

**RECENT CASES INVOLVING  
LIMITED LIABILITY COMPANIES AND  
LIMITED LIABILITY PARTNERSHIPS**

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By Elizabeth S. Miller  
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This paper summarizes cases that have appeared since the Limited Liability Entities – 2007 program. A cumulative survey of LLP and LLC cases may be accessed at the Baylor Law School web site at <http://law.baylor.edu>.

**I. Limited Liability Partnerships**

**A. Diversity Jurisdiction**

*Thompson v. Deloitte & Touche LLP*, 503 F.Supp.2d 1118 (S.D. Iowa 2007). The court held that an LLP's citizenship is determined by the citizenship of all partners and that the presence of one "stateless" partner thus rendered the partnership stateless and destroyed diversity jurisdiction. Further, even if the stateless partner were excluded from consideration, partners who were not United States citizens destroyed diversity jurisdiction because there were also alien plaintiffs in the case, and diversity jurisdiction cannot be maintained where aliens are on opposite sides of an action.

**B. Limited Liability of Partners**

*Ederer v. Gursky*, \_\_\_ N.E.2d \_\_\_, 2007 WL 4438937 (N.Y. 2007). A withdrawn partner sued the partnership and its partners for breach of contract and an accounting of funds owed the withdrawn partner under a withdrawal agreement between the partner and the partnership. The partners claimed that they did not have personal liability because the partnership was an LLP, but the court concluded that the New York LLP liability shield only applies to debts and liabilities to third parties and does not protect partners from liability for obligations of the partnership to other partners nor eliminate the right to an accounting. The New York LLP provisions state that "[e]xcept as provided by subdivisions (c) and (d) of this section, no partner of a partnership which is a registered limited liability partnership is liable or accountable, directly or indirectly (including by way of indemnification, contribution or otherwise), for any debts, obligations or liabilities of, or chargeable to, the registered limited liability partnership or each other, whether arising in tort, contract or otherwise, which are incurred, created or assumed by such partnership while such partnership is a registered limited liability partnership, solely by reason of being such a partner." Subdivision (c) excludes from the liability shield "any negligent or wrongful act or misconduct committed by [a partner] or by any person under his or her direct supervision and control while rendering professional services on behalf of" the LLP. Subdivision (d) allows partners to opt out of or limit the scope of the liability protection. The court reviewed the background and history of LLP legislation and rejected the defendants' argument that the statutory protection from liability for "any debts" applies to debts of the partnership to the partners as well as debts to third parties. The court concluded that the liability protection under the LLP provisions is restricted to liability to third parties because the phrase "any debts" is part of a provision that has always governed only a partner's liability to third parties and is part of Article 3 of the New York Uniform Partnership Act ("Relations of Partners to Persons Dealing with the Partnership") rather than Article 4 ("Relations of Partners to One Another"). The court also rejected the defendants' two arguments reconciling the right to an accounting in a winding up with their interpretation of the LLP provisions. The defendants argued that their fiduciary duty as partners to account to one another is different from personal liability for debts disclosed by an accounting, and they further argued that a partner is only personally liable for debts disclosed by an accounting that are attributable to that partner's own torts or wrongful conduct or supervisory lapses. The court responded that the right to an accounting is restitutionary in nature and that it is not limited in the manner argued by the defendants. The court pointed out that the statute confers a right to an accounting absent an agreement to the contrary and stated that partners may thus limit the right to contribution or indemnity or eliminate it altogether, but the partners in this case had no written partnership agreement and were governed by the default provisions of the statute as interpreted by the court. The dissenting opinion pointed out that a former partner is a third party where a partnership is concerned and argued that there is no good reason to treat him more favorably than any other third party. The dissenting opinion describes how the majority's approach

results in odd and perverse results where a withdrawn partner is able to hold remaining partners personally liable for his share when the business of a partnership goes badly after the partner withdraws and before the partner is paid his share.

*PCO, Inc. v. Christensen, Miller, Fink, Jacobs, Glaser, Weil & Shapiro, LLP*, 150 Cal.App.4th 384 (Cal. App. 2 Dist. 2007) (commenting that individual partners in LLP are not vicariously liable for partnership obligations that do not arise from their personal misconduct or guarantees).

*City of Bridgeport v. C.J. Fucci, Inc.*, No. X03CV065008250S, 2007 WL 1120537 (Conn. Super. March 28, 2007) (stating that partner in LLP may be held liable for his or her own negligence but other partners may not be held liable for that partner's negligence simply because they are both members of the partnership).

*Campbell v. Lichtenfels*, No. CV44005066S, 2007 WL 447919 (Conn. Super. Jan. 26, 2007) (imposing personal liability on partner for malpractice claim against partnership in absence of proof that partnership filed certificate of limited liability partnership with Secretary of State).

### C. Securities Laws

*Securities and Exchange Commission v. Merchant Capital, LLC*, 483 F.3d 787 (11<sup>th</sup> Cir. 2007). In this securities enforcement action brought by the SEC against the managing general partner (and its two individual principals) of 28 Colorado LLPs formed to purchase and collect debt pools of charged-off consumer debt, the Eleventh Circuit Court of Appeals reversed the district court and held that the general partnership interests sold to the investors were securities under the federal securities laws. The district court applied the *Howey* test and concluded that the partners had legal powers to control the partnership and were not so inexperienced or unknowledgeable in business affairs as to be incapable of intelligently exercising their partnership powers. The court of appeals also applied the *Howey* test, but reached a different conclusion. The court described in detail the structure and operations of the partnerships. Each LLP was limited to 20 partners. The investors all had a net worth of at least \$250,000, and more than three-fourths of the partners reported a net worth in excess of \$500,000. Though none of the partners had demonstrated experience in the debt purchasing business, ninety percent of the partners self-reported their business experience between "average" and "excellent." The partnership materials told the partners that they were expected to have an active role in managing the partnership, and the agreement reserved a number of powers to the partners, including the ability to select and remove the managing general partner. In practice, however, the partners exercised little control over the operations. The managing general partner had sole authority to bind the partnership and made the key business decisions. Applying the *Howey* test and relying on the *Williamson* case, the court concluded that the LLP interests were investment contracts. The court avoided deciding whether the *Williamson* presumption that general partnership interests are not securities applies in the case of LLPs since it found that the interests were securities under the *Williamson* criteria. Noting that the powers in an LLP cannot exceed those in a regular general partnership, and commenting that an LLP interest may be somewhat more likely to be an investment contract because of the incentive against exercising control produced by the liability shield, the court stated that it need not decide the general applicability of the *Williamson* presumption to LLP interests if any of the *Williamson* tests were met. Under *Williamson*, a general partnership interest is an investment contract if (1) the agreement between the parties leaves so little power in the hands of the partner that the arrangement in fact distributes power as would a limited partnership, (2) the partner is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership powers, or (3) the partner is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager or otherwise exercise meaningful partnership powers. The court analyzed each of these tests and concluded that all three were met. The court found that the arrangement distributed power as if the partnerships were limited partnerships because the power to name the managing partner was not significant, the power to remove the managing partner was illusory, and the voting procedures giving partners the ability to approve all obligations over \$5,000 were a sham and did not give the partners any meaningful control. The court discounted the fact that one of the partnerships had actually removed the managing partner because the removal occurred in a liquidation context when the managing partner would receive no more fees and did not oppose removal, and the promoters had an active interest at that time in encouraging removal because the SEC investigation was in progress. The court did not view the partners' remaining powers— the right to inspect books and records, participate in committees, and hold meetings— as providing the partners the ability to control management of the business. The court went on to conclude that the partners were so inexperienced and

unknowledgeable in business affairs that they were incapable of intelligently exercising their partnership powers because the investors had no experience in the debt purchasing business. The court stated that the district court had erroneously focused on the general business experience of the investors rather than their experience in the particular enterprise. The court rejected the defendants' argument that anyone with general business experience could easily learn to be successful in the debt purchasing business, characterizing the debt purchasing business as a complicated and sophisticated business that could not be quickly or easily learned. Finally, the court concluded that the partners were so dependent upon the managing partner that they could not replace it or otherwise exercise meaningful control. The court determined that the partners had no realistic alternative to the managing partner's management (in addition to having no practical ability to remove the managing partner) because the assets of all the LLPs were combined and invested in pools of accounts owned by a third party servicer. The partnerships had no contractual right to demand the return of the debtor accounts; therefore, even if an individual partnership had replaced the managing partner it would find its major assets were still tied up in fractional form in a third party's debt pool. The court gave no weight to procedures intended to assist partnerships in removing their assets from the debt pools, noting that these procedures were not devised until after the SEC investigation began and that there were still practical barriers to obtaining the accounts.

## **II. Limited Liability Companies**

### **A. Diversity Jurisdiction**

Federal courts of appeals and district courts continue to hold that an LLC has the citizenship of each of its members for diversity jurisdiction purposes. The district court opinions to this effect are too numerous to list. Recent opinions in which circuit courts of appeals have applied or recognized this rule include *OnePoint Solutions, LLC v. Borchert*, 486 F.3d 342 (8<sup>th</sup> Cir. 2007) and *Camico Mutual Insurance Company v. Citizens Bank*, 474 F.3d 989 (7<sup>th</sup> Cir. 2007).

A somewhat unusual application of diversity jurisdiction principles occurred in *ConnectU LLC v. Zuckerberg*, 482 F.Supp.2d 3 (D. Mass. 2007) (concluding that LLC plaintiff had no members for purposes of diversity jurisdiction at time suit was filed and that LLC was thus "stateless" and destroyed diversity jurisdiction).

The following case represents one of the few exceptions to the cases applying the *Carden* rule that an LLC has the citizenship of each of its members: *Harvey v. Grey Wolf Drilling Co.*, Civil Action No. 05-3068, 2007 WL 3332774 (E.D. La. Nov. 7, 2007) (noting that Fifth Circuit has not spoken to issue of LLC's citizenship for diversity purposes and concluding 28 U.S.C. 1332(c) should be read to include LLCs, i.e., that LLCs should be treated as corporations for diversity jurisdiction purposes).

### **B. Personal Jurisdiction Over Members and Managers**

*Taurus IP, LLC v. DaimlerChrysler Corporation*, 519 F.Supp.2d 905 (W.D. Wis. 2007) (concluding that numerous Texas and Wisconsin LLCs were alter egos of individual who operated LLCs for purposes of personal jurisdiction based on prima facie showing that individual used entities to perpetrate fraud and exerted complete domination over entities; noting that alter ego doctrine can be applied in reverse and concluding that LLCs and individual were all alter egos of one another based on such application, and exercising personal jurisdiction over all such parties based on consent to jurisdiction by one of LLCs).

*Christ v. Cormick*, C.A. No. 06-275-GMS, 2007 WL 2022053 (D. Del. 2007) (analyzing application of Delaware provision subjecting manager of Delaware LLC to personal jurisdiction in Delaware where suit involves business of LLC or violation of duty of manager and finding sole initial manager of Delaware LLC was subject to jurisdiction based on manager's alleged involvement in formation of LLC as part of alleged scheme to defraud plaintiff).

*Huber v. Dave Pratt Enterprises, LLC*, No. CIV. S-07-10089 FCD/CMK, 2007 WL 2156084 (E.D. Cal. July 25, 2007). The court found that it lacked personal jurisdiction over an Arizona resident who was the managing member of an Arizona LLC that employed the plaintiff to work in its restaurant in Arizona pursuant to a contract executed in Arizona after the defendant and plaintiff moved to Arizona. Although the plaintiff and defendant had engaged in

preliminary discussions and negotiations while the plaintiff and defendant lived in California, and the defendant had formed a California LLC, the California LLC never had assets or conducted business, and the court characterized defendants' interjection in California as relatively insignificant.

***Ritchie Capital Management, L.L.C. v. Coventry First LLC***, No. 07 Civ. 3494(DLC), 2007 WL 2044656 (S.D. N.Y. July 17, 2007) (relying on internal affairs doctrine and applying Delaware law in determining that grounds for piercing veil of Delaware LLC had been sufficiently alleged for purposes of liability and personal jurisdiction).

***Lulla v. Effective Minds, LLC***, 646 S.E.2d 129 (N.C. App. 2007) (finding contacts of New York based LLC and individual who was its sole "director, shareholder, and officer" insufficient to establish personal jurisdiction over defendants where contract with North Carolina resident was governed by Delaware law, work was not performed in North Carolina, and individual defendant had never been to North Carolina).

***Shafik v. Andria***, No. HHBCV065001472S, 2007 WL 1677431 (Conn. Super. June 1, 2007) (holding that, in view of "corporate-styled liability shield," general rule that there is no personal jurisdiction over nonresident officers of corporation where only contact with state was in capacity as corporate officer applied to individual who purchased LLC that had contracted with plaintiff and thereafter interacted with plaintiff on LLC's behalf).

***Graymore, LLC v. Gray***, Civil Action No. 06-cv-00638-EWN-CBS, 2007 WL 1059004 (D. Colo. April 6, 2007) (holding that founder and "initial consulting manager" of Colorado LLC had insufficient contacts to support exercise of personal jurisdiction in Colorado).

***Romanowski v. RNI, LLC***, No. C 06-6575 PJH, 2007 WL 323019 (N.D. Cal. Jan. 31, 2007) (holding mere status as sole managing member was insufficient to support jurisdiction over individual with respect to certain claims, but individual could not rely on fiduciary shield doctrine with respect to claims because of individual's own alleged wrongdoing).

### **C. Service of Process**

***2505 Victory Boulevard, LLC v. Victory Holding, LLC***, \_\_\_ N.Y.S.2d \_\_\_, 2007 WL 3375811 (N.Y. City Civ. Ct. 2007) (concluding LLCs are subject to service of process under New York Real Property Actions and Proceedings Law (RPAPL) though New York LLC law refers to LLC as "unincorporated organization" and RPAPL refers to "corporation, joint-stock or other unincorporated association").

***Lauria v. Mennes***, No. FSTCV075003950, 2007 WL 3041948 (Conn. Super. Oct. 2, 2007) (noting that there is no Connecticut long-arm statute specifically covering LLCs but adhering to previous holding that statute applicable to "nonresident individual, foreign partnership or foreign voluntary association" applies to LLCs although question is not free from doubt).

***Wayland v. Suffield Village, LLC***, No. CV054009738S, 2007 WL 1470856 (Conn. Super. May 9, 2007) (dismissing action against LLC for failure to properly serve LLC because place at which agent was served was neither his abode (as specified by statute addressing service on LLC) nor place of business of LLC (as specified by statute addressing service on corporation)).

***126 Spruce Street, LLC v. Club Central, LLC***, 830 N.Y.S.2d 506 (N.Y. Dist. Ct. 2007) (holding service of process on individual identified as "managing agent of corporation and authorized to accept service" satisfied statutory requirement for service on LLC).

### **D. Venue**

***Coffee Bean Trading-Roasting, LLC v. Coffee Holding, Inc.***, 510 F.Supp.2d 1075 (S.D. Fla. 2007) (granting motion to dismiss on basis that forum selection clause in LLC operating agreement that provided "exclusive venue" of any action brought in connection with agreement "may be laid in the State of Delaware" was mandatory).

***Continental Commercial Products, LLC v. Sunshine Mid-America, LLC***, No. 4:07CV1087-DJS, 2007 WL 2434039 (E.D. Mo. Aug. 22, 2007) (noting that plaintiff asserted, and defendant did not dispute, that LLCs are treated like corporations for purposes of venue under 28 U.S.C. 1391).

***Mohr v. Kokopelli Franchise Company, LLC***, No. 3:07 CV 1004, 2007 WL 2344764 (N.D. Ohio Aug. 15, 2007) (stating that LLC is included in “corporation” as defined in 28 U.S.C. 1391(c), which provides that corporation is deemed to reside in any judicial district in which it is subject to personal jurisdiction at time action is commenced).

***United States v. Heide***, No. 04 MS-5609, 2007 WL 581601 (D. Idaho Feb. 20, 2007) (declining to transfer venue of government action against non-resident for writ of execution with respect to ownership of LLC registered to transact business in Idaho).

#### **E. Standing/Authority to Sue**

***Elecor, LLC v. King***, No. CV065006235S, 2007 WL 4578003 (Conn. Super. Dec. 5, 2007). An LLC and one of its members sued the defendants alleging trade secret violations based on misuse by the defendants of the LLC’s assets, breach of fiduciary duties by the defendants, and conversion and unfair trade practices based on the defendants’ failure to assign patents to the LLC as agreed by the parties. The defendants argued that the LLC lacked standing to pursue the claims because it dissolved after instituting the lawsuit. The court found that the LLC had standing to pursue the lawsuit because the Connecticut LLC statute permits the persons winding up the business and affairs of the LLC to prosecute and defend suits in the name and on behalf of the LLC. The court also cited LLC and corporate case law. The defendants challenged the standing of the plaintiff member of the LLC, arguing that her claims related solely to her alleged ownership interest in the LLC. The plaintiffs countered that the member was personally aggrieved. The court concluded that the statutes supported the defendants’ position because the statute provides that a member or manager is not a proper party to a proceeding by or against an LLC solely by reason of being a member or manager, except where the object of the proceeding is to enforce the member’s or manager’s right against or liability to the LLC. Further, the statute provides that a member has no interest in specific LLC property. The court also analyzed case law in the LLC and corporate context and concluded the member was not classically aggrieved and did not have standing to sue personally.

***Wilcox v. Webster Insurance***, No. CV075010093S, 2007 WL 3380293 (Conn. Super. Oct. 25, 2007) (holding that LLC rather than its members had standing to assert insurance claim in connection with accident involving LLC’s dump truck).

***Vectren Energy Marketing & Service, Inc. v. Executive Risk Specialty Insurance Company***, 875 N.E.2d 774 (Ind. App. 2007) (holding that LLC members did not have standing to pursue insured LLC’s rights under insurance policy).

***Formcrete, Co., Inc. v. NuRock Construction, LLC***, No. 4:07cv290, 2007 WL 2746812 (E.D. Tex. Sept. 19, 2007) (holding that plaintiff LLC lacked capacity to sue because its corporate existence had been forfeited under Texas Tax Code which provides that forfeiture results in loss of ability to sue or defend, stating that plaintiff cited no authority for its requested abatement, and denying abatement pending reinstatement).

***Weyand v Hubman Foundation***, No. 4:064CV343, 2007 WL 3377162 (E.D. Tex. June 28, 2007) (holding that member did not have standing to represent LLC’s interest and LLC may not be represented by non-lawyer).

***Young v. Vlahos***, 929 A.2d 362 (Conn. App. 2007) (concluding that plaintiff had standing to bring suit as “Roy Young doing business as Silvermine Investors, LLC” on lease which identified lessor as Silvermine Investors, L.L.C. because defendant’s answer to complaint admitted that plaintiff was lessor and defect in complaint did not confuse or otherwise prejudice defendant).



**Bagley v. Promenade Group, L.L.C.**, Civil Action No. 05-0457-M, 2007 WL 2154163 (S.D. Ala. July 24, 2007) (denying defendant's motion for summary judgment on claim that Thomas Bagley and "Bagley Properties" did not have standing to pursue declaratory judgment with respect to contract entered into under name of "Bagley Properties, L.L.C.," where Bagley claimed that such names were merely names under which Bagley did business and uncertainty by parties created fact issue as to form of business of Bagley Properties and Bagley Properties, L.L.C.).

**Orgain v. City of Salisbury**, 521 F.Supp.2d 465 (D. Md. 2007) (holding that members of LLC had standing to sue for emotional distress and financial loss personal to them but lacked standing to assert claims for damages suffered by LLC; noting that LLC is person for purposes of Equal Protection and Due Process Clauses of Fourteenth Amendment and thus has standing to assert claims for damages suffered based on discrimination against clientele under 42 U.S.C. 1983, but LLC did not have standing to sue county liquor licensing board because individual members rather than LLC held license, and members were proper plaintiffs with respect to claims against board).

**Baer v. New England Home Delivery Services, LLC**, No. CV064021976, 2007 WL 1828264 (Conn. Super. June 6, 2007) (stating that defendant was correct that suit to recover damages to LLC must be brought by LLC, but facts alleged in complaint, taken as true, did not indicate that LLC rather than individual plaintiffs were damaged by defendant's conduct).

**Michael Reilly Design, Inc. v. Houraney**, 835 N.Y.S.2d 640 (N.Y. A.D. 2 Dept. 2007) (holding that LLC member was not aggrieved by judgment entered against LLC and did not have standing to appeal).

**Kranz v. Koenig**, 484 F.Supp.2d 997 (D. Minn. 2007) (holding that LLC's judgment creditors lacked standing to assert illegal distribution claims under Minnesota LLC Act, which provides that member who receives distribution in violation of statute is liable "to the limited liability company, its receiver or other person winding up its affairs").

**Gear v. Public Utility District No. 2 of Grant County**, No. 25071-7-III, 2007 WL 1129580 (Wash. App. April 17, 2007) (holding that former owners of LLC did not have standing to assert claim that defendant entered contracts illegally giving preference to LLC's competitors, noting that plaintiffs did not attempt to join LLC, which court characterized as real party in interest, or LLC's current member, which court characterized as necessary party).

**Truck America Training, LLC v. City of Hillview**, No. 2006-CA-000727-MR, 2007 WL 866694 (Ky. App. March 23, 2007) (holding that contract signed by individuals indicating representative capacity but without naming LLC represented was deemed binding on individuals rather than LLC by virtue of individuals' failure to respond to request for admissions, but fact issue remained as to whether LLC had standing to sue on contract as third party beneficiary).

**AMP Management, LLC v. Scottsdale Insurance Company**, No. 06-4079-SAC, 2007 WL 677633 (D. Kan. Feb. 28, 2007) (citing foreign corporation provisions and holding foreign LLC lacked standing to sue based on failure to qualify to do business in Kansas).

**GxG Management LLC v. Young Brothers and Co., Inc.**, Civil No. 05-162-B-K, 2007 WL 551761 (D. Me. Feb. 21, 2007), supplemented, 2007 WL 1702872 (D. Me. June 11, 2007) (holding LLC had standing to bring breach of contract and related claims as real party in interest even though series held nominal ownership of boat that was subject of contract, noting that Delaware statute does not address standing of LLC to pursue litigation on behalf of its series or standing of series to pursue litigation in its own behalf, and commenting that LLC and its series are not separate entities; clarifying in order on motion to amend verdict that reference to series as entity in original opinion was not finding that series was entity, and LLC itself was appropriate party to pursue tort and contract claims related to workmanship on vessel held by series).

**Garfield v. Suntrust Bank**, 477 F.Supp.2d 1181 (S.D. Fla. 2006) (holding that plaintiffs did not have standing to sue depository bank for losses related to unauthorized withdrawals from LLC's account where plaintiffs were trustees for partnerships and trusts that were members of LLC but were not individually members, rejecting plaintiff's arguments

that they suffered direct damages, and noting that, under either Florida or Nevada law, only LLC members may sue derivatively on behalf of LLC).

#### **F. Pro Se Representation**

*Sea Island Company v. The IRI Group, LLC*, Civil No. 3:07cv013, 2007 WL 2997660 (W.D. N.C. Oct. 12, 2007) (holding that LLC may not appear *pro se*).

*Weyand v Hubman Foundation*, No. 4:064CV343, 2007 WL 3377162 (E.D. Tex. June 28, 2007) (holding that LLC may not be represented by non-lawyer).

*Edizone, L.C. v. Cloud Nine*, No. 1:04-CV-117 TS, 2007 WL 2455290 (D. Utah Aug. 23, 2007) (holding that LLC must be represented by counsel).

*In re Klundt*, No. 05-42197, 2007 WL 2302506 (Bankr. D. S.D. Aug. 8, 2007) (noting that all legal entities such as corporations, partnerships, and LLCs may appear only through an attorney in federal courts in Eighth Circuit).

*Wilkinson Industries, Inc. v. Taylor's Industrial Services, LLC*, No. 8:06CV405, 2007 WL 1751739 (D. Neb. June 18, 2007) (entering default judgments against LLCs whose counsel had withdrawn because layperson may not represent legal entities such as corporations and LLCs).

*Michael Reilly Design, Inc. v. Houraney*, 835 N.Y.S.2d 640 (N.Y. A.D. 2 Dept. 2007) (holding that LLC, as legal entity distinct from its members, must be represented by attorney and may not be represented by one of its members who is not licensed to practice law).

*Senna v. Judyski*, 2007 WL 987157 (N.J. Super. A.D. April 4, 2007) (holding that LLC must be represented in court by licensed attorney).

*Lattanzio v. Comta*, 481 F.3d 137 (2<sup>nd</sup> Cir. 2007) (holding that LLC, like partnership or corporation, may appear in federal court only through licensed attorney).

#### **G. Derivative Suits**

*Tzolis v. Wolff*, \_\_\_ N.E.2d \_\_\_, 2008 WL 382345 (N.Y. 2008). In a 4-3 decision, the New York high court held that the omission of derivative suit provisions from the New York Limited Liability Company Law does not constitute a prohibition on such suits, thus resolving a split of authority as to whether derivative suits are allowed on behalf of New York LLCs. The court reviewed the history of derivative suits under New York law in the corporate and limited partnership contexts, where such actions were first recognized by the courts before being codified by statute. The court noted the purpose underlying derivative suits, i.e., to ensure that the victims are not without a remedy when fiduciaries are faithless to their trust, and stated that abolishing derivative suits in the LLC context would be a radical step. The court noted problems that would result from the abolition of derivative suits and pointed to cases in which courts had held that there was no derivative remedy for LLC members as illustrative of some of these problems. The court discussed the legislative history of the New York LLC statute and derivative suit reforms that were being proposed in other legislation at the time and concluded that there was no clear indication that the Legislature intended to eliminate derivative suits in the LLC context. Though the Legislature clearly decided not to include derivative suit provisions in the LLC statute (such provisions having been deleted, at the Senate's insistence, from the initial bill passed by the Assembly), the court found no evidence that the Legislature thought that the absence of the derivative suit provisions would render derivative suits non-existent. The court acknowledged that some legislators may have expected that there would be no derivative suits while others may have expected the courts to recognize a common law right to sue derivatively (noting testimony by one witness expressing such expectation at a legislative public hearing). The court stated that the Senate may have expected one thing, and the Assembly another, or that neither may have expected anything except that the problem would become the courts' rather than the Legislature's. In light of the ambiguity in the legislative history, the court stated that it could not infer that the Legislature intended "wholly to eliminate, in the LLC

context, a basic, centuries-old protection of shareholders, leaving the courts to devise some new substitute remedy.” The court differed with the dissent’s assertion that the court was leaving the right to sue derivatively in the LLC context unfettered by safeguards against abuse adopted by the Legislature in other contexts. The court noted that limitations on the right to sue derivatively are not all of legislative origin, pointing out that the current demand requirement in the corporation and limited partnership statutes is a codification of a limitation imposed in the case law in which derivative suits originated. The court stated that it was not holding or suggesting that there are no limitations on the right of an LLC member to sue derivatively and pointed out that the issue was not before the court. A strenuous dissent argued that the legislative history of the LLC statute reflected a conscious decision to omit derivative rights in the LLC context.

***Mission Residential, LLC v. Triple Net Properties, LLC***, 654 S.E.2d 888 (Va. 2008). The Virginia Supreme Court held that an arbitration clause in an LLC operating agreement did not require arbitration of a member’s derivative claim against the other member because the claim belonged to the LLC and the LLC was not a party to the operating agreement. The arbitration clause in the operating agreement required that the members in good faith use their best efforts to settle “disputes regarding their rights and obligations thereunder” and required arbitration of “all disputes” that the parties failed to resolve. One of the members commenced an arbitration proceeding against the other, asserting a direct claim for breach of contract and a derivative claim on behalf of the LLC. The arbitrator ruled that the plaintiff member lacked standing to assert the direct claim, but allowed the derivative claim to proceed. The defendant member brought an action seeking a declaratory judgment that there was no agreement to arbitrate disputes between it and the LLC. The supreme court stated that a party cannot be compelled to submit to arbitration unless he has agreed to arbitrate, and the court held that the plaintiff member failed to prove the existence of an agreement by the defendant member to arbitrate its disputes with the LLC. The plaintiff member argued that the derivative claim was nothing more than a dispute regarding the defendant’s duties under the operating agreement, but the court disagreed, stating that this argument ignored the separate existence of the LLC, which was not a party to the operating agreement. The court pointed out that an LLC, like a corporation, is a separate legal entity from the shareholders or members and that a derivative action is an equitable proceeding in which a member asserts, on behalf of the LLC, a claim that belongs to the LLC rather than the member. The court stated that the parties might have chosen to employ language committing them to arbitrate their disputes with the LLC, but they did not do so, and there was thus no contractual undertaking by which the defendant member agreed to arbitrate any dispute with the LLC.

***Wilcke v. Seaport Lofts, LLC***, 846 N.Y.S.2d 133 (N.Y. A.D. 1 Dept. 2007) (holding that lower court erred in concluding that members of LLCs may not bring derivative action, but causes of action based on breach of fiduciary duty and breach of LLC’s operating agreement failed in any event).

***Gas Technology Institute v. Rehmat***, 524 F.Supp.2d 1058 (N.D. Ill. 2007). The court analyzed whether the claims brought by LLC members were direct or derivative and concluded that there may be more flexibility in determining whether fraud and breach of fiduciary duty claims may be brought directly in the context of an LLC than a corporation based on case law in the partnership context. The allegations also indicated that members suffered injury distinct from the LLC and thus had standing to bring fraud and breach of fiduciary duty claims directly. Since the plaintiffs did not plead that the demand requirement or futility exception of Rule 23 was met, the plaintiffs could not assert the claims derivatively.

***Cement-Lock v. Gas Technology Institute***, 523 F.Supp.2d 827 (N.D. Ill. 2007)(concluding that two LLC members had standing to bring derivative action against third member and various other defendants asserting federal RICO and state law claims based on alleged actions that injured LLC).

***Flores v. Murray***, 2007 WL 3034512 (N.J. Super. A.D. Oct. 19, 2007) (reversing trial court’s award of attorney’s fees because action was brought by members individually and not as derivative action and there was no statutory or rule authority to award attorney’s fees as there is under New Jersey LLC statute in derivative action).

***Law v. Harvey***, No. C 07-00134 WHA, 2007 WL 2990426 (N.D. Cal. Oct. 11, 2007) (granting motion to dismiss LLC member’s trademark infringement claims because they were derivative and plaintiff failed to make required allegations regarding statutory demand requirement).

***In re Wheland Foundry, LLC (Reese v. Livingston Company)***, Bankruptcy No. 06-10904, Adversary No. 07-1044, 2007 WL 2934869 (Bankr. E.D. Tenn. Oct. 5, 2007) (concluding LLC members' claims of breach of fiduciary duty and usurpation of company opportunity did not involve any special injury permitting them to bring direct action under Georgia law and that exception allowing direct actions in context of close corporation or small LLC under Georgia law under certain circumstances did not apply because LLC had numerous unpaid creditors; allegations of fraudulent conduct that damaged plaintiffs "by loss of their membership interest and capital contributions" also alleged derivative injuries; allegations of misrepresentations relied upon by plaintiffs to their detriment vaguely alleged special injury; tortious interference claims alleged injuries separate and apart from LLC's injury).

***Hakim v. Bay Sales Corporation***, Civil Action No. 06-6088 (JLL), 2007 WL 2752077 (D. N.J. Sept. 17, 2007) (granting defendants' motion for more definite statement with respect to what appeared to be various derivative and non-derivative causes of action asserted by majority members of an LLC for breach of contract, fraud, misappropriation, conversion, and breach of fiduciary duty by defendants who allegedly agreed to "join forces" with plaintiffs and were acting as "minority shareholders and/or officers and directors" of the LLC).

***Pinnacle Labs, LLC v. Goldberg***, No. 07-C-196-S, 2007 WL 2572275 (W.D. Wis. Sept. 5, 2007) (stating that defendants might be correct in asserting that claim was derivative action to extent asserted by individual plaintiff who was not member of LLC during alleged period of actionable conduct, but pointing out that LLC itself was bringing claim on its own behalf).

***Rimawi v. Atkins***, 840 N.Y.S.2d 217 (N.Y. A.D. 3 Dept. 2007) (holding that plaintiff member's claim that co-member's actions diluted plaintiff's interest in Delaware LLC raised issues that must be asserted in derivative action governed by Delaware law).

***EOS Partners SMIC, L.P. v. Levine***, 839 N.Y.S.2d 729 (N.Y. A.D. 1 Dept. 2007) (granting motion to dismiss plaintiff's derivative suit asserting claims on behalf of Delaware LLC because complaint failed to contain particularized allegations creating a reasonable doubt that the board could have properly exercised its disinterested and independent business judgment in responding to a demand and plaintiff thus failed to demonstrate that demand on LLC's board of directors was futile).

***Barton Properties, Inc. v. King, Purtich, Holmes, Paterno & Berliner***, No. B186499, 2007 WL 1830813 (Cal. App. June 27, 2007). An LLC member (who had previously been the managing member), and the member's president asserted direct and derivative claims against certain non-managing members and a law firm in which the members were partners. The plaintiffs asserted breach of fiduciary duty and malpractice claims arising out of alleged improper conduct on the part of the defendants in connection with an easement dispute in which the LLC was involved. The court stated that corporate shareholder derivative suit principles apply in the LLC context and held that the plaintiffs lacked standing to pursue direct claims for breach of fiduciary duty and malpractice against the defendants. The court acknowledged that the California LLC statute clearly provides that managers of an LLC have a fiduciary duty to the members of the LLC, but stated that "[i]t is less clear whether those members have a corresponding fiduciary duty to the manager or, if not, whether such a duty arises when the nonmanager members are acting under ostensible authority." The court quoted from a treatise that observed that the California LLC statute leaves unaddressed the degree to which non-manager members of an LLC that does not have managers are subject to fiduciary duties. The court found it unnecessary to resolve these questions, however, because the alleged injury (i.e., loss suffered from the alleged wrongful settlement of the LLC's action over easement rights on property adjacent to the LLC's property) was wholly the LLC's. The plaintiffs' assertion of the claims derivatively was barred by res judicata since the LLC (while it was being managed by the plaintiff) had already asserted claims arising out of the same facts directly and (after the former managing member was removed as manager) the LLC had dismissed its appeal from an adverse judgment on the claims. Furthermore, the former managing member's president had no standing since he was not a member of the LLC. The plaintiffs did not pursue an action against the other members for dismissing what would have been a meritorious appeal; therefore, the court was not confronted with the question of whether dismissal of the appeal following the managing member's removal as manager was a breach of duty by the new management, whether such a claim would be direct or derivative, or whether it would be barred by limitations.

**Heer v. Price**, No. 1:06CV-114-R, 2007 WL 1100693 (W.D. Ky. April 11, 2007) (holding that North Carolina LLC Act did not preclude court from asserting jurisdiction of action brought by member of North Carolina LLC against manager of LLC for fraud and breach of fiduciary duty regardless of whether suit was characterized as direct or derivative suit).

**Rizzo v. Joseph Rizzo and Sons Construction Company, Inc.**, No. Civ.A. 2551-VCS, 2007 WL 1114079 (Del. Ch. April 10, 2007) (holding ejectment claim becomes creature of equity when brought derivatively, and court had jurisdiction to hear LLC member's ejectment claim where it was brought derivatively on behalf of LLC, rested on alleged breach of fiduciary duty, and was ancillary to remainder of plaintiff's claims, all of which sounded in equity).

**Bischoff v. Boar's Head Provisions Co., Inc.**, 834 N.Y.S.2d 22 (N.Y. A.D. 1 Dept. 2007) (holding that LLC member retains common law right to bring derivative suit on behalf of LLC and thus rejecting assertion that plaintiff lacked standing to assert derivative claim on behalf of LLC).

**Kasten v. MOA Investments, LLC**, Nos. 2006AP386, 2006AP1405, 2006 AP1510, 2007 WL 677804 (Wis. App. March 7, 2007). A minority member of an LLC brought suit individually and on behalf of the LLC asserting that the corporate member holding the largest interest in the LLC and the corporate member's shareholders breached fiduciary duties and acted unfairly in transferring assets and business opportunities away from the LLC. The court held that the plaintiff member was disqualified from asserting claims on behalf of the LLC because the suit was not authorized by a vote of the members. The court found that the plaintiff member was disqualified from voting because she sought judicial dissolution and thus had an interest in the outcome of the suit that was adverse to the interests of the LLC. The court concluded that the corporate primary injury rule applies to LLCs and that the member's claims alleging diversion of the LLC's assets, inappropriate payments of LLC funds, and diversion of business opportunities were derivative claims that she was not authorized to bring. The plaintiff's individual claims that she was improperly denied voting rights were without merit because the LLC's manager or a supermajority of members controlled the LLC and the plaintiff was not damaged by any lost opportunity to vote. The court stated that a claim for minority oppression is not itself a cause of action but merely a standard for judicial dissolution, and the plaintiff's claim for judicial dissolution was abandoned by repeated assertions in the lower court that the plaintiff did not want to dissolve the LLC. The court upheld amendments to the operating agreement permitting members with a financial interest in the outcome of a pending action to vote to dismiss, requiring members asserting or maintaining a derivative action without approval to indemnify the LLC, and imposing a one year limitation on claims asserted by a member against the LLC or other members. The court found the consent resolution adopting the amendments was valid because it was adopted by a supermajority of members and it was not unfair for the LLC or its members to take action to preserve its business against a complaint for dissolution, particularly when the plaintiff's derivative claims were not properly authorized.

**Brownstone Investment Group, LLC v. Levey**, 468 F.Supp.2d 654 (S.D. N.Y. 2007) (dismissing claim for aiding and abetting fiduciary duty because plaintiff's injury was not direct and claim must be brought by LLC or derivatively).

**Southwest Health and Wellness, L.L.C. v. Work**, 282 Ga.App. 619 (Ga. App. 2006) (holding minority members' claims for breach of operating agreement and breach of fiduciary duty must be brought derivatively because plaintiffs failed to allege separate and distinct injury and exception permitting direct action in context of closely held LLC was not satisfied because all shareholders were not parties).

**Garfield v. Suntrust Bank**, 477 F.Supp.2d 1181 (S.D. Fla. 2006) (noting that, under either Florida or Nevada law, only LLC members may sue derivatively on behalf of LLC).

**In re Wells (Andrews v. Wells)**, 368 B.R. 506 (Bankr. M.D. La. 2006) (holding that member of LLC who contributed all of LLC's capital had standing to sue managing member who depleted capital because member who contributed capital suffered loss and requiring member to sue on behalf of defunct LLC would exalt form over substance).

## H. Necessary Parties

*Corman v. LaFountain*, 835 N.Y.S.2d 201 (N.Y. A.D. 2 Dept. 2007) (holding that LLC was necessary party with respect to plaintiff's alter ego claim against individual thus precluding action from being brought outside of LLC's bankruptcy proceeding).

*NAMA Holdings, LLC v. Related World Market Center, LLC*, 922 A.2d 417 (Del. Ch. 2007). The plaintiff, an indirect owner of a Delaware LLC, sued the LLC and one of its two members, seeking to enforce provisions of the LLC's operating agreement as to which the plaintiff was an explicit third party beneficiary. The plaintiff sought specific performance of a provision requiring the defendant member to segregate funds when a dispute arose regarding the amount of certain payments and fees to various related entities. The defendants argued that these other entities were necessary parties because the requested relief might deprive them of funds to which they were due, but the court found that the non-parties would not be deprived of their rights to ultimately protect their interests in the segregated funds and thus were not necessary parties.

## I. Scope of Discovery

*Panasuk v. Viola Park Realty, LLC*, 839 N.Y.S.2d 520 (N.Y. A.D. 2 Dept. 2007) (holding plaintiffs failed to sustain burden of showing disclosure of member's tax returns was warranted in connection with plaintiffs' opposition to member's motion for summary judgment motion on issue of member's liability on contract entered by LLC).

*Nakdimen v. Landa*, No. 11267-06, 2007 WL 1881006 (N.Y. Sup. June 25, 2007). The plaintiff, whose status as a member in various LLCs was an issue in the case, sought to subpoena LLC bank statements, checks, and mortgage documents in possession of a non-party, and the defendants sought to quash the subpoenas on the ground that the information sought was irrelevant to the dispute over plaintiff's membership status. Since the plaintiff's status as a member was not the only issue in the case, and the information was relevant to accounting and breach of fiduciary duty claims brought by the plaintiff, the court found that the documents were properly subject to discovery. The court stated that the plaintiffs' reliance on inspection provisions of the LLC statute was misplaced since the application related to subpoenas served on third parties.

*Wachovia Capital Partners, LLC v. Frank Harvey Investment Family Limited Partnership*, No. 05 CVS 20568, 2007 WL 2570838 (N.C. Super. March 5, 2007) (discussing production of information and protection of confidential commercial information of LLC where member seeking information had connections with competitor of LLC).

## J. Arbitration

*Mission Residential, LLC v. Triple Net Properties, LLC*, 654 S.E.2d 888 (Va. 2008). The Virginia Supreme Court held that an arbitration clause in an LLC operating agreement did not require arbitration of a member's derivative claim because the claim belonged to the LLC and the LLC was not a party to the operating agreement. The arbitration clause in the operating agreement required that the members in good faith use their best efforts to settle "disputes regarding their rights and obligations thereunder" and required arbitration of "all disputes" that the parties failed to resolve. One of the members commenced an arbitration proceeding against the other, asserting a direct claim for breach of contract and a derivative claim on behalf of the LLC. The arbitrator ruled that the plaintiff member lacked standing to assert the direct claim, but allowed the derivative claim to proceed. The defendant member brought an action seeking a declaratory judgment that there was no agreement to arbitrate disputes between it and the LLC. The supreme court stated that a party cannot be compelled to submit to arbitration unless he has agreed to arbitrate, and the court held that the plaintiff member failed to prove the existence of an agreement by the defendant member to arbitrate its disputes with the LLC. The plaintiff member argued that the derivative claim was nothing more than a dispute regarding the defendant's duties under the operating agreement, but the court disagreed, stating that this argument ignored the separate existence of the LLC, which was not a party to the operating agreement. The court pointed out that an LLC, like a corporation, is a separate legal entity from the shareholders or members and that a derivative action is an equitable proceeding in which a member asserts, on behalf of the LLC, a claim that belongs to the LLC rather than the member.

The court stated that the parties might have chosen to employ language committing them to arbitrate their disputes with the LLC, but they did not do so, and there was thus no contractual undertaking by which the defendant member agreed to arbitrate any dispute with the LLC.

***Brown v. T-Ink, LLC***, Civil Action No. 3190-VCP, 2007 WL 4302594 (Del. Ch. Dec. 4, 2007). This action was filed by an LLC member (“Brown”) to enjoin another member (T-Ink, LLC or “T-Ink”) from proceeding with an arbitration. T-Ink argued the court should dismiss the case on the grounds that the arbitrator should decide matters of substantive arbitrability (i.e., whether T-Ink’s claims are arbitrable) as well as procedural arbitrability (i.e., whether T-Ink complied with the terms of the arbitration clause). The LLC agreement required arbitration of disputes “concerning the interpretation or performance of this Agreement,” and the court determined that the federal majority rule that substantive arbitrability is determined by the arbitrator did not apply because the clause did not refer all disputes to arbitration. The court compared the language used in the arbitration clause to broader language used in the waiver of jury trial contained in the LLC agreement, as well as suggested and sample clauses of the American Arbitration Association and National Arbitration Forum, and concluded that the reference to disputes concerning “interpretation or performance” of the LLC agreement did not refer all disputes to arbitration. The court found no other evidence indicating a clear and unmistakable intent to refer questions of substantive arbitrability to the arbitrator because a reference to the American Arbitration Association rules in the clause was not alone sufficient to establish an intent to commit the question of substantive arbitrability to the arbitrator. The court determined that T-Ink’s fraud claims fell outside the narrow scope of “interpretation and enforcement” of the LLC agreement (in contrast to the scope of broader language encompassing disputes “arising out of or relating to” the agreement as suggested by the American Arbitration Association and used in the waiver of jury trial contained in the agreement). T-Ink’s fiduciary duty claims arising from general fiduciary duty principles under Delaware law, and not related to specific aspects of the LLC agreement, also were not encompassed by the arbitration clause because those claims did not concern “interpretation and performance” of the LLC agreement. Fiduciary duty claims arising at least in part by virtue of specific obligations created by the LLC agreement involved “interpretation and enforcement” of the LLC agreement, but claims based on fiduciary duties arising by virtue of any statutory, common law, or other requirement as a consequence of the formation of the LLC without regard to the specific terms of the LLC agreement were not subject to arbitration. Stating that wrongful enforcement of an arbitration clause constitutes irreparable harm, and balancing the equities, the court enjoined T-Ink from arbitrating its fraud claims and breach of fiduciary duty claims springing from general fiduciary duty principles under Delaware law. The court dismissed the aspects of Brown’s claims premised on issues of procedural arbitrability because, unlike substantive arbitrability, matters of procedural arbitrability are presumptively for the arbitrator to decide.

***Segal v. Silberstein***, 156 Cal.App.4th 627, 67 Cal.Rptr.3d 426 (Cal App. 2 Dist. 2007) (compelling arbitration of dispute between member-investors of two LLCs based on arbitration clauses that stated arbitration was exclusive dispute resolution process in Texas but not elsewhere; stating that provision was “poorly worded” and expressing concern that such a troubling provision has found its way into use in California; holding that trial court erred in refusing to compel arbitration under arbitration clause in LLC agreement to which LLC was not party where allegations showed dispute between LLC’s member-investors over interpretation and enforcement of their operating agreement and commenting that it was unclear to appellate court why LLC itself would have to be named as defendant to invoke arbitration provision).

***Gas Technology Institute v. Rehmat***, 524 F.Supp.2d 1058 (N.D. Ill. 2007) (holding that defendants waived rights to invoke arbitration clause in LLC agreement by not invoking provision at earliest opportunity).

***Nacio Systems, Inc. v. Gottlieb***, No. C 07-3481 PJH, 2007 WL 3171271 (N.D. Cal. Oct. 26, 2007) (stating that court was unaware of any authority holding that LLC cannot be successor to individual and finding that LLC was arguably successor of individual who entered employment agreement with defendant and thereby bound by arbitration clause in individual’s employment agreement).

***In re Wolff***, 231 S.W.3d 466 (Tex. App. 2007) (ordering do novo review of prior order compelling arbitration under provisions of LLC regulations).

***Ashley River Properties, I, LLC v. Ashley River Properties II, LLC***, 648 S.E.2d 295 (S.C. App. 2007). The operating agreement of a South Carolina LLC contained a New York choice of forum clause and an arbitration clause

requiring disputes to be arbitrated in New York. In a dispute between the members of the LLC, a New York arbitration panel found it had jurisdiction over an individual who signed the LLC operating agreement as manager of one of the LLC's members and also signed personally with respect to sections of the agreement containing representations of the member and indemnification provisions. The panel rendered a final decision in the arbitration, and the individual argued that the arbitration panel did not have jurisdiction over him and that the circuit court in South Carolina erred in dismissing claims the individual asserted in this action. The court held that the New York choice of forum clause in the operating agreement was enforceable such that New York was the proper forum for a proceeding to modify, vacate, or confirm the arbitration award. The court also held that the lower court did not err in dismissing the individual's claims because there was no dispute that the individual signed the operating agreement and was specifically adjudicated by the arbitration panel to be subject to and a party in the arbitration proceeding.

*Green v. Short*, No. 06 CVS 22085, 2007 WL 2570821 (N.C. Super. March 9, 2007) (interpreting arbitration provision in operating agreement of North Carolina LLC and concluding that defendant nonsignatory companies (which were wholly owned by defendant LLC member and alleged to have committed wrongs intertwined with defendant member's violation of operating agreement) could invoke arbitration clause and compel arbitration in direct and derivative action brought by LLC member and that all of member's claims, including claim for dissolution, fell within scope of arbitration clause).

*NAMA Holdings, LLC v. Related World Market Center, LLC*, 922 A.2d 417 (Del. Ch. 2007). The plaintiff, an indirect owner of a Delaware LLC, sued the LLC and one of the LLC's two members, seeking to enforce provisions of the LLC's operating agreement as to which the plaintiff was an explicit third party beneficiary. The plaintiff sought access to the LLC's books and records and specific performance of a provision requiring the defendant member to segregate funds when a dispute arose regarding the amount of certain payments and fees to various related entities. The defendants moved for dismissal of the claims on the basis that the claims were subject to arbitration. The court held that the claims were not subject to arbitration because the arbitration clause relied upon by the defendants merely permitted, but did not require, the parties to the operating agreement to jointly consent to arbitrate disputes between themselves that were not otherwise required to be arbitrated. The court stated that it would be inequitable and illogical to hold that an arbitration clause acts more broadly on a third party beneficiary than upon one of its signatories. The court concluded that a second arbitration clause pertaining to disputes over certain exhibits did not apply to the plaintiff's claims either. The plaintiff, as a third party beneficiary who was not a signatory of the agreement, only had standing to bring claims based on rights found in certain provisions of the agreement, and the inspection right did not turn on the exhibits referenced in the arbitration clause. The court also rejected the defendants' argument that arbitration was required under an arbitration clause in another agreement to which the defendants were not parties.

*Duke v. Graham*, 158 P.3d 540 (Utah 2007). The court concluded that provisions of the Utah Limited Liability Company Act providing for judicial expulsion of members and judicial removal of managers did not strip arbitrators of the authority to remove members and managers. Because the statute also contains provisions authorizing expulsion of members and removal of managers as provided in an operating agreement, the court concluded that expulsion of members and removal of managers may be accomplished through mechanisms described in an LLC's operating agreement, including an agreement to arbitrate. Thus, an arbitration award expelling members of an LLC and removing one of them as a manager in an arbitration proceeding brought pursuant to an arbitration clause in the operating agreement did not exceed the arbitrator's power. The court stated that its conclusion that the legislature did not limit the mechanism for expulsion and removal to a judicial decree is also consistent with the Utah Arbitration Act.

*Santa Monica Properties v. A/R Capital, LLC*, No. B190712, 2007 WL 466828 (Cal. App. 2 Dist. Feb. 14, 2007) (holding operating agreement provision entitling prevailing party in arbitration to attorney's fees applied only to arbitrations and thus did not apply to action brought in court).

#### **K. Nature of LLC**

*Sporting Land, L.L.C. v. CHC Energy, L.L.C.*, Civil Action No. 07-1692, 2007 WL 4124537 (W.D. La. Nov. 19, 2007). The court granted a request by an LLC and corporation for preliminary injunctive relief related to use of property owned by the LLC and corporation for hunting purposes although the defendant argued an LLC or corporation



cannot have a “loss of enjoyment” of hunting rights. The plaintiffs’ chief concern was with hunting rights of its members, shareholders and directors, and the court noted an LLC or corporation can only act through its members and agents who testified that the right to hunt undisturbed during a limited period each year was an issue of central and utmost importance in the land transactions in question involving an easement and use agreement.

*Abbas v. RIH Acquisitions IN, LLC*, no. 2:06 CV 315 JM, 2007 WL 2962649 (N.D. Ind. Oct. 9, 2007) (assuming without expressing any view that LLC is “person” for purposes of liability under Section 1983).

*In re Grosman (Bar-Am v. Grosman)*, Bankruptcy No. 6:05-bk-10450-KSJ, Adversary No. 6:05-ap-328, 2007 WL 1526701 (Bankr. M.D. Fla. May 22, 2007) (characterizing LLC as joint venture whose members owed one another fiduciary duties as joint venturers).

*Colle v. Goldman*, No. 05 CV 3981(JG), 2007 WL 1395561 (E.D. N.Y. May 14, 2007) (concluding that formation of LLC to hold title to real property was not necessarily inconsistent with agreement to form larger joint venture for purchase, development, and resale of property).

*Cathcart v. Magruder*, 960 So.2d 1032 (La. App. 2007) (discussing permissible purposes for which LLC may be organized, holding that LLC’s ownership of property did not necessarily violate restrictive covenant confining property to residential, recreational, or other non-commercial use where there was no showing that property was used for anything other than recreational or residential use of members, and commenting that, if “business” of LLC is maintenance and management of property for recreational and residential use of members, such does not equate to “commercial” use of property).

*Ginsberg v. Bistricher*, 2007 WL 987162 (N.J. Super. A.D. April 4, 2007) (distinguishing LLC from partnership and pointing out that Uniform Partnership Act does not govern LLCs).

*In re Enron Creditors Recovery Corp.*, 370 B.R. 64 (Bankr. S.D. N.Y. 2007) (concluding LLC fell within scope of term “corporation” as used in indenture for purposes of determining whether LLC was “subsidiary” as defined in indenture).

*Didion Milling, Inc. v. Agro Distribution, LLC*, No. 05-C-227, 2007 WL 702808 (E.D. Wis. March 2, 2007) (interpreting net cash flow term of contract with corporate buyer that had subsidiaries where contract was subsequently assigned to LLC disregarded entity owned by corporate members and finding that parties would have intended that calculation of net cash flow for earn-out purposes include deduction of taxes at tax rate applied to member companies’ subsidiaries or divisions).

#### **L. Pre-Formation Transactions**

*Stone v. Jetmar Properties, LLC*, 733 N.W.2d 480 (Minn. App. 2007). The court determined that neither the de facto corporation doctrine nor the corporation by estoppel doctrine applied to a conveyance of real property to an LLC that did not yet exist, and the deed was thus void. Although the promoter had drafted and signed articles of organization, he had made no attempt to file them; therefore, the court concluded that there had been no colorable attempt to organize the LLC under the statute, and the de facto corporation doctrine would not have been satisfied even if it applied. The court went on, however, to conclude that the de facto corporation doctrine has been abolished in Minnesota in both the corporate and LLC contexts. Relying on the reporter’s notes to the Minnesota corporate statute adopted in 1981, the court concluded that the de facto corporation doctrine was abolished by the provision specifying the effective date of a corporation’s articles of incorporation. The court concluded that the provision of the LLC statute specifying that the organization of an LLC is effective upon the filing of articles of organization similarly precludes recognition of de facto existence of an LLC because the corporate provision was the source of the LLC provision. Furthermore, the subsequent formation of the LLC did not result in a conveyance at the time the entity was formed. The court held that a deed to an entity that does not exist at the time of delivery is void. Although the court stated that the corporation by estoppel doctrine survives in Minnesota despite the inapplicability of the de facto corporation doctrine, the court did not reach the question of whether the corporation by estoppel doctrine also applies in the LLC context. Assuming, without

deciding, that the corporation by estoppel doctrine applies to LLCs, the court concluded that the doctrine did not apply to the facts of this case because the execution of the deed was done in reliance on false representations, promises, and assurances by the promoter.

*VGY Development, LLC v. 376 South Colony Realty Corporation*, No. CV-65002733, 2007 WL 1675090 (Conn. Super. May 22, 2007) (holding that contract with unformed LLC was not automatically rendered void where contract was executed by natural person with capacity to contract, and LLC, once properly formed by filing of articles of organization, is empowered thereafter to sue to enforce contract).

*Fiume v. Chadwick*, 840 N.Y.S.2d 278 (N.Y. Sup. 2007) (failure to join applicant LLC, which was non-existent entity developers intended to form, in zoning proceeding was minor irregularity and not jurisdictional defect that tolled limitations for seeking review of administrative actions).

*BRJM, LLC v. Output Systems, Inc.*, 917 A.2d 605 (Conn. App. 2007) (applying law of agency and corporations to contract signed by individual as member of non-existent LLC and holding contract was valid contract personally binding individual who executed contract).

#### **M. Formation of LLC/Failure to Form LLC**

*Advantage Inspection International, LLC v. Sumner*, C.A. No. 6:06-3466-HMH, 2007 WL 2973538 (D. S.C. Oct. 9, 2007). The defendant sought to dismiss the plaintiff LLC's complaint on the basis that the LLC was not legally organized because it did not have an LLC agreement as required by the Delaware LLC statute. The court compared the language of the Delaware statute before and after the August 1, 2007 amendments and concluded that the pre-amendment statute did not require an LLC agreement to properly form an LLC. The court found no evidence that the amendment was intended to be retroactive and thus concluded that the plaintiff became a legal entity upon the filing of its certificate of formation. Furthermore, even if an LLC agreement was required, the plaintiff presented evidence that its members agreed to the terms of an operating agreement; therefore, the factual dispute over the existence of an agreement precluded dismissal.

*Berrios-Bones v. Nexidis, LLC*, No. 2:07CV193DAK, 2007 WL 3231549 (D. Utah Oct. 30, 2007) (refusing to dismiss claims against defendants who contracted in name of LLC that was never formed under Utah law because LLC was in reality a dba or alter ego of the defendants and Utah LLC statute provides that all persons who assume to act as a company without complying with the statute are jointly and severally liable for the debts and liabilities incurred).

*In re Butler (Freelife International, LLC v. Butler)*, 377 B.R. 895 (Bankr. D. Utah 2006) (holding that individuals were not protected from liability with respect to transfers involving non-existent LLC, citing provision of Utah LLC statute imposing joint and several liability on all persons who assume to act as company without complying with statute).

*Bagley v. Promenade Group, L.L.C.*, Civil Action No. 05-0457-M, 2007 WL 2154163 (S.D. Ala. July 24, 2007) (denying defendant's motion for summary judgment on claim that Thomas Bagley and "Bagley Properties" did not have standing to pursue declaratory judgment with respect to contract entered into under name of "Bagley Properties, L.L.C.," where Bagley claimed that such names were merely names under which Bagley did business and uncertainty by parties created fact issue as to form of business of Bagley Properties and Bagley Properties, L.L.C.).

*Stein v. Gelfand*, 476 F.Supp.2d 427 (S.D. N.Y. 2007) (holding that parties who never reached agreement on terms of LLC did not intend to be bound by alleged oral partnership agreement based on brief and incomplete telephone conversation).

#### **N. Fraudulent Inducement to Form LLC**

*Brownstone Investment Group, LLC v. Levey*, 468 F.Supp.2d 654 (S.D. N.Y. 2007) (dismissing fraud claims relating to formation of LLC against individuals where allegations did not specify misrepresentations made by individuals

prior to litigation; recognizing possibility of conspiracy claim against individuals but finding allegations conclusory and insufficient).

**O. Limited Liability of LLC Members and Managers/Personal Liability Under Agency or Other Principles**

*Luna v. A.E. Engineering Services, LLC*, 938 A.2d 744 (D.C. App. 2007). The court held that the dismissal of claims against an individual who claimed to be insulated from personal liability was premature. The individual argued that the complaint failed to state a claim against him and that he conducted business with the plaintiffs only in his role as an LLC officer. The court reversed the dismissal because the complaint alleged that the individual contracted without disclosing that the business was an LLC. The court noted that use of a trade name alone is insufficient to establish disclosure of corporate status. The complaint also alleged that the individual participated in several torts, including negligent misrepresentation, negligent supervision, and negligence in the installation of a boiler. The court relied on the general rule that corporate officers are personally liable for torts they commit, participate in, or inspire, even though the acts are performed in the name of the corporation and stated that the extent of the individual's participation in and responsibility for the alleged torts was a question of fact that could not be answered at the pleading stage.

*Wachovia Securities, LLC v. Neuhauser*, 528 F.Supp.2d 834 (N.D. Ill. 2007). Wachovia sought to hold an individual personally liable on an account opened by the individual for an Illinois LLC that was dissolved and not had not been reinstated at the time the account was opened. The account was opened under the LLC's name but was opened as a partnership account. Wachovia argued that the individual could be held liable to the same extent as a director or shareholder of a dissolved corporation under the Illinois corporation statute, but the court pointed out that the provision in the Illinois LLC statute that provided a member or manager could be held personally liable to the same extent as a director or shareholder of a corporation had been removed from the statute. The revised statute also provides that the failure of an LLC to observe usual corporate formalities is not a ground for imposing personal liability on members or managers; thus, the court held that the LLC statute did not provide for liability of a member or manager to a third party for the LLC's debts and the individual could not be held liable even though the LLC was dissolved at the time the account was opened. In addition, the court also pointed out that the individual was not a member or manager of the LLC. The court further relied upon the retroactive nature of the statutory reinstatement provision as precluding Wachovia's claim against the individual. Finally, the court rejected Wachovia's argument that the individual was personally liable because he signed an account agreement in the capacity of "general partner" for the LLC. The court noted that it was undisputed that the entity entering the account agreement was an LLC, and Wachovia's misunderstanding of the individual's role was not a basis for personal liability. Wachovia also attempted to pierce the veil of the LLC, but the court stated Wachovia presented little to no evidence supporting its assertion that there was a unity of interest and ownership between the LLC and its members, and failed to overcome the heavy burden of meeting the stringent standards applicable to a voluntary contract creditor seeking to pierce the corporate veil under Illinois law.

*Hamby v. Profile Products, L.L.C.*, 652 S.E.2d 231 (N.C. 2007). An employee of an LLC was injured, and the employee sought to hold the LLC's sole member (which was also an LLC) liable for negligence in managing the LLC's safety program. Under the North Carolina workers' compensation law, the exclusivity protection extends beyond the employer to "those conducting [the employer's] business," and the North Carolina Supreme Court concluded that the LLC's member was conducting the LLC's business and was protected under the exclusivity provision. The LLC and its parent were Delaware LLCs, and the LLC's member was charged with exclusive management of the LLC's business under the LLC's operating agreement. The North Carolina LLC statute provides that the liability of a foreign LLC's managers and members is governed by the laws of the LLC's state of formation, and the court applied Delaware law to the question of the member-manager's liability, noting that the Delaware and North Carolina statutes are similar in this regard. The court cited the provisions of the Delaware LLC statute regarding management and authority and shielding member-managers from liability. The court concluded that member-managers are specifically shielded from liability when acting as LLC managers, stating that "when a member-manager acts in its managerial capacity, it acts *for* the LLC, and obligations incurred while acting in that capacity are those *of* the LLC." The court also found support for its conclusion in corporate case law where the exclusivity provision applied to the president and sole shareholder of a corporation.

***Restoration Industry Association, Inc. v. Certified Restorers Consulting Group, LLC***, No. CV-07-227-S-BLW, 2007 WL 2898698 (D. Idaho Sept. 28, 2007) (noting that Idaho Supreme Court has made clear that Idaho LLC statute does not bar actions against LLC members under all circumstances, but merely provides that member is not liable for LLC debts solely by reason of being member).

***Irrigation Mart, Inc. v. Gray***, 965 So.2d 988 (La. App. 2007) (holding that individual who purchased supplies under trade names that did not indicate existence of LLCs was personally liable based on rule that agent is personally bound when agent contracts without disclosing identity of principal).

***Sudamax Industria E Comercio De Cigarros, Ltda v. Buttes & Ashes, Inc.***, 516 F.Supp.2d 841 (W.D. Ky. 2007) (holding that individual who negotiated oral contract in his role as president of LLC was not personally liable on contract because he was acting as agent of disclosed principal; evidence did not support plaintiffs' veil piercing claim).

***Wierbicki v. Advatech***, LLC, No. 1:06-CV-269, 2007 WL 2725944 (E.D. Tenn. Sept. 17, 2007). An employee brought a breach of contract and retaliatory discharge claim (under the Tennessee Public Protection Act) against a Delaware LLC and its two members, and the non-managing member moved to dismiss the claims against it alleging it was simply a member of the LLC that employed the plaintiff. The plaintiff claimed that the LLC was a "joint venture" between the two members. The court stated the plaintiff had provided no credible evidence that the employer was not an LLC that provided liability protection rather than a joint venture or partnership. The court noted the liability protection provided members under both Delaware and Tennessee LLC law and found that the plaintiff provided no evidence to support an employment relationship between the plaintiff and the member and no basis to impose vicarious liability on the member.

***Hollingsworth v. Choates***, 963 So.2d 1089 (La. App. 2007) (concluding individual who signed deed as manager of LLC and who may have had role in construction on property could not be sued personally as builder because individual was not "builder" as defined by New Home Warranty Act which provided exclusive remedy).

***Roth v. Voodoo BBQ, LLC***, 964 So.2d 1095 (La. App. 2007). The plaintiffs leased premises to an LLC, and the premises were abandoned after they were damaged in Hurricane Katrina. The plaintiffs sought to hold the managers of the LLC liable for "acquiescing, fostering, or permitting" the LLC's failure to adequately secure and maintain the premises before and after the hurricane. The plaintiff later amended the petition to add allegations that the managers entered the premises following the hurricane and removed equipment and furnishings. The court quoted the provisions of the Louisiana LLC statute providing that members, managers, and agents of an LLC are not liable for the debts, obligations, or liabilities of the LLC. The plaintiffs argued that they had alleged individual tortious acts separate and apart from the defendants' roles as managers, but the court held that the petition did not sufficiently allege wrongful conduct separable from the roles of the defendants as managers. In particular, the court noted that the thrust of the litigation was a breach of contract action against the LLC and that the property allegedly removed from the leased premises belonged to the LLC. Thus, the allegations necessarily related to decisions regarding property owned and used by the LLC. The court added that there were no particularized allegations of fraud and that the allegations were insufficient to pierce the veil of LLC statutory protection afforded members and managers.

***Matias v. Mondo Properties LLC***, 841 N.Y.S.2d 279 (N.Y. A.D. 1 Dept. 2007). The court dismissed plaintiffs' claims for exposure to lead paint against the previous and current members of the LLCs that owned and managed the premises occupied by the plaintiffs. The former member had sold the LLCs prior to plaintiffs' occupancy and had no continuing involvement in the LLCs, and the plaintiffs failed to raise a fact issue as to the current member who, despite her involvement as an officer and owner, did not exclusively and completely control the buildings and had no duties related to remediation or hazardous conditions. The mere fact that the member signed her individual name as a contact person or authorized representative did not raise a fact issue implicating her individual liability. The court commented that corporate veil piercing applies to LLCs but noted that there is a heavy burden to show that domination of the company resulted in wrongful consequences, and the court found that the plaintiff failed to raise any triable issue of fact in this regard.

**Hartford Restoration Services, Inc. v. 12-20 Cottage Street, LLC**, No. CV044000508S, 2007 WL 2593795 (Conn. Super. Aug. 28, 2007) (assuming arguendo that the statutory requirements for membership may be ignored to generate “de facto” membership in an LLC, that status is insufficient to create personal liability for the debts of the LLC or other members because the statute provides that a member or manager does not have such liability).

**Equipoise PM LLC v. International Truck and Engine Corp.**, No. 05 C 6008, 2007 WL 2228621 (N.D. Ill. July 31, 2007) (stating that Delaware LLC statute shields members and managers from liability solely by reason of being or acting as LLC members and managers, but individuals could be liable for breach of LLC’s agreement if they assumed liability on agreement or for tortious acts that they committed, authorized, or ratified while acting for LLC).

**Spaulding v. Honeywell International, Inc.**, 646 S.E.2d 645 (N.C. App. 2007). The court held that a non-manager member’s alleged participation in the management of an LLC was not grounds to impose liability on the member for the LLC’s acts inasmuch as the North Carolina LLC statute specifically provides that participating in the management or control of an LLC’s business is not grounds to impose liability on a member for the LLC’s acts. The LLC employer owed the plaintiff a non-delegable duty to provide a safe workplace, but the non-manager member did not undertake any independent duty to ensure worker safety under the terms of the operating agreement – the member did not affirmatively undertake such a duty, and the member’s agreement to be responsible for budgetary expenditures in response to an environmental event was insufficient as a matter of law to impose an independent duty upon the member to the employees. The plaintiff failed to show he was an intended or indirect beneficiary of the operating agreement.

**Bloodworth v. Aden**, No. 01-05-00796-CV, 2007 WL 1845111 (Tex. App. 2007). An attorney was sanctioned for filing a frivolous pleading, and the attorney argued that the trial court erred in imposing a sanction on him personally rather than his professional LLC. The attorney argued that he signed the pleading on behalf of the LLC and that the Texas LLC statute protected him from personal liability. The court rejected this argument and stated that the attorney could be sanctioned as the “person who signed” the pleading under the provisions of the Texas Rules of Civil Procedure regarding sanctions. The court noted that an attorney may also subject his firm to liability for a sanction in certain circumstances.

**Functional Furnishings, Inc. v. White**, No. 06AP-614, 2007 WL 1847686 (Ohio App. June 28, 2007). The plaintiff sought to hold an individual who signed a contract on behalf of a non-existent corporation personally liable, and the defendant argued that the contract mistakenly referred to a corporation when it should have identified a similarly named LLC. In response to the plaintiff’s motion for summary judgement, the defendant argued that she was not a party to the contract, that she negotiated the contract in her capacity as a member of the LLC, and that the parties did not intend for her to be personally liable, citing the provision of the Ohio LLC statute providing that a member is not personally liable for the obligations of the LLC. The defendant also argued that the LLC would be solely liable for any breach of the contract. The trial court reformed the contract based on mistake, but the court of appeals remanded for further proceedings because the issue of reformation based on mutual or unilateral mistake was never raised in the motion for summary judgment before the trial court or in the supporting briefs and materials.

**PSG Poker, LLC v. DeRosa-Grund**, No. 06 Civ. 1104(DLC), 2007 WL 1837135 (S.D. N.Y. June 27, 2007) (referring to Delaware LLC as corporation throughout opinion, relying on Delaware veil piercing principles, stating that individual who was “sole shareholder, officer, and director” would not be liable without resort to veil piercing principles, stating that individual could be personally liable absent piercing if he engaged in fraudulent misrepresentation, and stating adverse inferences could be drawn if individual did not comply with discovery obligations).

**Weber v. U.S. Sterling Securities, Inc.**, 924 A.2d 816 (Conn. 2007) (holding that liability protection of managers and members under Delaware LLC statute does not protect members or managers from direct liability for their torts and thus members of Delaware LLC would not be protected from liability for their own conduct violating federal Telephone Consumer Protection Act).

**Panasuk v. Viola Park Realty, LLC**, 839 N.Y.S.2d 520 (N.Y. A.D. 2 Dept. 2007) (granting summary judgment to LLC member because member cannot be held liable on contract entered into by LLC provided he did not purport to bind himself individually).

**Marlin Broadcasting, LLC v. Law Office of Kent Avery, LLC**, 922 A.2d 1131 (Conn. App. 2007). An LLC law firm failed to pay for radio advertising, and the court determined that the limited record before the court supported a prejudgment remedy against the LLC's sole member for unjust enrichment based on personal benefits received by the attorney member from the advertising. The attorney's benefit was not derived solely by virtue of the fact that he was a member of the firm since the radio advertisements featured the member's voice and referred specifically to the individual member by name.

**Corman v. LaFountain**, 835 N.Y.S.2d 201 (N.Y. A.D. 2 Dept. 2007) (holding that plaintiff had no valid cause of action against individual defendant because plaintiff clearly and unambiguously contracted with LLC).

**McNamee v. Dept. of Treasury**, 488 F.3d 100 (2<sup>nd</sup> Cir. 2007). The Second Circuit joined the Sixth Circuit in upholding the validity of the check-the-box regulations and affirming the ability of the IRS to hold a single member of a disregarded LLC personally liable for unpaid employment taxes. McNamee was the owner of a single member LLC that had not elected to be treated as a corporation under the check-the-box regulations. The LLC failed to pay any required payroll taxes (i.e., unemployment, social security and Medicare as well as withheld employee income taxes and employee FICA contributions) for a year and a half. The IRS assessed the taxes against McNamee personally and placed a lien on his property. McNamee argued that the IRS did not have authority to pierce the veil of an LLC and that the check-the-box regulations conflicted with the Internal Revenue Code. The court of appeals held that the check-the-box regulations are eminently reasonable in light of the emergence of LLCs and the ambiguous statutory treatment under the Internal Revenue Code. The court also rejected McNamee's argument that proposed changes to the regulations, under which a disregarded LLC's owner would not be liable for payroll taxes, indicate that the current regulations are wrong. The court held that the proposed changes provide no basis for finding the existing regulations unreasonable. Finally, the court rejected McNamee's argument that the IRS's attempt to collect the LLC's unpaid payroll taxes from him violates state law. The court concluded that single member LLCs are entitled to whatever advantages state law provides, but state law cannot abrogate the owner's federal tax liability.

**Belden v. Thorkildsen**, 156 P.3d 320 (Wyo. 2007). An individual who signed a note in his capacity as LLC member argued he was not liable because members have no personal liability for LLC debts, but the Wyoming Supreme Court held that the trial court improperly failed to consider evidence of an alleged oral side agreement that the member would reimburse the LLC for payments made on the note. The note paid off and refinanced an original note executed by the individual to finance the individual's purchase of a partnership interest in the predecessor partnership of the LLC, and the oral side agreement was not barred by the parol evidence rule because the agreement to reimburse the LLC and co-member was not inconsistent with the terms of the notes.

**Babb v. Bynum & Murphrey, PLLC**, 643 S.E.2d 55 (N.C. App. 2007). The plaintiffs sued Bynum and Murphrey, two members of a law firm LLC, alleging that Bynum engaged in numerous acts of fiduciary fraud in connection with the handling of a trust. The plaintiffs alleged claims against Murphrey for negligence, negligent supervision, and breach of fiduciary duty. The plaintiff argued that Murphrey had a duty to them under the North Carolina Limited Liability Act and the firm's operating agreement. First, the court cited the statutory provision protecting a member from liability for the obligation of the LLC but providing that a member may become liable for the member's own acts or conduct. Though the plaintiffs claimed that they were seeking to hold Murphrey liable for his own acts and omissions, the court concluded that the plaintiffs failed to allege any direct acts by Murphrey and were relying on Murphrey's failure to act. The court concluded that the LLC statute did not impose a duty on Murphrey to investigate Bynum if Murphrey did not have any actual knowledge, which the record established Murphrey did not have. The court also rejected the plaintiffs' claim that the operating agreement created a duty on the part of Murphrey. Although the operating agreement stated that a member shall be liable for his own professional negligence and that a member must comply with the rules of professional conduct, the court concluded that the plaintiffs were not third party beneficiaries of the agreement. The court said that the intent of the parties was to benefit the law firm and its members, not to directly benefit the plaintiffs. Thus, the plaintiffs were at most incidental beneficiaries and not third party beneficiaries with standing to sue.

**Litriello v. United States**, 484 F.3d 372 (6<sup>th</sup> Cir. 2007). The plaintiff, the sole member of several disregarded LLCs, was deemed to be the sole proprietor of the businesses under Internal Revenue Code Section 7701, and the IRS

sought to levy on the plaintiff's property in connection with unpaid employment taxes arising from the LLCs' operations. The plaintiff challenged the check-the-box regulations on several grounds. The court rejected the plaintiffs' challenges, holding that the check-the-box regulations are a reasonable interpretation of ambiguous provisions of Section 7701 and a valid exercise of agency authority by the Treasury. The court also concluded that the plaintiff's failure to make an election under the check-the-box regulations dictated that the LLCs be treated as disregarded entities under the regulations and prevented them from being treated as corporations; therefore, the plaintiff was deemed to be the sole proprietor of the businesses under Section 7701 and had personal liability for the employment taxes arising from the businesses. Finally, the court rejected the plaintiff's claim that the regulations impermissibly altered the legal status of the LLCs as separate entities under state law. While the plaintiff's LLCs were entitled to whatever advantages state law provided, the court concluded that state law could not abrogate his tax liability. The court noted that, after the plaintiff filed his notice of appeal in this case, the IRS proposed amendments to its entity classification regulations that would shield individuals in the plaintiff's circumstances from personal liability, but the court rejected the argument that the proposed regulations should be deemed to reflect the Treasury's current policy and applied to the plaintiff's case. The court concluded that the proposed regulations did not in any way undermine the determination that the current regulations are reasonable and valid.

*Van Meter v. Calpac*, Civil No. 05-00037, 2007 WL 1129198 (D. Guam April 10, 2007) (characterizing member of member-managed LLC as a managerial employee under Title VII, and holding member as well as LLC's general manager were sued in their capacities as supervisors and were not liable under Title VII because there is no personal liability of individual supervisors under Title VII).

*Harada v. Doiron*, No. 2:04-CV-1320-PMP-RJJ, 2007 WL 983843 (D. Nev. March 30, 2007) (granting member's motion for summary judgment as to liability on loan based on limited liability of members under Nevada LLC statute).

*Truck America Training, LLC v. City of Hillview*, No. 2006-CA-000727-MR, 2007 WL 866694 (Ky. App. March 23, 2007) (holding that contract signed by individuals indicating representative capacity but without naming LLC represented was deemed binding on individuals rather than LLC by virtue of individuals' failure to respond to request for admissions).

*McFarland v. Virginia Retirement Services of Chesterfield, L.L.C.*, 477 F.Supp.2d 727 (E.D. Va. 2007) (acknowledging general rule of limited liability of LLC members under Virginia LLC statute but concluding member who personally participates in tortious conduct of LLC may be held personally liable).

*Ledy v. Wilson*, 831 N.Y.S.2d 61 (N.Y. A.D. 1 Dept. 2007) (recognizing potential personal liability of LLC officers for LLC's breach of contract if officers acted on LLC's behalf and breach involved bad faith misrepresentations).

*Keesling v. T.E.K. Partners, LLC*, 861 N.E.2d 1246 (Ind. App. 2007) (noting that members of LLC were not liable for payables of LLC because members have no personal liability for debts and obligations of LLC).

*Miller v. Sabilia*, No. CV065002162S, 2007 WL 706740 (Conn. Super. Feb. 15, 2007) (stating LLC member cannot be sued simply by reason of membership in LLC because statute specifies member is not proper party in suit against LLC solely by reason of being member).

*Archer v. Permanent Spray On Siding, LLC*, No. CV064004785S, 2007 WL 586846 (Conn. Super. Feb. 1, 2007) (dismissing negligence claim against individual LLC agent who negotiated contract but was not involved in alleged faulty installation of product, but declining to dismiss unfair practices claim against individual because claim was based on individual's personal involvement in negotiating contract and selling product).

*Causey v. Lachmandes*, No. 3:04-0797, 2005 WL 2000625 (M.D.Tenn. Aug. 18, 2005) (dismissing claims against LLC owners in connection with shooting of guest at hotel owned by LLC, citing liability protection of members provided under Tennessee LLC statute subject to one exception where member, holder, or agent is personally liable by

reason of such person's own acts or conduct, but pointing to dearth of allegations to support claim of personal liability on part of owners).

#### **P. LLC Veil Piercing**

***Bramante v. McClain***, Civil Action No. SA-06-CA-0010 OG (NN), 2007 WL 4555943 (W.D. Tex. Dec. 18, 2007). The plaintiffs, judgment creditors of an individual, sought to reverse pierce numerous LLCs on the basis that the LLCs were the alter egos of the individual under Texas veil piercing principles. The LLCs sought summary judgment, arguing that there was no evidence of unity between the LLCs and the individual because the plaintiffs could not show that the individual had an ownership interest in, or control over, the LLCs. The court, however, found that the plaintiffs raised a fact question based on summary judgment evidence that the individual created a group of entities that ultimately became the LLC defendants in the case. Evidence that the individual was the sole owner of the entities that ultimately became the LLC defendants constituted evidence sufficient to raise a fact question regarding the individual's ownership and control of the LLCs. The court also found that the plaintiffs had raised a fact question as to whether the individual judgment debtor used entities owned by him to fraudulently transfer assets to the LLCs. Further, the court concluded that the plaintiffs stated a claim against the LLCs for conspiring by agreement to commit fraudulent transfers to avoid collection on the judgment. The court found no authority, however, supporting liability beyond the amounts actually transferred.

***Greater St. Louis Construction Laborers Welfare Fund v. Mertens Plumbing and Mechanical, Inc.***, No. 4:05CV2266CDP, 2007 WL 4392122 (E.D. Mo. Dec. 13, 2007) (applying alter ego doctrine under Labor Management Relations Act and Missouri veil piercing law to conclude that LLC and commonly controlled entities were not operated as separate entities and all were liable for one another's obligations).

***HFR, Inc. v. Hildyard***, No. 05-2300-JWL, 2007 WL 4374174 (D. Kan. Dec. 13, 2007) (setting aside default judgment against individual members of LLC based on demonstration of excusable neglect and existence of meritorious defense to plaintiff's veil piercing claim).

***In re Moore (Cadle Company v. Brunswick Homes, LLC)***, 379 B.R. 284, Bankruptcy No. 06-31859-SGJ-7, Adversary No. 06-3417 (Bankr. N.D. Tex. 2007). A judgment creditor sought to reverse pierce the veil of an LLC to impose liability on the LLC for the creditor's judgment against an individual debtor. The court applied Texas law to the veil piercing claims based on the rule that the law of the state of incorporation applies to corporate veil issues. The court discussed the development of both traditional and reverse corporate veil piercing under Texas law and concluded that the doctrine of reverse veil piercing is applicable under Texas law although the doctrine has rather "thin roots" in Texas. Noting that neither the Texas Supreme Court nor the Texas legislature has opined on reverse veil piercing, the court relied upon Fifth Circuit case law that has recognized the doctrine under Texas law. The court, however, was troubled by the fact that the doctrine of reverse piercing has evolved and been accepted into the mainstream of Texas veil piercing jurisprudence at the same time the Texas legislature has been limiting traditional veil piercing and without meaningful discussion of what the doctrine in substance accomplishes. The court concluded that the concept should be applied only when it is clear that it will not prejudice non-culpable shareholders or other stakeholders (such as creditors) of the corporation. The court applied corporate veil piercing principles to the LLC in issue, stating that whether an entity is a corporation or an LLC is a "distinction without a difference" for purposes of veil piercing. The fact that reverse piercing was sought with respect to an individual who was not a record or nominal equity owner of the LLC did not preclude the claim since the plaintiffs sought to establish that the individual had a *de facto* interest in the LLC. The court concluded that fact issues precluded summary judgment for the LLC on the reverse veil piercing claim and a claim for constructive trust on the LLC's assets. The court held that the ten year statute of limitations for enforcement of a judgment applied to the reverse alter ego and constructive trust claims since the claims were being pursued to collect a judgment.

***Flores v. DDJ, Inc.***, No. 1:99 CV 5878 AWI DLB, 2007 WL 4269259 (E.D. Cal. Nov. 30, 2007). The plaintiffs sought to pierce the veil of a corporation and LLC and add the individual owners to a judgment obtained against the entities based on the alter ego theory. The plaintiffs argued that the entities no longer had any tangible assets due to sales of their assets from which the owners profited, did not issue stock, failed to maintain minutes or adequate



corporate records, and were not adequately capitalized, and that the owners diverted corporate funds for their own use. The court reviewed the evidence as it related to both entities and denied the plaintiffs' request to add the owners of the entities to the judgment. With respect to the LLC, the court stated that it was not completely following formalities with regard to the roles it assigned based on evidence that two individuals who were members (one of whom testified she did not know she was a member) attended no meetings and were not involved in the business; however, the court concluded that the evidence of failure to follow formalities, in particular failure to hold meetings, did not assist the plaintiffs because the California LLC statute specifies that failure to hold meetings is not a factor to be considered in determining whether a member is the alter ego of an LLC, and the LLC's operating agreement specifically stated that no annual or regular meetings were required and that members were to devote whatever time or effort they deemed appropriate for the furtherance of the LLC's business. With respect to the absence of evidence that the LLC ever issued stock, the court pointed out that LLCs do not issue stock, but the court stated that an LLC's failure to issue membership interests, rather than stock, would be a factor to consider in the alter ego analysis. The owners offered evidence of the LLC's issuance of membership certificates in this case, and the court concluded this factor did not support finding a unity of interest and control. The court rejected the argument that the entities were undercapitalized because there was no evidence that the entities were undercapitalized at the time they were formed or during the time frame in issue. The court also addressed an argument by the plaintiffs that the LLC continued to operate after it sold substantially all of its assets which was an event of dissolution under the operating agreement. The court stated that it was unclear how this fact implicated the alter ego analysis, but noted that the plaintiff might be attempting to show a failure to follow corporate formalities. The court stated that the LLC had not sold substantially all of its assets in any event because it continued to hold a note from the buyer that was a substantial asset after it sold its physical assets. Looking at the totality of the circumstances, the court found the evidence insufficient to support a finding of alter ego liability. Additionally, the court found the evidence insufficient to meet the requirement that an inequitable result will follow if the corporate form is not disregarded. The existence of an unsatisfied creditor does not itself create an inequitable result, and an inequitable result does not follow in cases where the corporation was once adequately capitalized and then encountered bad financial times.

*Wachovia Securities, LLC v. Neuhauser*, 528 F.Supp.2d 834 (N.D. Ill. 2007) (stating that plaintiff presented little to no evidence supporting its assertion that there was unity of interest and ownership between LLC and its members and failed to overcome heavy burden of meeting stringent standards applicable to voluntary contract creditor seeking to pierce corporate veil under Illinois law).

*In re Storer*, 380 B.R. 223 (Bankr. D. Mont. 2007) (applying Montana corporate veil piercing principles to LLC and concluding that LLC was alter ego of one of its two members based on fact that member listed creditors of LLC as his creditors on his bankruptcy schedule, but holding member did not use LLC as subterfuge to perpetrate fraud).

*In re Schwab*, 378 B.R. 854 (Bankr. D. Minn. 2007) (concluding that principles of equity allowed member to reverse pierce LLC veil and claim ownership of accounts receivable where LLC had no debts or obligations of its own at time member filed bankruptcy, receivables consisted of charges for member's labor, and member had no other source of earnings).

*Intercept Corp. v. Calima Financial, LLC*, 741 N.W.2d 209 (N.D. 2007) (concluding that evidence supported finding individual was member of LLC and not merely employee because individual's testimony and documentary evidence of transfer of ownership were not credible, and trial court's findings supported piercing veil of LLC to hold individual member liable under corporate veil piercing principles applicable to North Dakota LLCs).

*Axtmann v. Chillemi*, 740 N.W.2d 838 (N.D. 2007). The dissenting opinion in this North Dakota Supreme Court corporate veil piercing case argues that the majority opinion makes piercing the corporate veil the rule rather than an exception and could provide dangerous precedent susceptible of stifling start up businesses and exposing small business owners to liability beyond the Legislature's intention. The dissenting opinion contains a footnote that points out that the holding in the case regarding corporate veil piercing reaches beyond the corporate context since North Dakota LLC and LLP statutes provide that case law stating conditions and circumstances under which the corporate veil of limited liability may be pierced applies to LLCs and LLPs.

***Arsenault v. Orthopedics Specialist of Texarkana***, No. 06-07-00022-CV, 2007 WL 3353730 (Tex. App. Nov. 14, 2007) (finding no pleading or evidence supporting alter ego and single business enterprise veil piercing claims against owner of professional LLC).

***Cement-Lock v. Gas Technology Institute***, 523 F.Supp.2d 827 (N.D. Ill. 2007) (applying Delaware veil piercing principles to analyze whether Delaware LLC's veil should be pierced and noting that failure to follow corporate formalities may not be as significant for LLC as for corporation; concluding that there was sufficient veil piercing evidence for claim to survive summary judgment based on allegations that would show LLC was intended to and did serve fraudulent purpose).

***Odnil Music Limited v. Katharsis LLC***, No. CIV S-05-0545 WBS EFB PS, 2007 WL 3308857 (E.D. Cal. Nov. 6, 2007) (applying alter ego doctrine under California law and concluding LLC owner's trust was owner's alter ego and thus alter ego of LLC, such that assets of trust could be reached to satisfy judgment against LLC and owner; LLC owner's trust was also liable for judgment against LLC on basis that liability was necessary in order to prevent injustice).

***Taurus IP, LLC v. DaimlerChrysler Corporation***, 519 F.Supp.2d 905 (W.D. Wis. 2007) (stating that court should look to law of state of incorporation of entity to determine whether corporate form should be disregarded; concluding that numerous Texas and Wisconsin LLCs were alter egos of individual who operated LLCs for purposes of personal jurisdiction based on prima facie showing that individual used entities to perpetrate fraud and exerted complete domination over entities; noting that alter ego doctrine can be applied in reverse and concluding that LLCs and individual were all alter egos of one another based on such application, and exercising personal jurisdiction over all such parties based on consent to jurisdiction by one of LLCs; denying motion to dismiss various claims against individual and LLCs operated by him based on allegations supporting application of alter ego doctrine).

***White Family Harmony Investment, Ltd. v. Transwestern West Valley, LLC***, No. 2:05CV495DAK, 2007 WL 2821798 (D. Utah Sept. 27, 2007). An LLC lessee was liable to the plaintiff lessor for unpaid rent and other payments due under the lease, and the plaintiff, relying on the alter ego doctrine, sought to pierce the veil of the LLC under Utah law and hold liable its parent LLC and a commonly owned LLC that held fee title to the property. The defendants filed a motion for summary judgment, and the plaintiff filed a cross-motion for summary judgment against the parent. The court stated that Utah law required proof of two elements to succeed on an alter ego claim: (1) that there is such unity of interest and ownership between the entities that the separate personalities of the different entities no longer exist (referred to by the court as the "formalities element"), and (2) that the observance of the corporate form would sanction a fraud, promote injustice, and cause an inequitable result (referred to by the court as the "fairness element"). The court discussed each of these elements and the summary judgment evidence and concluded that the plaintiff had established both elements as a matter of law with regard to the parent and was entitled to summary judgment on its alter ego claim against the parent. The LLC that owned fee title to the property was not entitled to summary judgment because the plaintiff demonstrated that it shared a unity of interest with the LLC lessee and parent and played a role in the injustice to the plaintiff. Discussing the formalities element at length, the court first pointed to the fact that the parent was the sole member of the LLC and that the two entities had the same managers. Further, there was a substantial overlap in the individuals who participated in the two entities and other related entities that participated in the management of the LLC. The LLC was initially capitalized by its parent not with cash, but entirely with the leasehold, and all available excess cash was distributed to the parent without regard to requirements contained in the lease or prospective liabilities in connection with the lease. Eventually the LLC began to incur operating losses which the parent covered until the LLC ceased making rent payments. The court concluded that this state of affairs constituted a state of "gross undercapitalization" as defined by Utah law. The parent argued that the fact that the parent made contributions to the LLC to enable it to cover the lease payments when it began operating at a loss was evidence that the parent acted properly, but the court stated that this was evidence that it was the alter ego of the LLC because payment of a subsidiary's expenses by a parent is a relevant factor in the alter ego analysis. The court also pointed out that the parent paid hundreds of thousands of dollars to a related entity that served as asset manager for the parent and its subsidiaries, including the LLC lessee. The asset manager, as agent of the parent, controlled every aspect of the LLC's business and ensured that the LLC hired only affiliates, including an affiliate that acted as property manager for the leasehold. The court also attached significance to the fact that the parent generated consolidated financial statements and as a consequence reflected the LLC's property as its own. The court noted that the LLC had never filed a tax return and did not have its own tax identification number.

The court described various other transactions and accounting practices and observed that the LLC did not have the appearance of an independent personality. Additional concerns raised by the court were the LLC's failure to maintain its registration with the State of Utah and failure to follow corporate formalities. The leasehold was assigned to the LLC prior to its registration with the state, and the LLC at one point allowed its registration to expire, leaving the impression that its managers were unconcerned with formalities. The court stated that the LLC failed to comply with basic record keeping requirements and demonstrated a failure to follow corporate formalities. The LLC's managers failed to hold any meetings and could produce only two unanimous consents when asked to produce all meeting minutes, resolutions, annual reports, and corporate filings. Decisions to make distributions, execute lease agreements with subtenants, stop making lease payments, and surrender the leasehold were not documented. Another indicator of "unity of interest and ownership" was the fact that the property manager repeatedly confused the LLC with its affiliate that owned fee title to the property. The defendants relied heavily on public policy arguments favoring the liability protection afforded by corporations and LLCs, but the court concluded that such public policy does not trump other public policy concerns and that the evidence overwhelmingly satisfied the plaintiff's burden as to the formalities element of its alter ego claim. The court then examined the fairness element and noted that the plaintiff need not show actual fraud, only that a failure to pierce would result in injustice. The court found that the plaintiff satisfied its burden on the fairness element with respect to the parent because it not only played a role in the LLC's breach of the lease, but was the primary cause of the breach and the party responsible for the LLC's inability to make the plaintiff whole. The parent decided that the LLC would cease making its lease payments and received the LLC's cash reserves and kept it undercapitalized. The court concluded that the related LLC that owned fee title to the property was not entitled to summary judgment because it also played a role in the unfairness.

*Sudamax Industria E Comercio De Cigarros, Ltda v. Buttes & Ashes, Inc.*, 516 F.Supp.2d 841 (W.D. Ky. 2007). The plaintiff sought to pierce the veil of an LLC, and the court applied corporate veil piercing principles (stating that the following is required to pierce corporate veil: (1) that there is such unity of interest and ownership that the separate personalities of the corporation and its owner cease to exist, and (2) that the adherence to the normal attributes of separate corporate existence would sanction a fraud or promote injustice) and concluded that the evidence did not support piercing the LLC veil to hold its individual owner and related entities liable where the LLC and its related entities were in good standing under Kentucky law and observed corporate formalities by maintaining bank accounts and filing tax returns and financial statements. The plaintiffs' own expert was able to track the flow of money between the related entities, and there was no evidence that the individual defendant commingled personal funds with corporate funds and no evidence that others were paying or guaranteeing the LLC's debts. There was no evidence of undercapitalization, and the LLC was not defending the breach based on having insufficient funds to meet its obligation, but simply disputed the amount due. Even if evidence had been produced on the element of unity and lack of separateness, the court found no evidence of fraud or injustice, but merely failure to pay a debt.

*In re JNS Aviation, LLC (Nick Corp. v. JNS Aviation, Inc.)*, 376 B.R. 500 (Bankr. N.D. Tex. 2007). The court rejected the argument that a member's statutory liability protection under the Texas LLC statute precludes veil piercing and followed Texas cases that have applied corporate veil piercing principles to LLCs. The court undertook a lengthy discussion of various veil piercing theories under Texas law and found that the facts satisfied certain factors associated with several theories, but concluded that the facts best fit within the "sham to perpetrate a fraud" doctrine. The court found that shutting down the LLC without notice to the creditor (as required by the winding up provisions of the LLC statute), allowing the creditor to take a default judgment against the LLC, and distributing the LLC's assets to the owners who contributed the assets to a newly formed entity, was a scheme to isolate the judgment in a shell entity and constituted an actual fraud for the personal benefit of the owners of the entities.

*Siva v. 1138 LLC*, No. 06AP-959, 2007 WL 2634007 (Ohio App. Sept. 11, 2007). The court found that an LLC member failed to preserve his argument that the legislature did not intend that corporate veil piercing principles apply to LLCs, but affirmed the trial court's finding that the plaintiff failed to prove the member exercised the requisite degree of control to justify piercing the LLC veil under corporate veil piercing principles. Assuming the evidence was sufficient to show the requisite control, the court concluded the evidence did not show that the member purposely undercapitalized the LLC or that it was formed in an effort to avoid paying creditors. Further, there was no evidence of any fraudulent transfer of funds or diversion of funds to the member. The primary reason the LLC failed to pay its rent was that the LLC was not profitable and, even if the record suggested poor business judgment, it did not demonstrate the LLC was

formed to defraud creditors. The evidence did not show the plaintiff was misguided as to the fact he was dealing with an LLC, and the plaintiff admitted that he did not ask any owners to sign the lease in their individual capacity.

***Lee v. BSB Greenwich Mortgage Limited Partnership***, No. X08CV040200344S, 2007 WL 2743435 (Conn. Super. Aug. 31, 2007) (noting that “alter ego” and “instrumentality” theories are veil piercing theories that apply to LLCs under Connecticut law and denying defendant members’ motion for summary judgment on veil piercing claims because plaintiff’s claims were not exclusively tied to fraudulent transfers barred by statute of limitations, but also involved collection of judgment obtained by plaintiff against limited partnership of which LLC was general partner, and statute of limitations on suit to enforce judgment is twenty-five years from date of final judgment).

***NII-JII Entertainment, LLC v. Troha***, No. 2006AP2204, 2007 WL 1695176 (Wis. App. June 13, 2007) (noting that Wisconsin LLC statute calls for common law corporate veil piercing principles to apply to LLCs and stating that no allegations supported veil piercing to disregard separate existence of two LLCs that were direct and indirect owners of LLC).

***Feitshans v. Kahn***, No. 06 Civ. 2125(SAS), 2007 WL 2438411 (S.D. N.Y. Aug. 22, 2007) (applying corporate veil piercing principles to corporation and LLC and finding fact issues as to both domination/control and fraud/wrong precluded summary judgment in favor of either plaintiffs or defendants).

***Matias v. Mondo Properties LLC***, 841 N.Y.S.2d 279 (N.Y. A.D. 1 Dept. 2007) (commenting that corporate veil piercing applies to LLCs, but noting heavy burden to show domination of company resulted in wrongful consequences, and finding that plaintiff failed to raise triable issue of fact in this regard).

***In re Mooney (LaCarubba v. Mooney)***, Bankruptcy No. 05-13392-JMD, Adversary No. 05-1205-JMD, 2007 WL 2403774 (Bankr. D. N.H. Aug. 17, 2007) (noting that plaintiff did not allege liability based on veil piercing theory, but commenting that Massachusetts would likely apply corporate veil piercing principles to LLCs and that corporate veil piercing is permitted only in rare circumstances to prevent gross inequity).

***Woodman Investment Group, LLC v. Superior Court***, No. B188553, 2007 WL 2084053 (Cal. App. 2 Dist. July 23, 2007) (concluding substantial evidence supported trial court’s finding that single-member, single-purpose LLC was alter ego of individual where LLC was wholly owned by revocable trust formed by individual for his own personal estate planning purposes, individual purchased property described as LLC’s purpose, individual controlled LLC although he attempted to hide this fact by having his nephew appointed as manager, individual borrowed money from LLC for his own personal investment purposes, individual did not deny that there were substantial liens on property, and individual drained cash from LLC indicating inequitable result would follow if individual were not held liable for LLC’s debts).

***Four Seasons Manufacturing, Inc. v. 1001 Coliseum, LLC***, 870 N.E.2d 494 (Ind. App. 2007) (applying corporate veil piercing principles to LLC without discussion of fact that entity was LLC rather than corporation and finding piercing was warranted to hold liable sole member of LLC who orchestrated fraudulent transfer to second wholly owned LLC; concluding sole member of debtor LLC was also debtor under fraudulent transfer statute where member was liable for LLC’s obligation under piercing theory).

***Ritchie Capital Management, L.L.C. v. Coventry First LLC***, No. 07 Civ. 3494(DLC), 2007 WL 2044656 (S.D. N.Y. July 17, 2007) (relying on internal affairs doctrine and applying Delaware law in determining that grounds for piercing veil of Delaware LLC had been sufficiently alleged for purposes of liability and personal jurisdiction).

***Vanderford Company, Inc. v. Knudson***, 165 P.3d 261 (Idaho 2007). The court held that there was sufficient evidence presented to support submission of the plaintiff’s requested jury instructions on its argument that an LLC was the alter ego of the managing member where there was evidence that he paid himself, as manager of the LLC, to manage his personal investment properties and he and his accountant testified that the LLC’s checking account was so confusing that the accountant could not be sure whose money was in the account at times.

**McCarthy v. Wani Venture, A.S.**, \_\_\_ S.W.3d \_\_\_, 2007 WL 1845088 (Tex. App. 2007). The court held that corporate veil piercing principles apply to Texas LLCs and that the evidence was sufficient to support the jury's finding that the defendant, McCarthy, caused an LLC to be used to perpetrate an actual fraud upon the plaintiff for McCarthy's direct personal benefit. McCarthy and two other individuals were the owners of numerous interrelated companies involved in the case. Among these entities was an LLC of which McCarthy was a one-third member and vice-president. The plaintiff supplied over \$1 million of wallboard to the LLC, and the LLC paid for only about \$500,000 of the wallboard. The plaintiff sued the LLC, several related entities, and the three individual members of the LLC, alleging tort, breach of contract, and veil piercing claims. At the time of trial, all of the original defendants other than McCarthy had filed bankruptcy, been severed out, or been non-suited. An expert testified about the dealings of the entities and individuals and expressed concern about various issues and irregularities. He summed up his findings by referring to "multiple companies that are intermingling," "monies coming in, monies coming out," "a lack of documentation," "a lack of supporting information," "an accounting nightmare," "transfers between parties," "a lot of red flags," and "inventories that are being shifted and moved." There was also evidence from which the court of appeals concluded that the LLC concealed material facts about its financial condition and operations and induced the plaintiff to supply the LLC wallboard for which it was never paid. The jury charge included a question that inquired whether McCarthy caused the LLC to be used to perpetrate an actual fraud, and did perpetrate an actual fraud upon the plaintiff, primarily for her own direct personal benefit (i.e., tracking the veil piercing standard specified by the Texas Business Corporation Act). The jury answered this issue in the affirmative, and also found damages in the amount of unpaid invoices and attorney's fees. The trial court entered a judgment against McCarthy based on the findings, and McCarthy appealed. McCarthy argued that the trial court erred in holding her personally liable for the LLC's debt because the Texas Limited Liability Company Act provides for liability of a member under very limited circumstances and specifically provides that a member is not liable for a debt of the LLC. McCarthy argued that the LLC veil is impenetrable because the LLC statute does not address whether or under what circumstances a litigant may pierce the veil of an LLC. The court disagreed, stating that courts in Texas and other jurisdictions have applied to LLCs the same state law principles for veil piercing that are applicable to corporations. McCarthy also argued that "actual fraud" was improperly defined for the jury, that there was insufficient evidence that the LLC committed fraud, that the evidence was insufficient to support the findings of damages and attorney's fees, and that there was insufficient evidence that McCarthy caused the LLC to be used to perpetrate a fraud for her direct personal benefit. The court of appeals rejected all of these arguments. A dissenting justice did not challenge the proposition that corporate veil piercing principles apply to Texas LLCs, but disagreed with the majority that the evidence was sufficient to support the jury's finding that McCarthy caused the LLC to perpetrate a fraud for her direct personal benefit.

**PSG Poker, LLC v. DeRosa-Grund**, No. 06 Civ. 1104(DLC), 2007 WL 1837135 (S.D. N.Y. June 27, 2007) (referring to Delaware LLC as corporation throughout opinion, relying on Delaware veil piercing principles, stating that individual who was "sole shareholder, officer, and director" would not be liable without resort to veil piercing principles, stating that individual could be personally liable absent piercing if he engaged in fraudulent misrepresentation, and stating adverse inferences could be drawn if individual did not comply with discovery obligations).

**Smith v. Shining Rock Golf Community, LLC**, No. 20061510B, 2007 WL 2110958 (Mass. Super. June 20, 2007) (finding plaintiff failed to sufficiently alleged grounds to pierce veil of single member LLC, noting that single-shareholder corporations or LLCs are not de facto illegal or inherently a sham).

**Kowalski v. Integral Seafood LLC**, Civ. Nos. 05-00679 BMK, 06-00182 BMK, 2007 WL 1376378 (D. Hawaii May 4, 2007) (referring to LLC as corporation and recognizing that standard to pierce veil on alter ego grounds for personal jurisdiction purposes is lower than for purposes of determining liability, but finding plaintiffs failed to meet lower standard).

**Tzvolos v. Wiseman**, No. CV040488839, 2007 WL 1532760 (Conn. Super. May 3, 2007) (stating that corporate veil piercing theories apply to Connecticut LLCs and concluding that commonly owned LLCs and corporation should be pierced under instrumentality theory because evidenced established failure to follow formalities (citing failure to comply with LLC operating agreement requirement that affiliated transactions be approved by majority vote of members), overlapping ownership and management, common office space, lack of arms length dealing, preferences exercised in favor of family owned entities, unity of interest, lack of independence, and injustice and inequity).

**Flentye v. Kathrein**, 485 F.Supp.2d 903 (N.D. Ill. 2007) (stating plaintiffs could rely on corporate veil piercing principles to pierce LLC veil, stating that “reverse piercing” was potentially applicable, and finding allegations sufficient to state alter ego claim).

**Union County Improvement Authority v. Artaki, LLC**, 920 A.2d 125 (N.J. Super. A.D. 2007) (analyzing “unity of ownership” concept with respect to question of court’s authority to consolidate condemnation proceedings involving tracts owned by LLC and tracts owned individually by members of LLC).

**Bronstein v. Crowell, Weedon & Co.**, No. B191738, 2007 WL 969559 (Cal. App. 2 Dist. April 3, 2007). The plaintiffs sought to pierce the veil of a Delaware LLC and hold a 30% owner liable under the alter ego doctrine. The court noted the application of the alter ego doctrine to LLCs under the California LLC statute and stated that the alter ego doctrine is also applicable to Delaware LLCs. The court stated that the liability of members of a foreign LLC is governed by the law of the state of formation under California law. The court concluded that the plaintiffs failed to present evidence raising a triable issue of fact as to whether the 30% owner of the LLC was liable under the alter ego doctrine, finding that the owner’s alleged concealment of his ownership in the LLC was insignificant inasmuch as a 30% interest is insufficient to make a controlling decision in a Delaware LLC. The court acknowledged the limited liability of members in a Delaware LLC (noting as well the comparable provision under California law) and concluded that the plaintiffs failed to raise a triable issue of fact as to whether the owner of the LLC should be liable on a theory that the LLC was a joint venture, stating that any joint venture or partnership terminated upon the LLC’s formation.

**Butler v. Adoption Media, LLC**, 486 F.Supp.2d 1022(N.D. Cal. 2007). After a general partnership refused to post the profile of a gay couple on the partnership’s website facilitating adoption, the couple sued the partnership, its two individual partners, two Arizona LLCs subsequently formed by the individuals, and two corporations formed by the individuals to serve as members of the LLCs. The plaintiffs argued that the LLCs were liable as successors of the partnership and that the LLCs and other entity defendants were all alter egos of the individuals. After the partnership refused to post the plaintiffs’ profile on its web site, the individual partners formed the two LLCs, transferred assets from the partnership to the LLCs, formed two corporations (one owned by each of the individuals) to serve as members of the LLCs, and transferred their membership interests in the LLCs to the corporations. Applying California successor liability rules to the analysis of whether the LLCs were liable as successors of the partnership, the court concluded that there was no basis for successor liability because there was no express or implied assumption, the requirements of the de facto merger and mere continuation doctrines were not met (since the partnership continued to exist), and there was no evidence that the partnership transferred assets to the LLCs for a fraudulent purpose. Applying California law to the analysis of whether the LLCs and other entity defendants were alter egos of the individuals and one another, the court granted summary judgment to the defendants. The plaintiffs argued that the business entity defendants were all alter egos of the two individuals because they failed to maintain their separateness and confused the various entities. The plaintiffs also contended that it was the individuals’ intent to create a business structure in which no single entity or individual could be held liable for the discriminatory practice of not allowing same-sex couples to post on the adoption profile web site. The court reviewed the parties’ arguments regarding the evidence bearing on the alter ego issue and concluded that the plaintiffs provided some evidence of a material dispute with regard to a unity of interest and ownership among the individuals and entity defendants; however, the court characterized the evidence of the individuals’ occasional disregard of corporate formalities and distinctions among the entities as “not particularly compelling,” stating that the interests of management and ownership generally collide in a closely held corporation and that lack of formality is not unusual in a closely held corporation. More important, the court said, was the plaintiffs’ failure to provide any evidence of bad faith or that the LLCs were created to avoid the operation of a statute. The plaintiffs failed to rebut the defendants’ evidence of legitimate business and estate planning reasons to form the LLCs and corporations. Finally, to the extent triable issues were raised, the court stated that they were not material inasmuch as the plaintiffs had argued that an inquiry into alter ego liability would be superfluous.

**Global Diagnostic Development, LLC v. Diagnostic Imaging of Atlanta**, 643 S.E.2d 338 (Ga. App. 2007) (holding that common ownership of corporation and LLC was not sufficient to disregard separate existence of LLC and treat it as single entity with corporation for purposes of certificate of need awarded to LLC after denial to corporation and transfer of corporation’s assets to LLC).

***Meneo v. Patrick***, No. CV065004523, 2007 WL 1053511 (Conn. Super. March 23, 2007) (finding insufficient grounds to pierce veil of single member LLC; acknowledging that manager/sole member could have personal liability for his own participation in wrongful acts, but finding evidence did not support claims).

***Wellman v. Dow Chemical Company***, Civ. No. 05-280-SLR, 2007 WL 842084 (D. Del. March 20, 2007) (stating that LLC formed under Delaware law is treated for liability purposes like corporation and that record did not support proposition that corporate member of LLC joint venture was involved in operations of LLC to any extent, let alone to extent necessary to pierce veil and treat member as employer of LLC's employee in context of discrimination claim).

***Gaskey v. Fulton Bellows, LLC***, No. 3:05-CV-540, 2007 WL 869621 (E.D. Tenn. March 20, 2007) (concluding that plaintiffs alleging age discrimination claims failed to show LLC general partner of limited partnership that owned 96% of LLC ever made or participated in hiring decisions and presented no factual support for allegations that LLC general partner of member was alter ego of LLC).

***Sundance Rehabilitation Corporation v. New Vision Care Associates II, Inc.***, No. 04-3571-CV-S-FJG, 2007 WL 709014 (W.D. Mo. March 5, 2007) (holding that plaintiff did not establish grounds to pierce veil of corporate and LLC entities, stating that criteria necessary to satisfy corporate continuation doctrine differs significantly from test to pierce corporate veil).

***Scribner v. McMillan***, Civil No. 06-4460 (DWF/RLE), 2007 WL 685048 (D. Minn. March 2, 2007) (holding plaintiff in sexual harassment action alleged sufficient facts to support piercing LLC veil to hold commonly owned entity and individual owners liable under single employer and veil piercing theories).

***Ledy v. Wilson***, 831 N.Y.S.2d 61 (N.Y. A.D. 1 Dept. 2007) (holding summary judgment evidence was sufficient to raise fact issue regarding piercing of LLC).

***In re Gilbert (Teasck v. Gilbert)***, Bankruptcy No. 06-10119-JMD, Adversary No. 06-1142-JMD, 2007 WL 397018 (Bankr. D. N.H. Feb. 1, 2007). The court concluded that New Hampshire courts would apply corporate veil piercing principles to New Hampshire LLCs, but the court rejected the plaintiff's theory that the veil of an LLC could be pierced to hold the debtor liable simply because the debtor was the sole managing member and owner of the LLC and all of the plaintiff's dealings with the LLC were through the debtor. The court stated that the plaintiffs must show that the LLC was used by the debtor to promote his own private business and to promote an injustice or fraud. The court pointed out that the record did not show that the creditor was misled about the status of LLC, nor did it show that the debtor conducted personal business through LLC. Additionally, the record did not show that the debtor commingled personal and LLC assets or used assets of the LLC to pay any obligations other than those of LLC. The court also rejected the plaintiff's undercapitalization argument and stated that business failure alone does not constitute the type of unfairness that is sufficient to pierce the veil.

***Kreisler v. Goldberg***, 478 F.3d 209 (4<sup>th</sup> Cir. 2007) (applying Maryland law and concluding there existed no basis to conclude that wholly owned LLC subsidiary of LLC debtor should not be recognized as separate legal entity and that automatic stay did not protect debtor's LLC subsidiary nor did debtor have any direct interest in assets of LLC subsidiary).

***Truckstop.Net, L.L.C. v. Spring Communications Company, L.P.***, Nos. CV-04-561-S-BLW, CV-05-138-S-BLW, 2007 WL 1366546 (D. Idaho Jan. 12, 2007). The plaintiff, a Delaware LLC, provided wireless internet access to subscribers through access points at truck stops. The plaintiff sued Sprint for losses allegedly caused by faulty networks installed by Sprint that led to the cancellation of subscriptions by many of plaintiff's customers. Sprint counterclaimed for fees owed by the plaintiff for installation of the networks. After the deadline for amendments had passed, Sprint sought to amend its counterclaim to pierce the veil of the plaintiff and hold investors liable. The court noted that Sprint did not identify any Delaware decision that expressly applies veil piercing doctrines to LLCs, but the court agreed with the author of a law review article cited by Sprint that Delaware courts would apply corporate veil

piercing or some variation to LLCs. Sprint advanced two veil piercing arguments. The first was that the investors hid the LLC's inadequate capitalization and insolvency from Sprint, refused to fund the LLC, and chose to put the LLC out of business. The court concluded that Sprint knew of the LLC's financial condition and that the investors were refusing to bail it out long before it sought to amend its pleadings, and there was no good cause for the delay in amending. Sprint's second argument for piercing the LLC veil was based on more recent deposition testimony by investors that they stood ready to invest additional capital if the networks were installed properly. The court stated that this argument could not form the basis to pierce the veil. The court stated that evidence of co-mingling assets could support piercing, but Sprint offered no evidence of co-mingling. According to the court, if the proposed investment could only have been accomplished by co-mingling, Sprint might have had a stronger position, but no evidence supported such speculation. The court stated that the LLC agreement contemplated non-obligatory loans or capital contributions under certain conditions, signaling that an investor could make a non-obligatory investment without disregarding the separate structure of the LLC.

*RLS Associates, LLC v. United Bank of Kuwait PLC*, 464 F.Supp.2d 206 (S.D. N.Y. 2006) (holding LLC's bond requirement may take into account assets of LLC's member).

#### **Q. Authority of Members and Managers**

*In re Northlake Development, LLC (Kinwood Capital Group, LLC v. Northlake Development, LLC)*, Bankruptcy No. 06-01934-NPO, Adversary No. 06-00171-NPO, 2007 WL 4375226 (Bankr. S.D. Miss. Dec. 13, 2007). The court held that a minority member of an LLC did not have authority to execute a deed of the LLC's property to the minority member's wholly owned LLC. The court reviewed provisions of the Mississippi LLC statute regarding the powers and structure of LLCs as well as provisions of the LLC's operating agreement. The LLC was member-managed, and the certificate of formation contained no limitations on the purposes or powers of the LLC; however, the operating agreement stated that management decisions shall be made by a vote of members owning a majority of the membership interests, and the affirmative vote of at least 75% of all membership interests was required to approve the sale or other disposition of all or substantially all of the LLC's assets other than in the ordinary course of business. Thus, whether the transfer of the LLC's property in issue was within the ordinary course or not, the majority member's approval was required for the transfer of the property. The evidence showed the minority member converted funds of the LLC for his own use and then converted the LLC's real property by deeding it to his wholly owned LLC. The court rejected the minority member's "absurd" argument that he and the majority member had an agreement that the minority member had express authority to transfer the property to the minority member's LLC without consideration. The court also rejected the argument that the minority member had apparent authority to transfer the LLC's property because there was no third party reliance where the grantee was an LLC wholly owned by the minority member and the minority member knew he had no authority to act. The bank which took a deed of trust from the grantee could not rely on apparent authority since it did not take its deed of trust from the LLC that owned the property. The court concluded that the deed conveying the property was void ab initio because the minority member lacked actual or apparent authority and actions taken by a member in contravention of an LLC operating agreement are null and void. The grantee thus had no interest to convey, and the deed of trust executed by it to the bank did not create a valid security interest.

*In re Newco Aggregate Company, LLC*, Bankruptcy No. 7-03-11787 SF, Adversary No. 05-1065 S, 2007 WL 3138637 (Bankr. D. N.M. Oct. 15, 2007) (finding that note and security agreement were properly executed on behalf of LLC where LLC was member-managed and documents were signed by individual who was president of corporation that was majority member of LLC).

*Boyd v. U.S. Bank National Association*, No. 06-2115-KGS, 2007 WL 2822518 (D. Kan. Sept. 26, 2007) (relying on common law agency principles in analyzing actual and apparent authority of LLC president in drawing on LLC's line of credit).

*In re The 1031 Tax Group, LLC*, No. 07-11448(MG), 2007 WL 2085384 (S.D. N.Y. July 17, 2007) (discussing provisions of Delaware LLC statute regarding member's ability to structure management of LLC by manager, agreeing with debtors (which consisted of parent LLC and various affiliated entities) that valid business justification existed for approval of consulting agreement whereby consultant would be retained to supervise day to day management



of debtor entities, but concluding that state law must be followed in appointment of consultant as manager or director of debtor entities and proper action by member to amend organizational documents or take such other actions required to properly appoint consultant as manager or director of each debtor entity must be taken).

*Wasatch Oil & Gas, L.L.C. v. Reott*, 163 P.3d 713 (Utah App. 2007). The court concluded that the failure of mineral lease assignments signed by an LLC manager to identify the manager as an agent did not preclude title from passing because a principal is bound by the act of its agent within the scope of the agent's authority whether the principal is disclosed or undisclosed. The court noted that the statutory requirement that an agent must be authorized in writing to execute a conveyance of real estate applies to corporations, subject to a judicial exception when the corporate agent is orally authorized and is either a general agent or executive officer. The LLC operating agreement authorized managers to execute contracts, deeds, and other agreements but also provided that a deed or conveyance of real estate shall be valid and binding if executed by any two managers; therefore, the assignments in issue, having been executed by only one manager, were not executed pursuant to written authorization, and the court remanded for a determination of whether the manager acted with oral authorization.

*Estate of E.A. Collins v. Geist*, 153 P.3d 1167 (Idaho 2007). Two individuals, Michael Collins and Russell Purcell, formed an Idaho LLC. The articles of organization stated that management was vested in the managers and listed each as a manager. Purcell testified that he had nothing further to do with the LLC after signing the articles of organization and that he was not a member. Michael Collins later amended the articles of organization to change the name of the LLC, remove Purcell as a manager, and add Michael's father as a manager. A corporation owned by Michael's father transferred various improved and unimproved lots and a model home to the LLC, and the LLC's sole purpose at that point was to develop and sell that property. After Michael's father died, his estate sought to set aside deeds executed by Michael on behalf of the LLC conveying various lots. The court first found that there was no genuine issue of fact as to whether Michael was a manager of the LLC. The estate argued that Michael could not have been a manager because the Idaho Limited Liability Company Act states that management is vested in the members unless an operating agreement vests management in one or more managers. The estate contended there was no operating agreement, but the court pointed out that, under Idaho law, an operating agreement is any agreement, written or oral, among all the members as to the conduct of the business and affairs of the LLC. The court concluded that Michael was a member of the LLC, even though he did not provide any capital (i.e., money or assets) to the LLC, because his use of credit to obtain construction loans was sufficient consideration for issuance of an LLC interest under the Idaho LLC statute. Since Purcell did not provide any consideration to the LLC and testified that he had no further involvement after signing the articles of organization, the court concluded that Michael was the sole member of the LLC and that there was an operating agreement if Michael was in agreement regarding the business and affairs of the LLC. The court stated that Michael obviously agreed that he would conduct the business and affairs of the LLC. Thus, there was an operating agreement, and Michael qualified as a manager. After Michael amended the articles of organization to remove Purcell as a manager and add his father, it was unclear whether his father became a member. Assuming his father became a member, the court concluded that Michael and his father agreed that Michael would manage the LLC. Although Michael testified in his deposition that they had no operating agreement, the court accepted Michael's explanation that he thought the question referred to a written operating agreement. The court concluded that the conduct of Michael and his father clearly showed that they had agreed that Michael would conduct the business and affairs of the LLC, and Michael thus qualified as a manager. The court then rejected the estate's argument that Michael's authority to convey real estate on behalf of the LLC must be in writing under the provisions of an Idaho statute that requires conveyance of an estate in real property to be made by a written instrument that is signed by the conveyer or the conveyer's agent authorized in writing. The court relied upon provisions of the Idaho LLC statute conferring apparent authority on a manager when apparently carrying on the business of the LLC in the usual way and providing that title to LLC property may be transferred by an instrument of transfer executed by a manager in the name of the LLC. The court noted that an LLC may only act through its agents and concluded that the specific provisions of the LLC statute control over the more general statute requiring an agent's authority to be in writing when a conveyance of real property is involved.

*Bloom v. Danbury Sports, LLC*, No. CV065000685S, 2007 WL 706758 (Conn. Super. Feb. 16, 2007) (holding that contract signed by member was binding on LLC notwithstanding limitation on authority in operating agreement

because statute specifies that every member is LLC's agent for purpose of LLC's business and member's act binds LLC unless person with whom member is dealing has knowledge that member lacks authority).

#### **R. Admission of Members**

*HFR, Inc. v. Hildyard*, No. 05-2300-JWL, 2007 WL 4374174 (D. Kan. Dec. 13, 2007) (finding that diversity of citizenship between plaintiff and defendants was established because plaintiff's allegation that LLC had no members other than individuals was supported by articles of organization, annual report, and lack of evidence that any interest was ever transferred or issued to any person or entity other than individuals, notwithstanding that memorandum of understanding between individuals and entity which was to provide financing stated that entity would own interest in LLC).

*Facebook, Inc. v. ConnectU LLC*, No. C 07-01389 RS, 2007 WL 4249924 (N.D. Cal. Nov. 30, 2007). The court concluded that the defendants' assertion in this case that they were members of an LLC was not wholly irreconcilable with the position taken in Massachusetts litigation in which they argued that they were not members for purposes of diversity jurisdiction. The fact that legal formalities necessary to make the individuals members did not take place until a retroactive operating agreement was executed did not render their contentions that they were members prior to execution of the operating agreement sanctionable. If the defendants exceeded the legal bounds of reasonable advocacy in the Massachusetts litigation, it was a matter for the Massachusetts court to address.

*Intercept Corp. v. Calima Financial, LLC*, 741 N.W.2d 209 (N.D. 2007) (concluding that evidence supported finding individual was member of LLC and not merely employee because individual's testimony and documentary evidence of transfer of ownership were not credible).

*D'Esposito v. Gusrae, Kaplan & Bruno PLLC*, 844 N.Y.S.2d 214 (N.Y. A.D. 1 Dept. 2007) (affirming lower court's finding that plaintiff was not equity member of PLLC where plaintiff, though he was identified as partner in Martindale-Hubble and on firm's letterhead and tax return and received distributions of profits, was not responsible for firm's rent or losses, was not signatory to partnership or operating agreement, made no capital investment, had no ownership interest, and had no control; causes of action based on purported promise to make plaintiff full partner/member were barred by statute of frauds because alleged oral agreement called for performance of indefinite duration and was terminable within one year only by breach).

*Flores v. Murray*, 2007 WL 3034512 (N.J. Super. A.D. Oct. 19, 2007) (holding that individuals who were reflected as members in memorandum of understanding and attachment to operating agreement were admitted as members upon formation of LLC though they did not sign operating agreement).

*Glickman v. Sollod*, 2007 WL 3034273 (N.J. Super. A.D. Oct. 19, 2007) (interpreting letter agreement and operating agreement and concluding investors did not become members of LLC where "formal stockholders' agreement" contemplated by letter agreement was never executed and operating agreement was not amended to reflect admission of members).

*Bobrow v. Liebman*, No. 061132/04, 2007 WL 1139417 (N.Y. Sup. April 16, 2007) (discussing New York law regarding admission to membership in dispute regarding plaintiff's status as member and amount of plaintiff's membership interest).

*ConnectU LLC v. Zuckerberg*, 482 F.Supp.2d 3 (D. Mass. 2007). The court analyzed the membership of a Delaware LLC in order to determine whether diversity jurisdiction existed and concluded that the LLC plaintiff had no members for purposes of diversity jurisdiction at the time the suit was filed; therefore, the LLC was "stateless" and destroyed diversity jurisdiction. In the course of its opinion, the court engaged in a lengthy analysis and discussion of the provisions of the Delaware LLC Act relating to formation of an LLC and admission of members. Because an LLC has the citizenship of each of its members, and one of the defendants was a citizen of New York, a principal focus of the court's analysis was whether a New York citizen, who was admitted as a member under the LLC's retroactive operating agreement entered eleven months after the complaint was filed and more than a year after the LLC was formed, was a

member of the LLC when the suit was filed for purposes of determining diversity jurisdiction. Although the court acknowledged that the Delaware LLC Act permits an LLC agreement to have retroactive effect (i.e., the statute permits an LLC agreement to be entered after the filing of a certificate of formation and to be effective as of the formation of the LLC), the court concluded that the analysis must turn on the facts as they existed at the time the complaint was filed without reference to the later executed operating agreement. Thus, the court proceeded to determine who, if anyone, was a member of the LLC under Delaware law at the time the suit was filed on September 2, 2004. The court looked to the statutory definition of a “member” and the provisions addressing admission of members in connection with the formation of an LLC. The court stated that the documentary evidence made clear, and the parties did not appear to dispute, that no one became a member of the LLC at the time the certificate of formation was filed on April 6, 2004. The court observed that this was “perfectly acceptable” under Delaware law and did not in any way implicate the validity of the LLC. The court acknowledged that the individuals named in the subsequently executed operating agreement eventually became members in connection with the formation of the LLC, but the court’s concern was with what occurred prior to the time the suit was filed. The court stressed that “there simply is no requirement under Delaware law that there be members of an LLC at formation” and concluded that there were none for purposes of the diversity jurisdiction question. Moving on to consider membership subsequent to formation of the LLC, the court examined whether the statutory conditions for admission of any members had been met at the time the suit was filed. The court stated that, since there were no members of the LLC at formation, there were no members to consent to the admission of a member, and there were no records reflecting the admission of members before the date the complaint was filed. The court examined evidence of the parties’ intentions and course of conduct and found that the record did not establish that the LLC had any members on the date the complaint was filed. The testimony of the individuals who ultimately became members under the operating agreement reflected that they gave little, if any, thought to who the members were at the time the LLC was formed because they were concentrating on getting the business going. The court refused to consider tax returns identifying the members since they were prepared after the suit was filed. The court also found unpersuasive two documents that identified members of the LLC prior to the date the suit was filed. One of the documents was a bank signature card, and it was unclear who printed the word “member” on the card and whether it was there when the card was signed by those identified as members. The other document was an application to do business in Connecticut that was prepared and signed by someone other than the members identified. (The court’s opinion referred to testimony that indicated there may have been an understanding at the time of formation regarding who was a member and who was not, but the court apparently found the intentions too vague to warrant a conclusion that the LLC had members at the time.) Though the court commented that the parties had struggled valiantly to establish that the LLC had members on the date the complaint was filed, the court concluded that, “in the snapshot of Delaware law, there were none.”

*Man Choi Chiu v. Chiu*, 832 N.Y.S.2d 89 (N.Y. A.D. 2 Dept. 2007) (reversing lower court’s determination that defendant was never member of LLC, noting opinion letter of LLC’s counsel attesting to valid and binding nature of loan documents signed by defendant as member, and stating determination of membership should have been based primarily on LLC’s own records which included tax returns listing defendant as member with 25% ownership).

*Moise v. Moise*, 956 So.2d 9 (La. App. 2007) (concluding that wife of LLC’s member was manager, not member, of LLC despite being identified on lease as member and despite sharing in profits inasmuch as equal share in profits did not necessarily indicate membership because profits of LLC are community property).

*Estate of E.A. Collins v. Geist*, 153 P.3d 1167 (Idaho 2007). Two individuals, Michael Collins and Russell Purcell, formed an Idaho LLC. The articles of organization stated that management was vested in the managers and listed each as a manager. Purcell testified that he had nothing further to do with the LLC after signing the articles of organization and that he was not a member. Michael Collins later amended the articles of organization to change the name of the LLC, remove Purcell as a manager, and add Michael’s father as a manager. A corporation owned by Michael’s father transferred various improved and unimproved lots and a model home to the LLC, and the LLC’s sole purpose at that point was to develop and sell that property. After Michael’s father died, his estate sought to set aside deeds executed by Michael on behalf of the LLC conveying various lots. The estate contended there was no operating agreement, but the court pointed out that, under Idaho law, an operating agreement is any agreement, written or oral, among all the members as to the conduct of the business and affairs of the LLC. The court concluded that Michael was a member of the LLC, even though he did not provide any capital (i.e., money or assets) to the LLC, because his use of credit to obtain construction loans was sufficient consideration for issuance of an LLC interest under the Idaho LLC

statute. Since Purcell did not provide any consideration to the LLC and testified that he had no further involvement after signing the articles of organization, the court concluded that Michael was the sole member of the LLC and that there was an operating agreement if Michael was in agreement regarding the business and affairs of the LLC. The court stated that Michael obviously agreed that he would conduct the business and affairs of the LLC. Thus, there was an operating agreement, and Michael qualified as a manager. After Michael amended the articles of organization to remove Purcell as a manager and add his father, it was unclear whether his father became a member. Assuming his father became a member, the court concluded that Michael and his father agreed that Michael would manage the LLC. Although Michael testified in his deposition that they had no operating agreement, the court accepted Michael's explanation that he thought the question referred to a written operating agreement. The court concluded that the conduct of Michael and his father clearly showed that they had agreed that Michael would conduct the business and affairs of the LLC, and Michael thus qualified as a manager.

*In re Bayou Group, L.L.C. (Adams v. Marwil)*, 363 B.R. 674 (S.D. N.Y. 2007). Ten affiliated hedge fund LLCs (consisting of six Delaware LLCs, three New York LLCs, and one Connecticut LLC) were operated by their principals as a fraudulent Ponzi scheme, and a group of creditors of the LLCs filed a lawsuit in federal court seeking appointment of a "federal equity receiver" for the LLCs. The district court appointed a receiver pursuant to its powers under Section 10b of the Exchange Act and Rule 10b-5 and its inherent equity power. The order appointed Jeff Marwil as "non-bankruptcy federal equity receiver and exclusive managing member" of the LLCs. Marwil ultimately filed bankruptcy petitions for the LLCs and signed each petition as "sole managing member." The United States trustee asked the bankruptcy court to appoint a Chapter 11 trustee, and the bankruptcy court denied the request. The district court affirmed the bankruptcy court's denial because the court concluded that Marwil was not merely a custodian or receiver, but was the new exclusive managing member of the LLCs. The court stated that the order appointing Marwil was made pursuant to federal securities laws and its inherent equity power, and the corporate management powers conferred were not merely derivative of the receivership appointment. Thus, his corporate management role did not cease when he caused the LLCs to file bankruptcy. The court noted that it could have appointed Marwil as manager pursuant to federal receivership statutes alone, and, in that case, the corporate management powers would have ceased when the LLCs filed for bankruptcy. The court, however, stressed that it appointed Marwil as manager pursuant to federal securities laws and the court's inherent equity authority. In view of the criminal violations of the federal securities laws committed by the principals of the LLCs, the court concluded that both the federal securities laws and the court's equity jurisdiction provided a basis for appointment of Marwil as managing member. The court commented that the state law of Delaware, New York, and Connecticut would have provided a basis to appoint Marwil as a receiver to manage the LLCs, but the court noted that the state law issues were not briefed and that the court did not appoint Marwil pursuant to state law. The court concluded that Marwil, as managing member of the LLCs, could act as debtor-in-possession, and the court observed that the proceedings exposed a loophole in the Bankruptcy Code insofar as the creditors had essentially been able to appoint their own bankruptcy "trustee" by having a district judge appoint corporate governance of the LLCs prior to filing of any bankruptcy.

*In re Modanlo (Modanlo v. Mead)*, Civil Action No. DKC 2006-1168, 2006 WL 4486537 (D. Md. Oct. 26, 2006). The sole member of a Delaware LLC filed bankruptcy, and the trustee took several steps in order to take control of the LLC and a corporation owned by the LLC. The steps taken by the trustee in this regard included a "Written Consent of and Agreement Regarding Admission of Personal Representative of Last Remaining Member" under Section 18-806 of the Delaware LLC Act. In that document, the trustee consented to the continuation of the LLC effective as of the date of the occurrence of an event described in Section 18-801(a)(4) of the Delaware LLC Act (i.e., the bankruptcy of the last remaining member) and, as personal representative of the last remaining member, agreed to the admission of the trustee as a member as of that date. The court agreed with the trustee that the LLC was dissolved upon the bankruptcy of the sole member because, under Section 18-304(1) of the Delaware LLC Act, a person ceases to be a member upon the person's bankruptcy, and, under Section 18-801(a), an LLC is dissolved if it has no remaining members. Under Section 18-801(a)(4), there is an exception to dissolution upon the termination of the last remaining member if a successor member is appointed within 90 days, but the trustee was not appointed until more than 90 days after the filing of the member's bankruptcy; therefore, this exception was not available to the trustee. The LLC was resuscitated under Section 18-806, however, which permits the personal representative of the last remaining member of an LLC to avoid the dissolution and winding up of an LLC by consenting in writing to the continuation of the LLC and agreeing to become a member of the LLC. The court found that the bankruptcy trustee's consent met these requirements.

The court analyzed the definition of a “personal representative” under the Delaware LLC Act and concluded that a bankruptcy trustee falls within the definition. Section 18-101(13) defines a “personal representative” broadly to include “as to a natural person, the executor, administrator, guardian, conservator or other legal representative thereof...” Because the scope of the term “other legal representative” is not clear on its face, the court looked to decisions analyzing the same language in other contexts and examined the policy rationale behind other sections of the Delaware LLC Act. The court concluded that the Delaware Supreme Court would likely hold that a bankruptcy trustee meets the statutory definition of a “personal representative.” The court rejected the debtor’s argument that the bankruptcy estate held only an economic interest and that the trustee could not become a member or participate in the LLC’s management. The court stated that the debtor’s argument ignored the effect of Section 18-806, and the court distinguished other Delaware cases in which the bankruptcy of a member occurred in the context of an LLC that had other remaining members.

#### **S. LLC Property/Interest of Member**

*In re Silver Dollar, LLC (Jones v. First Community Bank East Tennessee)*, Nos. 2:07-cv-25, 2:07-cv-26, 2008 WL 53695 (E.D. Tenn. Jan. 2, 2008). A Tennessee LLC named “Silver Dollar, LLC” filed an assumed name application for the assumed name “Silver Dollar Stores, LLC,” and property was subsequently conveyed to the LLC in the assumed name. The LLC later executed a deed of trust in favor of a bank to secure several promissory notes. The deed of trust was executed under the assumed name. In the LLC’s bankruptcy, the trustee and a creditor argued that the deed of trust was defective and subject to the trustee’s avoidance powers because it was executed in the LLC’s assumed name rather than its legal name. The bankruptcy court concluded that the deed of trust was valid and could not be avoided, and the district court agreed. The court rejected the argument that the Tennessee LLC statute does not authorize an LLC to own real property in its assumed name and that a transfer of real estate to an LLC in its assumed name is void. In fact, the court found that the statute suggests just the opposite. The court noted that an LLC has the same powers as an individual to do all things necessary to carry out its business, including power to purchase, own, improve, and otherwise deal with real or personal property. Further, the Tennessee LLC statute clearly authorizes an LLC to transact business under an assumed name, and the transaction of business includes purchasing and encumbering real estate. The court distinguished a case in which a conveyance to a fictitious grantee was held to be void, and the court refused to limit the holding of a case in which the Tennessee Court of Appeals recognized a conveyance to a sole proprietor under his trade name. In that case, the court of appeals held that a conveyance to a living or existing legal person described by an assumed name is valid. The district court held that this rule applies to a legal person such as a corporation or LLC as well as an individual. The court also rejected the argument that the deed of trust would not put one on constructive notice that Silver Dollar Stores, LLC was the assumed name of Silver Dollar, LLC. The court stated that nothing in the registration statute or case law supported the position that only recordation of instruments in the Register of Deeds office creates notice to a bona fide purchaser. The court agreed with the bankruptcy court that a hypothetical bona fide purchaser conducting a title search of the property would have discovered that the LLC held title in its assumed name and that the LLC granted the bank a deed of trust under its assumed name. The court stated that even a rudimentary understanding of title law would have caused one to inquire further by examining the records of the Secretary of State where the assumed name certificate of the LLC would have been easily discovered. Thus, a bona fide purchaser would have been unable, under Tennessee law, to defeat the bank’s interest in the LLC’s property, and the bankruptcy court did not err in holding that the deed and deed of trust were valid and in granting the bank relief from the stay.

*In re Schwab*, 378 B.R. 854 (Bankr. D. Minn. 2007) (finding that equipment used by LLC belonged to LLC’s sole member, notwithstanding that member’s tax return assigned depreciation to LLC, where equipment was purchased in member’s name and paid for by personal line of credit; principles of equity allowed member to reverse pierce LLC veil and claim ownership of accounts receivable where LLC had no debts or obligations of its own at time member filed bankruptcy, receivables consisted of charges for member’s labor, and member had no other source of earnings).

*Peoples Bank v. Bryan Brothers Cattle Company*, 504 F.3d 549 (5<sup>th</sup> Cir. 2007) (stating that security interest in cattle granted by individual to secure personal debt was not valid if cattle belonged to LLC in which individual was member since member has no interest in specific LLC property).

*FirstMerit Bank, N.A. v. Washington Square Enterprises*, No. 88798, 2007 WL 2206545 (Ohio App. Aug. 2, 2007). The judgment creditor of a member of an LLC obtained an order appointing a receiver of the LLC’s property.

The order authorized the receiver to possess, manage, control, and protect the property and business of the LLC. The judgment creditor argued that the LLC was wholly owned by the judgment debtor and that its assets could thus be applied to satisfy the judgment. The court of appeals held that the judgment creditor did not have the right to satisfy its judgment from assets of the LLC because LLCs are separate entities from their owners. Citing provisions of the Ohio LLC statute, the court pointed out that the member's membership interest was an asset which could be charged to satisfy her judgment debt, but the membership interest did not include any direct interest in the assets of the LLC that could be used by her creditors to satisfy her debts. Rather, a judgment creditor of a member has only the rights of an assignee of a membership interest, i.e., only the right to receive distributions that would have been paid to the member-assignor. The court expressed no opinion as to whether a judgment creditor of an LLC member could seek judicial dissolution under the Ohio statute. Because the judgment creditor did not demonstrate any right to satisfy its judgment from the assets of the LLC, the trial court abused its discretion in placing the LLC and its property in receivership.

*Yonaty v. Glauber*, 834 N.Y.S.2d 744 (N.Y. A.D. 3 Dept. 2007) (relying on principle that membership interest constitutes personal property and member has no interest in specific property of LLC and cancelling notices of pendency because plaintiff's action to enforce defendant's promise to convey 20% interest in LLC was not action involving real property where plaintiff did not assert interest in real property acquired by LLC but only claimed right to obtain interest in LLC).

*Valley/50th Avenue, L.L.C. v. Stewart*, 153 P.3d 186 (Wash. 2007) (holding that member and LLC were separate entities both of whom were owed duty by attorneys who took deed of trust on LLC's property to secure payment of legal fees owed by member and concluding that fact issues as to firm's compliance with ethical obligations precluded summary judgment foreclosing deed of trust).

*Kreisler v. Goldberg*, 478 F.3d 209 (4<sup>th</sup> Cir. 2007) (applying Maryland law and concluding there existed no basis to conclude that wholly owned LLC subsidiary of LLC debtor should not be recognized as separate legal entity and that automatic stay did not protect debtor's LLC subsidiary nor did debtor have any direct interest in assets of LLC subsidiary).

*United States v. Heide*, No. 04 MS-5609, 2007 WL 581601 (D. Idaho Feb. 20, 2007) (declining to transfer venue of government action against non-resident for writ of execution with respect to ownership of LLC registered to transact business in Idaho).

#### **T. Fiduciary Duties of Members and Managers**

*Omega Center for Pain Management, L.L.C. v. Omega Institute of Health, Inc.*, \_\_ So.2d \_\_, 2007 WL 4554068 (La. App. 2007) (stating that, under Louisiana LLC statute, member or manager of LLC is deemed to be in fiduciary relationship with LLC and its members and shall discharge its duties in good faith, with diligence, care, judgment and skill which an ordinary prudent person would exercise under similar circumstances and that, at minimum, gross negligence standard and business judgment rule are employed to determine whether member has breached fiduciary duty; granting plaintiff opportunity to amend petition where petition asserted that entity was part owner of LLC, thus standing in fiduciary relationship with LLC, but facts alleged in petition did not support claim of breach of fiduciary duty).

*Wilcke v. Seaport Lofts, LLC*, 846 N.Y.S.2d 133 (N.Y. A.D. 1 Dept. 2007) (holding that, while vote of interested managers (who owned collectively 40.9% of membership interests) was necessary to approve sale of real estate, making it incumbent on interested parties to establish fairness of transaction to LLC, record established requisite fairness of transaction based on independent appraisal and bids received, and causes of action based on breach of fiduciary duty and breach of LLC's operating agreement failed).

*Cement-Lock v. Gas Technology Institute*, 523 F.Supp.2d 827 (N.D. Ill. 2007). The court concluded that two LLC members had standing to bring a derivative action against the third member and various other defendants asserting federal RICO and various state law claims on behalf of the LLC based on alleged actions that injured the LLC. The court expressed uncertainty regarding the parties' assumption that Delaware law governed the breach of fiduciary duty claim

in light of a choice of law provision in the LLC agreement specifying that the agreement be construed under Illinois law, but the court analyzed the claim under Delaware law as briefed by the parties. The court stated that actions of a director are protected under Delaware law by the business judgment rule unless the plaintiff proves the director's breach of duty of loyalty, good faith, or due care. The court also noted that Delaware law permits an LLC agreement to expand, restrict, or eliminate the duties of a manager or member subject to certain exceptions. The LLC agreement contained a clause specifying that a manager shall perform his duties as a member of the operating board in good faith, in a manner reasonably believed to be in the best interest of the LLC and members, and with similar care as an ordinarily prudent person, and that a person who so performed his duties has no liability by reason of being a manager. The agreement further specified that the operating board would have no liability to the LLC or members for any action or failure to act on behalf of the LLC within the scope of authority conferred on the board except for a claim based on fraud, gross negligence or bad faith of the board. Thus, the court stated that the agreement made clear that there was an affirmative duty of good faith and care and that there was liability for fraud, gross negligence, or bad faith. Further, the court stated that the duty to act in the best interest of the LLC constituted the managers' duty of loyalty. The court analyzed claims of self-dealing, misappropriation of intellectual property, failure to implement internal controls, willful suppression of the development of technology, and subordination of the LLC's interests to those of an affiliate of a member and found fact issues existed as to these breach of fiduciary duty claims. The court turned to analyzing which defendants might be liable for wrongdoing and observed that there appeared to be no dispute that the corporate defendant that was a member owed fiduciary duties, but the court stated that the parent of the corporate member would only owe fiduciary duties if the corporate veil of the member could be pierced, and the jury was entitled to consider the veil piercing claim based on disputed facts. The court applied Delaware veil piercing principles to analyze whether the veil of a Delaware LLC affiliated with the corporate member should be pierced and noted that failure to follow corporate formalities may not be as significant for an LLC as it is for a corporation. Even applying fairly rigorous standards, the court concluded that there was sufficient veil piercing evidence for the claim to survive summary judgment based on allegations that would show the LLC was intended to and did serve a fraudulent purpose. The court analyzed the breach of fiduciary claims against several individuals who served on the LLC's operating board (one of whom also served as president of the LLC) and concluded that various claims based on self-dealing, misappropriation of intellectual property, actions conflicting with the LLC's interest, and failure to set up internal controls survived summary judgment. One individual argued that he was serving on the board as the representative of the corporate member rather than in his individual capacity and that the corporate member was thus the board member, but the court rejected this attempt to avoid liability because the LLC agreement specified that the members of the board were the representatives designated by the three members of the LLC. The court also addressed additional arguments by the defendants and concluded, inter alia, that fact issues existed as to the defendants' intent to deceive in connection with alleged RICO predicate acts, that fact issues existed as to fraudulent concealment and misrepresentation claims, and that the LLC did not have a negligent misrepresentation or unjust enrichment claim.

*HLHZ Investments, LLC v. Plaid Pantries, Inc.*, Civil No. 06-797-KI, 2007 WL 3129985 (D. Or. Oct. 23, 2007), as modified by 2007 WL 4180659 (D. Or. Nov. 21, 2007). An LLC was formed to serve as a joint venture vehicle to acquire a block of stock in a corporation. Several years later, a member of the LLC withdrew from the LLC and, pursuant to the terms of the LLC operating agreement, received shares of stock held by the LLC in the corporation. The shares received by the member caused the member to cross the threshold of ownership specified in the Oregon Control Share Acquisition Act (the "CSA"), and the shares were thus stripped of voting rights unless the corporation waived the provisions of the CSA. The member argued this result was not intended under the operating agreement and that the corporation's board of directors was required to waive the provisions of the CSA, but the court found that the corporation was not a party to the operating agreement and that the operating agreement could not be read to require the LLC to deliver stock which could be voted in spite of the CSA. The court also found that failure to disclose the potential application of the CSA was not a basis for a securities fraud claim against the LLC or its manager. Though the court initially concluded it did not need to rely on the business judgment rule to dismiss the member's breach of fiduciary duty claim against the LLC manager (because the court concluded there was no evidence that the manager could control a decision of the corporation whether to opt out of the CSA), the court commented that it did not see anything in the statutes to persuade the court that the business judgment rule would not apply to managers of Oregon LLCs. (The Oregon LLC statute specifies that the duties owed by the manager are the duties of loyalty and care set forth in the statute.) The court in a subsequent opinion modified its original opinion and denied summary judgment in favor of the LLC manager because there was evidence that the LLC in fact held a slight majority of the stock of the corporation and

the manager had the authority to vote the shares. The court concluded that a decision on whether the manager was protected by the business judgment rule was too fact dependent to be determined at the summary judgment stage.

***Marsala v. Mayo***, Civil Action No. 06-3846, 2007 WL 3245434 (E.D. La. Nov. 2, 2007). An LLC member sued his two co-members alleging breach of fiduciary duty and fraud claims. The LLC was a Delaware LLC and its operating agreement contained a Georgia choice of law clause. Applying Louisiana choice of law rules (under which tort claims such as fraud and breach of fiduciary duty are governed by the law of the state whose policies would be most seriously impaired if its law were not applied), the court agreed with the parties that Georgia law applied to the dispute. The court then concluded that the Georgia internal affairs choice of law provision of the Georgia LLC statute required application of Delaware law to the breach of fiduciary claims. Disputed issues of material fact precluded summary judgment on the breach of fiduciary duty claims. Applying Georgia law to the LLC member's fraud claims, the court concluded that the claims for fraud based on claims of misrepresentations pre-dating the operating agreement were barred because the operating agreement contained a merger clause. The plaintiff's other fraud claims failed under Georgia law as well, with the exception of one claim based on the alleged misrepresentation of the defendants' net worth to induce plaintiff to execute personal guarantees.

***Cox v. Southern Garrett, L.L.C.***, \_\_\_ S.W.3d \_\_\_, 2007 WL 2963756 (Tex. App. 2007). An LLC member asserted various claims against the LLC and his co-members in connection with the withdrawal and buyout of the member. The member argued that the buyout of his interest did not become effective and that he was still entitled to receive membership distributions because the buyout violated transfer restrictions in the LLC membership regulations (i.e., the operating agreement). The court found that the buyout did not violate the transfer restriction because the transfer did not involve a transfer to a non-member. The court also concluded that the LLC had complied with provisions of the membership regulations governing distributions to a withdrawing member. The court found that the LLC's offer to purchase the member's interest substantially complied with the requirement that a withdrawing member receive the fair value of his interest as of the first day of the month following the date of the occurrence giving rise to the member's withdrawal. The court rejected the member's claims that the other owners of the LLC breached a fiduciary duty to him in connection with the repurchase of his interest. The member couched his argument in terms of duties owed in the context of a closely held corporation and argued that the defendants had the burden to establish the fairness of the transaction. The court stated that the member's breach of fiduciary duty claim regarding the voiding of his interest depended upon his argument that the transfer restrictions applied to the purchase of his interest, and the claim thus failed as a matter of law. The court stated that another breach of fiduciary duty claim based on alleged fraudulent transfers of ownership in the LLC related to transactions that occurred after the member's withdrawal and that the LLC owed him none of the duties owed members after that date.

***Flores v. Murray***, 2007 WL 3034512 (N.J. Super. A.D. Oct. 19, 2007) (concluding that evidence supported finding that member breached fiduciary duty in connection with hidden payments to son and use of LLC funds to pay personal debt, and judicial expulsion of defendant member was warranted based on breaches of fiduciary duty, which were material and detrimental to LLC).

***Rudney v. International Offshore Services, LLC***, Civil Action No. 07-3908, 2007 WL 2900230 (E.D. La. Oct. 1, 2007). An LLC member sued for a TRO or preliminary injunction, pending arbitration, against the LLC's expulsion and buyout of the member and the LLC's obtaining a loan to fund disproportionate distributions to the majority member. The other members had signed a consent to obtain the loan for the disproportionate distributions and had voted to expel the member after previously amending the operating agreement to add a provision providing for termination of a member upon the vote of 75% in interest of the members and specifying a method of valuing a terminated member's interest. The court noted provisions of the Louisiana LLC statute protecting members and managers from liability unless they act in a grossly negligent manner, providing for distributions to be allocated in accordance with a written operating agreement, providing that incurrence of indebtedness other than in the ordinary course of business requires the vote of a majority of the members, and providing that amendment of the operating agreement requires the vote of a majority of the members. The Louisiana statute is silent, however, on terminations or expulsions of members. The court concluded that the member was not likely to prevail on the argument that the LLC could not take out a loan since the operating agreement in this case specifically provided that management had the power to incur indebtedness, and there was no evidence that the loan itself would be a breach of duty. The plaintiff, however, was substantially likely to prevail on the



merits of his claim challenging disproportionate distributions because the operating agreement provided for proportionate distributions. In the event of a disproportionate distribution, the court ordered that the LLC must set aside ten percent to protect the plaintiff's interest. The court stated that the LLC was free to make proportionate distributions and otherwise carry on its affairs; it was merely enjoined from making distributions prohibited by the agreement. The court stated that it did not find that distributing funds that would act as debits to capital accounts may not be deemed necessary pursuant to the good faith business judgment of the managers. With respect to the plaintiff's argument that Louisiana law does not permit expulsions or terminations of members, the court acknowledged that Louisiana law does not address expulsions or terminations, but noted that courts have upheld expulsion or termination clauses in operating agreements. In this case, an amendment to the operating agreement was passed in accordance with the agreement and Louisiana law. Though members are limited by their obligation to discharge their fiduciary duties in good faith, the plaintiff did not meet his burden of demonstrating that he was substantially likely to succeed on this breach of duty claim. Additionally, the member did not meet his burden of showing that the other members breached their fiduciary duty by undervaluing his interest.

*Anderson v. Wilder*, No. E2006-2647-COA-R3-CV, 2007 WL 2700068 (Tenn. Ct. App. Sept. 17, 2007). The plaintiffs were expelled as members of an LLC and bought out at \$150 per unit, and the defendants shortly thereafter sold the units to a third party for \$250 per unit. The plaintiffs sued alleging, *inter alia*, breach of fiduciary duty and breach of the duty of good faith. The plaintiffs prevailed at trial, and the defendants appealed. The court stated that the defendants' arguments primarily rested on their belief that a prior opinion of the court of appeals in this case was incorrect in determining that the majority member of an LLC owes a fiduciary obligation to a minority member and that each LLC member is obligated to discharge his or her duty in good faith. The court reviewed the testimony of various members regarding differences in opinion that developed between the majority and minority as to whether cash should be distributed and how to handle various offers for the sale of the company or interests in the company. The evidence also included testimony from an attorney who reviewed the operating agreement and advised the majority that they could expel the minority members under the terms of the operating agreement which provided that a member could be expelled by a majority vote of the members. The court found that the evidence supported the jury's verdict in favor of the plaintiffs against the defendants who voted their interests to expel the plaintiffs. The court stated that the trial court did not err in refusing to submit the following instruction requested by the defendants: "If you find that the understanding of the parties to the Operating Agreement was that the members who hold a majority of the units could expel any other member, or members, with or without cause, then you must find in favor of the Defendants." The defendants argued that this instruction tracked the Tennessee statute on modification of standards of conduct in the operating agreement (which states that the operating agreement may define the standard of conduct in a manner to reflect the understanding of the parties provided such definition is not manifestly unreasonable). The court stated that the instruction did not track the statute and was an attempt to circumvent its prior holding regarding fiduciary duties and good faith.

*Hakim v. Bay Sales Corporation*, Civil Action No. 06-6088 (JLL), 2007 WL 2752077 (D. N.J. Sept. 17, 2007) (granting defendants' motion for more definite statement with respect to what appeared to be various derivative and non-derivative causes of action asserted by LLC's majority members for breach of contract, fraud, misappropriation, conversion, and breach of fiduciary duty by defendants who allegedly agreed to "join forces" with plaintiffs and were acting as LLC's "minority shareholders and/or officers and directors" of the LLC).

*Lynes v. Helm*, 168 P.3d 651 (Mont. 2007). Lynes and others formed a Montana LLC, and Lynes pledged personal assets to secure a bank loan to the LLC. When ticket sales for a concert arranged by the LLC were poor and the LLC was faced with the possibility of having to cancel the concert, some of the members of the LLC supplied funds to pay the bands so that the concert could take place. The income from the concert was not enough to pay all of the costs of the concert, and additional investments were solicited from the members. After receiving the additional investments, the LLC was able to reimburse the members who advanced funds to pay the bands, as well as pay local creditors and repay part of the bank loan, but the balance of the bank loan was not paid, and Lynes ultimately paid the loan personally. Lynes and the LLC sued the members who advanced the funds to pay the bands, alleging that the LLC's repayment of the funds advanced by the members was an unlawful distribution of capital contributions that left the LLC unable to pay its debts. Lynes relied upon the Montana Limited Liability Company Act, which prohibits a distribution (i.e., a transfer of money, property, or other benefit to a member in the member's capacity as a member) if the distribution renders the LLC unable to pay its debts, and imposes liability on a member or manager who assents to a distribution in violation of

the statute. The court agreed with the members that the funds supplied by the members were loans and that the repayment was not contrary to law. The court relied upon provisions of the Montana LLC statute that require an LLC to reimburse and indemnify a member or manager for payments made or liabilities incurred in the ordinary course of business of the LLC or for the preservation of its business or properties. The court characterized the payments as occurring in the ordinary course of business for the benefit of the LLC and to preserve its business. Although the members were acting in a managerial role when they authorized the LLC to reimburse them, the court noted that the statute permits a member, even in a managerial position, to lend money to and transact other business with the LLC and requires the LLC to repay amounts loaned to the LLC. Thus, the LLC had both the obligation and right to repay the members. The court also rejected an argument by Lynes that there was a material issue of fact as to whether the members breached their duty of loyalty to the LLC and acted as persons with an interest adverse to the LLC when they repaid themselves. The court quoted the Montana statutory provisions that state the only duties owed by a member of a member-managed LLC are the duty of care and duty of loyalty and that limit the duty of loyalty to certain matters, including refraining from dealing with the LLC on behalf of a party or as a person having an interest adverse to the LLC. The court stated that the uncontested facts showed the LLC had more debt than it could pay, and the court noted that Lynes had acknowledged in his brief that the decision on which debts should be paid first was simply a business decision. The court stated that a debtor may pay one creditor in preference to another and that the members did not breach their duty of loyalty by paying themselves first.

*Pinnacle Labs, LLC v. Goldberg*, No. 07-C-196-S, 2007 WL 2572275 (W.D. Wis. Sept. 5, 2007). Two individuals, Goldberg and Palen, formed a Minnesota LLC for the purpose of acquiring a business located in Wisconsin. Under the terms of a loan agreement with Larson, an owner of the business, the LLC acquired the assets of the business. The LLC had the right to operate the business for 60 days while it conducted due diligence and determined whether it wished to retain the assets. In addition, if the LLC exercised the put option, Goldberg and Palen were obligated to transfer their membership interests to Larson, and the LLC was to act as liquidating agent to wind up and liquidate the business. During the 60-day option period, the LLC suffered a significant net loss, and the LLC exercised the put option near the end of the 60-day period. Financial statements of the LLC during the 60-day option period reflected that liabilities exceeded assets. The LLC, through Goldberg and Palen, operated the assets for a period of about three weeks thereafter as liquidating agent at which time Larson terminated the association of Goldberg and Palen with the LLC as liquidating agents. Larson and the LLC sued Goldberg and Palen, alleging that Goldberg and Palen, as governors and managers, breached fiduciary duties to the LLC, breached fiduciary duties to Larson as a secured lender, and maliciously injured the LLC in violation of a Wisconsin statute. Goldberg and Palen sought summary judgment, arguing that the claim for breach of fiduciary duty to the LLC was an inappropriate derivative action, that they owed no fiduciary duty to Larson, that Wisconsin law was inapplicable, and that all the claims were precluded because the defendants' conduct fell within the protection of the business judgment rule. The court first held that all the claims were governed by Minnesota law since the Wisconsin LLC statute provides that the laws of the state under which an LLC is organized shall govern the LLC's organization and internal affairs and the liability and authority of its managers and members. With respect to the claim that Goldberg and Palen breached fiduciary duties to the LLC, the defendants argued that the action was a disguised derivative action precluded by the fact that Larson was not a member of the LLC during the period of actionable conduct, and that the conduct fell within the protection of the business judgment rule in any event. The court stated that the defendants might be correct in asserting that the claim was a derivative action to the extent asserted by Larson, but the court pointed out that the LLC itself was bringing the claim on its own behalf. The court then discussed the business judgment rule under Minnesota law, citing the Minnesota LLC statute, which provides that a manager shall discharge the duties of an office in good faith, in a manner reasonably believed to be in the best interests of the LLC, and with the care an ordinarily prudent person would exercise under similar circumstances. The court quoted case law in the corporate context and stated that a plaintiff, to overcome the presumption that a business decision is consistent with fiduciary duties, must present evidence of a breach of the three essential components of fiduciary duty – good faith, loyalty, and due care. The court stated that the plaintiff must demonstrate gross negligence to prove a lack of due care. The court concluded that some of the conduct in the plaintiffs' litany of alleged improper actions was clearly protected by the business judgment rule, but found that several allegations arguably fell outside the realm of business judgment and tended to demonstrate gross negligence. In addition, the court stated that certain payments to the defendants for management services raised the issue of whether they personally benefitted as creditors by inappropriate cash payments that implicated the good faith and loyalty components of the business judgment rule. The court next addressed Larson's argument that the defendants assumed a trustee role as a result of the debtor-creditor relationship. The court stated that

there was no basis for such a claim under the loan documents or Minnesota law. The court stated that Minnesota law expressly rejects the notion that a trust relationship or a duty to manage the company for the benefit of creditors arises under these circumstances. The court acknowledged that Minnesota law recognizes that managers of a corporation become fiduciaries of the corporate assets for the benefit of creditors when a corporation is insolvent or on the verge of insolvency, but the court stated that the duty is limited and does not extend beyond the prohibition against self-dealing or preferential treatment. The duty is breached only if the managers' transfer of assets enables them to recover a greater portion of their debt than other similarly situated creditors, and the burden is on the manager to show any payment to him was in good faith and not a preference. The court stated that, under this standard, allegations of mismanagement and losses resulting from allegedly poor or reckless business practices could not form the basis of a claim by Larson even if Larson could establish the conduct fell outside the business judgment rule. Larson could only prevail to the extent the defendants made preferential transfers to themselves while the LLC was insolvent or on the verge of insolvency. The court concluded that the plaintiffs had provided ample evidence of insolvency to preclude summary judgment on that issue. The court found that there existed fact issues on the preferential nature of certain management fees, but found no basis for the argument that a loan repayment was preferential. Finally, the court rejected the plaintiffs' statutory claim for punitive damages under Wisconsin law since the action was controlled by Minnesota law, and the court concluded that there was no suggestion that the evidence could support a finding of clear and convincing evidence of malicious conduct or willful injury in any event.

*Florida Estate Developers, LLC v. Ben Tobin Companies, Ltd.*, 964 So.2d 238 (Fla. App. 2007). The court analyzed the plaintiff's claims that the defendant violated Section 608.425 of the Florida LLC statute (stating that a manager and managing member owes a duty of loyalty and a duty of care to the LLC and its members) and Section 608.423 (providing that LLC members may enter an operating agreement and setting forth the extent to which the operating agreement may modify the statutory duties). The court dismissed the claim for violation of Section 608.423 because there were no allegations that the parties executed an operating agreement that violated the statutory restrictions. The court dismissed a claim that the defendant breached its statutory duties by engaging in self-dealing because the deeding of the property to the defendant was expressly provided for in the operating agreement. The court also dismissed a claim that the defendant violated its statutory duties by causing the LLC to enter into a usurious loan transaction because the allegations did not demonstrate a usurious loan transaction. The court found that various allegations relating to the defendant's failure to account for transactions and to provide information and documentation supported a claim for breach of the statutory duty of loyalty because the duty includes a duty to account to the LLC. The court noted that any claim for denial of access to LLC records should be brought against the LLC, not the managing member, based on the record keeping provisions of the statute. The court stated that an allegation that the defendant violated the statute by "failing to deal with the members in good faith" was insufficient alone to state a cause of action for breach of the statute, but factual allegations of intentional misconduct in other portions of the complaint supported a cause of action for breach of the statutory duty of care.

*In re Mooney (LaCarubba v. Mooney)*, Bankruptcy No. 05-13392-JMD, Adversary No. 05-1205-JMD, 2007 WL 2403774 (Bankr. D. N.H. Aug. 17, 2007). A creditor of an LLC asserted breach of fiduciary duty claims against the managing member of the LLC, and the creditor asserted that the managing member's liability to the creditor was non-dischargeable under Section 523(a)(4) (which excepts from discharge obligation arising out of a defalcation in a fiduciary capacity). The court held that the creditor had no standing to bring an individual claim for breach of fiduciary duty against the member. The court stated that a Massachusetts LLC, like a corporation, is treated as a separate legal entity whose liabilities are not attributable to its owners and managing members. The court stated that it was not clear, however, whether LLC managers or members have the same duty to creditors as corporate officers and directors, noting that the lack of case law on this issue was likely due to the relatively recent origin of LLCs. Because Massachusetts law provides the owners and managing members of an LLC with the same kind of limited liability as owners and officers of a corporation, the court assumed Massachusetts would impose similar fiduciary duties on the members and managers of an insolvent LLC. Nevertheless, the court stated that the plaintiff's claim failed because individual creditors do not have standing to bring individual claims for breach of fiduciary duty against officers and directors of insolvent corporations.

*In re Howell (Fabing v Howell)*, 373 B.R. 1 (Bankr. W.D. Ky. 2007) (holding that statutory standard of liability of LLC manager under Kentucky statute does not rise to level of willful injury or constitute express or technical trust so as to fall within nondischargeability provisions of Bankruptcy Code).

*Dragt v. Dragt/DeTray, LLC*, 161 P.3d 473 (Wash. App. 2007). The court held that non-managing members of a Washington LLC do not owe fiduciary duties to other members unless fiduciary duties are imposed under the operating agreement; therefore, two non-managing members of an LLC formed to develop land owned by the non-managing members were not required to notify the managing member before selling the land to a third party. The non-managing members, Henry and Jane Dragt, owned land that they wanted to develop, but they lacked the funds and expertise to develop the land. They formed an LLC with DeTray, a land developer, who agreed to front the costs and provide his expertise to develop the land. The operating agreement gave the LLC a future option to purchase the land because the Dragts did not want to transfer title to the land to the LLC. After a number of years, the Dragts became frustrated with the progress of the land development and consulted an attorney who advised them that the LLC's option was unenforceable. The Dragts then sold the land to a third party without informing DeTray. The trial court determined that the option was unenforceable, but found that the parties modified the operating agreement by oral agreement and course of conduct and that the Dragts agreed to hold the property for development by DeTray and to compensate DeTray for his capital contributions out of the sale proceeds of the property. The trial court reasoned that the parties were "partners" who owed one another fiduciary duties, and awarded DeTray damages against the Dragts for breach of contract and breach of fiduciary duty based on their sale of the property without notice to DeTray and their refusal to divide the sale proceeds as called for in the operating agreement. The trial court's decision that the option was unenforceable was not challenged on appeal, but the court of appeals reversed the other decisions of the trial court. The court of appeals found there was no modification of the contract because there was no changed understanding or circumstance and no separate consideration for a modification. The parties operated pursuant to their understanding of the original agreement. Neither party thought the Dragts were assuming a new obligation to hold the property for the LLC because they believed that the LLC already had an option to purchase the property. Similarly, there was no new or additional consideration; all the promises were made when the parties signed the agreement and remained unchanged. The court noted that the parties discussed and rejected forming a general partnership before forming the LLC. The court next reviewed a right of first refusal provision in the operating agreement and concluded that the Dragts did not breach the agreement by selling the land without giving notice to DeTray because the provision applied to transfers of membership interests, and the Dragts sold their land rather than their membership interests. The court concluded that the Dragts did not breach any fiduciary duty owed to DeTray because the Dragts were merely members of a manager-managed LLC and as such did not owe any fiduciary duties. The operating agreement specifically imposed fiduciary duties on DeTray as manager but did not address fiduciary duties of members. In the absence of Washington case law on the issue, the court relied upon the Uniform Limited Liability Company Act to assist in its interpretation of Washington law. The court cited the provision of ULLCA providing that a member of a manager-managed LLC owes no duties to the LLC or the other members solely by reason of being a member. The court found that the trial court erred in basing damages on the provision of the operating agreement governing the division of LLC profits because the land was owned by the Dragts and the proceeds of the land sale were not LLC profits. The court concluded that the Dragts were unjustly enriched, however, by DeTray's financial contributions and services to the LLC during the development venture, and the trial court should have acted in equity to award DeTray restitution. The case was thus remanded for the trial court to award DeTray his costs in developing the land (mortgage payments, sewer connection, consultant reports and designs, and access to wastewater treatment) along with the reasonable value of the benefit of his services.

*In re Tsiaoushis (Endeka Enterprises, LLC v. Meiburger)*, No. 1:07cv436, Bankr. No. 05-15135 (RGM), 2007 WL 2156162 (E.D. Va. July 19, 2007). The district court agreed with the bankruptcy court that the trustee of a debtor member of a District of Columbia LLC was entitled to a partial summary judgment declaring enforceable the provisions of the LLC operating agreement requiring dissolution and winding up as a result of the debtor's bankruptcy filing. The court rejected the argument that members of small LLCs owe fiduciary duties to their LLCs as a matter of course and that all LLC operating agreements are, therefore, executory contracts subject to Section 365(e) of the Bankruptcy Code. Assuming *arguendo* that the existence of a fiduciary duty alone constitutes a continuing obligation, the court concluded that the LLC and its non-debtor member failed to establish that D.C. law recognizes fiduciary duties between members of a manager-managed LLC. The court stated that it found no *per se* rule governing the issue. Based on a particularized evaluation of the LLC's operating agreement, the court concluded that it was not an executory contract because it did

not create any material, continuing obligation of the debtor member. The court noted that the debtor was not a manager or director of the LLC and had no duties as such when he filed for bankruptcy. Further, the operating agreement provided that members of the LLC could engage in other activities without incurring any obligation to offer any interest in the activities to the LLC or its members. Finally, the D.C. LLC statute does not contain any express provisions imposing fiduciary duties on mere members.

***Foster-Thompson, LLC v. Thompson***, No. 8:04-CV-2128-T-EAJ, 2007 WL 1725198 (M.D. Fla. June 14, 2007). The court discussed the duties of an LLC manager or managing member under the Florida LLC statute and held that a member had a direct claim for breach of the duties of loyalty and care against his co-member, the 51% managing member and president of the LLC, based on the managing member's use of LLC funds for personal purposes and to promote the interests of the managing member's other business. While the court found that the evidence supported the jury's verdict that the managing member breached her fiduciary duties, the court remanded the case for a new trial on the issue of damages because the evidence did not support the verdict as to the amount of damages.

***In re Mega Systems, L.L.C. (Anderson v. Mega Lift Systems, L.L.C.)***, Bankruptcy No. 03-30190, Adversary No. 04-6085, 2007 WL 1643182 (Bankr. E.D. Tex. June 4, 2007). The court found that transfers from the debtor LLC to a commonly controlled LLC were fraudulent under the constructive and actual fraud provisions of the Texas Fraudulent Transfer Act and Bankruptcy Code; however, the trustee failed to prove fraud or breach of fiduciary duty on the part of the individuals who owned and controlled the LLCs because there was insufficient evidence of actual damages arising from any fraud or breach of fiduciary duty distinct from a failure to transfer reasonably equivalent value to the debtor as alleged under the fraudulent transfer cause of action. The court acknowledged the trustee's arguments that fiduciary duties arise in favor of creditors when a debtor approaches a "zone of insolvency," but noted the cogent analysis and rejection of this theory by Judge Harmon in *Floyd v. Hefner*, 2006 WL 2844245 (S.D. Tex. Sept. 29, 2006).

***Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer***, No. 06 CVS 6091, 2007 WL 2570749 (N.C. Super. May 8, 2007) (finding that North Carolina LLC statute and exculpatory provisions of professional LLC's articles of organization did not pose insurmountable bar to plaintiffs' breach of duty claims where allegations could support claim for acts or omissions defendants knew were in conflict with LLC's interests or transactions from which they derived improper personal benefit).

***Wachovia Capital Partners, LLC v. Frank Harvey Investment Family Limited Partnership***, No. 05 CVS 20568, 2007 WL 2570838 (N.C. Super. March 5, 2007) (dismissing various claims against managers of Delaware LLC in view of insufficiency of allegations to overcome protection of Delaware business judgment rule).

***In re Regional Diagnostics, LLC (Morris v. Zelch)***, 372 B.R. 3 (Bankr. N.D. Ohio 2007). Defendant managers of an LLC argued that the trustee failed to state a claim against them under Delaware law for breach of fiduciary duty. The court reviewed the duties of loyalty and care of a director of a Delaware corporation and stated that Delaware courts have applied the business judgment rule in the LLC context. The court noted that fiduciary duties of LLC managers may be altered by agreement and quoted a recent article by Justice Steele for the proposition that "[t]here is an assumed default to traditional corporate governance fiduciary duties where the agreement is silent, or at least not inconsistent with the common law fiduciary duties." The court rejected several arguments advanced by the manager defendants regarding the sufficiency of the trustee's pleading. The defendants argued that the LLC agreement eliminated liability for breach of the duty of loyalty, but the court rejected this argument because the provision did not restrict or limit the managers' fiduciary obligations; it only limited their liability to the extent they acted in good faith. Since a breach of the duty of loyalty can be premised on a failure to act in good faith the agreement did not eliminate potential liability for breach of the duty of loyalty. The managers next argued that the complaint failed to state a claim because it did not contain specific facts to overcome the business judgment rule. The court stated that the heightened pleading standard required by Delaware courts does not apply in federal courts where notice pleading is the standard. Thus, the trustee was not required to plead specific facts to overcome the business judgment rule. To the extent the business judgment rule is an affirmative defense, the court found the complaint did not show on its face that relief was barred since the trustee pled that the defendants were not protected by the rule by virtue of their financial interests in the LLC and the leveraged buyout in issue. Finally, the court concluded that the trustee stated a claim for breach of the managers' duty of loyalty by their intentional failure to exercise oversight responsibilities. The facts alleged in the complaint, viewed in the light most

favorable to the plaintiff, raised a reasonable expectation that discovery would reveal evidence of a lack of good faith and conscious lack of oversight.

*Westbard Apartments, LLC v. Westwood Joint Venture, LLC*, \_\_ A.2d \_\_, 2007 WL 1518992 (Md. App. 2007). The court interpreted the fiduciary duty provisions of the LLC agreement of a Delaware LLC formed to invest in and develop certain real estate in Bethesda, Maryland. The two members of the LLC were a large pension fund (National Electrical Benefit Fund or “NEBF”) and an entity owned and controlled by a real estate developer named Cohen. Cohen’s entity was the managing member of the LLC. Cohen was designated as the managing member’s representative, and Cohen provided a personal guaranty of the managing member’s fiduciary duties to the other member. The LLC agreement provided that the managing member was required to exercise the power and authority granted under the agreement and to perform its duties as managing member in good faith, in a manner reasonably believed to be in the best interest of the LLC, and with the care of a prudent real estate professional in a like position under similar circumstances. This section of the agreement went on to provide that the managing member owed the fiduciary duties that a “general partner undertakes to a limited partnership and its limited partners under the statutes and case law of the State of Delaware applicable to the limited partnership form of business organization.” The next section of the LLC agreement required the managing member to manage the LLC as its exclusive function and prohibited it from having any business interests or activities other than those relating to the LLC. This provision permitted other members to have other business interests and activities in addition to those relating to the LLC even if such other ventures were competitive with the LLC. With NEBF’s knowledge and consent, Cohen negotiated an agreement under which an entity owned by Cohen would purchase the property that was leased by the LLC. Cohen waived on behalf of the LLC certain rights of first refusal held by the LLC under the lease. NEBF’s managing director for real estate testified that he presumed Cohen was negotiating the purchase on behalf of the LLC since he would not be permitted under the LLC agreement to take the deal for himself. After Cohen and NEBF failed to agree on terms for a new joint venture to purchase the property, Cohen informed NEBF that he believed the LLC agreement permitted him to pursue the transaction in his individual capacity. NEBF and the LLC filed suit against Cohen and various Cohen-controlled entities, and the trial court found that the fiduciary duty provisions of the LLC agreement were ambiguous and that NEBF could not complain about Cohen’s conduct because it encouraged him to pursue the deal. The trial court found the testimony by the NEBF representative to be incredible and untruthful. The court of appeals discussed fiduciary duties under Delaware law and the contractual freedom to vary such duties. The court perceived no ambiguity in the fiduciary duty provisions and stated that the parties, who were “sophisticated real estate developers,” were bound by the terms of the agreement. The court concluded that the wide latitude given to non-managing members and affiliates of members (including affiliates of the managing member) to pursue business opportunities was confined to ventures *other than those relating to the LLC*. The purchase of the property was a business interest related to the LLC and did not qualify as an “other venture or activity.” The court of appeals concluded that the trial court’s erroneous interpretation of the LLC agreement led to erroneous fact-finding with regard to the truthfulness of statements by NEBF’s representative regarding his understanding of Cohen’s actions in pursuing the purchase of the property. The court of appeals vacated the lower court’s decision and remanded for a new trial on the issue of whether NEBF waived or was estopped to object to Cohen’s purchase of the property.

*Trebilcock v. Elinsky*, No. 1:05 CV 2428, 2007 WL 1567710 (N.D. Ohio May 25, 2007) (rejecting member’s breach of fiduciary duty claim based on failure to show damages, stating that allegation that member would not have invested in LLC had he known of its management and ownership structure may establish causation but did not itself establish damages, and commenting that member would not be permitted to do end-run around agreement to sell interest for particular sum under guise of breach of fiduciary duty claim).

*In re Grosman (Bar-Am v. Grosman)*, Bankruptcy No. 6:05-bk-10450-KSJ, Adversary No. 6:05-ap-328, 2007 WL 1526701 (Bankr. M.D. Fla. May 22, 2007) (characterizing LLC as joint venture whose members owed one another fiduciary duties as joint venturers, discussing fiduciary duties of managing member under Florida LLC statute, and concluding that managing member’s statutory fiduciary duties of loyalty and care did not amount to express or technical trust required to constitute fiduciary duty under Bankruptcy Code Section 523(a)(4) exception from discharge for defalcation in fiduciary capacity, but holding managing member’s transfer of LLC assets to himself, entities he controlled, and family members without distributing any assets to co-member was willful and malicious injury of another entity or its property satisfying exception to discharge under Section 523(a)(6)).

***Hofmesiter Family Trust v. FGH Industries, LLC***, No. 06-CV-13984-DT, 2007 WL 1106144 (E.D. Mich. April 12, 2007) (concluding minority members of LLC holding company stated claim for oppression based on allegations that majority members caused corporate subsidiary to cease making distributions to plaintiffs under purchase agreement and failed to cause LLC to make distributions to plaintiffs).

***In re Senior Cottages of America, LLC (Moratzka v. Morris)***, 482 F.3d. 997 (8<sup>th</sup> Cir. 2007) (holding that trustee had standing to bring claim against attorneys for aiding and abetting breach of fiduciary duty of manager/majority owner of debtor LLC because debtor could have asserted claim prior to filing of bankruptcy, and trustee adequately stated claim for aiding and abetting breach of duty where trustee alleged manager/majority owner stripped LLC's assets without reasonable compensation, attorneys knew action was in breach of owner's fiduciary duty, and attorneys provided substantial assistance and advised LLC to conclude transaction).

***Kasten v. MOA Investments, LLC***, Nos. 2006AP386, 2006AP1405, 2006 AP1510, 2007 WL 677804 (Wis. App. March 7, 2007). A minority member of an LLC brought suit individually and on behalf of the LLC asserting that the corporate member holding the largest interest in the LLC and the corporate member's shareholders breached fiduciary duties and acted unfairly in transferring assets and business opportunities away from the LLC. The court held that the plaintiff member was disqualified from asserting claims on behalf of the LLC because the suit was not authorized by a vote of the members. The court found that the plaintiff member was disqualified from voting because she sought judicial dissolution and thus had an interest in the outcome of the suit that was adverse to the interests of the LLC. The court concluded that the corporate primary injury rule applies to LLCs and that the member's claims alleging diversion of the LLC's assets, inappropriate payments of LLC funds, and diversion of business opportunities were derivative claims that she was not authorized to bring. The plaintiff's individual claims that she was improperly denied voting rights were without merit because the LLC's manager or a supermajority of members controlled the LLC and the plaintiff was not damaged by any lost opportunity to vote. The court stated that a claim for minority oppression is not itself a cause of action but merely a standard for judicial dissolution, and the plaintiff's claim for judicial dissolution was abandoned by repeated assertions in the lower court that the plaintiff did not want to dissolve the LLC. The court upheld amendments to the operating agreement permitting members with a financial interest in the outcome of a pending action to vote to dismiss, requiring members asserting or maintaining a derivative action without approval to indemnify the LLC, and imposing a one year limitation on claims asserted by a member against the LLC or other members. The court found the consent resolution adopting the amendments was valid because it was adopted by a supermajority of members and it was not unfair for the LLC or its members to take action to preserve its business against a complaint for dissolution, particularly when the plaintiff's derivative claims were not properly authorized.

***In re Lowry (Lowry Food Products, Inc. v. Alto Dairy Cooperative)***, Bankruptcy No. 03-33950 HDH-7, Adversary No. 05-3108, 2007 WL 738144 (Bankr. N.D. Tex. March 7, 2007). The debtor and the defendant formed a Wisconsin LLC under a formation agreement that provided Wisconsin law would govern. Applying Texas choice of law rules and using a "most significant relationship" analysis, the court concluded that Wisconsin law applied to breach of contract and breach of duty claims brought by the trustee against the defendant member. The court rejected the breach of contract and breach of duty claims. With respect to the breach of duty claim, the court stated that the exclusive standard for duties under Wisconsin law is the statutory standard that provides that a member must not willfully fail to deal fairly in matters in which the member has a material conflict of interest. The court found that the trustee failed to present substantial or persuasive evidence of conduct violating the statutory standard. The court stated that Wisconsin law emphasizes freedom of contract in the conduct of LLC affairs and concluded that no action of the defendant undertaken consistent with its contractual rights under the formation or operating agreements constituted a violation of fiduciary duties recognized under the Wisconsin LLC statute.

***Zanker Group, LLC v. Summerville at Litchfield Hills, LLC***, Nos. UWY(X10)CV044010223S, UWY(X10)CV044010567S, 2007 WL 865904 (Conn. Super. March 6, 2007). The court interpreted an operating agreement provision addressing transactions with affiliates and concluded that the transaction in issue was within the scope of the provision. Although the transaction did not receive the required approval of 90% of members, it fell within an exception for arm's length transactions. The court considered breach of fiduciary duty claims in the context of liquidation and stated that the statutory obligation of a manager or member is the same as that under common law. The court concluded that the operating agreement provision requiring 90% approval of transactions with affiliates was

inapplicable after dissolution, that the managers were authorized to liquidate the LLCs, and that fair value was paid in a transaction where property interests of the LLCs were transferred to wholly owned entities of one of the members.

***In re Allentown Ambassadors, Inc. (Allentown Ambassadors, Inc. v. Northeast American Baseball, LLC)***, 361 B.R. 422 (Bankr. E.D. Pa. 2007). The court addressed several issues in a lengthy opinion dealing with the debtor corporation's rights and status as a member of a dissolved LLC. The debtor corporation operated a minor league baseball team and was a member of a baseball league organized as a North Carolina LLC. The debtor's primary claim was that the other members of the LLC exercised control over property of the estate, in violation of the automatic stay provision of Section 362(a)(3) of the Bankruptcy Code, when the members dissolved the LLC and formed a new league without the debtor. The debtor also claimed that an individual manager of the LLC breached his fiduciary duty to the debtor. With respect to the individual manager's fiduciary duty claim, the court examined provisions of the North Carolina LLC Act as well as the operating agreement and rejected the manager's argument that his duty was owed solely to the LLC and not to individual members. The court predicted that North Carolina appellate courts would extend to LLCs the principles developed in the case law of closely held corporations. The court thus concluded that majority members of an LLC owe a fiduciary duty to minority members (based on the duty owed by majority shareholders to minority shareholders) and that the defendant manager would also owe a duty to the individual members because the manager's powers were derived from and delegated to the manager by the member-managers of the LLC. While the court acknowledged that the debtor might have a difficult time proving that the manager breached his duty, the court perceived the possibility that the challenged conduct was part of a pattern to "oppress" the debtor. Thus, the manager was not entitled to summary judgment.

***Slyter & Slyter, LLC v. Ryland***, 953 So.2d 1000 (La. App. 2007) (holding office manager/controller who was not "manager" under LLC organizational documents was officer who owed fiduciary duty to LLC under Louisiana law).

***Gottsacker v. Monnier***, No. 2006AP766, 2007 WL 259836 (Wis. App. Jan. 31, 2007). This is the third appellate opinion in a case arising from a dispute among three members of a Wisconsin LLC. The plaintiff sued his two co-members who voted to transfer the LLC's real estate (the LLC's sole asset) to their newly formed LLC without advising the plaintiff. The Wisconsin Court of Appeals held that the conflict of interest of the two members did not preclude them from voting, but held that the members had acted unfairly. The Wisconsin Supreme Court agreed with the court of appeals that the two members possessed the majority interest necessary to authorize the transfer of the LLC's property, but remanded for a determination of whether the two members willfully failed to deal fairly with the other member or the LLC. The supreme court concluded that properly authorized members with a material conflict of interest can vote their ownership interests unless their act or failure to act constitutes a "willful failure to deal fairly" with the LLC or its members. The court relied upon a provision of the Wisconsin LLC statute that states that, unless otherwise provided in the operating agreement, no member or manager shall act or fail to act in a manner that constitutes a willful failure to deal fairly with the LLC or its members in connection with a matter in which the member or manager has a material conflict of interest. The members had no agreement relieving them of the statutory obligation, and the trial court on remand examined the actions of the majority members. The court found that certain actions could be construed as unfair (lack of notice to the third member or an opportunity to vote or be heard, no effort to market the property, no arm's length transaction, no third party appraisal, and no assets left in the LLC). However, the court found that the sale price was not unfair based on all the evidence, and the sale was not adverse to the LLC. Although the trial court found that the majority's actions were not "appropriate," they fell short of a willful failure to deal fairly. The court of appeals affirmed the trial court's decision, noting that the supreme court had explained that a determination of "willful unfairness" necessitated both unfairness (conduct) and injury (end result). The court concluded that the evidence supported the trial court's determination that the plaintiff had not demonstrated the requisite injury.

***First American Real Estate Information Services, Inc. v. Consumer Benefit Services, Inc.***, No. 03CV0633 BNL, 2004 WL 5203206 (S.D. Cal. April 23, 2004). The court concluded that members of an LLC have fiduciary duties under California law regardless of whether they choose to turn control of the LLC over to managers, and the court found that the provisions of an LLC operating agreement limiting fiduciary duties of the LLC's managers did not change the fiduciary duties that the members may have owed the LLC. The operating agreement provided that the parties waived the fiduciary duty owed by managers to the LLC as long as the manager acted in the best interest of the member it



represented. The court stated that the parties, who were “sophisticated players in the market place,” could have limited the fiduciary duties owed as members, but chose not to do so. The court thus rejected the defendant member’s claim that the provision of the operating agreement addressing the duty of the managers waived the duty owed to the LLC as a member.

#### **U. Inspection and Access to Information**

*Florida Estate Developers, LLC v. Ben Tobin Companies, Ltd.*, 964 So.2d 238 (Fla. App. 2007) (finding that allegations relating to managing member’s failure to account for transactions and to provide information and documentation supported claim for breach of managing member’s statutory duty of loyalty because duty of loyalty includes duty to account to LLC, but noting that any claim for denial of access to LLC records should be brought against LLC rather than managing member, based on statute’s record keeping provisions).

*NAMA Holdings, LLC v. World Market Center Venture, LLC*, C.A. No. 2756-VCL, 2007 WL 2088851 (Del. Ch. July 20, 2007). NAMA Holdings, LLC (NAMA), an indirect owner of a Delaware LLC, brought an action to inspect the LLC’s books and records pursuant to provisions in the LLC’s operating agreement. NAMA argued that the operating agreement granted NAMA an unrestricted right of access to sensitive and proprietary information, but the LLC sought to limit the classes of documents available to NAMA and to require NAMA to execute a confidentiality agreement before granting access. The court concluded that, under the terms of the operating agreement, the managing members retained substantial discretion to determine the scope of access to information. Under the operating agreement, NAMA (as an explicit third party beneficiary) was entitled to “reasonable access at reasonable times” to books and records that the agreement required the managing members to maintain. The court stressed the freedom of contract enjoyed under the Delaware LLC statute and characterized NAMA’s argument that the contractual inspection provision should be construed to mirror the statutory inspection provision as a “non-starter.” The court stated that the statute might be a useful referent to resolve ambiguity, but the statute should not be used to overshadow the express contractual agreement reached by the parties in this case. The court explained that inclusion of the term “reasonable” to describe the scope of NAMA’s access was inconsistent with NAMA’s argument that it had an unconditional right of access. The court stated that the reasonableness limitation on the right of access indicated the parties contemplated someone making a judgment call as to exactly what would constitute “reasonable access.” The court noted that the operating agreement vested the managing members with typical management authority, and the court concluded that the managing members had the power to determine what constitutes “reasonable access” in the absence of explicit language in the inspection provision vesting someone other than the managing members with such right. The court found that the LLC’s limitation of the scope of NAMA’s inspection to non-sensitive information, prohibition on photocopying of the LLC’s books and records, and insistence upon execution of a confidentiality agreement were all reasonable limitations under the circumstances. The court concluded, however, that it was not reasonable to require NAMA to conduct its inspection through a specified individual alone rather than another duly authorized representative of NAMA. The court agreed with NAMA that a party with an inspection right must be able to enlist the sophisticated help of attorneys, accountants, and other experts in meaningfully evaluating complex information if the inspection right is to have any substantive force.

*Kasten v. Doral Dental USA, LLC*, 733 N.W.2d 300 (Wis. 2007). The Wisconsin Supreme Court interpreted provisions of an operating agreement granting members access to “Company documents” and concluded that the operating agreement conferred broader access rights than the default provision of the Wisconsin LLC statute that grants access to “records” because the term “Company documents” is a broader category of stored information than “records.” An LLC member sought access to email communications and drafts of documents, and the court concluded that such items were encompassed in “Company documents” (except for email that was of a strictly personal or social nature). The court also addressed how to determine if a request for records (or “Company documents” in this case) is a “reasonable request” as required by the statute (or the operating agreement in this case). In analyzing the plaintiff member’s inspection and information rights, the court examined both the statutory provisions of the Wisconsin LLC statute and the provisions of the operating agreement. The statute provides a member the right to inspect and copy, “upon reasonable request,” any LLC record required to be kept under the statute and, unless otherwise provided in the operating agreement, “any other record” wherever located. The statute further imposes a duty on LLC managers, upon reasonable request of a member, to disclose “true and full information of all things affecting the members.” The operating agreement included a provision giving members access to the LLC’s books of account and all other LLC

records at reasonable times. Another provision gave each member, “upon reasonable request,” the right to inspect and copy “Company documents.” The operating agreement did not address the managers’ duty to disclose information to members. The court examined the record inspection provisions of the corporation and partnership statutes and noted differences between each of those statutes and the LLC statute. The limited partnership statute restricts the right to inspect records to those records required to be kept under the statute, and the corporate statute contains numerous limitations relating to shareholder access to records. The court contrasted the lack of restrictions in the inspection provisions of the LLC statute and stated that the scope of a member’s right under the default provisions of the LLC statute is exceptionally broad and hinges on what constitutes an LLC “record” and the degree and kind of restrictions that the requirement of a “reasonable request” imposes. The court characterized the broad rights provided under the LLC statute as consistent with the purposes of simplicity and freedom of contract that are at the heart of the statute. The court stated that the default rules, which do not include cumbersome restrictions, were designed for less sophisticated companies that would be less likely to craft their own inspection rules, while the statute envisions that larger, more sophisticated companies with multiple members may adopt rules that may be more suited to their needs. The court consulted the dictionary definitions of “document” and “record” and concluded that the term “document” is a broader category of stored information than “record.” The court concluded that the term “Company documents” under the operating agreement encompassed document drafts and email (other than purely personal or social email), and the court expressly refrained from addressing whether the statutory phrase “any other records” embraces informal or non-financial records, email, or document drafts. The court did explain that the statutory requirement that managers provide “true and full information of all things affecting members” imposes a duty on managers to provide such information regardless of whether the information is recorded and stored as a record or document. The court construed the phrase “all things affecting the members” to mean all things affecting the requesting member’s financial interest in the LLC. While the member’s right to “true and full information” under this provision is limited to matters affecting the member’s financial interest, the court rejected the argument that a member’s statutory right of access to records is limited to records affecting the member’s financial interest. The court next examined what constitutes a “reasonable request” with respect to member inspection rights. The court rejected the argument that the “reasonable request” requirement limits the types of records subject to inspection, but also refused to interpret the phrase as pertaining only to the time and manner of inspection. While the phrase “reasonable request” applies only to the time and manner of inspection under the limited partnership statute, the court pointed out that the limited partnership statute differs from the LLC statute in that the limited partnership statute authorizes inspection of only specified records. The court discussed various approaches taken in other state LLC statutes and concluded that the absence of a “proper purpose” requirement in the Wisconsin statute is significant but does not mean that the statute is blind to a member’s motive for making an inspection request. The court concluded that the purpose of the “reasonable request” requirement in the Wisconsin LLC inspection provision is to protect the LLC from member inspection requests that impose undue financial burdens on the LLC, and the requirement relates to the breadth of the request as well as the timing and form of inspection. The court provided a non-exclusive list of factors that may be relevant in balancing the statute’s bias in favor of member access against the costs of the inspection to the LLC in determining whether a request is so burdensome as to be unreasonable. The court remanded the case to the trial court for a determination of the reasonableness of the member’s request to inspect email and document drafts.

## V. Interpretation of Operating Agreement

*Mission Residential, LLC v. Triple Net Properties, LLC*, 654 S.E.2d 888 (Va. 2008). The Virginia Supreme Court held that an arbitration clause in an LLC operating agreement did not require arbitration of a member’s derivative claim because the claim belonged to the LLC and the LLC was not a party to the operating agreement. The arbitration clause in the operating agreement required that the members in good faith use their best efforts to settle “disputes regarding their rights and obligations thereunder” and required arbitration of “all disputes” that the parties failed to resolve. One of the members commenced an arbitration proceeding against the other, asserting a direct claim for breach of contract and a derivative claim on behalf of the LLC. The arbitrator ruled that the plaintiff member lacked standing to assert the direct claim, but allowed the derivative claim to proceed. The defendant member brought an action seeking a declaratory judgment that there was no agreement to arbitrate disputes between it and the LLC. The supreme court stated that a party cannot be compelled to submit to arbitration unless he has agreed to arbitrate, and the court held that the plaintiff member failed to prove the existence of an agreement by the defendant member to arbitrate its disputes with the LLC. The plaintiff member argued that the derivative claim was nothing more than a dispute regarding the

defendant's duties under the operating agreement, but the court disagreed, stating that this argument ignored the separate existence of the LLC, which was not a party to the operating agreement. The court pointed out that an LLC, like a corporation, is a separate legal entity from the shareholders or members and that a derivative action is an equitable proceeding in which a member asserts, on behalf of the LLC, a claim that belongs to the LLC rather than the member. The court stated that the parties might have chosen to employ language committing them to arbitrate their disputes with the LLC, but they did not do so, and there was thus no contractual undertaking by which the defendant member agreed to arbitrate any dispute with the LLC.

***Brown v. T-Ink, LLC***, Civil Action No. 3190-VCP, 2007 WL 4302594 (Del. Ch. Dec. 4, 2007). This action was filed by an LLC member ("Brown") to enjoin another member (T-Ink, LLC or "T-Ink") from proceeding with an arbitration. T-Ink argued the court should dismiss the case on the grounds that the arbitrator should decide matters of substantive arbitrability (i.e., whether T-Ink's claims are arbitrable) as well as procedural arbitrability (i.e., whether T-Ink complied with the terms of the arbitration clause). The LLC agreement required arbitration of disputes "concerning the interpretation or performance of this Agreement," and the court determined that the federal majority rule that substantive arbitrability is determined by the arbitrator did not apply because the clause did not refer all disputes to arbitration. The court compared the language used in the arbitration clause to broader language used in the waiver of jury trial contained in the LLC agreement, as well as suggested and sample clauses of the American Arbitration Association and National Arbitration Forum, and concluded that the reference to disputes concerning "interpretation or performance" of the LLC agreement did not refer all disputes to arbitration. The court found no other evidence indicating a clear and unmistakable intent to refer questions of substantive arbitrability to the arbitrator because a reference to the American Arbitration Association rules in the clause was not alone sufficient to establish an intent to commit the question of substantive arbitrability to the arbitrator. The court determined that T-Ink's fraud claims fell outside the narrow scope of "interpretation and enforcement" of the LLC agreement (in contrast to the scope of broader language encompassing disputes "arising out of or relating to" the agreement as suggested by the American Arbitration Association and used in the waiver of jury trial contained in the agreement). T-Ink's fiduciary duty claims arising from general fiduciary duty principles under Delaware law, and not related to specific aspects of the LLC agreement, also were not encompassed by the arbitration clause because those claims did not concern "interpretation and performance" of the LLC agreement. Fiduciary duty claims arising at least in part by virtue of specific obligations created by the LLC agreement involved "interpretation and enforcement" of the LLC agreement, but claims based on fiduciary duties arising by virtue of any statutory, common law, or other requirement as a consequence of the formation of the LLC without regard to the specific terms of the LLC agreement were not subject to arbitration. Stating that wrongful enforcement of an arbitration clause constitutes irreparable harm, and balancing the equities, the court enjoined T-Ink from arbitrating its fraud claims and breach of fiduciary duty claims springing from general fiduciary duty principles under Delaware law. The court dismissed the aspects of Brown's claims premised on issues of procedural arbitrability because, unlike substantive arbitrability, matters of procedural arbitrability are presumptively for the arbitrator to decide.

***In re J.S. II, L.L.C.***, No. 07 B 3856, 2007 WL 4233090 (Bankr. N.D. Ill. Nov. 29, 2007). An individual was admitted as a 50% member of an LLC under a memorandum of understanding providing that the respective rights and responsibilities of the members would be memorialized in the future. The LLC had two other members and they proposed a sale of certain LLC properties. The issue was whether the sale required consent of the 50% member. The Illinois LLC statute and operating agreement required consent of all members for a sale of all or substantially all the LLC assets. The proponents of the sale argued that their consent would satisfy this provision of the operating agreement because only they were parties to the operating agreement and the other member's rights and responsibilities had yet to be determined. With respect to matters requiring a majority vote, the operating agreement provided that, in the event of a deadlock on a vote requiring a majority in interest, the majority of the individual members rather than the percentage interests would prevail, thereby allowing the other two members to prevail over the 50% member. The 50% member argued the proposed sale amounted to 71% of the LLC assets, and the other two members argued the properties amounted to 38% of the assets. The court stated that the sale involved less than substantially all the LLC assets in either event, and the 50% member's approval was not required.

***Bernstein v. TractManager, Inc.***, C.A. No. 2763-VCL, 2007 WL 4179088 (Del. Ch. Nov. 20, 2007). An LLC converted to a corporation, and the corporation's bylaws provided for mandatory advancement of expenses to current and former officers and directors of the corporation. The corporation asserted claims against Bernstein, a director of

the corporation who was also a co-founder and manager of the predecessor LLC, based on actions taken prior to the conversion. The LLC operating agreement provided for mandatory indemnification but not mandatory advancement. The court acknowledged that the LLC's obligation to indemnify Bernstein under the operating agreement was preserved in the conversion, but the operating agreement did not provide for mandatory advancement, and the court rejected Bernstein's claim that he was entitled to advancement of expenses under the bylaws. Bernstein argued that the bylaws provision granting advancement rights to any person made a party to an action "by reason of the fact that he or she is or was a director or officer of the corporation" should be read to include managers of the predecessor LLC. The court distinguished the instant case as involving a more fundamental change in identity than a case relied upon by Bernstein in which a corporation reincorporated in another state. The court pointed to the differences in the corporate and LLC statutes regarding indemnification and the fact that the bylaws provided for mandatory advancement only for directors and officers of the corporation when they easily could have included language granting advancement rights to managers and officers of the LLC. The court stated that the operating agreement should control just as it would if the tables were turned, i.e., if later adopted bylaws were more restrictive regarding the rights applicable to officers and directors of the corporation. The court thought it unlikely that a court in such a case would infer a silent intention to alter the more generous arrangements previously enjoyed by the managers or officers of the predecessor LLC.

*Cement-Lock v. Gas Technology Institute*, 523 F.Supp.2d 827 (N.D. Ill. 2007). The court concluded that two LLC members had standing to bring a derivative action against the third member and various other defendants asserting federal RICO and various state law claims on behalf of the LLC based on alleged actions that injured the LLC. The court expressed uncertainty regarding the parties' assumption that Delaware law governed the breach of fiduciary duty claim in light of a choice of law provision in the LLC agreement specifying that the agreement be construed under Illinois law, but the court analyzed the claim under Delaware law as briefed by the parties. The court stated that actions of a director are protected under Delaware law by the business judgment rule unless the plaintiff proves the director's breach of duty of loyalty, good faith, or due care. The court also noted that Delaware law permits an LLC agreement to expand, restrict, or eliminate the duties of a manager or member subject to certain exceptions. The LLC agreement contained a clause specifying that a manager shall perform his duties as a member of the operating board in good faith, in a manner reasonably believed to be in the best interest of the LLC and members, and with similar care as an ordinarily prudent person, and that a person who so performed his duties has no liability by reason of being a manager. The agreement further specified that the operating board would have no liability to the LLC or members for any action or failure to act on behalf of the LLC within the scope of authority conferred on the board except for a claim based on fraud, gross negligence or bad faith of the board. Thus, the court stated that the agreement made clear that there was an affirmative duty of good faith and care and that there was liability for fraud, gross negligence, or bad faith. Further, the court stated that the duty to act in the best interest of the LLC constituted the managers' duty of loyalty. The court analyzed claims of self-dealing, misappropriation of intellectual property, failure to implement internal controls, willful suppression of the development of technology, and subordination of the LLC's interests to those of an affiliate of a member and found fact issues existed as to these breach of fiduciary duty claims. The court turned to analyzing which defendants might be liable for wrongdoing and observed that there appeared to be no dispute that the corporate defendant that was a member owed fiduciary duties, but the court stated that the parent of the corporate member would only owe fiduciary duties if the corporate veil of the member could be pierced, and the jury was entitled to consider the veil piercing claim based on disputed facts. The court applied Delaware veil piercing principles to analyze whether the veil of a Delaware LLC affiliated with the corporate member should be pierced and noted that failure to follow corporate formalities may not be as significant for an LLC as it is for a corporation. Even applying fairly rigorous standards, the court concluded that there was sufficient veil piercing evidence for the claim to survive summary judgment based on allegations that would show the LLC was intended to and did serve a fraudulent purpose. The court analyzed the breach of fiduciary claims against several individuals who served on the LLC's operating board (one of whom also served as president of the LLC) and concluded that various claims based on self-dealing, misappropriation of intellectual property, actions conflicting with the LLC's interest, and failure to set up internal controls survived summary judgment. One individual argued that he was serving on the board as the representative of the corporate member rather than in his individual capacity and that the corporate member was thus the board member, but the court rejected this attempt to avoid liability because the LLC agreement specified that the members of the board were the representatives designated by the three members of the LLC.

*HLHZ Investments, LLC v. Plaid Pantries, Inc.*, Civil No. 06-797-KI, 2007 WL 3129985 (D. Or. Oct. 23, 2007), as modified by 2007 WL 4180659 (D. Or. Nov. 21, 2007). An LLC was formed to serve as a joint venture vehicle

to acquire a block of stock in a corporation. Several years later, a member of the LLC withdrew from the LLC and, pursuant to the terms of the LLC operating agreement, received shares of stock held by the LLC in the corporation. The shares received by the member caused the member to cross the threshold of ownership specified in the Oregon Control Share Acquisition Act (the “CSA”), and the shares were thus stripped of voting rights unless the corporation waived the provisions of the CSA. The member argued this result was not intended under the operating agreement and that the corporation’s board of directors was required to waive the provisions of the CSA, but the court found that the corporation was not a party to the operating agreement and that the operating agreement could not be read to require the LLC to deliver stock which could be voted in spite of the CSA. The court concluded that there was no basis to read into, or reform the operating agreement to include, additional provisions where the parties simply failed to consider and anticipate the application of the Oregon CSA. (The court commented at the outset of its opinion that all parties were sophisticated and had been represented by experienced counsel in entering the transaction, and the court expressed its intent to interpret the contracts to mean what they said and no more.) The court also found that failure to disclose the potential application of the CSA was not a basis for a securities fraud claim against the LLC or its manager. The court concluded that the CSA exemption for a transaction with the issuing public corporation was not available because the transaction was with the LLC, and the exemption for a transaction with an affiliate was not available because the member’s interest, although it was a 70% interest in the LLC which owned a controlling interest in the corporation, had limited power under the operating agreement and did not constitute control. The court denied summary judgment in favor of the LLC manager because there was evidence that the LLC in fact held a slight majority of the stock of the corporation and the manager had the authority to vote the shares. The court concluded that a decision on whether the manager was protected by the business judgment rule was too fact dependent to be determined at the summary judgment stage. The court granted summary judgment in favor of the plaintiff member with respect to a counterclaim against the member for breach of the operating agreement. The court strictly construed a right of first refusal provision in the LLC operating agreement and found that the transfer of a portion of the member’s economic interest to the member’s employees as a bonus was not subject to the right of first refusal provision because the provision was not triggered unless there was a bona fide written offer from a person who wished to buy the interest. To provide broader protection, the provision should have been drafted to prevent any transfer of the interest without notification to other members. The court held that the corporation in which the LLC owned stock was not entitled to attorney’s fees under a provision of the operating agreement that entitled a prevailing party to attorney’s fees in an action to enforce or interpret the operating agreement. The court reached this conclusion based on its holding that the corporation was not a party to the operating agreement. The court discussed Oregon case law extending the reciprocal attorney fee statute to a non-signatory and concluded that the case law extended the entitlement only to one sued on a contract as an assignee.

*Marsala v. Mayo*, Civil Action No. 06-3846, 2007 WL 3245434 (E.D. La. Nov. 2, 2007) (applying Georgia law to LLC member’s fraud claims and concluding that claims for fraud based on claims of misrepresentations pre-dating operating agreement were barred because operating agreement contained merger clause).

*Segal v. Silberstein*, 156 Cal.App.4th 627, 67 Cal.Rptr.3d 426 (Cal App. 2 Dist. 2007) (compelling arbitration of dispute between member-investors of two LLCs based on arbitration clauses that stated arbitration was exclusive dispute resolution process in Texas but not elsewhere; stating that provision was “poorly worded” and expressing concern that such troubling provision has found its way into use in California; holding that trial court erred in refusing to compel arbitration under arbitration clause in LLC agreement to which LLC was not party where allegations showed dispute between LLC’s member-investors over interpretation and enforcement of their operating agreement and commenting that it was unclear to appellate court why LLC itself would have to be named as defendant to invoke arbitration provision).

*Cox v. Southern Garrett, L.L.C.*, \_\_\_ S.W.3d \_\_\_, 2007 WL 2963756 (Tex. App. 2007). An LLC member asserted various claims against the LLC and his co-members in connection with the withdrawal and buyout of the member. The member cashed a check tendered by the LLC for his interest but did not sign a letter accompanying the check. The letter contained a release of liability and stated that the member’s signed acceptance of the terms constituted the member’s agreement that his ownership was relinquished. The member argued that the buyout of his interest did not become effective and that he was still entitled to receive membership distributions because the buyout violated transfer restrictions in the LLC membership regulations (i.e., the operating agreement). The transfer restrictions prohibited a member from disposing of all or any portion of his membership interest without complying with specified conditions and stated that any attempted disposition in violation of the agreement was void. The transfer restriction provision referred

to the “Person” to whom the membership interest was transferred, and the agreement defined “Person” as having the meaning given the term in the Texas LLC statute. The statute defined the term broadly to include individuals and entities. The court concluded, however, that the transfer restriction only applied to a transfer to a person who was not a member. The court stated that a plain reading of the provision demonstrated that its purpose was to provide rules for disposition of a member’s interest to a non-member. In support of this interpretation, the court pointed to the fact that the phrase “Person to be admitted” was used in various subsections of the transfer restriction provision. The court found that the buyout did not violate the transfer restriction because the transfer did not involve a transfer to a non-member. The court also concluded that the LLC had complied with provisions of the membership regulations governing distributions to a withdrawing member. The court found that the LLC’s offer to purchase the member’s interest substantially complied with the requirement that a withdrawing member receive the fair value of his interest as of the first day of the month following the date of the occurrence giving rise to the member’s withdrawal. The letter stated that the purchase price would be calculated based on the retained earnings of the LLC as of the last day of the month of the member’s withdrawal. Although the member did not sign the letter accompanying the check, the court found that the member accepted the buyout of his interest by signing and depositing the check and completed his withdrawal effective as of the date specified in the letter. The court rejected the member’s claims that the other owners of the LLC breached a fiduciary duty to him in connection with the repurchase of his interest. The member couched his argument in terms of duties owed in the context of a closely held corporation and argued that the defendants had the burden to establish the fairness of the transaction. The court stated that the member’s breach of fiduciary duty claim regarding the voiding of his interest depended upon his argument that the transfer restrictions applied to the purchase of his interest, and the claim thus failed as a matter of law. The court stated that another breach of fiduciary duty claim based on alleged fraudulent transfers of ownership in the LLC related to transactions that occurred after the member’s withdrawal and that the LLC owed him none of the duties owed members after that date.

*Flores v. Murray*, 2007 WL 3034512 (N.J. Super. A.D. Oct. 19, 2007). The court held that individuals who were reflected as members in a memorandum of understanding and attachment to an operating agreement were admitted as members upon formation of the LLC though they did not sign the operating agreement. The court held that the members who did not sign the operating agreement were not bound by the merger clause in the operating agreement, and the court stated that the provisions of the previously signed memorandum of understanding and partially executed operating agreement should be read together in interpreting the intent of the members. The court determined that the provisions of the prior memorandum of understanding spelling out the contribution obligation of the defendant member was binding on the member, and that the trial court correctly determined that the defendant member breached the agreement by failing to make the required contribution and forfeited his membership interest in accordance with the memorandum of understanding and operating agreement. The court also concluded that the evidence supported a finding that the member breached his fiduciary duty in connection with hidden payments to his son and use of LLC funds to pay personal debt. The court pointed out that judicial expulsion of the defendant member was warranted under the New Jersey LLC statute based on his breaches of fiduciary duty, which were material and detrimental to the LLC, and concluded that equitable intervention to set aside the forfeiture of the member’s interest was not warranted given the member’s conduct. The court reversed the trial court’s award of attorney’s fees because the action was brought by members individually and not as a derivative action, and there was no statutory or rule authority to award attorney’s fees as there is under the New Jersey LLC statute in a derivative action.

*Glickman v. Sollod*, 2007 WL 3034273 (N.J. Super. A.D. Oct. 19, 2007) (interpreting letter agreement and operating agreement and concluding investors did not become members of LLC where “formal stockholders’ agreement” contemplated by letter agreement was never executed and operating agreement was not amended to reflect admission of members).

*Advantage Inspection International, LLC v. Sumner*, C.A. No. 6:06-3466-HMH, 2007 WL 2973538 (D. S.C. Oct. 9, 2007). The defendant sought to dismiss the plaintiff LLC’s complaint on the basis that the LLC was not legally organized because it did not have an LLC agreement as required by the Delaware LLC statute. The court compared the language of the Delaware statute before and after the August 1, 2007 amendments and concluded that the pre-amendment statute did not require an LLC agreement to properly form an LLC. The court found no evidence that the amendment was intended to be retroactive and thus concluded that the plaintiff became a legal entity upon the filing of its certificate of formation. Furthermore, even if an LLC agreement was required, the plaintiff presented evidence that its members

agreed to the terms of an operating agreement; therefore, the factual dispute over the existence of an agreement precluded dismissal.

***Gitlitz v. Bellock***, 171 P.3d 1274 (Colo. App. 2007) (holding that loss of contractual rights to manage a business may constitute irreparable harm for purposes of injunctive relief and remanding case to trial court for contractual interpretation of operating agreements and fact findings on plaintiffs' allegation that improper election of third manager of land investment LLCs diluted bargained-for contractual management rights).

***Rudney v. International Offshore Services, LLC***, Civil Action No. 07-3908, 2007 WL 2900230 (E.D. La. Oct. 1, 2007). An LLC member sued for a TRO or preliminary injunction, pending arbitration, against the LLC's expulsion and buyout of the member and the LLC's obtaining a loan to fund disproportionate distributions to the majority member. The other members had signed a consent to obtain the loan for the disproportionate distributions and had voted to expel the member after previously amending the operating agreement to add a provision providing for termination of a member upon the vote of 75% in interest of the members and specifying a method of valuing a terminated member's interest. The court noted provisions of the Louisiana LLC statute protecting members and managers from liability unless they act in a grossly negligent manner, providing for distributions to be allocated in accordance with a written operating agreement, providing that incurrence of indebtedness other than in the ordinary course of business requires the vote of a majority of the members, and providing that amendment of the operating agreement requires the vote of a majority of the members. The Louisiana statute is silent, however, on terminations or expulsions of members. The court concluded that the member was not likely to prevail on the argument that the LLC could not take out a loan since the operating agreement in this case specifically provided that management had the power to incur indebtedness, and there was no evidence that the loan itself would be a breach of duty. The plaintiff, however, was substantially likely to prevail on the merits of his claim challenging disproportionate distributions because the operating agreement provided for proportionate distributions. In the event of a disproportionate distribution, the court ordered that the LLC must set aside ten percent to protect the plaintiff's interest. The court stated that the LLC was free to make proportionate distributions and otherwise carry on its affairs; it was merely enjoined from making distributions prohibited by the agreement. The court stated that it did not find that distributing funds that would act as debits to capital accounts may not be deemed necessary pursuant to the good faith business judgment of the managers. With respect to the plaintiff's argument that Louisiana law does not permit expulsions or terminations of members, the court acknowledged that Louisiana law does not address expulsions or terminations, but noted that courts have upheld expulsion or termination clauses in operating agreements. In this case, an amendment to the operating agreement was passed in accordance with the agreement and Louisiana law.

***Parker v. Kohl-Parker***, \_\_ N.E.2d \_\_, 2007 WL 2743836 (Ohio App. 2007) (concluding trial court did not abuse discretion in finding that spouse's withdrawal of funds from couple's LLC account was not financial misconduct where operating agreement provided for LLC to pay for long term care and disability policies and spouse testified that withdrawal was for purposes of reimbursing spouse for payment of premiums on such policies).

***Sanluis Developments, L.L.C. v. CCP Sanluis, L.L.C.***, 498 F.Supp.2d 699 (S.D. N.Y. 2007). A Delaware LLC's operating agreement provided for Class A and Class B owners, and a dispute arose as to whether certain buy out provisions of the operating agreement required that the value of the Class B liquidation preference be taken into account in determining fair market value of the Class B units. An arbitration clause was invoked, and the arbitrator determined that "any investment banker who may be asked to determine the fair market value of the Class B Units should value those units as if a sale of the Company were to take place and the Class B shareholders were entitled to receive the Liquidation Preference in connection with the distribution of the proceeds of the sale." The court concluded that the arbitrator's decision did not constitute a "manifest disregard of the agreement" but rather took into account the terms of the agreement.

***NII-JII Entertainment, LLC v. Troha***, No. 2006AP2204, 2007 WL 1695176 (Wis. App. June 13, 2007). An individual who was a direct and indirect owner of a member of an LLC formed for the purpose of developing a casino for the Menominee Indian Tribe allegedly secretly made a deal with the Tribe to develop the casino independently of the LLC. The court concluded that the individual was not bound by a non-competition provision in the LLC's operating agreement because the individual did not execute the operating agreement. Noting that the Wisconsin LLC statute calls for common law corporate veil piercing principles to apply to LLCs, the court stated that no allegations supported

piercing the veil to disregard the separate existence of the two LLCs that were direct and indirect owners of the LLC. The allegations did not support the claim that the entities were acting as an agent of the individual because the complaint did not allege conduct by the principal that gave the agent reason to believe it was authorized to act on the principal's behalf or that gave a third person reason to believe the agent was so authorized. The allegations did not support a claim that the individual was bound as a successor of the dissolved LLCs that were the direct and indirect owners of the LLC because the allegations did not establish that the membership interest in the LLC was distributed to the individual. Since the individual was not bound by the operating agreement, the claims for breach of contract and breach of the implied duty of good faith and fair dealing failed.

*Coffee Bean Trading-Roasting, LLC v. Coffee Holding, Inc.*, 510 F.Supp.2d 1075 (S.D. Fla. 2007) (granting motion to dismiss on basis that forum selection clause in LLC operating agreement that provided "exclusive venue" of any action brought in connection with agreement "may be laid in the State of Delaware" was mandatory).

*Concrete Company v. Lambert*, 510 F.Supp.2d 570 (M.D. Ala. 2007) (concluding that purchase and sale of LLC interest involved sale of good will for purposes of statutory provision permitting non-competition agreements in connection with sale of good will of business, but holding that non-competition provision of LLC agreement prohibiting general manager/owner of 50% member from working in sand and gravel business in specified territory for five years after buyout of interest in LLC was unenforceable inasmuch as LLC lacked sufficiently unique protectable interest, five year period was unreasonable, and provision imposed undue hardship).

*Noble v. A & R Environmental Services, LLC*, 164 P.3d 519 (Wash. App. 2007) (concluding that statutory default provisions regarding distribution of assets in dissolution applied in absence of written operating agreement regardless of subjective intent of members regarding ownership interests because Washington LLC statute defines operating agreement as written agreement).

*Spaulding v. Honeywell International, Inc.*, 646 S.E.2d 645 (N.C. App. 2007) (holding that non-manager member did not undertake independent duty to ensure worker safety under terms of operating agreement because member did not affirmatively undertake duty, member's agreement to be responsible for budgetary expenditures in response to environmental event was insufficient to impose independent duty upon member to employees, and plaintiff failed to show he was intended or indirect beneficiary of operating agreement).

*Ashley River Properties, I, LLC v. Ashley River Properties II, LLC*, 648 S.E.2d 295 (S.C. App. 2007) (holding New York choice of forum clause in South Carolina LLC's operating agreement was enforceable such that New York was proper forum for proceeding to modify, vacate, or confirm arbitration award, and lower court did not err in dismissing claims asserted by individual where arbitration panel had found that it had jurisdiction over individual in prior arbitration proceeding based on individual's execution of LLC operating agreement as manager of one of LLC's members and in individual capacity with respect to specified provisions of agreement).

*NAMA Holdings, LLC v. World Market Center Venture, LLC*, C.A. No. 2756-VCL, 2007 WL 2088851 (Del. Ch. July 20, 2007) (concluding inspection provision of operating agreement granting "reasonable access at reasonable times" to books and records gave managing members substantial discretion to determine scope of access to information, and LLC's limitation of scope of NAMA's inspection to non-sensitive information, prohibition on photocopying of LLC's books and records, and insistence upon execution of confidentiality agreement were all reasonable limitations under circumstances).

*Vanderford Company, Inc. v. Knudson*, 165 P.3d 261 (Idaho 2007) (concluding that there was no contract that barred one member's claim of unjust enrichment against other member and other member's wife because there was no contract between all parties that could act as bar where operating agreement was between members only and did not include member's wife as party).

*Mixon v. Iberia Surgical, L.L.C.*, 956 So.2d 76 (La. App. 2007). The court concluded that an LLC's actions in expelling a member as permitted by the terms of its operating agreement did not constitute a "deceptive" trade practice under the Louisiana Unfair Trade Practices and Consumer Protection Law, and the member was not a "consumer or



competitor” within the meaning of the statute. Furthermore, the expulsion was not actionable under the “abuse of rights” doctrine. No evidence suggested that expulsion of the member pursuant to the operating agreement (which permitted expulsion without cause by a unanimous vote of the remaining members) after disagreements and animosity arose between the expelled member and the remaining members was done to cause harm or for any reason other than legitimate business purpose, and the member’s expulsion did not violate moral rules, good faith, or elementary fairness. The member was compensated for his LLC interest in accordance with the terms of the operating agreement because he received book value based on the terms of the operating agreement, which provided for computation of a “Fair Market Value” purchase price using a “Book Value” method.

***Kasten v. Doral Dental USA, LLC***, 733 N.W.2d 300 (Wis. 2007) (interpreting provisions of operating agreement granting members access to “Company documents” and concluding that operating agreement conferred broader access rights than default provision of Wisconsin LLC statute that grants access to “records” because “Company documents” is broader category of stored information than “records”).

***Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer***, No. 06 CVS 6091, 2007 WL 2570749 (N.C. Super. May 8, 2007) (finding that issue of whether correspondence regarding professional LLC’s breakup constituted operating agreement providing for withdrawal of member was at best fact question, and that statute and exculpatory provisions of articles of organization did not pose insurmountable bar to plaintiff’s breach of duty claims where allegations supported claim for acts or omissions defendants knew were in conflict with LLC’s interests or transactions from which they derived improper personal benefit).

***Green v. Short***, No. 06 CVS 22085, 2007 WL 2570821 (N.C. Super. March 9, 2007) (interpreting arbitration provision in operating agreement of North Carolina LLC and concluding that defendant nonsignatory companies (which were wholly owned by defendant LLC member and alleged to have committed wrongs intertwined with defendant member’s violation of operating agreement) could invoke arbitration clause and compel arbitration in direct and derivative action brought by LLC member and that all of member’s claims, including claim for dissolution, fell within scope of arbitration clause).

***NAMA Holdings, LLC v. Related World Market Center, LLC***, 922 A.2d 417 (Del. Ch. 2007). The plaintiff, an indirect owner of a Delaware LLC, sued the LLC and one of the LLC’s two members, seeking to enforce provisions of the LLC’s operating agreement as to which the plaintiff was an explicit third party beneficiary. The plaintiff sought access to the LLC’s books and records and specific performance of a provision requiring the defendant member to segregate funds when a dispute arose regarding the amount of certain payments and fees to various related entities. The defendants moved for dismissal of the claims on the basis that the claims were subject to arbitration, and on various other grounds including that the plaintiff had an adequate remedy at law. The court held that the claims were not subject to arbitration because the arbitration clause relied upon by the defendants merely permitted, but did not require, the parties to the operating agreement to jointly consent to arbitrate disputes between themselves that were not otherwise required to be arbitrated. The court stated that it would be inequitable and illogical to hold that an arbitration clause acts more broadly on a third party beneficiary than upon one of its signatories. The court concluded that a second arbitration clause pertaining to disputes over certain exhibits did not apply to the plaintiff’s claims either. The plaintiff, as a third party beneficiary who was not a signatory of the agreement, only had standing to bring claims based on rights found in certain provisions of the agreement, and the inspection right did not turn on the exhibits referenced in the arbitration clause. The court also rejected the defendants’ argument that arbitration was required under an arbitration clause in another agreement to which the defendants were not parties. After analyzing and rejecting several other arguments for dismissal of the specific performance action, the court concluded that the plaintiff did not have an adequate remedy at law because money damages for the failure to comply with the operating agreement might not be available. The operating agreement provided that the defendant member’s duties were ministerial and that the member would have no liability for any action taken or omitted except for willful misconduct, gross negligence, or bad faith, so long as the member acted in good faith. Thus, even if the plaintiff proved non-compliance by the other member, the plaintiff would be left without a remedy if the non-compliance occurred only negligently and in good faith. Furthermore, the court stated that money damages would not provide a complete and efficient remedy such as that provided in the contractual covenant the plaintiff sought to enforce. The court stated that it could not put a meaningful dollar value on the unique economic bargaining power conferred on the plaintiff under the provision requiring the segregation of funds.

*In re Regional Diagnostics, LLC (Morris v. Zelch)*, 372 B.R.3 (Bankr. N.D. Ohio 2007). Defendant managers of an LLC argued that the trustee failed to state a claim against them under Delaware law for breach of fiduciary duty. The court reviewed the duties of loyalty and care of a director of a Delaware corporation and stated that Delaware courts have applied the business judgment rule in the LLC context. The court noted that fiduciary duties of LLC managers may be altered by agreement and quoted a recent article by Justice Steele for the proposition that “[t]here is an assumed default to traditional corporate governance fiduciary duties where the agreement is silent, or at least not inconsistent with the common law fiduciary duties.” The agreement contained an exculpatory provision that provided that a covered person shall not be liable to the LLC or any other covered person for any loss, damage, or claim incurred by reason of any act or omission performed or omitted in good faith on behalf of the LLC and in a manner reasonably believed to be within the scope of authority conferred on the covered person by the agreement, except that a covered person shall be liable for any such loss, damage, or claim incurred by reason of such covered person’s gross negligence or willful misconduct. The defendants argued that the LLC agreement eliminated liability for breach of the duty of loyalty, but the court rejected this argument because the provision did not restrict or limit the managers’ fiduciary obligations; it only limited their liability to the extent they acted in good faith. The court thus concluded that, since a breach of the duty of loyalty can be premised on a failure to act in good faith, “an agreement that does not alter a manager’s duty of loyalty and only restricts liability to the extent of actions performed and omissions made in good faith, does not eliminate potential liability for breach of the duty of loyalty.”

*Westbard Apartments, LLC v. Westwood Joint Venture, LLC*, \_\_\_ A.2d \_\_\_, 2007 WL 1518992 (Md. App. 2007). This suit arose out of a dispute between two members of a Delaware LLC formed to invest in and develop certain real estate in Bethesda, Maryland. The LLC leased the property, and the lease conferred on the LLC various rights, including a right of first refusal on the property. The two members of the LLC were a large pension fund (National Electrical Benefit Fund or “NEBF”) and an entity owned and controlled by a real estate developer named Cohen. Cohen’s entity was the managing member of the LLC, and Cohen was designated as the representative to act on behalf of the managing member. A couple years after NEBF entered the venture, NEBF and Cohen began discussing the possible purchase of the property. With NEBF’s knowledge and consent, Cohen negotiated an agreement under which an entity owned by Cohen would purchase the property that was leased by the LLC. Cohen waived on behalf of the LLC certain rights of first refusal held by the LLC under the lease. NEBF’s managing director for real estate testified that he presumed Cohen was negotiating the purchase on behalf of the LLC since he did not believe Cohen would be permitted under the LLC agreement to take the deal for himself. After Cohen and NEBF failed to agree on terms for a new joint venture to purchase the property, Cohen informed NEBF that he believed the LLC agreement permitted him to pursue the transaction in his individual capacity. NEBF and the LLC filed suit against Cohen, various Cohen-controlled entities, and the seller of the property. The court first analyzed waivers of jury trial contained in the LLC agreement and the lease and concluded that the LLC and NEBF were bound by the waivers and could not demand a jury trial in NEBF’s derivative suit brought against the managing member, Cohen, Cohen-controlled entities, and the seller of the property. The court next interpreted the fiduciary duty provisions of the LLC agreement. The LLC agreement provided that the managing member was required to exercise the power and authority granted under the agreement and to perform its duties as managing member in good faith, in a manner reasonably believed to be in the best interest of the LLC, and with the care of a prudent real estate professional in a like position under similar circumstances. This section of the agreement went on to provide that the managing member owed the fiduciary duties that a “general partner undertakes to a limited partnership and its limited partners under the statutes and case law of the State of Delaware applicable to the limited partnership form of business organization.” The next section of the LLC agreement required the managing member to manage the LLC as its exclusive function and prohibited it from having any business interests or activities other than those relating to the LLC. This provision permitted other members to have other business interests and activities in addition to those relating to the LLC even if such other ventures were competitive with the LLC. The trial court found that the fiduciary duty provisions of the LLC agreement were ambiguous and that NEBF could not complain about Cohen’s conduct because it encouraged him to pursue the deal. The trial court found the testimony by the NEBF representative to be incredible and untruthful. The court of appeals discussed fiduciary duties under Delaware law and the contractual freedom to vary such duties. The court perceived no ambiguity in the fiduciary duty provisions and stated that the parties, who were “sophisticated real estate developers,” were bound by the terms of the agreement. The court concluded that the wide latitude given to non-managing members and affiliates of members (including affiliates of the managing member) to pursue business opportunities was confined to ventures *other than those relating to the LLC*. The purchase of the property was a business interest related to the LLC and did not qualify as an “other venture or activity.”

The court of appeals concluded that the trial court's erroneous interpretation of the LLC agreement led to erroneous fact-finding with regard to the truthfulness of statements by NEBF's representative regarding his understanding of Cohen's actions in pursuing the purchase of the property. The court of appeals vacated the lower court's decision and remanded for a new trial on the issue of whether NEBF waived or was estopped to object to Cohen's purchase of the property.

***Darwin Limes, LLC v. Limes***, No. WD-06-049, 2007 WL 1378357 (Ohio App. May 11, 2007). Disputes arose in a family farm organized as an LLC. The LLC was owned by four siblings, Charles, Dale, Donald, and Betty Limes. Charles, Dale, and Donald each owned 32.667%, and Betty owned 2%. Under the original operating agreement, they were each managing members, but the parties agreed in an addendum that Betty was no longer a managing member, although she was still a non-voting member. Donald had traditionally farmed the land on a cash rent basis under an alleged oral lease. The other members decided to terminate any lease arrangement with Donald, and litigation involving claims for receivership, judicial dissolution, and declaratory judgment ensued. While the litigation was pending, Charles and Dale voted to remove Donald as a managing member. They also voted to take bids on a lease of the land from Dale and Donald. Donald won the bid and retained the lease for another year. Donald argued that the LLC was dissolved automatically when both Donald and Dale filed for judicial dissolution and there was no agreement to continue. The court interpreted a provision of the Ohio LLC statute which provides that it is an event of withdrawal of a member if the member "files a petition or answer in any reorganization, ...dissolution, or similar relief proceeding under any law or rule that seeks for himself any of those types of relief." Relying on this provision, which was also included in the dissociation provisions of the operating agreement, Donald argued that Dale ceased to be a member (thus causing dissolution of the LLC) upon Dale's filing of a claim for judicial dissolution of the LLC. The court pointed out, however, that dissociation occurs when a member seeks dissolution for himself or itself. Thus, no member was dissociated when Dale or Donald filed claims for judicial dissolution of the LLC. Additionally, the court concluded that, even if it agreed with Donald's interpretation that Dale was dissociated, dissolution did not occur under the dissolution provision of the operating agreement, which listed the types of dissociation that would trigger dissolution but did not include the filing of a dissolution proceeding in the list of dissociation events dissolving the LLC. The court next interpreted the standard for judicial dissolution – that it is not reasonably practicable to carry on the business of the LLC in conformity with its articles of organization and operating agreement – and concluded that judicial dissolution was not appropriate. The court pointed out that the business of the LLC was farming, the operating agreement provided for continuation of the LLC even if Donald dissociated, and the LLC was in fact carrying on its business based on the award of the farming lease under the newly instituted bidding procedure. Finally, the court concluded that Donald was properly removed as a managing member. The operating agreement provided that a managing member could be removed for cause by the affirmative vote of all the other members. Donald argued that Betty's vote was required and not just the vote of the managing members, but the court relied upon the addendum that provided Betty was no longer a voting member to conclude that only the vote of Charles and Dale was required to remove Donald. The court noted that "for cause" was not defined, but the court pointed to the standard of care of a managing member in the operating agreement (good faith discharge of duties in a manner reasonably believed to be in the best interests of the LLC) and concluded that the trial court did not err in considering Donald's refusal to entertain the possibility of someone other than himself farming the land as cause for removal.

***Morris v. Younis***, Civil Action No. 06-CV-2576, 2007 WL 1314633 (E.D. Pa. May 3, 2007) (rejecting defendant's argument that Pennsylvania statutory default rule providing for equal division of ownership of LLC applied in absence of written operating agreement because fact issues existed regarding terms of unwritten operating agreement).

***Babb v. Bynum & Murphrey, PLLC***, 643 S.E.2d 55 (N.C. App. 2007). The plaintiffs sued Bynum and Murphrey, two members of a law firm LLC, alleging that Bynum engaged in numerous acts of fiduciary fraud in connection with the handling of a trust. The plaintiffs alleged claims against Murphrey for negligence, negligent supervision, and breach of fiduciary duty. The plaintiff argued that Murphrey had a duty to them under the North Carolina Limited Liability Act and the firm's operating agreement. Though the plaintiffs claimed that they were seeking to hold Murphrey liable for his own acts and omissions, the court concluded that the plaintiffs failed to allege any direct acts by Murphrey and were relying on Murphrey's failure to act. The court concluded that the LLC statute did not impose a duty on Murphrey to investigate Bynum if Murphrey did not have any actual knowledge. The court also rejected the plaintiffs' claim that the operating agreement created a duty on the part of Murphrey. Although the operating agreement stated that a member shall be liable for his own professional negligence and that a member must comply with

the rules of professional conduct, the court concluded that the plaintiffs were not third party beneficiaries of the agreement. The court said that the intent of the parties was to benefit the law firm and its members, not to directly benefit the plaintiffs. Thus, the plaintiffs were at most incidental beneficiaries and not third party beneficiaries with standing to sue.

*Aryian v. Marottoli*, No. CV065001934S, 2007 WL 1196461 (Conn. Super. April 10, 2007) (denying motion to strike allegations against LLC, its managing member, and accountant complaining of LLC's failure to distribute to plaintiff amounts to which plaintiff was allegedly entitled under operating agreement or LLC statute).

*Estate of E.A. Collins v. Geist*, 153 P.3d 1167 (Idaho 2007). Two individuals, Michael Collins and Russell Purcell, formed an Idaho LLC. The articles of organization stated that management was vested in the managers and listed each as a manager. Purcell testified that he had nothing further to do with the LLC after signing the articles of organization and that he was not a member. Michael Collins later amended the articles of organization to change the name of the LLC, remove Purcell as a manager, and add Michael's father as a manager. A corporation owned by Michael's father transferred various improved and unimproved lots and a model home to the LLC, and the LLC's sole purpose at that point was to develop and sell that property. After Michael's father died, his estate sought to set aside deeds executed by Michael on behalf of the LLC conveying various lots. The court first found that there was no genuine issue of fact as to whether Michael was a manager of the LLC. The estate argued that Michael could not have been a manager because the Idaho Limited Liability Company Act states that management is vested in the members unless an operating agreement vests management in one or more managers. The estate contended there was no operating agreement, but the court pointed out that, under Idaho law, an operating agreement is any agreement, written or oral, among all the members as to the conduct of the business and affairs of the LLC. The court concluded that Michael was a member of the LLC, even though he did not provide any capital (i.e., money or assets) to the LLC, because his use of credit to obtain construction loans was sufficient consideration for issuance of an LLC interest under the Idaho LLC statute. Since Purcell did not provide any consideration to the LLC and testified that he had no further involvement after signing the articles of organization, the court concluded that Michael was the sole member of the LLC and that there was an operating agreement if Michael was in agreement regarding the business and affairs of the LLC. The court stated that Michael obviously agreed that he would conduct the business and affairs of the LLC. Thus, there was an operating agreement, and Michael qualified as a manager. After Michael amended the articles of organization to remove Purcell as a manager and add his father, it was unclear whether his father became a member. Assuming his father became a member, the court concluded that Michael and his father agreed that Michael would manage the LLC. Although Michael testified in his deposition that they had no operating agreement, the court accepted Michael's explanation that he thought the question referred to a written operating agreement. The court concluded that the conduct of Michael and his father clearly showed that they had agreed that Michael would conduct the business and affairs of the LLC, and Michael thus qualified as a manager.

*Kasten v. MOA Investments, LLC*, Nos. 2006AP386, 2006AP1405, 2006 AP1510, 2007 WL 677804 (Wis. App. March 7, 2007). A minority member of an LLC brought suit individually and on behalf of the LLC asserting that the corporate member holding the largest interest in the LLC and the corporate member's shareholders breached fiduciary duties and acted unfairly in transferring assets and business opportunities away from the LLC. The court held that the plaintiff member was disqualified from asserting claims on behalf of the LLC because the suit was not authorized by a vote of the members. The court found that the plaintiff member was disqualified from voting because she sought judicial dissolution and thus had an interest in the outcome of the suit that was adverse to the interests of the LLC. The court concluded that the corporate primary injury rule applies to LLCs and that the member's claims alleging diversion of the LLC's assets, inappropriate payments of LLC funds, and diversion of business opportunities were derivative claims that she was not authorized to bring. The plaintiff's individual claims that she was improperly denied voting rights were without merit because the LLC's manager or a supermajority of members controlled the LLC and the plaintiff was not damaged by any lost opportunity to vote. The court stated that a claim for minority oppression is not itself a cause of action but merely a standard for judicial dissolution, and the plaintiff's claim for judicial dissolution was abandoned by repeated assertions in the lower court that the plaintiff did not want to dissolve the LLC. The court upheld amendments to the operating agreement permitting members with a financial interest in the outcome of a pending action to vote to dismiss, requiring members asserting or maintaining a derivative action without approval to indemnify the LLC, and imposing a one year limitation on claims asserted by a member against the LLC or other members. The court found the

consent resolution adopting the amendments was valid because it was adopted by a supermajority of members and it was not unfair for the LLC or its members to take action to preserve its business against a complaint for dissolution, particularly when the plaintiff's derivative claims were not properly authorized.

*In re Lowry (Lowry Food Products, Inc. v. Alto Dairy Cooperative)*, Bankruptcy No. 03-33950 HDH-7, Adversary No. 05-3108, 2007 WL 738144 (Bankr. N.D. Tex. March 7, 2007). The debtor and the defendant formed a Wisconsin LLC under a formation agreement that provided Wisconsin law would govern. Applying Texas choice of law rules and using a "most significant relationship" analysis, the court concluded that Wisconsin law applied to breach of contract and breach of duty claims brought by the trustee against the defendant member. The court rejected the trustee's claim that the defendant materially breached the terms of the LLC agreements with respect to operation and management of the LLC. The court also found that breach of the arbitration clause by seeking judicial relief did not damage the debtor member. Finally, the court rejected the trustee's breach of duty claim. The court stated that the exclusive standard for duties under Wisconsin law is the statutory standard that provides that a member must not willfully fail to deal fairly in matters in which the member has a material conflict of interest. The court found that the trustee failed to present substantial or persuasive evidence of conduct violating the statutory standard. The court stated that Wisconsin law emphasizes freedom of contract in the conduct of LLC affairs and concluded that no action of the defendant undertaken consistent with its contractual rights under the formation or operating agreements constituted a violation of fiduciary duties recognized under the Wisconsin LLC statute.

*Zanker Group, LLC v. Summerville at Litchfield Hills, LLC*, Nos. UWY(X10)CV044010223S, UWY(X10)CV044010567S, 2007 WL 865904 (Conn. Super. March 6, 2007). The court interpreted an operating agreement provision addressing transactions with affiliates and concluded that the transaction in issue was within the scope of the provision. Although the transaction did not receive the required approval of 90% of members, it fell within an exception for arm's length transactions. The court considered breach of fiduciary duty claims in the context of liquidation and stated that the statutory obligation of a manager or member is the same as that under common law. The court concluded that the operating agreement provision requiring 90% approval of transactions with affiliates was inapplicable after dissolution, that the managers were authorized to liquidate the LLCs, and that fair value was paid in a transaction where property interests of the LLCs were transferred to wholly owned entities of one of the members.

*Chase Manhattan Bank v. Iridium Africa Corp.*, 474 F.Supp.2d 613 (D. Del. 2007) (holding that members were precluded from raising defenses in regard to capital contribution obligations because LLC agreement provided obligations were absolute and unconditional and waived members' defenses regarding obligations).

*Santa Monica Properties v. A/R Capital, LLC*, No. B190712, 2007 WL 466828 (Cal. App. 2 Dist. Feb. 14, 2007) (holding operating agreement provision entitling prevailing party in arbitration to attorney's fees applied only to arbitrations and thus did not apply to action brought in court).

*Smith v. Davis Surgical Center, LLC*, 472 F.Supp.2d 1316 (D. Utah 2007) (interpreting "provided, however, that, except" clause of buy-sell provision of operating agreement).

*In re Green Power Kenansville, LLC*, No. 04-08384-8-JRL, 2004 WL 5413067 (Bankr. E.D. N.C. Nov. 18, 2004). (Although this opinion was issued more than three years ago, it has just recently appeared on Westlaw.) The sole member of an LLC assigned its interest to another entity, and the LLC's new owner caused the LLC to file a Chapter 7 bankruptcy. The LLC's lender argued the bankruptcy filing violated provisions of the LLC's loan documents and its operating agreement and was unauthorized and invalid. The court reviewed provisions of the loan documents and operating agreement pertaining to the issue and determined that the assignment of the sole member's interest was invalid because a pledge agreement of the sole member prohibited any change of control of the LLC and provided that the member's voting rights would become vested in the lender upon an event of default. The sole member's president conceded in testimony that he lacked authority to make the challenged assignment. The operating agreement provided for an independent manager whose written approval was required for any bankruptcy-type filing of the LLC. The independent manager could not be removed without amending the operating agreement, and an amendment required approval of all members and all material creditors of the LLC. The court noted that the North Carolina LLC statute permits the authority of a manager to be delegated to persons other than managers if and to the extent the operating

agreement provides, and the court concluded the statute authorized the provision of the operating agreement “displacing” the manager with the independent manager as the sole person who can make decisions in a certain area. The court also concluded that the new owner was bound by the operating agreement when the interest was transferred, whether the new owner knew of the agreement or not, because the North Carolina LLC statute provides that a member is bound by any operating agreement which was in effect at the time the member became a member if the agreement was in writing or its terms were known to the member. Since the provisions of the written operating agreement regarding a bankruptcy filing were not followed, the bankruptcy filing was without authorization and the court dismissed the filing *nunc pro tunc*.

*First American Real Estate Information Services, Inc. v. Consumer Benefit Services, Inc.*, No. 03CV0633 BNLs, 2004 WL 5203206 (S.D. Cal. April 23, 2004). The court concluded that members of an LLC have fiduciary duties under California law regardless of whether they choose to turn control of the LLC over to managers, and the court found that the provisions of an LLC operating agreement limiting fiduciary duties of the LLC’s managers did not change the fiduciary duties that the members may have owed the LLC. The operating agreement provided that the parties waived the fiduciary duty owed by managers to the LLC as long as the manager acted in the best interest of the member it represented. The court stated that the parties, who were “sophisticated players in the market place,” could have limited the fiduciary duties owed as members, but chose not to do so. The court thus rejected the defendant member’s claim that the provision of the operating agreement addressing the duty of the managers waived the duty owed to the LLC as a member.

#### **W. Transfer of Interest/Buy-Out of Member**

*HLHZ Investments, LLC v. Plaid Pantries, Inc.*, Civil No. 06-797-KI, 2007 WL 3129985 (D. Or. Oct. 23, 2007), as modified by 2007 WL 4180659 (D. Or. Nov. 21, 2007) (strictly construing right of first refusal provision in LLC operating agreement and finding that transfer of portion of member’s economic interest to member’s employees as bonus was not subject to right of first refusal provision because provision was not triggered unless there was bona fide written offer from person who wished to buy interest; in order to provide broader protection, provision should have been drafted to prevent any transfer without notification to other members).

*Cox v. Southern Garrett, L.L.C.*, \_\_\_ S.W.3d \_\_\_, 2007 WL 2963756 (Tex. App. 2007). An LLC member asserted various claims against the LLC and his co-members in connection with the withdrawal and buyout of the member. The member cashed a check tendered by the LLC for his interest but did not sign a letter accompanying the check. The letter contained a release of liability and stated that the member’s signed acceptance of the terms constituted the member’s agreement that his ownership was relinquished. The member argued that the buyout of his interest did not become effective and that he was still entitled to receive membership distributions because the buyout violated transfer restrictions in the LLC membership regulations (i.e., the operating agreement). The transfer restrictions prohibited a member from disposing of all or any portion of his membership interest without complying with specified conditions and stated that any attempted disposition in violation of the agreement was void. The transfer restriction provision referred to the “Person” to whom the membership interest was transferred, and the agreement defined “Person” as having the meaning given the term in the Texas LLC statute. The statute defined the term broadly to include individuals and entities. The court concluded, however, that the transfer restriction only applied to a transfer to a person who was not a member. The court stated that a plain reading of the provision demonstrated that its purpose was to provide rules for disposition of a member’s interest to a non-member. In support of this interpretation, the court pointed to the fact that the phrase “Person to be admitted” was used in various subsections of the transfer restriction provision. The court found that the buyout did not violate the transfer restriction because the transfer did not involve a transfer to a non-member. The court also concluded that the LLC had complied with provisions of the membership regulations governing distributions to a withdrawing member. The court found that the LLC’s offer to purchase the member’s interest substantially complied with the requirement that a withdrawing member receive the fair value of his interest as of the first day of the month following the date of the occurrence giving rise to the member’s withdrawal. The letter stated that the purchase price would be calculated based on the retained earnings of the LLC as of the last day of the month of the member’s withdrawal. Although the member did not sign the letter accompanying the check, the court found that the member accepted the buyout of his interest by signing and depositing the check and completed his withdrawal effective as of the date specified in the letter. The court rejected the member’s claims that the other owners of the LLC breached a fiduciary duty to him in connection with the repurchase of his interest. The member couched his argument in terms of duties owed

in the context of a closely held corporation and argued that the defendants had the burden to establish the fairness of the transaction. The court stated that the member's breach of fiduciary duty claim regarding the voiding of his interest depended upon his argument that the transfer restrictions applied to the purchase of his interest, and the claim thus failed as a matter of law. The court stated that another breach of fiduciary duty claim based on alleged fraudulent transfers of ownership in the LLC related to transactions that occurred after the member's withdrawal and that the LLC owed him none of the duties owed members after that date.

***DeNike v. Cupo***, 926 A.2d 869 (N.J. Super. A.D. 2007). The court addressed numerous issues, including the proper valuation date and the meaning of "fair value," in connection with an action for the dissociation and buy out of an LLC member. The court of appeals agreed with Cupo that the trial court erred in specifying a date other than the date on which the court deemed Cupo dissociated as the valuation date. The court examined the provisions of the LLC statute regarding dissociation and noted that the New Jersey LLC statute does not specify how a valuation date is determined for purposes of purchasing a dissociated member's interest other than in the case of a member's resignation. The court concluded, however, that the legislature intended for a dissociated member's interest to be valued in the same manner as that specified for a resigning member. The New Jersey statute specifies that a resigning member is entitled to the fair value of his or her interest as of the date of resignation and does not give the court discretion to determine another valuation date. The court of appeals distinguished the terms "fair market value" and "fair value" and concluded that the trial court's expert applied the proper valuation standard in recognizing that Cupo's interest was not readily marketable and would not give a third party a controlling interest. The court stated that the traditional "fair market value" test (which assumes a willing buyer and willing seller) did not apply because Cupo's interest had little value to outsiders but significant intrinsic value to DeNike, who wanted to continue the business. The court of appeals concluded that the trial court did not abuse its discretion in relying on the expert's calculations and conclusions regarding value. The court of appeals also gave deference to the trial court's action in equalizing the members' capital accounts based on an alleged agreement to "true up" their contributions to the business. Further, the court of appeals concluded that the trial court acted within its discretion in implicitly finding that there was no manifest injustice in denying prejudgment interest. Finally, the court of appeals rejected Cupo's argument that the trial court erred in failing to enter the final judgment against DeNike and in permitting the judgment to be paid over time. The trial court's rationale was that the operating agreement manifested an intent to allow the LLC to continue as a viable enterprise, and the trial court believed the buy out obligation was that of the LLC and not the remaining member even though he became the only member of the LLC. The court of appeals pointed out that the complaint was filed by DeNike individually and on behalf of the LLC, and that the operating agreement provided that a distribution, payable in a lump sum or by a five-year installment promissory note, was to be made when a member's interest was terminated. The court of appeals concluded that the trial court's order thus enforced the parties' agreement.

***Mixon v. Iberia Surgical, L.L.C.***, 956 So.2d 76 (La. App. 2007) (concluding expelled member was compensated for his LLC interest in accordance with operating agreement where expelled member received book value based on terms of operating agreement providing for computation of "Fair Market Value" purchase price using "Book Value" method).

***Trebilcock v. Elinsky***, No. 1:05 CV 2428, 2007 WL 1567710 (N.D. Ohio May 25, 2007) (rejecting member's claim that he was owed "market value" for his interest in LLC where member contracted to sell his interest for specific purchase price, and commenting that member would not be permitted to do end-run around agreement to sell interest for particular sum under guise of breach of fiduciary duty claim).

***Meyercord v. Curry***, 832 N.Y.S.2d 29 (N.Y. A.D. 1 Dept. 2007) (holding employee could not show detrimental reliance in connection with alleged fraudulent inducement to sign agreement to sell interest in LLC where he had previously signed and was bound by operating agreement requiring him to sell his interest upon termination of employment).

***Smith v. Davis Surgical Center, LLC***, 472 F.Supp.2d 1316 (D. Utah 2007) (interpreting "provided, however, that, except" clause of buy-sell provision of operating agreement).

## **X. Capital Contributions and Contribution Obligations**

*Flores v. Murray*, 2007 WL 3034512 (N.J. Super. A.D. Oct. 19, 2007) (concluding that defendant member breached agreement to make required contribution and forfeited his membership interest in accordance with terms of agreement, and equitable intervention to set aside forfeiture of member's interest was not warranted given member's material breach of fiduciary duty by making hidden payments to son and using LLC funds to pay personal debt).

*Lynes v. Helm*, 168 P.3d 651 (Mont. 2007) (holding that funds supplied by members to pay bands so that concert arranged by LLC could take place were loans by members rather than capital contributions).

*Egle v. Egle*, 963 So.2d 454 (La. App. 2007) (holding LLC membership interests were validly issued although subscription agreements recited that purchase price was paid in cash by members where members instead executed promissory notes in favor of party who ultimately furnished funds for all members' capital contributions and promissory notes were ultimately satisfied when LLC was sold).

*Chase Manhattan Bank v. Iridium Africa Corp.*, 474 F.Supp.2d 613 (D. Del. 2007) (holding that members were precluded from raising defenses in regard to capital contribution obligations because LLC agreement provided obligations were absolute and unconditional and waived members' defenses regarding obligations).

*Brownstone Investment Group, LLC v. Levey*, 468 F.Supp.2d 654 (S.D. N.Y. 2007) (declining to dismiss declaratory judgment claim seeking declaration that plaintiff owned software if plaintiff was not member who contributed software to LLC).

## **Y. Compensation of Member**

*Gottier's Furniture, LLC v. La Pointe*, No. CV040084606S, 2007 WL 1600021 (Conn. Super. May 16, 2007) (concluding increases in managing member's compensation and that of member's spouse were reasonable under circumstances where they assumed additional duties and restored financial stability to LLC after other member's misappropriation of funds).

## **Z. Series LLC**

*GxG Management LLC v. Young Brothers and Co., Inc.*, Civil No. 05-162-B-K, 2007 WL 551761 (D. Me. Feb. 21, 2007), supplemented, 2007 WL 1702872 (D. Me. June 11, 2007) (holding LLC had standing to bring breach of contract and related claims as real party in interest even though series held nominal ownership of boat that was subject of contract, noting that Delaware statute does not address standing of LLC to pursue litigation on behalf of its series or standing of series to pursue litigation in its own behalf, and commenting that LLC and its series are not separate entities; clarifying in order on motion to amend verdict that reference to series as entity in original opinion was not finding that series was entity, and LLC itself was appropriate party to pursue tort and contract claims related to workmanship on vessel held by series).

## **AA. Improper Distributions**

*Rudney v. International Offshore Services, LLC*, Civil Action No. 07-3908, 2007 WL 2900230 (E.D. La. Oct. 1, 2007). An LLC member sued for a TRO or preliminary injunction, pending arbitration, against the LLC's expulsion and buyout of the member and the LLC's obtaining a loan to fund disproportionate distributions to the majority member. The other members had signed a consent to obtain the loan for the disproportionate distributions and had voted to expel the member after previously amending the operating agreement to add a provision providing for termination of a member upon the vote of 75% in interest of the members and specifying a method of valuing a terminated member's interest. The court noted provisions of the Louisiana LLC statute protecting members and managers from liability unless they act in a grossly negligent manner, providing for distributions to be allocated in accordance with a written operating agreement, providing that incurrence of indebtedness other than in the ordinary course of business requires the vote of a majority of the members, and providing that amendment of the operating agreement requires the vote of a majority of



the members. The court concluded that the member was not likely to prevail on the argument that the LLC could not take out a loan since the operating agreement in this case specifically provided that management had the power to incur indebtedness, and there was no evidence that the loan itself would be a breach of duty. The plaintiff, however, was substantially likely to prevail on the merits of his claim challenging disproportionate distributions because the operating agreement provided for proportionate distributions. In the event of a disproportionate distribution, the court ordered that the LLC must set aside ten percent to protect the plaintiff's interest. The court stated that the LLC was free to make proportionate distributions and otherwise carry on its affairs; it was merely enjoined from making distributions prohibited by the agreement. The court stated that it did not find that distributing funds that would act as debits to capital accounts may not be deemed necessary pursuant to the good faith business judgment of the managers.

*In the Matter of the Succession of Templet*, \_\_\_ So.2d \_\_\_, 2007 WL 3246600 (La. App. 2007) (concluding that, for purposes of distribution of decedent member's estate, LLC distribution was cash dividend rather than liquidation dividend, notwithstanding that distribution resulted from sale of substantial asset of LLC (1,300 acres of property used to grow sugarcane), because payment was not in liquidation of member's interest nor was LLC being liquidated in whole or in part since part of sales proceeds were used to purchase more income producing property).

*Lynes v. Helm*, 168 P.3d 651 (Mont. 2007). Lynes and others formed a Montana LLC, and Lynes pledged personal assets to secure a bank loan to the LLC. When ticket sales for a concert arranged by the LLC were poor and the LLC was faced with the possibility of having to cancel the concert, some of the members of the LLC supplied funds to pay the bands so that the concert could take place. The income from the concert was not enough to pay all of the costs of the concert, and additional investments were solicited from the members. After receiving the additional investments, the LLC was able to reimburse the members who advanced funds to pay the bands, as well as pay local creditors and repay part of the bank loan, but the balance of the bank loan was not paid, and Lynes ultimately paid the loan personally. Lynes and the LLC sued the members who advanced the funds to pay the bands, alleging that the LLC's repayment of the funds advanced by the members was an unlawful distribution of capital contributions that left the LLC unable to pay its debts. Lynes relied upon the Montana Limited Liability Company Act, which prohibits a distribution (i.e., a transfer of money, property, or other benefit to a member in the member's capacity as a member) if the distribution renders the LLC unable to pay its debts, and imposes liability to the LLC on a member or manager who assents to a distribution in violation of the statute. The court agreed with the members that the funds supplied by the members were loans and that the repayment was not contrary to law. The court relied upon provisions of the Montana LLC statute that require an LLC to reimburse and indemnify a member or manager for payments made or liabilities incurred in the ordinary course of business of the LLC or for the preservation of its business or properties. The court characterized the payments as occurring in the ordinary course of business for the benefit of the LLC and to preserve its business.

*Kranz v. Koenig*, 484 F.Supp.2d 997 (D. Minn. 2007) (holding that LLC's judgment creditors lacked standing to assert illegal distribution claims under Minnesota LLC Act, which provides that member who receives distribution in violation of statute is liable "to the limited liability company, its receiver or other person winding up its affairs").

*Hofmesiter Family Trust v. FGH Industries, LLC*, No. 06-CV-13984-DT, 2007 WL 1106144 (E.D. Mich. April 12, 2007) (concluding minority members of LLC holding company stated claim for oppression based on allegations that majority members caused corporate subsidiary to cease making distributions to plaintiffs under purchase agreement and failed to cause LLC to make distributions to plaintiffs).

*Aryian v. Marottoli*, No. CV065001934S, 2007 WL 1196461 (Conn. Super. April 10, 2007) (denying motion to strike allegations against LLC, its managing member, and accountant complaining of LLC's failure to distribute to plaintiff amounts to which plaintiff was allegedly entitled under operating agreement or LLC statute).

#### **BB. Withdrawal, Expulsion, or Termination of Member**

*Cox v. Southern Garrett, L.L.C.*, \_\_\_ S.W.3d \_\_\_, 2007 WL 2963756 (Tex. App. 2007). An LLC member asserted various claims against the LLC and his co-members in connection with the withdrawal and buyout of the member. The member argued that the buyout of his interest did not become effective and that he was still entitled to receive membership distributions because the buyout violated transfer restrictions in the LLC membership regulations

(i.e., the operating agreement). The court concluded, however, that the transfer restriction only applied to a transfer to a person who was not a member. The court also concluded that the LLC had complied with provisions of the membership regulations governing distributions to a withdrawing member. The court found that the LLC's offer to purchase the member's interest substantially complied with the requirement that a withdrawing member receive the fair value of his interest as of the first day of the month following the date of the occurrence giving rise to the member's withdrawal. The court rejected the member's claims that the other owners of the LLC breached a fiduciary duty to him in connection with the repurchase of his interest. The member couched his argument in terms of duties owed in the context of a closely held corporation and argued that the defendants had the burden to establish the fairness of the transaction. The court stated that the member's breach of fiduciary duty claim regarding the voiding of his interest depended upon his argument that the transfer restrictions applied to the purchase of his interest, and the claim thus failed as a matter of law. The court stated that another breach of fiduciary duty claim based on alleged fraudulent transfers of ownership in the LLC related to transactions that occurred after the member's withdrawal and that the LLC owed him none of the duties owed members after that date.

*Flores v. Murray*, 2007 WL 3034512 (N.J. Super. A.D. Oct. 19, 2007) (concluding that evidence supported finding that member breached fiduciary duty in connection with hidden payments to son and use of LLC funds to pay personal debt, and stating that judicial expulsion of defendant member was warranted based on breaches of fiduciary duty, which were material and detrimental to LLC).

*Rudney v. International Offshore Services, LLC*, Civil Action No. 07-3908, 2007 WL 2900230 (E.D. La. Oct. 1, 2007). An LLC member sued for a TRO or preliminary injunction, pending arbitration, against the LLC's expulsion and buyout of the member and the LLC's obtaining a loan to fund disproportionate distributions to the majority member. The other members had signed a consent to obtain the loan for the disproportionate distributions and had voted to expel the member after previously amending the operating agreement to add a provision providing for termination of a member upon the vote of 75% in interest of the members and specifying a method of valuing a terminated member's interest. The court noted provisions of the Louisiana LLC statute protecting members and managers from liability unless they act in a grossly negligent manner, providing for distributions to be allocated in accordance with a written operating agreement, providing that incurrence of indebtedness other than in the ordinary course of business requires the vote of a majority of the members, and providing that amendment of the operating agreement requires the vote of a majority of the members. The Louisiana statute is silent, however, on terminations or expulsions of members. The court concluded that the member was not likely to prevail on the argument that the LLC could not take out a loan since the operating agreement in this case specifically provided that management had the power to incur indebtedness, and there was no evidence that the loan itself would be a breach of duty. The plaintiff, however, was substantially likely to prevail on the merits of his claim challenging disproportionate distributions because the operating agreement provided for proportionate distributions. With respect to the plaintiff's argument that Louisiana law does not permit expulsions or terminations of members, the court acknowledged that Louisiana law does not address expulsions or terminations, but noted that courts have upheld expulsion or termination clauses in operating agreements. In this case, an amendment to the operating agreement was passed in accordance with the agreement and Louisiana law. Though members are limited by their obligation to discharge their fiduciary duties in good faith, the plaintiff did not meet his burden of demonstrating that he was substantially likely to succeed on this breach of duty claim. Additionally, the member did not meet his burden of showing that the other members breached their fiduciary duty by undervaluing his interest.

*Anderson v. Wilder*, No. E2006-2647-COA-R3-CV, 2007 WL 2700068 (Tenn. Ct. App. Sept. 17, 2007). The plaintiffs were expelled as members of an LLC and bought out at \$150 per unit, and the defendants shortly thereafter sold the units to a third party for \$250 per unit. The plaintiffs sued alleging, *inter alia*, breach of fiduciary duty and breach of the duty of good faith. The plaintiffs prevailed at trial, and the defendants appealed. The court stated that the defendants' arguments primarily rested on their belief that a prior opinion of the court of appeals in this case was incorrect in determining that the majority member of an LLC owes a fiduciary obligation to a minority member and that each LLC member is obligated to discharge his or her duty in good faith. The court reviewed the testimony of various members regarding differences in opinion that developed between the majority and minority as to whether cash should be distributed and how to handle various offers for the sale of the company or interests in the company. The evidence also included testimony from an attorney who reviewed the operating agreement and advised the majority that they could expel the minority members under the terms of the operating agreement which provided that a member could be expelled

by a majority vote of the members. The court found that the evidence supported the jury's verdict in favor of the plaintiffs against the defendants who voted their interests to expel the plaintiffs. The court stated that the trial court did not err in refusing to submit the following instruction requested by the defendants: "If you find that the understanding of the parties to the Operating Agreement was that the members who hold a majority of the units could expel any other member, or members, with or without cause, then you must find in favor of the Defendants." The defendants argued that this instruction tracked the Tennessee statute on modification of standards of conduct in the operating agreement (which states that the operating agreement may define the standard of conduct in a manner to reflect the understanding of the parties provided such definition is not manifestly unreasonable). The court stated that the instruction did not track the statute and was an attempt to circumvent its prior holding regarding fiduciary duties and good faith.

*DeNike v. Cupo*, 926 A.2d 869 (N.J. Super. A.D. 2007). The court addressed numerous issues, including the proper valuation date and the meaning of "fair value," in connection with an action for the dissociation and buy out of an LLC member. Relations between the two members of a New Jersey LLC became strained, and they decided to go their separate ways but could not agree on the terms of a buy out. The members, DeNike and Cupo, mediated their dispute but did not reach an agreement. After the mediation failed, DeNike filed a complaint seeking to terminate Cupo's membership and to acquire his interest. After the trial court entered an order deeming Cupo dissociated and entitled to compensation for his interest, Cupo filed a counterclaim for the fair value of his interest, an accounting, and repayment of certain amounts paid to DeNike. The trial court granted a motion by DeNike to establish the valuation date for Cupo's interest as December 31, 2002, which was the date the parties had adopted as a valuation date in the unsuccessful mediation. Cupo argued that the valuation date should be seven months later on the date the court deemed him dissociated from the LLC. The trial court heard evidence from the members, the LLC's accountant, and valuation experts of each of the members, and the court issued an initial decision. In the initial decision, the trial judge made findings with respect to a number of issues but concluded that the opinions of both parties' experts were flawed. The trial court appointed its own expert and accepted that expert's calculations and opinions. The trial court agreed with the court-appointed expert that Cupo's interest should not be modified by a marketability or minority discount. The court of appeals first addressed a challenge to the judgment based on the trial judge's acceptance of an offer from the law firm representing the plaintiff prior to entry of the final judgment in the case. The court of appeals held that there was no appearance of impropriety because the judge negotiated his post-retirement employment with the law firm after he had rendered all substantive decisions in the case. The court of appeals then addressed a number of specific challenges to the judgment by Cupo. The court of appeals agreed with Cupo that the trial court erred in specifying December 31, 2002 as the valuation date rather than the later date on which the court deemed Cupo dissociated. The court pointed out the distinction between the language used in the oppressed shareholder statute (which permits a court-ordered sale of a shareholder's stock as valued at the date of commencement of the action or such earlier or later date deemed equitable by the court) and the New Jersey LLC statute. The court examined the provisions of the LLC statute regarding dissociation and noted that the New Jersey LLC statute does not specify how a valuation date is determined for purposes of purchasing a dissociated member's interest other than in the case of a member's resignation. The court concluded, however, that the legislature intended for a dissociated member's interest to be valued in the same manner as that specified for a resigning member. The New Jersey statute specifies that a resigning member is entitled to the fair value of his or her interest as of the date of resignation and does not give the court discretion to determine another valuation date. Thus, the court of appeals concluded that the trial court erred in using the date established by the parties for purposes of the failed mediation rather than the date on which the trial court deemed Cupo dissociated. The court of appeals next addressed Cupo's argument that the trial court erred in determining the fair value of his interest. The court applied an abuse of discretion test to the trial court's acceptance of the expert's methodology and opinion as to valuation but noted that the question of standards of value was subject to de novo review. The court of appeals distinguished the terms "fair market value" and "fair value" and concluded that the trial court's expert applied the proper valuation standard in recognizing that Cupo's interest was not readily marketable and would not give a third party a controlling interest. The court stated that the traditional "fair market value" test (which assumes a willing buyer and willing seller) did not apply because Cupo's interest had little value to outsiders but significant intrinsic value to DeNike, who wanted to continue the business. The court of appeals concluded that the trial court did not abuse its discretion in relying on the expert's calculations and conclusions regarding value. The court of appeals also gave deference to the trial court's action in equalizing the members' capital accounts based on an alleged agreement to "true up" their contributions to the business. The court reviewed the testimony on this disputed matter and concluded that there was credible evidence to support the trial court's decision. Further, the court of appeals concluded that the trial court acted within its discretion

in implicitly finding that there was no manifest injustice in denying prejudgment interest. Finally, the court of appeals rejected Cupo's argument that the trial court erred in failing to enter the final judgment against DeNike and in permitting the judgment to be paid over time. The trial court's rationale was that the operating agreement manifested an intent to allow the LLC to continue as a viable enterprise, and the trial court believed the buy out obligation was that of the LLC and not the remaining member even though he became the only member of the LLC. The court of appeals pointed out that the complaint was filed by DeNike individually and on behalf of the LLC, and that the operating agreement provided that a distribution, payable in a lump sum or by a five-year installment promissory note, was to be made when a member's interest was terminated. The court of appeals concluded that the trial court's order thus enforced the parties' agreement.

***Mixon v. Iberia Surgical, L.L.C.***, 956 So.2d 76 (La. App. 2007) . The court concluded that an LLC's actions in expelling a member as permitted by the terms of its operating agreement did not constitute a "deceptive" trade practice under the Louisiana Unfair Trade Practices and Consumer Protection Law, and the member was not a "consumer or competitor" within the meaning of the statute. The LLC's alleged practice regarding referral of Medicaid patients did not violate Louisiana Medical Assistance Programs Integrity Law, and the expelled member thus was not protected by the statute's whistleblower provision. Furthermore, the expulsion was not actionable under the "abuse of rights" doctrine. No evidence suggested that expulsion of the member pursuant to the operating agreement (which permitted expulsion without cause by a unanimous vote of the remaining members) after disagreements and animosity arose between the expelled member and the remaining members was done to cause harm or for any reason other than legitimate business purpose, and the member's expulsion did not violate moral rules, good faith, or elementary fairness. The member was compensated for his LLC interest in accordance with the terms of the operating agreement because he received book value based on the terms of the operating agreement, which provided for computation of a "Fair Market Value" purchase price using a "Book Value" method.

***In re Modanlo***, Nos. 05-26549-NVA, 06-10158-NVA, 2007 WL 2609470 (Bankr. D. Md. May 19, 2007). The court determined that a debtor's single member Delaware LLC, which dissolved upon the debtor's bankruptcy, was resuscitated by the actions of the debtor's trustee (acting as the debtor's personal representative) and that the trustee possessed management rights in the LLC in addition to the debtor's economic interest. Based on this determination, the court granted the trustee's request for leave to cause the LLC to call a meeting of shareholders in a corporation in which the LLC was the controlling shareholder. The debtor argued that the trustee acquired only economic rights in the LLC (and no rights to control and make decisions for the LLC) because, under Sections 18-304 and 18-801 of the Delaware Limited Liability Company Act, the debtor ceased to be a member and the LLC dissolved upon the filing of the member's bankruptcy. The court, however, agreed with the trustee's argument that he had revoked the dissolution, as provided under Section 18-806 of the Delaware LLC statute, by taking action that amounted to a written consent to continuation of the LLC, admission of the trustee as a member, and appointment of himself as manager. The debtor argued that, even if the actions taken by the trustee were otherwise sufficient to revive the LLC, the statute only permitted the actions to be taken by the "personal representative" of the last remaining member. The Delaware LLC statute defines the term "personal representative" in the context of a natural person as the "executor, administrator, guardian, conservator, or other legal representative" of the person, and the court concluded that the term includes a bankruptcy trustee. The court distinguished Delaware case law holding that an LLC member's management or governance rights are not assignable because the case law was decided in the context of a multi-member LLC. The court cited with approval and characterized as "persuasive" the opinion of a Colorado bankruptcy court in *In re Albright*. Although the parties themselves did not raise Sections 18-702 and 18-704 of the Delaware LLC statute (requiring the approval of all members other than the assigning member to admit an assignee as a member), the court took the initiative in addressing these provisions and stated that they are inapplicable in the context of a single member LLC since there are no members other than the assigning member. The court again referred to the *Albright* decision as persuasive and concluded that these provisions of the Delaware statute did not preclude the trustee from exercising management rights.

***Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer***, No. 06 CVS 6091, 2007 WL 2570749 (N.C. Super. May 8, 2007). This case arose out of the break up of a law firm LLC, and the plaintiff members brought suit on their own behalf and on behalf of the LLC asserting a claim for additional distributions in connection with the winding up of the LLC and breach of duty and unfair trade practice claims based on the defendants' failure to provide a sufficient accounting and denial of the plaintiffs' right to share in fees from pending contingent fee cases. The defendants sought dismissal of the claims asserted on behalf of the LLC on the basis that the plaintiffs had withdrawn

and lacked standing to bring an action on behalf of the LLC. The defendants claimed that, notwithstanding the plaintiffs' allegation that no written operating agreement was ever executed, references to "withdrawal" in correspondence between the members concerning the breakup of the firm constituted an operating agreement concerning withdrawal and were a judicial admission on the part of the plaintiffs. The court found that nothing in the record indicated that the plaintiff members had withdrawn prior to filing the action or that "withdrawal" was defined, anticipated, or otherwise dealt with in the LLC's articles of organization or a written operating agreement. The court stated that "withdrawal" in the LLC context describes an occurrence specifically allowed for and limited by the North Carolina LLC statute (which provides that a member may withdraw only at the time or upon the happening of events specified in the articles of organization or operating agreement), and that the court could not conclude as a matter of law that the plaintiffs had judicially admitted that they withdrew from the LLC prior to filing the action or that the correspondence constituted an operating agreement pursuant to which the plaintiffs withdrew. The court stated that the issue of whether the correspondence was an operating agreement was at best a question of fact and was not appropriate for determination at this stage of the litigation.

***Darwin Limes, LLC v. Limes***, No. WD-06-049, 2007 WL 1378357 (Ohio App. May 11, 2007). Disputes arose in a family farm organized as an LLC. The LLC was owned by four siblings, Charles, Dale, Donald, and Betty Limes. Donald had traditionally farmed the land on a cash rent basis under an alleged oral lease. The other members decided to terminate any lease arrangement with Donald, and litigation involving claims for receivership, judicial dissolution, and declaratory judgment ensued. Donald won the bid and retained the lease for another year. Donald argued that the LLC was dissolved automatically when both Donald and Dale filed for judicial dissolution and there was no agreement to continue. The court interpreted a provision of the Ohio LLC statute which provides that it is an event of withdrawal of a member if the member "files a petition or answer in any reorganization, ...dissolution, or similar relief proceeding under any law or rule that seeks for himself any of those types of relief." Relying on this provision, which was also included in the dissociation provisions of the operating agreement, Donald argued that Dale ceased to be a member (thus causing dissolution of the LLC) upon Dale's filing of a claim for judicial dissolution of the LLC. The court pointed out, however, that dissociation occurs when a member seeks dissolution for himself or itself. Thus, no member was dissociated when Dale or Donald filed claims for judicial dissolution of the LLC.

***Ptasynski v. CO2 Claims Coalition, LLC***, Civil Action No. 02-WM-00830-WDM-MEH, 2007 WL 1306492 (D. Colo. May 3, 2007) (agreeing with plaintiff that withdrawal merely terminated his management rights and that plaintiff retained his ongoing pro rata financial rights as if he had not withdrawn (as opposed to pro rata interest in LLC's value at time of withdrawal), but holding that plaintiff failed to prove amounts to which plaintiff was entitled).

***Duke v. Graham***, 158 P.3d 540 (Utah 2007). The court concluded that provisions of the Utah Limited Liability Company Act providing for judicial expulsion of members and judicial removal of managers did not strip arbitrators of the authority to remove members and managers. Because the statute also contains provisions authorizing expulsion of members and removal of managers as provided in an operating agreement, the court concluded that expulsion of members and removal of managers may be accomplished through mechanisms described in an LLC's operating agreement, including an agreement to arbitrate. Thus, an arbitration award expelling members of an LLC and removing one of them as a manager in an arbitration proceeding brought pursuant to an arbitration clause in the operating agreement did not exceed the arbitrator's power. The court stated that its conclusion that the legislature did not limit the mechanism for expulsion and removal to a judicial decree is also consistent with the Utah Arbitration Act.

***In re Modanlo (Modanlo v. Mead)***, Civil Action No. DKC 2006-1168, 2006 WL 4486537 (D. Md. Oct. 26, 2006). The sole member of a Delaware LLC filed bankruptcy, and the trustee took several steps in order to take control of the LLC and a corporation owned by the LLC. The steps taken by the trustee in this regard included a "Written Consent of and Agreement Regarding Admission of Personal Representative of Last Remaining Member" under Section 18-806 of the Delaware LLC Act. In that document, the trustee consented to the continuation of the LLC effective as of the date of the occurrence of an event described in Section 18-801(a)(4) of the Delaware LLC Act (i.e., the bankruptcy of the last remaining member) and, as personal representative of the last remaining member, agreed to the admission of the trustee as a member as of that date. The court agreed with the trustee that the LLC was dissolved upon the bankruptcy of the sole member because, under Section 18-304(1) of the Delaware LLC Act, a person ceases to be a member upon the person's bankruptcy, and, under Section 18-801(a), an LLC is dissolved if it has no remaining

members. Under Section 18-801(a)(4), there is an exception to dissolution upon the termination of the last remaining member if a successor member is appointed within 90 days, but the trustee was not appointed until more than 90 days after the filing of the member's bankruptcy; therefore, this exception was not available to the trustee. The LLC was resuscitated under Section 18-806, however, which permits the personal representative of the last remaining member of an LLC to avoid the dissolution and winding up of an LLC by consenting in writing to the continuation of the LLC and agreeing to become a member of the LLC. The court found that the bankruptcy trustee's consent met these requirements. The court analyzed the definition of a "personal representative" under the Delaware LLC Act and concluded that a bankruptcy trustee falls within the definition. Section 18-101(13) defines a "personal representative" broadly to include "as to a natural person, the executor, administrator, guardian, conservator or other legal representative thereof..." Because the scope of the term "other legal representative" is not clear on its face, the court looked to decisions analyzing the same language in other contexts and examined the policy rationale behind other sections of the Delaware LLC Act. The court concluded that the Delaware Supreme Court would likely hold that a bankruptcy trustee meets the statutory definition of a "personal representative." The court rejected the debtor's argument that the bankruptcy estate held only an economic interest and that the trustee could not become a member or participate in the LLC's management. The court stated that the debtor's argument ignored the effect of Section 18-806, and the court distinguished other Delaware cases in which the bankruptcy of a member occurred in the context of an LLC that had other remaining members.

### **CC. Dissolution and Winding Up**

*Elecor, LLC v. King*, No. CV065006235S, 2007 WL 4578003 (Conn. Super. Dec. 5, 2007). An LLC and one of its members sued the defendants alleging trade secret violations based on misuse by the defendants of the LLC's assets, breach of fiduciary duties by the defendants, and conversion and unfair trade practices based on the defendants' failure to assign patents to the LLC as agreed by the parties. The defendants argued that the LLC lacked standing to pursue the claims because it dissolved after instituting the lawsuit. The court found that the LLC had standing to pursue the lawsuit because the Connecticut LLC statute permits the persons winding up the business and affairs of the LLC to prosecute and defend suits in the name and on behalf of the LLC. The court also cited LLC and corporate case law.

*Roz Trading Ltd. v. Zeromax Group, Inc.*, 517 F.Supp.2d 377 (D. D.C. 2007). The court concluded that it lacked personal jurisdiction over a dissolved Delaware LLC because winding up did not amount to "doing business" or a continuing presence in D.C. The court stated that the Delaware LLC statute did not provide support for plaintiffs' claim that LLCs "maintain life" after dissolution; rather, the statute merely requires dissolving LLCs to set aside funds to pay claims brought against LLCs after dissolution.

*Levine v. O'Dorisio*, No. 266166, 2007 WL 2120548 (Mich. App. July 24, 2007). The court reversed the trial court's determination of distributions and division of assets of a professional LLC upon dissolution because the trial court failed to follow the terms of the operating agreement governing accounting, liquidation, and distribution of property upon dissolution. The PLLC dissolved under the terms of its operating agreement upon the defendant's withdrawal because the operating agreement provided that dissolution occurred when there were less than two remaining members. The court stated that the trial court's reliance on a case involving a buy-sell agreement in a professional corporation was erroneous because the present case did not involve a partner withdrawal or buy-sell agreement, but rather a dissolution governed by the operating agreement. The court pointed out the terms of the operating agreement that controlled and noted that the trial court on remand should not consider the testimony of the defendant's expert regarding the value of the PLLC. The expert valued the PLLC as a going concern, taking into account future earnings and goodwill. The court stated that this type of valuation would be appropriate in a divorce or condemnation, but is not an appropriate way to value a dissolved business.

*Noble v. A & R Environmental Services, LLC*, 164 P.3d 519 (Wash. App. 2007). The trial court's equal division of a Washington LLC's assets between the LLC's two members in a judicial dissolution action was reversed and remanded due to the trial court's failure to make findings from which the court of appeals could determine that the statutory dissolution procedures were followed. The trial court found that the parties intended to be equal members, and the court valued their contributions equally without respect to their actual value. The trial court made no findings regarding the value of any of the assets, nor did it make any findings regarding creditors. The court of appeals reversed and remanded for further findings because it was impossible to determine if the distribution of assets complied with the

dissolution provisions of the Washington LLC statute. The court pointed out that the Washington LLC statute defines an operating agreement as a written agreement; therefore, the statutory default provisions regarding distribution of the assets applied regardless of the subjective intent of the members regarding their ownership interests. Because the statute requires that assets first be distributed to pay the claims of creditors, the trial court erred in making no findings regarding creditors. Further, the court of appeals concluded that the trial court was required to make findings as to who contributed what to the LLC because the statute requires a return of capital contributions prior to distributions in proportion to which members share distributions. Finally, the court of appeals addressed a judgment which one of the members obtained against the other on behalf of the LLC for loss of a business opportunity. The trial court had deemed the judgment satisfied in order to equalize the distribution of the LLC's assets. The court of appeals stated that the judgment was not an asset of the LLC that was subject to distribution and that the trial court could consider whether the member who obtained the judgment became a creditor.

***Chadwick Farms Owners Association v. FHC, LLC***, 160 P.3d 1061 (Wash. App. 2007). This is one of three opinions issued at the same time addressing suits by or against dissolved and cancelled LLCs and the effect of a 2006 amendment to the Washington Limited Liability Company Act providing for a three-year post-dissolution survival period within which a claimant may commence an action against a dissolved LLC. The court in this case held that the 2006 amendment to the LLC statute providing for a three-year post-dissolution survival period was retroactive, and a suit against an administratively cancelled LLC that was filed within that period could proceed. The LLC was administratively dissolved by the Secretary of State in 1999 due to failure to file its annual report and renewal fee. The plaintiff, a homeowners' association, brought suit against the LLC in 2004, alleging the LLC was responsible for numerous construction defects. The LLC was cancelled seven months later because two years had passed since the Secretary of State issued the notice of dissolution. The court analyzed the 2006 amendment providing for the post-dissolution survival period for the commencement of claims and determined the statute had retroactive effect. The court rejected the LLC's argument that the statute did not permit claims against cancelled LLCs. The court concluded the survival provision applies to dissolved LLCs whether or not a certificate of cancellation has been issued. The court did not think the legislature was anything other than "inartful" in choosing the term "dissolution" and noted that construing the statute otherwise would nullify its stated purpose and render the statute useless since a dissolved LLC could sue and be sued as part of the winding up process prior to the amendment. The court also found that the amendment for survival of claims only applies to actions brought *against* an LLC, and the LLC's failure to reinstate was fatal to the pursuit of third party claims it sought to assert against subcontractors. Finally, the court observed that a person winding up an LLC's affairs who does not comply with the statutory requirements for winding up (i.e., does not make provision for known liabilities of the LLC) may be personally liable to the claimants depending upon the particular facts.

***Maple Court Seattle Condominium Association v. Roosevelt, LLC***, 160 P.3d 1068 (Wash. App. 2007). This is one of three opinions issued at the same time addressing suits by or against dissolved and cancelled LLCs and the effect of a 2006 amendment to the Washington Limited Liability Company Act providing for a three-year post-dissolution survival period within which a claimant may commence an action against a dissolved LLC. The court in this case held that an administratively cancelled LLC that had settled condominium owners' claims regarding construction defects ceased to be a legal entity with standing to sue when it was cancelled. The LLC argued that it was still able to wind up its affairs after being cancelled, but the court stated that such a position ignored the plain language of the statute requiring winding up of an administratively dissolved LLC within two years of dissolution. The LLC could have reinstated after the administrative dissolution, but failed to do so and thus lost the ability to pursue its claims against the subcontractors. The court also held that the project manager, against whom the LLC had brought third party claims and which had paid toward the settlement of the condominium owners' claims, essentially made a gratuitous payment since the LLC no longer had the capacity to maintain an action against the project manager after the LLC's cancellation. The project manager could not recover against the subcontractors because the project manager's rights were essentially derivative of the LLC's.

***Emily Lane Homeowners Association v. Colonial Development, L.L.C.***, 160 P.3d 1073 (Wash. App. 2007). This is one of three opinions issued at the same time addressing suits by or against dissolved and cancelled LLCs and the effect of a 2006 amendment to the Washington Limited Liability Company Act providing for a three-year post-dissolution survival period within which a claimant may commence an action against a dissolved LLC. The court in this case held that the amendment providing for a post-dissolution three-year survival period was retroactive and that a suit

against an LLC that had been voluntarily dissolved and cancelled by the members could proceed. The court also stated that the members of a dissolved LLC are not immune from liability if the LLC is not properly wound up in accordance with the statute or if grounds for veil piercing exist.

***Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer***, No. 06 CVS 6091, 2007 WL 2570749 (N.C. Super. May 8, 2007). This case involved the break up of a law firm organized as a professional LLC, and the pivotal issue addressed by the court was whether, upon dissolution of the firm, an unresolved contingent fee case was a firm asset as to which a member attorney had distributive rights even if the attorney performed no work on the case. The court concluded that, upon either withdrawal or dissolution, each member would be entitled to his or her respective share of firm profits and losses from any engagements, including contingent fee cases, regardless of whether the member provided legal services on a particular engagement. The court found no basis to conclude that the rules of ethics would require that a member provide legal services on an engagement in order to share in the distribution of the value of the engagement. The court rejected the defendants' argument that the value of contingent fee cases is so speculative as to be incapable of determination and that such cases thus have no value for purposes of distributions to the plaintiffs, and the court concluded that the potential difficulty in measuring the value of contingent fee cases did not constitute an insurmountable bar to the plaintiffs' claim that they had a right to share in the value of contingent fee cases in the dissolution context.

***Darwin Limes, LLC v. Limes***, No. WD-06-049, 2007 WL 1378357 (Ohio App. May 11, 2007). Disputes arose in a family farm organized as an LLC. The LLC was owned by four siblings, Charles, Dale, Donald, and Betty Limes. Donald had traditionally farmed the land on a cash rent basis under an alleged oral lease. The other members decided to terminate any lease arrangement with Donald, and litigation involving claims for receivership, judicial dissolution, and declaratory judgment ensued. While the litigation was pending, the managing members voted to take bids on a lease of the land from Dale and Donald. Donald won the bid and retained the lease for another year. Donald argued that the LLC was dissolved automatically when both Donald and Dale filed for judicial dissolution and there was no agreement to continue. The court interpreted a provision of the Ohio LLC statute which provides that it is an event of withdrawal of a member if the member "files a petition or answer in any reorganization,...dissolution, or similar relief proceeding under any law or rule that seeks for himself any of those types of relief." Relying on this provision, which was also included in the dissociation provisions of the operating agreement, Donald argued that Dale ceased to be a member (thus causing dissolution of the LLC) upon Dale's filing of a claim for judicial dissolution of the LLC. The court pointed out, however, that dissociation occurs when a member seeks dissolution for himself or itself. Thus, no member was dissociated when Dale or Donald filed claims for judicial dissolution of the LLC. Additionally, the court concluded that, even if it agreed with Donald's interpretation that Dale was dissociated, dissolution did not occur under the dissolution provision of the operating agreement, which listed the types of dissociation that would trigger dissolution but did not include the filing of a dissolution proceeding in the list of dissociation events dissolving the LLC. The court next interpreted the standard for judicial dissolution – that it is not reasonably practicable to carry on the business of the LLC in conformity with its articles of organization and operating agreement – and concluded that judicial dissolution was not appropriate. The court pointed out that the business of the LLC was farming, the operating agreement provided for continuation of the LLC even if Donald dissociated, and the LLC was in fact carrying on its business based on the award of the farming lease under the newly instituted bidding procedure.

***Venezia Resort, LLC v. Favret***, No. 3:07cv74/MCR/EMT, 2007 WL 1364342 (N.D. Fla. May 8, 2007) (staying action involving funds in dispute in dissolution of LLC, in part relying on fact that Mississippi court would have jurisdiction to wind up LLC's affairs and such action would result in piecemeal, duplicative, and wasteful litigation).

***Gottier's Furniture, LLC v. La Pointe***, No. CV040084606S, 2007 WL 1600021 (Conn. Super. May 16, 2007) (declining defendant member's request to appoint receiver to wind up affairs of LLC inasmuch as defendant member had misappropriated LLC funds and had unclean hands, and, alternatively, because dissolution receivership is extraordinary remedy that is not warranted merely based on dissension of members or financial difficulty).

***Drayton Grain Processors v. NE Foods, Inc.***, Civil File No. 3:06-cv-37, 2007 WL 983825 (D. N.D. March 20, 2007) (finding that dissolved LLC's winding up without notification to claimant and "troubling" assertion that it had made reasonable provision for known and anticipated liabilities when it had rebuffed attempts to resolve claim against



it was basis to impose successor liability on corporate sole member that received dissolved LLC's assets in attempt to defraud claimant).

*Union Square Grill Hospitality Group, LLC v. Blue Smoke American Bar & Grill LLC*, No. 3:06-CV-00976 (PCD), 2007 WL 869024 (D. Conn. March 19, 2007). The court discussed the requirement under the Connecticut LLC statute that notice of an LLC's dissolution be given to known claimants, and the court held that the "managing partner" of an LLC that failed to give notice to a creditor was personally liable to the extent of the assets distributed to the managing partner after dissolution. The court also concluded that an LLC that succeeded to the dissolved LLC's business was liable for a judgment against the predecessor LLC under the "continuity" doctrine of successor liability.

*Zanker Group, LLC v. Summerville at Litchfield Hills, LLC*, Nos. UWY(X10)CV044010223S, UWY(X10)CV044010567S, 2007 WL 865904 (Conn. Super. March 6, 2007). The court considered breach of fiduciary duty claims in the context of liquidation and stated that the statutory obligation of a manager or member is the same as that under common law. The court concluded that an operating agreement provision requiring 90% approval of transactions with affiliates was inapplicable after dissolution, that the managers were authorized to liquidate the LLCs, and that fair value was paid in a transaction where property interests of the LLCs were transferred to wholly owned entities of one of the members.

#### **DD. Judicial or Administrative Dissolution**

*Ahern v. Ahern*, 938 A.2d 35 (Me. 2008). The wife in a divorce action argued that the trial court erred in not nullifying an LLC which held real estate used in her husband's dental practice so that the real estate would be treated as marital property. The LLC was formed by the husband, who initially was the sole member, but he later transferred 10% ownership interests to each of his four children. The operating agreement effecting the transfers was signed by the wife four times as custodian for each of the children. Later, the husband transferred an additional 10% to each child, with the wife again acting as custodian. Thus, at the time of the divorce, the children collectively owned 80% of the LLC. The court held that the divorce court did not err in not nullifying the LLC agreement. The court pointed out that the Maine LLC statute provides for judicial dissolution only in specified circumstances and does not recognize the divorce of a party who created the LLC as a basis for dissolution. The court stated that, absent an agreement of the parties and other interested persons, a court is without authority to dissolve or refuse to recognize an LLC except as provided in the judicial dissolution provision of the Maine Limited Liability Company Act. The court noted that a spouse who is not a member of an LLC and cannot bring a dissolution action is not without recourse in a divorce proceeding. If the creation or operation of an LLC constituted economic misconduct, the court could consider that a factor when equitably distributing property and awarding spousal support. This case, however, did not involve an allegation or evidence that the husband committed economic misconduct in forming the LLC or transferring the interests to his children.

*Wachovia Securities, LLC v. Neuhauser*, 528 F.Supp.2d 834 (N.D. Ill. 2007). Wachovia sought to hold an individual personally liable on an account opened by the individual for an Illinois LLC that was dissolved and not had not been reinstated at the time the account was opened. Wachovia argued that the individual could be held liable to the same extent as a director or shareholder of a dissolved corporation under the Illinois corporation statute, but the court pointed out that the provision of the Illinois LLC statute which provided that a member or manager could be held personally liable to the same extent as a director or shareholder of a corporation had been removed. The revised statute also provides that the failure of an LLC to observe usual corporate formalities is not a ground for imposing personal liability on members or managers; thus, the court held that the LLC statute did not provide for liability of a member or manager to a third party for the LLC's debts and the individual could not be held liable even though the LLC was dissolved at the time the account was opened. In addition, the court also pointed out that the individual was not a member or manager of the LLC. The court further relied upon the retroactive nature of the statutory reinstatement provision as precluding Wachovia's claim against the individual.

*In re Olympus Construction, LC (Matthews v. Olympus Construction, LC)*, 173 P.3d 192 (Utah App. 2007) (interpreting judicial dissolution and receivership provisions of Utah LLC statute and concluding that trial court could

extend statutory period for rejecting claims based on great latitude granted to trial court in statutory language governing receiverships and trial court's order explicitly stating that court may expand and modify receiver's powers).

***Formcrete, Co., Inc. v. NuRock Construction, LLC***, No. 4:07cv290, 2007 WL 2746812 (E.D. Tex. Sept. 19, 2007) (holding that plaintiff LLC lacked capacity to sue because its corporate existence had been forfeited under Texas Tax Code which provides that forfeiture results in loss of ability to sue or defend, stating that plaintiff cited no authority for its requested abatement, and denying abatement pending reinstatement).

***Broussard v. Chandler***, No. 2006 CA 1958, 2007 WL 2482494 (La. App. Sept. 5, 2007) (reversing trial court's judgment adopting liquidation plan in judicial dissolution action because plan did not comply with mandatory statutory requirements for winding up in that it did not provide for distribution of assets to members after payment of debts but instead provided that remaining assets would belong to newly formed LLC owned by one of dissolving LLC's members).

***The Follieri Group, LLC v. Follieri/Yucaipa Investments, LLC***, No. Civ.A. 3015-VCL, 2007 WL 2459226 (Del. Ch. Aug. 23, 2007). The court denied a putative creditor's request to intervene in a proceeding to judicially dissolve an LLC. The claimant had filed an action to collect on an alleged debt of the LLC in New Jersey, and the claimant argued it was entitled to intervene because the litigation could adversely affect its ability to collect its debt from the LLC. The court concluded that merely having a claim against an LLC for payment of money does not give a claimant any interest in the LLC or in an action to dissolve the LLC, and there was thus no right to intervene under Rule 24(a). The court pointed out that any judgment entered in the judicial dissolution action would not threaten the claimant with an adverse effect because the winding up and distribution provisions of the Delaware LLC statute protect the interests of creditors. Under these provisions, a dissolved LLC must make reasonable provision to pay any claim which is the subject of a pending action before any distribution to members. The court also found no basis to permit intervention under Rule 24(b) because the claimant's claim for payment against the LLC and the dissolution action (in which the question was whether or not it was reasonably practicable to carry on the business of the LLC in conformity with the LLC agreement) did not have any question of law or fact in common.

***Rimawi v. Atkins***, 840 N.Y.S.2d 217 (N.Y. A.D. 3 Dept. 2007) (holding that plaintiff's cause of action for judicial dissolution and ancillary accounting of Delaware LLC was one over which New York courts lack subject matter jurisdiction).

***Noble v. A & R Environmental Services, LLC***, 164 P.3d 519 (Wash. App. 2007). The trial court's equal division of a Washington LLC's assets between the LLC's two members in a judicial dissolution action was reversed and remanded due to the trial court's failure to make findings from which the court of appeals could determine that the statutory dissolution procedures were followed. The trial court found that the parties intended to be equal members, and the court valued their contributions equally without respect to their actual value. The trial court made no findings regarding the value of any of the assets, nor did it make any findings regarding creditors. The court of appeals reversed and remanded for further findings because it was impossible to determine if the distribution of assets complied with the dissolution provisions of the Washington LLC statute. The court pointed out that the Washington LLC statute defines an operating agreement as a written agreement; therefore, the statutory default provisions regarding distribution of the assets applied regardless of the subjective intent of the members regarding their ownership interests. Because the statute requires that assets first be distributed to pay the claims of creditors, the trial court erred in making no findings regarding creditors. Further, the court of appeals concluded that the trial court was required to make findings as to who contributed what to the LLC because the statute requires a return of capital contributions prior to distributions in proportion to which members share distributions. Finally, the court of appeals addressed a judgment which one of the members obtained against the other on behalf of the LLC for loss of a business opportunity. The trial court had deemed the judgment satisfied in order to equalize the distribution of the LLC's assets. The court of appeals stated that the judgment was not an asset of the LLC that was subject to distribution and that the trial court could consider whether the member who obtained the judgment became a creditor.

***Chadwick Farms Owners Association v. FHC, LLC***, 160 P.3d 1061 (Wash. App. 2007). The court in this case held that a 2006 amendment to the Washington LLC statute providing for a three-year post-dissolution survival period was retroactive, and a suit against an administratively cancelled LLC that was filed within that period could

proceed. The LLC was administratively dissolved by the Secretary of State in 1999 due to failure to file its annual report and renewal fee. The plaintiff, a homeowners' association, brought suit against the LLC in 2004, alleging the LLC was responsible for numerous construction defects. The LLC was cancelled seven months later because two years had passed since the Secretary of State issued the notice of dissolution. The court analyzed the 2006 amendment providing for the post-dissolution survival period for the commencement of claims and determined the statute had retroactive effect. The court rejected the LLC's argument that the statute did not permit claims against cancelled LLCs. The court concluded the survival provision applies to dissolved LLCs whether or not a certificate of cancellation has been issued. The court did not think the legislature was anything other than "inartful" in choosing the term "dissolution" and noted that construing the statute otherwise would nullify its stated purpose and render the statute useless since a dissolved LLC could sue and be sued as part of the winding up process prior to the amendment. The court also found that the amendment for survival of claims only applies to actions brought *against* an LLC, and the LLC's failure to reinstate was fatal to the pursuit of third party claims it sought to assert against subcontractors. Finally, the court observed that a person winding up an LLC's affairs who does not comply with the statutory requirements for winding up (i.e., does not make provision for known liabilities of the LLC) may be personally liable to the claimants depending upon the particular facts.

*Maple Court Seattle Condominium Association v. Roosevelt, LLC*, 160 P.3d 1068 (Wash. App. 2007). The court in this case held that an administratively cancelled LLC that had settled condominium owners' claims regarding construction defects ceased to be a legal entity with standing to sue when it was cancelled. The LLC argued that it was still able to wind up its affairs after being cancelled, but the court stated that such a position ignored the plain language of the statute requiring winding up of an administratively dissolved LLC within two years of dissolution. The LLC could have reinstated after the administrative dissolution, but failed to do so and thus lost the ability to pursue its claims against the subcontractors. The court also held that the project manager, against whom the LLC had brought third party claims and which had paid toward the settlement of the condominium owners' claims, essentially made a gratuitous payment since the LLC no longer had the capacity to maintain an action against the project manager after the LLC's cancellation. The project manager could not recover against the subcontractors because the project manager's rights were essentially derivative of the LLC's.

*Darwin Limes, LLC v. Limes*, No. WD-06-049, 2007 WL 1378357 (Ohio App. May 11, 2007). Disputes arose in a family farm organized as an LLC. The LLC was owned by four siblings, Charles, Dale, Donald, and Betty Limes. Donald had traditionally farmed the land on a cash rent basis under an alleged oral lease. The other members decided to terminate any lease arrangement with Donald, and litigation involving claims for receivership, judicial dissolution, and declaratory judgment ensued. While the litigation was pending, the managing members voted to take bids on a lease of the land from Dale and Donald. The court interpreted the standard for judicial dissolution – that it is not reasonably practicable to carry on the business of the LLC in conformity with its articles of organization and operating agreement – and concluded that judicial dissolution was not appropriate. The court pointed out that the business of the LLC was farming, the operating agreement provided for continuation of the LLC even if Donald dissociated, and the LLC was in fact carrying on its business based on the award of the farming lease under the newly instituted bidding procedure.

*Vieira v. Eiswert*, No. E040984, 2007 WL 891330 (Cal. App. March 26, 2007) (holding that LLC member's breach of contract, fraud, and dissolution claims against co-members did not violate anti-SLAPP statute).

#### **EE. Professional LLCs**

*D'Esposito v. Gusrae, Kaplan & Bruno PLLC*, 844 N.Y.S.2d 214 (N.Y. A.D. 1 Dept. 2007) (affirming lower court's finding that plaintiff was not equity member of PLLC where plaintiff, though he was identified as partner in Martindale-Hubbe and on firm's letterhead and tax return and received distributions of profits, was not responsible for firm's rent or losses, was not signatory to partnership or operating agreement, made no capital investment, had no ownership interest, and had no control; causes of action based on purported promise to make plaintiff full partner/member were barred by statute of frauds because alleged oral agreement called for performance of indefinite duration and was terminable within one year only by breach).

***Multiquest, P.L.L.C. v. Allstate Insurance Company***, 844 N.Y.S.2d 565 (N.Y. Sup. App. Term 2007) (holding that PLLC organized to provide psychological services was not eligible for reimbursement under New York insurance law because it failed to meet requirements of New York LLC statute where psychologist who was listed as member and manager testified she was never owner or member of LLC).

***National Union Fire Insurance Company of Pittsburgh v. Wuerth***, No. C-2-03-0160, 2007 WL 2071911 (S.D. Ohio July 17, 2007) (concluding that “direct claim” for legal malpractice cannot be asserted against non-attorney, and LLC law firm could not be liable for alleged malpractice because lawyers upon whose negligence liability would rest were not sued within statute of limitations).

***Bloodworth v. Aden***, No. 01-05-00796-CV, 2007 WL 1845111 (Tex. App. 2007). An attorney was sanctioned for filing a frivolous pleading, and the attorney argued that the trial court erred in imposing a sanction on him personally rather than his professional LLC. The attorney argued that he signed the pleading on behalf of the LLC and that the Texas LLC statute protected him from personal liability. The court rejected this argument and stated that the attorney could be sanctioned as the “person who signed” the pleading under the provisions of the Texas Rules of Civil Procedure regarding sanctions. The court noted that an attorney may also subject his firm to liability for a sanction in certain circumstances.

***Marlin Broadcasting, LLC v. Law Office of Kent Avery, LLC***, 922 A.2d 1131 (Conn. App. 2007). An LLC law firm failed to pay for radio advertising, and the court determined that the limited record before the court supported a prejudgment remedy against the LLC’s sole member for unjust enrichment based on personal benefits received by the attorney member from the advertising. The attorney’s benefit was not derived solely by virtue of the fact that he was a member of the firm since the radio advertisements featured the member’s voice and referred specifically to the individual member by name.

***Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer***, No. 06 CVS 6091, 2007 WL 2570749 (N.C. Super. May 8, 2007). This case arose out of the break up of a law firm LLC, and the plaintiff members brought suit on their own behalf and on behalf of the LLC asserting a right to additional distributions in connection with the winding up of the LLC and claiming that the defendants’ failure to provide a sufficient accounting and denial of the plaintiffs’ right to share in fees from pending contingent fee cases constituted a breach of duty and unfair trade practice. The defendants sought dismissal of the claims asserted on behalf of the LLC on the basis that the plaintiffs had withdrawn and lacked standing to bring an action on behalf of the LLC. The defendants claimed that, notwithstanding the plaintiffs’ allegation that no written operating agreement was ever executed, references to “withdrawal” in correspondence between the members concerning the breakup of the firm constituted an operating agreement concerning withdrawal and were a judicial admission on the part of the plaintiffs. The court found that nothing in the record indicated that the plaintiff members had withdrawn prior to filing the action or that “withdrawal” was defined, anticipated, or otherwise dealt with in the LLC’s articles of organization or a written operating agreement. The court stated that “withdrawal” in the LLC context describes an occurrence specifically allowed for and limited by the North Carolina LLC statute (which provides that a member may withdraw only at the time or upon the happening of events specified in the articles of organization or operating agreement), and that the court could not conclude as a matter of law that the plaintiffs had judicially admitted that they withdrew from the LLC prior to filing the action or that the correspondence constituted an operating agreement pursuant to which the plaintiffs withdrew. The court stated that the issue of whether the correspondence was an operating agreement was at best a question of fact and was not appropriate for determination at this stage of the litigation. The court also rejected an argument by the defendants that the breach of duty claims were barred by exculpatory provisions in the articles of organization and North Carolina LLC statute because the allegations could support a claim for acts or omissions the defendants knew were in conflict with the LLC’s interests or transactions from which they derived improper personal benefit. The court then addressed what it characterized as the pivotal issue in the case. That issue was whether, upon dissolution of the firm, an unresolved contingent fee case was a firm asset as to which a member attorney had distributive rights even if the attorney performed no work on the case. The court concluded that, upon either withdrawal or dissolution, each member would be entitled to his or her respective share of firm profits and losses from any engagements, including contingent fee cases, regardless of whether the member provided legal services on a particular engagement. The court found no basis to conclude that the rules of ethics would require that a member provide legal services on an engagement in order to share in the

distribution of the value of the engagement. The court rejected the defendants' argument that the value of contingent fee cases is so speculative as to be incapable of determination and that such cases thus have no value for purposes of distributions to the plaintiffs, and the court concluded that the potential difficulty in measuring the value of contingent fee cases did not constitute an insurmountable bar to the plaintiffs' claim that they had a right to share in the value of contingent fee cases in the dissolution context.

*Physicians' Reciprocal Insurers v. Jordan*, 836 N.Y.S.2d 215 (N.Y. A.D. 2 Dept. 2007) (holding that physician was acting as employee of professional LLC of which he was also member when he treated patient in malpractice action and physician thus was not insured as "stockholder" under LLC's excess professional liability policy).

*Babb v. Bynum & Murphrey, PLLC*, 643 S.E.2d 55 (N.C. App. April 17, 2007). The plaintiffs sued Bynum and Murphrey, two members of a law firm LLC, alleging that Bynum engaged in numerous acts of fiduciary fraud in connection with the handling of a trust. The plaintiffs alleged claims against Murphrey for negligence, negligent supervision, and breach of fiduciary duty. The plaintiff argued that Murphrey had a duty to them under the North Carolina Limited Liability Act and the firm's operating agreement. First, the court cited the statutory provision protecting a member from liability for the obligation of the LLC but providing that a member may become liable for the member's own acts or conduct. Though the plaintiffs claimed that they were seeking to hold Murphrey liable for his own acts and omissions, the court concluded that the plaintiffs failed to allege any direct acts by Murphrey and were relying on Murphrey's failure to act. The court concluded that the LLC statute did not impose a duty on Murphrey to investigate Bynum if Murphrey did not have any actual knowledge, which the record established Murphrey did not have. The court also rejected the plaintiffs' claim that the operating agreement created a duty on the part of Murphrey. Although the operating agreement stated that a member shall be liable for his own professional negligence and that a member must comply with the rules of professional conduct, the court concluded that the plaintiffs were not third party beneficiaries of the agreement. The court said that the intent of the parties was to benefit the law firm and its members, not to directly benefit the plaintiffs. Thus, the plaintiffs were at most incidental beneficiaries and not third party beneficiaries with standing to sue.

#### **FF. Foreign LLC - Failure to Qualify to Do Business**

*Columbus Steel Castings Company v. Transportation & Transit Associates, LLC*, No. 06AP-1247, 2007 WL 4340558 (Ohio App. Dec. 13, 2007) (analyzing provisions prohibiting foreign LLC from maintaining action until it has registered and concluding that rules of civil procedure controlled over inconsistent provisions of statute such that LLC could assert compulsory counterclaim and LLC was permitted to raise affirmative defense of equitable recoupment because statute permits LLC to defend actions in state court).

*Fahs Rolston Paving Corp. v. Pennington Properties Development Corp., Inc.*, No. 03-4593(MLC), 2007 WL 2362606 (D. N.J. Aug. 14, 2007) (holding that foreign LLC that is not registered to transact business in New Jersey may avoid dismissal of its claims by registering during course of proceeding).

*Kattula v. Stout*, No. 5:06CV-181-M, 2007 WL 2155690 (W.D. Ky. July 25, 2007). The court concluded that a foreign LLC whose certificate of authority had been revoked had authority to maintain the action upon complying with the statute by obtaining a new certificate of authority. The court stated that a foreign LLC whose certificate of authority has been revoked does not have to reinstate the certificate, and the certificate obtained need not have the same organization number as that on the original certificate of authority. Further, there is no requirement that a foreign LLC actually have a certificate of authority when it commences suit, the only requirement being that it obtain a certificate of authority in order to maintain the action.

*Ferron v. Search Cactus, L.L.C.*, No. 2:06-cv-327, 2007 WL 1792331 (S.D. Ohio June 19, 2007) (declining to dismiss claim brought by foreign LLC that was not registered to transact business in Ohio when suit was brought but later corrected mistake by complying with registration requirement).

*AMP Management, LLC v. Scottsdale Insurance Company*, No. 06-4079-SAC, 2007 WL 677633 (D. Kan. Feb. 28, 2007) (citing foreign corporation provisions and holding foreign LLC lacked standing to sue based on failure to qualify to do business in Kansas).

*Ferron v. VC E-Commerce Solutions, Inc.*, No. 2:06-CV-322, 2007 WL 295455 (S.D. Ohio Jan. 29, 2007) (holding foreign LLC's failure to qualify to transact business was not deceptive trade practice under Ohio Consumer Sales Practices Act).

#### **GG. Foreign LLCs - Constitutionality of Fee or Tax**

*Northwest Energetic Services, LLC v. California Franchise Tax Board*, 71 Cal.Rptr.3d 642 (Cal. App. 1<sup>st</sup> Dist. 2008). A foreign LLC that conducted no business in California but nevertheless registered to do business in California challenged the levy imposed on it under section 17942 of the Revenue and Taxation Code. The trial court held that the LLC was entitled to a refund of the amounts paid under the provision because the levy was unconstitutional. The trial court also awarded the LLC attorney's fees in an amount several times greater than the lodestar. The court of appeals affirmed the trial court's judgment granting a refund, but reversed the award of attorney's fees and remanded for further consideration consistent with the court's opinion. The court held that the levy imposed under the pre-2007 version of section 17942 violated the Commerce Clause as applied to the LLC, and the court thus did not reach the question of whether the statute is unconstitutional on its face or whether it violates the Due Process Clause. The levy violated the Commerce Clause because it was imposed on the LLC's statutorily defined "total income," wherever earned, without apportionment. The court held that the levy more closely resembles a tax than a regulatory fee and that it was not fairly apportioned under the internal and external consistency requirements. The court also held that the levy, even if treated as a fee, would not pass muster under the *Pike* balancing test. Finally, the court rejected the argument that the LLC could not bring a Commerce Clause challenge when it had voluntarily registered as a foreign LLC and did not elect to be taxed as a corporation, which would have subjected it to a taxation scheme with apportionment. In affirming the refund of all amounts paid under section 17492, the court noted that, as a general matter, only the portion of the levy that exceeds Commerce Clause limits must be refunded, but the LLC was entitled to a refund of the entire amount it paid under section 17492 because none of its income was derived from California sources.

#### **HH. Foreign LLC – Governing Law**

*Marsala v. Mayo*, Civil Action No. 06-3846, 2007 WL 3245434 (E.D. La. Nov. 2, 2007). An LLC member sued his two co-members alleging breach of fiduciary duty and fraud claims. The LLC was a Delaware LLC and its operating agreement contained a Georgia choice of law clause. Applying Louisiana choice of law rules (under which tort claims such as fraud and breach of fiduciary duty are governed by the law of the state whose policies would be most seriously impaired if its law were not applied), the court agreed with the parties that Georgia law applied to the dispute. The court then concluded that the Georgia internal affairs choice of law provision of the Georgia LLC statute required application of Delaware law to the breach of fiduciary claims. Disputed issues of material fact precluded summary judgment on the breach of fiduciary duty claims. Applying Georgia law to the LLC member's fraud claims, the court concluded that the claims for fraud based on claims of misrepresentations pre-dating the operating agreement were barred because the operating agreement contained a merger clause. The plaintiff's other fraud claims failed under Georgia law as well, with the exception of one claim based on the alleged misrepresentation of the defendants' net worth to induce plaintiff to execute personal guarantees.

*Taurus IP, LLC v. DaimlerChrysler Corporation*, 519 F.Supp.2d 905 (W.D. Wis. 2007) (stating that court should look to law of state of incorporation of entity to determine whether corporate form should be disregarded; concluding that numerous Texas and Wisconsin LLCs were alter egos of individual who operated LLCs for purposes of personal jurisdiction based on prima facie showing that individual used entities to perpetrate fraud and exerted complete domination over entities; noting that alter ego doctrine can be applied in reverse and concluding that LLCs and individual were all alter egos of one another based on such application, and exercising personal jurisdiction over all such parties based on consent to jurisdiction by one of LLCs; denying motion to dismiss various claims against individual and LLCs operated by him based on allegations supporting application of alter ego doctrine).

*Miller v. Ross*, 841 N.Y.S.2d 586 (N.Y. A.D. 1 Dept. Sept. 20, 2007) (holding that lower court correctly applied New York rather than Delaware law in suit seeking to unwind conversion of New York limited partnership into Delaware LLC).

*Pinnacle Labs, LLC v. Goldberg*, No. 07-C-196-S, 2007 WL 2572275 (W.D. Wis. Sept. 5, 2007) (holding that claims of breach of fiduciary duty and malicious injury asserted by Minnesota LLC and LLC's creditor against LLC's members were governed by Minnesota law rather than Wisconsin law since Wisconsin's LLC statute provides that laws of state under which LLC is organized shall govern organization and internal affairs of LLC and liability and authority of its managers and members).

*Rimawi v. Atkins*, 840 N.Y.S.2d 217 (N.Y. A.D. 3 Dept. 2007) (holding that plaintiff member's claim that co-member's actions diluted plaintiff's interest in Delaware LLC raised issues that must be asserted in derivative action governed by Delaware law, and plaintiff's cause of action for judicial dissolution and ancillary accounting of Delaware LLC was one over which New York courts lack subject matter jurisdiction).

*Ritchie Capital Management, L.L.C. v. Coventry First LLC*, No. 07 Civ. 3494(DLC), 2007 WL 2044656 (S.D. N.Y. July 17, 2007) (relying on internal affairs doctrine and applying Delaware law in determining that grounds for piercing veil of Delaware LLC had been sufficiently alleged for purposes of liability and personal jurisdiction).

*Weber v. U.S. Sterling Securities, Inc.*, 924 A.2d 816 (Conn. 2007) (applying Delaware law to issue of liability of members of Delaware LLC and holding that liability protection of managers and members under Delaware LLC statute does not protect members or managers from direct liability for their torts and thus members of Delaware LLC would not be protected from liability for their own conduct violating federal Telephone Consumer Protection Act).

*Freeman Management Corporation v. Shurgard Storage Centers, Inc.*, No. 3:06cv736, 2007 WL 1541877 (M.D. Tenn. May 23, 2007). The court held that the merger of a corporation into a newly formed Delaware LLC effected a transfer by operation of law of the corporation's interests in several joint ventures and thus violated a provision in the joint venture agreements prohibiting transfer of the joint venture interest without the consent of the other joint venturer. The merger was accomplished under the Washington Business Corporation Act and the Delaware Limited Liability Company Act, but the joint venture agreements provided that they were governed by Tennessee law. The court determined that Tennessee law applied to the issue of whether the merger resulted in a transfer for purposes of the prohibition on transfer under the joint venture agreements.

*Heer v. Price*, No. 1:06CV-114-R, 2007 WL 1100693 (W.D. Ky. April 11, 2007) (holding that North Carolina law applied to dispute arising under Membership Acquisition Agreement containing North Carolina choice of law provision and North Carolina LLC Act did not preclude court from asserting jurisdiction of action brought by member of North Carolina LLC against manager of LLC for fraud and breach of fiduciary duty regardless of whether suit was characterized as direct or derivative suit).

*In re Lowry (Lowry Food Products, Inc. v. Alto Dairy Cooperative)*, Bankruptcy No. 03-33950 HDH-7, Adversary No. 05-3108, 2007 WL 738144 (Bankr. N.D. Tex. March 7, 2007) (applying Texas most significant relationship test to conflict of laws question and concluding Wisconsin law applied to breach of contract claim based on Wisconsin LLC agreements and breach of duty claim).

## II. Charging Order

*FirstMerit Bank, N.A. v. Washington Square Enterprises*, No. 88798, 2007 WL 2206545 (Ohio App. Aug. 2, 2007). The judgment creditor of a member of an LLC obtained an order appointing a receiver of the LLC's property. The order authorized the receiver to possess, manage, control, and protect the property and business of the LLC. The judgment creditor argued that the LLC was wholly owned by the judgment debtor and that its assets could thus be applied to satisfy the judgment. The court of appeals held that the judgment creditor did not have the right to satisfy its judgment from assets of the LLC because LLCs are separate entities from their owners. Citing provisions of the Ohio LLC statute, the court pointed out that the member's membership interest was an asset which could be charged to satisfy her judgment

debt, but the membership interest did not include any direct interest in the assets of the LLC that could be used by her creditors to satisfy her debts. Rather, a judgment creditor of a member has only the rights of an assignee of a membership interest, i.e., only the right to receive distributions that would have been paid to the member-assignor. The court expressed no opinion as to whether a judgment creditor of an LLC member could seek judicial dissolution under the Ohio statute. Because the judgment creditor did not demonstrate any right to satisfy its judgment from the assets of the LLC, the trial court abused its discretion in placing the LLC and its property in receivership.

*Ivy v. Brown*, No. 57832-4-I, 2007 WL 1739696 (Wash. App. June 18, 2007). The court held that the trial court's refusal to grant a charging order against a membership interest in an LLC in which the judgment debtor admitted he was a member was an abuse of discretion and remanded the trial court's refusal to grant a charging order with respect to interests in other LLCs because the grounds for refusal were unclear, i.e., whether the refusal was based on inadequate proof of ownership, failure to prove the value of the interest, or failure to use supplemental proceedings. The court noted that the charging order statute does not require an interest to be valued prior to being charged and does not require a creditor to seek supplemental proceedings in order to seek a charging order.

#### **JJ. Divorce of Member**

*Ahern v. Ahern*, 938 A.2d 35 (Me. 2008). The wife in a divorce action argued that the trial court erred in not nullifying an LLC which held real estate used in her husband's dental practice so that the real estate could be treated as marital property. The LLC was formed by the husband, who initially was the sole member, but he later transferred 10% ownership interests to each of his four children. The operating agreement effecting the transfers was signed by the wife four times as custodian for each of the children. Later, the husband transferred an additional 10% to each child, with the wife again acting as custodian. Thus, at the time of the divorce, the children collectively owned 80% of the LLC. The court held that the divorce court did not err in not nullifying the LLC agreement. The court pointed out that the Maine LLC statute provides for judicial dissolution only in specified circumstances and does not recognize the divorce of a party who created the LLC as a basis for dissolution. The court stated that, absent an agreement of the parties and other interested persons, a court is without authority to dissolve or refuse to recognize an LLC except as provided in the judicial dissolution provision of the Maine Limited Liability Company Act. The court noted that a spouse who is not a member of an LLC and cannot bring a dissolution action is not without recourse in a divorce proceeding. If the creation or operation of an LLC constituted economic misconduct, the court could consider that a factor when equitably distributing property and awarding spousal support. This case, however, did not involve an allegation or evidence that the husband committed economic misconduct in forming the LLC or transferring the interests to his children.

*In re Marriage of Mead*, No. C052999, 2007 WL 3208746 (Cal. App. Nov. 1, 2007) (affirming trial court's conclusion that spouse accurately described her interest in LLC when she described it as "member without controlling interests" and assigned no value to it where spouse testified her parents set up LLC as estate planning device, spouse and her two sisters each owned 14% interest, and income was under complete control of spouse's father and was not distributed to spouse and her sisters except that spouse's father provided money necessary to pay taxes on LLC's income).

*In the Matter of Marriage of Overbey*, 139 Wash.App. 1017, 2007 WL 1733214 (Wash. App. 2007). The valuation formula specified by a buy/sell agreement among the members of an LLC did not bind the trial court in the divorce of one of the LLC members since the agreement was not a statutorily authorized "separation contract" between spouses and because the triggering event under the agreement, a transfer of interest by divorce to a member's spouse, did not occur when the interest was awarded to the husband member. Notwithstanding the wife's community property interest in her husband's membership interest, she was not a "member" as the term was used in the members' buy/sell agreement. The income valuation method used by the trial court based on an expert's valuation analysis was supported by substantial evidence.

*In re the Marriage of Villarreal*, No. 06-1652, 2007 WL 1486097 (Iowa App. May 23, 2007) (holding LLC with negative net worth was properly valued at zero for purposes of award on divorce because neither party had personal liability for LLC's debts).



*Moise v. Moise*, 956 So.2d 9 (La. App. 2007) (holding that LLC interest was separate property of husband who contributed separate property in exchange for 100% interest in LLC, that wife was manager, not member, of LLC despite being identified on lease as member and despite sharing in profits, and that equal share in profits did not necessarily indicate membership because profits of LLC are community property).

#### **KK. Receivership**

*Neece v. National Premier Protective Services, LLC*, No. 89643, 2007 WL 3293386 (Ohio App. Nov. 8, 2007) (reversing appointment of receiver for LLC where trial court did not specify statutory provisions or evidence upon which it was relying and record did not show trial court had any evidentiary material supporting plaintiffs' allegations in support of appointment of receiver).

*In re Olympus Construction, LC (Matthews v. Olympus Construction, LC)*, 173 P.3d 192 (Utah App. 2007) (interpreting judicial dissolution and receivership provisions of Utah LLC statute and concluding that trial court could extend statutory period for rejecting claims based on great latitude granted to trial court in statutory language governing receiverships and trial court's order explicitly stating that court may expand and modify receiver's powers).

*FirstMerit Bank, N.A. v. Washington Square Enterprises*, No. 88798, 2007 WL 2206545 (Ohio App. Aug. 2, 2007). The judgment creditor of a member of an LLC obtained an order appointing a receiver of the LLC's property. The order authorized the receiver to possess, manage, control, and protect the property and business of the LLC. The judgment creditor argued that the LLC was wholly owned by the judgment debtor and that its assets could thus be applied to satisfy the judgment. The court of appeals held that the judgment creditor did not have the right to satisfy its judgment from assets of the LLC because LLCs are separate entities from their owners. Citing provisions of the Ohio LLC statute, the court pointed out that the member's membership interest was an asset which could be charged to satisfy her judgment debt, but the membership interest did not include any direct interest in the assets of the LLC that could be used by her creditors to satisfy her debts. Rather, a judgment creditor of a member has only the rights of an assignee of a membership interest, i.e., only the right to receive distributions that would have been paid to the member-assignor. The court expressed no opinion as to whether a judgment creditor of an LLC member could seek judicial dissolution under the Ohio statute. Because the judgment creditor did not demonstrate any right to satisfy its judgment from the assets of the LLC, the trial court abused its discretion in placing the LLC and its property in receivership.

*Gottier's Furniture, LLC v. La Pointe*, No. CV040084606S, 2007 WL 1600021 (Conn. Super. May 16, 2007) (declining defendant member's request to appoint receiver to wind up affairs of LLC inasmuch as defendant member had misappropriated LLC funds and had unclean hands, and, alternatively, because dissolution receivership is extraordinary remedy that is not warranted merely based on dissension of members or financial difficulty).

*In re Bayou Group, L.L.C. (Adams v. Marwil)*, 363 B.R. 674 (S.D. N.Y. 2007). Ten affiliated hedge fund LLCs (consisting of six Delaware LLCs, three New York LLCs, and one Connecticut LLC) were operated by their principals as a fraudulent Ponzi scheme, and a group of creditors of the LLCs filed a lawsuit in federal court seeking appointment of a "federal equity receiver" for the LLCs. The district court appointed a receiver pursuant to its powers under Section 10b of the Exchange Act and Rule 10b-5 and its inherent equity power. The order appointed Jeff Marwil as "non-bankruptcy federal equity receiver and exclusive managing member" of the LLCs. Marwil ultimately filed bankruptcy petitions for the LLCs and signed each petition as "sole managing member." The United States trustee asked the bankruptcy court to appoint a Chapter 11 trustee, and the bankruptcy court denied the request. The district court affirmed the bankruptcy court's denial because the court concluded that Marwil was not merely a custodian or receiver, but was the new exclusive managing member of the LLCs. The court stated that the order appointing Marwil was made pursuant to federal securities laws and its inherent equity power, and the corporate management powers conferred were not merely derivative of the receivership appointment. Thus, his corporate management role did not cease when he caused the LLCs to file bankruptcy. The court noted that it could have appointed Marwil as manager pursuant to federal receivership statutes alone, and, in that case, the corporate management powers would have ceased when the LLCs filed for bankruptcy. The court, however, stressed that it appointed Marwil as manager pursuant to federal securities laws and the court's inherent equity authority. In view of the criminal violations of the federal securities laws committed by the principals of the LLCs, the court concluded that both the federal securities laws and the court's equity jurisdiction

provided a basis for appointment of Marwil as managing member. The court commented that the state law of Delaware, New York, and Connecticut would have provided a basis to appoint Marwil as a receiver to manage the LLCs, but the court noted that the state law issues were not briefed and that the court did not appoint Marwil pursuant to state law. The court concluded that Marwil, as managing member of the LLCs, could act as debtor-in-possession, and the court observed that the proceedings exposed a loophole in the Bankruptcy Code insofar as the creditors had essentially been able to appoint their own bankruptcy “trustee” by having a district judge appoint corporate governance of the LLCs prior to filing of any bankruptcy.

## **LL. Bankruptcy**

*In re Colvin (Hopkins v. Saratoga Holdings, LLC)*, Bankruptcy No. 04-42331-JDP, Adversary No. 07-8045, 2007 WL 4553352 (Bankr. D. Idaho Dec. 20, 2007). Three individuals formed an LLC and one of the members, Colvin, was not able to satisfy capital calls made on the members. Eventually, Colvin expressed a desire to be relieved of his financial obligations, and an agreement for the LLC to buy out Colvin’s interest was executed by the members. The agreement required the LLC to pay Colvin a total of \$45,000 plus interest in monthly installments, and Colvin agreed that he would do nothing to hinder, delay, slander or tarnish the reputation of the LLC, its owners or agents. After the agreement was made, Colvin left the LLC and worked for another business. The LLC never paid any amounts to Colvin required under the agreement. The court analyzed the nature of the agreement between Colvin and the LLC and determined it was an “executory contract” because all parties had unfulfilled obligations to perform. Because the trustee in Colvin’s bankruptcy did not timely assume the contract, it was deemed rejected. The court noted that there were substantial questions regarding whether Colvin had already defaulted under the agreement before the bankruptcy was filed and whether the default could have been cured. (Colvin had recruited employees from the LLC to work for his new employer and had made spiteful comments about one of the members of the LLC.) In any event, the failure to timely assume the agreement was a rejection that constituted a default of the contract immediately before Colvin’s bankruptcy petition was filed and precluded the trustee’s attempts to enforce the contract.

*In re Storer*, 380 B.R. 223 (Bankr. D. Mont. 2007) (applying Montana corporate veil piercing principles to LLC and concluding that LLC was alter ego of one of its two members based on fact that member listed creditors of LLC as his creditors on his bankruptcy schedule, but holding member did not use LLC as subterfuge to perpetrate fraud; even if court were to pierce veil of LLC, creditors did not establish fraud required for dischargeability exception under Section 523(a)(2)(A)).

*In re Schwab*, 378 B.R. 854 (Bankr. D. Minn. 2007) (finding that equipment used by LLC belonged to LLC’s sole member where equipment was purchased in member’s name and paid for by personal line of credit although member’s tax return assigned depreciation to LLC, and principles of equity allowed member to reverse pierce LLC veil and claim ownership of accounts receivable where LLC had no debts or obligations of its own at time member filed bankruptcy, receivables consisted of charges for member’s labor, and member had no other source of earnings).

*In re Avery*, 377 B.R. 264 (Bankr. D. Alaska 2007) (substantively consolidating Chapter 7 estates of various LLCs where there was no opposition to motion and LLCs were owned, managed, and controlled by debtor and had no separate identity when bankruptcy was filed).

*In re Weiss*, 376 B.R. 867 (Bankr. N.D. Ill. 2007) (holding that debtor’s pledge of his membership and partnership interests in numerous LLCs and limited partnerships was unenforceable because LLC and partnership agreements prohibited transfer or required prior written consent of manager, members, or partners and such consent was not obtained prior to debtor’s grant of security interest in LLC and partnership interests, and stating that lender’s policy argument that consent provisions were designed to protect other members and partners and not assigning party was not persuasive because bankruptcy context requires safeguarding interests of all creditors and does not permit requirements of validity of security interest to be ignored).

*In re Strausbaugh (Swartz v. Strausbaugh)*, 376 B.R. 631 (Bankr. S.D. Ohio 2007) (holding that claims by LLC member against managing member for fraud, fraudulent inducement, forgery, embezzlement, and breach of fiduciary duty arose in context of business relationship and thus were not “consumer debt” within meaning of Section

523(d) of Bankruptcy Code notwithstanding that small portion of LLC funds allegedly diverted by managing member were put to personal use).

*In the Matter of Strug-Division, LLC*, 375 B.R. 445 (Bankr. N.D. Ill. 2007) (dismissing bankruptcies of single member, single purpose, single asset LLCs that were sole members of non-debtor single asset real estate LLCs based on bad faith filing because proposed reorganization plans were not feasible where they relied upon sale of properties owned by non-debtor LLC subsidiaries rather than by debtors).

*In re Knefel (Gibbons v. Knefel)*, No. 07-11534-SSM, 2007 WL 2416535 (Bankr. E.D. Va. Aug. 17, 2007) (holding that bankruptcy of member or manager does not create automatic stay of litigation against LLC and suit against LLC wholly owned by debtor would not be precluded because LLC is separate entity from its managers and members).

*In re Felt Manufacturing Co., Inc.*, 371 B.R. 589 (Bankr. D. N.H. 2007) (analyzing sufficiency of allegations that avoidable transfers were made to LLC for benefit of member such that claim for recovery against member was stated under Section 550(a) of Bankruptcy Code and finding allegations sufficient with respect to certain transfers but not others).

*In re Howell (Fabing v Howell)*, 373 B.R. 1 (Bankr. W.D. Ky. 2007) (holding that statutory standard of liability of LLC manager under Kentucky statute does not rise to level of willful injury or constitute express or technical trust so as to fall within nondischargeability provisions of Bankruptcy Code).

*In re Tsiaoushis (Endeka Enterprises, LLC v. Meiburger)*, No. 1:07cv436, Bankr. No. 05-15135 (RGM), 2007 WL 2156162 (E.D. Va. July 19, 2007). The district court agreed with the bankruptcy court that the trustee of a debtor member of a District of Columbia LLC was entitled to a partial summary judgment declaring enforceable the provisions of the LLC operating agreement requiring dissolution and winding up as a result of the debtor's bankruptcy filing. The court rejected the argument that members of small LLCs owe fiduciary duties to their LLCs as a matter of course and that all LLC operating agreements are, therefore, executory contracts subject to Section 365(e) of the Bankruptcy Code. Assuming *arguendo* that the existence of a fiduciary duty alone constitutes a continuing obligation, the court concluded that the LLC and its non-debtor member failed to establish that D.C. law recognizes fiduciary duties between members of a manager-managed LLC. The court stated that it found no *per se* rule governing the issue. Based on a particularized evaluation of the LLC's operating agreement, the court concluded that it was not an executory contract because it did not create any material, continuing obligation of the debtor member. The court noted that the debtor was not a manager or director of the LLC and had no duties as such when he filed for bankruptcy. Further, the operating agreement provided that members of the LLC could engage in other activities without incurring any obligation to offer any interest in the activities to the LLC or its members. Finally, the D.C. LLC statute does not contain any express provisions imposing fiduciary duties on mere members.

*In re The 1031 Tax Group, LLC*, No. 07-11448(MG), 2007 WL 2085384 (S.D. N.Y. July 17, 2007) (discussing provisions of Delaware LLC statute regarding member's ability to structure management of LLC by manager and agreeing with debtors (which consisted of parent LLC and various affiliated entities) that valid business justification existed for approval of consulting agreement whereby consultant would be retained to supervise day to day management of debtor entities, but concluding that state law must be followed in appointment of consultant as manager or director of debtor entities and proper action by member to amend organizational documents or take such other actions required to properly appoint consultant as manager or director of each debtor entity must be taken).

*In re Mattera*, No. 05-39171, 2007 WL 1813763 (Bankr. D. N.J. June 13, 2007) (granting request of debtor's spouse for order compelling compliance with subpoenas against lawyers who allegedly obtained interests in LLC resulting from post-petition conversion of debtor's law practice from general partnership to LLC without court's consent because subpoenas sought to determine if additional assets of bankruptcy estate existed (stating that it could be argued that assets of general partnership become assets of bankruptcy estate of partner because general partnership has no legal existence separate from its owners), and conversion of firm to LLC could affect determination of non-dischargeability for fraud).

***In re Modanlo***, Nos. 05-26549-NVA, 06-10158-NVA, 2007 WL 2609470 (Bankr. D. Md. May 19, 2007). The court determined that a debtor's single member Delaware LLC, which dissolved upon the debtor's bankruptcy, was resuscitated by the actions of the debtor's trustee (acting as the debtor's personal representative) and that the trustee possessed management rights in the LLC in addition to the debtor's economic interest. Based on this determination, the court granted the trustee's request for leave to cause the LLC to call a meeting of shareholders in a corporation in which the LLC was the controlling shareholder. The debtor argued that the trustee acquired only economic rights in the LLC (and no rights to control and make decisions for the LLC) because, under Sections 18-304 and 18-801 of the Delaware Limited Liability Company Act, the debtor ceased to be a member and the LLC dissolved upon the filing of the member's bankruptcy. The court, however, agreed with the trustee's argument that he had revoked the dissolution, as provided under Section 18-806 of the Delaware LLC statute, by taking action that amounted to a written consent to continuation of the LLC, admission of the trustee as a member, and appointment of himself as manager. The debtor argued that, even if the actions taken by the trustee were otherwise sufficient to revive the LLC, the statute only permitted the actions to be taken by the "personal representative" of the last remaining member. The Delaware LLC statute defines the term "personal representative" in the context of a natural person as the "executor, administrator, guardian, conservator, or other legal representative" of the person, and the court concluded that the term includes a bankruptcy trustee. The court distinguished Delaware case law holding that an LLC member's management or governance rights are not assignable because the case law was decided in the context of a multi-member LLC. The court cited with approval and characterized as "persuasive" the opinion of a Colorado bankruptcy court in *In re Albright*. Although the parties themselves did not raise Sections 18-702 and 18-704 of the Delaware LLC statute (requiring the approval of all members other than the assigning member to admit an assignee as a member), the court took the initiative in addressing these provisions and stated that they are inapplicable in the context of a single member LLC since there are no members other than the assigning member. The court again referred to the *Albright* decision as persuasive and concluded that these provisions of the Delaware statute did not preclude the trustee from exercising management rights.

***In re Grosman (Bar-Am v. Grosman)***, Bankruptcy No. 6:05-bk-10450-KSJ, Adversary No. 6:05-ap-328, 2007 WL 1526701 (Bankr. M.D. Fla. May 22, 2007) (characterizing LLC as joint venture whose members owed one another fiduciary duties as joint venturers, discussing fiduciary duties of managing member under Florida LLC statute, and concluding that managing member's statutory fiduciary duties of loyalty and care did not amount to express or technical trust required to constitute fiduciary duty under Bankruptcy Code Section 523(a)(4) exception from discharge for defalcation in fiduciary capacity, but holding managing member's transfer of LLC assets to himself, entities he controlled, and family members without distributing any assets to co-member was willful and malicious injury of another entity or its property satisfying exception to discharge under Section 523(a)(6)).

***In re Hurley (Vickers v. Hurley)***, Bankruptcy No. 03-16467-JNF, Adversary No. 04-1438 (Bankr. D. Mass. May 15, 2007) (finding debtor's transfer of assets to 97% owned LLC was made with intent to defraud creditors and warranted denial of discharge).

***In re J.S. II, LLC***, 371 B.R. 311 (Bankr. N.D. Ill. 2007) (granting motion to employ special counsel for LLCs in derivative litigation filed by non-manager members against manager members, finding that counsel had previously been employed by LLCs and that counsel's interests were not adverse to interests of LLCs even though counsel represented non-manager members with respect to derivative claims asserted against them by manager members).

***In re Silver (Lincoln National Life Insurance Co. v. Silver)***, 367 B.R. 795 (Bankr. D. N.M. 2007) (revoking discharge of debtor based on debtor's failure to turn over art and furnishings fraudulently transferred to LLC and ultimately returned to debtor).

***In re Reserve Capital Corp; In re Hawkins Development LLC; In re Hawkins; In re Hawkins Family, LLC; In re Hawkins Manufactured Housing, Inc.; In re Forest View, LLC; In re Wooded Estates, LLC; In re Tioga Park, LLC***, Nos. 03-60071, 03-60072, 03-60073, 03-60074, 03-60075, 03-60076, 03-60077, 03-60078, 2007 WL 880600 (Bankr. N.D. N.Y. March 21, 2007) The court analyzed a motion to substantively consolidate the bankruptcy cases of individuals and various corporations and entities owned by the individuals and concluded that substantive consolidation was not justified under either of two critical factors examined: (i) whether creditors dealt with the entities as a single economic unit and did not rely on their separate identities in extending credit, or (ii) whether the affairs of the debtors

are so entangled that consolidation will benefit all creditors. The court noted that the assertion that the income and expenses of the LLCs appeared on the individual debtors' tax returns did not serve as a basis for substantive consolidation under the first factor.

*Kreisler v. Goldberg*, 478 F.3d 209 (4<sup>th</sup> Cir. 2007) (applying Maryland law and concluding there existed no basis to conclude that wholly owned LLC subsidiary of LLC debtor should not be recognized as separate legal entity and that automatic stay did not protect debtor's LLC subsidiary nor did debtor have any direct interest in assets of LLC subsidiary).

*In re Bayou Group, L.L.C. (Adams v. Marwil)*, 363 B.R. 674 (S.D. N.Y. 2007). Ten affiliated hedge fund LLCs (consisting of six Delaware LLCs, three New York LLCs, and one Connecticut LLC) were operated by their principals as a fraudulent Ponzi scheme, and a group of creditors of the LLCs filed a lawsuit in federal court seeking appointment of a "federal equity receiver" for the LLCs. The district court appointed a receiver pursuant to its powers under Section 10b of the Exchange Act and Rule 10b-5 and its inherent equity power. The order appointed Jeff Marwil as "non-bankruptcy federal equity receiver and exclusive managing member" of the LLCs. Marwil ultimately filed bankruptcy petitions for the LLCs and signed each petition as "sole managing member." The United States trustee asked the bankruptcy court to appoint a Chapter 11 trustee, and the bankruptcy court denied the request. The district court affirmed the bankruptcy court's denial because the court concluded that Marwil was not merely a custodian or receiver, but was the new exclusive managing member of the LLCs. The court stated that the order appointing Marwil was made pursuant to federal securities laws and its inherent equity power, and the corporate management powers conferred were not merely derivative of the receivership appointment. Thus, his corporate management role did not cease when he caused the LLCs to file bankruptcy. The court noted that it could have appointed Marwil as manager pursuant to federal receivership statutes alone, and, in that case, the corporate management powers would have ceased when the LLCs filed for bankruptcy. The court, however, stressed that it appointed Marwil as manager pursuant to federal securities laws and the court's inherent equity authority. In view of the criminal violations of the federal securities laws committed by the principals of the LLCs, the court concluded that both the federal securities laws and the court's equity jurisdiction provided a basis for appointment of Marwil as managing member. The court commented that the state law of Delaware, New York, and Connecticut would have provided a basis to appoint Marwil as a receiver to manage the LLCs, but the court noted that the state law issues were not briefed and that the court did not appoint Marwil pursuant to state law. The court concluded that Marwil, as managing member of the LLCs, could act as debtor-in-possession, and the court observed that the proceedings exposed a loophole in the Bankruptcy Code insofar as the creditors had essentially been able to appoint their own bankruptcy "trustee" by having a district judge appoint corporate governance of the LLCs prior to filing of any bankruptcy.

*In re Allentown Ambassadors, Inc. (Allentown Ambassadors, Inc. v. Northeast American Baseball, LLC)*, 361 B.R. 422 (Bankr. E.D. Pa. 2007). The court addressed several issues in a lengthy opinion dealing with the debtor corporation's rights and status as a member of a dissolved LLC. The debtor corporation operated a minor league baseball team and was a member of a baseball league organized as a North Carolina LLC. The debtor's primary claim was that the other members of the LLC exercised control over property of the estate, in violation of the automatic stay provision of Section 362(a)(3) of the Bankruptcy Code, when the members dissolved the LLC and formed a new league without the debtor. The debtor also claimed that an individual manager of the LLC breached his fiduciary duty to the debtor. The defendants sought summary judgment on these claims, but the court denied the motion as to both claims. With respect to the first claim, the defendants argued that the debtor's bankruptcy terminated its membership in the LLC under the terms of the operating agreement, which resulted in the debtor's status changing from that of member to assignee. The defendants claimed that the subsequent dissolution of the LLC did not deprive the debtor of any rights and was not a violation of Section 362(a)(3) since the debtor still had its economic rights to receive the distributions to which it was entitled under the operating agreement. After a lengthy analysis, the court concluded that the record was inadequate at this stage of the proceedings to permit the court to determine whether the provision of the LLC operating agreement purporting to terminate the debtor's membership in the LLC upon the debtor's bankruptcy filing was enforceable under Section 365(e) of the Bankruptcy Code. The court analyzed the rights of a member under the North Carolina Limited Liability Company Act as well as the enforceability of the ipso facto provision in the operating agreement and concluded that the operating agreement was an executory contract but that the record did not establish whether the ipso facto provision terminating the debtor's membership upon its bankruptcy filing was enforceable. In the course of its

discussion, the court concluded that the provisions of the North Carolina LLC statute, which provide that a membership interest is assignable in whole or in part, but require unanimous consent of the other members for an assignee to become a member, do not constitute a clear and unequivocal prohibition on assignment under “applicable law ... excus[ing] a party from accepting performance from or rendering performance to” an assignee for purposes of Section 365(c)(1) and (e)(2). The court then considered the nature of the operations of the LLC baseball league and concluded that the record did not permit the court to determine whether the identity of a member was a material aspect of the operating agreement or whether the only material prerequisite to admission of a new member was the member’s ability to perform its obligations under the agreement. Because the court could not determine whether the debtor’s membership terminated upon its bankruptcy, and the parties did not dispute that the debtor retained its economic rights in the LLC, the defendants were not entitled to summary judgment on the debtor’s claim that they violated Section 362(a)(3) by exercising control over the debtor’s property when they dissolved the LLC. Finally, even assuming the debtor only retained its economic rights in the LLC, the court determined that the impact of dissolution of the LLC on those rights alone was significant enough to warrant denial of the defendants’ summary judgment motion on the Section 362(a)(3) claim. With respect to the individual manager’s fiduciary duty claim, the court examined provisions of the North Carolina LLC Act as well as the operating agreement and rejected the manager’s argument that his duty was owed solely to the LLC and not to individual members. The court predicted that North Carolina appellate courts would extend to LLCs the principles developed in the case law of closely held corporations. The court thus concluded that majority members of an LLC owe a fiduciary duty to minority members (based on the duty owed by majority shareholders to minority shareholders) and that the defendant manager would also owe a duty to the individual members because the manager’s powers were derived from and delegated to the manager by the member-managers of the LLC. While the court acknowledged that the debtor might have a difficult time proving that the manager breached his duty, the court perceived the possibility that the challenged conduct was part of a pattern to “oppress” the debtor. Thus, the manager was not entitled to summary judgment.

*In re Modanlo (Modanlo v. Mead)*, Civil Action No. DKC 2006-1168, 2006 WL 4486537 (D. Md. Oct. 26, 2006). The sole member of a Delaware LLC filed bankruptcy, and the trustee took several steps in order to take control of the LLC and a corporation owned by the LLC. The steps taken by the trustee in this regard included a “Written Consent of and Agreement Regarding Admission of Personal Representative of Last Remaining Member” under Section 18-806 of the Delaware LLC Act. In that document, the trustee consented to the continuation of the LLC effective as of the date of the occurrence of an event described in Section 18-801(a)(4) of the Delaware LLC Act (i.e., the bankruptcy of the last remaining member) and, as personal representative of the last remaining member, agreed to the admission of the trustee as a member as of that date. The court agreed with the trustee that the LLC was dissolved upon the bankruptcy of the sole member because, under Section 18-304(1) of the Delaware LLC Act, a person ceases to be a member upon the person’s bankruptcy, and, under Section 18-801(a), an LLC is dissolved if it has no remaining members. Under Section 18-801(a)(4), there is an exception to dissolution upon the termination of the last remaining member if a successor member is appointed within 90 days, but the trustee was not appointed until more than 90 days after the filing of the member’s bankruptcy; therefore, this exception was not available to the trustee. The LLC was resuscitated under Section 18-806, however, which permits the personal representative of the last remaining member of an LLC to avoid the dissolution and winding up of an LLC by consenting in writing to the continuation of the LLC and agreeing to become a member of the LLC. The court found that the bankruptcy trustee’s consent met these requirements. The court analyzed the definition of a “personal representative” under the Delaware LLC Act and concluded that a bankruptcy trustee falls within the definition. Section 18-101(13) defines a “personal representative” broadly to include “as to a natural person, the executor, administrator, guardian, conservator or other legal representative thereof...” Because the scope of the term “other legal representative” is not clear on its face, the court looked to decisions analyzing the same language in other contexts and examined the policy rationale behind other sections of the Delaware LLC Act. The court concluded that the Delaware Supreme Court would likely hold that a bankruptcy trustee meets the statutory definition of a “personal representative.” The court rejected the debtor’s argument that the bankruptcy estate held only an economic interest and that the trustee could not become a member or participate in the LLC’s management. The court stated that the debtor’s argument ignored the effect of Section 18-806, and the court distinguished other Delaware cases in which the bankruptcy of a member occurred in the context of an LLC that had other remaining members.

*In re Wells (Andrews v. Wells)*, 368 B.R. 506 (Bankr. M.D. La. 2006) (holding managing member of Louisiana LLC was in fiduciary relationship with other member of LLC for purposes of dischargeability exception of Bankruptcy

Code, and managing member's use of LLC funds for which managing member could not account constituted defalcation in fiduciary capacity excepted from discharge).

*In re Green Power Kenansville, LLC*, No. 04-08384-8-JRL, 2004 WL 5413067 (Bankr. E.D. N.C. Nov. 18, 2004). (Although this opinion was issued more than three years ago, it has just recently appeared on Westlaw.) The sole member of an LLC assigned its interest to another entity, and the LLC's new owner caused the LLC to file a Chapter 7 bankruptcy. The LLC's lender argued the bankruptcy filing violated provisions of the LLC's loan documents and its operating agreement and was unauthorized and invalid. The court reviewed provisions of the loan documents and operating agreement pertaining to the issue and determined that the assignment of the sole member's interest was invalid because a pledge agreement of the sole member prohibited any change of control of the LLC and provided that the member's voting rights would become vested in the lender upon an event of default. The sole member's president conceded in testimony that he lacked authority to make the challenged assignment. The operating agreement provided for an independent manager whose written approval was required for any bankruptcy-type filing of the LLC. The independent manager could not be removed without amending the operating agreement, and an amendment required approval of all members and all material creditors of the LLC. The court noted that the North Carolina LLC statute permits the authority of a manager to be delegated to persons other than managers if and to the extent the operating agreement provides, and the court concluded the statute authorized the provision of the operating agreement "displacing" the manager with the independent manager as the sole person who can make decisions in a certain area. The court also concluded that the new owner was bound by the operating agreement when the interest was transferred, whether the new owner knew of the agreement or not, because the North Carolina LLC statute provides that a member is bound by any operating agreement which was in effect at the time the member became a member if the agreement was in writing or its terms were known to the member. Since the provisions of the written operating agreement regarding a bankruptcy filing were not followed, the bankruptcy filing was without authorization and the court dismissed the filing nunc pro tunc.

#### **MM. Fraudulent Transfer**

*Bramante v. McClain*, Civil Action No. SA-06-CA-0010 OG (NN), 2007 WL 4555943 (W.D. Tex. Dec. 18, 2007) (finding that plaintiffs had raised fact question as to whether individual judgment debtor used entities owned by him to fraudulently transfer assets to LLCs, and concluding that plaintiffs stated claim against LLCs for conspiring by agreement to commit fraudulent transfers to avoid collection of judgment, but finding no authority supporting liability beyond amounts actually transferred).

*Four Seasons Manufacturing, Inc. v. 1001 Coliseum, LLC*, 870 N.E.2d 494 (Ind. App. 2007) (applying corporate veil piercing principles to LLC without discussion of fact that entity was LLC rather than corporation and finding piercing was warranted to hold liable sole member of LLC who orchestrated fraudulent transfer to second wholly owned LLC; concluding sole member of debtor LLC was also debtor under fraudulent transfer statute where member was liable for LLC's obligation under piercing theory).

*In re Mega Systems, L.L.C. (Anderson v. Mega Lift Systems, L.L.C.)*, Bankruptcy No. 03-30190, Adversary No. 04-6085, 2007 WL 1643182 (Bankr. E.D. Tex. June 4, 2007). The court found that transfers from the debtor LLC to a commonly controlled LLC were fraudulent under the constructive and actual fraud provisions of the Texas Fraudulent Transfer Act and Bankruptcy Code; however, the trustee failed to prove fraud or breach of fiduciary duty on the part of the individuals who owned and controlled the LLCs because there was insufficient evidence of actual damages arising from any fraud or breach of fiduciary duty distinct from a failure to transfer reasonably equivalent value to the debtor as alleged under the fraudulent transfer cause of action. The court acknowledged the trustee's arguments that fiduciary duties arise in favor of creditors when a debtor approaches a "zone of insolvency," but noted the cogent analysis and rejection of this theory by Judge Harmon in *Floyd v. Hefner*, 2006 WL 2844245 (S.D. Tex. Sept. 29, 2006).

*In re Hurley (Vickers v. Hurley)*, Bankruptcy No. 03-16467-JNF, Adversary No. 04-1438, 2007 WL 1455983 (Bankr. D. Mass. May 15, 2007) (finding debtor's transfer of assets to 97% owned LLC was made with intent to defraud creditors and warranted denial of discharge).

*In re Silver (Lincoln National Life Insurance Co. v. Silver)*, 367 B.R. 795 (Bankr. D. N.M. 2007) (revoking discharge of debtor based on debtor's failure to turn over art and furnishings fraudulently transferred to LLC and ultimately returned to debtor).

*In re Herrman (Compton v. Herrman)*, 355 B.R. 287 (Bankr. D. Kan. 2006) (denying creditor's motion for summary judgment because creditor failed to establish as matter of law that transfer of debtor's home to debtor's wholly owned LLC was made with requisite intent for fraudulent transfer, noting that transfer of home to wholly owned LLC could not have affected debtor's net worth and did not change house from non-exempt to exempt property).

#### **NN. Creditor's Rights**

*Fidelity National Title Insurance Co. v. Gil*, 482 F.Supp.2d 274 (D. Conn. 2007) (concluding that judgment debtor's executor, judgment debtor's co-member in LLC, and LLC were not in contempt of garnishment order served on LLC with respect to distribution of proceeds of sale of LLC's property to deceased member's executor where order did not directly bind parties and order did not account for treatment of sale proceeds subsequently realized by LLC in which debtor member had interest).

#### **OO. Secured Transactions**

*In re Weiss*, 376 B.R. 867 (Bankr. N.D. Ill. 2007). A debtor's pledge of his membership and partnership interests in numerous LLCs and limited partnerships was unenforceable because the LLC and partnership agreements prohibited transfer or required prior written consent of the manager, members, or partners and such consent was not obtained prior to the debtor's grant of a security interest in the interests. Although the lender had filed financing statements, the court held that the security interests were invalid because the debtor's rights in the collateral were not validly assigned. The court concluded that LLC interests are general intangibles like limited partnership interests and, analogizing to limited partnership cases, the pledge of the LLC interests without the required consent under the LLC agreements was not enforceable. Subsequent consent did not cure the defect in the assignment because the LLC agreements required prior consent. The court rejected the argument that the pledge created a valid security interest in "proceeds" of the interests. First, the court pointed out that the debtor purported to assign his entire interests in the limited partnerships and LLCs, not just portions of the interests. Second, the court stated that the term "proceeds" is so broadly defined in Article 9 of the U.C.C. that there is very little difference between proceeds and the entire business interest. Finally, and most importantly, the court stated that the operating agreements prohibited the assignment of any portion or part of the interests without consent, and proceeds, distributions, profits, or income all constitute a part or portion of the interests. The court rejected the lender's argument that the debtor should be estopped from using his own violation of the operating agreements to benefit himself by avoiding the pledge. The court pointed out that the debtor had informed the lender that he did not have authority to pledge the interests, and he had crossed out a portion of the security agreement that represented he had authority to transfer the interests. The lender also knew that the consent required to assign the interests had not been obtained. The court did not find persuasive the lender's policy argument that the consent provisions were designed to protect other members and partners and not the assigning party. The court said that the bankruptcy context requires the interests of all creditors to be safeguarded and that the requirements of attachment, perfection, and validity of the security interest could not be ignored.

*Peoples Bank v. Bryan Brothers Cattle Company*, 504 F.3d 549 (5<sup>th</sup> Cir. 2007) (stating that security interest in cattle granted by individual to secure personal debt was not valid if cattle belonged to LLC in which individual was member since member has no interest in specific LLC property, and certificate of formation filed with Secretary of State was not sufficient to support trial court's conclusion that LLC existed as matter of law because such evidence without more did not sufficiently develop facts to establish operation of LLC at relevant times in case).

*In re Coldwave Systems, LLC (Braunstein v. Gateway Management Services Limited)*, 368 B.R. 91 (Bankr. D. Mass. 2007) (noting that Massachusetts LLC was "registered organization" within meaning of California UCC and that Massachusetts was thus correct location for filing of financing statement on LLC's patent).



## PP. Securities Laws

**Howard v. Webb**, No. A06-1847, 2007 WL 4393181 (Minn. App. Dec. 18, 2007). Investors in real estate LLCs sued the developer/manager for fraud, breach of fiduciary duty, securities violations, and civil theft. The jury found that the manager committed fraud, but found against the investors on the securities, breach of contract, and civil theft claims. The plaintiffs argued that the fraud finding supported a judgment for securities violations and civil theft, but the court noted that, while the claims have overlapping elements, there are distinctions. The securities claim required that the fraud occur in connection with the offer, sale or purchase of a security as opposed to fraud related to the manager's course of conduct generally. Given the complexity of the record, the court declined to second guess the jury's determination that the manager committed common law fraud but not securities fraud specifically in connection with the offer or sale of a security. Similarly, the court concluded that the jury might have determined that the manager did not initially obtain the investors' money by improper practices, but retained and used it fraudulently, thus supporting a fraud finding but not a civil theft finding.

**Burnett v. Rowzee**, No. SACV07641DOCANX, 2007 WL 2809769 (C.D. Cal. Sept. 26, 2007). The plaintiffs filed a securities fraud suit over an alleged Ponzi scheme involving the sale of interests in an LLC. The plaintiffs sought to enjoin the spouse of the scheme's promoter/manager from transferring proceeds of the scheme that were allegedly fraudulently transferred to her, and the spouse argued that the plaintiffs had not stated a claim for securities fraud so as to establish subject matter jurisdiction. The spouse argued that the plaintiffs had the right to control the LLC and in fact did so when they seized control and ousted the manager. The court stated that the fact that a majority of the LLC's members were ultimately able to oust the manager after the scheme came to light did not establish that the members were in control or played a management role in the LLC's operation from the beginning. The operating agreement delegated "full authority, power, and discretion to manage and control the business, affairs, and properties" of the LLC to the manager. Analyzing the expectations of control at the time the interest was sold, the court found that the delegation of all management authority to the manager supported the plaintiffs' contention that they intended to be passive investors with no right to control the investments. The court agreed with the plaintiffs that the complaint and the operating agreement established that the plaintiffs were the functional equivalent of limited partners, i.e., passive investors who relied on the managerial efforts of the promoter. Additionally, the plaintiffs alleged facts establishing the first prong of the Fifth Circuit's test in *Williamson*, i.e., that the agreement among the parties left so little power in the hands of the members that the arrangement in fact distributed power as would a limited partnership.

**Endico v. Fontes**, 485 F.Supp.2d 411 (S.D. N.Y. 2007). The plaintiff brought suit under Section 10(b) of the Exchange Act and Rule 10b-5, alleging that he was defrauded in connection with his sale of a 2/3 membership interest in an LLC. The court determined that the sale did not involve the sale of a "security" and dismissed the case. The plaintiff sued in his own right and derivatively on behalf of the LLC, claiming that the defendants tricked the plaintiff into transferring a 2/3 membership interest without paying for it, caused the LLC to buy property with the plaintiff's money, mortgaged the property, and looted the proceeds from the LLC. Though the plaintiff tried to establish that he was a passive investor in order to establish that the membership interest was an investment contract under the *Howey* test, the court concluded that the record did not establish that the interests sold by the plaintiff were passive. Focusing on what the plaintiff sold, the court pointed out that the defendants became the managing members of the LLC and certainly were not passive investors. Thus, the court said it was extremely doubtful that the interests he sold were securities even if the plaintiff was thereafter a passive investor. Moreover, the court concluded that the plaintiff retained important elements of control after the sale such that he was not a passive investor even if the court looked exclusively at the plaintiff's status following the sale. The court pointed out that the plaintiff was a signatory on the LLC's checking account and had a veto right over the sale and mortgage of LLC property. Thus, based on the record, the court found no material prospect that the plaintiff would succeed in establishing that the interests he sold were securities and thus no material prospect that he could prevail on the securities fraud claim.

**In re Bayou Group, L.L.C. (Adams v. Marwil)**, 363 B.R. 674 (S.D. N.Y. 2007). Ten affiliated hedge fund LLCs (consisting of six Delaware LLCs, three New York LLCs, and one Connecticut LLC) were operated by their principals as a fraudulent Ponzi scheme, and a group of creditors of the LLCs filed a lawsuit in federal court seeking appointment of a "federal equity receiver" for the LLCs. The district court appointed a receiver pursuant to its powers under Section 10b of the Exchange Act and Rule 10b-5 and its inherent equity power. The order appointed Jeff Marwil

as “non-bankruptcy federal equity receiver and exclusive managing member” of the LLCs. Marwil ultimately filed bankruptcy petitions for the LLCs and signed each petition as “sole managing member.” The United States trustee asked the bankruptcy court to appoint a Chapter 11 trustee, and the bankruptcy court denied the request. The district court affirmed the bankruptcy court’s denial because the court concluded that Marwil was not merely a custodian or receiver, but was the new exclusive managing member of the LLCs. The court stated that the order appointing Marwil was made pursuant to federal securities laws and its inherent equity power, and the corporate management powers conferred were not merely derivative of the receivership appointment. Thus, his corporate management role did not cease when he caused the LLCs to file bankruptcy. The court noted that it could have appointed Marwil as manager pursuant to federal receivership statutes alone, and, in that case, the corporate management powers would have ceased when the LLCs filed for bankruptcy. The court, however, stressed that it appointed Marwil as manager pursuant to federal securities laws and the court’s inherent equity authority. In view of the criminal violations of the federal securities laws committed by the principals of the LLCs, the court concluded that both the federal securities laws and the court’s equity jurisdiction provided a basis for appointment of Marwil as managing member. The court commented that the state law of Delaware, New York, and Connecticut would have provided a basis to appoint Marwil as a receiver to manage the LLCs, but the court noted that the state law issues were not briefed and that the court did not appoint Marwil pursuant to state law. The court concluded that Marwil, as managing member of the LLCs, could act as debtor-in-possession, and the court observed that the proceedings exposed a loophole in the Bankruptcy Code insofar as the creditors had essentially been able to appoint their own bankruptcy “trustee” by having a district judge appoint corporate governance of the LLCs prior to filing of any bankruptcy.

#### **QQ. Worker’s Compensation**

*Masley v. Herlew Realty Corp.*, 846 N.Y.S.2d 252 (N.Y. App. Div. 2 Dept. 2007) (holding that LLC which owned property where plaintiff was injured was not officer of corporation employing plaintiff and thus was not co-employee of plaintiff entitled to workers’ compensation defense).

*Hamby v. Profile Products, L.L.C.*, 652 S.E.2d 231 (N.C. 2007). An employee of an LLC was injured, and the employee sought to hold the LLC’s sole member (which was also an LLC) liable for negligence in managing the LLC’s safety program. Under the North Carolina workers’ compensation law, the exclusivity protection extends beyond the employer to “those conducting [the employer’s] business,” and the North Carolina Supreme Court concluded that the LLC’s member was conducting the LLC’s business and was protected under the exclusivity provision. The LLC and its parent were Delaware LLCs, and the LLC’s member was charged with exclusive management of the LLC’s business under the LLC’s operating agreement. The North Carolina LLC statute provides that the liability of a foreign LLC’s managers and members is governed by the laws of the LLC’s state of formation, and the court applied Delaware law to the question of the member-manager’s liability, noting that the Delaware and North Carolina statutes are similar in this regard. The court cited the provisions of the Delaware LLC statute regarding management and authority and shielding member-managers from liability. The court concluded that member-managers are specifically shielded from liability when acting as LLC managers, stating that “when a member-manager acts in its managerial capacity, it acts *for* the LLC, and obligations incurred while acting in that capacity are those *of* the LLC.” The court also found support for its conclusion in corporate case law where the exclusivity provision applied to the president and sole shareholder of a corporation.

*Jessie v. Dermitt*, No. 2005-CI-001961-MR, 2006 WL 3524524 (Ky. App. Dec. 8, 2006) (holding that LLC managers would fall within exclusivity provisions of workers’ compensation statute that protects employer’s “employee, officers or directors” along with employer, but finding defendants were not sued for their actions as managers but for their actions as landlords of building where business was operated).

#### **RR. State and Local Taxes**

*Montgomery County v. Wildwood Medical Center, L.L.C.*, 934 A.2d 484 (Md. App. 2007) (holding that transfer of title to LLC from family members who claimed to own property as general partnership was not exempt from recordation and transfer tax under exemption available to transfers from predecessor entity to LLC because family

members had not transferred title to general partnership and essentially sought to avoid payment of recordation and transfer taxes on both transfer to general partnership and that to LLC).

***GDT CGT1, LLC v. Oklahoma County Board of Equalization***, 172 P.3d 628 (Okla. Civ. App. 2007) (holding that property leased rent-free from for-profit corporation by nonprofit single member LLC owned by 501(c)(3) corporation was exempt from ad valorem taxation under Oklahoma property tax exemption for property “used exclusively and directly for charitable purposes” where LLC operated charitable fitness center as adjunct of charitable parent).

***In re Assessments for Year 2005 of Certain Real Property Owned by Askins Properties, L.L.C.***, 161 P.3d 303 (Okla. 2007) (holding transfer of real estate from individuals’ trust to individuals’ LLC was not transfer or conveyance excepted from constitutional limit on increase of assessed value for ad valorem tax purposes).

***Montgomery County v. Wildwood Medical Center, L.L.C.***, 934 A.2d 484 (Md. App. 2007) (holding that conveyance of real estate from individuals doing business as general partnership to LLC did not qualify for exemption from recordation and transfer tax applicable to transfer of title from predecessor entity to LLC because title was never transferred from individuals to partnership and title thus was transferred to LLC from individuals rather than from predecessor entity).

#### **SS. Common Law/Statutory Indemnification**

***Beane v. Beane***, Civil No. 06-cv-446-SM, 2007 WL 3051255 (D. N.H. Oct. 18, 2007) (citing New Hampshire LLC statute and common law for proposition that member had right to be indemnified for payments of LLC expenses and indebtedness and granting member’s motion for pre-judgment attachment of LLC property).

***Medzilla, Inc. v. SciStaff Services LLC***, No. C06-506-MJP, 2007 WL 1795602 (W.D. Wash. June 20, 2007) (concluding LLC agent’s claim for indemnification was not novel and complex issue of New Jersey law and exercise of supplemental jurisdiction over claim was thus appropriate because New Jersey has long recognized that common law principles of indemnification govern in absence of express contrary provisions and defendant cited no provision of New Jersey’s LLC statute overruling common law indemnification principles).

#### **TT. Unfair Business Practices Statutes**

***Voris v. Creditors Alliance, Inc.***, No. 05 C 6840, 2007 WL 4219198 (N.D. Ill. Nov. 28, 2007) (concluding debt collection efforts were not subject to Fair Debt Collection Practices Act because debt for accounting and tax preparation services was incurred by individual’s single member LLC and was not primarily for personal or household purposes).

***Mixon v. Iberia Surgical, L.L.C.***, 956 So.2d 76 (La. App. 2007) (concluded that LLC’s actions in expelling member as permitted by terms of operating agreement did not constitute “deceptive” trade practice under Louisiana Unfair Trade Practices and Consumer Protection Law, and the member was not “consumer or competitor” within meaning of statute).

***Schwenk v. Auburn Sportsplex, LLC***, 483 F.Supp.2d 81 (D. Mass. 2007) (holding that Massachusetts unfair business practices statute, which applies to sale of “any security” but does not apply to transactions between joint venturers or fiduciaries within single company, did not apply to LLC investor’s complaints that he did not receive appropriate ownership certificate, financial information, monthly dividends, or performance of contractual buyback option).

#### **UU. Insurance**

***Hilliard v. Jacobs***, 874 N.E.2d 1060 (Ind. App. 2007) (where 50% member had insurable interest in co-member’s life at time life insurance policy was purchased, termination of insurable interest upon sale of LLC assets and dissolution of LLC did not render policy void since it was valid at its inception).

*Cincinnati Insurance Company v. Grand Pointe, LLC*, 501 F.Supp.2d 1145 (E.D. Tenn. 2007) (holding individual sued as member and manager of LLC was jointly and severally liable with other defendants for reimbursement of insurer for costs of defense provided by insurer with no duty to defend where policy stated that insured persons included members of named LLC and managers with respect to duties as managers, reservation of rights letter sent by insured listed individual as insured, and individual did not refuse insurer's defense).

*Acuity v. North Central Video, LLLP*, No. 1:05-cv-010, 2007 WL 1356919 (D. N.D. May 7, 2007) (commenting that reference to LLC "manager" in insurance policy referred to statutorily-created position equivalent to CEO or managing partner under North Dakota LLC statute and does not apply to subordinate employees such as store manager).

#### **VV. Statute of Frauds**

*D'Esposito v. Gusrae, Kaplan & Bruno PLLC*, 844 N.Y.S.2d 214 (N.Y. A.D. 1 Dept. 2007) (holding causes of action based on purported promise to make plaintiff full partner/member were barred by statute of frauds because alleged oral agreement called for performance of indefinite duration and was terminable within one year only by breach).

*Estate of E.A. Collins v. Geist*, 153 P.3d 1167 (Idaho 2007). The court rejected the argument that a manager's authority to convey real estate on behalf of an LLC must be in writing under the provisions of an Idaho statute that requires conveyance of an estate in real property to be made by a written instrument that is signed by the conveyor or the conveyor's agent authorized in writing. The court relied upon provisions of the Idaho LLC statute conferring apparent authority on a manager when apparently carrying on the business of the LLC in the usual way and providing that title to LLC property may be transferred by an instrument of transfer executed by a manager in the name of the LLC. The court noted that an LLC may only act through its agents and concluded that the specific provisions of the LLC statute control over the more general statute requiring an agent's authority to be in writing when a conveyance of real property is involved.

#### **WW. Tortious Interference**

*Venezia Resort, LLC v. Favret*, No. 3:07cv74/MCR/EMT, 2007 WL 1364342 (N.D. Fla. May 8, 2007) (holding that lawyer and lawyer's law firm, as agent of LLC member and member's manager, were not strangers to, and thus could not be liable for tortious interference with, banking relationship between LLC and its bank).

#### **XX. Successor Liability**

*Allied Investments v. Lee Pacific, LLC*, No. D050164, 2007 WL 4395689 (Cal. App. Dec. 18, 2007) (noting that courts generally apply corporate successor liability rules to all types of business entities and applying successor liability principles to impose liability on LLC that purchased assets from another LLC based on de facto merger doctrine).

*Odnil Music Limited v. Katharsis LLC*, No. CIV S-05-0545 WBS EFB PS, 2007 WL 3308857 (E.D. Cal. Nov. 6, 2007) (finding that trust that purchased LLC's assets was successor of LLC under mere continuation doctrine of successor liability).

*Societe Anonyme Dauphitex v. Schoenfelder Corporation*, No. 07 Civ. 489, 2007 WL 3253592 (S.D. N.Y. Nov. 2, 2007) (concluding that successor liability of LLC for obligation of corporation was adequately alleged under de facto merger and mere continuation doctrines).

*Nacio Systems, Inc. v. Gottlieb*, No. C 07-3481 PJH, 2007 WL 3171271 (N.D. Cal. Oct. 26, 2007) (stating that court was unaware of any authority holding that LLC cannot be successor to individual and finding that LLC was arguably successor of individual who entered employment agreement with defendant and thereby bound by arbitration clause in individual's employment agreement).

***Kowalski v. Integral Seafood LLC***, Civ. Nos. 05-00679 BMK, 06-00182 BMK, 2007 WL 1376378 (D. Hawaii May 4, 2007) (joining LLC as transferee of interest in patent infringement action based on evidence of transfer to LLC of goodwill and business contacts of member).

***Storage and Office Systems, LLC v. United States***, 490 Supp.2d 955 (S.D. Ind. 2007) (refusing to apply federal common law successor liability principles to hold LLC purchaser of corporation's assets liable for unpaid taxes because tax lien was not filed at time of sale and federal common law should not be applied to supplement or modify scheme established by IRC Section 6323).

***Butler v. Adoption Media, LLC***, 486 F.Supp.2d 1022 (N.D. Cal. 2007). After a general partnership refused to post the profile of a gay couple on the partnership's website facilitating adoption, the couple sued the partnership, its two individual partners, two Arizona LLCs subsequently formed by the individuals, and two corporations formed by the individuals to serve as members of the LLCs. The plaintiffs argued that the LLCs were liable as successors of the partnership and that the LLCs and other entity defendants were all alter egos of the individuals. After the partnership refused to post the plaintiffs' profile on its web site, the individual partners formed the two LLCs, transferred assets from the partnership to the LLCs, formed two corporations (one owned by each of the individuals) to serve as members of the LLCs, and transferred their membership interests in the LLCs to the corporations. Applying California successor liability rules to the analysis of whether the LLCs were liable as successors of the partnership, the court concluded that there was no basis for successor liability because there was no express or implied assumption, the requirements of the de facto merger and mere continuation doctrines were not met (since the partnership continued to exist), and there was no evidence that the partnership transferred assets to the LLCs for a fraudulent purpose. Applying California law to the analysis of whether the LLCs and other entity defendants were alter egos of the individuals and one another, the court granted summary judgment to the defendants.

***Baca v. Depot Sales, LLC***, Civil Action No. 06-cv-00714-EWN-PAC, 2007 WL 988061 (D. Colo. March 30, 2007) (applying successor liability principles to LLC that acquired sole proprietorship).

***Drayton Grain Processors v. NE Foods, Inc.***, Civil File No. 3:06-cv-37, 2007 WL 983825 (D. N.D. March 20, 2007) (concluding that corporation was liable as successor to dissolved LLC under any of four exceptions to general rule that purchaser of assets does not assume liabilities of purchased company).

***Union Square Grill Hospitality Group, LLC v. Blue Smoke American Bar & Grill LLC***, No. 3:06-CV-00976 (PCD), 2007 WL 869024 (D. Conn. March 19, 2007) (concluding that LLC that succeeded to dissolved LLC's business was liable for judgment against predecessor LLC under "continuity" doctrine of successor liability).

***Sundance Rehabilitation Corporation v. New Vision Care Associates II, Inc.***, No. 04-3571-CV-S-FJG, 2007 WL 709014 (W.D. Mo. March 5, 2007) (holding that plaintiff did not establish grounds to pierce veil of corporate and LLC entities even though LLC had been found to be continuation of corporate predecessors because criteria necessary to satisfy corporate continuation doctrine differs significantly from test to pierce corporate veil).

#### **YY. Conversion, Merger, Reorganization**

***In re Touch America Holdings, Inc.***, No. 03-111915 (KJC), 2007 WL 4522328 (Bankr. D. Del. Dec. 17, 2007) (stating that surviving Delaware LLC that merged with Montana corporation succeeded to all of corporation's pre-merger property rights and liabilities under Montana and Delaware law and that holding company that owned LLC had no direct interest in LLC's property).

***Bernstein v. TractManager, Inc.***, C.A. No. 2763-VCL, 2007 WL 4179088 (Del. Ch. Nov. 20, 2007). An LLC converted to a corporation, and the corporation's bylaws provided for mandatory advancement of expenses to current and former officers and directors of the corporation. The corporation asserted claims against Bernstein, a director of the corporation who was also a co-founder and manager of the predecessor LLC, based on actions taken prior to the conversion. The LLC operating agreement provided for mandatory indemnification but not mandatory advancement. The court acknowledged that the LLC's obligation to indemnify Bernstein under the operating agreement was preserved

in the conversion, but the operating agreement did not provide for mandatory advancement, and the court rejected Bernstein's claim that he was entitled to advancement of expenses under the bylaws. Bernstein argued that the bylaws provision granting advancement rights to any person made a party to an action "by reason of the fact that he or she is or was a director or officer of the corporation" should be read to include managers of the predecessor LLC. The court distinguished the instant case as involving a more fundamental change in identity than a case relied upon by Bernstein in which a corporation reincorporated in another state. The court pointed to the differences in the corporate and LLC statutes regarding indemnification and the fact that the bylaws provided for mandatory advancement only for directors and officers of the corporation when they easily could have included language granting advancement rights to managers and officers of the LLC. The court stated that the operating agreement should control just as it would if the tables were turned, i.e., if later adopted bylaws were more restrictive regarding the rights applicable to officers and directors of the corporation. The court thought it unlikely that a court in such a case would infer a silent intention to alter the more generous arrangements previously enjoyed by the managers or officers of the predecessor LLC.

*Miller v. Ross*, 841 N.Y.S.2d 586 (N.Y. A.D. 1 Dept. Sept. 20, 2007) (holding that lower court correctly applied New York rather than Delaware law in suit seeking to unwind conversion of New York limited partnership into Delaware LLC and that court properly found conversion was ineffective where sole member of entire class of ownership interest voted against conversion, concluding that statutory mechanism requiring consent of class was sole manner of making entity change absent merger or consolidation, and limited partnership agreement was properly interpreted to limit general partner's powers rather than grant authority to change organization of limited partnership).

*NDC LLC v. Topinka*, 871 N.E.2d 210 (Ill. App. 2007). The court held that a Delaware LLC was liable for the franchise tax of a Delaware corporation that merged into the LLC, although the Illinois Business Corporation Act imposes franchise taxes only on corporations, because the Delaware merger statute, which governed the effect of the merger of the Delaware corporation into the Delaware LLC, provides that all debts, liabilities, and duties of the merging entities attach to the surviving or resulting entity and may be enforced against it. The tax accrued when a change in the corporation's paid in capital occurred prior to the merger, and the fact that the certificate indicating the increase in the corporation's paid in capital was not filed and did not become payable until after the merger did not preclude the tax from being imposed on the LLC.

*In re Mattera*, No. 05-39171, 2007 WL 1813763 (Bankr. D. N.J. June 13, 2007) (granting request of debtor's spouse for order compelling compliance with subpoenas against lawyers who allegedly obtained interests in LLC resulting from post-petition conversion of debtor's law practice from general partnership to LLC without court's consent because subpoenas sought to determine if additional assets of bankruptcy estate existed (stating that it could be argued that assets of a general partnership become assets of the bankruptcy estate of a partner because a general partnership has no legal existence separate from its owners), and conversion of firm to LLC could affect determination of non-dischargeability for fraud).

*Regency Plaza, LLC v. Morantz*, No. 06AP-837, 2007 WL 1536812 (Ohio App. May 29, 2007) (concluding that transfer of real property from individuals to wholly owned general partnership and then to wholly owned LLC were not changes in ownership contemplated by settlement agreement that would void agreement).

*Freeman Management Corporation v. Shurgard Storage Centers, Inc.*, No. 3:06cv736, 2007 WL 1541877 (M.D. Tenn. May 23, 2007). The court held that the merger of a corporation into a newly formed Delaware LLC effected a transfer by operation of law of the corporation's interests in several joint ventures and thus violated a provision in the joint venture agreements prohibiting transfer of the joint venture interest without the consent of the other joint venturer. The merger was accomplished under the Washington Business Corporation Act and the Delaware Limited Liability Company Act, but the joint venture agreements provided that they were governed by Tennessee law. The court determined that Tennessee law applied to the issue of whether the merger resulted in a transfer for purposes of the prohibition on transfer under the joint venture agreements. The court reviewed Tennessee merger statutes and case law and concluded that a merger results in a transfer by operation of law under Tennessee law. The court also reviewed case law in other jurisdictions supporting its conclusion that "vesting" language in a merger statute involves a transfer. The court distinguished a Texas case that concluded a merger does not result in a transfer, pointing out the explicit language in the Texas statute providing that property vests "without any transfer." The court also noted that the new LLC in this

case was owned by a third-party competitor, and the court stated that construing the merger as not having effected a transfer would result in forcing the other joint venturers to accept as a partner a person with which they did not consent to be partners.

*Beacon Square Limited Partnership v. Inland Wetlands*, No. CV064011011S, 2007 WL 1247094 (Conn. Super. April 13, 2007) (discussing effect of conversion of limited partnership to LLC and holding LLC and its manager were aggrieved parties in land development permit proceeding where application for permit was made by manager of LLC and land was actually owned by LLC but record title was held in predecessor limited partnership).

*Browning Ferris Industries, Inc. v. United States*, 75 Fed.Cl.591, 99 A.F.T.R.2d 2007-1312, 2007-1 USTC ¶ 50,374 (Fed. Cl. 2007) (holding that common parent corporation of consolidated group that converted (under Delaware conversion provisions) to single member disregarded LLC was constructively liquidated upon conversion and ceased to exist for purposes of serving as agent of consolidated group).

#### **ZZ. Liability of Sole Member of Disregarded LLC for Employment Taxes**

*Stearn & Company, L.L.C. v. United States*, 499 F.Supp.2d 899 (E.D. Mich. 2007). The court held that the sole member of a disregarded LLC was personally liable for penalties and interest on unpaid federal employment taxes. The court rejected the member's arguments that the check-the-box regulations do not apply to federal employment taxation and that proposed amendments to the check-the-box regulations reflect the existing meaning of the rules. The court also rejected the member's argument that state law protected him from liability. Finally, the court concluded that the member had waived his argument that he never received adequate notice that he would be liable for the disregarded LLC's employment tax liability. The court stated that IRS notices and pronouncements regarding employment tax liability for owners of disregarded LLCs were sufficient notice even if the member had not waived this argument.

*McNamee v. Dept. of Treasury*, 488 F.3d 100 (2<sup>nd</sup> Cir. 2007). The Second Circuit joined the Sixth Circuit in upholding the validity of the check-the-box regulations and affirming the ability of the IRS to hold a single member of a disregarded LLC personally liable for unpaid employment taxes. McNamee was the owner of a single member LLC that had not elected to be treated as a corporation under the check-the-box regulations. The LLC failed to pay any required payroll taxes (i.e., unemployment, social security and Medicare as well as withheld employee income taxes and employee FICA contributions) for a year and a half. The IRS assessed the taxes against McNamee personally and placed a lien on his property. McNamee argued that the IRS did not have authority to pierce the veil of an LLC and that the check-the-box regulations conflicted with the Internal Revenue Code. The court of appeals held that the check-the-box regulations are eminently reasonable in light of the emergence of LLCs and the ambiguous statutory treatment under the Internal Revenue Code. The court also rejected McNamee's argument that proposed changes to the regulations, under which a disregarded LLC's owner would not be liable for payroll taxes, indicate that the current regulations are wrong. The court held that the proposed changes provide no basis for finding the existing regulations unreasonable. Finally, the court rejected McNamee's argument that the IRS's attempt to collect the LLC's unpaid payroll taxes from him violates state law. The court concluded that single member LLCs are entitled to whatever advantages state law provides, but state law cannot abrogate the owner's federal tax liability.

*Litriello v. United States*, 484 F.3d 372 (6<sup>th</sup> Cir. 2007). The plaintiff, the sole member of several disregarded LLCs, was deemed to be the sole proprietor of the businesses under Internal Revenue Code Section 7701, and the IRS sought to levy on the plaintiff's property in connection with unpaid employment taxes arising from the LLCs' operations. The plaintiff challenged the check-the-box regulations on several grounds. The court rejected the plaintiffs' challenges, holding that the check-the-box regulations are a reasonable interpretation of ambiguous provisions of Section 7701 and a valid exercise of agency authority by the Treasury. The court also concluded that the plaintiff's failure to make an election under the check-the-box regulations dictated that the LLCs be treated as disregarded entities under the regulations and prevented them from being treated as corporations; therefore, the plaintiff was deemed to be the sole proprietor of the businesses under Section 7701 and had personal liability for the employment taxes arising from the businesses. Finally, the court rejected the plaintiff's claim that the regulations impermissibly altered the legal status of the LLCs as separate entities under state law. While the plaintiff's LLCs were entitled to whatever advantages state law provided, the court concluded that state law could not abrogate his tax liability. The court noted that, after the plaintiff

filed his notice of appeal in this case, the IRS proposed amendments to its entity classification regulations that would shield individuals in the plaintiff's circumstances from personal liability, but the court rejected the argument that the proposed regulations should be deemed to reflect the Treasury's current policy and applied to the plaintiff's case. The court concluded that the proposed regulations did not in any way undermine the determination that the current regulations are reasonable and valid.

#### **AAA. Single Member LLC and Privilege Against Self Incrimination**

*United States v. Lu*, 248 Fed.Appx. 806, 2007 WL 2753030 (9<sup>th</sup> Cir. 2007). The court held that single member LLCs are not protected by the Fifth Amendment privilege against self-incrimination and that the district court properly denied a member's motion to quash a subpoena ordering production of business records of her single member LLCs. Though the Fifth Amendment privilege is available to sole proprietorships, it is not available to collective entities because they are separate legal entities from their owners. The Supreme Court left open in *Braswell v. U.S.* whether Fifth Amendment protection applies to production of business records when a corporation, which would generally be a collective entity, has only a single employee who also serves as the sole officer. The sole owner of the LLCs in this case argued that the LLCs were not collective units because she was the sole owner and operator and there were no employees. She attempted to bolster the argument that her single member LLCs were analogous to sole proprietorships by noting that she was subject to tax as an individual. The court stated that the single member LLCs were hybrids of both corporations and sole proprietorships, but the crucial distinction was that the individual member was acting in a representative capacity. The state law requirement that an LLC have a statutory agent indicates an agency relationship. The court pointed out that the member served as statutory agent and was free to add other members, which would implicate other aspects of collective entities. The court stated that the member intentionally took advantage of corporate characteristics of the LLC structure to obtain asset-protection benefits, and the business documents were not personal to her because she clearly intended the business to be separate in the event of a lawsuit. Having chosen to organize her businesses as LLCs and obtain the benefits, the member was not free to disregard the creation of separate entities to obtain Fifth Amendment protection for the LLCs' records. The member argued that production of the subpoenaed documents would incriminate her because she was the sole owner and employee and the jury would reasonably conclude she created the documents. The Supreme Court left open the possibility of Fifth Amendment protection in such a situation in *Braswell*, but the court said the jury in this case could reasonably conclude other persons produced the business documents because it appeared highly unlikely a person could own and operate multiple massage parlors without employees.

#### **BBB. Attorney Liability, Disqualification**

*In re Senior Cottages of America, LLC (Moratzka v. Morris)*, 482 F.3d. 997 (8<sup>th</sup> Cir. 2007) (holding that trustee had standing to bring claim against attorneys for aiding and abetting breach of fiduciary duty of manager/majority owner of debtor LLC because debtor could have asserted claim prior to filing of bankruptcy, and trustee adequately stated claim for aiding and abetting breach of duty where trustee alleged manager/majority owner stripped LLC's assets without reasonable compensation, attorneys knew action was in breach of owner's fiduciary duty, and attorneys provided substantial assistance and advised LLC to conclude transaction).

*Valley/50th Avenue, L.L.C. v. Stewart*, 153 P.3d 186 (Wash. 2007) (holding that member and LLC were separate entities both of whom were owed duty by attorneys who took deed of trust on LLC's property to secure payment of legal fees owed by member and concluding that fact issues as to firm's compliance with ethical obligations precluded summary judgment foreclosing deed of trust).

#### **CCC. Attorney Client Privilege**

*Union Square Grill Hospitality Group, LLC v. Blue Smoke American Bar & Grill LLC*, No. 3:06-CV-00976 (PCD), 2007 WL 869024 (D. Conn. March 19, 2007) (holding LLC liable for judgment against predecessor dissolved LLC under "continuity" doctrine of successor liability).



***Melcher v. Apollo Medical Fund Management, L.L.C.***, 829 N.Y.S.2d 483 (N.Y. A.D. 1 Dept. 2007) (holding that member waived attorney-client privilege with respect to conversations with counsel relating to formation of LLC where member selectively disclosed portions of communications beneficial to his position in affidavit and deposition).