

UNINCORPORATED BUSINESS ENTITIES

LexisNexis Law School Publishing Advisory Board

William Araiza

Professor of Law
Brooklyn Law School

Lenni B. Benson

Professor of Law & Associate Dean for Professional Development
New York Law School

Raj Bhala

Rice Distinguished Professor
University of Kansas, School of Law

Ruth Colker

*Distinguished University Professor & Heck-Faust Memorial Chair in
Constitutional Law*
Ohio State University, Moritz College of Law

David Gamage

Assistant Professor of Law
UC Berkeley School of Law

Joan Heminway

College of Law Distinguished Professor of Law
University of Tennessee College of Law

Edward Imwinkelried

Edward L. Barrett, Jr. Professor of Law
UC Davis School of Law

David I. C. Thomson

LP Professor & Director, Lawyering Process Program
University of Denver, Sturm College of Law

Melissa Weresh

Director of Legal Writing and Professor of Law
Drake University Law School

UNINCORPORATED BUSINESS ENTITIES

FOURTH EDITION

SUMMER 2011

CUMULATIVE SUPPLEMENT

August 2011

LARRY E. RIBSTEIN

Mildred van Voorhis Jones Chair
University of Illinois College of Law

JEFFREY M. LIPSHAW

Associate Professor
Suffolk University Law School

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis, the knowledge burst logo, and Michie are trademarks of Reed Elsevier Properties Inc, used under license. Matthew Bender is a registered trademark of Matthew Bender Properties Inc.

Copyright © 2011 Matthew Bender & Company, Inc., a member of the LexisNexis Group. All Rights Reserved.

No copyright is claimed in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material exceeding fair use, 17 U.S.C. § 107, may be licensed for a fee of 25¢ per page per copy from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

NOTE TO USERS

To ensure that you are using the latest materials available in this area, please be sure to periodically check the LexisNexis Law School website for downloadable updates and supplements at www.lexisnexis.com/lawschool.

Editorial Offices
121 Chanlon Road, New Providence, NJ 07974
201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200
www.lexisnexis.com

(Pub.3572)

TABLE OF CONTENTS

3.02	Existence of Partnership: Partnership Law.....	1
3.03	Existence of Partnership: Other Law.....	2
5.03	Partners' Wrongful Acts.....	3
6.02	Creditors' Contracts with Partners.....	4
7.02	Transfer of Partnership Interests.....	4
8.01	The Nature of Partners' Fiduciary Duties.....	4
9.02	Dissolution and Dissociation Causes.....	4
A.	Dissolution at Will: Term and At-Will Partnerships.....	4
D.	Judicial Dissolution.....	5
9.04	Continuation and Buyout of Dissociating Partner.....	5
A.	Valuation.....	5
1.	The Minority Discount.....	5
9.06	Buyout and Continuation Agreements.....	6
C.	Work-in-Process in Professional Firms.....	6
11.07	Fiduciary Duties and Remedies.....	6
A.	Fiduciary Duties of General Partners.....	6
(C)	Remedies.....	7
12.01	Introduction.....	7
A.	The Current State of LLC Law.....	7
12.02	LLC Formalities.....	7
A.	Organizing the LLC.....	7
C.	The Operating Agreement.....	8
1.	The Role of the Operating Agreement.....	8
2.	Writing Requirements.....	9
E.	Series LLCs.....	9
F.	Non-Profit LLCs.....	9
12.03	Management.....	10
C.	The Agency Power of Members and Managers.....	10
D.	Member Voting Rights.....	10
12.04	Members' Financial Rights and Obligations.....	11
12.05	Transfer of Interests.....	12
B.	Creditors Remedies.....	12
	OLMSTEAD v. FEDERAL TRADE COMMISSION.....	12
12.06	Issues of Limited Liability.....	19
12.07	Fiduciary Duties.....	19
B.	Members' Duties.....	19
C.	Fiduciary Duty Contracts.....	21

KELLY v. BLUM	21
D. Remedies	26
1. Derivative Actions	26
2. Contractual Remedies.....	29
12.08 Dissociation and Dissolution	29
A. Dissociation	29
1. Default Rules.....	29
3. Expulsion.....	29
B. Dissolution	30
LOLA CARS INT'L LTD. v. KROHN RACING, LLC	30
IN RE 1545 OCEAN AVE., LLC	35
IN RE SUPERIOR VENDING, LLC	41
12.09 Special Issues in LLC Law	43
A. Application of Other Law	43
2. Other regulatory law.....	43
13.05 Tax and Regulatory Aspects of LLPs	43
E. Professional Firms as LLPs	43
ADDITIONAL SELECTED PROVISIONS FROM THE DELAWARE LIMITED LIABILITY ACT	44

3.02 Existence of Partnership: Partnership Law

73, note 3-1, add new paragraph at end:

Courts may be concerned that informal partnership can be used as an end run around limitations on common law marriage. *See* *Ontiveros v. Silva*, No. 29,892 (N.M. App., Jan. 5, 2011) (affirming trial court's determination of non-partnership, discussing case law refusing to imply agreement to own property based on cohabiting conduct and "conclud[ing] that the parties may not circumvent the prohibition of common-law marriage through an implied joint venture or partnership based upon their conduct"). Anti-palimony statutes requiring a writing for agreements regarding sexual non-marital relationships may influence the determination of a partnership or joint venture between the parties to such a relationship. *See* *McDonald v. Cahlander*, 2008 Minn. Unpub. LEXIS 966 (Minn. Ct. App., Aug. 12, 2008) (supporting partnership where sexual relationship was not the sole consideration for the agreement).

85, note 3-2(7), add at end:

Since the financial crisis of 2008-09, dissolutions and bankruptcies of major law firms have become more common. One such firm, Altheimer & Gray, was a substantial firm in Chicago. Judge Easterbrook, writing for the 7th Circuit, held that a former equity partner who had given up his right to share in the profits of the firm, and was now a "non-unit" partner, was a partner of the firm and not a creditor under the firm's plan of reorganization in bankruptcy.

The plan of reorganization defines the firm's partners to include both "Unit Partners" and "Non-Unit Partners." That definition follows the law firm's norm, not the Uniform Partnership Act's. The bankruptcy judge and district judge classified Berens as a non-unit partner under the plan—and, since his own claim applied that label to himself, he is hardly in a position to complain. His argument that he was not a partner under the Uniform Partnership Act, and therefore cannot have been a "non-unit partner" under the plan, is a non-sequitur.

No rule of bankruptcy law (or any other law) requires a plan of reorganization to define terms in the same way as any particular statute. Suppose that the plan had provided that borogroves stand in line behind all other creditors, then defined "borogrove" as "anyone called a 'unit partner' or 'non-unit partner' in the debtor's ordinary operations." Neither Berens nor anyone else could complain that the word "borogrove" can't be found in dictionaries, that it comes from a nonsense poem (Lewis Carroll's "Jabberwocky"), that unlike "chortle" (another of Carroll's invented words) it never caught on in English, or that it means something different from the word "partner" in the Uniform Partnership Act.

Just so with the plan's actual definition. It uses words as Altheimer & Gray did, not as the Uniform Partnership Act does—and this choice makes perfect sense because it provides clarity and simplicity to people who were affiliated with that firm or did business with it. Why design an elaborate definitional clause, or list the subordinated claims one by one, when Altheimer & Gray already had phrases that could be plugged into the plan? When Berens called himself a "non-unit partner," he signaled that he was not

competing with any outside creditor for the estate's assets. Small wonder no one objected.

In re Alzheimer & Gray, [601 F.2d 740](#) (7th Cir. 2010). The case deals with a non-equity partner's claim against the assets of the partnership. Would the same logic apply if, as in *United Foods*, a creditor of the partnership were making a claim against the non-equity partner under §15(b) of the UPA or §306(a) of RUPA? If Berens signaled that he was not competing with outside creditors for the estate's assets by using the word "partner," would it be equally plausible to say that he was holding himself out as liable for the firm's contractual obligations as a partner?

86, note 3-2(11), add at end:

In another recent case, the court held that a shopping center lease did not create a partnership whereby the landlord would be liable for the debts of the tenant. *Big Easy Cajun Corp. v. Dallas Galleria Ltd.*, [293 S.W.3d 345](#) (Tex. Ct. App. 2009).

87, note 3-2(13), add new paragraph at end:

See also *Ingram v. Deere*, [288 S.W.3d 886](#) (Tex. 2009), in which the issue was whether a psychiatrist acting as the medical director of a multi-disciplinary pain clinic was a partner or an employee under Texas Supreme Court's revised definition of partnership. The Texas Revised Partnership Act does not track RUPA §202 and instead incorporates indicia of partnership developed under Texas common law, one of which is "expression of an intent to be partners in the business." The court held that the psychiatrist had failed to establish any of the statutory indicia, noting in particular that the terms used by the parties in referring to the relationship did not constitute an expression of intent to be partners.

89, add after note 3-2(17):

18. Requirement of a writing. As these cases and notes make clear, neither the UPA nor RUPA require that a partnership agreement be in writing. Indeed, the troubling aspect of the cases for a party like *United Foods* is that it can be deemed a partner based on conduct that satisfies the partnership definition regardless of whether it has entered into a formal partnership agreement. Statutes of frauds, however, generally make unenforceable agreements that cannot be performed in less than one year. RESTATEMENT (SECOND) OF CONTRACTS §130, cmt. a. This would not apply to an agreement without a definite term. But what if the oral partnership agreement contained a provision such as a multi-year earn-out that requires payments based on the performance of the business over time. Since the agreement cannot be performed within one year it would seem to be unenforceable. However, Delaware legislation has made the statute of frauds inapplicable to LLC operating agreements. See Supplement §12.02(C)(2). Note that, unlike a partnership, an LLC cannot be formed merely by conduct; a written filing with a state office is a prerequisite of valid formation. Might this justify different rules regarding oral agreements in the LLC and partnership contexts?

3.03 Existence of Partnership: Other Law

90, second paragraph, add after first sentence:

For example, a "contract partner" not making capital contributions, not sharing in profits, having no ownership interest in assets, and not exposed to liability for debts, was not a partner for purposes of a law firm's citizenship in determining federal diversity jurisdiction.

Morson v. Kreindler & Kreindler, LLP, [616 F. Supp. 2d 171](#) (D. Mass. 2009). In a bankruptcy case, whether there was an exception to a discharge turned on whether the debtor's equity participation with the creditor was a partnership, thus creating a fiduciary relationship. *In re McClendon*, [415 B.R. 170](#) (Bankr. D. Md. 2009). An arrangement between an orthodontist and a business services firm was held to be unenforceable because it created an illegal partnership under the Pennsylvania professional corporation statute. *OCA, Inc. v. Hodges*, [615 F. Supp. 2d 477](#) (E.D. La. 2009).

94, add as the first full paragraph:

The application of the federal Age Discrimination in Employment Act to law firm partnerships remains an open issue, particularly as "Big Law" firms respond to the decline in business after the financial crisis of 2008-09. In 2010, the EEOC, acting on a complaint from an older partner, sued the Kelley Drye law firm, alleging that its policy of mandatory retirement at age seventy also violated the Act. According to the EEOC complaint,

all attorneys who reach the age of 70 and wish to continue to practice law [must] give up any equity interest they may have with Defendant; relinquish their authority to manage or significantly influence the firm; and be compensated for their work performed solely on the basis of an annual "bonus" payment that is wholly discretionary with Defendant's Executive Committee.

The "not quite ready to retire" partner claimed that his compensation under the policy was significantly less than that paid to younger attorneys in the firm with similar client collections, billings, and other measures of productivity. See Ashby Jones, *Kelley Drye Hit With Age-Bias Suit; More on the Way For BigLaw?*, <http://blogs.wsj.com/law/2010/01/28/kelley-drye-hit-with-age-bias-suit-more-on-the-way-for-biglaw/>.

5.03 Partners' Wrongful Acts

140, add the following at the end of Notes and Questions 5-2:

3. Fraud on the Partnership Exception. Section 12 of the UPA broadly attributes to the partnership a partner's knowledge and notice of any matter relating to partnership affairs, "except in the case of a fraud on the partnership committed by or with the consent of that partner." The exception lets a partnership sue a defrauding partner, and avoids the odd result in which the knowledge of the wrongdoing partner would defeat the fraud action. The court construed Section 12 in *FDIC v. Jeff Miller Stables*, [573 F.3d 289](#) (6th Cir. 2009). Steve was the CEO of a failed bank, had embezzled millions of dollars, and went to prison. The FDIC sought to recover the embezzled funds, and found that Steve had used some of the embezzled money to purchase a horseracing stable in which Steve and his brother Jeff were general partners. The FDIC successfully brought an unjust enrichment claim against the partnership for which the majority held that the innocent partner, Jeff, was vicariously liable. The concurring opinion observed that Section 12 (as codified in Ohio) was not a defense to the unjust enrichment or the vicarious liability claims, even if Jeff were innocent, because the partnership (and, derivatively, Jeff) benefitted from the fraud. The dissent agreed that the partnership was liable, but would have held that the Steve had committed fraud on the partnership, relieving Jeff of vicarious liability.

6.02 Creditors' Contracts with Partners

166, add to Notes and Questions 6-2:

4. Partner Signing Credit Agreement as Agent for the Partnership. The general rule is that an agent is not liable on a contract the agent executes for a disclosed principal. See Restatement (Third) Agency §6.01; Notes and Questions 2-5. Can a partner who signs as an agent for the partnership as a disclosed principal assert that rule as a defense to vicarious liability as a partner? See *Trizechahn Gateway LLC v. Titus*, [601 Pa. 637](#), 976 A.2d 474 (2009) (a lease's general no-liability clause for agent-signers did not limit a partner's personal liability for partnership debts).

7.02 Transfer of Partnership Interests

178, add the following at the end of Notes and Questions 7-1(4):

In re Hake, [419 B.R. 328](#) (B.A.P. 6th Cir. 2009), notes that the majority view is that transfer restrictions in partnership agreements otherwise silent on the issue do not restrict so-called "upstream transfers" having the effect of avoiding the restriction, distinguishing *Asian Yards*. The court's citations for the majority position include the *Northeast Communications of Wisconsin, Inc.* case included in the materials on transfer of limited partnership interests in §11.06(A).

8.01 The Nature of Partners' Fiduciary Duties

196, add at the end of the first paragraph of Notes and Questions 8-1(6):

Note that where the contract establishes a duty, the Delaware courts do not favor independent fiduciary claims that arise out of precisely the same facts that establish the breach of contract claim. See *Grunstein v. Silva*, [2009 Del. Ch. LEXIS 206](#) (Dec. 8, 2009).

9.02 Dissolution and Dissociation Causes

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

249, add a new paragraph at the end of Notes and Questions 9-1(2):

In *Saint Alphonsus Diversified Care, Inc. v. MRI Associates, LLP*, [148 Idaho 479](#), 224 P.3d 1068 (2009), 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. Since the concept of dissociation did not exist under the UPA, the court applied RUPA §602(b)(1), which provides that dissociation is wrongful if "in breach of an express provision of the partnership agreement." Although the agreement contained a specific list of conditions under which a partner could withdraw, the court held that the dissociation was not wrongful under RUPA unless the agreement expressly provided those conditions were exclusive. Whether or not one agrees with the court's construction of the contract language, the case notes the subtle difference between the UPA §31(2)'s "in contravention of the agreement between the partners" and RUPA §602(b)(1)'s "in breach of an express provision." Compare *BPR Group Ltd. Partnership v. Bendetson*, [453 Mass. 853](#), 906 N.E.2d 956 (2009), interpreting the UPA. There the relationship among the partners had soured, and one of the partners purported to dissolve what he claimed was 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. 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)?

D. Judicial Dissolution

251, add after the last sentence:

The judicial dissolution cases often present, as one court put it, "the unhappy story of a financially successful [partnership] that became an environment of distrust, rancor and paralysis." *Brennan v. Brennan Associates*, [293 Conn. 60](#), 977 A.2d 106 (2009). In *BPR Group Ltd. Partnership v. Bendetson*, [453 Mass. 853](#), 906 N.E.2d 956 (2009), the court described generally the kinds of circumstances warranting judicial dissolution: "neither a partner's curmudgeonly disposition," nor "a simple difference of opinion in business judgment," but instead "dissension among the partners . . . so serious, irreconcilable, and permanent that it would be inequitable to require them to continue as partners." The court's non-exhaustive list of considerations relevant to an application for judicial dissolution included: (1) the extent of the dissension; (2) the relative fault of the partners in creating and contributing to dissension; (3) the profitability of the partnership notwithstanding partner dissension; (4) the involvement of the partners in the day-to-day operations of the partnership; and (5) whether dissolution would work a substantial financial detriment to the value of the partnership business.

252, add a new paragraph after the first paragraph:

The Connecticut Supreme Court in *Brennan* noted the distinction between dissolution under RUPA and dissociation under the UPA in a case where two of the partners sought the judicial dissociation of a criminally convicted partner in an otherwise financial viable business:

Prior to Connecticut's adoption of our partnership act, which was modeled on [RUPA], the sole mechanism for relief under the [UPA] would have been for Aiello and Mihaly to obtain a dissolution of the partnership, which in turn would have left them free to reformulate a new partnership without the plaintiff. Under [RUPA], a partnership now has a choice, either to dissolve the partnership or to seek the dissociation of a partner who has made it not reasonably practicable to carry on the partnership with him. The new remedy of dissociation permits a financially viable partnership to remain intact without dissolving the partnership and reconstituting it. As the commentary to the revised partnership act notes: "[RUPA] dramatically changes the law governing partnership breakups and dissolution. An entirely new concept, 'dissociation,' is used in lieu of the [UPA] term 'dissolution' to denote the change in the relationship caused by a partner's ceasing to be associated in the carrying on of the business."

9.04 Continuation and Buyout of Dissociating Partner

A. Valuation

1. The Minority Discount

254, add at the end of second paragraph:

The Louisiana Supreme Court recently observed that the trend nationally was not to apply

minority discounts in partnership dissolution valuations. *Cannon v. Bertrand*, 2 So. 3d 393 (La. 2009).

9.06 Buyout and Continuation Agreements

C. Work-in-Process in Professional Firms

263, add the following paragraph after the first full paragraph:

The court noted the distinction between the UPA and RUPA as to law firm "unfinished business" in the highly publicized liquidation of the Brobeck firm. The default rule under the UPA in California had required partners to account to the dissolved firm for unfinished business absent an agreement to the contrary. Accordingly, Brobeck's partnership agreement provided, as later explicitly permitted under RUPA §401(h), that it "intended to expressly *waive, opt out of and be in lieu of any right any Partner or the Partnership may have to 'unfinished business' of the Partnership, as that term is defined in [the California case law interpreting UPA §18(f)] or as otherwise might be provided in the absence of this provision through interpretation or application of [RUPA].*" The bankruptcy court held that the waiver was valid under either the UPA or RUPA, depriving the trustee of the right to recoup the fees for the benefit of Brobeck's creditors. *In re Brobeck, Phleger & Harrison LLP*, [408 B.R. 318](#) (Bankr. N.D. Cal. 2009).

11.07 Fiduciary Duties and Remedies

A. Fiduciary Duties of General Partners

382, add at the end of Notes and Questions 11-7(4):

c. *Additional Delaware guidance.* *In re Inergy L.P.*, [2010 Del. Ch. LEXIS 217](#) (Oct. 29, 2010), denied a motion to preliminarily enjoin the proposed merger of a limited partnership holding, among other things, that plaintiffs had not shown a likelihood of success on the merits for breach of fiduciary duty. The court held that the Master Limited Partnership Agreement eliminated the general partner's fiduciary duty to limited partners, contrasting partnership law with the Delaware General Corporation Law's more restrictive approach to waivers. The court looked to the Agreement to determine the precise extent of the general partner's duties. *Loneragan v. EPE Holdings, LLC*, 5 A.3d 1008 (Del. Ch. 2010) held that although the parties to a Delaware limited partnership agreement may not waive the implied covenant of good faith and fair dealing, limited partners may not invoke such duty "to circumvent the parties' bargain, or to create a free-floating duty unattached to the underlying legal documents."

d. *Drafting under non-Delaware law.* General partners and their lawyers need to tread cautiously when drafting and interpreting fiduciary waiver provisions, particularly outside of Delaware. For example, an Illinois limited partnership agreement contained the following provision: "The General Partner and each Limited Partner may, notwithstanding this Agreement, engage in whatever activities they choose, whether the same are competitive with the Partnership or otherwise, without having or incurring any obligation to offer any interest in such activities to the Partnership or any Partner." The Illinois court held that this provision did *not* exonerate a general partner who took fees and profits that should have gone to the limited partnership, citing *Labovitz v. Dolan* (see §8.03 supra) for the proposition that RUPA §103(b)(3) did not permit wholesale reduction or elimination of the general partner's fiduciary duties by contract. *1515 North Wells, L.P. v. 1513 North Wells, L.L.C.*, [392 Ill. App. 3d 863](#), 913 N.E.2d 1 (2009).

C. Remedies

391, add at the end of Notes and Questions 11-8:

3. Derivative versus direct claims in Madoff Ponzi scheme and other duty of care lawsuits. On June 29, 2009, Bernard Madoff was sentenced to 150 years in prison for having operated a multi-billion dollar Ponzi scheme that affected thousands of investors. The ensuing claims filed by defrauded investors against investment advisers who had invested money with Madoff generated a number of cases dealing with the distinction between direct and derivative claims in limited partnerships. *Newman v. Family Management Corp.*, [748 F. Supp. 299](#) (S.D.N.Y. 2010), involved federal securities law and state law fiduciary duties claims against the general partners of various “feeder funds,” organized as Delaware limited partnerships, for failure to respond to “red flags” in the Madoff Ponzi scheme. The court dismissed all of the direct claims by the limited partners against the general partner, holding that they could only be asserted derivatively because the injuries were inflicted on the partnership, and distinguishing the facts in *Anglo-American*. The court noted in dicta that claims of fraud in the inducement to invest in the limited partnership might be brought directly. The court dismissed all of the derivative claims (based on the same duty of care theory) for failure to make a demand upon the limited partnership, holding that such a demand would not have been futile. *See also Goldweber v. Harmony Partners, Ltd.*, [2010 U.S. Dist. LEXIS 96803](#) (S.D. Fla., Sept. 16, 2010) (similar result under Florida law); *Lewin v. Lipper Convertibles, L.P.*, [756 F. Supp. 2d 432](#) (S.D.N.Y. 2010) (similar result under New York law).

Stephenson v. Citco Group Ltd., [700 F.2d 599](#) (S.D.N.Y. 2010), held similarly with respect to a derivative claim, and dismissed plaintiffs’ claims on the further basis that the Martin Act, New York’s Blue Sky Law, pre-empted the limited partners’ breach of fiduciary duty and negligence claims.

12.01 Introduction

A. The Current State of LLC Law

417, add at the end of the first paragraph of Notes 12-1(1):

A more recent study showed that, in 2007, the numbers for LLCs, corporations and limited partnerships (and percentage of the total) were, respectively, 1,375,148 (63.58%), 747,533 (34.56%) and 40,229 (1.86%). *See* Rodney D. Chrisman, *LLCs are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States Between 2004-2007 and How LLCs were Taxed for Tax Years 2002-2006*, 15 *FORDHAM J. L. & FIN.* 459 (2010).

12.02 LLC Formalities

A. Organizing the LLC

419, add at the end of Notes and Questions 12-2(1):

See also In re Hausman, [51 A.D.3d 922](#), 858 N.Y.S.2d 330 (2008), *aff’d*, [13 N.Y.3d 408](#) (2009), in which the court applied the de facto corporation doctrine to LLCs, but held that the test was not met in this case because there was no colorable attempt to comply with the statute prior to the execution of the deed at issue in the case. A dissent argued that completion of organization of LLC and filing two weeks after execution of deed should be deemed colorable intent.

420, add at the end of Notes and Questions 12-2:

4. Federal diversity of citizenship jurisdiction. While the citizenship of a corporation for federal diversity jurisdiction purposes is determined by the corporation's state of incorporation and its principal place of business, the general rule is that all unincorporated entities have the citizenship of each partner or member for purposes of determining whether diversity jurisdiction exists. It is therefore generally more difficult to establish complete diversity as between plaintiffs and defendants when the parties include partnerships. One artifact of the hybrid nature of the LLC is that despite its differences from partnership an LLC is characterized as a partnership for diversity citizenship purposes. See *Zambelli Fireworks Mfg. Co., Inc. v. Wood*, [592 F.3d 412, 418, 420](#) (3d Cir. 2010) (addressing the issue “for the first time in this circuit,” noting that “every federal court of appeals to address the question has concluded that a limited liability company . . . should be treated as a partnership for purposes of establishing citizenship,” and holding that diversity was not present because of citizenship of LLC member of defendant LLC); *Delay v. Rosenthal Collins Group, LLC*, [585 F.3d 1003, 1005](#) (6th Cir. 2009) (deciding to “join every other circuit that has addressed this issue”).

Whether or not diversity jurisdiction exists, a federal court may not be obliged to hear the matter when it relates to the judicial dissolution of an LLC. As to the substantive standards for judicial dissolution, see the materials at §12.08(B)(2) in the Supplement. Compare *Polak v. Kobayashi*, [2008 U.S. Dist. LEXIS 92254](#) (D. Del., Nov. 13, 2008) (adjudicating dissolution of a Delaware LLC after determining that the LLC was not a real party in interest), with *Cammack New Liberty, LLC v. International Greetings USA, Inc.*, [653 F. Supp. 2d 709](#) (E.D. Ky. 2009) (declining to hear plaintiff's request for an accounting and declaratory judgment regarding an allegedly unlawful dissolution despite the existence of diversity jurisdiction because Kentucky's “complex and comprehensive” LLC statute called for federal abstention and the application of state court expertise, also noting the Kentucky choice-of-law provision in the operating agreement indicating the parties' intention that Kentucky law would apply).

C. The Operating Agreement

1. The Role of the Operating Agreement

422, add after the final paragraph:

Notes and Questions 12-3A

Since the LLC statute fills the gaps in oral and written operating agreements, an LLC can exist without an express operating agreement. Although an agreement may bear on the parties' intent to have a partnership, in LLCs the filing alone evinces that intent. But what if the LLC *had* an operating agreement that terminated? Should that bear on the existence of the LLC as opposed to the terms of the agreement among the members? In *Matter of Fassa Corp.*, [31 Misc. 3d 782](#) (N.Y. Sup. Ct., Feb. 1, 2011), the court held that termination of the operating agreement effectively terminated the LLC. Note that, unlike ULLCA or the Delaware LLC Act, which do not mandate the form of the operating agreement, the [New York LLC Law §417\(a\)](#) provides that “the members of a limited liability company *shall* adopt a written operating agreement....” The court observed that the operating agreement did not expressly provide for the consequence of its termination on dissolution. The court reasoned that the parties could not have intended to continue without an operating agreement, and in any event judicial dissolution would be justified in this situation. For a discussion of the case

see Mahler, "Termination of Operating Agreement Triggers LLC Dissolution," *NEW YORK BUSINESS DIVORCE* (Feb. 14, 2011), <http://www.nybusinessdivorce.com/2011/02/articles/llcs/termination-of-operating-agreement-triggers-llc-dissolution/index.html> (questioning the drafting wisdom of giving any member the unqualified option to terminate the operating agreement but failing to provide for the effect of the agreement's termination on the status of the LLC).

2. Writing Requirements

423, add a new first paragraph:

Olson has since been overruled legislatively. After the Delaware Supreme Court affirmed the Chancery Court decision ([986 A.2d 1150](#) (Del. 2009)), reasoning that the freedom-of-contract provisions in the later-enacted LLC act should not be construed as repealing the earlier-enacted statute of frauds if the two provisions can be reconciled, the Delaware legislature amended §18-101(7) to read that "a limited liability company agreement is not subject to any statute of frauds (including §2714 of this title)." 77 Del. Laws ch. 287, § 1.

E. Series LLCs

428, add as a new paragraph at the end §12.08(E):

Series LLCs are an example of the kind of experimentation to address different business needs that can arise in different jurisdictions. For a discussion of non-U.S. "protected cell companies," by which contractual arrangements to "ring-fence" sets of assets from creditors' claims against related assets, often in finance and insurance organizations, were codified in jurisdictions like Bermuda and Guernsey, see Ribstein, *Series and Protected Cell Companies*, <http://busmovie.typepad.com/ideoblog/2010/02/series-llcs-and-protected-cell-companies.html>. Delaware joined this global law competition, its insurance commissioner announcing on January 25, 2010 the licensing of the world's first "serial captive insurance company."

F. Non-Profit LLCs

429, add a new paragraph before first full paragraph:

A hybrid form of LLC, sitting somewhere between a standard for-profit and a non-profit is the so-called low-profit limited liability company or "L3C." These are intended to signal to foundations and donor directed funds that entities formed under these provisions shall conduct their activities so as to qualify as investments related to the foundation's or donor's programs. The first such statute was adopted in Vermont. See [VT. CODE, title 11](#), ch. 21, §3001(27). This statute requires the L3C, among other things, not to have a "significant purpose" of producing income or property appreciation. For a critique of the L3C concept, see RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES §4.10; Ribstein, *The Nature of the L3C*, <http://truthonthemarket.com/2010/06/17/the-nature-of-the-l3c/>. L3Cs have generated substantial academic discussion. For criticisms of the L3C, see Bishop, *The Low-Profit LLC (L3C): Program Related Investment by Proxy or Perversion?*, [63 ARK. L. REV. 243](#) (2010); Callison & Vestal, *The L3C Illusion: Why Low-Profit Limited Liability Companies Will Not Stimulate Socially Optimal Private Foundation Investment in Entrepreneurial Ventures*, [35 VT. L. REV. 273](#) (2010); Kleinberger, *A Myth Deconstructed: The 'Emperor's New Clothes' on the Low Profit Limited Liability Company*, [35 DEL. J. CORP. L. 879](#) (2010). For more sympathetic commentary on the L3C, see Elizabeth Schmidt, *Vermont's Social Hybrid*

Pioneers: Early Observation and Questions to Ponder, [35 VT. L. REV. 163](#) (2010); John Tyler, *Negating the Legal Problem of Having 'Two Masters': A Framework for L3C Fiduciary Duties and Accountability*, [35 VT. L. REV. 117](#) (2010). Other articles on the L3C are included in Symposium, *Corporate Creativity: The Vermont L3C and Other Developments in Social Entrepreneurship*, [35 VT. L. REV. 1](#) (2010).

12.03 Management

C. The Agency Power of Members and Managers

435, add at the end of Notes and Questions 12-7:

4. Agency power created by the operating agreement. Consider the following cases dealing with the actual and apparent authority of LLC managers.

—*Pitman Place Development, LLC v. Howard Investments, LLC*, [330 S.W.3d 519](#) (Mo. Ct. App. 2010). The operating agreement actually authorized the manager to borrow up to \$50,000. The manager took out a much larger loan on behalf of the LLC, fraudulently altering the operating agreement to raise the amount to \$750,000. The court concluded that because the loan was consistent with the LLC's stated business purpose, the LLC had cloaked the manager with apparent authority, and the bank reasonably relied on the altered operating agreement.

—*Synectic Ventures I, LLC v. EVI Corp.*, [251 P.3d 216](#) (Or. Ct. App. 2011). Several investment funds organized as LLCs sought to foreclose on loans made to EVI. The LLC manager, however, had executed loan amendments extending EVI's time to pay, despite circumstances indicating the LLC manager had a conflict of interest regarding the amendment. Each of the LLC operating agreements vested management exclusively in the manager, the loan agreement empowered the manager to act on behalf of the LLCs, the operating agreements expressly gave third parties the right to rely on the certificates signed by the manager, and the operating agreement authorized the alleged conflict of interest. The court reasoned that even if the borrower were deemed to know of the self-dealing, any inquiry still would have revealed that the manager was authorized to bind the LLCs.

Compare these outcomes to *Luddington* in §11.04, which held the general partner did not have actual and apparent authority to bind the limited partnership. Is there a principled basis for distinguishing the outcomes? Do you think the LLC members intended the firm to be bound in these situations? How might the LLC operating agreements in the above cases have been drafted to reduce the chance the LLC would be bound in the above cases?

D. Member Voting Rights

441, add at the end of Notes 12-9(5):

For an example, see *Simmons Family Properties, LLLP v. Shelton*, [307 Ga. App. 361](#), 705 S.E.2d 258 (2010), in which the court dissolved an LLC on the grounds it was no longer reasonably practicable to carry on the business. One of the bases for the conclusion was that the LLC failed to hold meetings as provided for in operating agreement where such meetings would have been the primary venue for hearing views of non-managing members and the failure to hold the meetings evidenced irresolvable deadlock.

12.04 Members' Financial Rights and Obligations

444, add as new paragraph at the end of Notes and Questions 12-10(2):

Not surprisingly, litigation can arise where members are reluctant to provide additional capital. A member's status as such does not obligate him to make additional capital contributions. *72-52 Inv. Group, LLC v. Lodish*, [2009 Mich. App. LEXIS 2273](#) (Oct. 29, 2009). Hence, the obligation will turn on interpretation of the operating agreement. In *West Town Line Associates, LLC v. Mack & Meldrum Associates, LLC*, [2010 Mich. App. LEXIS 454](#) (Mar. 09, 2010), for example, the agreement was ambiguous on the question whether capital calls were permitted, but otherwise provided that the LLC's borrowings were to be the "direct obligations of the company." The managing member loaned money to the LLC and then issued a capital call for funds the LLC could use to repay him. The Court of Appeals reversed a grant of summary judgment for the reluctant member, holding that nothing in the agreement prohibited a capital call for that purpose. *See also Racing Investment Fund 2000, LLC v. Clay Ward Agency, Inc.*, [320 S.W.3d 654](#) (Ky. 2010) (capital call provision in agreement could not be used as basis for satisfying judgment against LLC for unpaid insurance premiums because members' contractual assumption of statutory limited liability must be provided for unequivocally); *Headway Inv. Partners II v. A.M. Todd Group, Inc.*, [2010 U.S. Dist. LEXIS 107178](#) (W.D. Mich., Oct. 6, 2010) (under Delaware law, liquidated damages provision in the operating agreement did not exclude other remedies for breach of contract to make the contribution; also, contribution obligation not excused for impracticability based on the worldwide financial crisis because this could have been anticipated at the time of the agreement).

These cases may raise a question as to whether express operating agreement requirements are tempered by considerations of "reasonableness" or "fairness." For example, in *Related Westpac LLC v. JER Snowmass LLC*, [2010 Del. Ch. LEXIS 158](#) (July 23, 2010), the operating member, Related, sued the "money" member, JER Snowmass, over the latter's refusal to respond to a capital call. Vice Chancellor (now Chancellor) Strine dismissed the complaint:

Related struck a bargain whereby it realized that JER Snowmass had only made certain contractual obligations to it, and had not made others. That is, Related knew that JER Snowmass was reserving the right whether to agree, by consenting, to future Material Actions that might, for example, require JER Snowmass to invest more into the LLCs than it had previously committed to by agreeing to business plans and budgets. At the bargaining table, Related clearly relinquished any reasonableness condition to JER Snowmass's consent right as to future business plans and budgets. It proceeded knowing that if JER Snowmass did not view a proposal for a Material Action as in JER Snowmass's best interests, JER Snowmass could refuse to give consent.

What Related now wishes is for me to subject all consents under the Operating Agreements to a reasonableness condition. Thus, it seeks for me to imply a condition into the consent right JER Snowmass was given as to actions constituting Material Actions that was expressly excluded by the terms of the contract! Delaware law respects the freedom of parties in commerce to strike bargains and honors and enforces those bargains as plainly written. There is no lack of clarity here.

Disputes over additional capital arise in other contexts. Compare, for example, *Chandler*

Medical in §9.06B, in which the court held that partnership agreement provided expressly for failure to make a capital contribution by making the sole remedy the dissolution of the partnership, and *Fisk Ventures* in §12.06C, in which the court held there was no fiduciary obligation on the part of a member to fund an LLC in the absence of an express obligation to do so.

12.05 Transfer of Interests

B. Creditors Remedies

448, add before Notes and Questions 12-12:

The following case deals with the problem of how to treat charging orders issued against an LLC's sole member. Consider whether there is a statutory basis for holding that non-LLC remedies could apply in the instance of a single-member LLC but not if there were additional members.

OLMSTEAD v. FEDERAL TRADE COMMISSION

Florida Supreme Court

44 So. 3d 76 (2010)

CANADY, J.

In this case we consider a question of law certified by the United States Court of Appeals for the Eleventh Circuit concerning the rights of a judgment creditor, the appellee Federal Trade Commission (FTC), regarding the respective ownership interests of appellants Shaun Olmstead and Julie Connell in certain Florida single-member limited liability companies (LLCs). * * *

For the reasons we explain, we conclude that the statutory charging order provision does not preclude application of the creditor's remedy of execution on an interest in a single-member LLC. In line with our analysis, we rephrase the certified question as follows: "Whether Florida law permits a court to order a judgment debtor to surrender all right, title, and interest in the debtor's single-member limited liability company to satisfy an outstanding judgment." We answer the rephrased question in the affirmative.

I. BACKGROUND

The appellants, through certain corporate entities, "operated an advance-fee credit card scam." In response to this scam, the FTC sued the appellants and the corporate entities for unfair or deceptive trade practices. Assets of these defendants were frozen and placed in receivership. Among the assets placed in receivership were several single-member Florida LLCs in which either appellant was the sole member. Ultimately, the FTC obtained judgment for more than \$10 million in restitution. To partially satisfy that judgment, the FTC obtained – over the appellants' objection – an order compelling appellants to endorse and surrender to the receiver all of their right, title, and interest in their LLCs. This order is the subject of the appeal in the Eleventh Circuit that precipitated the certified question we now consider.

II. ANALYSIS

* * * [We conclude] that Florida law permits a court to order a judgment debtor to surrender all right, title, and interest in the debtor's single-member LLC to satisfy an

outstanding judgment. In brief, this conclusion rests on the uncontested right of the owner of the single-member LLC to transfer the owner's full interest in the LLC and the absence of any basis in the LLC Act for abrogating in this context the long-standing creditor's remedy of levy and sale under execution.

A. Nature of LLCs and Charging Orders

* * * [T]he transfer of management rights in an LLC generally is restricted. This particular characteristic of LLCs underlies the establishment of the LLC charging order remedy, a remedy derived from the charging order remedy created for the personal creditors of partners. * * * The charging order affords a judgment creditor access to a judgment debtor's rights to profits and distributions from the business entity in which the debtor has an ownership interest.

B. Statutory Framework for Florida LLCs

* * * Section 608.405, Florida Statutes (2008), provides that “[o]ne or more persons may form a limited liability company.”

* * * Section 608.432 contains provisions governing the “[a]ssignment of member's interest.” * * * [A]n assignment of a membership interest will not necessarily transfer the associated right to participate in the LLC's management. * * * Section 608.433(1) states: “Unless otherwise provided in the articles of organization or operating agreement, an assignee of a limited liability company interest may become a member only if all members other than the member assigning the interest consent.” Section 608.433(4) sets forth the provision – mentioned in the certified question – which authorizes the charging order remedy for a judgment creditor of a member:

On application to a court of competent jurisdiction by any judgment creditor of a member, the court may charge the limited liability company membership interest of the member with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of such interest. This chapter does not deprive any member of the benefit of any exemption laws applicable to the member's interest.

C. Generally Available Creditor's Remedy of Levy and Sale under Execution

Section 56.061, Florida Statutes (2008), provides that various categories of real and personal property, including “stock in corporations,” “shall be subject to levy and sale under execution.” A similar provision giving judgment creditors a remedy against a judgment debtor's ownership interest in a corporation has been a part of the law of Florida since 1889. * * * An LLC is a type of corporate entity, and an ownership interest in an LLC is personal property that is reasonably understood to fall within the scope of “corporate stock.” * * * At no point have the appellants contended that section 56.061 does not by its own terms extend to an ownership interest in an LLC or that the order challenged in the Eleventh Circuit did not comport with the requirements of section 56.061. Instead, they rely solely on the contention that the Legislature adopted the charging order remedy as an exclusive remedy, supplanting section 56.061.

D. Creditor's Remedies Against the Ownership Interest in a Single-Member LLC

Since the charging order remedy clearly does not authorize the transfer to a judgment

creditor of all an LLC member's "right, title and interest" in an LLC, while section 56.061 clearly does authorize such a transfer, the answer to the question at issue in this case turns on whether the charging order provision in section 608.433(4) always displaces the remedy available under section 56.061. Specifically, we must decide whether section 608.433(4) establishes the exclusive judgment creditor's remedy - and thus displaces section 56.061 - with respect to a judgment debtor's ownership interest in a single-member LLC.

As a preliminary matter, we recognize the uncontested point that the sole member in a single-member LLC may freely transfer the owner's entire interest in the LLC. This is accomplished through a simple assignment of the sole member's membership interest to the transferee. Since such an interest is freely and fully alienable by its owner, section 56.061 authorizes a judgment creditor with a judgment for an amount equaling or exceeding the value of the membership interest to levy on that interest and to obtain full title to it, including all the rights of membership - that is, unless the operation of section 56.061 has been limited by section 608.433(4).

Section 608.433 deals with the right of assignees or transferees to become members of an LLC. * * * The provision in section 608.433(4) with respect to charging orders must be understood in the context of this basic rule.

The limitation on assignee rights in section 608.433(1) has no application to the transfer of rights in a single-member LLC. In such an entity, the set of "all members other than the member assigning the interest" is empty. Accordingly, an assignee of the membership interest of the sole member in a single-member LLC becomes a member - a and takes the full right, title, and interest of the transferor - without the consent of anyone other than the transferor.

Section 608.433(4) recognizes the application of the rule regarding assignee rights stated in section 608.433(1) in the context of creditor rights. It provides a special means - i.e., a charging order - for a creditor to seek satisfaction when a debtor's membership interest is not freely transferable but is subject to the right of other LLC members to object to a transferee becoming a member and exercising the management rights attendant to membership status. * * *

Section 608.433(4)'s provision that a "judgment creditor has only the rights of an assignee of [an LLC] interest" simply acknowledges that a judgment creditor cannot defeat the rights of nondebtor members of an LLC to withhold consent to the transfer of management rights. The provision does not, however, support an interpretation which gives a judgment creditor of the sole owner of an LLC less extensive rights than the rights that are freely assignable by the judgment debtor. *See In re Albright*, [291 B.R. 538, 540](#) (D. Colo. 2003) * * *.

Our understanding of section 608.433(4) flows from the language of the subsection which limits the rights of a judgment creditor to the rights of an assignee but which does not expressly establish the charging order remedy as an exclusive remedy. The relevant question is not whether the purpose of the charging order provision - i.e., to authorize a special remedy designed to reach no further than the rights of the nondebtor members of the LLC will permit - provides a basis for implying an exception from the operation of that provision for single-member LLCs. Instead, the question is whether it is justified to infer that the LLC charging order mechanism is an *exclusive remedy*.

On its face, the charging order provision establishes a *nonexclusive* remedial mechanism. There is no express provision in the statutory text providing that the charging order remedy

is the *only* remedy that can be utilized with respect to a judgment debtor's membership interest in an LLC. The operative language of section 608.433(4) – “the court may charge the [LLC] membership interest of the member with payment of the unsatisfied amount of the judgment with interest” – does not in any way suggest that the charging order is an exclusive remedy.

In this regard, the charging order provision in the LLC Act stands in stark contrast to the charging order provisions in both the Florida Revised Uniform Partnership Act, §§ 620.81001-.9902, [Fla. Stat. \(2008\)](#), and the Florida Revised Uniform Limited Partnership Act, §§ 620.1101-.2205, [Fla. Stat. \(2008\)](#). Although the core language of the charging order provisions in each of the three statutes is strikingly similar, the absence of an exclusive remedy provision sets the LLC Act apart from the other two statutes. * * * The existence of the express exclusive-remedy provisions in the partnership and limited partnership statutes therefore decisively undermines the appellants' argument that the charging order provision of the LLC Act – which does not contain such an exclusive remedy provision – should be read to displace the remedy available under section 56.061.

* * * In sum, we reject the appellants' argument because it is predicated on an unwarranted interpretive inference which transforms a remedy that is nonexclusive on its face into an exclusive remedy. Specifically, we conclude that there is no reasonable basis for inferring that the provision authorizing the use of charging orders under section 608.433(4) establishes the sole remedy for a judgment creditor against a judgment debtor's interest in single-member LLC. Contrary to the appellants' argument, recognition of the full scope of a judgment creditor's rights with respect to a judgment debtor's freely alienable membership interest in a single-member LLC does not involve the denial of the plain meaning of the statute. Nothing in the text or context of the LLC Act supports the appellants' position.

LEWIS, J., dissenting.

I cannot join my colleagues in the judicial rewriting of Florida's LLC Act. Make no mistake, the majority today steps across the line of statutory interpretation and reaches far into the realm of rewriting this legislative act. The academic community has clearly recognized that to reach the result of today's majority requires a judicial rewriting of this legislative act. *See, e.g.*, Carter G. Bishop & Daniel S. Kleinberger, *Limited Liability Companies: Tax and Business Law*, ¶ 1.04[3][d] (2008) (discussing fact that statutes which do not contemplate issues with judgment creditors of single-member LLCs “invite *Albright-style* judicial invention”); Carter G. Bishop, *Reverse Piercing: A Single Member LLC Paradox*, [54 S.D. L. Rev. 199, 202](#) (2009); Larry E. Ribstein, *Reverse Limited Liability and the Design of Business Associations*, [30 Del. J. Corp. L. 199, 221-25](#) (2005) (“The situation in *Albright* theoretically might seem to be better redressed through explicit application of traditional state remedies than by a federal court trying to *shoehorn its preferred result into the state LLC statute*. The problem ... is that no state remedy is appropriate because the asset protection was explicitly permitted by the applicable statute. The appropriate solution, therefore, lies in *fixing the statute*.” (emphasis supplied)); Thomas E. Rutledge & Thomas Earl Geu, *The Albright Decision-Why an SMLLC Is Not an Appropriate Asset Protection Vehicle*, *Bus. Entities*, Sept.-Oct.2003, at 16; Jacob Stein, *Building Stumbling Blocks: A Practical Take on Charging Orders*, *Bus. Entities*, Sept.-Oct.2006, at 29. (stating that the *Albright* court “ignored Colorado law with respect to the applicability of a charging order” where the “statute does not exempt single-member LLCs from the charging order limitation”). An adequate remedy is available without the extreme step taken by the majority in rewriting the plain and unambiguous language of a statute. This is extremely important and has far-reaching impact because the principles used to ignore the LLC statutory language under the current factual circumstances apply with equal force to

multimember LLC entities and, in essence, today's decision crushes a very important element for all LLCs in Florida. If the remedies available under the LLC Act do not apply here because the phrase “exclusive remedy” is not present, the same theories apply to multimember LLCs and render the assets of all LLCs vulnerable.

I would answer the certified question in the negative based on the plain language of the statute and an *in pari materia* reading of chapter 608 in its entirety. At the outset, the majority signals its departure from the LLC Act as it rephrases the certified question to frame the result. The question certified by the Eleventh Circuit requested this Court to address whether, *pursuant to section 608.433(4)*, a court may order a judgment debtor to surrender all “right, title, and interest” in the debtor's single-member limited liability company to satisfy an outstanding judgment. The majority modifies the certified question and fails to directly address the critical issue of whether the charging order provision applies uniformly to all limited liability companies regardless of membership composition. In addition, the majority advances a position with regard to chapter 56 of the Florida Statutes that was neither asserted by the parties nor discussed in the opinion of the federal court.

Despite the majority's claim that it is not creating an exception to the charging order provision of the statute for single-member LLCs, its analysis necessarily does so in contravention of the plain statutory language and general principles of Florida law. The LLC Act inherently displaces the availability of the execution provisions in chapter 56 of the Florida Statutes by providing a remedy that is intended to prevent judgment creditors from seizing ownership of the membership interests in an LLC and from liquidating the separate assets of the LLC. In doing so, the LLC Act applies uniformly to single and multimember limited liability companies, and does *not* provide either an implicit or express exception that permits the *involuntary* transfer of all right, title, and interest in a single-member LLC to a judgment creditor. The statute also does not permit a judgment creditor to liquidate the assets of a non-debtor LLC in the manner allowed by the majority today. Therefore, under the current statutory scheme, a judgment creditor seeking satisfaction must follow the statutory remedies specifically afforded under chapter 608, which include but are not limited to a charging order, regardless of the membership composition of the LLC.

Although this plain reading may require additional steps for judgment creditors to satisfy, an LLC is a purely statutory entity that is created, authorized, and operated under the terms required by the Legislature. This Court does *not* possess the authority to judicially rewrite those operative statutes through a speculative inference not reflected in the legislation. The Legislature has the authority to amend chapter 608 to provide any additional remedies or exceptions for judgment creditors, such as an exception to the application of the charging order provision to single-member LLCs, if that is the desired result. However, by basing its premise on principles of law with regard to *voluntary* transfers, the majority suggests a result that can only be achieved by rewriting the clear statutory provisions. In effect, the majority accomplishes its result by judicially legislating section 608.433(4) out of Florida law.

* * * [A]n LLC is a distinct entity that operates independently from its individual members. This characteristic directly distinguishes it from partnerships. Specifically, an LLC is not immediately responsible for the personal liabilities of its members. *See Litchfield Asset Mgmt. Corp. v. Howell*, [799 A.2d 298, 312](#) (Conn.App.Ct.2002), *overruled on other grounds by Robinson v. Coughlin*, [830 A.2d 1114](#) (Conn.2003). The majority obliterates the clearly defined lines between the LLC as an entity and the owners as members.

Further, when the Legislature amended the LLC requirements for formation to allow single-member LLCs, it did *not* enact other changes to the provisions in the LLC Act relating

to an involuntary assignment or transfer of a membership interest to a judgment creditor of a member or to the remedies afforded to a judgment creditor. Moreover, no other amendments were made to the statute to demonstrate any different application of the provisions of the LLC Act to single-member and multimember LLCs. For example, the LLC Act generally does not refer to the number of members in an LLC within the separate statutory provisions. The Legislature is presumed to have known of the charging order statute and other remedies when it introduced the single-member LLC statute. Accordingly, by choosing not to make any further changes to the statute in response to this addition, the Legislature indicated its intent for the charging order provision and other statutory remedies to apply uniformly to all LLCs. This Court should not disregard the clear and plain language of the statute.

In addition, the majority fails to correctly set forth the status of a member in an LLC and the associated rights and interests that such membership entails. * * * In stripping the statutory protections designed to protect an LLC as an entity distinct from its owners, the majority obliterates the distinction between economic and governance rights by allowing a judgment creditor to seize both from the member and to liquidate the separate assets of the entity.

* * * Whether the LLC Act allows a judgment creditor of an individual member to obtain this entire membership interest to exert full control over the assets of the LLC is the heart of the underlying dispute. Neither the Uniform Limited Liability Company Act nor the Florida LLC Act contemplates the present situation in providing for single-member LLCs but restricting the transferability of interests. This problematic issue is not one solely limited to our state, though our decision must be based solely on the language and purpose of the Florida LLC Act. Thus, in my view, this Court must apply the plain meaning of the statute unless doing so would render an absurd result. In contrast, the majority simply rewrites the statute by ignoring those inconvenient provisions that preclude its result.

* * * [E]xceptions not found within the statute cannot simply be read into the statute, as the majority does by holding that single-member LLCs are an *implicit* exception to the charging order provision. The remedy provided to the FTC by the federal district court and approved by the majority in this instance – that a judgment creditor of a single-member LLC is entitled to receive a surrender and transfer of the full right, title, and interest of the judgment debtor and to liquidate the LLC assets – is *not* provided for under the plain language of the LLC Act without judicially writing an exception into the statute.

* * * The Florida LLC Act has neither adopted an explicit surrender-and-transfer remedy nor does it include a provision explicitly stating that the charging order is the exclusive remedy of the judgment creditor. The plain language of the charging order provision only provides one remedy that a judgment creditor may choose to request from a court and that the court may, in its discretion, choose to impose.

To support its conclusion that charging orders are inapplicable to single-member LLCs, the majority compares the provision in the partnership statute that mandates a charging order as an exclusive remedy to the non-exclusive provision in the LLC Act. The exclusivity of the remedy is irrelevant to this analysis. By relying on an inapplicable statute, the majority ignores the plain language of the LLC Act and the other restrictions of the statute, which universally apply the use of a charging order to judgment creditors of all LLCs, regardless of the composition of the membership. The majority opinion now eliminates the charging order remedy for multimember LLCs under its theory of “nonexclusivity” which is a disaster for those entities.

* * * Here, the plain language crafted by the Legislature does *not* limit this remedy to the multimember circumstance, as the majority holds. * * *

The distinction asserted by the FTC is clearly inconsistent with the plain language of section 608.434 with regard to the proper method for a judgment creditor to reach the interest of a member in a LLC in that a complete surrender of the membership interest and the subsequent liquidation of the LLC assets are *not* contemplated by the LLC Act. The majority's interpretation that the charging order remedy only applies to multimember LLCs can only be given effect if the plain language of this provision renders an absurd result, which it does not.

The purpose of creating the charging order provision was never limited to the protection of “innocent” members of an LLC. Moreover, when amending the LLC Act to permit single-member LLCs, the Legislature did not also amend the assignment of interest and charging order provisions to create different procedures for single- and multimember LLCs. The appellants argue that this indicates a manifestation of legislative intent; however, it appears more likely that our Legislature, as with many other states, had not yet contemplated the situation before us. Even so, the appropriate remedy in this circumstance is not for this Court to impose its speculative interpretation, but for the Legislature to amend the statute to reflect its specific intention, if necessary. * * * Here, the actual language of the statute does not distinguish between the number of members in an LLC. Thus, the charging order applies with equal force to both single-member and multimember LLCs, and the assignment provision of section 608.433 does not render an absurd result.

* * *

Based on the plain language of the statute and the construction of chapter 608 *in pari materia*, I would answer the certified question in the negative: A court may *not* order a judgment debtor to surrender and transfer outright all “right, title, and interest” in the debtor's single-member LLC to satisfy an outstanding judgment. If a judgment creditor wishes to proceed against a single-member LLC, it may first request a court of competent jurisdiction to impose a charging order on the member's interest. If the judgment creditor is concerned that the member is constraining distribution of assets and incomes, the creditor may seek judicial remedies to enforce proper distribution. In addition, if the economic interest so charged is insufficient to satisfy the judgment, the judgment creditor may move through additional proceedings: (1) seek to dissolve the LLC and to have its assets liquidated and subsequently distributed to the judgment creditor; (2) seek an order of insolvency against the judgment debtor, in which case the trustee of the bankruptcy estate will control the assets of the LLC, or (3) request a court to pierce the liability shield to make available the personal assets of the company to satisfy the personal debts of its member. This plain reading of chapter 608 may create additional steps for judgment creditors and judgment debtors to satisfy, as characterized by the federal district court in this case. However, only the Legislature, as the architects of this statutorily created entity, has the authority to provide a more streamlined surrender of these rights, not the judicial branch through selective reading and rewriting of the statute. * * *

450, add at the end of Notes and Questions 12-12(2):

See also RIBSTEIN & KEATINGE ON LIMITED LIABILITIES COMPANIES §7:2:

The entity characterization of LLC property ownership may surprise those who are using LLCs primarily as vehicles to avoid the consequences of direct ownership, particularly for leisure or residential property. The courts

are not likely to be receptive to arguments that the LLC owner only wanted to shield assets from taxes or creditors while retaining other incidents of direct ownership such as the right to sue for damage.

451, add at the end of Notes and Questions 12-12:

4. **Discussion of the *Olmstead* Case.** The 11th Circuit has since followed *Olmstead*, ordering surrender of all of a sole member's rights under a charging order. *FTC v. Peoples Credit First, LLC*, [621 F.3d 1327](#) (11th Cir. 2010). For an analysis of *Olmstead*, and the view that legislature and not the courts need to fix the problem where a single member LLC exists solely as a debtor protection vehicle, see Ribstein, *The Olmstead Decision and the Problem of Single Member LLCs*, <http://truthonthemarket.com/2010/06/27/the-olmstead-decision-and-the-problem-of-single-member-llcs/>. For additional discussion, see Callison, *Charging Order Exclusivity: A Pragmatic Approach to Olmstead v. Federal Trade Commission*, [66 BUS. LAW. 339](#) (2011); Geu, Debruyne & Rutledge, *To Be or Not to Be Exclusive: Statutory Construction of the Charging Order in the Single Member LLC*, [9 DEPAUL BUS. & COMM. L. J. 83](#) (2010).

12.06 Issues of Limited Liability

451, add at the end of Notes and Questions 12-13(2):

For other *Countryman*-like cases, see *Allen v. Dackman*, [413 Md. 132](#), 991 A.2d 1216 (2010) (the trier of fact could find defendant personally liable where defendant managed the LLC's day-to-day affairs while it owned the property, there was no evidence anyone else managed the LLC during that period, and evidence indicated that defendant "personally committed, inspired, or participated in [the LLC's] decisions regarding maintenance of the property" by, for example, directing others to inspect or maintain the property or not to do so, or failing to order inspection or maintenance); *Sturm v. Harb Development, LLC*, [298 Conn. 124, 2 A.3d 859](#) (2010) (LLC manager personally liable for supervising construction).

A Hawaii statute provides 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." [Haw. Rev. Stat. §480-17\(b\)](#). How might this provision affect the result in cases like *Countryman*?

12.07 Fiduciary Duties

B. Members' Duties

460, add at the end of §12.07(B):

The courts continue to struggle with finding the right legal cubbyhole for wrongful member conduct. In *In re South Canaan Cellular Investments, LLC*, [427 B.R. 85](#) (Bankr. E.D. Pa. 2010), the defendant LLC member allegedly misused the LLC's confidential information to which the member had been granted access to buy a debt owed by the LLC to a third party. The court held this was not a breach of fiduciary duty because the non-controlling/non-managing member did not have a fiduciary duty. It also held there was no breach of the implied covenant of good faith and fair dealing because the Delaware statute lets a member lend money and transact business with the LLC, and because the member was granted access to the information by the LLC. Even if those holdings were correct, should there still be a fiduciary obligation on the part of a non-managing member with respect to the LLC's property rights in information? See Ribstein, *Are Partners Fiduciaries?*, [2005 U.](#)

In *Kuroda v. SPJS Holdings, L.L.C.*, [2010 Del. Ch. LEXIS 57](#) (Mar. 16, 2010), a member who allegedly played a “central role” in providing consulting services to an investment business left the firm and opened a competing fund applying a substantially similar investment strategy. In setting up his new firm the member allegedly used information about the firm's strategies received in his former position as well as the firm's property, including its customer contacts list. The Chancellor dismissed a claim for breach of fiduciary duty because the defendant was clearly a non-managing and non-controlling member and therefore could not be deemed to have breached fiduciary duties. He also dismissed a claim for breach of the implied covenant of good faith and fair dealing because of the lack of a contract provision from which to imply the covenant. In this case some of the parties' interrelated agreements included express confidentiality provisions but there was no such provision in the LLC agreement at issue. The court reasoned:

I concur with plaintiff's assertion at oral argument that defendants are seeking to impose any additional duties they can tack on beyond those found in the Consulting Agreement, and that defendants are doing so because the Consulting Agreement contains a provision mandating arbitration in Japan. Among those additional duties defendants seek me to impose are fiduciary ones on an individual who clearly is not a fiduciary. This I cannot do. A rose by any other name may smell as sweet, but calling Kuroda a fiduciary here would smell of inaccuracy – and imposing upon him ex post some kind of fiduciary duties would reek of injustice. Had defendants wanted everyone to enjoy a red rose of fiduciary duty, they should not have planted white roses of contractual obligations and now ask me to paint over them. I grant in full plaintiff's motion to dismiss defendants' counterclaim for breach of fiduciary duty.

Should a member be deemed to have no fiduciary duty just because he lacked control? Note that, unlike *South Canaan*, the parties' agreements arguably justified the member's use of the firm's information. Even if the agreements did justify the use of the information, were the parties sufficiently explicit in eliminating the existence of a fiduciary duty? Compare the court's approach in *Kelly v. Blum* in the next section.

Notes and Questions 12-15A

1. Duties of members in formation of the LLC. Recall that RUPA eliminated fiduciary duties in formation of the partnership. See Notes and Questions 8-2(3) and 8-3(7) and compare UPA §21 and RUPA §404(b)(1). Section 409 in each of ULLCA and RULLCA are consistent with RUPA's approach. Should an LLC member have fiduciary duties to other members in the context of formation? In *Roni LLC v. Arfa*, [74 A.D.3d 442](#), 903 N.Y.S.2d 352 (2010), the court denied a motion to dismiss a complaint alleging that the organizers of an LLC owed the plaintiff member a fiduciary duty to disclose their profits from business transactions connected with the formation of the LLC. The court relied on §203(a)(iii) of the New York LLC Law, which merely provides that an organizer may form an LLC, and analogized to the fiduciary duties of incorporators under traditional corporate law. Do you agree? For a view that the more appropriate analogy is to partnership law, see Ribstein, *Pre-formation fiduciary duties in LLCs: another NY problem* (June 21, 2010), <http://truthonthemarket.com/2010/06/21/pre-formation-fiduciary-duties-in-llcs-another-ny-problem/>.

C. Fiduciary Duty Contracts

468, add following Notes and Questions 12-16:

Despite Delaware's broad endorsement of freedom of contract if the parties choose to eliminate fiduciary duties, the contract must make that choice clear. The following case demonstrates the drafting issues both as to the elimination of the duties and exculpation for monetary damages even if the duties continue to exist.

KELLY v. BLUM

Delaware Chancery Court

[2010 Del. Ch. LEXIS 31](#) (Feb. 24, 2010)

[After Marconi Broadcasting Company, LLC ("Marconi") had been merged with another company, Kelly, a non-managing member, brought an action against Marconi's managers and controlling members, claiming that they breached their fiduciary duties by willfully engaging in a non-arm's length, unfair, self-dealing transaction aimed at squeezing Kelly out of his interest in Marconi. Defendants moved to dismiss, among other claims, the breach of fiduciary duty claim.]

PARSONS, VICE CHANCELLOR.

I deny the motion to dismiss ... as to ... Counts II and VI, which allege, respectively, breach of fiduciary duties owed to Plaintiff and aiding and abetting breach of fiduciary duties.

As to Counts II and VI, I also note that, even though contracting parties to an LLC agreement have the freedom to expand, restrict, or eliminate fiduciary duties owed by managers to the LLC and its members and by members to each other, in the absence of a provision explicitly altering such duties, an LLC's managers and controlling members in a manager-managed LLC owe the traditional fiduciary duties that directors and controlling shareholders in a corporation would. In this case, I find that Marconi's LLC agreement does not explicitly alter those default fiduciary duties and that, consequently, Marconi's managers and controlling members owe Plaintiff the traditional duties of loyalty and care.

The LLC agreement does contain, however, an exculpation clause limiting the monetary liability of Marconi's managers for breaches of fiduciary duty to those instances where such managers "willfully" violate their duty of loyalty or care. The agreement also allows the Company to enter affiliated transactions provided the managers proceed at arm's length. In doing so, the LLC agreement arguably precludes application of the traditional entire fairness standard under the duty of loyalty by exculpating managers from liability for anything less than willfully violating their fiduciary duties to Plaintiff.

* * *

In the second count of the Complaint, Kelly claims that, by virtue of their status as Members or Managers of Marconi, Defendants Blum, Breen, Kestenbaum, MBC Investment, and MBC Lender each "owed various fiduciary duties to Kelly as the minority equity owner." Kelly further avers that these Defendants violated their duties of loyalty and care to him by entering into a self-interested Merger on terms that were unfair to Kelly.

Defendants counter that they did not owe Kelly a fiduciary duty of loyalty because any fiduciary duties of members or managers of an LLC must be expressly set forth in the

LLC agreement and Section 7.5 of the 2008 LLC Agreement, entitled “Duties,” only imposes duties akin to the duty of care. Defendants further argue that, even if they did somehow breach some form of fiduciary duties, Kelly’s claim merely questions the adequacy of consideration Marconi received in the Merger, a claim that is solely derivative. In this regard, I find that, under the 2008 LLC Agreement, the Managers of Marconi did owe Kelly traditional fiduciary duties and that, therefore, he has standing to bring a direct claim for breach of those duties.

The basic approach of the LLC Act is to “provide members with broad discretion in drafting the [LLC] Agreement and to furnish default provisions when the members’ agreement is silent.” In the case of fiduciary duties, the LLC Act permits LLC contracting parties to expand, restrict, or eliminate duties, including fiduciary duties, owed by members and managers to each other and to the LLC. Section 18-1101(c) does not specify a statutory default provision as do other sections of the LLC Act; rather, it implies that some default fiduciary duties may exist “at law or in equity,” inviting Delaware courts to make an important policy decision and determine the default level of those duties.

Indeed, the LLC Act expressly provides that it is the policy of the Act “to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.” 6 *Del. C.* § 18-1101(b). Thus, the LLC Act grants LLC members significant discretion and wide latitude in the ordering of their relationships, “including the flexibility to limit or eliminate fiduciary duties.” * * * Because of this statutorily-granted discretion, investors in the LLC context should be “on notice that fiduciary duties may be altered” and that they should, therefore, read carefully the LLC agreement before becoming members. See *Miller v. Am. Real Estate P’rs, L.P.*, 2001 WL 1045643, at *8 (Del.Ch. Sept.6, 2001) (“In large measure, the DRULPA [and LLC Act] reflect[] the doctrine of *caveat emptor*, as is fitting given that investors in limited partnerships [and LLCs] have countless other investment opportunities available to them that involve less risk and/or more legal protection.”).

Accepting that invitation, Delaware cases interpreting Section 18-1101(c) have concluded that, despite the wide latitude of freedom of contract afforded to contracting parties in the LLC context, “in the absence of a contrary provision in the LLC agreement,” LLC managers and members owe “traditional fiduciary duties of loyalty and care” to each other and to the company. Thus, unless the LLC agreement in a manager-managed LLC explicitly expands, restricts, or eliminates traditional fiduciary duties, managers owe those duties to the LLC and its members and controlling members owe those duties to minority members. Therefore, I must determine whether the 2008 LLC Agreement expanded, restricted, or eliminated the default fiduciary duties the Managers (Blum, Breen, and Kestenbaum) and controlling Members (MBC Investment and MBC Lender) owed to Kelly, and whether a breach of any existing duty would support a direct, as opposed to a derivative, claim.

a. Managers’ duties to Marconi and Kelly

In large measure, the 2008 LLC Agreement is silent on the issue of duties owed by Managers to the LLC and its Members, with the exception of Sections 7.5 and 7.9. In its entirety, Section 7.5, entitled “Duties,” states that

[t]he Board of Managers shall manage the affairs of the Company in a prudent and businesslike manner and shall devote such time to the Company affairs as they shall, in their discretion exercised in good faith, determine is reasonably necessary for the conduct of such affairs.

In relevant part, Section 7.9, which limits the monetary liability of Managers, states that

[i]n carrying out their duties hereunder, the Managers shall not be liable for money damages **for breach of fiduciary duty to the Company nor to any Member** for their good faith actions or failure to act ... but only for their own willful or fraudulent misconduct or willful breach of their contractual or **fiduciary duties** under this Agreement.

(Emphasis added).

I do not read these clauses, individually or collectively, as “explicitly disclaim[ing or limiting] the applicability of default principles of fiduciary duty.” Indeed, far from limiting such duties, Section 7.9 suggests that the parties intended traditional fiduciary duties to apply. Additionally, Section 7.5 does not limit the Managers' duties so much as place control of Marconi's affairs in the board of Managers, rather than the Members, allowing each Manager the discretion to determine the amount of time she must devote to running Marconi.

Because no clause in the 2008 LLC Agreement explicitly restricts or eliminates the default applicability of fiduciary duties, I find that Blum, Breen, and Kestenbaum, as Managers of Marconi, were required to treat Kelly in accordance with such traditional fiduciary duties. Furthermore, if the allegations in Kelly's Complaint are true, then Blum, Breen, and Kestenbaum entered the Merger largely intending to profit from a “premeditated scheme to squeeze Kelly out of Marconi and seize control of the FCC license” held by Marconi-actions that support a claim for breach of the duty of loyalty. Thus, drawing reasonable inferences in Kelly's favor, I find that his Complaint alleges sufficient facts to support his claim that the Managers breached these duties by entering into a Merger designed solely to eliminate Kelly's interest in Marconi.

1. LLC Agreement exculpatory provision

Even though Kelly alleged facts that, if true, are sufficient to show that Blum, Breen, and Kestenbaum may have breached their fiduciary duties, those Defendants still might avoid liability because the 2008 LLC Agreement contains an exculpatory provision limiting the monetary liability of Managers. Section 18-1101(e) of the LLC Act permits members, in their LLC agreement, to limit or eliminate a manager's or member's liability for “breach of contract and breach of duties (including fiduciary duties),” except for liability arising from a “bad faith violation of the implied contractual covenant of good faith and fair dealing.” While somewhat analogous to 8 *Del. C.* § 102(b)(7), which authorizes a corporation to adopt provisions limiting liability for a director's breach of the duty of care, Section 18-1101(e) goes further by allowing broad exculpation of *all* liabilities for breach of fiduciary duties-including the duty of loyalty.

Here, Section 7.9 of the 2008 LLC Agreement eliminates the Managers' monetary liability for all conduct except “willful or fraudulent misconduct or willful breach of ... contractual or fiduciary duties under this Agreement.” Although the default duties of loyalty and care remain, this provision requires more than application of a standard like entire fairness and requires that Kelly allege facts showing scienter. That is, under Section 7.9, liability attaches only where a Manager willfully breaches his fiduciary duties. In those cases, such as this one, where managers are contractually exculpated from liability for certain conduct, “a serious threat of liability may only be found to exist if the plaintiff pleads

a *non-exculpated* claim against the directors based on particularized facts.” Thus, I next consider whether Kelly's Complaint alleges facts that, if true, would support a finding of a *willful* breach of the Managers' contractual or fiduciary duties.

Defendants argue that willfulness must rise to the level of “actual, specific or evil intent to harm someone or acting recklessly and outside the bounds of reason,” and cite two cases in support of this definition. Neither case, however, provides a definition of “willfulness” that applies here and Defendants have failed to demonstrate why their proffered definition should be used. For instance, Black's Law Dictionary defines “willful” as “[v]oluntary and intentional, but not necessarily malicious” and willful is defined under the Delaware Uniform Trade Secrets Act as “awareness, either actual or constructive, of one's conduct and a realization of its probable consequences.”

Even under Defendants' proffered standard, however, their motion to dismiss Count II must be denied because Kelly alleges facts suggesting that a significant level of mistrust and rancor towards Kelly existed among the other Managers, particularly Blum, and that these Managers actually and specifically intended to extinguish Kelly's membership interest in Marconi, knowing that such action would harm Kelly. Because these allegations, if true, support Kelly's claim that Defendants' willful self-dealing led to an unfair Merger that was not an arm's length transaction, I deny the motion to dismiss Count II as to the Managers, Blum, Breen, and Kestenbaum.

b. Members' duties to Kelly

The question remains, however, whether Defendants MBC Investment and MBC Lender owed fiduciary duties to Kelly as controlling Members of Marconi and whether Kelly adequately has alleged breach of those duties.

As with LLC managers, “in the absence of provisions in the LLC agreement explicitly disclaiming the applicability of default principles of fiduciary duty,” controlling members in a manager-managed LLC owe minority members “the traditional fiduciary duties” that controlling shareholders owe minority shareholders. Controlling shareholders – typically defined as shareholders who have voting power to elect directors, cause a break-up of the company, merge the company with another, or otherwise materially alter the nature of the corporation and the public shareholder's interests – owe certain fiduciary duties to minority shareholders. Specifically, and very pertinently to this case, such fiduciary duties include the duty “not to cause the corporation to effect a transaction that would benefit the fiduciary at the expense of the minority stockholders.”

Under the 2008 LLC Agreement and accompanying documents, MBC Investment and MBC Lender had authority to appoint Managers with 24% and 51% of the voting power of the board of Managers, respectively. Additionally, through the Agreement, MBC Investment and MBC Lender held the power to, on their own or through their designated Managers, issue membership units, enter affiliated transactions, sell a material amount of Marconi's assets, enter agreements involving any merger, conversion, consolidation, or business combination, amend the Agreement or Certificate of Formation, and incur any Indebtedness without Kelly's input or approval. Indeed, in this case, the only clear-cut formal approval of the Merger appears to be by the Written Consent of the Members. Thus, in taking that action, MBC Investment and MBC Lender exercised their power as controlling Members of Marconi.

Because the 2008 LLC Agreement is silent as to what duties controlling members owe minority members, I find that MBC Investment and MBC Lender owed Kelly traditional

fiduciary duties, including, among others, the duty not to cause Marconi to enter a transaction that would benefit the controlling Members at the expense of Kelly, Marconi's minority Member. I also find that Kelly has stated facts that, if true, are sufficient to show that MBC Investment and MBC Lender did, with the aid of their appointed Managers, effect the Merger in order to benefit themselves at the expense of Kelly. Thus, Kelly has stated a direct claim that is not subject to any exculpation provision in the Agreement, and I deny Defendants' motion to dismiss Count II of Kelly's Complaint as to MBC Investment and MBC Lender.

Notes and Questions 12-16A

1. Choice of law and fiduciary duty contracts. For a discussion of the issues that arise when parties specify governing law in the operating agreement that modifies the default rule under the "internal affairs doctrine," see Ribstein, *How Clear Must a Fiduciary Waiver Be in NY and Delaware?*, IDEOBLOG, <http://busmovie.typepad.com/ideoblog/2010/03/how-clear-must-a-fiduciary-waiver-be-in-ny-and-delaware.html>. The note discusses *Pappas v. Tzolis*, Mem. Dec., Index No. 601115/09 (Sup. Ct. N.Y. Cty., Mar. 3, 2010), which involved a member who bought out the other two while secretly negotiating to sell the LLC's sole asset to an outside buyer, and then sold it six months after the buyout for a price much higher than he paid the former members. The parties choose to apply New York law to the operating agreement in a Delaware LLC. Should freedom of contract extend to the choice of law? *Rosenmiller v. Bordes*, [607 A.2d 465, 468-69](#) (Del. Ch. 1991), applied Delaware law despite a New Jersey choice of law clause in the shareholder agreement. Professor Ribstein observes:

Delaware arguably can protect its significant investment in its corporate law infrastructure only if it can restrict the privilege of using Delaware law in Delaware courts to Delaware corporations, which have paid the full incorporation fee. This suggests that Delaware would hesitate to let parties circumvent the fee by incorporating elsewhere and agreeing to apply Delaware law. To prevent firms from choosing Delaware law without incorporating there, Delaware's courts set a valuable precedent by disallowing a Delaware firm from doing the reverse by contracting for an alternative state's law.

See Ribstein, *Delaware, Lawyers and Choice of Law*, [19 DEL. J. CORP. L. 999, 1022-1025](#) (1994). Do you agree?

2. Effect of explicit fiduciary duty disclaimers under Delaware law. Defendants' problem in *Kelly* was that the operating agreement, while limiting the exposure to monetary damages, did not disclaim fiduciary duties to the fullest extent permitted under Delaware law. For a case in which the operating agreement limited or disclaimed fiduciary obligations, see Vice-Chancellor (now Chancellor) Strine's opinion in *Related Westpac LLC v. JER Snowmass LLC*, [2010 Del. Ch. LEXIS 158](#) (July 23, 2010), discussed in Notes and Questions 12-10(2) above.

3. Publicly-traded LLCs. Challenges by minority shareholders to corporate mergers and acquisitions have long been a staple of public company fiduciary duty litigation in Delaware. *In re Atlas Energy Resources, LLC*, [2010 Del. Ch. LEXIS 216](#) (Oct. 28, 2010), illustrates how the analysis changes for *unincorporated* publicly traded firms. Here minority members in a publicly traded LLC challenged a proposed merger with the controlling member, a widely held corporation. The opinion noted the flexibility LLC members have to craft their own set of applicable duties, but demonstrated the potential pitfalls when, as in

Kelly, the purported disclaiming contractual language is less than explicit. The court observed: “one aspect of this flexibility is that parties to a limited liability agreement can contractually expand, restrict, modify, or fully eliminate the fiduciary duties owed by the company or its members, subject to certain limitations. By contrast, in the absence of explicit provisions in a limited liability company agreement to the contrary, the traditional fiduciary duties owed by corporate directors and controlling shareholders apply in the limited liability company context.” The court distinguished the explicitness of the fiduciary duty waiver (governed by an identical standard) contained in the limited partnership agreement in *Loneragan* (discussed in Notes and Questions 11-7(4) in this supplement).

Compare the waiver of conflicts of interest described in The Blackstone Group L.P. public offering document at Notes and Questions 11-7(6). If a transaction were to be challenged by minority unit holders on account of a hypothetical transaction in which the general partner of the Blackstone limited partnership had a conflict of interest, would the contract language require a dismissal of the claims? Consider this passage from *Atlas*:

Emphasizing that limited liability companies are creatures of contract, [Defendants] argue that the protections provided by the common law to minority shareholders are unnecessary because parties are able to define the protections they desire by contract. Had the LLC Agreement expressly addressed the duties and the conflict of interest at issue in this case, Defendants would have been correct.

Just as a merger between a parent and its corporate subsidiary inherently threatens the interests of minority shareholders, a merger between a parent and its publicly held limited liability company subsidiary inherently threatens the rights of minority unitholders. The difference is that, in the context of a limited liability company, the parties can specify by contract the protections, or lack thereof, that they want the minority to have against such threats. If they do so, a court will respect the parties' freedom of contract and will not apply the default standard of review.

As with limited partnership agreements, however, parties to a limited liability company agreement bear the risk that they have drafted it incompletely.

4. Eliminating fiduciary duties under New York law. In *Pappas*, the court avoided ruling on the choice of law issue by saying that the relevant law was the same in both Delaware and NY. Was the court correct? The court referred to Delaware's very clear freedom-of-contract provision in Section 1101(c) of its act, and stated that "under New York law, parties are free to contract as they wish, so long as the terms of their contract are neither unlawful, nor in violation of public policy." Note, however, there is nothing in the New York LLC statute comparable to the Delaware provision. Indeed, §409(a) of the New York LLC statute requires a manager to "perform his or her duties as a manager . . . in good faith and with that degree of care that an ordinarily prudent person in a like position would use under similar circumstances."

D. Remedies

1. Derivative Actions

474, add at the end of Notes and Questions 12-17(2):

Remedies for breach of fiduciary duty in the New York courts remain a moving target

after *Tzolis*. In a one-paragraph opinion, the trial court in *Gottlieb v. Northriver Trading Co. LLC*, [58 A.D.3d 550](#), 872 N.Y.S.2d 46 (2009), cited *Tzolis* for the proposition that LLC members not limited to statutory remedies and could seek an equitable accounting. For discussions of *Gottlieb*, see Mahler, *Court Adds Accounting Remedy to LLC Members' Arsenal*, NEW YORK BUSINESS DIVORCE (Feb. 16, 2009), <http://www.nybusinessdivorce.com/2009/02/articles/llcs/court-adds-accounting-remedy-to-llc-members-arsenal/index.html>; Ribstein, *Does NY have a law on LLCs?* (Feb. 16, 2009), IDEOBLOG, <http://busmovie.typepad.com/ideoblog/2009/02/does-ny-have-a-law-on-llcs.html> (noting the irony of the reliance on *Tzolis*, which had justified the application of the extra-statutory derivative remedy in part because no other remedies were available). Although not inferring extra-statutory remedies in every instance, the New York courts continue to hear arguments based on *Tzolis* for broad extra-statutory judicial remedies for breach of fiduciary duty, including for reading a common law fraud remedy into the appraisal remedy in the limited partnership statute, and permitting expulsion for an LLC member's breach. See Ribstein, *New York Continues to Pay the Wages of Tzolis*, IDEOBLOG, <http://busmovie.typepad.com/ideoblog/2010/03/new-york-continues-to-pay-the-wages-of-tzolis.html>. For more on judicial expulsion, see §12.08(A)(3).

475, add at the end of Notes and Questions 12-17(5):

In *Anglo-American*, the limited partnership case dealing with the direct-derivative claim distinction in §11.07C, the direct remedy turned on the court's holding that “the injury accrues irrevocably and almost immediately to the current partners” through their investment accounts. The court noted that one effect of permitting a derivative action would be to deny recovery to withdrawn partners who had actually suffered the loss and permit subsequently invested partners to receive windfalls. In light of this rationale, compare cases dealing with the direct-derivative distinction in the LLC context. *George Wasserman & Janice Wasserman Goldsten Family LLC v. Kay*, [197 Md. App. 586, 14 A.3d 1193](#) (2011), required partners in five real estate investment general partnerships and members in two real estate investment LLCs to sue the managing member and de facto managing partner of the general partnership directly for allegedly taking money from the real estate investment vehicles and investing and losing it with Madoff. After a review of the remedies available to investors in the corporate, general partnership and LLC forms of organization, the court stated:

We perceive no reason to permit an action on behalf of the entities. The entities exist to produce money. In many ways, they are unlike other entities, such as industrial, commercial or retail operations, in which a breach of contract or tort duty results in harm to the enterprise that may not necessarily and directly affect partners' and members' accounts. Moreover, there does not appear to be a risk of multiple actions against Mr. Kay.

What are the relevant policies in these cases? Although the timing and traceability of the injury to those who owned the entity at the time of the alleged wrong may seem compelling in *Anglo-American*, the same logic arguably could be extended to any “pass through” entity. Consider the following cases:

—In *Freedom Financial Group, Inc. v. Woolley*, [280 Neb. 825](#), 792 N.W.2d 134 (2010), although the sole LLC member asserted standing to sue the LLC's lawyer directly for malpractice directly because the member lost profits that would have “flowed through” the LLC to the member, the court concluded that only the LLC had standing.

—In *National Jockey Club v. Ganassi*, [740 F. Supp. 2d 950](#) (N.D. Ill. 2010) (Ill. law),

the parties formed an LLC and executed an operating agreement under which they planned to convert the horse track Sportsman's Park in Cicero, Illinois (originally constructed as a dog track by Al Capone) into a motor sports venue. After the venture failed, NJC sued Ganassi, claiming, *inter alia*, direct injury arising from Ganassi's accounting malfeasance in inflating its member's contribution obligation. The court permitted the action, holding that the alleged injury arose directly out of a breach of the operating agreement.

—In *Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer*, [705 S.E.2d 757](#) (N.C. Ct. App. 2011), the court held that (a) a minority of the members did not have the authority to cause the firm to sue the other members for breach of fiduciary duty (see Note 12-17(4) above), (b) the members did not have standing to assert individual claims based on duties owed by other members to the firm, and (c) nevertheless, each of the contending groups could assert derivative claims against the other on behalf of the firm.

Note that all of these cases involve closely held businesses. Even if there is a sound reason for the maintaining the direct-derivative distinction in cases brought by partners or members of widely held limited partnerships or LLCs, is the distinction worth the cost and trouble in closely held businesses like those in the above cases? See Ribstein, *Litigating in LLCs*, [64 BUS. LAW. 739](#) (2009).

476, add after Notes and Questions 12-17(8):

9. Creditors and the derivative remedy in Delaware. Under Delaware corporate law, creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties, notwithstanding that DGCL §327 provides that “[i]n any derivative suit *instituted by a stockholder of a corporation*, it shall be averred in the complaint that the plaintiff was a stockholder of the corporation at the time of the transaction....” (emphasis added). See *N. Am. Catholic Educ. Programming Foundation, Inc. v. Gheewalla*, [930 A.2d 92, 101](#) (Del. 2007); *Production Resources Group, L.L.C., v. NCT Group, Inc.*, [863 A.2d 772](#) (Del. 2004). Section 18-1001 et seq. of the Delaware LLC act provide for derivative actions brought by members or assignees of LLC interests in the right of LLCs against managers or members. Should the rule with respect to creditors in *corporate* derivative actions be imported into LLC law despite the difference between the relevant statutes?

Vice-Chancellor Laster answered this in the negative in *CML V, LLC v. Bax*, 6 A.3d 238 (Del. Ch. 2010), concluding that “courts should be wary of uncritically importing requirements from the DGCL into the [alternative entity] context.” His scholarly opinion turns on three points: (a) the history of the adoption of the limited partnership and LLC derivative action statutes demonstrates that the Delaware legislature intended those actions, unlike the corporate derivative action in DGCL §327, to be limited exclusively to the partners or members, or their assignees, respectively, and not extended to creditors; (b) the corporate creditor derivative action in DGCL §327 has its roots in the trust fund doctrine that permitted creditors to sue shareholders to fulfill their subscription agreement, which is addressed by a different specific statute in the LLC Act; and (c) the LLC Act, unlike the corporation law, facilitates contractual protection of creditors, including through tailored provisions in the operating agreement or series LLC provisions to supplement security interests in specific assets.

For additional arguments in support of the distinction between the corporate and “unincorporate” derivative action provision in terms of creditors’ standing, see Ribstein & Alces, *Directors’ Duties in Failing Firms*, 1 J. BUS. & TECH. L. 529, 536 (2007); Ribstein, *Creditor derivative suits in Delaware LLCs*, TRUTH ON THE MARKET (November 7, 2010),

<http://truthonthemarket.com/2010/11/07/creditor-derivative-suits-in-delaware-llcs/>.

2. Contractual Remedies

477, add before Notes and Questions 12-18:

Following the *Elf Atochem* decision, the Delaware legislature amended its limited partnership and LLC statutes, respectively, to bar limited partners and non-manager members from waiving their right to sue in Delaware courts as to matters relating to internal organization of their firms. See [6 Del. Code §17-109\(d\)](#) (limited partnerships) and [§18-109\(d\)](#) (LLCs) (the latter is set forth in full at the end of this Supplement).

In *Baker v. Impact Holding, Inc.*, [2010 Del. LEXIS 277](#) (May 13, 2010), the court dismissed a shareholder's suit claiming the right to be seated as a corporate director under the Shareholders' Agreement in favor of a proceeding in Texas mandated by the forum selection clause in that agreement. The corporation contended that §§17-109(d) and 18-109(d) reflected a general public policy rendering unenforceable contractual provisions that prevent Delaware courts from hearing matters related to the internal affairs of Delaware business entities. The court disagreed, observing that the Delaware legislature had not made any such similar amendment to the DGCL. The court did not otherwise explain or speculate about policy reasons for the distinct treatment as between limited partnerships and LLCs, on one hand, and corporations, on the other. Why might Delaware want to make this distinction? Why might the Delaware legislature want to restrict a limited partnership's or LLC's freedom to contract out of a Delaware forum given the generally strong freedom-of-contract approach in Delaware limited partnership and LLC law?

12.08 Dissociation and Dissolution

A. Dissociation

1. Default Rules

484, add to Notes and Questions 12-19(6):

The Nevada statute deals with the tax valuation issue by providing that LLCs may make a statutory election to be “restricted,” thereby precluding them from making distributions to members for the next ten years. Nev. Rev. St. §86.161. Imposing the restriction by statute rather than the operating agreement is intended to make the LLC eligible for favorable tax valuation of the LLC interests.

485, add to Notes and Questions 12-19(7) following the *Lieberman* paragraph:

Lieberman filed a new complaint against the LLC members claiming among other things that defendants had misappropriated his equity interest. In a fourth appeal, the Wyoming Supreme Court held that Lieberman had been dissociated from the firm by the return of his capital contribution so that the LLC had to make a distribution of his capital account. Since it did not do so the LLC was deemed to have converted Lieberman's interest. *Lieberman v. Mossbrook*, [208 P.3d 1296](#) (Wyo., 2009).

3. Expulsion

493, add before the last sentence of the second paragraph:

(Note, however, that the New York Supreme Court, Appellate Division, recently declined to order expulsion as a remedy for breach of fiduciary duty because the remedy was not set forth in the New York LLC act. *Man Choi Chiu v. Chiu*, [71 A.D.3d 646](#), 896 N.Y.S.2d 131 (2010); Mahler, *Tzolis No Solace for Proponent of LLC Member Expulsion*, NEW YORK BUSINESS DIVORCE, <http://www.nybusinessdivorce.com/2010/03/articles/expulsion/tzolis-no-solace-for-proponent-of-llc-member-expulsion/index.html>).

B. Dissolution

496: Change (2) to **Oppression and Deadlock**

498, add before paragraph beginning "As to whether ...":

Whether and how courts should intervene in the affairs of an LLC under the “not reasonably practicable” standard applied in *Fisk* continues to be a hotly litigated topic in Delaware and elsewhere, as discussed in the following cases.

LOLA CARS INT’L LTD. v. KROHN RACING, LLC

Delaware Chancery Court

[2009 Del. Ch. LEXIS 193](#) (Nov. 12, 2009)

NOBLE, VICE CHANCELLOR.

[Two companies, Lola Cars and Krohn Racing, formed an LLC, Proto-Auto, in which they carried on a joint venture. Hazell, who managed Krohn, also served as the CEO of Proto-Auto. Lola and Krohn deadlocked on the issue whether to remove Hazell as the CEO, and Lola sued Krohn seeking judicial dissolution of Proto-Auto.]

The Defendants first move to dismiss Lola's request for judicial dissolution. Section 18-801 of the Act provides, without qualification, that a limited liability company may be dissolved and its affairs wound up upon “the entry of a decree of judicial dissolution.” Specifically, upon application by a member or manager, this Court may decree the dissolution of a limited liability company “whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement.”

The Defendants claim that, upon the facts as alleged, this Court cannot conclude that it is no longer reasonably practicable for Proto-Auto to carry on its business in accord with its Operating Agreement. In particular, the Defendants focus on Lola's averments that Proto-Auto is insolvent, has two members who apparently can no longer cooperate, and its allegations concerning Hazell's breach of his fiduciary duties and Krohn's breach of the Operating Agreement. They argue that each of these facts, standing alone, or in concert, cannot support a finding that Proto-Auto can no longer carry on its business based upon the statutory reasonable practicability standard, which they interpret to mean that the business “has been abandoned or that its purpose is not being pursued.”

To hold that judicial dissolution is appropriate only when the business has been abandoned would belie the language of the Act. Section 18-802 makes clear that the standard to be applied in this context is whether the Company can carry on its business with reasonable practicability in conformity with its operating agreement. The Court in *Fisk* laid out three factual scenarios this Court should consider when ordering judicial dissolution under Section 18-802's reasonable practicability standard: 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. The *Fisk* court explained that none of these factors is individually conclusive, nor must each be found for a court to order dissolution. Rather they provide guidance to the ultimate inquiry of whether the company can continue to pursue its stated business purpose with reasonable practicability.

All three of the circumstances laid out in *Fisk* are at issue here. For one, Lola and Krohn are allegedly deadlocked over whether to replace Hazell as chief executive officer. The Operating Agreement provides a buy-out mechanism in the event of a member dispute; this self-help disentanglement provision, however, is entirely voluntary. Lastly, there is doubt as to whether Proto-Auto can continue to operate in its current financial condition. Lola argues that the Company is insolvent insofar as its liabilities significantly exceed its assets. The Defendants counter that these liabilities largely represent loans required to be made by its members in the event that Proto-Auto's balance sheet shows negative net assets for a given year and that, under the Operating Agreement, the members are limited in their ability to demand repayment. Turning back to the Act once again, the relevant inquiry is not whether the Company cannot possibly continue its business in accord with the Operating Agreement, but rather whether to do so would be reasonably practicable. The fact that Proto-Auto's members have extended it significant additional working capital raises an inference that it is no longer reasonably practicable for the Company to exist even if these loans, if granted on a continual basis, could stave off ultimate business failure. Thus, Lola's allegations can satisfy two of *Fisk's* three criteria.

Stepping aside from the particular factors articulated in *Fisk*, there are important other facts alleged that allow for a reasonable conclusion that Proto-Auto's dissolution would be appropriate. The Company's primary purpose is to develop and manufacture race cars for sale in the Grand Am market with the long-term goal of continually strengthening and expanding its position in this market. Lola was tasked with designing and manufacturing the vehicles, while Krohn was responsible for testing the vehicles and, of perhaps of greater importance, providing Hazell as Proto-Auto's chief executive officer. The Operating Agreement does not specify who is to be responsible for marketing and selling the vehicles, but it is not unreasonable for one to assume that duty belonged to Hazell as, not only the chief executive officer, but also one of two named officers in the Operating Agreement. In addition, Hazell's services were expressly agreed to be provided by Krohn in the Operating Agreement-perhaps as Krohn's primary obligation-which speaks to Hazell's central role in Proto-Auto's management.

The First Complaint alleged Hazell's failure to manage properly Proto-Auto's business, which included the lack of vehicle sales. More importantly, Lola claimed that Hazell managed Proto-Auto more for Krohn's benefit than for the Company's, and that Krohn refuses even to consider Hazell's replacement. Lola's allegations of mismanagement and disloyalty, coupled with Proto-Auto's poor performance and Hazell's apparent entrenchment as chief executive officer allow for the conclusion that it is no longer reasonably practicable for Proto-Auto to continue its stated business purpose. In fact, it is difficult to imagine how any company can attain commercial success with, as alleged here, a careless and disloyal chief executive.

The Defendants also argue that the Operating Agreement clearly defines the circumstances upon which it may be terminated and that, because such circumstances do not include judicial dissolution, that option is necessarily precluded. Assuming for current purposes that judicial dissolution under § 18-802 may be precluded contractually, the fact that this particular Operating Agreement merely contains several self-termination options and does not expressly provide for judicial dissolution does not make that statutory remedy

unavailable. Each of the termination provisions contained in the Operating Agreement is permissive and may be triggered at a member's election. Moreover, 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.

Notes and Questions 12-20A

1. **Opinion on the merits in *Lola Cars*.** The *Lola Cars* case proceeded to trial. In its opinion setting forth its final judgment on the merits, [2010 Del. Ch. LEXIS 176](#) (Aug. 2, 2010), the court concluded there was no breach of contract or fiduciary duty and declined to order dissolution of the LLC where the members had agreed upon a contractual mechanism through which the disgruntled party, “which notably brought on much of the discord itself,” could exit the company. In contrast to the original opinion, in which the court was obliged to take the well pled facts of the complaint as true, the final opinion was based on extensively and detailed factual findings about the parties’ relationship and the alleged managerial misconduct. The plaintiffs had not succeeded in proving at trial the allegations of the complaint, which, if shown, may well have justified judicial dissolution. The court concluded:

But without such success, Lola's frustration amounts to little more than disappointment with how Proto-Auto is structured and managed and how Proto-Auto is attempting to expand its market presence. Unfortunately for Lola, it agreed to this arrangement when it partnered with Krohn Racing. Given its overzealous role in escalating this dispute, the Court will leave it to Lola to assess whether to exercise the deadlock procedure contained within the Operating Agreement—a provision that provides a no less reasonable means by which the Member Parties may disentangle themselves than dissolution.

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 itself from what it considers a bad deal. ... Moreover, the Member Parties in their private ordering effort embraced a provision within the Operating Agreement that allows for disentanglement. Lola may not be in an enviable position. ... [I]t is not for the Court to terminate, or rewrite, the Operating Agreement.

Did the court need a full trial on the merits when the result as to judicial dissolution turned on the language of the operating agreement? See Ribstein, *Judicial dissolution of LLCs and the operating agreement*, (Sept. 1, 2010), <http://truthonthemarket.com/2010/09/01/judicial-dissolution-of-llcs-and-the-operating-agreement/> for view that the court could have dismissed the dissolution claim at the pleading stage, leaving damages as the exclusive remedy for any breach of duty the court might have found at trial.

2. **Discussions of *Fisk* and *Lola Cars*.** For discussions of *Fisk Ventures* case above this note, see Pileggi, *Chancery Dissolves LLC Based on Section 18-802 "Reasonably Practicable" Standard*, DELAWARE CORPORATE AND COMMERCIAL LITIGATION BLOG, <http://www.delawarelitigation.com/2009/01/articles/chancery-court-updates/chancery-dissolves-llc-based-on-section-18802-reasonably-practicable-standard/> (Jan. 16, 2009); Ribstein, *Reconciling oppression with an LLC agreement*, IDEOBLOG,

<http://busmovie.typepad.com/ideoblog/2009/01/reconciling-oppression-with-an-llc-agreement.html> (Jan. 27, 2009). For discussions of *Lola Cars*, see Pileggi, *Court of Chancery Decides Fiduciary Duty Claims Against LLC Manager and Allows Dissolution Claim to Proceed*, DELAWARE CORPORATE AND COMMERCIAL LITIGATION BLOG, <http://www.delawarelitigation.com/2009/11/articles/chancery-court-updates/court-of-chancery-decides-fiduciary-duty-claims-against-llc-manager-and-allows-dissolution-claim-to-proceed> (Nov. 14, 2009); Mahler, *Two-Member LLC Operating Agreement Contains Recipe for Dissension and Litigation*, NEW YORK BUSINESS DIVORCE, (Dec. 21, 2009), <http://www.nybusinessdivorce.com/2009/12/articles/delaware/twomember-llc-operating-agreement-contains-recipe-for-dissension-and-litigation/index.html>; Ribstein, *Contracting for termination of an LLC*, IDEOBLOG, <http://busmovie.typepad.com/ideoblog/2009/12/contracting-for-termination-of-an-llc.html> (Dec. 22, 2009).

3. Other Delaware Cases. The Delaware Chancery Court determines on a case-by-case basis the use of judicial dissolution to rescue warring parties from themselves. *Homer C. Gutchess 1998 Irrevocable Trust v. Gutchess Companies, LLC*, [2010 Del. Ch. LEXIS 90](#) (Feb. 22, 2010), denied an order of judicial dissolution based on the owner's dissatisfaction with management short of "absolute frustration or futility," noting the deliberate separation of management and control under an estate plan. See Mahler, *"Unusual Actions Breed Unusual Outcomes": Delaware Court Dismisses Non-Voting Trust's Action to Dissolve LLC Born of Estate Plan* (Mar. 1, 2010), NEW YORK BUSINESS DIVORCE, <http://www.nybusinessdivorce.com/2010/03/articles/llcs/unusual-actions-breed-unusual-outcomes-delaware-court-dismisses-nonvoting-trusts-action-to-dissolve-llc-born-of-estate-plan/index.html> (analyzing transcript of hearing containing court's bench ruling). By contrast, *Spellman v. Katz*, [2009 Del. Ch. LEXIS 18](#) (Feb. 6, 2009), held that dissolution of an equal two-person medical practice was compelled pursuant to the explicit provisions of the operating agreement upon completion of the medical facility the LLC was organized to construct. The court noted that it might reach the same result on deadlock grounds under the "not reasonably practicable" standard of the Delaware statute.

Vice-Chancellor (now Chancellor) Strine applied the "reasonably practicable" standard in an interesting case involving the well-known television home improvement expert, Bob Vila. In *Vila v. BVWebTies LLC*, [2010 Del. Ch. LEXIS 202](#) (Oct. 1, 2010), Vila and Hill were coequal owners and managers of an LLC they had organized in 2000 to develop the commercial website "BobVila.com." The operating agreement provided that all decisions required a majority vote of the managers, and thus required agreement by Vila and Hill. Nevertheless, the informal relationship was that Vila focused on his television show while Hill ran the LLC. The business suffered severe reverses after 2007 brought on by the cancellation of Vila's syndicated television show, the termination of his endorsement contract with Sears, and the decline in the economy. Vila refocused his attention on the LLC's business and he and Hill came to disagree sharply on its strategic direction. Vila sued for judicial dissolution under §18-802, claiming it was "not reasonably practicable to carry on the business in conformity with a limited liability company agreement." The court found that Hill's unilateral arrogation of decision-making authority to himself and pursuit of a business strategy Vila adamantly opposed demonstrated a fundamental impasse warranting dissolution under §18-802:

This case is one in which an LLC has two managers whose agreement is contractually required for WebTies to move forward with a properly authorized strategy. Neither manager can act in isolation for WebTies without the assent of the other. This sort of deadlock has classically provided the basis for a dissolution in the corporate context when a joint venture with two coequal shareholders faces a deadlock; indeed, a specific section of the

DGCL, §273, addresses that scenario. Given that a deadlocked management board is a quintessential example of a situation justifying a judicial dissolution, it is not surprising that this court has looked to §273 of the DGCL by analogy in determining whether alternative entities, like LLCs, should be dissolved because it is not reasonably practicable for them to operate under their governing instruments [citing *Haley v. Talcott*, [864 A.2d 86](#) (Del.Ch. 2004) (applying the analysis under DGCL §273 to a deadlocked LLC)]. Section 273 “essentially sets forth three prerequisites for a judicial order of dissolution: 1) the corporation must have two 50% stockholders, 2) those stockholders must be engaged in a joint venture, and 3) they must be unable to agree upon whether to discontinue the business or how to dispose of its assets.” The reason that the § 273 analysis is useful in the LLC context is obvious: when an LLC agreement requires that there be agreement between two managers for business decisions to be made, those two managers are deadlocked over serious issues, and the LLC agreement provides no alternative basis for resolving the deadlock, it is not “reasonably practicable” to continue to carry on the LLC business “*in conformity* with [its] limited liability company agreement.”

The trial record indisputably demonstrates that Vila and Hill are deadlocked over serious managerial issues. ...

In prior cases, this court has rejected the notion that one co-equal fiduciary may ignore the entity's governing agreement and declare himself the sole “decider.” In *Haley*, for example, one co-owner of a restaurant business forbade the other from physically entering the restaurant premises, and defended in part on the ground that the restaurant was doing just fine under his sole dominion. The court rejected that defense because under the LLC agreement, both co-owners were to make the decisions, not just the one who had changed the locks and managed the restaurant as he saw fit. As in *Haley*, other decisions under alternative entity statutes have held that a business is not being operated in accordance with its governing instrument when one fiduciary acts as sole manager in a situation where the agreement of others is required. In this case, WebTies' LLC Agreement could not be any clearer that WebTies is to be managed by “the Managers,” and not by a single manager acting independently of his co-equal manager.

Although Hill has at times tried to minimize the serious nature of his disagreements with Vila, the documentary evidence contains admissions on his own part of how widely and deeply they are divided. Furthermore, given the clarity of the License Agreement and the fact that Vila only terminated the License Agreement after making good faith efforts to resolve the disagreement and to revitalize WebTies, there is no apparent way for WebTies to force Vila to restore the Vila IP to it. Whether Hill and his staff wish to admit it or not, WebTies was premised on building around Vila's name and reputation. WebTies cannot do that now. That Hill and his staff say that WebTies can be profitable under a different website name and without content involving the Vila IP further makes Vila's point, and cuts against Hill's argument opposing dissolution. What Hill wishes to do is to pursue a business having nothing to do with the basic purpose for which WebTies was formed and to do so over the objection of one of its two managers.

Of course, the existence of a deadlock would not necessarily justify a dissolution if the LLC Agreement provided a means to resolve it equitably. But the LLC Agreement does not contain a buy-sell arrangement or any other provision (such as one providing for the appointment of an agreed-upon third manager) to resolve the deadlock. Rather, the LLC Agreement contemplates that a member or manager may seek judicial dissolution. This is what Vila has done, and he has succeeded in proving that dissolution is warranted. * * *

4. Statutory approaches to the deadlock problem. Some statutes clarify the remedy for deadlock. *See, e.g.*, Kans. St. Ann. §17-76.117(b) (authorizing dissolution “[i]f the business of the limited liability company is suffering or is threatened with irreparable injury because the members of a limited liability company, or the managers of a limited liability company having more than one manager, are so deadlocked respecting the management of the affairs of the limited liability company that the requisite vote for action cannot be obtained and the members are unable to terminate such deadlock * * * if the district court determines that such irreparable injury and deadlock exists.”). The provision was applied in *In re Metcalf Associates-2000, L.L.C.*, [213 P.3d 751](#) (Kan. Ct. App. 2009). The court affirmed dissolution where the LLC was set up for the specific purpose of buying and selling office buildings. The operating agreement required unanimous member consent for the sale of real estate, and the parties disagreed about the sale and refinancing of a building. The court held that the parties’ disagreement was “fundamental” and that the deadlock prevented the LLC from moving forward in its sole business despite its substantial rental income from the building. The court reasoned that the argument that a solvent LLC should not be judicially dissolved is better addressed to the legislature, since the statute explicitly requires the court to order dissolution if it determines that there is irreparable injury and deadlock.

Compare the approach to dissolution under Delaware law in *Lola Cars* with that applied under the New York LLC statute in the following cases.

IN RE 1545 OCEAN AVE., LLC
New York Supreme Court, Appellate Division
[72 A.D.3d 121](#), 893 N.Y.S.2d 590 (2010)

AUSTIN, J.

On this appeal, we are asked to determine whether the Supreme Court properly granted the petition of Crown Royal Ventures, LLC (hereinafter Crown Royal), to dissolve 1545 Ocean Avenue, LLC (hereinafter 1545 LLC). For the following reasons, we answer in the negative and reverse the order of the Supreme Court.

I

1545 LLC was formed in November 2006 when its Articles of Organization were filed with the Department of State. On November 15, 2006, two membership certificates for 50 units each were issued respectively to Crown Royal and the appellant, Ocean Suffolk Properties, LLC (hereinafter Ocean Suffolk).

On the same date that the membership certificates were issued, an operating agreement was executed by Ocean Suffolk and Crown Royal. The operating agreement provided for two managers; Walter T. Van Houten (hereinafter Van Houten), who was a member of Ocean Suffolk, and John J. King, who was a member of Crown Royal. Each member of 1545 LLC contributed 50% of the capital which was used to purchase premises known as 1545 Ocean Avenue in Bohemia (hereinafter the property) on January 5, 2007.

1545 LLC was formed to purchase the property, rehabilitate an existing building, and build a second building for commercial rental (hereinafter Building A and B, respectively).

* * *

II

Article 4.1 of the operating agreement provides that “[a]t any time when there is more than one Manager, any one Manager may take any action permitted under the Agreement, unless the approval of more than one of the Managers is expressly required pursuant to the [operating agreement] or the [Limited Liability Company Law, hereinafter LLCL].”

Article 4.12 of the operating agreement entitled, “Regular Meetings,” does not require meetings of the Managers with any particular regularity. Meetings may be called without notice as the Managers may “from time to time determine.”

Article 7.4 of the operating agreement provides, “any matter not specifically covered by a provision of the [operating agreement], including without limitation, dissolution of the Company, shall be governed by the applicable provisions of the [LLCL].” Accordingly, dissolution of 1545 LLC is governed by LLCL article VII.

III

This proceeding was commenced by order to show cause and verified petition seeking the dissolution of 1545 LLC and related relief. The sole ground for dissolution cited by Crown Royal is deadlock between the managing members arising from Van Houten's alleged violations of various provisions of article 4 of the operating agreement. There was no allegation of fraud or frustration of the purpose of 1545 LLC on the part of Ocean Suffolk [and] Van Houten.

Answering the petition, Van Houten, on behalf of his company and Ocean Suffolk, denied the allegations in the petition and set forth their claim that they did business in accordance with the operating agreement. Van Houten alleged that the only significant dissension among the members arose from the inability of the parties to agree on a buy-out of each other's interest in 1545 LLC. Significantly, Van Houten alleged, without dispute, that the renovation of Building A was within three to four weeks of completion when this proceeding was commenced.

Van Houten also contended that, as a result of King's resignation as a managing member, Crown Royal could not reasonably claim that a deadlock existed. Moreover, there is no evidence that King complied with article 4.8 of the operating agreement by submitting a written resignation. Nevertheless, by May 10, 2007, in anticipation of a buy-out of the Crown Royal interest in the venture, the parties were operating as if Van Houten was the sole managing member of 1545 LLC. Indeed, throughout the negotiations for the buy-out, the renovation work on Building A continued.

IV

[Section 702 of the New York LLC Law] LLCL 702 provides for judicial dissolution as follows:

“On application by or for a member, the Supreme Court in the judicial district

in which the office of the limited liability company is located may decree dissolution of a limited liability company *whenever it is not reasonably practicable to carry on the business* in conformity with the articles of organization or operating agreement” (emphasis added).

The LLCL came into being in 1994. Many of its provisions were amended in 1999 (L. 1999, ch. 420) to track changes in federal tax code treatment of such entities (*see Mahler, When Limited Liability Companies Seek Judicial Dissolution, Will the Statute Be Up to the Task?*, 74 N.Y. St. BJ 5 [June 2002]). Such amendments included changes in how the withdrawal of a member was to be treated (LLCL 606) and events of dissolution which relate back to the operating agreement (LLCL 701).

Although various provisions of the LLCL were amended, LLCL 702 was neither modified nor amended in 1999. In declining to amend LLCL 702, the Legislature can only have intended the dissolution standard therein provided to remain the sole basis for judicial dissolution of a limited liability company (*see McKinney's Statutes* §§ 74, 153, 191). Phrased differently, since the Legislature, in determining the criteria for dissolution of various business entities in New York, did not cross-reference such grounds from one type of entity to another, it would be inappropriate for this Court to import dissolution grounds from the Business Corporation Law or Partnership Law to the LLCL.

Despite the standard for dissolution enunciated in LLCL 702, there is no definition of “not reasonably practicable” in the context of the dissolution of a limited liability company. Most New York decisions involving limited liability company dissolution issues have avoided discussion of this standard altogether. * * * Such standard, however, is not to be confused with the standard for the judicial dissolution of corporations (*see Business Corporation Law* §§ 1104, 1104-a) or partnerships (*see Partnership Law* § 62) * * *. Limited liability companies * * * fall within the ambit of neither the Business Corporation Law nor the Partnership Law.

The language of LLCL 702 appears to be borrowed from Revised Limited Partnership Act (Partnership Law) § 121-802 (dissolution is authorized when it is “not reasonably practicable to carry on the business in conformity with the partnership agreement”) and Partnership Law § 63(1)(d), in which dissolution is permitted, inter alia, where a partner's conduct of the partnership business makes it “not reasonably practicable to carry on the business in partnership with him.” While there are no New York cases which interpret and apply this standard in the context of limited partnerships, it has been held to mean that, without more, disagreements between the partners with regard to the accounting of the entity are insufficient to warrant dissolution (*see Red Sail Easter Ltd. Partners, L.P. v. Radio City Music Hall Productions, Inc.*, 1992 WL 251380, *5-6 [Del. Ch. 1992]).

The LLCL also clarifies its scope by defining “limited liability company” as “an unincorporated organization of one or more persons having limited liability ... other than a partnership or trust” (LLCL 102[m]). Thus, the existence and character of these various entities are statutorily dissimilar as are the laws relating to their dissolution (*compare Business Corporation Law* art. 11; *Partnership Law* §§ 62, 63; LLCL 702). Indeed, it was found to be improper to apply partnership dissolution standards to a cause for dissolution of a limited liability company (*see Matter of Spires v. Lighthouse Solutions*, [4 Misc.3d at 431](#), 778 N.Y.S.2d 259).

In the absence of applying Business Corporation Law or Partnership Law dissolution factors to the analysis of what is “not reasonably practicable,” the standard for dissolution under LLCL 702 remains unresolved in New York. However, LLCL 702 is clear that unlike

the judicial dissolution standards in the Business Corporation Law and the Partnership Law, the court must first examine the limited liability company's operating agreement * * * to determine, in light of the circumstances presented, whether it is or is not “reasonably practicable” for the limited liability company to continue to carry on its business in conformity with the operating agreement. * * * Thus, the dissolution of a limited liability company under LLCL 702 is initially a contract-based analysis.

* * *

The operating agreement of 1545 LLC does not contain any specific provisions relating to dissolution. It provides only in article 1.5 that “(t)he Company's term is perpetual from the date of filing of the Articles of Organization ... unless the Company is dissolved.”

Crown Royal argues for dissolution based on the parties' failure to hold regular meetings, failure to achieve quorums, and deadlock. The operating agreement, however, does not require regular meetings or quorums * * *. It only provides, in article 4.12, for meetings to be held at such times as the managers may “from time to time determine.” The record demonstrates that the managers, King and Van Houten, communicated with each other on a regular basis without the formality of a noticed meeting which appears to conform with the spirit and letter of the operating agreement and the continued ability of 1545 LLC to function in that context.

King and Van Houten did not always agree as to the construction work to be performed on the 1545 LLC property. King claims that this forced the parties into a “deadlock.” “Deadlock” is a basis, in and of itself, for judicial dissolution under Business Corporation Law §1104. However, no such independent ground for dissolution is available under LLCL 702. Instead, the court must consider the managers' disagreement in light of the operating agreement and the continued ability of 1545 LLC to function in that context.

It has been suggested that judicial dissolution is only available when the petitioning member can show that the limited liability company is unable to function as intended or that it is failing financially (*see Schindler v. Niche Media Holdings*, [1 Misc.3d 713, 716](#), 772 N.Y.S.2d 781). Neither circumstance is demonstrated by the petitioner here. On the contrary, the purpose of 1545 LLC was feasibly and reasonably being met.

The “not reasonably practicable” standard for dissolution of limited liability companies and partnerships has been examined in other jurisdictions. In Delaware, the Chancery Court has observed, “Given its extreme nature, judicial dissolution is a limited remedy that this court grants sparingly” (*Matter of Arrow Inv. Advisors, LLC*, 2009 WL 1101682, *2 [Del.Ch.2009]). In Virginia, dissolution is only available when the business cannot continue “in accord with its ... operating agreement” (*Dunbar Group, LLC v. Tignor*, [267 Va. 361, 367](#), 593 S.E.2d 216, 218 [2004][serious differences of opinion among the members and the managers and the commingling of funds was insufficient to warrant a finding that it was not reasonably practicable for the company to continue]). However, where the economic purpose of the limited liability company is not met, dissolution is appropriate (*see Kirksey v. Grohmann*, [754 N.W.2d 825](#) [S.D. 2008]). Several courts take the view that the “not reasonably practicable” standard should be read as “capable of being done logically and in a reasonable, feasible manner” (*Taki v. Hami*, 2001 WL 672399, *6 [Mich. Ct. App. 2001] [dissolution granted where the two partners had not spoken in years and there were allegations of violence and expulsion]), or as “one of reasonable practicability, not impossibility” (*PC Tower Ctr., Inc. v. Tower Ctr. Dev. Assoc. L.P.*, 1989 WL 63901, *6 [Del. Ch.1989]).

Here, a single manager's unilateral action in furtherance of the business of 1545 LLC is specifically contemplated and permitted. Article 4.1 of the 1545 LLC Operating Agreement states:

“At any time when there is more than one Manager, *any one manager may take any action permitted under the Agreement*, unless the approval of more than one of the Managers is expressly required pursuant to the Agreement or the Act” (emphasis added).

This provision does not require that the managers conduct the business of 1545 LLC by majority vote. It empowers each manager to act autonomously and to unilaterally bind the entity in furtherance of the business of the entity. The 1545 LLC operating agreement, however, is silent as to the issue of manager conflicts. Thus, the only basis for dissolution can be if 1545 LLC cannot effectively operate under the operating agreement to meet and achieve the purpose for which it was created. In this case, that is the development of the property which purpose, despite the disagreements between the managing members, was being met. As the Delaware Chancery Court noted in *Matter of Arrow Inv. Advisors, LLC*,

“The court will not dissolve an LLC merely because the LLC has not experienced a smooth glide to profitability or because events have not turned out exactly as the LLC's owners originally envisioned; such events are, of course, common in the risk-laden process of birthing new entities in the hope that they will become mature, profitable ventures. In part because a hair-trigger dissolution standard would ignore this market reality and thwart the expectations of reasonable investors that entities will not be judicially terminated simply because of some market turbulence, dissolution is reserved for situations in which the LLC's management has become so dysfunctional or its business purpose so thwarted that it is no longer practicable to operate the business, such as in the case of a voting deadlock or where the defined purpose of the entity has become impossible to fulfill.”

...

“Dissolution of an entity chartered for a broad business purpose remains possible upon a strong showing that a confluence of situationally specific adverse financial, market, product, managerial, or corporate governance circumstances make it nihilistic for the entity to continue” * * *

Here, the operating agreement avoids the possibility of “deadlock” by permitting each managing member to operate unilaterally in furtherance of 1545 LLC's purpose.

V

After careful examination of the various factors considered in applying the “not reasonably practicable” standard, we hold that for dissolution of a limited liability company pursuant to LLCL 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.

VI

Dissolution is a drastic remedy (*see Matter of Arrow Inv. Advisors, LLC*, 2009 WL

1101682, *2 [Del.Ch.2009]). Although the petitioner has failed to meet the standard for dissolution enunciated here, there are numerous other factors which support the conclusion that dissolution of 1545 LLC is inappropriate under the circumstances of this case.

First, the dispute between King and Van Houten was not shown to be inimicable to achieving the purpose of 1545 LLC (*see e.g. Haley v. Talcott*, 864 A.2d 86, 94 [Del. Ch. 2004] [Delaware's "not reasonably practicable" standard "has the obvious purpose of providing an avenue of relief when an LLC cannot continue to function in accordance with its chartering agreement"]). Indeed, the test is "whether it is 'reasonably practicable' to carry on the business of the [LLC], and not whether it is 'impossible' " (*Fisk Ventures, LLC v. Segal*, 2009 WL 73957, *3 [Del. Ch. 2009], *aff'd*, [984 A.2d 124](#) [Del. Supr. 2009]).

King never objected to the quality of Van Houten's construction work, but only to its expense. The work on Building A was all but complete when this proceeding was commenced. King approved and praised it. Further, the parties were operating in conformity with the operating agreement.

Second, there is a remedy available in the LLCL to regulate Van Houten's conduct. LLCL 411 permits a limited liability company to avoid contracts entered into between it and an interested manager, or another limited liability company in which a manager has a substantial financial interest, unless the manager can prove the contract was fair and reasonable. Crown Royal took no action under LLCL 411 here. Beyond complaining about the cost of [the] work and seeking to withdraw from 1545 LLC, the record is clear that Crown Royal ratified, albeit grudgingly at times, Van Houten's unilateral efforts.

The notion that 1545 LLC could void the contract with VHC in its entirety may serve as a check on Van Houten's unilaterally hiring his own company for future construction work on the property, and may result in Van Houten being made to disgorge excess moneys paid in derogation of 1545 LLC's best interest at the time of the accounting of the members. In any event, a fair reading of LLCL 702 demonstrates that an application to dissolve 1545 LLC does not flow from a claim under LLCL 411.

Finally, if Crown Royal is truly aggrieved by Van Houten's actions as manager, the Court of Appeals has found that a derivative claim is available (*see Tzolis v. Wolff*, [10 N.Y.3d 100](#), 855 N.Y.S.2d 6, 884 N.E.2d 1005). Nevertheless, such remedy cannot serve as the basis for dissolution unless the wrongful acts of a managing member which give rise to the derivative claim are contrary to the contemplated functioning and purpose of the limited liability company.

VII

"The appropriateness of an order for dissolution of the limited liability company is vested in the sound discretion of the court hearing the petition" * * *. However, in applying the standard for dissolution of a limited liability company, upon a review of the evidence submitted, we conclude that the Supreme Court did not providently exercise its discretion in granting the petition for dissolution. Thus, the order of the Supreme Court should be reversed, the petition denied, and the proceeding dismissed.

FISHER, J.P., concurs in part and dissents in part:

A limited liability company may be judicially dissolved when the court, in the exercise of its discretion, finds that it is no longer reasonably practicable for the company to carry on its business in conformity with its articles of organization or operating agreement

(see *Matter of Extreme Wireless*, 299 A.D.2d at 550, 750 N.Y.S.2d 520; Limited Liability Company Law [hereinafter LLCL] § 702). I have no serious quarrel with the standard the majority adopts based on its analysis of the authorities it cites. In my view, those authorities and the plain language of the statute suggest that, pursuant to LLCL 702, it is “not reasonably practicable” for a limited liability company to carry on its business in conformity with its articles of organization or operating agreement when disagreement or conflict among the members regarding the means, methods, or finances of the company's operations is so fundamental and intractable as to make it unfeasible for the company to carry on its business as originally intended.

* * *

In my view, without a factual finding, we cannot meaningfully decide whether the Supreme Court providently exercised its discretion in finding that the actions of the parties rendered it not reasonably practicable for 1545 LLC to carry on its business in conformity with its articles of organization or operating agreement. Accordingly, I would remit the matter to the Supreme Court, Suffolk County, for a fact-finding hearing and thereafter for a new determination on the petition * * *.

IN RE SUPERIOR VENDING, LLC
New York Supreme Court, Appellate Division
[71 A.D.3d 1153](#), 898 N.Y.S.2d 191

In a special proceeding pursuant to Limited Liability Company Law § 702, inter alia, to dissolve Superior Vending, LLC, the petitioner, Arik Tal, appeals * * * from so much of a judgment of the Supreme Court, Westchester County [that] directed the respondent Peter Plotkin to pay the principal sum of only \$256,549.43 to purchase [Tal's] membership interest in Superior Vending, LLC, and denied that branch of the petition which was for an accounting and interim distributions.

ORDERED that the judgment is affirmed insofar as appealed from, with costs.

In 1997 Peter Plotkin incorporated a vending machine company that distributed beverages and snacks to businesses, schools, and hospitals throughout the New York City metropolitan area. In 2000 Arik Tal helped Plotkin to acquire a second vending machine company. Specifically, Tal paid a down payment in the sum of \$170,000 and executed a promissory note pursuant to which he agreed to pay the remaining balance of the purchase price in monthly installments. Although Plotkin and Tal formed a limited liability company known as Superior Vending, LLC (hereinafter Superior), to operate the business, they never executed an operating agreement.

Plotkin and Tal, in effect, terminated their business relationship in November 2002. Although Tal initially commenced an action in March 2003, inter alia, to dissolve Superior, he failed to pursue the dissolution claim. That action was marked off the trial calendar in May 2004, and dismissed in May 2005. Meanwhile, Plotkin continued to operate and expand the vending machine business. In June 2007 Tal commenced the instant proceeding pursuant to Limited Liability Company Law § 702, inter alia, to dissolve Superior and recover his share of Superior's assets and interim distributions.

Although Tal and Plotkin consented to the dissolution of Superior, they disagreed about the distribution of the assets. After a six-day hearing in March 2008, the Supreme Court determined, based on Limited Liability Company Law § 704(c), that Tal was entitled to recover his initial investment in the amount of \$170,000, plus \$99,320.86 for the 26

payments that he made on the promissory note. The Supreme Court reduced Tal's recovery by the sum of \$12,771.43, upon finding in favor of Plotkin on Plotkin's counterclaim for 50% of the money that Tal had misappropriated from Superior.

Although the Limited Liability Company Law does not expressly authorize a buyout in a dissolution proceeding, the Supreme Court properly determined that the most equitable method of liquidation in this case was to provide Plotkin a period of 45 days within which to purchase all of Tal's right, title, and interest in Superior for the principal sum of \$256,549.43, plus 9% interest from November 22, 2002 (*see Lyons v. Salamone*, [32 A.D.3d 757, 758](#), 821 N.Y.S.2d 188). This approach, which excluded an award of interim distributions made by Superior after November 2002, allowed Tal to recover his investment plus a reasonable return on that investment with respect to his membership interest in Superior, which terminated in November 2002.

Notes and Questions 12-20B

1. Discussions of 1545 Ocean Avenue. For discussions of the *1545 Ocean Avenue* case, see Mahler, *It Only Took 16 Years: New York Appellate Court Defines Standard for Judicial Dissolution of Limited Liability Companies*, NEW YORK BUSINESS DIVORCE, <http://www.nybusinessdivorce.com/2010/02/articles/llcs/it-only-took-16-years-new-york-appellate-court-defines-standard-for-judicial-dissolution-of-limited-liability-companies/index.html> (February 8, 2010); Ribstein, *LLC dissolution and the operating agreement*, IDEOBLOG, <http://busmovie.typepad.com/ideoblog/2010/02/llc-dissolution-and-the-operating-agreement.html> (February 8, 2010).

2. Extra-statutory remedies in New York. *1545 Ocean Avenue* refers to the judicially created derivative remedy in *Tzolis*, and *Superior Vending* affirms the order of a buyout in the absence of statutory authorization for the remedy. For discussions of *Superior Vending* focusing on the wisdom of permitting the extra-statutory remedy, see Mahler, *Appeals Court Upholds Equitable Buyout Remedy in LLC Dissolution*, NEW YORK BUSINESS DIVORCE, <http://www.nybusinessdivorce.com/2010/04/articles/llcs/appeals-court-upholds-equitable-buyout-remedy-in-llc-dissolution/index.html> (April 5, 2010); Ribstein, *The continuing trouble with NY LLC law*, IDEOBLOG, <http://busmovie.typepad.com/ideoblog/2010/04/the-continuing-trouble-with-ny-llc-law.html> (Apr. 5, 2010).

3. Comparison of Delaware and New York approaches. For analyses of the New York and Delaware contract-based dissolution cases, see Ribstein, *Close Corporation Remedies and the Evolution of the Closely Held Firm*, 33 W. NEW ENG. L. REV. ___ (forthcoming 2011), <http://ssrn.com/abstract=1710006>; Mahler, *The Emerging Influence of 1545 Ocean Avenue on Judicial Dissolution of LLCs*, (Feb. 7, 2011), NEW YORK BUSINESS DIVORCE, <http://www.nybusinessdivorce.com/2011/02/articles/llcs/the-emerging-influence-of-1545-ocean-avenue-on-judicial-dissolution-of-llcs/index.html>.

498, immediately after the preceding insertion, add the following heading:

2a. Alternatives to Judicial Dissolution

498, add at the end of the final sentence in the paragraph beginning “As to whether alternative remedies ...”:

; *Simmons Family Properties, LLLP v. Shelton*, [307 Ga. App. 361](#), 705 S.E.2d 258 (2010); *Gordon v. Kuzara*, [358 Mont. 432](#), 245 P.3d 37 (2010) (both holding that the statutory

dissolution remedy based on the “not reasonably practicable” standard was independent of and not precluded by the operating agreement’s arbitration clause where the claimed basis for the dissolution did not arise out of the subject to which the arbitration provision applied—a breach or interpretation of the operating agreement).

12.09 Special Issues in LLC Law

A. Application of Other Law

2. Other regulatory law

507, add a new paragraph at the end of Notes and Questions 12-23(2):

Conversely, a court permitted a criminal action against an LLC on the grounds that it was not a "corporation" but it was a "person." In *People v. Highgate LTC Management, LLC*, [69 A.D.3d 185](#), 887 N.Y.S.2d 298 (2009), the court imposed criminal liability on a long term care facility for deficiencies in care, reasoning that while the penal law explicitly extends liability for certain intentional crimes only to corporations, the relevant statute applied to “persons,” the LLC statute and the Penal Law deemed unincorporated associations to be “persons,” courts had long held corporations liable for their agents’ intentional acts, and the operation of a nursing home is “intertwined with the public interest.”

13.05 Tax and Regulatory Aspects of LLPs

E. Professional Firms as LLPs

536, add at the end of Notes and Questions 13-2:

7. Effect of law firm failure to register as LLP. One of the consequences of the financial crisis of 2008-09 has been the dissolution and bankruptcy of huge law firms once thought immune to this kind of financial collapse. See generally Ribstein, *The Death of Big Law*, [2010 WIS. L. REV. 749](#). One recent victim is the renowned Howrey firm, whose partners voted to dissolve the firm in March 2011, and which was thereafter the subject of an involuntary petition in bankruptcy filed on April 11, 2011 by the firm’s creditors in the Northern District of California. See <http://www.howreyinfo.com/maincase.php>; *Howrey LLP Involuntary Bankruptcy Converted to Chapter 11; Venue Transfer To Be Considered Later This Month*, BKRCY. NEWS & ANALYSIS, <http://blog.ch11cases.com/2011/06/howrey-llp-involuntary-bankruptcy.html>; Julie Triedman, *An Expert in Law Firm Breakups Looks at Possible Howrey Scenarios*, AM LAW DAILY, <http://amlawdaily.typepad.com/amlawdaily/2011/03/xx.html>.

One of the claims in the bankruptcy proceeding is that Howrey inadvertently neglected to register with the California bar as an LLP when it opened its California office, pursuant to California Corporations Code §16306(f), which provides that “the limitation of liability [pursuant to which a partner in a registered limited liability partnership is not liable for debts of the partnership] shall not apply to claims based upon acts, errors, or omissions arising out of the rendering of professional limited liability partnership services of a registered limited liability partnership providing legal services unless that partnership has a currently effective certificate of registration issued by the State Bar.” The creditors have claimed that the consequence of this failure is to deny limited liability protection to the Howrey partners in California. See *In re Howrey LLP*, Case No. 11-31376 (Brkcy. N.D. Cal.), *Separate Opposition Of The Petitioning Creditors Of Howrey LLP to the Motion of Debtor for Order: (A) Authorizing Use Of Cash Collateral On An Interim And Final Basis; (B) Granting Adequate Protection And Related Relief; And (C) Scheduling Final Hearing On Use Of Cash Collateral*, filed June 7, 2011, http://www.Howreyinfo.com/pdflib/74_31376.pdf.

**ADDITIONAL SELECTED PROVISIONS FROM THE
DELAWARE LIMITED LIABILITY ACT**

§ 18-109. Service of process on managers and liquidating trustees

(a) A manager or a liquidating trustee of a limited liability company may be served with process in the manner prescribed in this section in all civil actions or proceedings brought in the State of Delaware involving or relating to the business of the limited liability company or a violation by the manager or the liquidating trustee of a duty to the limited liability company or any member of the limited liability company, whether or not the manager or the liquidating trustee is a manager or a liquidating trustee at the time suit is commenced. A manager's or a liquidating trustee's serving as such constitutes such person's consent to the appointment of the registered agent of the limited liability company (or, if there is none, the Secretary of State) as such person's agent upon whom service of process may be made as provided in this section. Such service as a manager or a liquidating trustee shall signify the consent of such manager or liquidating trustee that any process when so served shall be of the same legal force and validity as if served upon such manager or liquidating trustee within the State of Delaware and such appointment of the registered agent (or, if there is none, the Secretary of State) shall be irrevocable. As used in this subsection (a) and in subsections (b), (c) and (d) of this section, the term "manager" refers (i) to a person who is a manager as defined in § 18-101(10) of this title and (ii) to a person, whether or not a member of a limited liability company, who, although not a manager as defined in § 18-101(10) of this title, participates materially in the management of the limited liability company; provided however, that the power to elect or otherwise select or to participate in the election or selection of a person to be a manager as defined in § 18-101(10) of this title shall not, by itself, constitute participation in the management of the limited liability company.

(b) Service of process shall be effected by serving the registered agent (or, if there is none, the Secretary of State) with 1 copy of such process in the manner provided by law for service of writs of summons. In the event service is made under this subsection upon the Secretary of State, the plaintiff shall pay to the Secretary of State the sum of \$50 for the use of the State of Delaware, which sum shall be taxed as part of the costs of the proceeding if the plaintiff shall prevail therein. In addition, the Prothonotary or the Register in Chancery of the court in which the civil action or proceeding is pending shall, within 7 days of such service, deposit in the United States mails, by registered mail, postage prepaid, true and attested copies of the process, together with a statement that service is being made pursuant to this section, addressed to such manager or liquidating trustee at the registered office of the limited liability company and at the manager's or liquidating trustee's address last known to the party desiring to make such service.

(c) In any action in which any such manager or liquidating trustee has been served with process as hereinabove provided, the time in which a defendant shall be required to appear and file a responsive pleading shall be computed from the date of mailing by the Prothonotary or the Register in Chancery as provided in subsection (b) of this section; however, the court in which such action has been commenced may order such continuance or continuances as may be necessary to afford such manager or liquidating trustee reasonable opportunity to defend the action.

(d) In a written limited liability company agreement or other writing, a manager or member may consent to be subject to the nonexclusive jurisdiction of the courts of, or arbitration in, a specified jurisdiction, or the exclusive jurisdiction of the courts of the State of Delaware, or the exclusivity of arbitration in a specified jurisdiction or the State of Delaware, and to be served with legal process in the manner prescribed in such limited liability company

agreement or other writing. Except by agreeing to arbitrate any arbitrable matter in a specified jurisdiction or in the State of Delaware, a member who is not a manager may not waive its right to maintain a legal action or proceeding in the courts of the State of Delaware with respect to matters relating to the organization or internal affairs of a limited liability company.

(e) Nothing herein contained limits or affects the right to serve process in any other manner now or hereafter provided by law. This section is an extension of and not a limitation upon the right otherwise existing of service of legal process upon nonresidents.

(f) The Court of Chancery and the Superior Court may make all necessary rules respecting the form of process, the manner of issuance and return thereof and such other rules which may be necessary to implement this section and are not inconsistent with this section.