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UNINCORPORATED BUSINESS ENTITIES

FOURTH EDITION

TEACHER'S GUIDE FOR SELECTED MATERIALS IN THE 2011 SUMMER CUMULATIVE SUPPLEMENT

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3.02 Existence of Partnership: Partnership Law

Page references: 2011 Supplement, 1; Teacher's Guide, 73 (add before Problem Set 3-1).

We have added an excerpt from Judge Easterbrook's opinion in the *Alzheimer & Gray* reorganization case to Note 3-2(7). This is a troubling analysis in a troubling case. The court denied a non-equity partner's claim against the bankrupt estate on the theory that the use of the word "partner," even appended to "non-unit," signaled to creditors that he was not competing with them for the assets of the firm. In substance, notwithstanding the "signaling," Berens was likely not a partner, at least in the usual sense under UPA and RUPA, of being a co-owner. We have posed the question whether the same analysis Judge Easterbrook employed would hold were Berens to have been sued by creditors in his capacity as an alleged partner to make good on the obligations of the firm.

Should Judge Easterbrook's holding have implications beyond the application of the reorganization plan involved in that case? Specifically, should someone being held out as a partner in a law firm, while actually having status within the firm under a description like "non-unit partner," "salaried partner," or "non-equity partner," be concerned that he or she will be exposed to the downside of individual partner liability upon dissolution or bankruptcy while not receiving the upside of equity participation during the life of the organization? Does the title "partner" signal, as suggested by Judge Easterbrook, the status of equity owner, or is it a title used to justify higher hourly rates, and/or to assuage the ego of the lawyer? Given the economic retrenchment and restructuring likely to affect many large law firms, should potential non-equity partners be concerned?

9.02 Dissolution and Dissociation Causes

A. Dissolution at Will: Term and At-Will Partnerships

Page references: 2011 Supplement, 4-5; Teacher's Guide, 186 (insert after discussion of *Page*).

The two cases added to Note 9-1(2), *Saint Alphonsus Diversified Care* and *BPR Group*, emphasize the importance of thoughtful drafting, particularly on an issue that ought to be fundamental to the business relationship, such as whether the partnership is at-will or for a term. In the 2010 Supplement, we pose the question, "How do the holdings in these two cases differ regarding the balance between the cost of partner illiquidity and the cost of partnership discontinuity discussed in §9.01(C)?"

In *Saint Alphonsus*, the UPA was in effect when the general partnership was formed, but RUPA was in effect when one of the partners purported to dissociate for a reason other than that stated in the partnership agreement. The problem was that RUPA not only introduced the concept of "dissociation" but also changed the relevant language governing whether a dissociation was wrongful (i.e. what the parties could do to contract around the "at-will" default rule). Under UPA §31(2), dissolution was wrongful if "in contravention of the agreement between the partners." Under RUPA §602(b)(1), wrongful dissociation occurs when a partner is "in breach of an express provision." Thus, the court held that the dissociation was not wrongful under RUPA unless the agreement expressly provided that the conditions for withdrawal were exclusive.

In *BPR*, the court applied the UPA. One of the partners purported to dissolve what he claimed was an at-will partnership. The court disagreed, holding that the agreement's

enumeration of four conditions (even though they were not expressly exclusive) created a partnership for a definite term or a particular undertaking.

We take these teaching points from the cases:

1. The cases, when read together, suggest that the standard for contracting around the default rule is indeed different under the UPA and RUPA. Under RUPA, a partner will not be bound for a term or a definite undertaking by contract language that simply enumerates particular conditions under which a partner may dissociate, and falls short of something like "any dissolution or purported dissolution shall be deemed a breach of the partnership agreement." In short, under RUPA, unless you make express the terms under which you expect your partner to remain in the partnership, you leave open the possibility of an at-will withdrawal.

2. Clearly, the RUPA provision (at least as applied in *Saint Alphonsus* compared to *BPR*) favors partner liquidity over partnership continuity. This contrasts with other RUPA changes that increase continuity.

3. The easiest way, in practice, to avoid an abstract discussion of issues like "liquidity" versus "continuity" is to have a provision that covers the situation unambiguously. Private ordering in this context trumps policy.

11.07 Fiduciary Duties and Remedies

C. Remedies

Page references: 2011 Supplement, 7; Teacher's Guide, 246 (insert after discussion of *Anglo-American*).

We have added some topical cases to the notes in which the direct-derivative distinction has surfaced in cases filed in the aftermath of the Madoff debacle against various funds organized as limited partnership (and LLCs). *Newman*, *Goldweber*, and *Lewin* all involve claims against the managers of Madoff's "feeder funds."

12.03 Management

C. The Agency Power of Members and Managers

Page references: 2011 Supplement, 11; Teacher's Guide, 274 (add at the end of the section).

We've added two cases to Notes and Questions 12-7 that reach the fairly unremarkable conclusion, at least under agency law, that the LLC is likely to be bound by the apparent authority of the manager, notwithstanding limitations on the authority within the operating agreement. The note asks students to compare this result to *Luddington*, the limited partnership case in which the court held that the general partner did not have apparent authority to sign a mortgage, based on a close reading of the publicly filed limited partnership certificate which authorized the GP to borrow and lend, but not merely to mortgage. We think these cases are more typical of the outcomes one should expect, i.e. that LLC members should be the least-cost avoiders as against third parties with respect to questions of authority. Whether there is any operating agreement drafting solution depends on whether the third party should be expected to closely review the LLC's internal documentation. See our discussion of *Luddington* at page 233 of the Teacher's Guide.

12.04 Members' Financial Rights and Obligations

Page references: 2011 Supplement, 12; Teacher's Guide, 279 (add at the end of the carry-over paragraph).

Notes and Questions 12-10(2) discuss several cases that deal with interpretation of the operating agreement where members have been called upon for additional capital. Vice-Chancellor Strine's opinion in the *Related Westpac* case highlights a common issue of "liquidity crisis opportunism" that we saw in *Chandler* and will see again in *Fisk Ventures*. The firm desperately needs money or a drastic change in policy and the agreement appears to give the partner or member who is the finance source full discretion in deciding whether or not to proceed. *Chandler* addressed the issue in terms of contract interpretation; *Related Westpac* upholds the clear language of the discretionary power in the agreement in the face of "reasonableness" or fairness arguments, and *Fisk Ventures* does the same with respect to claims of fiduciary obligation.

12.05 Transfer of Interests

B. Creditors' Remedies

Page references: 2011 Supplement, 13-21; Teacher's Guide, 283 (add at the end of the section).

Olmstead

This case is a thorough vetting of the single member LLC issue in the context of creditor avoidance. Since Larry has a more passionate view on the policy issue than Jeff, we outline two views here because it may help you in stirring up class discussion.

The FTC had successfully sued a couple of scammers, and was now seeking to get at their assets for purposes of restitution to the victims of the scams. The U.S. District Court hearing the case ordered the scammers to "endorse and surrender to the receiver all of [scammers'] right, title, and interest" in several single member LLCs. The federal court certified to the Florida Supreme Court the issue whether this was permissible under the Florida LLC Act. The Florida LLC act ([Fla. Stat. Section 608.433\(4\)](#)), like other LLC acts, lets an LLC member's creditors reach only the member's interest in the LLC, via something borrowed from partnership law called a "charging order." LLC acts typically define this interest to include only the member's economic rights, including the right to distributions (e.g., Fla. section 608.402(23)). A single member LLC often has the sort of property, like the debtor's residence, which does not generate any distributions. Anyway, the debtor, as the sole member, controls whether the distributions are made. Thus, the charging order basically gives the creditor only the right to sit and wait for the debtor to decide to get generous and distribute the LLC's assets to his creditors.

As we have seen in the partnership (see *Hellman v. Anderson*) and LLC discussions, the charging order remedy was designed to protect partners' governance rights. In the traditional partnership these are substantial, which is understandable since each partner has personal liability for the debts of the business. If a single partner's creditor could take over the partner's governance rights, this could disrupt the traditionally close and co-equal partnership relationship. Notably, partnerships are defined as having two or more members. The charging order carried over to LLCs, which have been based from the beginning largely on the partnership model. Limited liability arguably reduced the need to be careful about usurping members' governance rights, but didn't make enough of a difference to make the

charging order clearly inappropriate.

The majority (five justices) of the Florida Supreme Court immediately broadened the certified question from that posed by the federal court – namely whether this was permissible under the Florida LLC Act. Finding itself unduly constrained by the charging order provision, the court instead asked whether “*Florida law*” requires the surrender of all membership rights. The majority noted, as a matter of policy (and reality), that co-member consent to transfer of governance rights was irrelevant by definition in single-member LLCs. But that still left the clear statutory language that precluded the transfer of governance rights (in this case, to the FTC's receiver). The court dealt with this by reasoning that applying the charging order provision would effectively abrogate the general execution statute that makes various types of property, including corporate stock, subject to attachment and execution. The LLC, said the court without any basis or citation, is “a type of corporate entity.” Anyway, the LLC statute, while specifying the charging order remedy, didn’t say explicitly that was the “exclusive” remedy (as it had in other unincorporate statutes). This gave the court enough of a hook to apply the general attachment statute.

Two of the seven justices dissented. The opinion noted the unanimity of academic opinion in opposition to the majority approach, citing among others, Ribstein's article, *Reverse Liability and the Design of Business Associations*, [30 DEL. J. CORP. L. 199](#) (2005), from which the dissenters drew a long quote. The dissenters also discussed, among other things, the obvious problem that the majority had usurped the legislature’s role stomping on the Florida LLC act; that by relying on non-exclusivity it had unsettled creditor remedies for all LLCs and not just the single-member ones they were worried about; that exclusivity is the only reasonable reading where the statute applies only one remedy; and that the court’s remedy could support transferring management rights even where the judgment is for less than the value of the interest. The dissenters also suggested alternative approaches for dealing with single-member LLCs that did less violence to the statutory language: dissolving the LLC when a charging order effectively emptied out the whole economic interest; or dealing with the problem in bankruptcy, where the whole economic interest is transferred to the bankruptcy estate whether or not it equals or exceeds a particular judgment.

Larry views this as a fundamental problem with permitting single-member LLCs. See his post, *The Olmstead decision and the problems with single member LLCs*, <http://truthonthemarket.com/2010/06/27/the-olmstead-decision-and-the-problem-of-single-member-llcs/>. He argues there that the move from the multiple-owner partnership model to permitting single-member LLCs was questionable, or at least should have been undertaken with great care. The charging order illustrates the problem: it was designed specifically to accommodate the rights of both creditors and non-debtor members, and therefore is arguably unnecessary if there are no non-debtor members. Moreover, charging orders are more subject to debtor opportunism in single member LLCs because they invite a distribution policy designed solely to frustrate the debtor’s creditors. He also cites empirical evidence suggesting that single member LLCs have been widely used specifically as debtor-protection vehicles.

The opinion raises two issues. First, we have a court trying to jam a square peg of the charging order policy into the round hole of a single member business association. Larry thinks it's incumbent on legislatures to fix the problem perhaps by providing that creditors are not restricted to charging orders in single member LLCs. That, of course, raises the "peppercorn" issue again if there are nominal members with very small governance interests. More drastically, legislatures also might remove the temptation for asset protection by reinstating the business purpose requirement for LLCs, or at least qualifying the use of the charging order for LLCs used primarily for protecting assets from creditors. Here's a quote

from Larry's *The Rise of the Uncorporation*:

The basic problem is that business association statutes should not have allowed nonbusiness and one-member LLCs because the statutes were not designed for these situations. The charging order provisions exist to protect ongoing businesses with multiple members. Opening up the statutes to relationships that do not fit the rules of the business association rendered them incoherent. It should not be surprising that this led to unintended consequences. The result is the chaos engendered by *Albright* and now *Olmstead*, where neither creditors nor members of any LLCs can be sure what their rights are.

Jeff, on the other hand, thought one of the most perceptive comments in Larry's blog post was that the issue "outwardly appeals only to the sort of people who think about LLCs in the shower." Thankfully, people like Larry think about the overall coherence of standard form business associations so as to construct schemes that most effectively reduce transaction costs. Jeff wholly concurs with Larry that (a) the dissent clearly had the better of the legal, rational argument, and (b) legislatures ought to be careful in thinking about the consequence of the kinds of default rules they put in place so as to weight unduly the balance between creditors and debtors.

Nevertheless, as a person who is quite sure he has never thought about LLCs while in the shower, Jeff is sympathetic to the motivations (even if unimpressed by the argumentation) of the majority. "Whaddaya mean we can't get at the assets of something somebody owns by his or her lonesome?" Jeff thinks the charging order remedy combined with a single-member LLC makes no sense, for all the reasons Larry asserts. But Jeff sees no reason to ban single member LLCs, any more than to ban single shareholder corporations (which, by the way, is not an uncommon practice in civil law jurisdictions – when we fired an executive in France, for example, we always had to find out whether he or she was one of the seven shareholders that we were required to have to maintain a French S.A.). Jeff thinks the sensible solution is to bar charging orders for single-member LLC, but otherwise let them have the same risks and rewards of limited liability (including veil-piercing) as the 100% shareholder of a corporation.

12.06 Issues of Limited Liability

Page references: 2011 Supplement, 21; Teacher's Guide, 284 (add after the discussion of *Countryman*).

The supplement adds a reference to a Hawaii statute providing that violation of a statutory penal provision "shall be deemed to be also that of the individual members, managers, or agents of the limited liability company who have authorized, ordered, or done any of the acts constituting in whole or in part the violation."

We ask, "How might this provision affect the result in cases like *Countryman*?" As we noted, *Countryman* was a less an LLC case than a "tort liability of an agent" case. The Hawaii statute, unremarkably, provides that the liability shield of the LLC does not preempt respondeat inferior as to a responsibility of a member, manager or agent for that individual's own torts. It seems to us the tougher question is the breadth of the statute. If the manager of an LLC assigns an employee to dispose of solid waste, and the employee violates company policy and the Hawaii Penal Code by dumping it off Diamond Head into the Pacific, the manager *did* "authorize ... any of the acts constituting ...in part the violation." Would a penal action against the authorizing manager survive a constitutional challenge?

12.07 Fiduciary Duties

B. Members' Duties

Page references: 2011 Supplement, 22; Teacher's Guide, 290 (add after the second full paragraph on the page).

Note 12-15A raises the issue of the existence of duties in the formation of the LLC, and reflects the continuing confusion between the LLC and the corporate standard forms. *Roni LLC* held that the organizer of an LLC had a pre-formation fiduciary duty to the members, akin to the fiduciary duty of an incorporator. We think this is the wrong analogy, for the reasons set forth in Larry's cited blog post. In the absence of express statutory language, the better analogy is to the default rule for pre-formation duties among *partners*, which is that they do not exist.

C. Fiduciary Duty Contracts

Kelly

Page references: 2011 Supplement, 23-30; Teacher's Guide, 291 (add before paragraph beginning "In Note 12-15(1)....")

We referred to *Fisk's* approach as "ultra-contractarian;" *Kelly* provides a nice bookend to *Fisk* on relatively simple facts. The underlying issue in *Fisk* was really about construing a sophisticated and tightly negotiated venture capital arrangement for a startup company; the fiduciary issue was really a pretext for renegotiating the exit provisions after the fact, and Chancellor Chandler was appropriately unsympathetic. *Kelly* involves more venal doings – not just a squeeze-out, but one executed by way of an undisclosed self-dealing transaction (a la the situation in *Labovitz v. Dolan*). *Kelly* makes it clear that Delaware is indeed contractarian as to the waiver of fiduciary duties, but the default rule is still that those duties exist, and a waiver has to be clear.

The logic of *Kelly* runs as follows:

1. Even though Section 18-1101 of the Delaware LLC Act permits members the freedom, by contract, to expand, restrict, or eliminate duties, including fiduciary duties, owed by members and managers to each other and to the LLC, and even though there is no statutory default rule in the Delaware statute on fiduciary obligations, it is still *not* the case, as the *Kelly* defendants contended, that the only fiduciary obligations are the ones the parties expressly create.
2. The default fiduciary duties under Delaware LLC law are the same as the traditional fiduciary duties that directors and controlling shareholders in a corporation would owe to the other shareholders.
3. The operating agreement in *Kelly* affirmed the existence, rather than explicitly disclaiming or limiting, traditional fiduciary duties.
4. The exculpatory clause on fiduciary breach in the operating agreement made an exception for willful breach of contractual or fiduciary obligations, and the facts alleged supported a claim of willfulness.

5. As a default rule, the controlling members of an LLC carry the same traditional fiduciary obligation with respect to "minority oppression" as has developed in the case law for controlling shareholders: the duty 'not to cause the corporation to effect a transaction that would benefit the fiduciary at the expense of the minority stockholders."

6. Nothing in the operating agreement was an explicit limitation or elimination of these default duties.

We discussed the policy argument for and against permitting fiduciary duty waivers at Note 8-4(2) of the text. At least in Delaware, *whether* a complete waiver is permissible is settled in theory. We noted in the Teacher's Guide discussion of that note "the idea that most contracting parties would expect fiduciary duties to exist, and that the least-cost avoider with respect to a retrenchment from that default is the party seeking the waiver." *Kelly's* result seems to demonstrate how a complete waiver needs to work in practice. Sensible default rules are those we'd expect the parties to agree to had they thought about or addressed the matter. The least-cost avoider is the party seeking to eliminate the duties, and the failure (or unwillingness) to be bold enough to say something like the following (in more appropriate legalese) is telling: **"I HAVE NO FIDUCIARY DUTIES OF ANY KIND TO YOU – I COULD BE DISLOYAL, APPROPRIATE OPPORTUNITIES, SLACK OFF, BE NEGLIGENT OR RECKLESS, AND YOU HAVE NO, REPEAT NO, LEGAL RECOURSE WHATSOEVER, IN THIS WORLD OR ANY OTHER WORLD AGAINST ME. SO THERE."** That's about what Blackstone said to its unit owners in the IPO. What was implicit as the next paragraph for Blackstone would have been something like this: **"SO YOU ARE GOING TO HAVE TO RELY TOTALLY ON TRUST AND NOT THE LAW TO PROTECT YOU."** And sure enough, that worked, because for those unit owners the opportunities outweighed the benefit of the legal remedies otherwise waived.

Notes and Questions 12-16A in the Supplement provide additional cases on this point. Note (2) points out Vice-Chancellor Strine's opinion in *Related Westpac*, excerpted in Notes and Questions 12-10(2), which held that the operating agreement successfully limited or disclaimed the fiduciary duties. Note (3) discusses *Atlas Energy Resources*, involving a publicly held LLC, in which the waiver language was insufficient to exculpate the controlling, and compares it to the Blackstone documentation.

D. Remedies

1. Derivative Actions

Page references: 2011 Supplement, 30-33; Teacher's Guide, 293 (add after the discussion of *Tzolis*).

We have some additional materials following up on *Tzolis* in New York, where the statute did not provide for a derivative action, but the courts have implied one.

The additional material in Notes and Questions 12-17(5) follows up on the direct-derivative claim distinction addressed by *Anglo-American* in the limited partnership context. (Note that, unlike New York, these are all jurisdictions in which the legislature has explicitly created the derivative remedy for LLCs.) The policy question, as discussed in Larry's *Business Lawyer* article, is whether the importation of the derivative remedy into the LLC laws makes any sense where the businesses are closely held.

Added Notes and Questions 12-17(9) address the new topic of whether LLC creditors should have the same right as corporate creditors in Delaware to to assert derivative claims

against officers and directors of the corporation. In a scholarly opinion, Vice-Chancellor Laster answered both questions in the negative. The opinion might be worth assigning for its excellent analysis of the contractual nature of LLC law even if the specific question in the case does not warrant the time and space.

2. Contractual Remedies

Page references: 2011 Supplement, 33; Teacher's Guide, 293 (add at the bottom of the page).

This is a discussion of the amendment to the Delaware limited partnership and LLC laws, undertaken in response to *Elf Atochem*, that bars limited partners and non-manager members of LLCs from waiving their right to sue in Delaware courts in connection with the internal organization of their firms. We've asked how this can be squared with Delaware's "freedom-of-contract" policy in unincorporation cases. The *Baker* case declined to extend this judicially to corporations in view of the absence of any such provisions in the DGCL, but did not expound on the policy reasons for the distinction between the two contexts. The Delaware legislature appears to have responded explicitly to the *Elf Atochem* opinion ("Had the General Assembly intended to prohibit the parties from vesting exclusive jurisdiction in arbitration or court proceedings in another state, it could have proscribed such an option."). Jeff's guess is that the General Assembly did not actually see a difference, and was in fact sensitive to Delaware's desire to be the jurisdiction of choice for corporations as well as LLCs. Larry would add that any distinctions between the two contexts generally stress the pro-contractual nature of unincorporations, a distinction that cuts the other way in this situation.

12.08 Dissociation and Dissolution

B. Dissolution

2. Oppression and Deadlock

Page references: 2011 Supplement, 33-49; Teachers' Guide, 303 (add at the end of the section).

A lot has happened over the last two years, so we've broken up what used to be Section 12.08(B)(2), headed "**The Oppression Remedy**," into two sections. Section 12.08(B)(2), now headed "**Oppression and Deadlock**," runs through the discussion of *Fisk Ventures* to the middle of page 498, where we've added the Supplement insert of the three cases and the additional note. A new section, 12.08(B)(2a), headed "**Alternatives to Judicial Dissolution**," then starts with the paragraph beginning "As to whether...." (The heading changes only appear in the online, not the printed, versions of the 2010 Summer Supplement.)

We left off in the middle of page 498 with the *Fisk Ventures* case in which Chancellor Chandler used his power under the LLC Act to dissolve the troubled Genitrix LLC (Fisk Johnson having declined to bail it out) because deadlock made it "not reasonably practicable" to continue operating. We've added a series of cases decided since that opinion, as well as citations to commentary, highlighting the approaches of the New York and Delaware courts to intervening in the affairs of an LLC when the members do not get along any more.

Lola Cars

Here Vice Chancellor Noble fleshed out the standard for determining if deadlock justified judicial dissolution of an LLC, over the assertion of one of the members that such an order was permissible only if the business has been abandoned or its purpose is not being pursued.

The three "reasonably practicable" indicia from *Fisk Ventures* were:

- (1) Whether the members' vote is deadlocked at the Board level;
- (2) Whether there exists a mechanism within the operating agreement to resolve this deadlock; and
- (3) Whether there is still a business to operate based on the company's financial condition.

None of the factors is individually conclusive, nor need they all be found to justify dissolution.

The first part of *Lola Cars* is the application of these indicia to the facts, with the conclusion that it was not reasonable practicable to continue. (Notes and Questions 12-20A(2) in the Supplement highlights other cases in which the Delaware courts have also applied the standard.) The interesting question, however, is (a) whether an operating agreement can legally preclude judicial dissolution, and (b) if so, what does it take to do that? As to (a), the court's answer in *Lola Cars* is "assume so for now." (Larry's blog post, referred to in the Supplement, refers to *R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, 2008 WL 3846318 (Del.Ch. Aug. 19, 2008), in which Chancellor Chandler held that the answer to this was "yes".) As to (b), the court's answer is that having a voluntary buy-out provision or the right to withdraw upon the other member's breach is insufficient to eliminate the judicial dissolution remedy: "It simply cannot be true that a number of nonexclusive, permissive termination clauses in the Operating Agreement can preclude judicial dissolution as provided for in the Act."

An excerpt from Larry's blog post on *Lola Cars*, cited in the Supplement, is helpful:

The main question here is whether the court should hold that the oppression remedy was waived. There was no such explicit waiver [as in *R&R Capital*] in the *Lola* agreement—simply an agreement specifying alternative remedies. But overall, the agreement arguably did express the parties' intent as to how to dissolve the relationship.

Moreover, the statute calls for judicial dissolution "when it is "not reasonably practicable to carry on the business in conformity with a limited liability company agreement." or similar language. This language has the advantage of inviting the court to analyze the parties' expectations under the agreement. In my discussion of these issues in *Rise of the Uncorporation*, 180-82, I emphasize the dissolution remedy's "connection with the agreement." These expectations arguably are embodied in the agreement's termination provision. This provision may not be ideal, but it has the virtue of being what the parties agreed to.

Finally, even enforcing the termination provision will not necessarily get rid of the derivative suit. These suits raise other problems in very closely held

LLCs...

The bottom line is that this case indicates that the legal drafting "technology" in LLCs still has not been perfected. This leaves the courts to struggle through the relationship between the agreement and the default provisions of the statute. Perhaps the best thing that can be said for the way things stand in *Lola* is that it encourages parties to LLCs to get their act together in the agreement or face watching their expectations go through a statutory wringer.

With these considerations in mind, we would ask whether it would be appropriate to distinguish *Lola* from *Fisk* given the termination provisions in the former case.

We've added Notes and Questions 12-20A following the *Lola Cars* case. Note (1) compares the opinion after full trial on the merits to the opinion on the original motion to dismiss in *Lola Cars*. Larry's concern, reflected in his blog, is that the court was inconsistent in its first and second opinions, given that the operating agreement language on which the final opinion rested didn't change:

In the earlier *Lola Cars* opinion, the court held that

the Operating Agreement nowhere requires that a member terminate the Operating Agreement solely in accord with its stipulated termination provisions. Thus, the Court cannot conclude that these terms are exclusive. It simply cannot be true that a number of nonexclusive, permissive termination clauses in the Operating Agreement can preclude judicial dissolution as provided for in the Act.

However, in the most recent opinion the court denied dissolution after trial. The court again relied on the operating agreement:

The Court concludes by emphasizing that a party to a limited liability company agreement may not seek judicial dissolution simply as a means of freeing Lola itself from what it considers a bad deal. This is so even if the Member Parties' relationship has—as here, due largely to pressure applied by Lola both within and without the litigation context—been badly damaged. Endorsing such a rule would allow for one party—unfairly—to defeat the reasonable expectations of its counterparty. Moreover, the Member Parties in their private ordering effort embraced a provision within the Operating Agreement that allows for disentanglement. * * * [I]t is not for the Court to terminate, or rewrite, the Operating Agreement.

The court explained its apparent change of heart from the earlier opinion by noting that the level of managerial misconduct proved at trial fell short of the complaint's allegations.

I'm not completely comfortable with these opinions, for several reasons:

- Although the court could read the agreement either to permit or not to permit dissolution, I don't see how it could read the agreement both ways in the same case.
- I don't like the court's use of "moreover" in the quote immediately above, which suggests that "reasonable expectations" might come from something other than the operating agreement.
- The court's footnote explanation that the remedy depends on the level of party misconduct is unsatisfying. If the agreement's termination provisions were intended to preclude judicial dissolution, then damages, and not judicial dissolution, should be the exclusive remedy for any breach of duty the court might have found at trial.

In the final analysis, however, the real problem lies in the agreement. As I said in my previous post on *Lola*:

The bottom line is that this case indicates that the legal drafting "technology" in LLCs still has not been perfected. This leaves the courts to struggle through the relationship between the agreement and the default provisions of the statute.

Or as Chancellor Chandler said, when holding that non-dissolution agreements are enforceable (quoting the Bard): "our remedies oft in ourselves do lie."

Jeff wonders whether it's as much a change in position on the reading of the operating agreement as a reflection of courts' reticence, even in Delaware Chancery, to dismiss factually complex cases on the pleadings.

In contrast to the substantive conclusion in *Lola Cars*, Vice-Chancellor Strine found that it was indeed not reasonably practicable to carry on the business under an LLC operating agreement in the *Bob Vila* case, which we have excerpted at length in additional Note 12-20A(3). *Lola Cars* and *Vila* ought to provide the basis for a nice discussion of the circumstances under which a court will or will not grant relief.

Following the new notes, and having looked at Delaware, we consider how New York has dealt with the deadlock issue.

1545 Ocean Avenue

The facts are pretty clear that this is a successful operation, and that the dispute relates to a member's desire to be bought out, rather than any failures of operations or financing. That is, if the member who wants to liquidate can show a complete breakdown of the relationship with the other member, perhaps a court will help achieve the objective.

Section 702 of the New York LLC Law, as in Delaware, permits judicial dissolution "whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement." The Appellate Division concluded:

1. It would be inappropriate to cross-reference the dissolution standards from one form of business entity (corporations or partnerships) to another (LLCs).

2. Because of the reference in Section 702 to carrying on the business in conformation with the article and operating agreement in determining whether the LLC should be dissolved (contra the judicial dissolution standards in the Business Corporation Law and the Partnership Law), the inquiry in the first instance requires an analysis of the parties' contract.

3. The operating agreement here had no reference to dissolution. Although "deadlock" is a basis for dissolution under the Business Corporation Law, there is no reference to deadlock as the basis for dissolution under Section 702 of the LLC Law.

4. For dissolution of a limited liability company pursuant to Section 702, the petitioning member must establish, in the context of the terms of the operating agreement or articles of incorporation, that (1) the management of the entity is unable or unwilling to reasonably permit or promote the stated purpose of the entity to be realized or achieved, or (2) continuing the entity is financially unfeasible.

5. Under that standard, there was no basis for dissolving the LLC:

- The dispute wasn't hindering the achievement of the LLC's contractual purpose.
- An aggrieved member had alternative remedies of avoiding self-dealing contracts or the derivative remedy against the manager under *Tzolis*.

It is a good idea to ask when, under the court's holding, dissolution for misconduct is appropriate in New York. This question highlights the difference between LLCs and close corporations, since controlling owner misconduct is central to dissolution in the latter context. Is the court in *1545 Ocean* suggesting that a resort to a derivative remedy is always preferable to dissolution? Compare the partnership context where the "accounting exclusivity" rule tends to "bundle" fiduciary litigation with exit. This could trigger a discussion of when bundling is appropriate. It seems more likely that *1545* rests on the special circumstance that the LLC was a simple renovation project that was close to completion. The court might have dissolved a firm whose objectives would have been impeded by the parties' dispute and allegations of misconduct.

For more, see Larry's blog post (cited at Note and Question 12-20B(1) of the Supplement), which concludes about this case:

In short, it seems that NY is joining Delaware in emphasizing the role of the operating agreement in judicial dissolution cases. As noted above, this could emerge as an important distinction between LLCs and close corporations, and therefore a factor in choice of form. It also places new emphasis on the need for care in drafting the operating agreement. However, New York has not yet explicitly embraced the operating agreement as determinative. We will have to await further developments to see if New York can shed its long legacy of close corporation law in LLC dissolution cases.

Superior Vending

We've included *Superior Vending*, a short case, because it is part of the continuing saga (after *Tzolis*) in the New York courts on the creation of remedies in the LLC area notwithstanding the language of the LLC Law itself. The two members, Tal and Plotkin, agreed to dissolve the LLC, but could not agree on the distribution of assets. While acknowledging that the LLC Law "does not expressly authorize a buyout in a dissolution

proceeding," the Appellate Division affirmed the Supreme Court's decision that the most equitable method of liquidation was to require one member to buy out the other (i.e. Plotkin had 45 days to purchase Tal's membership interest).

Note and Question 12-20B(2) in the Supplement refers to commentary by Larry and Peter Mahler, the latter referring to *Superior Vending* as yet another example of New York appellate courts resorting "to uncodified, implied duties and equitable remedies designed to bypass statutory omissions." The result in *Superior* might be defended on the ground that the result of a dissolution order is often a buyout in any case. But given the emphasis on the agreement in the LLC cases, shouldn't the court hesitate to alter statutory remedies that the parties may have relied on?