancellation of the certificate of dissolution by the secretary of state in a reinstatement result in a retroactive undoing of the dissolution as if the administrative dissolution never took place.

The court next addressed the effect of the administrative dissolution and subsequent reinstatement of the LLC with regard to Shannon's potential liability based on agency principles. This analysis involved two sub-questions. First, could Shannon be personally liable merely by reason of being an agent of a dissolved LLC? Second, could Shannon be personally liable as an agent who acted without authority? With respect to the first question, the court noted that the statutory protection from liability for the debts, obligations, and liabilities of an LLC extends to managers and agents as well as LLC members. Thus, the analysis above as to why a member of an administratively dissolved LLC is protected from liability by the retroactive effect of reinstatement would also apply to the extent liability was predicated solely on Shannon's status as a manager or agent. The court went on to address Pannell's argument that Kentucky should follow the majority rule that reinstatement of a corporation does not shield officers from personal liability for debts incurred after dissolution. The court stated that the existence of a majority rule was only persuasive if the rule is based on statutes like those in Kentucky, and the court stated that many of the cases in other jurisdictions proclaiming the majority rule depended on statutes different from Kentucky's and may not even reflect the current statutory law in those jurisdictions. Under the Kentucky statutory provisions regarding dissolution, reinstatement, and liability protection of agents of LLCs, Shannon was not personally liable based merely on her status as an agent of an administratively dissolved LLC. Likewise, the court concluded that the retroactive effect of reinstatement meant there was never a failure of Shannon's authority as an agent of the LLC. Pannell argued that Shannon lacked authority to act on behalf of the LLC because there was no LLC in existence when the lease was signed and the dissolution statute limited the LLC's permitted activities to winding up its business. But the court noted that a dissolved LLC continues to exist under the Kentucky LLC statute, and the retroactive effect of reinstatement creates a "seamless existence and functionality for the LLC" so that there was never a failure of Shannon's authority. Pannell complained that the LLC's

reinstatement occurred only after he filed suit, and Pannell suggested that the court's reading of the statute had an inequitable effect, but the court characterized reinstatement as a matter between the state and the LLC and pointed out that Pannell received what he expected in the transaction.

Houk v. Best Development & Construction Company, Inc., 322 P.3d 29 (Wash. App. 2014).

The plaintiffs moved into a newly constructed home in 2004 and sued the LLC developer in 2010 after discovering defects in the home. The LLC was administratively dissolved by the Washington Secretary of State in 2006. Under the 2006 version of the Washington LLC statute, the three-year statute of limitations applicable to claims against a dissolved LLC began to run on the effective date of an LLC's dissolution regardless of whether the LLC was administratively or non-administratively dissolved. In 2010, the Washington legislature amended the LLC statute to provide that the dissolution of an LLC does not take away or impair any remedy to or against an LLC for any pre- or post-dissolution claim or liability unless the LLC has filed a certificate of dissolution. If the 2010 version applied retroactively, the plaintiff's lawsuit was timely, but under the prior version, the plaintiffs were required to file their lawsuit within three years from the date of the LLC's administrative dissolution. The court analyzed the amended version and concluded that the plaintiffs failed to show legislative intent that it apply retroactively or that it was clearly curative or remedial. Thus, the court followed the presumption that the amended statute operated prospectively, and the plaintiffs' suit was time-barred.

In re Interstate General Media Holdings, LLC, C.A. No. 9221-VCP, 2014 WL 1697030 (Del. Ch. April 25, 2014).

One of the members of a two-member LLC petitioned for judicial dissolution of the LLC, and the court in this proceeding determined what would be the most appropriate method of liquidating the LLC's assets. Prior to the dispute, the LLC acquired a media network and its subsidiaries, including the Philadelphia Inquirer, the Daily News, and Philly.com. The management committee consisted of two persons, one of which was appointed by each member of the LLC. Following the LLC's acquisition of the media network, the LLC's management committee members could not agree on the management of the LLC, and one of the LLC's members petitioned the court to dissolve the LLC. The dispute addressed in this opinion involved what type of auction would be most appropriate to wind down the LLC's affairs—a public auction orchestrated by an auctioneer (advocated by the petitioner) or an "English-style" open-outcry auction (favored by the other member). Because the LLC agreement did not contain a provision governing the type of auction that should be used, the court analyzed what type of auction would maximize the LLC's value. The court determined that a public auction would be unlikely to maximize the company's value because the record indicated a reasonable probability that no serious outside bidders would emerge to bid on the LLC. Because only the parties involved had a desire to purchase the LLC, a private auction would be more likely to expediently and efficiently liquidate the LLC. The court also concluded that a private "English-style" auction would be cheaper and thus the preferable method to auction assets.

Foreign LLCs: Governing Law

Heaps v. Nuriche, LLC, 2015 WL 404572, __ P.3d __ (Utah 2015).

Employees of a Nevada LLC sought to hold the managers of the LLC personally liable for unpaid wages under the Utah Payment of Wages Act (UPWA), which provides for civil and criminal liability on the part of employers for unpaid wages and defines an "employer" as "every person, firm,

partnership, association, corporation, receiver or other officer of a court of this state, and any agent or officer of the above-mentioned classes, employing any person in this state." The court first rejected the managers' argument that Nevada law applied to their liability under the Utah Revised Uniform Limited Liability Company Act, which provides that the law of the jurisdiction of formation of a foreign LLC governs "the liability of a member as member and a manager as manager for a debt, obligation, or other liability of the company." The managers argued that unpaid wages are like any other debt of an LLC and that Nevada law should be applied to determine the managers' liability for the unpaid wages. The court responded that the employees were not seeking to hold the managers liable for an obligation of the LLC but were arguing that UPWA imposed direct liability on the managers. Because the employees' theory was premised on direct liability, and the conflict-of-laws provision in the Utah LLC statute applied to liability for obligations of the LLC, the conflict provision did not apply to this case. Further, the court pointed out that the Utah LLC statute provides that registration of a foreign LLC to do business in Utah does not authorize the foreign LLC to engage in activities or exercise any power that a Utah LLC may not engage in or exercise in Utah. Because a foreign LLC that employs employees in Utah is required to follow Utah wage law, any claim of illegal wage practice by a Utah employee will be governed by Utah wage law. The court next analyzed the UPWA and concluded that it did not impose personal liability for unpaid wages on managers of an LLC employer.

Thomas v. Bridges, 144 So. 1001 (La. 2014).

Thomas, a Louisiana resident, formed a Montana LLC solely to avoid the Louisiana sales tax on a recreational vehicle. Montana is the only state that does not impose sales tax on the purchases of vehicles by its residents, including resident LLCs, and Montana LLCs are commonly formed for the sole purpose of avoiding sales tax. The purchase of the RV was the only business conducted by the LLC, and the RV was kept in Mississippi. The Louisiana Department of Revenue assessed sales tax against Thomas on the RV, and Thomas appealed the assessment to the Board of Tax Appeals, which affirmed the assessment. The district court reversed the assessment, and the court of appeals upheld the reversal. The Louisiana Supreme Court concluded that the Department did not establish a basis to assess Thomas individually for the tax and affirmed the lower courts' reversal of the assessment. The supreme court acknowledged that the purpose of forming an LLC is to protect the LLC's members from personal liability, and the court stated that the Department erred in ignoring the LLC's separate existence and assessing Thomas individually before establishing any basis for doing so. After Thomas appealed the assessment, the Department contended that the veil of the LLC should be pierced, but the supreme court stated that "this after-the-fact appraisal the veil should be pierced does not change the fact the existence of [the LLC], a validly formed Montana LLC, was ignored in derogation of Louisiana's statutory protections for LLCs, Louisiana's obligation under the United States constitution to provide full faith and credit to the laws of Montana, and Thomas's constitutional right to due process." Instead of pursuing Thomas individually, the court stated that the Department should have first assessed the LLC. Under the Louisiana LLC statute, the question of whether the LLC was validly formed and the extent of personal liability of the members are governed by the law of the jurisdiction of organization of the LLC, but the Department never applied Montana law in determining whether to pierce the LLC's veil. The court went on to note that the Department could still have assessed Thomas individually, even if no personal liability existed under Montana law, if the Department established fraud on the part of Thomas, relying on a provision of the Louisiana LLC statute that provides that nothing in the statute shall be in derogation of any rights

a person may have against a member of an LLC because of any fraud practiced on the person. There was no evidence, however, of any fraud on Thomas's part.

GE Mobile Water, Inc. v. Red Desert Reclamation, LLC, 6 F.Supp.2d 195 (D.N.H. 2014).

The plaintiff sued an LLC and its parent corporation for the LLC's failure to fulfill its obligations under a contract with the plaintiff. The parties cited both New Hampshire and Virginia law, and the court stated that neither party made a serious attempt to analyze the choice-of-law issues or claimed that its argument on any issue depended upon how choice-of-law questions were resolved. The court thus applied New Hampshire law without any choice-of-law analysis.

Trinity Industries Leasing Company v. Midwest Gas Storage, Inc., 33 F.Supp.3d 947 (N.D. Ill. 2014).

The plaintiff obtained a default judgment in Texas state court for breach of contract against a Delaware LLC headquartered in Illinois. In this case, the plaintiff sued the judgment debtor LLC's president and CEO, O'Malley, alleging that O'Malley schemed to defraud the plaintiff by causing the LLC to lease railcars from the plaintiff and sublease those railcars to other companies and then funneling the payments from the other companies to himself and other entities under his control. The plaintiff claimed that O'Malley misrepresented the financial condition of the LLC when it entered into the lease with the plaintiff and that the LLC was in the process of selling its business at that time. In this case, the plaintiff asserted claims based on fraud, veil piercing, and fraudulent transfer. The parties agreed that Texas law applied to the plaintiff's fraud claim, and the court held, under Indiana choice-of-law rules, that Texas law applied to the extent that the plaintiff's fraud claim rested on breach of fiduciary duty as well. The court rejected the plaintiff's argument that Delaware law governed the question of whether O'Malley owed the plaintiff a duty under the trust fund doctrine because Indiana choice-of-law rules do not permit different issues within the same claim to be governed by different laws. The plaintiff did not rely on the trust fund doctrine as a separate basis of recovery but sought to extrapolate a fiduciary duty to creditors pursuant to the trust fund doctrine. The court noted that Texas had slowly abrogated the trust fund doctrine by the enactment of remedial statutes, and the parties disputed whether the doctrine remained viable in Texas. Although the court recognized that Indiana choice-of-law rules required the application of Texas law to each element of the plaintiff's fraud claims, the court also stated that whether the trust fund doctrine imposes a fiduciary duty on directors and officers of a corporation or LLC is a matter of internal affairs governed by the law of the state of formation under Indiana corporate and LLC choice-of-law laws. While the scope of the trust fund doctrine was uncertain in Texas, it has clearly been rejected in the LLC context in Delaware so that creditors of a Delaware LLC have no claim for breach of fiduciary duty under the trust fund doctrine. Because the judgment debtor LLC was a Delaware LLC, the court stated that the plaintiff could not rely on the trust fund doctrine to establish that O'Malley owed the plaintiff a fiduciary duty. Because the judgment debtor LLC was organized in Delaware, the parties agreed that Delaware law controlled the plaintiff's alter-ego claim against O'Malley. The court stated that the same rules that apply to corporate veil piercing apply to LLCs under Delaware law, and the court held that the plaintiff pled facts sufficient to state a claim to disregard the LLC's organizational structure and hold O'Malley liable under an alter-ego theory. The parties agreed that Texas law applied to the plaintiff's fraudulent transfer claims, but the plaintiff claimed that Indiana's statute of limitations for fraudulent transfers should apply because Indiana's procedural law applied to the lawsuit. The defendants argued that the Texas Uniform Fraudulent Transfer Act (TUFTA) contains a statute of repose, not limitations, and that this statute of repose applied to the plaintiff's claims. The

court agreed with the defendants that the TUFTA statute of repose applied, but the court concluded that Texas law recognizes an exception to the statute of repose for discovery and that the plaintiff's claims were sufficient to trigger that exception.

Lopes v. JetSetDC, LLC, 994 F.Supp.2d 135 (D.D.C. 2014).

The plaintiff relied on veil-piercing theory as a basis to hold two individual members of an LLC liable for tort claims against the LLC, and the members sought dismissal of the claims on the basis that the plaintiff did not plead facts sufficient to pierce the veil of the LLC. The court noted that there was a question as to whether the veil-piercing doctrine of the District of Columbia (where the events occurred) or Maryland (the jurisdiction in which the LLC was organized and its principal office was located) applied in this case. The court stated that the District of Columbia choice-of-law rules required the court to conduct an "interest analysis" to determine which jurisdiction's underlying policy would be most advanced by having its law applied. The court concluded that no real conflict existed between the veil-piecing doctrines of the District of Columbia and Maryland in that both doctrines are firmly grounded in equity and recognize the alter ego theory as a means to pierce the corporate veil. The court then proceeded to apply the law of the District of Columbia.

Charging Order

Levy v. Carolinian, LLC, 763 S.E.2d 594 (S.C. 2014).

After obtaining a $2.5 million judgment against an LLC member, the judgment creditors obtained a charging order against the member's interest and purchased the interest at a foreclosure sale for $215,000. The LLC was represented at the foreclosure sale, but the judgment creditors outbid the LLC. The South Carolina LLC statute provides that a charging order is the exclusive remedy by which a judgment creditor may satisfy a judgment out of the judgment debtor's distributional interest, and a charging order constitutes a lien that may be foreclosed at any time by order of a court. Both the South Carolina statute and the operating agreement provided that the LLC had the right to redeem the judgment debtor's interest at any time prior to foreclosure. The operating agreement also provided that a creditor who obtained any part of a member's interest by charging order could only become a member with the written consent of all members after the transfer and that such a transferee had no right to vote or participate in the management of the LLC. These provisions were consistent with the provisions of the South Carolina statute regarding a distributional interest and the rights of a transferee. Neither the LLC nor its members redeemed the judgment debtor's interest before the foreclosure sale, and the judgment creditors did not seek to be admitted as members of the LLC. After the foreclosure sale, the LLC asserted that provisions of the operating agreement gave the LLC the right to force the judgment creditor to sell the interest to the LLC. The LLC relied on Article 11 of the operating agreement, which contained restrictions on transfer of a member's interest. Section 11.1 of the operating agreement contained a provision that prohibited a member from voluntarily or involuntarily selling, transferring, hypothecating, or otherwise conveying any portion of the member's interest without the prior written consent of members having 67% of the voting rights. Section 11.1 also stated that any attempted conveyance or encumbrance by a member without the required consent was null and void. Section 11.2 provided that a member who attempted to transfer all or a portion of his interest without obtaining the other members' consent was deemed to have offered to the LLC all of the member's interest. The judgment creditors argued that the ability of the LLC to redeem the judgment debtor's interest was extinguished by the foreclosure sale and that Article 11 did not compel the judgment creditors to sell

their interest to the LLC. The supreme court agreed with the judgment creditors. The court pointed out that, consistent with the LLC statute, the operating agreement provided that a member's interest may be redeemed at any time prior to the foreclosure sale, and the court reviewed the provisions of the South Carolina LLC statute relating to transfer of a distributional interest and the rights of a transferee. The court noted that the operating agreement is the essential contract governing the affairs of an LLC, but the operating agreement may not restrict the rights of a person other than a manager, member, and transferee of a member's distributional interest. The supreme court concluded that Article 11 did not apply to the judgment creditors before they became transferees and did not restrict them from foreclosing their charging order lien. The court pointed out that the transfer restrictions in Section 11.1 applied only to "members," and the judgment creditors merely became transferees. Further, they were not even transferees until after the foreclosure sale. Thus, the court stated that the operating agreement could not restrict the statutory rights of the judgment creditors by requiring consent of the LLC or its members before the foreclosure sale, and the restrictions of Section 11.1 did not apply to the judgment creditors at the time they foreclosed their charging order lien. Further, because they were not required to obtain consent under Section 11.1, the court concluded that the LLC could not invoke a right to purchase under Section 11.2. In sum, the court held that the LLC's ability to purchase the judgment debtor's interest was not controlled by any part of Article 11, but rather by Section 3.5, which provided the opportunity to purchase the interest before the foreclosure sale. The court noted that the LLC also had the opportunity to obtain the interest at the foreclosure sale itself, and this opportunity was limited only by the LLC's decision not to outbid the judgment creditor.

First Bank v. S & R Grandview, L.L.C., 755 S.E.2d 393 (N.C. App. 2014).

A trial court entered a charging order against a judgment debtor's interest in an LLC. The trial court's order stated that the judgment creditor shall have the rights of an assignee and was to be treated as an assignee, and the order enjoined the judgment debtor from exercising any rights of a member until the judgment was paid and provided that his "membership right shall lie fallow" until the judgment was satisfied. The court of appeals agreed with the judgment debtor that the trial court erred in concluding that the charging order effectuated an assignment of his membership interest and by enjoining him from exercising his management rights and ruling that these rights "lie fallow." The court of appeals interpreted the charging order provision of the North Carolina LLC statute prior to recent amendments, but the court found that the recent amendments supported the court's conclusion. Before it was amended, the provision stated that a judgment creditor who received a charging order had only the rights of an assignee of the membership interest to the extent the interest was charged. The statutory provision addressing an assignment of a membership interest provides that an assignee is entitled to distributions and allocations to which the assignor would be entitled but for the assignment and also provides that a member ceases to be a member upon assignment of all of his membership interest. The judgment debtor relied on this latter provision for the proposition that the judgment debtor ceased to be a member upon entry of the charging order because it amounted to an assignment of his interest. The court disagreed with the judgment creditor's interpretation. While the charging order provision stated that the judgment creditor has only the rights of an assignee, the provision did not state that a charging order effectuates an assignment and terminates the member's membership in the LLC. The court examined the charging order provision of the new North Carolina Limited Liability Company Act that became effective January 1, 2014, and concluded that the language of the new charging order provision clarifies the rights of a judgment creditor seeking a charging order. The new provision states that, to the extent an interest

is charged, a judgment creditor has only the right to receive distributions that otherwise would be paid to the interest owner, that the charging order is a lien on the judgment debtor's economic interest, and that the interest owner is not deprived of any right. The court distinguished a charging order from an actual assignment, pointing out that a trial court may charge the membership interest of the member with payment of the *unsatisfied* amount of the judgment so that once the judgment is paid, the member's interest is no longer charged. An assignee of a member's interest in the LLC has no such limitation. The court rejected the judgment creditor's argument that a charging order was not included in the statutory exceptions to the rule that a member ceases to be a member upon assignment of all of a member's membership interest. The court concluded that a charging order is an encumbrance encompassed in the portion of the statute providing that "the pledge of, or granting of a security interest, lien, or other encumbrance in or against, all or any part of the membership interest of a member shall not cause the member to cease to be a member or the secured party to have the power to exercise any rights or powers of a member." Finally, the court rejected the argument that the title to the section of the North Carolina Limited Liability Company Act containing the charging order provision required that charging orders be interpreted to effectuate assignments. The fact that the legislature placed the charging order provision in a section entitled "Assignment of Membership Interests; Withdrawal" did not change the plain meaning of the provision, which unambiguously gives the judgment creditor the rights of an assignee but does not provide for actual assignment.

Young v. Levy, 140 So.3d 1109 (Fla. App. 2014).

Levy, the 51% member of an LLC, terminated Young, the 49% member, and denied her access to the business premises and bank accounts of the LLC. Young sought and obtained an emergency preliminary injunction, but the trial court subsequently vacated the injunction, and the court of appeals affirmed. Levy moved for an award of attorney's fees and recovery of the bond posted by Young, and the trial court granted these requests. Levy then sought and obtained a writ of garnishment ordering the LLC to disburse to Levy funds owed by the LLC to Young to satisfy the judgment for attorney's fees owed by Young to Levy. Young appealed the trial court's order of disbursement of moneys to Levy through a writ of garnishment. The court of appeals held that the charging order provision of the Florida LLC statute precluded the use of garnishment as a remedy in this case. The Florida LLC statute provides that a charging order is the sole and exclusive remedy by which a judgment creditor of a member may satisfy a judgment from the member's interest in the LLC or rights to distributions from the LLC. Levy argued that the funds here were "profits" or "dividends" subject to garnishment, but the court pointed out that the statutory definition of a member's "interest" in the LLC is the member's share of the profits and losses of the LLC and the right to receive distributions from the LLC. Thus, utilizing garnishment as a remedy to satisfy Levy's judgment against Young violated the plain language of the statute.

In re Boone County Utilities, LLC (Boone County Utilities, LLC v. The Branham Corporation), 518 B.R. 511 (Bankr. S.D. Ind. 2014).

The Branham Corporation ("Branham") obtained a judgment against Newland Resources, LLC, the sole member of the debtor, Boone County Utilities, LLC ("BCU"), after the plan had been confirmed and all BCU's assets had been distributed to Newland under the plan more than nine years ago. Branham's aggressive efforts to collect the judgment in the bankruptcy proceedings led BCU to file a complaint asking the bankruptcy court to enter a declaratory judgment that the plan and various other matters occurring in the bankruptcy proceeding were not subject to collateral attack

by Branham. Branham filed a counterclaim asking for discovery and for garnishment of Newland's economic interest in BCU. The court discussed various principles in order to address the specific issue before the court, which was whether Branham should be allowed to take a deposition of a representative of BCU and conduct paper discovery. The court first stated that the Indiana LLC statute permits a judgment creditor to seek a charging order against the LLC, which entitles the judgment creditor only to the rights of an assignee of the member's economic interest. The judgment creditor cannot become a member via execution. Although an LLC interest is personal property and is subject to execution, the court stated that the interest is limited to economic rights, and Branham could not receive through execution any of Newland's rights to participate in management or inspect the books and records of Newland. The court stated that the result of the limited remedy provided by the charging order was that Branham was not entitled to membership in Newland, not entitled to participate in corporate actions or force a distribution, not entitled to inspect Newland's books and records, not entitled to participate in the management, governance, or direction of Newland, and did not acquire any rights to Newland's membership in BCU or to participate in corporate actions, management, governance, or direction of BCU. The court went on to reach various conclusions about Branham's requested discovery in the bankruptcy proceeding. In sum, the court found that BCU need not produce any discovery regarding its corporate governance or any facts responding to its pre-confirmation operations, claims, or assets. To the extent Branham's discovery pertained to BCU's post-confirmation activity, assets, or claims, that discovery should be sought in the state court action.

Fraudulent Transfer

In re Galaz (Galaz v. Galaz), 765 F.3d 426 (5th Cir. 2014).

Lisa Galaz brought an adversary proceeding against her ex-husband, Raul Galaz, for fraudulently transferring the assets of an LLC in which Lisa owned a 25% economic interest. In Lisa and Raul's divorce, they executed a divorce decree under which Raul assigned half of his LLC 50% interest to Lisa. The transfer occurred in violation of the operating agreement without the other member's consent, and Lisa therefore received a 25% economic interest with no management or voting rights. Raul, as manager of the LLC, transferred the assets of the LLC to another entity that he formed with his father. The bankruptcy court found that the transfer was invalid under the Texas Uniform Fraudulent Transfer Act and awarded Lisa a judgment for damages against the defendants. The court of appeals clarified that Lisa was a "creditor" under the Texas Uniform Fraudulent Transfer Act because she had a right to payment or property that existed at the time of the fraudulent transfer or that arose within a reasonable time after the transfer. The court reasoned that, as an economic interest holder of the LLC, "a creature of California corporate law," she had a right to payment and was entitled to distributions before the LLC was dissolved and Raul transferred its assets. Because the California LLC statute provides that an economic interest includes a person's right to receive distributions from the LLC and an economic interest constitutes personal property of an assignee, Lisa had standing to bring her fraudulent transfer claim.

In re Howland (Spradlin v. Beads and Steeds Inns, LLC), 516 B.R. 163 (Bankr. E.D. Ky. 2014).

The defendant in this action by a bankruptcy trustee to avoid a conveyance of property from an LLC to the defendant as a fraudulent conveyance sought dismissal of the action on the basis that the trustee failed to state a claim. The trustee's claim hinged on being able to characterize the

transfer by the LLC as a transfer by the debtor members of the LLC under a reverse veil-piercing theory. The court explained that there are two types of reverse veil piercing: (1) outsider reverse veil piercing, in which a third-party creditor pierces the corporate veil in reverse to reach the assets of a corporation to satisfy the debt of a corporate insider, and (2) insider reverse veil piercing, in which an insider of the corporation seeks to disregard the corporate form for his own benefit. The court stated that it was not clear which type of reverse piercing was involved here due to the trustee's unique position of being able to assert causes of action belonging to the debtors as well as asserting causes of action that belong to the bankruptcy estate. In either event, however, the court stated that the trustee's claim failed. The court pointed out that Kentucky courts have neither accepted nor rejected reverse veil piercing, but the court acknowledged that it was not unreasonable to conclude that Kentucky might ultimately adopt the doctrine in the right circumstances based on its adoption of traditional veil piercing. The court commented in a footnote that the defendant's argument that veil piercing is limited to corporations and does not apply to LLCs was not persuasive. Even assuming Kentucky courts would accept either of the two types of reverse veil piercing, the court stated that the trustee's attempted use of it was not consistent with Kentucky's treatment of veil piercing as a remedy rather than a cause of action. The court stated that the trustee needed more from reverse veil piercing than merely the right to pursue the LLC's assets; the trustee sought to consolidate the debtor members and the LLC to pursue federal and state fraudulent conveyance claims. The trustee's attempt to treat the transfer by the LLC as occurring by the debtor members directly was not based on whether the debtors or LLC committed alleged wrongdoing, but would simply treat the assets of both as merged both prospectively and retroactively in order to give rise to a fraudulent transfer claim. Consistent with traditional veil piercing under Kentucky law, which requires that a corporation commit wrongdoing before allowing the injured party to recover for that harm from the shareholders, officers, or directors, the court stated that it was reasonable to conclude that Kentucky would treat reverse veil piercing as an equitable remedy that requires wrongdoing by the corporation's shareholders, officers, or directors before considering whether justice requires piercing the veil to recover from the corporation's assets. The court distinguished cases from other jurisdictions relied on by the trustee as inconsistent with Kentucky law. In sum, the court held that Kentucky law does not recognize reverse veil piercing as a means to consolidate owners and their company to allow pursuit of federal and state fraudulent conveyance claims. During oral argument, the trustee sought leave to amend the complaint to add a count addressing substantive consolidation, and the court granted the trustee an opportunity to memorialize the request to amend, which the defendant would have an opportunity to oppose.

Trinity Industries Leasing Company v. Midwest Gas Storage, Inc., 33 F.Supp.3d 947 (N.D. Ill. 2014).

The plaintiff obtained a default judgment in Texas state court for breach of contract against a Delaware LLC headquartered in Illinois. In this case, the plaintiff sued the judgment debtor LLC's president and CEO, O'Malley, alleging that O'Malley schemed to defraud the plaintiff by causing the LLC to lease railcars from the plaintiff and sublease those railcars to other companies and then funneling the payments from the other companies to himself and other entities under his control. The plaintiff claimed that O'Malley misrepresented the financial condition of the LLC when it entered into the lease with the plaintiff and that the LLC was in the process of selling its business at that time. In this case, the plaintiff asserted claims based on fraud, veil piercing, and fraudulent transfer. The parties agreed that Texas law applied to the plaintiff's fraudulent transfer claims, but the plaintiff claimed that Indiana's statute of limitations for fraudulent transfers should apply because

Indiana's procedural law applied to the lawsuit. The defendants argued that the Texas Uniform Fraudulent Transfer Act (TUFTA) contains a statute of repose, not limitations, and that this statute of repose applied to the plaintiff's claims. The court agreed with the defendants that the TUFTA statute of repose applied, but the court concluded that Texas law recognizes an exception to the statute of repose for discovery and that the plaintiff's claims were sufficient to trigger that exception. The court concluded that the plaintiff stated a claim for fraudulent transfer against O'Malley and two related entities based on numerous alleged transfers from the LLC with actual intent to defraud the plaintiff before or within a reasonable time after the lease with the plaintiff was entered into. The court also concluded that the plaintiff stated a claim for transfers made by the LLC after the lease without receiving consideration and while the LLC was insolvent. The court concluded that the plaintiff failed to state a claim against Mrs. O'Malley for fraudulent transfer. The plaintiff did not allege that Mrs. O'Malley received any fraudulent transfer from the LLC or its subsequent transferees. The plaintiff alleged that Mrs. O'Malley received from her husband a membership interest in an LLC that received transfers from the judgment debtor LLC. The plaintiff argued that the TUFTA's definition of transferee is broad enough to include marital property transfers, but the court stated that the plaintiff did not allege that O'Malley used any funds from the judgment debtor LLC to purchase his interest in the other LLC, and the subsequent transfer of the interest in the other LLC to Mrs. O'Malley thus was not actionable as a transfer under TUFTA. The only transfer alleged between the O'Malley's was not related to the alleged fraudulent transfers made by the judgment debtor LLC.

Bankruptcy

In re Denman, 513 B.R. 720 (Bankr. W.D. Tenn. 2014).

Denman, a 70% member of a Tennessee LLC, filed a Chapter 13 bankruptcy petition, thus triggering a provision under the LLC operating agreement that gave any member the option to purchase another member's interest in the LLC for an agreed value if the other member filed a petition under the Bankruptcy Code. Another member sought to exercise the option to purchase Denman's interest, and the court analyzed whether the operating agreement was an executory contract under Section 365(e)(1) or the Bankruptcy Code or whether Denman's interest became property of the estate under Section 541. The court concluded that the operating agreement was not an executory contract and that Denman's membership interest became property of the bankruptcy estate and was not subject to the purchase option because the provision was an unenforceable ipso facto clause.

The court first analyzed the nature of a Tennessee LLC operating agreement and concluded that it is not an executory contract under Section 365(e)(1) of the Bankruptcy Code. As defined by the Sixth Circuit Court of Appeals, an executory contract must have material obligations left to be performed by both parties to the contract, and the obligations must be so far unperformed that the failure by either party to perform completely must constitute a material breach excusing performance by the other. The court identified numerous characteristics of an LLC operating agreement under the Tennessee LLC statute that are inconsistent with an executory contract. First, the court pointed out that a material breach or default of an executory obligation in a Tennessee LLC operating agreement does not excuse the other parties from making their contributions. The court stated that the members of an LLC are capitalizing the entity and not transferring consideration among themselves, and the court characterized the members' obligations as unilateral obligations to the LLC and not bilateral obligations among the members. Next the court observed that an LLC may be

formed by one member, in which case the operating agreement can satisfy neither the mutual assent nor the exchange of consideration element of contract law. According to the court, this problem demonstrates that LLC members are not contracting amongst themselves but rather are organizing and structuring a new entity to receive their contributions. The court also pointed out that the Tennessee LLC statute provides that new members are deemed to have agreed to the operating agreement. The court stated that this makes sense if the operating agreement is a governance instrument but is inconsistent with contract law, under which parties cannot be deemed to be parties without their assent. The court also pointed out that the Tennessee LLC statute does not necessarily require all members to assent to amendment of the operating agreement. In sum, because operating agreements may lack mutual assent, consideration, and privity, and because a member's failure to perform under an operating agreement does not excuse the other members' performance, the court concluded that Tennessee LLC operating agreements cannot satisfy the standards for executory contracts. The court acknowledged that some other courts have reached contrary conclusions regarding LLC operating agreements, but the court concluded that these other courts failed to fully consider the nature of an operating agreement.

Turning to the operating agreement at issue in this case, the court held that it was not an executory contract governed by Section 365 of the Bankruptcy Code. The operating agreement was intended to operate the LLC, a separate legal entity from the members. The only material obligation of the members under the operating agreement was the obligation to make an initial capital contribution. The court stated that the operating agreement was a legal instrument "more appropriately classified as a business formation and governance instrument," which defined the membership interests and rights that each member holds in the LLC. The court characterized Denman's membership interest as personal property analogous to shares of stock and held that the membership interest became property of the estate.

The court next concluded that the purchase option under the LLC operating agreement that was triggered by Denman's bankruptcy was an invalid ipso facto clause under Section 541(c)(1)(B) of the Bankruptcy Code. The option provision operated to prevent Denman's membership interest from becoming part of the bankruptcy estate without the authorization of the bankruptcy estate, and the court stated that this was the sort of modification or forfeiture that Sextion 541(c)(1)(B) was designed to prevent.

Northwest Wholesale, Inc. v. Pac Organic Fruit, LLC, 334 P.3d 63 (Wash. App. 2014).

Harold and Shirley Ostenson and Greg Holzman formed an LLC in 1998 to operate an orchard packing facility. The Ostensons and Greg Holzman, Inc. ("GHI") became the members of the LLC, and both the Ostensons and GHI were active in the business. The Ostensons owned 49% of the LLC, and GHI owned the remaining 51%, thus giving GHI control of the business decisions. The LLC began as a seasonal business but expanded to operate year-round. The members' versions of the decline of the LLC differed, but in any event the LLC financially collapsed in 2005. The Ostensons accused Holzman of wrongdoing, and Holzman claimed that the Ostensons were uncooperative and caused stored fruit to sit past its prime, which caused the LLC to lose revenue. Holzman fired the Ostensons from their positions with the LLC after the LLC defaulted on its operating line of credit and lease. The Ostensons filed for bankruptcy protection under Chapter 11 in early 2007. Later in 2007, a creditor of the LLC filed this lawsuit in state court against the LLC, GHI, and the Ostensons. The Ostensons filed cross claims and a third party complaint against Holzman, GHI, and another entity of Holzman's. These claims were in the nature of a derivative action on behalf of the LLC. In 2008, the bankruptcy court approved a "stipulation" that addressed

claims among the Ostensons, Holzman, and Holzman's affiliated entities. Under the stipulation, the Ostensons agreed to arbitrate some claims and litigate others. The stipulation stated that any claims of the LLC against Holzman and his entities would be litigated in this lawsuit. In 2010, Holzman filed a motion in the bankruptcy proceeding in which he argued for the first time that the Ostensons were no longer members of the LLC because the Washington LLC statute dissociated them from the LLC when they filed for bankruptcy. The bankruptcy court did not rule on this motion. This case went to trial in 2011, and Holzman and his entities moved to dismiss the Ostensons' derivative action after the Ostensons rested their case. The Holzman defendants argued that the Ostensons were no longer members of the LLC and lacked authority to bring their derivative action. Eventually, the trial court ruled that the Ostensons relinquished their membership in the LLC when they filed bankruptcy and could not maintain a derivative action on the LLC's behalf. The Ostensons appealed.

The court of appeals examined the standing of the Ostensons under state law to bring a derivative action on behalf of the LLC and agreed with the trial court that the Ostensons did not have standing. Under the Washington LLC statute, a derivative plaintiff must be a member at the time of the bringing of the action. The Washington LLC statute also provides that, unless otherwise provided in the LLC agreement, a person ceases to be a member, and attains the status of an assignee, of an LLC when the person files a voluntary petition in bankruptcy. The LLC agreement in this case provided that a person became dissociated upon any event of dissociation specified in the Washington LLC statute. Under Washington law, the Ostensons thus forfeited their right to bring a derivative action on behalf of the LLC when they filed for bankruptcy. As an assignee, a dissociated member retains the right to share in profits but loses any management rights. The court rejected the Ostensons' argument that Holzman consented in the bankruptcy stipulation to the continued membership of the Ostensons. While the stipulation preserved claims of the LLC against the Holzman defendants, it did not address whether the Ostensons could assert those claims. Even though unlikely, the LLC itself could assert those claims. Long before the stipulation, the membership of the Ostensons had ceased, and the stipulation did not indicate that it resurrected the membership of the Ostensons and their ability to file a derivative action on behalf of the LLC. Absent consent in writing to the Ostensons' continued membership in the LLC, the Ostensons lacked statutory authority and standing under state law to bring their derivative action.

The court next turned to the Ostensons' argument that federal bankruptcy law, specifically Section 541(c)(1) or Section 365 of the Bankruptcy Code, preempted the Washington LLC statute from dissociating them as members of the LLC. The court explained that the Washington LLC statute causes the dissociation of a member upon the member's filing of bankruptcy, but the dissociation of one member (assuming there is at least one remaining member) does not dissolve the LLC. The dissociated member assumes the status of an assignee and has no management rights in the LLC. Under Section 541(c)(1), an interest of the debtor becomes property of the estate notwithstanding any nonbankruptcy law restriction on transfer of that property. The Ostensons argued that their interest in the LLC became part of their bankruptcy estate. The court agreed but stated that this contention did not end the inquiry. The question was not whether the Ostensons retained some ownership interest but whether they retained management rights and the right to file a derivative action. While the Bankruptcy Code provides that a bankruptcy case creates an estate that includes all legal and equitable interests of the debtor in property, the Code also provides that a debtor's property rights are defined by state law. Thus, Washington law defines what property rights the Ostensons held upon filing bankruptcy. The Ostensons relied on *In re Daugherty Construction, Inc.*, 188 B.R. 607 (Bankr. D. Neb. 1995), to support their contention that they retained their membership and management rights in the LLC. The court did not find that case

persuasive in view of differences between Washington and Nebraska LLC law. Because the dissociation of a member upon the member's bankruptcy under Washington law does not result in a dissolution of the LLC, and the dissociated member retains economic rights, the court found the Washington LLC statute to be similar to the Virginia statute and adopted the reasoning of *In re Garrison-Ashburn, L.C.*, 253 B.R 700 (Bankr. E.D. Va. 2000), in which the bankruptcy court held that the bankruptcy estate of a member of a Virginia LLC had only the rights of an assignee (and not the membership or management rights) despite Section 541(c)(1).

The court next addressed Section 365(a), (c), and (e) of the Bankruptcy Code, which address the trustee's ability to assume or reject an executory contract. Under these provisions, the first question is whether an LLC agreement is an executory contract, and, if so, whether the applicable law excuses the other members from continuing to accept performance of the bankrupt member. These provisions are designed to protect nondebtor third parties whose rights may be prejudiced by having a contract performed by a party other than the one with which they originally contracted. If there are no material obligations that must be performed by the members of an LLC, then the contract is not executory and is not governed by Section 365. The Ostensons again relied on *Daugherty* and argued that their LLC agreement was executory based on provisions requiring the members to contribute capital at GHI's discretion, appointing GHI as the manager, and obligating Harold Ostenson to lease a packing facility to the LLC, obtain a loan towards improving the facility, and pay the loan. The court stated that these provisions may suffice to create an executory contract, but the court determined that it was not necessary to decide if the LLC agreement was an executory contract because Section 365 excused GHI from accepting or rendering performance under the agreement. Because of the similarities between LLCs and partnerships in this area of inquiry, the court looked to a Washington case that addressed the application of Section 365(e)(2) to a partnership. In that case, the court determined that partnership agreements are, at least in part, executory contracts, but the partners are not obligated to accept an assumption of the partnership agreement because partnerships are voluntary associations and partners are not obligated to accept a substitution for their choice of partner. Based on this conclusion, the provision of Section 365(e) invalidating ipso facto clauses did not apply, and state partnership law was not preempted. The debtor partner's economic interest was protected, but he was no longer entitled to be a partner. The same reasoning applied here, and bankruptcy law did not preempt the provisions of Washington law that removed the Ostensons as members of the LLC when they filed bankruptcy.

In re Boone County Utilities, LLC (Boone County Utilities, LLC v. The Branham Corporation), 518 B.R. 511 (Bankr. S.D. Ind. 2014).

The Branham Corporation ("Branham") obtained a judgment against Newland Resources, LLC ("Newland"), the sole member of the debtor, Boone County Utilities, LLC ("BCU"), after the plan had been confirmed and all BCU's assets had been distributed to Newland under the plan more than nine years ago. Branham's aggressive efforts to collect the judgment in the bankruptcy proceedings led BCU to file a complaint asking the bankruptcy court to enter a declaratory judgment that the plan and various other matters occurring in the bankruptcy proceeding were not subject to collateral attack by Branham. Branham filed a counterclaim asking for discovery and for garnishment of Newland's economic interest in BCU. The court discussed various principles in order to address the specific issue before the court, which was whether Branham should be allowed to take a deposition of a representative of BCU and conduct paper discovery. The court first stated that the Indiana LLC statute permits a judgment creditor to seek a charging order against the LLC, which entitles the judgment creditor only to the rights of an assignee of the member's economic

interest. The judgment creditor cannot become a member via execution. Although an LLC interest is personal property and is subject to execution, the court stated that the interest is limited to economic rights, and Branham could not receive through execution any of Newland's rights to participate in management or inspect the books and records of Newland. The court stated that the result of the limited remedy provided by the charging order was that Branham was not entitled to membership in Newland, not entitled to participate in corporate actions or force a distribution, not entitled to inspect Newland's books and records, not entitled to participate in the management, governance, or direction of Newland, and did not acquire any rights to Newland's membership in BCU or to participate in corporate actions, management, governance, or direction of BCU. The court went on to reach various conclusions about Branham's requested discovery. First, the court stated that Newland may not pursue or direct BCU to pursue any claims that accrued before the confirmation of the plan and receipt of assets by Newland from BCU; therefore, Branham, as a mere creditor of Newland post-bankruptcy could not interrogate BCU on any matter that pre-dated the confirmation order and distribution of assets. Further, Branham was not a creditor of BCU. Branham's only avenue to BCU is through Newland's economic rights, and Newland's economic rights do not include any claims of BCU prior to the confirmation order. If BCU acquired any causes of action after the confirmation and asset distribution, Newland could choose to pursue those, but Branham is not Newland and is not a creditor or member of BCU and may not directly pursue those claims. Branham's only ability to collect is to receive Newland's distributions from BCU. Branham may not direct Newland to pursue any claim that Newland does not choose to pursue. The court indicated that Branham might be able to pursue discovery regarding Newland's economic interests in BCU's assets acquired post-confirmation in the state court action. Branham, which essentially occupied the role of an assignee of Newland's interest in BCU, was not entitled to discovery into BCU's governance, including its authority to file bankruptcy. Any objection in this regard should have been raised when the petition was filed and not after confirmation of the plan. Branham also was not entitled to discovery regarding the propriety of distributions made pursuant to the plan. Branham's remedies do not include objecting to a distribution under a plan in which it was not a creditor. Finally, the court rejected Branham's argument that certain unlawful distributions could be disgorged on the basis that the plan did not properly provide for the preemption of applicable LLC law and BCU's governing documents. The court stated that BCU was not required to change its corporate governing documents when the plan clearly provided for the distribution, and Branham was barred from asserting any challenge to BCU's corporate governance because it had only the rights of an assignee of Newland's economic interest in BCU. In sum, the court found that BCU need not produce any discovery regarding its corporate governance or any facts responding to its pre-confirmation operations, claims, or assets. To the extent Branham's discovery pertained to BCU's post-confirmation activity, assets, or claims, that discovery should be sought in the state court action.

Divorce of Member

Feresi v. The Livery, LLC, 182 Cal.Rptr.3d 169 (Cal. App. 2014).

In 2006, Feresi was awarded one-half of a 25% LLC interest acquired during her marriage to Mesa. Feresi also obtained a security interest in Mesa's remaining 12.5% interest to secure payment obligations imposed on Mesa in the divorce. Feresi did not file a UCC-1 financing statement to perfect her security interest in Mesa's interest, but she gave the LLC's president and managing member, Hartley, and the other members written notice that the divorce decree gave her one-half of Mesa's share of the LLC and that Mesa pledged his remaining share as security for his

financial obligations to her. According to the court, amendments to the LLC's books and records showed Feresi as a member with a 12.5% ownership interest, and "corporate" tax returns identified her as a member. In 2008, when Mesa got in financial difficulty, Hartley made a loan to Mesa, and Mesa pledged his 12.5% interest to Hartley to secure that loan. Hartley did not disclose these transactions to Feresi. Later in 2008, Feresi filed an action to foreclose her lien and compel Mesa to convey his 12.5% interest to her. Hartley learned of Feresi's action and, having determined that Feresi had not filed a UCC-1, Hartely filed a UCC-1 perfecting the security interest taken to secure the loan made by Hartley to Mesa. In January of 2009, Feresi obtained a judgment requiring Mesa to convey his remaining 12.5% interest to her, and she notified the LLC that the records should be amended to identify her as the owner of a 25% membership interest. Later in 2009, Mesa failed to repay the loan from Hartley, and Hartley gave notice that Mesa's 12.5% interest would be sold to satisfy the debt. Feresi filed an action for injunctive and declaratory relief. The trial court found that Feresi was a member of the LLC and that Hartley breached a fiduciary duty to Feresi such that the security interest created in favor of Hartley was null and void. Thus, the trial court declared that Feresi had a 25% membership interest unencumbered by Hartley's claims. Hartley appealed, and the court of appeals affirmed the trial court's judgment.

On appeal, the court first rejected Hartley's argument that Feresi was not a member of the LLC and thus was not a person to whom he owed a duty of good faith and fair dealing. The court stated that substantial evidence supported the trial court's finding that Feresi was a member. The court stated that the other LLC members acknowledged that she was a member "by, for example, identifying her as a member on the LLC's tax returns." Under the California LLC statute, a manager of an LLC owes the members of an LLC the same duties of loyalty and good faith as a partner owes to the partnership and the partners. Thus, Hartley was obligated to act with the utmost loyalty and highest good faith in his dealings with Feresi. Citing *Meinhard v. Salmon*, the court held that Hartley breached his fiduciary duty to Feresi by surreptitiously perfecting his conflicting security interest in Mesa's ownership share, thus destroying the value of Feresi's security interest to advance his own. Hartley argued that his filing of the UCC-1 financing statement was not a breach of fiduciary duty because the partnership statute provides that a partner does not breach a duty merely because the partner's conduct furthers the partner's own interest. The court explained that the apparent purpose of this provision is to excuse partners from accounting for incidental benefits obtained in the course of partnership activities without detriment to the partnership, and the court stated that the provision did not apply in these circumstances where Hartley acted with actual knowledge of Feresi's pre-existing security interest and acted to render her security interest worthless. The court said that Feresi had no reason to protect the priority of her own interest since she was not aware of Hartley's conflicting interest. By concealing his interest and perfecting his interest ahead of Feresi's, Hartley betrayed her trust, and "[t]he primacy of Hartley's security interest in Mesa's share must succumb to the infection of his duplicity and silence." Hartley contended that the UCC draws a bright line and requires courts to disregard equities and accept "harsh results," but the court concluded that the doctrine of equitable subordination could be invoked. The court identified three conditions for invocation of equitable subordination that were met here: (1) the fiduciary engaged in inequitable conduct; (2) the misconduct resulted in injury to the petitioner or conferred unfair advantage on the fiduciary; and (3) invocation of the remedy will not be inconsistent with the Commercial Code. The court noted that the UCC itself provides that its provisions are to be supplemented by "principles of law and equity." The court concluded that "[t]he application of equitable principles in this case strengthens the statutory scheme" because "[n]ot rewarding the product of sharp practices in the

creation of a security interest lends stability and security in commercial transactions among fiduciaries."

In re Marriage of Schlichting, 19 N.E.3d 1055 (Ill. App. 2014).

In the divorce of Larisa and Bruce Schlichting, Larisa appealed the trial court's order disposing of Larisa's 20% membership interest in an LLC of which she and other family members of Bruce were members but Bruce was not. The operating agreement had a buyout procedure in the event of a member's divorce under which the LLC would purchase a divorcing member's interest at a valuation that involved a determination by the LLC's accountant. The trial court determined that Larisa's membership interest was marital property and divided and awarded "the potential cash distribution" from Larisa's interest in the LLC 65% to Larisa and 35% to Bruce, which was in accordance with the 65/35 split applied to the entire marital estate. Larisa moved to set the value of the LLC based on deposition testimony of the LLC's accountant. Based on the accountant's $150,000 valuation, Larisa's cash distribution would be $19,500, and Bruce's would be $10,500. Bruce believed the value of the LLC was significantly higher, and he thus requested that the court order Larisa to sell her interest to Bruce for $19,500 so that he could then pursue litigation with the LLC and establish a higher value. Larisa opposed Bruce's request, arguing that it would violate the operating agreement, which contained a provision prohibiting Larisa or any other member from transferring a membership interest without unanimous written consent of the other members. Larisa testified that the other members did not want Bruce to be part of the LLC and did not approve of her transferring rights to Bruce. Because Larisa was already a 20% member, Larisa argued that she could pay Bruce for his share of the cash distribution from her interest without having to get approval from the other members. Larisa proposed that she rather than the LLC should provide Bruce with the $10,500 payment, thus allowing her to retain her 20% membership interest. The trial court ultimately ordered that Larisa sell her membership interest to Bruce for $19,500. Upon payment by Bruce to Larisa, the order awarded all of Larisa's membership interest and rights and responsibilities under the LLC operating agreement to Bruce so that he could pursue litigation with the LLC over the value of the interest.

On appeal, the court first determined that the trial court ordered Larisa to violate the operating agreement when it ordered her to sell her membership interest to Bruce without the unanimous consent of the other members. Contrary to the transfer restriction in the operating agreement and the provision requiring the LLC to buy out a divorcing member's interest, the trial court ordered Larisa to sell her membership interest to Bruce without consent of the other members. The court also addressed a misinterpretation by Bruce and the trial court of the buyout provision of the operating agreement that applied in the divorce context. The LLC operating agreement provided for a buyout of the divorcing member's interest at the greater of the value established by the LLC's accountant or the value determined by the divorce court. If the divorce court set a value higher than the accountant's value, the divorcing member was required to pay the LLC the difference in the valuation. The court of appeals explained that this provision required the divorce court to make a valuation determination and required payment by the LLC for Larisa's membership interest based on the greater of the court's valuation or the LLC accountant's valuation. When the divorce court divided the cash distribution for Larisa's membership interest, Bruce would receive payment for his share based on the higher valuation, but the divorcing member (i.e., Larisa) would be required to pay the LLC the difference between the court's valuation and the accountant's valuation if the court's valuation was higher. Bruce mistakenly believed that it would be futile to provide evidence of a higher valuation in the divorce proceeding because he believed he would be required to reimburse

the LLC for a payment in excess of the accountant's valuation, but the operating agreement imposed that obligation on Larisa as the divorcing member. Thus, the trial court did not need to require Larisa to sell her membership interest to Bruce to allow Bruce to pursue a higher valuation.

Having determined that the trial court ordered Larisa to violate the operating agreement and that it was not necessary to do so to allow Bruce to pursue a higher valuation, the court of appeals explained that the trial court's order was an abuse of discretion. The court stated that no Illinois case requires a court to distribute marital property in accordance with an operating agreement binding on one or both parties in their business activities, but the court stated that case law establishes that failure to do so when compliance is easily possible is an abuse of discretion. The court discussed the nature and role of buy-sell agreements and discussed developing case law within and outside Illinois concerning the avoidance of potential conflict between marital dissolution orders and business operating agreements. The court saw no reason in this case to enter an order conflicting with the terms of the operating agreement when the agreement specified the valuation process in the event of a divorce and allowed for a nonmember spouse to contest the valuation during the divorce proceeding. Bruce was entitled to a portion of the cash value of the membership interest, but not an actual membership interest. Because the trial court's order was stayed during appeal, the court of appeals did not have to order the "undoing" of any transaction. The court of appeals concluded that the most efficient way to compensate Bruce for his 35% interest under the circumstances of this case was to order Larisa to pay Bruce $10,500 for his claim with respect to Larisa's membership interest. Bruce was bound by the accountant's valuation because he chose not to offer any evidence of valuation. The court stated that Larisa could accomplish the payment to Bruce with personal funds or by forcing the LLC to buy her out under the terms of the operating agreement.

In re Galaz (Galaz v. Galaz), 765 F.3d 426 (5th Cir. 2014).

Lisa Galaz brought an adversary proceeding against her ex-husband, Raul Galaz, for fraudulently transferring the assets of an LLC in which Lisa owned a 25% economic interest. In Lisa and Raul's divorce, they executed a divorce decree under which Raul assigned half of his LLC 50% interest to Lisa. The transfer occurred in violation of the operating agreement without the other member's consent, and Lisa therefore received a 25% economic interest with no management or voting rights. Raul, as manager of the LLC, transferred the assets of the LLC to another entity that he formed with his father. The bankruptcy court found that the transfer was invalid under the Texas Uniform Fraudulent Transfer Act and awarded Lisa a judgment for damages against the defendants. One of the contentions in this appeal by Raul and the transferee entity was that the bankruptcy court should have referred Lisa's claims to arbitration pursuant to a provision in the LLC operating agreement. The court rejected this argument because Lisa was not a party to the operating agreement. The operating agreement referred to the "parties" as the LLC's "Members," and Lisa held only an economic interest. The court stated that the Fifth Circuit has recognized limited circumstances in which a nonsignatory may be bound by an arbitration agreement, but there was no argument or evidence suggesting how Lisa, neither a member nor a party, was bound by the arbitration provision. The court of appeals also clarified that Lisa was a "creditor" under the Texas Uniform Fraudulent Transfer Act because she had a right to payment or property that existed at the time of the fraudulent transfer or that arose within a reasonable time after the transfer. The court reasoned that, as an economic interest holder of the LLC, "a creature of California corporate law," she had a right to payment and was entitled to distributions before the LLC was dissolved and Raul transferred its assets. Because the California LLC statute provides that an economic interest includes

a person's right to receive distributions from the LLC and an economic interest constitutes personal property of an assignee, Lisa had standing to bring her fraudulent transfer claim.

Conversion or Reorganization

Daniel v. Ripoli, 2015 IL App (1st) 122607, __ N.E.3d __ (Ill. App. 2015).

A general partnership accounting firm with two partners, Ripoli and Daniel, converted to an LLC effective January 1, 1999, and a third individual, Grieco, became a member of the firm and entered into an operating agreement with the two other members a few months later. The three members approved and ratified the articles of organization and agreed to operate under the articles and the operating agreement. Several years later, the members met to discuss concerns regarding the disparity between Daniel's profit-sharing percentage and the actual income generated from Daniel's clients. Daniel's profit-sharing percentage under the operating agreement was significantly higher than the income generated by his clients, and Greico's profit-sharing percentage was significantly lower than the income produced by his clients. Eventually, in December of 2003, the members signed an agreement that they would not follow the profit-sharing percentages in the operating agreement for 2003 and would determine the profit-sharing percentages for 2003 based on the financial statements for 2003. In January of 2004, the members signed an agreement adjusting the members' capital accounts in 2003 and specifying a method of determining Daniel's distributions in 2004. The members abided by the 2004 agreement until Daniel died in 2006. Daniel's estate sued Ripoli, Greico, the partnership, and the LLC seeking payment of the amount the estate claimed was owed for Daniel's capital account under the operating agreement. The estate argued that the January 2004 agreement did not permanently change the profit-sharing percentages because it did not expressly refer to future years. The court examined the terms of the 2004 agreement and the course of conduct of the parties and concluded that the 2004 agreement amended the operating agreement and established a permanent change in Daniel's capital account.

The court rejected an argument by Daniel's estate on appeal that the trial court erred in determining that Ripoli and Greico had no individual liability for breach of contract. First, the court pointed out that the LLC statute at one time allowed LLC members to be held personally liable to the same extent as shareholders of a corporation. That provision was removed by the legislature effective January 1, 1998, and the statute has provided that a member or manager is not personally liable for a debt, obligation, or liability of the LLC solely by reason of being or acting as a member or manager for the entire time period since the conversion in this case of the partnership to an LLC. The LLC statute provides for an exception to the liability protection of LLC members to the extent the articles of organization provide for personal liability in a provision to which a member has consented in writing, but this exception did not apply because there was no such provision in the LLC's articles of organization. Next the court rejected various attacks by Daniel's estate on the validity of the conversion. The court stated that the fact that the LLC members continued to treat certain aspects of the business as a partnership (giving as an example the filing of K-1 partnership tax statements) did not change the legal status of the business as an LLC, pointing to the provision of the LLC statute that provides that an LLC's failure to observe usual company formalities is not a ground for imposing personal liability on the members. Next the court described the conversion process. The only two partners at the time of the conversion filed a statement of conversion and articles of organization with the Illinois Secretary of State. The statement of conversion recited that each partner voted for the conversion, which satisfied the statutory requirement that all partners approve a conversion. Under the Illinois LLC statute, upon the filing of the articles of organization

there is a presumption that all prerequisites to formation have been satisfied, and the LLC's existence begins. The court stated that the estate's argument that the partnership's assets did not vest in the LLC was entirely refuted by the statutory conversion provisions, which provide that the converted entity is the same entity that existed before the conversion for all purposes and that the assets of a converting partnership automatically become assets of the LLC. Finally, the court rejected the estate's argument that it could sue the other members to enforce Daniel's rights under a provision of the LLC statute that provides a member may maintain an action against the LLC or another member to enforce the member's rights under the operating agreement or under the statute. The court stated that the plain language of the statute expressly provides only for an action by a "member." On a member's death, the member becomes dissociated, and the estate cited no authority allowing a member's estate to bring an action against individual LLC members. In sum, the court stated that the Illinois LLC statute was clear on both of the following points: (1) once a partnership converts to an LLC, it legally becomes an LLC, and inconsistent actions by the members cannot change that legal fact; and (2) LLC members have no individual liability to nonmembers. Thus, Daniel's estate was not entitled to a judgment against the members.

Attorney-Client Privilege

Carpenters Pension Trust v. Lindquist Family LLC, No. C-13-01063, 2014 WL 1569195 (N.D. Cal. Apr. 18, 2014).

Bockmiller, her mother (Mrs. Lindquist), Bockmiller's sister, and two brothers (Mark Lindquist and Kurt Lindquist) were members of an LLC that lent significant sums of money to Mark Lindquist over the years. These debts and promises to repay were not evidenced by contracts or promissory notes. The plaintiff obtained a judgment against Mark Lindquist in another lawsuit, and Mark Lindquist and the LLC executed promissory notes, pledge agreements, and UCC filings to document the earlier loan transactions. In this lawsuit, the plaintiff sought a declaratory judgment declaring that the promissory notes, pledge agreements, and UCC filings were executed to evade or avoid the liability that was the subject of the plaintiff's other lawsuit and should be disregarded. The plaintiff served Bockmiller (a non-party) with a subpoena, and Bockmiller sought to withhold certain email exchanges with the LLC's attorneys on the basis of attorney-client privilege. Mrs. Lindquist was the managing member of the LLC, and the plaintiff argued that the privilege was waived based on intentional disclosure of privileged communications with respect to email communications between the LLC's attorneys and members of the LLC other than Mrs. Lindquist and as to email communications received by Mrs. Lindquist and forwarded to other LLC members. Bockmiller argued that all members of the LLC who had a role in managing the LLC, not just Mrs. Lindquist, were entitled to assert the privilege so that the communications were not intentionally disclosed. The court commented on the hybrid nature of an LLC, which is neither a corporation nor a partnership, and the relative scarcity of authority on the application of the attorney-client privilege to members of an LLC. Relying on *Montgomery v. eTreppid Technologies, LLC*, the court was persuaded that corporate principles should be applied to LLCs with respect to the attorney-client privilege, but the court noted that federal common law treats partnerships as corporations for purposes of the attorney-client privilege in any event. Applying corporate law (under which the privilege applies to communications with any corporate employee concerning the scope of the employee's duties when the employee is aware that the information is being furnished to enable the attorney to provide legal advice to the corporation), the court examined the scope of the LLC members' duties and whether the members were aware that the information was furnished to enable the attorney to provide legal

advice to the LLC. Although Mrs. Lindquist was nominally the manager of the LLC, the documents examined by the court in camera showed that Bockmiller, her sister, Kurt Lindquist, and Mrs. Lindquist, or combinations of these members, communicated with each other and the LLC's attorneys about legal advice to the LLC, and Mrs. Lindquist was not solely responsible for the decisions of the LLC. Thus, the court concluded that Bockmiller, her sister, and Kurt Lindquist could assert that their communications with the LLC's attorneys and Mrs. Lindquist were protected by the attorney-client privilege.