LIABILITY OF PARTNERS
AND MEMBERS OF ENTITIES
IMPROPERLY FORMED

by

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Limited partners, limited liability companies and limited liability partnerships each provide some or all of their equity participants limited liability. But they are all creatures of statute, and each of the relevant statutes in the various states requires certain steps to be taken, most notably a filing with an agency of the state. What happens if the filing is done improperly or not at all? Are the innocent punished by imposing personal liability? This paper will review the cases and statutes on these issues.

I. Limited Partnerships

From the original Uniform Limited Partnership Act in 1916 through the Revised Uniform Limited Partnership Act of 2001, uniform limited partnership acts provided that limited partners who make an investment in a limited partnership, erroneously believing in good faith that they are a limited partner, are not liable for the enterprise’s obligations merely by reason of their investment provided they take certain steps. See ULPA §11; RULPA (1976) §304; RULPA (1985) §304; RULPA (2001) §306. However, a conceptual issue is raised by these statutes. On their face, it would seem that they only apply when a limited partnership has been formed and the putative partner is mischaracterized, or at least that there has been an attempted, if improper, filing. For one thing, the provision appears in the limited partnership law. Further, the comment to RULPA (1985) §304 states, “However, because the 1985 Act does not require limited partners to be named in the certificate, the only situation to which Section 304 would

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1 The author thanks Roy G. Locke, Jr., New York Law School Class of 2005, for his assistance.
now appear to be applicable is one in which a person intending to be a limited partner was erroneously identified as a general partner in the certificate”, apparently disregarding the non-filing scenario. In fact, however, the statutes have been applied in situations where there has been no filing. See, e.g., Briargate Condominium Assoc. v. Carpenter, 976 F.2d 868 (4th Cir. 1992); Gregg v. S.R. Investors, Ltd., 1998 WL 214712 (N.D. Ill. 1998). The provisions usually require the partner, upon discovery of error, either to file the necessary filing to establish a limited partnership, to file a corrective document listing the partner as a limited partner, or to withdraw from the entity to avoid liability. On compliance with those provisions, partners, if they erroneously but in good faith believed they were limited partners and fall within the requirements of the statute, are not liable to a third party for the enterprise’s liability. Gregg; see also Voudouris v. Walter E. Heller & Co., 560 S.W.2d 202 (Ct. of Civ. App. 1st Dist., Tex. 1977).

In Briargate, plaintiff sued defendant for outstanding association fees owed to plaintiff by defendant’s partnership. Citing North Carolina’s adoption of RULPA, NC §59-304, defendant argued that she could not be held liable as a general partner for the obligations of the partnership when she subjectively believed in good faith that she was a limited partner at the time she became a partner. The district court rejected defendant’s argument, finding in favor of plaintiff because defendant had received ample notice that she was in a general partnership rather than a limited partnership. However, the 4th Circuit Court of Appeals vacated the district court’s judgment and remanded the case for determination whether the defendant had the necessary “good faith” belief that she was a limited partner at the time she contributed and joined in
the partnership. If an objective good faith belief was determined, no liability would be imposed upon her as a general partner.

In Gregg, plaintiff sued a limited partnership, S.R. Investors, Ltd. (“SRI”) and each of its partners on the theory that the partnership, which was engaged in owning and operating a railroad, was statutorily barred from being formed as a limited partnership.² Plaintiff argued that, even though SRI had filed the necessary certificate of limited partnership, the entity was not a validly formed limited partnership, and therefore each partner should be liable as a general partner for the obligations of the business. Although the court initially supported this view (966 F. Supp. 746 (N. D. Ill. 1997)), after reargument based on § 304 of RULPA, the court rejected plaintiffs’ argument because two of the defendants had filed the proper withdrawal notices from the partnership upon discovery that they were not limited partners in a limited partnership. The court noted that it was for this purpose of shielding innocent limited partners from liability when a limited partnership was improperly formed or ceased to function as a limited partnership that RULPA §304(a) was created.

Similarly, in Voudouris a Texas appellate court found that a partner who had contributed to a partnership, believing in good faith that a limited partnership was formed, was not liable as a general partner for the entity’s debts even though the paperwork creating a limited partnership was never filed. Without reference to the “erroneous belief” provision³, the court stated that “the failure to file the limited partnership agreement with the Secretary of State did not result in the formation of a

² Under 805 ILCS 210/105 “a limited partnership may carry on any business that a partnership without limited partners may carry on except…the operation of railroads.”

³ Perhaps the provision was not raised by counsel who believed it did not apply in a non-filing situation.
general partnership.” 560 S.W.2d at 207. The court in essence applied the law of a limited partnership based on the parties’ intent to form a limited partnership rather than the hard and fast rule which would have recognized a default general partnership. To the contrary, in Ruth v. Crane, 392 F. Supp. 724 (E.D. Penn. 1975), the district court held that, under Pennsylvania law, without reference to the “erroneous belief” provisions, where parties intend to form a limited partnership but fail to comply with the requirements of the Limited Partnership Act, such as recording a proper certificate, the limited partnership is not formed; the parties are treated as general partners as to third persons and creditors.)

II. Limited Liability Companies

Imposition of liability upon members of an improperly formed LLC varies from state to state. Most of the cases arise in the context of pre-organizational agreements or liabilities. Often they do not directly involve the imposition of personal liability but rather the validity and enforceability of such actions. While it is difficult to discern a hard and fast rule, it seems that many of the cases are decided based on the court’s balancing of the equities. Thus, for example, in P.D. 2000 LLC v. First Financial Planners, 998 S.W.2d 108 (Mo. Ct. App. 1999) and Ruggio v. Vining, 755 So.2d 792

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4 Even though this was the rule of law in Ruth v. Crane, the case did not address the liability of a partner who erroneously believed he/she was a limited partner. This rule was cited for the proposition that a contract signed by one member of a partnership would hold all the members of the partnership liable as general partners for the contract obligation. Since the partnership itself was seeking specific performance of a contract to sell land, this point of law was raised to show that the partnership’s failure to properly form a limited partnership did not negate the fact that a partnership had entered into a contract for sale of land. Since Pennsylvania had incorporated a version of RUPA 304(a) in its 1917 statute (see, 59 P.S. §195), probably if a limited partner was seeking to escape the contract’s obligations, he would be able to limit liability if he could show a good faith belief that he was a limited partner and immediately withdrew from the partnership upon receiving notice that he was not a limited partner.

5 There is no provision equivalent to RULPA (1976) §304 or RULPA (2001) §306 in the Uniform Limited Liability Act or state LLC laws.
(Fla. Dist. Ct. App. 2000), defendants seeking to avoid liability on pre-organization transactions were rebuffed on the ground that they were aware of plaintiff's pre-organization status. Similarly, a party which has received benefits under a contract with a pre-organization LLC may be precluded from denying its validity. Thus, in Heritage National Assoc. Ltd. Partnership v. 21st Investment Group L.L.C., 2000 WL 426437 (Tex. Ct. App. 2000), Heritage entered into an agreement to sell real property to 21st Investment LLC and identified Paul Williams as a member-manager of 21st Investment. At the time of the agreement (which was drafted by Heritage's counsel), 21st Investment had not yet been organized as an LLC. When Heritage defaulted on the sale agreement, 21st Investment, having made a $25k earnest money deposit, sued for specific performance. Heritage countersued and raised an affirmative defense that the contract was void because Williams did not have capacity to enter into a contract for a non-existent entity. The Court of Appeals upheld the trial court’s decision finding that where Heritage knowingly received and accepted benefits under the contract, it was precluded from denying its validity.

In Brcka v. Falcon Electric Corp., 2001 WL 641524 (Minn. Ct. App. 2001), plaintiff transferred to defendant the assets of his motor controls manufacturing business which were ostensibly held in a limited liability company, ADA Engineering, LLC (“ADA”). Both plaintiff and defendant, Roger Johnston (“Johnston”) thought they were members of ADA. The deal was that Falcon Electric (“Falcon”) and Johnston, Falcon’s majority shareholder, would acquire all of the assets of ADA. Brcka would remain as a manager of the newly formed entity and Johnston would pay to Brcka fair value for the purchase. Sometime after the transfer, it was discovered that the attorney retained to form ADA as
an LLC had never filed the appropriate paperwork. In an unsigned memo written on Falcon stationary, Falcon, through Johnston, wrote that it would treat ADA as a partnership for purposes of documenting the purchase of ADA’s assets and liabilities. Although the assets of ADA were transferred to Falcon, Johnston never paid Brcka for the assets. Brcka then sued Falcon, ADA (in a shareholder derivative action) and Johnston for unjust enrichment and breach of fiduciary duty. In defense, Johnston argued that the court should have recognized a de facto LLC where it was the parties’ intent to form an LLC even though the formal filing procedure was not followed, so that Johnston would be personally shielded from liability for the unjust enrichment claims. The court rejected Johnston’s argument because Johnston was estopped from denying the existence of a partnership when he had previously acknowledged the partnership in writing. The court held that “a partnership may be the legal result of an agreement notwithstanding an expressed intention not to create such a relationship. It is the substance and not the name of the arrangement which determines the legal relation of the contracting parties to each other.” Brcka, 2001 WL 641524 at *6. Even though the parties may have intended to form an LLC, the court applied a default partnership status to the improperly formed entity. Thus Johnston was liable as a general partner for the obligations of the partnership. Probably a just result, but the reasoning leaves something to be desired.

In Balmer v. Anderson Creek, Inc., 589 S.E.2d 750 (N.C. App. 2003), plaintiff, a sole member of a purported limited liability company d/b/a Balmer Electric, LLC (“Balmer LLC”) entered into a contract with defendant to provide electrical wiring to defendant’s clubhouse. After four months without receiving payment, Balmer halted his
work and brought an action against defendant for money owed. Defendant, who discovered that Balmer had never filed a certificate for his LLC, argued that the contract was void because Balmer LLC did not exist at the time the contract was made and thus could not legally enter into a contract. Id. The court stated that Balmer could be held personally liable for any claims defendant could have brought against him (had Balmer been the original breaching party), since “one who contracts as an agent in the name of a non-existent or fictitious principal, or a principal without legal status or existence, is personally liable on the contract so made.” Therefore, the court acknowledged Balmer’s reciprocal right to bring this action against defendant.

Although the court seemed to find support for its holding in the principle of mutuality of contractual obligation, the court’s statement of law suggests that Balmer would not have been afforded the protection of a de facto LLC where the necessary paperwork was improperly filed. One basis for the court’s holding in this case may be in the fact that Balmer was a one member LLC and thus no other member of the LLC needed protection from liability where Balmer would be the sole person liable. In a situation where there were multiple members of Balmer LLC who later discovered they were not shielded from liability, it is possible that the court would not impose liability upon innocent members of the LLC. As is the trend with recent case law, the court would probably look to the parties’ intent to see what entity they intended to form.

For example, in Sysco Food Services of Austin, Inc. v. Miller, 2003 WL 21940009 (Tex. Ct. App. 2003), plaintiff (“Sysco”) individually sued defendant, Judith Miller (“Miller”), on a breach of contract claim after plaintiff failed to receive payment for food delivery made to “Vincent’s at Bushy Creek” (“Vincent’s”). Vincent’s was a restaurant
owned by Round Rock Restaurant Group, LLC (“RRRG”) in which Miller was a member. Sysco argued that at the time the contract was made Vincent Pisa (“Pisa”), the agent for Vincent’s, specified that Vincent’s was a corporation rather than a partnership or limited liability company. Pisa then listed Miller and Carol Hall (“Hall”) in the section of the contract for “individual proprietors, general partners or corporate officers.” Hall also individually guaranteed the debt. At the time the contract was signed, RRRG had not been formed; it was actually formed the day after the contract was signed. After discovering that the corporation mentioned never existed, plaintiff moved to hold all persons listed on the application personally liable as general partners of a general partnership. The court found Pisa, Hall, and RRRG liable for the payments owed to Sysco but refused to assign liability to Miller because Miller had not signed the contract with Vincent’s (unlike Pisa and Hall).⁶ Since Sysco could produce no evidence that Miller intended Pisa to act on her behalf, that she intended to be part of a partnership, or that Sysco thought it was dealing with a partnership, she was not held liable as a general partner. As shown in Sysco, whether or not a party had notice of an LLC’s status may affect how a court determines whether or not members should be liable for the prematurely or improperly formed LLC.

The principle of notice is also prominent in Leber Associates, LLC v. The Entertainment Group Fund, Inc., 2003 WL 21750211 (S.D.N.Y. 2003). Steve Leber (“Leber”), sole managing member of Celebration 2000 LLC (“C2000”), entered into four agreements with defendants on June 16, 1999 to organize and promote two concerts on December 28 or 29, 1999 in Albany, NY (the “Albany concert”) and on December 31,

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⁶ Pisa defaulted and judgment was entered against him. However, under the decision, Pisa should not have been held liable.
1999 in New York City (the “New York City concert”). Defendants agreed to produce opera singer Andrea Bocelli to perform at both of the concerts. The New York City concert agreement was made between C2000 and defendant, Gelb Promotions, Inc. (“Gelb”). The Albany concert agreement was made between Gelb and Leber Associates, LLC, an entity controlled by Leber and purportedly having a 70% interest in C2000. On November 22, 1999, C2000 cancelled the December 31, 1999 concert due to poor ticket sales. Consequently, Gelb and his associates kept all of the proceeds from the Albany concert as damages for the breach of the New York City concert agreement even though the Albany concert agreement was between Leber Associates, LLC and Gelb. In his suit for damages, Leber argued that Leber Associates, LLC was a separate entity than C2000 and the agreements should be treated separately. In their summary judgment motion for damages incurred by the New York City concert cancellation, the defendants argued that Leber and C2000 were the alter egos of Leber Associates and that the court should pierce the “corporate” veil. In addition, Leber Associates, LLC was not properly formed until February 21, 2001 -- long after the relevant events -- even though Leber had retained counsel to form the LLC in December 1996. Defendants argued that Leber should be personally liable for the breach of the contract. In addressing defendants’ claims, the court looked to Delaware corporate law (repeatedly referring to Leber Associates LLC as a “corporation”) to determine whether or not the court should recognize a de facto LLC by estoppel. In order to be recognized as a de facto LLC, Leber would have been required to make a “bona fide attempt to organize under the law and colorable compliance with the statutory requirements…” 2003 WL 21750211 at *10. Where the sole evidence of
Leber’s good faith attempt to properly organize the LLC was Leber’s affidavit stating that he retained counsel to form the LLC and believed that counsel had done so, the court held that was insufficient to meet the criteria necessary under law to find a de facto entity.

Similarly, in *Ehle v. Williams & Boshea, L.L.C.*, 2002 W. 373271 (E.D. La. 2002), plaintiff Ehle argued:

. . . that when Ehle met with Williams and Boshea, Ehle was dealing with them as individuals—that is, as potential business associates with whom to form a new L.L.C.—rather than as the entity of “Williams & Boshea, L.L.C.”

Nevertheless, the court stated:

Under these circumstances, the Court cannot say that Ehle would be unable to state a claim against Boshea under Louisiana state law, since the new entity never achieved a separate existence from the individuals who allegedly would become its members.

Finally, there is the troubling case of *The Pepsi-Cola Bottling Co. of Salisbury, Md. v. Handy*, 2000 WL 364199 (Del. Ch. 2000). Pepsi claimed that defendants sold it property, fraudulently failing to disclose that it contained wetlands. The complaint described the sequence of relevant events as follows:

-- *April 5, 1997* -- Handy contracts to purchase the Property with intent of forming an LLC with Ginsburg and McKinley for the purpose of building a residential community on the Property.

-- *August 5, 1997* -- Pepsi and Handy negotiate an option to purchase the Property. Pepsi discloses its intent to build a bottling facility on the Property and Handy has not disclosed the existence of wetlands.

-- *August 18, 1997* -- Defendants Handy, Ginsburg, and McKinley form Willow Creek Estates, LLC.
-- During option period -- Pepsi hires Hynes to do Phase I, during which time Hynes specifically asks Handy about the existence of wetlands, to which Handy responds in the negative.

-- September 4, 1997 -- The defendants, through Willow Creek, settle and take title to the Property.

-- Four months later -- The defendants, through Willow Creek, sell the unimproved Property to Pepsi for over twice the amount of their purchase price, and do not disclose the existence of wetlands.

Although the misrepresentation and fraud appear to have occurred after the creation of the selling LLC, the court states:

Because the facts alleged in the complaint establish that the LLC was not formed (and the Property was not acquired by the LLC) until after the allegedly critical wrongful acts had been committed, it follows that the defendants could not have been acting "solely as members of the LLC when they committed those acts.

* * *

Because all five counts of the complaint are based on conduct that occurred before the LLC was formed, those claims are not barred by § 18-303. Under the Limited Liability Company Act, no protection against liability is afforded to LLC members who (as here) are sued in capacities other than as members of the LLC.

In a footnote, the court states that the complaint alleges that at least one of the members made a fraudulent representation prior to formation of the LLC and that the other two members “had at least constructive knowledge that the Property contained wetlands and that the LLC would attempt to sell the Property without disclosing that fact.” But knowledge that an LLC is committing a fraud does not generally result in liability to its members. It seems that the court reached to achieve an equitable result.
III. Limited Liability Partnerships

Limited liability partnerships are subsets of existing general partnerships. (See, the Revised Uniform Partnership Act of 1997 §201(b) and comments). All states now have a provision within their general partnership law that provides for the formation of a limited liability partnership through a filing with the Secretary of State or similar government agency, although there are differences among the states in the scope of the liability shield and in who may be partners. However, LLPs are new and there are few cases. In assigning liability for pre-formation transactions or erroneous filings, courts have applied general partnership law.

In *Dow v. Jones*, 311 F. Supp.2d 461 (D. Maryland 2004), plaintiff, Jeffrey Dow (“Dow”) brought a legal malpractice action against James Jones (“Jones”) and the limited liability partnership law firm of Seals, Jones, Wilson, Garrow & Evans, LLP (“SJWGE”). Dow claimed that Jones made only a cursory investigation into the criminal allegations against him and that Jones’ lack of diligence resulted in Dow’s criminal conviction for second and third degree sexual offense. At the time Dow had retained Jones, Jones was listed as a partner in SJWGE’s registration as an LLP, which had been filed in 1994. Also, another partner of the firm was present when Jones agreed to represent Dow and the retainer letter was drafted on SJWGE’s letterhead. It was later discovered that, although SJWGE had been registered as an LLP in 1994, its limited liability status had been cancelled by the District of Columbia on June 27, 1997, approximately one month before Dow’s trial. SJWGE argued that it could not be held liable for Jones’ malpractice because it was no longer an LLP and therefore Jones was not a partner. However, the court stated that “general principles of agency and partnership law continue to govern registered LLP’s.” *Dow*, 311 F. Supp.2d at p. 468.
Accordingly, because SJWGE had held Jones out as a partner and allowed Jones to
use its letterhead to draft his retention letter with Dow, the entity was precluded from
denying that Jones was a partner and arguing that the partnership should not be liable
for Dow’s damages, if any. The court viewed both Jones’ and SJWGE’s liability as part
of the winding up of the limited liability partnership’s affairs.

plaintiffs, Edward Joachim (“Joachim”) and Stephen Frommer (“Frommer”), along with
defendant Sheldon Flanzig (“Flanzig”), agreed to form a limited liability partnership in
the name of Joachim & Flanzig, LLP. It was contemplated that Frommer would be a 6%
equity partner in the newly formed entity. However, the parties never registered as an
LLP with the Secretary of State; nor did they publish the notice as required by statute in
furtherance of their agreement. A subsequent agreement was made raising Frommer’s
interest to 10% in the LLP; still, no certificate to organize the LLP was filed. Upon the
dissolution of the firm after Flanzig’s death, Frommer sought to claim his 10% interest in
the firm. However, Flanzig’s family refused to acknowledge Frommer’s ownership
interest. They argued that since the articles of LLP were never filed, the LLP never
came into existence. They further claimed that no partnership was ever established
between Frommer, Flanzig, and Joachim. The court acknowledged that limited liability
partnerships are subsets of general partnerships and that the failure to file or publish the
requisite notices prohibited the LLP from maintaining any actions in its name. At p. 273.
However, the court recognized the underlying agreement among the parties to form a
partnership and that Frommer’s right to the parties’ agreements should be enforced.
The court recognized that, while limited liability protection would not exist, the underlying agreement to form a general partnership would remain.
The First Decade of LLC and LLP Case Law:  
A Survey of Cases Dealing With Registered  
Limited Liability Partnerships and  
Limited Liability Companies

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The First Decade of LLC and LLP Case Law:  
A Survey of Cases Dealing With  
Registered Limited Liability Partnerships and Limited Liability Companies  

Elizabeth S. Miller  

I. Introduction  

This paper summarizes cases that deal with limited liability company (LLC) and registered limited liability partnership (LLP) issues. Since these entities are of relatively recent origin, it will be some time before a substantial body of case law on these entities has developed. LLP cases number far fewer than LLC cases at this point. LLC cases have appeared with greater frequency and there is a growing number of cases in some significant areas such as veil piercing and fiduciary duties. Many of the opinions included below are unpublished and thus have limited precedential value. They are included, however, to illustrate the types of issues that have arisen and how the courts have dealt with them. Predictably, courts tend to analogize to corporations and partnerships when faced with LLC issues, and the results in the cases are generally not too surprising. In some cases, the courts do not appear to realize that they are dealing with an entity other than a corporation. In a few cases, the courts have not only recognized that an LLC is a distinct type of entity but have therefore refused to find corporate or partnership cases persuasive with respect to a particular issue.  

One thing that becomes clear in reading the cases is that litigants, courts, and headnote writers are struggling with the terminology and nature of LLCs and LLPs. Until recently, there was no “Limited Liability Company” headnote topic, and published LLC cases were digested under the “Corporations” (most often) or “Partnerships” (occasionally) topics of the West digest system. Headnotes sometimes fail to indicate that a case involves an LLC. Mistaken references to limited partnerships as LLPs and vice versa, to LLCs as corporations (or “limited liability corporations”), to members as shareholders or partners, etc. appear with disturbing frequency. The development of a clear, well-reasoned body of case law dealing with the newer types of unincorporated entities will depend in large part on how effectively litigants educate courts as these cases arise.  

II. Cases Involving Registered Limited Liability Partnerships  

There are as of yet relatively few decisions dealing with limited liability partnership issues. Set forth below is a summary of cases that have appeared to date.  

A. Suits By and Against Foreign LLPs: Personal Jurisdiction, Venue, etc.  


Issues discussed in this case include the capacity of an LLP to be sued, jurisdiction over partners of the LLP, the treatment and status of various partners of the LLP, and choice of law. The court addressed these issues as they related to the court’s consideration of the defendants’ motion to transfer venue from Massachusetts to Texas. The case was brought by Liberty Mutual Insurance Company ("Liberty Mutual") in federal district court in Massachusetts against a Dallas law firm, Gardere & Wynne, L.L.P. (Gardere & Wynne), a Texas registered limited liability partnership, and two Gardere & Wynne attorneys.  

Gardere & Wynne frequently represented Liberty Mutual in litigation involving Liberty Mutual and its insureds. Two attorneys, Nabors and Woods, left another Texas law firm to join Gardere & Wynne (Nabors as a partner and Woods as an associate), bringing with them a client whose interests were adverse to Liberty Mutual in some pending litigation. Liberty Mutual sued Gardere & Wynne, Nabors, and Woods in Massachusetts for breach of fiduciary duty in connection with the handling of a conflict of interest. The defendants moved for dismissal or transfer of the case to
Texas. The court pointed out that a number of thorny issues would be avoided or best resolved if the case were litigated in Texas. Thus, the court concluded that the litigation should be transferred to Texas under 28 U.S.C. § 1404(a).

Under the rule governing suits against general partnerships in Massachusetts, Liberty Mutual would have had to name and serve each partner individually. In contrast, Texas law permits a partnership to sue and be sued in the partnership name (and service upon one partner will constitute service on the partnership). The court noted that a plaintiff may sue a limited partnership in Massachusetts by naming only the general partners and speculated that it might be possible to characterize an LLP as a limited partnership and bring suit by naming only those partners that would be personally liable for the claims Liberty Mutual was asserting. However, this would have required the court to determine whether a breach of fiduciary duty claim fell within the liability protection provided by the Texas statute at the time and, if so, whether some or all of the partners would nevertheless be liable under certain other provisions of the act. The court was reluctant to delve into these unsettled questions of Texas law, especially in the preliminary context of a motion to dismiss. Transfer of the suit to Texas, where suit could be maintained against the partnership in its common name and without joining all partners, obviated the need for such a determination as a threshold matter.

Nabors and Woods sought to dismiss the Massachusetts lawsuit brought by Liberty Mutual based upon lack of personal jurisdiction. Though there had been other partners of Gardere & Wynne who had visited Liberty Mutual at its Boston office over the years, the court observed that it would not have jurisdiction over either Nabors or Woods based solely on their own personal contacts with Massachusetts. Jurisdiction over them would have to be based upon the contacts by other partners, who, by operation of partnership law, were acting as agents of Nabors and Woods. The court noted that personal jurisdiction over a person may be based upon acts of the person's agent or business partner but noted a number of factors complicating the analysis in this case, including whether Woods had become a partner at all, whether jurisdictional contacts of partners could be used to maintain jurisdiction over other partners who were admitted after those contacts occurred, and whether jurisdiction could be predicated on contacts of partners of an LLP who may not be vicariously liable on the underlying claim. None of these questions had to be decided upon transfer of the case to Texas because the Texas district court would unquestionably have jurisdiction over all the defendants.

The court noted that there would ultimately be difficult issues of Texas law involved in litigation of the merits of the case, and a Texas court would be best suited to determine these. The court as well as the parties evidently assumed that the Texas LLP statute would be given effect and that Texas law would govern the extent to which damages and injunctive relief could be granted against partners other than those directly involved in the alleged wrongdoing. The court noted, however, that the issues involving Gardere & Wynne's conflicts of interest and compliance with rules of ethics might be governed by national standards.


Defendant Andersen Consulting, L.L.P. ("AC LLP"), an Illinois registered limited liability partnership, argued that it was a foreign partnership within the meaning of the Connecticut long arm statute and that the long arm statute did not authorize personal jurisdiction over AC LLP because the suit did not arise out of the transaction of any business in Connecticut. The plaintiff argued that, because AC LLP had partners who resided in Connecticut, AC LLP was a citizen of Connecticut and not a "foreign partnership" under the long arm statute. Since the long arm statute did not define "foreign partnership," the court looked at other definitions. It looked at the definition of a foreign limited partnership and the definition of a foreign registered limited liability partnership in the partnership statutes and concluded that AC LLP was a foreign partnership under the long arm statute. However, the court concluded that the requirements of the long arm statute had been met.

**B. Diversity Jurisdiction**

In the following cases, the courts have held that the citizenship of an LLP for diversity jurisdiction purposes depends upon the citizenship of all of its partners. In other words, an LLP is a citizen of each state in which a partner resides. This rule follows from the United States Supreme Court case of *Carden v. Arkoma Associates*, 494 U.S. 185 (1990). In *Carden*, the Court reiterated the rule that the citizenship of an unincorporated association is determined based upon the citizenship of all of its members. Specifically, the Court held that a limited partnership is a citizen of every state in which a general or limited partner resides.

In this case, the presence of diversity jurisdiction turned upon whether the defendant law firm was a sole proprietorship or a limited liability partnership. The plaintiff argued that the law firm’s registration as an LLP was a fraud and that the firm was in fact and substance a sole proprietorship. However, the court found that the evidence overwhelmingly established that the firm was a New York LLP. Diversity was thus lacking because one of the partners was domiciled in the plaintiff’s state of domicile, New Jersey. The court imposed Rule 11 sanctions against the plaintiff for failing to make a good faith effort to determine the status of the LLP law firm.

After concluding that a registered limited liability partnership is a citizen of every state of which any of its partners is a citizen for diversity jurisdiction purposes, the court discussed the effect of the resignation of partners and dissolution of the partnership. The court concluded that, since a dissolved partnership continues to exist until winding up is completed, the partnership continues to exist and is a citizen of every state of which any of its partners was a citizen at the time the action was commenced. In the course of its discussion, the court commented by way of footnote that the New York “statute clearly enunciates that a general partnership that is registered as a RLLP is for all purposes the same entity that existed before registration and continues to be a general partnership under the laws of New York.”

Relying on Carden v. Arkoma Associates, the court rejected the plaintiff’s argument that the citizenship of partners in an LLP who are not potentially liable should not be considered in determining the LLP’s citizenship. The court stated that it was “particularly troubled that a Big Six accounting firm which operates offices within every state in the United States has effectively immunized itself from the reach of the diversity jurisdiction of the federal courts simply by organizing itself as a limited liability partnership rather than a corporation. Nevertheless, until Congress addresses the jurisdictional implications of this new class of business entities, this Court can reach no other result.” The court noted by way of footnote that Peat Marwick might have “won” more than it bargained for because it would now be judicially estopped from advancing a contrary argument in any other court and “the doors of the federal courts ought now to be closed to Peat Marwick save in cases that involve a federal litigant or which pose a federal question.” The court estimated that Peat Marwick was currently a litigant in approximately 93 diversity cases that ought not to be pending and stated that, if it had the database to determine all such cases, it would notify every court in which such a case was pending.

C. Pro Se Representation

Mutual Assignment and Indem. Co. v. Lind-Waldock & Co., LLC, 364 F.3d 858 (7th Cir. 2004) (stating that individual who was not licensed attorney could not represent LLP).


D. Limited Liability of Partners


Dow sued a District of Columbia LLP and its partners for legal malpractice in connection with representation of Dow in a criminal matter. Prior to removal of the action from state to federal court, the state court granted the individual partners other than Jones summary judgment but denied the LLP’s motion for summary judgment. After removal of the case, the LLP sought summary judgment once again. The LLP claimed that it was never a party to the retainer agreement and never formed an attorney-client relationship with Dow. The LLP also argued that it could not be held liable because it had dissolved at the time of the alleged malpractice. The court concluded there were genuine issues of material fact on these issues. The LLP also argued that the attempt to hold it liable was a “thinly disguised attempt to circumvent the statutory shield under the RLLPA and hold the individual partners of [the LLP] liable for another partner’s misconduct.” Since the LLP had no assets, it argued that the only purpose that would be served by
winning a judgment against the firm would be to provide grounds for “piercing the veil” of the former LLP and pursuing the assets of the individual partners. The court stated, however, that the action against the LLP served a legitimate purpose because the firm was required to maintain an insurance policy, and Dow was attempting to establish that his claim was covered under the policy.

**Rashti v. Miod**, No. B164954, 2003 WL 22995264 (Cal.App. Dec. 22, 2003) (stating that issue of whether an individual partner of an LLP can be held liable for discriminatory action in which he or she personally participated would appear to be unsettled in view of statutory language indicating individual partners may be held liable in some situations and thus action seeking to hold partners of LLP liable for employment discrimination claims could not be deemed frivolous where action was based upon decision to terminate plaintiff in which partners reputedly participated).


Bennett and Cochran were partners in a law firm LLP with no written partnership agreement. Bennett argued that Cochran orally agreed to pay half of all expenses and overhead of the partnership. The court noted that partners in a registered limited liability partnership ordinarily have no personal liability for the debts and obligations of the partnership. The court concluded there was no evidence the partners agreed to be personally liable for the expenses and overhead of the partnership as opposed to merely having their partnership interests equally burdened by the financial obligations of the partnership.

**Damaska v. Kandemir**, 760 N.Y.S.2d 842, withdrawn 2004 WL 852298 (N.Y.A.D. 1 Dept. 2003) (stating that “[a] partner in a limited liability partnership may be held liable for tortious conduct committed by another partner or individual working for the entity if the partner participates in the control of the business [citing Schaufler v. Mengel, Metzger, Barr & Co., LLP, and thereby perpetuating the confusion between a limited partnership and limited liability partnership] or if the person for whose conduct the partner is called upon to answer was, at the time of the misconduct, rendering professional services on behalf of the partnership under the partner’s direct supervision and control” and concluding that complaint seeking to impose liability upon LLP partner stated cause of action against the partner since complaint alleged that she participated in the control and operation of the business and was aware of prior similar acts of misconduct committed by her husband-partner).

**Griffin v. Fowler**, 579 S.E.2d 848 (Ga.App. 2003) (denying LLP partners’ motion for summary judgment regarding liability for another partner’s alleged malpractice and breach of fiduciary duty on the basis that there were legal services performed prior to the partnership’s registration as an LLP and partners thus could not escape potential liability).

**Verizon Yellow Pages Co. v. Sims & Sims, P.C.**, No. 02-00961, 2003 WL 836087 (Mass.Super. Feb. 24, 2003) (distinguishing partner in LLP from partner in traditional general partnership for purposes of pro se representation on basis that partner in LLP has limited liability and is legally separate and distinct from LLP).


The plaintiff sued a law firm LLP and its partners for malpractice and breach of fiduciary duty. The court granted the defendants summary judgment on the malpractice claim but determined there were fact issues regarding a breach of fiduciary duty claim. The breach of fiduciary duty claim was premised on alleged misrepresentations by the firm to the plaintiff that the plaintiff had a viable claim against the Orange County Transportation Authority (OCTA) when the firm knew that limitations had run on the claim. The plaintiff also complained of the firm’s continued representation and receipt of fees for worthless legal representation. The court determined that there were fact issues relating to the personal liability of the partners. The court cited the California LLP provisions for the proposition that partners in an LLP do not have vicarious liability for the torts of another partner, and the court stated that the plaintiff could only hold a partner liable who was “involved in the handling of the matter.” All three partners claimed that one of them was the “sole attorney” who handled the matter and that the other two had no involvement. However, the court found there were fact issues as to the involvement of the other two. The fact issues were raised by the admittedly-involved attorney’s testimony that “there might have been discussions” with the other two partners that the plaintiff had a viable malpractice claim against the lawyers that had previously represented the plaintiff on their claim against OCTA. The court said these discussions could support an inference that the partners knew the plaintiff’s claim against OCTA was time-barred and that they participated in the decision not to tell the plaintiff while the firm continued its
representation. In addition, the name of one of the partners who claimed he was not involved appeared on the caption page of the claim filed with OCTA, suggesting his involvement in the case.

_Schaufler v. Mengel, Metzger, Barr & Company, LLP_, 745 N.Y.S.2d 291 (N.Y. Sup. 2002) (apparently confusing LLP with limited partnership in stating that defendants had submitted insufficient evidence to establish that managing partner of accounting firm had no liability as a matter of law on buy-out agreement negotiated with plaintiff partner because the limited partnership act imposes joint and several personal liability on a general partner and on a limited partner who participates in the control of the business).

_Foxchase, LLP v. Clatt_, 562 S.E.2d 221 (Ga. App. 2002) (holding that partners in limited liability partnership could be held liable based on evidence of damages that occurred when individuals owned property prior to time it was conveyed to partnership).


The court held that an associate attorney who was terminated by her Massachusetts LLP law firm employer could not hold individual partners vicariously liable for Title VII gender discrimination claims, but would have to establish that an individual partner was negligent or committed some other kind of wrongful act, error or omission in order to hold the partner liable. The court refrained from deciding the “unsettled” questions regarding what proof would be required to hold individual partners liable if the plaintiff prevailed on her discrimination claim. The plaintiff was terminated after a meeting at which the partners considered and rejected admission of the plaintiff as a partner. The firm followed the statutory default rule that requires unanimity for admission of a partner. The firm claimed that no one spoke in favor of admitting the plaintiff. The plaintiff argued that each individual partner contributed to the decision to deny her partnership and that each partner’s negligence or wrongful act thus contributed to her injury. The court rejected this approach because it would “vastly expand the scope of relief beyond that provided in the statutes and precedents regarding Limited Liability Partnerships.” The defendants argued that, unless the plaintiff sued each partner for individual liability (which she might not be able to do under governing discrimination statutes), all of the partners were protected by the LLP statute and by the partnership’s “single vote” rule. (The firm argued that a single vote that was not discriminatory would preclude liability because there would be no damage resulting from any discriminatory intent on the part of any other partners.) The court balked at this approach as being too restrictive. The court stated that it need not decide the unsettled questions regarding the proof required of the plaintiff to reach individual partners’ assets because it would only be necessary if the plaintiff prevailed on her claims against the firm. The court, however, did go on to discuss the purpose of the LLP statute and its protection of partners from vicarious liability. The court recognized that individuals are not ordinarily liable under Title VII and state anti-discrimination statutes, the liability being, at least primarily, a partnership liability. The court recognized the protection from vicarious liability under the LLP statute but stated that the statute did not mean that partners in an LLP can never be liable in a discrimination suit. According to the court, the plaintiff must demonstrate some negligent or other wrongful act, error, or omission on the part of an individual partner that produced discrimination against the plaintiff. The court indicated that trial of these issues should be in a separate phase from the trial on the partnership’s liability because of the confusion and potential conflict of interest issues that would be likely to arise when dealing with individual partners’ liability. The court concluded that separate counsel was not necessary for each partner in a trial limited to the liability of the partnership. The court engaged in a lengthy discussion of professionalism and conflict of interest.


The court acknowledged that two defendants who were partners in a New York LLP could not be held vicariously liable for the liabilities of the partnership when the plaintiff had not alleged that any of the tortious acts were committed by the defendants or any individual acting under their control. However, the plaintiff also asserted claims arising out of the actions of a second partnership that was not registered as an LLP, and the defendants did have potential vicarious liability based upon their status as partners in that partnership. (On reconsideration, the court determined that the claims were time barred.)


The court affirmed the decision of the lower court (see _Schuman v. Gallet, Dreyer and Berkey, L.L.P.,_ 689 N.Y.S.2d 628 (N.Y. Sup. 1999)) determining that the plaintiff’s general release of the defendant law firm and its partners did not release Berkey in his individual capacity because, under the New York LLP provisions, each partner is liable for any negligent or wrongful act committed by him or her or under his or her direct supervision or control.

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The complaint alleged claims against Berkey individually for negligence, breach of fiduciary duty, and legal malpractice in the supervision of the firm’s escrow account. While the release was sufficient to release Berkey from his vicarious liability as a partner, it was not specific enough to release him for his own acts.


A client sought to hold the three partners of a law firm LLP liable in connection with the acts of one of the partners, Irving, in collecting a fee that exceeded that to which the client had agreed. The other two partners filed affidavits stating that they had no knowledge of Irving’s dealings with the client until after the matter was concluded, that they did not have any supervision or control of Irving, and that Irving retained all fees from his activities and did not share them with the other partners. The Connecticut LLP statute protects partners from liability for any debts, obligations, or liabilities of the partnership except for the partner’s own negligence, wrongful acts, or misconduct or that of any person under his direct supervision or control. The client claimed the other two partners were guilty of wrongful acts, negligence, and misconduct but produced no summary judgment evidence to that effect. The client also claimed that the other two partners violated provisions of Rule 5.1 of the rules of professional conduct. The court stated that even if there was evidence of a violation of Rule 5.1, the LLP statute supersedes the rule except where the other person is under the partners’ “direct supervision and control.” Since the other two partners shared no benefit, did not have supervision or control over Irving, and did not know of the matter until after it occurred, the court found that the other two partners were protected from liability.

**Cruz v. Benine**, 984 P.2d 1173 (Colo. 1999).

This case deals with issues of privity and claim preclusion in the context of a suit by a general partnership and its partners against Empire Enterprises Unlimited (“Empire”), two Empire partners, and an Empire employee. Throughout the opinion, the court referred to Empire as a limited partnership. In a prior suit, a partner in the general partnership plaintiff sued Empire and one of Empire’s partners. The court held that the plaintiff in the prior suit was in privity with both the partnership in which she was a partner and her partner so as to bar them from suing Empire and the Empire partner who had settled the prior suit. However, the court held that suit against Empire’s other partner and Empire’s employee was not barred because they were not parties in the prior suit. At this juncture in the opinion, the court makes a point about the “different liability standards [that apply] to general partnerships . . . and to limited partnerships.” Specifically, the court stated, “the UPL [Uniform Partnership Law] no longer provides for joint and several liability in a limited partnership.” The court then quoted Section 7-60-115(2), the provision on registered limited liability partnerships. Thus, the court appeared to exhibit a type of confusion that has been reflected in a number of cases — that is, the distinction between a limited partnership and a limited liability partnership. Of course, it is possible under Colorado law for a limited partnership to register as a limited liability partnership, but it is certainly not clear that this was the situation to which the court was referring.


The plaintiff, a CPA, sued her employer, BDO Seidman, LLP, and one of its partners for wrongful termination. The court, applying Colorado law, found that the partner was protected by the LLP shield. "A party seeking to hold a partner of a limited liability partnership personally liable for alleged improper actions of the partnership must proceed as if attempting to pierce the corporate veil," according to the court.

**Liberty Mutual Insurance Company v. Gardere & Wynne, L.L.P.**, Civ.A. No. 94-10609-MLW, 1994 WL 707133 (D.Mass. Dec. 6, 1994) (noting unsettled questions about scope of coverage of Texas partial LLP shield and implying that Texas LLP statute would be given effect in Massachusetts litigation and that Texas law would govern extent to which damages and injunctive relief could be granted against partners other than those directly involved in the alleged wrongdoing).

E. **Effect of Registration on Partnership**


Dow sued a District of Columbia LLP and its partners for legal malpractice in connection with representation of Dow in a criminal matter, and the court applied general principles of District of Columbia partnership law in concluding that the LLP was not entitled to summary judgment. Dow paid a retainer to Jones and executed a retainer agreement on LLP letterhead. The retainer agreement stated that Dow agreed “to retain the legal services of Attorney James Benny Jones to provide representation” in his criminal case. Prior to removal of the action from state to federal court, the state court granted the individual partners other than Jones summary judgment but denied the LLP’s motion.
for summary judgment. After removal of the case, the LLP sought summary judgment once again. The LLP claimed that it was never a party to the retainer agreement and never formed an attorney-client relationship with Dow. The LLP also argued that it could not be held liable because it had dissolved at the time of the alleged malpractice. The court rejected the LLP’s argument that a different standard should apply to an LLP than a partnership that is not registered as an LLP when determining whether an attorney-client relationship was formed with the LLP. The court stated that general principles of agency and partnership law continue to govern LLPs, and that Dow raised genuine issues of material fact as to whether Jones had apparent authority to enter a retainer agreement on behalf of the LLP under District of Columbia partnership law and agency principles. Further, even if Jones was not a partner, the court found that Dow raised genuine factual issues as to whether the LLP made public representations sufficient to confer on Jones the power to bind the LLP as if he were a partner. The court also found that Dow raised genuine factual issues regarding the LLP’s liability for post-dissolution malpractice. The court pointed out that an LLP does not terminate immediately upon dissolution, but instead continues until winding up is completed. The court stated that Dow could argue that his representation was a pending client matter that must be wound up following dissolution. Additionally, Dow could argue that Jones’s power to bind the partnership under ordinary agency and partnership law continued after dissolution as to Dow because he did not receive notice of the firm’s dissolution.

Brown Rudnick Berlack Israels LLP v. Brooks, 311 F.Supp.2d 131 (D.Mass. 2004) (holding LLP may bring suit in its own name under Massachusetts law, relying on prior Massachusetts Superior Court decision that stated only LLP need be named as defendant in suit on business debt against LLP since recovery is limited to LLP’s assets).

Moxness v. Hart, 131 S.W.3d 441 (Mo.App. 2004) (noting LLP may sue in its own name but general partnership may not).


Institute of Physical Medicine & Rehabilitation, LLP v. Country-Wide Insurance,752 N.Y.S.2d 232 (N.Y.City Civ.Ct. 2002) (stating that LLP may sue and be sued as if it were a partnership formed pursuant to the general provisions of the partnership law except for the limitation on liability of the partners because, under New York law, an LLP is a partnership even though the partners have limited liability).


It appears that the court erroneously referred to an LLP as an LLC in this case. In reciting the facts of the case, the court stated that a judgment based on legal malpractice was entered against Hager, an individual attorney, and his former law firm Nichols, Jackson, Kirk and Dillard, as well as Nichols, Jackson, Dillard, Hager & Smith, L.L.P. The style of the case also refers to Nichols, Jackson, Dillard, Hager and Smith, L.L.P. On appeal, the court held that the malpractice occurred after the law firm “registered as a limited liability company.” The court sustained the contention that the trial court improperly held the “dissolved firm” of Nichols, Jackson, Kirk and Dillard liable. According to the court, since the firm had registered as a “limited liability company” prior to the time of the particular act that damaged the client, Hager “alone” was responsible for the damages. It is not clear whether the court was actually saying that the LLC or LLP law firm would not be liable. In reversing the judgment based upon various errors in the trial court, the court of appeals specifically decreed that the plaintiff take nothing against Nichols, Jackson, Kirk and Dillard but did not mention the judgment against Nichols, Jackson, Dillard, Hager & Smith, L.L.P.


A law firm sued to recover under a contingency fee contract with the Levines. The law firm was organized as a professional corporation when it was engaged by the Levines, and it subsequently reorganized as an LLP and then a limited partnership. The Levines argued the contract was a personal services contract that was not assignable without their consent and that Bayne, Snell & Krause, Ltd. was not a proper party. The court rejected the argument on the basis that attorneys can assign their accounts receivable and that the assignment involved the contractual right to payment.
Canada Life Assurance Company v. Estate of Lebowitz, 185 F.3d 231 (4th Cir. 1999).

In this case involving whether benefits were due the estate of a deceased partner of an LLP under an ERISA life insurance policy, the court noted in a footnote that the partnership is a limited liability partnership “incorporated” in Maryland. The court explained that, “[a]lthough WTP is a limited liability partnership, under Maryland law it is still liable for the representations of its agent partners.” The court went on to cite provisions of the Maryland RUPA applicable to the question of the partnership’s position on coverage under the policy in issue.


The issue in this case was whether the original order of the bankruptcy court appointing Main, Hurdman & Cranstoung as accountants for the Trustee was sufficient to authorize a final allowance to KPMG Peat Marwick LLP. Between the order appointing Main, Hurdman & Cranstoung and the application for allowance in issue the following events occurred: (i) Main, Hurdman & Cranstoung changed its name to Main Hurdman, (ii) Main Hurdman merged with Peat Marwick Mitchell & Co. to form a partnership known as Peat Marwick Main & Co., (iii) Peat Marwick Main & Co. changed its name to KPMG Peat Marwick, and (iv) KPMG Peat Marwick became a limited liability partnership and changed its name to KPMG Peat Marwick LLP. The court declined to see the transition from Main, Hurdman & Cranstoung to KPMG Peat Marwick LLP as merely an evolution of one entity from one era to another. “While the rules contemplate that partners and associates will come and go, the rules do not contemplate that entire entities can be gobbled up by other entities and retain their privilege to perform services to a bankrupt estate. . . .I see no alternative but that a new application be filed for the superseding entity.” The court concluded, under the circumstances, that it should grant retroactive relief and approve compensation for KPMG; however, the court stated that its “holding serves as fair warning of the need, in the future, for professionals to reapply for appointment should the character of their firm change in any but a nominal character.”

Mudge Rose Guthrie Alexander & Ferdon v. Pickett, 11 F.Supp.2d 449 (S.D. N.Y. 1998) (commenting in footnote that the New York LLP statute “clearly enunciates that a general partnership that is registered as a RLLP is for all purposes the same entity that existed before registration and continues to be a general partnership under the laws of New York”).


This opinion addressed whether a shareholder derivative action that included claims against the corporation's outside auditor should be stayed based on an arbitration clause in a letter agreement between Ernst & Young, LLP and the corporation. In the course of its discussion, the court referred to Ernst & Young, LLP as Ernst & Young's "successor" and stated that "the two entities. . .are, but for the corporate change to a limited liability partnership designation, the same entities for all practical intents and purposes."


In this employment discrimination case, the court noted in passing that the defendant KPMG Peat Marwick became a limited liability partnership and amended its Articles of Partnership to add the suffix “LLP” to its name in August 1994. The court explained that the partnership “was not dissolved and continued without interruption with the same partners, principals, employees, assets, rights, obligations, liabilities and operations as maintained prior to the change.” The court continued, “Peat Marwick LLP is in all respects the successor in interest to Peat Marwick.”


Confusion regarding the nature of an LLP is apparent in the court’s opinion on the defendant's motion to strike in this case. The defendant argued the court to strike a number of specific counts of the plaintiff's complaint on various grounds and to strike the entire complaint as to Andersen Consulting, the general partnership, on the grounds that the entity by that name did not exist. The defendant claimed that the plaintiff could not assert a cause of action against both Andersen Consulting, the general partnership, and Andersen Consulting, LLP, because the plaintiff alleged that Andersen Consulting, LLP, was the successor in interest to Andersen Consulting, the general partnership. The plaintiff argued that the defendant was "merely trying to absolve the liability of the general partners of Andersen Consulting by limiting the plaintiff's target to the limited liability company only." After this mistaken reference to Andersen Consulting, LLP, as a "limited liability company," the court rejected the defendant's motion to strike. The court gave as reasons the fact that Andersen Consulting, LLP, had not stated that it had assumed all of the liabilities of Andersen Consulting, the general partnership, and the fact that individual partners need not be named to commence a civil action against a general partnership.

The law firm of Shannon, Gracey, Ratliff & Miller, L.L.P. was sued for malpractice and obtained a summary judgment that was upheld on appeal on the basis that a “successor partnership” is not liable for the torts of a predecessor partnership. It is not clear from the opinion whether the partnership’s registration as an LLP, which apparently took place after the malpractice suit was filed, was alone enough to make the partnership a “successor partnership” as that term was used by the court, but it seems unlikely. It is unfortunate, however, that the court did not provide greater insight into what it deemed a “successor partnership.” The law firm involved had, subsequent to the time the alleged malpractice occurred, merged and unmerged with another law firm, and the plaintiff alleged that Shannon, Gracey, Ratliff & Miller, L.L.P. was liable as the successor partnership of the Shannon, Gracey, Ratliff & Miller firm that had represented the plaintiff in the matter giving rise to the malpractice claim. (The plaintiff’s pleadings alleged that the firm was previously known as Reynolds, Shannon, Miller, Blinn, White & Cook, and, prior to that, as Shannon, Gracey, Ratliff, & Miller, and that the plaintiff’s suit was against the firm in its current form and all of its predecessors.)

The court of appeals upheld the trial court’s summary judgment on the basis that “even if Shannon, Gracey, Ratliff, & Miller, L.L.P. is a successor law firm, Texas does not recognize that successor partnerships are liable for the tortious conduct of predecessor partnerships.” The court’s opinion is brief and explores neither the factual background of the changes in the Shannon, Gracey firm nor the rationale for distinguishing between tort and contract claims when it comes to successor partnership liability. If the court’s opinion stands for the proposition that registration as an LLP is enough to make the partnership a different “successor” partnership, and thus cut off the entity’s liability for pre-registration tort claims, the opinion obviously has profound implications. It is unlikely, however, that this was the basis for the court’s opinion. (Such a view is inconsistent, in this writer’s opinion, with the underlying premise of the LLP statutes that an LLP is the same partnership as prior to registration.) Based upon the cases relied upon by the court, it appears that the court may have concluded that a dissolution results in a successor partnership which is not liable for the pre-dissolution torts of its predecessor. In view of the UPA approach to dissolution, under which any change in membership results in a technical dissolution, this proposition itself has significant implications. Query whether this approach suggests that the departure of a partner in a UPA partnership would, in some states, require a new LLP registration to preserve the liability limitation of the partners in the “new” partnership? Such a result obviously seems absurd and points to the wisdom of the clearer entity approach under RUPA.

In a subsequent decision by another Texas court of appeals, the court addressed the possibility that a professional corporation might be liable for the malpractice of the predecessor partnership. The court pointed out in dicta that the lawyer who committed the malpractice in the Shannon, Gracey case was not employed by the successor law firms whereas a principal of both the earlier partnership and the successor professional corporation was alleged to have acted negligently in the case before the court. The court suggested, but did not decide, that this distinction might be outcome determinative. See Andrews v. Diamond, Rash, Leslie & Smith, 959 S.W.2d 646 (Tex. App.--El Paso 1997, writ denied).

F. Liability Insurance Coverage


Two partners (Wheeler and Lawson) in a three man LLP law partnership essentially engaged in a kiting scheme involving client trust accounts. The third partner (Snyder) practiced in an office in another city and apparently knew nothing of the scheme. As managing partner of the firm, Wheeler made material misrepresentations to the firm’s professional liability carrier when applying for coverage. As a result of the numerous defalcations of Wheeler and Lawson, two title insurers paid claims to various individuals and sought recovery from the firm and its partners. The malpractice carrier sought a declaratory judgment that the firm’s policy was void by reason of the material representations, and one of the title insurers amended its complaint to assert that the firm’s LLP status should be declared void for failure to maintain professional liability insurance as required by New Jersey Rules of Court. The three actions were eventually consolidated, and the court of appeals held that the professional liability policy was void for all purposes. The New Jersey Supreme Court determined that the policy was void as to Wheeler, Lawson, and the firm, but that the equities did not warrant rescission of Snyder’s coverage. The court reviewed the substance of, and the policy underlying, the LLP provisions and the requirements that LLPs carry professional liability coverage under New Jersey Rules of Court. The court had no trouble concluding that the insurer had the right to rescind Wheeler’s coverage based on his blatant misrepresentations. The court acknowledged that Lawson’s role in furnishing the misinformation was less clear but concluded that Lawson knew or should have known that the forms submitted to the insurer were false or misleading. Thus, the court held the policy was void as to Lawson, as well. The court concluded that the insurer was entitled to rescind coverage with respect to the firm as an entity because two of the firm’s three
partners had engaged in wrongful conduct and the managing partner himself knowingly made the misrepresentations to the carrier. The court stated that the issue of Snyder’s coverage was the most difficult. The court stressed the fact that Snyder was not engaged in the fraudulent conduct of his partners. The court also pointed out that Snyder was a “distant partner in the sense that he did not share offices with Lawson and Wheeler, but instead conducted his practice in a separate Manhattan office that he alone maintained.” The court thus considered Snyder an “innocent partner” for purposes of balancing the equities in the case. The court stated that “by organizing the firm as a limited liability partnership, Snyder had every reason to expect that his exposure to liability would be circumscribed in accordance with the Uniform Partnership Law” and that “voiding Snyder’s coverage solely because of his partners’ wrongful conduct would expose Snyder to uninsured liability in a manner inconsistent with his expectations under the UPL.” The court pointed out that it was expressing no opinion on Snyder’s actual liability to any party or any allegation that an exclusion from coverage under the terms of the policy applied; rather, the sole task undertaken by the court was determining whether the policy itself was void as to Snyder. The court also was concerned that voiding the policy would mean Snyder no longer would possess coverage for any of his actions in unrelated matters, including simple malpractice, for which he expected to be covered. The court was concerned that it would be a “harsh and sweeping result ... contrary to the public interest” to leave members of the public whom Snyder had represented throughout the policy period unprotected when Snyder himself committed no fraud. The court concluded its opinion by acknowledging that the result reached involved a “certain amount of line drawing” but stated that it was convinced its disposition was consistent with rescission as an equitable remedy taking into account the totality of the circumstances.

G. Securities Laws


The court concluded that the partnership interests in LLP general partnerships formed ostensibly to operate competitive local telephone exchange carriers in Western states were securities. The court stated the general rule that units in a general partnership are not investment securities but noted that there are exceptions. Applying Williamson v. Tucker, the court found that the economic reality of the LLPs was that the individual defendants monopolized both the money and information necessary to operate the telephone companies, that the investors were unable to exercise any meaningful control over the LLPs due to the defendants’ behavior, that the investors were wholly dependent upon the defendants for the success or failure of the LLPs, and that the efforts of the defendants were the significant ones. The court acknowledged that the investors exercised certain powers and did, in fact, remove the management of certain LLPs; however, the court concluded that this fact did not establish that the investors were not dependent on the defendants for the success or failure of the LLPs. The court stated that by the time the investors were able to remove the management of certain LLPs, the vast majority of the proceeds were in the hands of the defendants, and the businesses had disintegrated. The court found that the power to replace the telephone company manager was thus illusory and did not establish that the investors were not dependent on the defendants for the success or failure of the LLPs.


The plaintiffs asserted various causes of action in connection with defendants’ role in the sale of interests in fifty-three LLPs formed to sell pre-paid cellular phone services. The interests were sold by phone solicitation to approximately 5,000 investors. At issue for purposes of class certification was the analysis involved in determining whether the LLP interests were securities under the Colorado Securities Act. The trial court relied upon Colorado case law adopting the rationale of Williamson v. Tucker in concluding that common questions did not predominate over individual questions because whether the interests were securities would require analysis of each individual investor in relation to each partnership. The court of appeals held that the presumption of Williamson v. Tucker that a general partnership interest is not an investment contract security is not applicable to an LLP interest. The court discussed the rationale for presuming that the interest of a general partner (who has a legal right to participate in the management of the partnership and is personally liable for partnership obligations) is not an investment contract and for not applying such a presumption to the interest of a limited partner (who is a passive investor with no personal liability for the obligations of the business). The court concluded that an LLP interest cannot be analogized to either general partnership or limited partnership interests. The court was persuaded by cases in the LLC area that have declined to adopt a presumption that an LLC interest is not an investment contract. The court held that the relevant inquiry for the trial court was not to apply the Williamson examples related to general partnership interests but rather to determine whether the investors expected profits from the managerial efforts of someone else and whether the investors had a substantial power to affect the success of the enterprise.
H. Bankruptcy

In re Mahoney Hawkes, LLP, 289 B.R. 285 (Bankr. D. Mass. 2002) (analyzing proposed release of LLP debtor’s partners under plan of reorganization providing for contribution of $200,000 per partner and partners’ relinquishment of claims for indemnity and defense under insurance policy and concluding that proposed release of partners was not proper under multi-factor test applied by court).

I. Status of LLP Partners Under Family Medical Leave Act


The court refused to accept an LLP law firm's summary judgment argument that its partners were not employees for purposes of the Family Medical Leave Act (FMLA). Siko, an employee of an LLP law firm, brought an employment discrimination case alleging various violations of state law and Title VII, ERISA, and the FMLA. With respect to the FMLA claim, the firm argued that it was not subject to the FMLA because it did not have 50 employees. Siko argued that the firm's partners should be treated as employees under the FMLA, which would cause the firm to be subject to the statute. The court concluded that there was insufficient evidence to support the firm's claim that its partners were not employees. The court's analysis is somewhat confusing because it mixes corporate and partnership terminology, but the court apparently concluded that LLP partners are distinguishable from both shareholders of a professional corporation and general partners of a traditional general partnership. The court distinguished cases holding that partners are not employees under federal anti-discrimination statutes on the basis that those cases "are limited to general partnerships where the partner is either a shareholder or subject to unlimited liability." By footnote, the court noted that the cases cited by the firm "involve general partners who are subject to unlimited liability of the corporation. As such, those partners, unlike those at Defendant's law firm, are accountable for all the benefits and pitfalls attributable to the corporation." The court went on to note that the "partners of Defendant's law firm are neither shareholders nor subject to unlimited liability, but, rather part of a limited liability partnership." Thus, the court concluded that the facts did not support the legal conclusion that the firm's partners were not employees.

III. Cases Involving Limited Liability Companies

Litigation involving limited liability companies is resulting in reported cases as well as unpublished opinions that are picked up by online legal research services. Such cases are appearing at a steadily increasing rate. Set forth below are brief synopses of LLC cases around the country to date.

A. Personal Jurisdiction Over Members, Managers, and Agents

Greystone Tribeca Acquisition, L.L.C. v. Ronstrom, 863 So.2d 473 (Fla. App. 2004) (concluding LLC and its members were not subject to jurisdiction by virtue of presence of subsidiary LLC in state).

Hagerty Partners Partnership v. Livingston, 128 S.W.3d 416 (Tex.App. 2004) (holding non-resident managers of Texas LLC were subject to personal jurisdiction of court because they attended several board meetings in Dallas and claims against them were based upon their roles as managers of a Texas LLC, specifically as alleged "control persons" and “aiders” under the Texas Securities Act and by engaging in negligent conduct as managers).

Toro Marketing, LLC v. Scheidle, No. 3:03-CV 611-R, 2004 WL 330701 (N.D. Tex. Feb. 20, 2004) (rejecting argument that individual who received interest in LLC pursuant to agreement to sell individual’s business to LLC was subject to personal jurisdiction in Texas based on forum selection clause in agreement and LLC regulations, and holding allegations that individual was alter ego of corporate signatory to agreement were merely conclusory and, though individual signed LLC regulations in individual capacity, forum selection clause is but one factor in determining minimum contacts).

XL Vision, LLC v. Holloway, 856 So.2d 1063 (Fla. App. 2003) (exercising personal jurisdiction over LLC’s foreign parent and LLC’s president where complaint alleged that parent and president formed, operated, and manipulated the LLC to defraud creditors, that they commingled funds, that they failed to maintain other corporate formalities, that the parent directly paid for liabilities of the LLC, and that the LLC was run by the parent and president for their benefit).
LaSalle Bank N.A. v. Mobile Hotel Properties, LLC, 274 F.Supp.2d 1293 (S.D. Ala. 2003) (concluding that plaintiff had not alleged sufficient facts for the court to find that LLC which entered the transaction in question was the alter ego of its parent LLC for purposes of holding the parent responsible for the contacts of the subsidiary LLC).


The plaintiff sued a Delaware LLC and its agents individually in Texas. The individual defendants claimed the court lacked jurisdiction over them. The plaintiff alleged that the individuals committed the torts of fraud and negligent misrepresentation. The court stated that the individuals may have been acting on behalf of the LLC but that corporate agents are liable for fraudulent or tortious acts committed while in the service of their corporation. The alleged misrepresentations occurred in telephone calls from California to Texas. The court found that the tort occurred in Texas because that is where reliance took place. The court determined that the Texas long-arm statute authorized the exercise of personal jurisdiction over the individuals and held that the exercise of jurisdiction satisfied due process requirements.

Benson v. City Finance Co., No. 1:02CV242-D-D, 2003 WL 21517998 (N.D. Miss. May 16, 2003) (concluding that, under Mississippi LLC act, Delaware law controlled determination of whether plaintiffs could pierce the veil of Delaware LLC in order to exercise personal jurisdiction over LLC’s member based on LLC’s contacts with the state of Mississippi, and holding that plaintiffs failed to allege sufficient facts to show deliberate and purposeful misuse of the LLC’s corporate form resulting in unfairness, injustice, and injury to plaintiffs as required under Delaware veil piercing test).

Nadler v. Grayson Construction Co., Inc., 34 Conn. L. Rptr. 482, 2003 WL 1963158 (Conn.Super. 2003) (holding that long-arm statute applicable to foreign partnerships applies to foreign LLCs and that evidentiary hearing must be held on alter ego allegations relied upon to sustain personal jurisdiction over foreign LLC).


In this dispute regarding two Delaware LLCs operating in Pennsylvania, the two defendants, Unger and Conrad, moved to dismiss for lack of personal jurisdiction. The court granted Unger’s motion because the court found that Unger did not transact any business in Delaware under § 3104(c)(1) of the Delaware long-arm statute. The plaintiffs argued that the LLCs never had managers, and the court held that it had personal jurisdiction over Conrad (who was a founding member, manager, and high level officer of the LLCs) pursuant to 6 Del. C. §§ 18-109(a) and 18-110(a) and thus avoided analysis of whether the LLCs would constitute the transaction of business under § 3104(c)(1) and whether the claims would have a sufficient nexus to those acts. Section 18-110(a) sustained jurisdiction with respect to claims involving removal and replacement of Conrad as a manager, and § 18-109 provided a basis for jurisdiction with respect to all of the claims, including disputes related to a buy-out provision. Section 18-110 provides that service on the LLC constitutes service on “the person or persons whose right to serve as a manager is contested and upon the persons, if any, claiming to be a manager or claiming the right to be a manager.” Although Conrad argued that the LLCs never had managers, the court noted that the plaintiffs had produced evidence that Conrad had previously claimed to be a manager, and the court concluded that the disputes over governance and management fell within the scope of § 18-110(a). The court went on to find that § 18-109 provided a basis for jurisdiction because it permits the exercise of personal jurisdiction over a manager “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 ... of a duty to the limited liability company, or any member of the limited liability company.” The court also determined that the exercise of jurisdiction satisfied due process. Finally, the court determined that it should stay the litigation in Delaware pending the outcome of litigation between the parties in Pennsylvania.

Caldwell-Baker Co. v. Southern Illinois Co., 225 F.Supp.2d 1243 (D. Kan. 2002) (granting Illinois LLC’s motion to dismiss for lack of jurisdiction where plaintiff failed to allege facts to indicate necessary minimum contacts, failed to address LLC’s argument that it was not alter ego of corporate member as alleged by plaintiff, and failed to show any partnership agreement or other contract whereby LLC agreed to assume responsibilities of corporation in issue).
Stomar, Inc. v. Lucky Seven Riverboat Company, L.L.C., 821 So.2d 1183 (Fla. App. 2002)(upholding application of “corporate shield” doctrine to preclude exercise of personal jurisdiction over individuals acting in representative capacity for LLC in executing brokerage agreement, but remanding for reconsideration, in light of recent judicial development, the possibility of exercise of jurisdiction over individuals based on fraudulent inducement of the contract).

International Bancorp, L.L.C. v. Societe des Bains de Mer et du Cercle des Entrangers a Monaco, 192 F.Supp.2d 467 (E.D. Va. 2002)(holding that record did not support piercing LLC veil to subject member to court’s personal jurisdiction under “stringent” Virginia veil piercing standard requiring “proof that the alleged alter ego used the corporation to disguise some legal wrong”).

Chase Manhattan Bank v. Iridium Africa Corporation, No. 00-0564-RRM(JJF)(MPT), 2002 WL 732070 (D. Del. April 5, 2002)(setting aside default judgment against Taiwanese corporation based upon reserve capital call obligations as member of Iridium LLC on showing that member presented potentially meritorious defense based upon its alleged transfer of interest and its good faith belief that it was no longer a member of the LLC, beyond the jurisdiction of the court, and not properly served).

In this dispute between the members and managers of an LLC, several defendants moved for dismissal based upon lack of personal jurisdiction. The court interpreted the Delaware implied consent statute which establishes jurisdiction over (i) a manager designated as such in, or pursuant to, the LLC agreement or (ii) a person who materially participates in the management of the LLC though not designated as a manager. While the LLC agreement conferred broad authority to members, the court determined that it actually vested management in a management committee. The court held the defendants who did not serve on that committee were not subject to service under the implied consent statute. The court also determined that an individual who was a member of the committee when many of the disputed events occurred was subject to the implied consent statute.

Stauffacher v. Lone Star Mud, Inc., 54 S.W.3d 810 (Tex.App. 2001)(holding that individual failed to negate plaintiff’s theory that individual was alter ego of a Wisconsin LLC for purposes of court’s exercise of personal jurisdiction over individual).

777388 Ontario Limited v. Lencore Acoustics Corp., 142 F. Supp.2d 309 (E.D. N.Y. 2001)(finding individuals who jointly owned and directed partnership and LLC were subject to personal jurisdiction based upon agency relationships).


The court in this trademark infringement action determined that it lacked jurisdiction over a nonresident LLC and its indirect owner who licensed the trademark to the LLC, the only contact with New Mexico being the fulfillment of an order placed over the Internet by an individual in New Mexico.

Hill v. Shell Oil Company, 140 F. Supp.2d 911 (N.D. Ill. 2001), order vacated in part on reconsideration, 149 F. Supp.3d 416 (concluding personal jurisdiction over a Delaware LLC with no direct presence in Illinois could not be sustained based upon jurisdiction over one of the LLC’s members, but if a joint venture between the LLC and co-venturers over whom the court had jurisdiction could be established, the minimum contacts of the co-venturers would be attributed to the LLC).

M.G. Incentives v. J.J. Marchand, No. C6-00-962, 2001 WL 96223 (Minn. App. Feb. 6, 2001) (finding it unnecessary to decide whether the fiduciary shield doctrine should apply in Minnesota so as to protect an individual acting on behalf of an LLC where the plaintiff alleged facts sufficient to pierce the veil, the distinction between the individual and LLC was blurry, and the plaintiff alleged fraud against individual).

Royal Mortgage Corporation v. Montague, 41 S.W.3d 721 (Tex. App. 2001) (finding that an individual and corporation were acting as agents of a foreign LLC so as to support the exercise of personal jurisdiction over the LLC.
but concluding that there was no evidence the LLC was acting as alter ego of its members for purposes of personal jurisdiction over the members).


In this case, the court interpreted and applied Delaware’s implied consent statute for obtaining personal jurisdiction over managers of Delaware LLCs. The case involved a dispute between two members/managers of a Delaware LLC with its principal place of business in Florida. All parties agreed that the defendant Rosheim had no contact with Delaware beyond his involvement as a founder and manager of the LLC. The court discussed the precise statutory language of Section 18-109 and noted differences between it and the provision addressing jurisdiction over corporate directors. Ultimately, the court concluded that Section 18-109 supported the exercise of jurisdiction over Rosheim regardless of whether the claims against him alleged a breach of fiduciary duty because the claims involved disputes regarding the parties’ rights under the LLC agreement and Delaware statutory and case law. The court concluded that Delaware has a compelling interest in the resolution of disagreements of this sort. Specifically, the court concluded that exercise of jurisdiction was proper in this case because: (1) the allegations against Rosheim centered on his “rights, duties and obligations” as a manager of a Delaware LLC; (2) resolution of the matter was “inextricably bound up in Delaware law;” and (3) Delaware has a strong interest in providing a forum for disputes relating to the ability of managers of a Delaware LLC to discharge their respective managerial functions.


The plaintiffs sued Kabro of East Lyme, LLC (“East Lyme, LLC”), a New York LLC, for breach of a contract to purchase real estate from the defendants. Additionally, the plaintiffs sought to pierce the veil of the LLC and hold several other non-resident parties personally liable under veil piercing theories. The court’s opinion dealt with its jurisdiction over the parties. The court found that East Lyme, LLC had transacted business in Connecticut so as to justify the court’s exercise of specific personal jurisdiction over the LLC. The court also concluded it had jurisdiction over one LLC member who was instrumental in the negotiations of the real estate transaction in issue. The plaintiffs sought to obtain personal jurisdiction over the other non-resident parties by piercing the veil of East Lyme, LLC, but the court concluded that the plaintiffs had not alleged sufficient facts to pierce the veil to obtain jurisdiction over the other members of the LLC nor to obtain jurisdiction over another New York LLC that allegedly provided funds to East Lyme, LLC.


Two members of an LLC argued that they were not subject to personal jurisdiction in Texas in an action against the members for breach of contract and breach of fiduciary duty. The members argued that their contacts with Texas were made in their official capacities on behalf of the LLC and were thus insufficient to support jurisdiction over them individually. The court equated an LLC to a corporation in this context, stating that “[j]urisdiction over an individual generally cannot be based on jurisdiction over a corporation with which he is associated unless the corporation is the alter ego of the individual.” The court examined the record, however, and found that the defendants’ purposefully established minimum contacts with Texas in their individual capacities by negotiating personal rights in certain transactions and by breaching their contractual and fiduciary duties. The court further concluded that assertion of personal jurisdiction would comport with fair play and substantial justice.


An LLC member sued two other members and the LLC in Illinois for an accounting of compensation and LLC profits allegedly owed. The plaintiff resided in Illinois, but the LLC was organized in Delaware and the two other members were citizens of Minnesota. The LLC agreement listed the LLC’s principal place of business as the address of one of the Minnesota members. The defendants moved to dismiss for lack of personal jurisdiction. The court reviewed the business of the LLC conducted in Illinois through the plaintiff and concluded that it had personal jurisdiction over the LLC and its members. The fiduciary shield doctrine did not avail the two Minnesota members inasmuch as they came to Illinois to meet with the plaintiff and discuss the formation of their business. The court also denied the defendants’ motion to transfer venue to a more convenient forum. (Interestingly, diversity jurisdiction was not questioned. If the plaintiff was indeed a member of the defendant LLC, diversity would be lacking under the line of cases noted below.)


The court determined that the court had personal jurisdiction over three defendants who challenged the court’s
jurisdiction. First, the court determined that it had jurisdiction over the defendant Oklahoma LLC. The court applied the Michigan long-arm statute regarding specific jurisdiction over unincorporated associations. Next, the court concluded that it had personal jurisdiction over the individual who signed various agreements on behalf of the LLC as its president. The court found that signing the agreements in his capacity as an officer rather than his individual capacity did not defeat the court's jurisdiction because Michigan courts have not adopted the fiduciary shield doctrine. Finally, the court determined that it had personal jurisdiction over a corporation to which the LLC delegated its tasks under its contracts with the plaintiff. The court found that the individual who signed the agreements on behalf of the LLC represented the corporation in the pre-contract negotiations and at the last minute signed as president of the LLC.


A futures commission merchant sued an LLC and two of its members to collect the deficit balance in the LLC's trading account. The court determined that it lacked personal jurisdiction over the LLC members based upon the fiduciary shield doctrine (described by the court as prohibiting the exercise of personal jurisdiction over a nonresident whose only contacts with the forum state were "solely on behalf of his employer or other principal"). The plaintiff attempted to avoid the effect of the fiduciary shield doctrine by relying on the corporate alter ego doctrine. The defendants countered with an affidavit reciting that the LLC's assets were not treated as the assets of the individual defendants, that the LLC maintained necessary corporate records, that the LLC did not commingle its assets with those of the individual defendants, and that the LLC maintained a separate banking account. The affidavit was uncontradicted, and the court rejected the alter ego argument.


This case involved personal jurisdiction over nonresident individuals who were members of an LLC. The plaintiff was a fellow member of the LLC asserting various causes of action arising from an agreement to form and operate a partnership and LLC. The plaintiff and two defendants formed a Georgia LLC to provide investment banking services in both Atlanta and Greenwich, Connecticut, but never came to an agreement on the terms of the operating agreement. They subsequently terminated their relationship. (The plaintiff claimed that the parties actually formed a general partnership which they then changed to an LLC. The court referred to the business relationship in varied terms throughout the opinion, including a "partnership," "limited liability company," and "limited liability corporation"). The defendants apparently resided in Georgia and contended that their only dealings with the plaintiff consisted of negotiations by correspondence and telephone between Connecticut and Georgia about the operating agreement. The defendants argued that they did not transact business in Connecticut for purposes of a Connecticut statute granting personal jurisdiction. The court found that the defendants had transacted business in Connecticut and thus were subject to the court's jurisdiction. The court additionally concluded that the situation did not involve a claim against the LLC itself; the claim that the defendants breached their agreement to operate the business was a claim that could be asserted against them in their individual capacities.


The defendant in this case was a doctor who was a limited partner in a limited partnership formed under North Carolina law to operate a hospital in McAllen, Texas. The limited partnership was formed as the result of a conversion from an LLC formed by the defendant and others. The parties involved in the creation of the LLC and limited partnership had a falling out, and the defendant was sued by the limited partnership in North Carolina. The defendant, who emphasized that he had never visited North Carolina, challenged the court's personal jurisdiction. The court found that the defendant had the requisite minimum contacts under North Carolina's long arm statute and the Constitution to warrant the exercise of jurisdiction. The court relied on the fact that the defendant played an active role in creating the limited partnership and assumed obligations to North Carolina business entities. In particular, the court stressed his participation in forming the LLC that was the predecessor to the limited partnership. The court pointed out that all of the business entities created by the parties were created under North Carolina law and that the defendant participated in the decisions regarding formation of the entities. (The court at one point mentioned that he signed the "articles of incorporation" of the LLC. This is in keeping with the court's later reference to another LLC as a "North Carolina corporation."). In connection with formation of the LLC, the defendant executed an operating agreement and a subscription agreement governed by North Carolina law. The defendant argued that status as a limited partner is not enough to create personal jurisdiction; however, the court distinguished the defendant from the type of passive investor that is a limited partner in a large limited partnership and is comparable to a shareholder in a large corporation. The defendant was more than a passive investor, according to the court, because he was one of the parties involved in
forming the limited partnership and he undertook obligations that differed from those assumed by passive investors. The court concluded that the defendant was more akin to a general partner than a shareholder.

B. Diversity Jurisdiction

There is a growing body of case law adhering to the rule that the citizenship of an LLC is determined by the citizenship of each of its members for purposes of diversity jurisdiction. Under this rule, an LLC is a citizen of each state in which a member resides. This rule follows from the United States Supreme Court case of Carden v. Arkoma Associates, 494 U.S. 185 (1990). In Carden, the Supreme Court held that a limited partnership is a citizen of every state in which a general or limited partner resides based upon the rule that citizenship of an unincorporated association is determined by the citizenship of all of its members. In one of the first cases to address the issue of an LLC’s citizenship, Carlos v. Adamy, No. 95 C 50264, 1996 WL 210019 (N.D. Ill. April 17, 1996), the court concluded that the corporate “nerve center” test would apply to an LLC, but the subsequent case law has embraced the Carden approach. The Second, Sixth, Seventh, Eighth, and Ninth Circuits have applied this rule to LLCs (see cases cited below). The district courts addressing the issue have overwhelmingly followed this approach; however, there are a few cases in which courts have applied the corporate rule for determining citizenship (basing citizenship upon state of incorporation and principal place of business). This approach typically appears to result from a failure to recognize that an LLC is a type of entity distinct from a corporation.

Mutual Assignment and Indemnity Co. v. Lind-Waldock & Co., LLC, 364 F.3d 858 (7th Cir. 2004) (noting that LLC is citizen of every state of which any member is citizen, and that citizenship may have to be traced through several members if any of its members is itself a partnership or LLC).

GMAC Commercial Credit LLC v. Dillard Dept. Stores, Inc., 357 F.3d 827 (8th Cir. 2004).

Belleville Catering Co. v. Champaign Marketing Place, L.L.C., 350 F.3d 691 (7th Cir. 2003) (criticizing counsel for the parties in scathing terms for treating LLC as corporation for purposes of diversity jurisdiction and ordering counsel to perform remaining services required to resolve dispute without charging the parties any attorney’s fees).


Handelsman v. Bedford Village Associates, L.L.C., 213 F.3d 48 (2nd Cir. 2000) (applying Carden in concluding that LLC’s citizenship is determined by citizenship of LLC’s members).

Cosgrove v. Bartolotta, 150 F.3d 729 (7th Cir. 1998) (applying Carden in concluding that citizenship of single member LLC is citizenship of its sole member).

C. Service of Process


Washington v. Premiere Automotive, L.L.C., 872 So.2d 1187 (La. App. 2004) (finding service of process on LLC was improper, relying on cases in corporate context because of similarity in provisions applicable to corporations and LLCs).

Kopff v. World Research Group, LLC, 298 F.Supp.2d 50 (D. D.C. 2003) (concluding plaintiff’s proof of service was ineffective under D.C. law because it failed to indicate any person who accepted service was proper individual to accept service for LLC).


Redwood Group, LLC v. Louiseau, 113 S.W.3d 866 (Tex. App. 2003) (holding record did not show compliance with statutory requirements for serving foreign LLC by serving Secretary of State).

CB Ellis, Buffalo, NY, LLC v. JLC Holdings, LLC, 761 N.Y.S.2d 899, 2003 WL 2136794 (N.Y. A.D. 4 Dept. 2003) (holding that service was properly effected pursuant to New York LLC act and defendant did not establish reasonable excuse for delay in timely filing answer).

Stuyvesant Fuel Service Corp. v. 99-105 3rd Avenue Realty LLC, 745 N.Y.S.2d 680 (N.Y. City Civ. Ct. 2002)(service on LLC did not comply with New York statute because individual served was not a member or manager of the LLC and statute does not authorize service on a “managing agent”).

Hovde Acquisition LLC v. Thomas, No. Civ.A. 19032, 2002 WL 1271681 (Del. Ch. June 5, 2002)(discussing improper and unsuccessful attempts to serve non-resident member and manager of Delaware LLC and allowing additional time to effectuate service that would relate back to the filing date of the lawsuit).


The defendant LLC moved to dismiss for failure to serve the LLC’s statutory agent. The plaintiff argued that the Connecticut statute providing for service on the statutory agent provides but one permissible method of service and permitted service on an LLC member fulfilled the requirements of the service statutes. The court agreed that the statute permitting service on the statutory agent was not exclusive and denied the motion to dismiss.

Scharmann’s Inc. v. 388 West Broadway, LLC, 685 N.Y.S.2d 33 (N.Y. A.D. 1 Dept. 1999)(dismissing case due to improper service on LLC defendant).


The LLC issue in this case was the effectiveness of an attempt to serve a subpoena on an LLC. The attempted service in this case was ineffective under the New York Limited Liability Company Act because service was attempted by delivery of the subpoena to an individual who was neither a manager nor a registered agent of the LLC.

D. Venue

Argos v. Orthotec LLC, 304 F.Supp.2d 591 (D. Del. 2004) (denying LLC’s motion to transfer venue of cybersquatting suit brought by French corporation to California, even though LLC’s principal place of business was in California, since LLC was organized as Delaware LLC and thus voluntarily exposed itself to the possibility of litigation in Delaware).

Crestman v. Independent Radiology Assoc., P.L.C., No. Civ.A. 03-1583, 2003 WL 22990413 (E.D.La. Dec. 17, 2003) (granting motion to dismiss for improper venue and holding that forum selection clause in LLC operating agreement was not against Louisiana public policy inasmuch as it was contained in an operating agreement for a professional LLC rather than an employment contract).

Cunningham v. Chalmette Medical Center, 859 So.2d 832 (La.App. 2003) (holding venue as to LLC was proper in parish where registered office of LLC is located, and venue as to other parties was proper in such parish as well because all of the parties were potentially jointly and solidarily liable).
**Graziuso v. 2060 Hylan Blvd. Restaurant Corp.,** 753 N.Y.S.2d 103 (N.Y.A.D. 2 Dept. 2002) (transferring venue to county in which LLC’s principal office was located as evidenced by articles of organization in absence of showing that articles had been amended to change principal office).


**ZPC 2000, Inc. v. The SCA Group, Inc.,** 86 F. Supp.2d 274 (S.D. N.Y. 2000) (concluding that venue of this case involving disputes between members of an Illinois LLC should be transferred to Illinois and rejecting argument that the forum selection clause of a non-disclosure agreement allegedly entered into between the members of the LLC should control).

**E. Pro Se Representation**

The cases thus far dealing with whether an LLC may appear *pro se* almost universally stand for the proposition that an LLC must appear through a licensed attorney. Some of the cases in this area are noted below.

**In re 1103 Norwalk Street, L.L.C.,** No. 01-10059C-7G, 2003 WL 23211564 (Bankr. M.D. N.C. Nov. 26, 2003).

**Carlo, L.L.C. v. Yorro,** No. SP1147/03, 2003 WL 32091320 (N.Y.Dist.Ct. April 30, 2003) (holding that an LLC must appear by an attorney like a corporation because an LLC has the attributes of a voluntary association with corporate limited liability protection).

**Board of Education v. Franklin County Board of Revision,** Nos. 01AP-878, 01AP-879, 2002 WL 416953 (Ohio App. March 19, 2002) (distinguishing LLC from partnership, an aggregate of individuals, and characterizing LLC as separate legal entity like corporation for purposes of requirement that it be represented by attorney in property tax valuation dispute, and holding statute permitting LLC member to file a complaint on behalf of LLC unconstitutional insofar as it permits persons who are not attorneys or owners of property to file a complaint before a board of revision on behalf of the owner).


**In re ICLNDS Notes Acquisition, LLC,** 259 B.R. 289 (Bankr. N.D. Ohio 2001) (holding that LLC may not file bankruptcy petition without being represented by counsel).

**Martinez v. Roscoe,** 33 P.3d 887 (N.M. App. 2001) (holding that provisions of New Mexico LLC act allowing authorized members to bring suit on behalf of the LLC do not permit members or managers who are not licensed attorneys to bring *pro se* claims on behalf of the LLC, but merely provide a mechanism for determining who may make the decision for the LLC to bring a lawsuit).


One member of a two-member LLC attempted to represent the LLC pro se. The court struck the appearance because only one of the members was before the court. The court stated that it would have jurisdiction if both members filed pro se appearances.


**F. Standing/Authority to Sue**

(See also certain cases under the heading “Derivative Suits.”)

**In the Matter of the Estate of Bender**, 806 N.E.2d 59 (Ind. App. 2004) (holding optionor did not have standing to assert that LLC’s option to purchase property, which was signed in individual’s capacity as member rather than manager, was improperly exercised because optionor was not injured; only other members and managers would have standing to challenge the exercise of the option as improper under Indiana LLC act and other fiduciary duties applicable to business entities).

**Moxness v. Hart**, 131 S.W.3d 441 (Mo.App. 2004) (allowing individual to intervene in garnishment of account held in name of “Northland Auto Brokers, LLC” on which individual and judgment debtors were signatories where there was no evidence in Secretary of State’s records that Northland Auto Brokers, LLC existed as an LLC and individual was allegedly doing business under the LLC name; however, Northland Auto Brokers, LLC could not intervene as an LLC nor could it intervene as a partnership because partners’ names were not set forth in its pleading).


**Meriden Concerned Citizens, LLC v. City of Meriden**, No. CV030284428, 2003 WL 22708667 (Conn.Super. Nov. 3, 2003) (holding that not-for-profit LLC, while separate entity from its members, must satisfy associational standing test and failed to establish that any of its individual members would have standing to sue).


The appointed fiduciary in a Securities Investor Protection Act winding up (the “Trustee”) created an LLC to receive assets in settlement of a claim asserted by the Trustee. The Trustee later filed an adversary proceeding seeking injunctive relief with respect to the assets received in the settlement by the LLC. The Trustee sought to cure deficiencies in the Trustee’s standing and questions as to the court’s jurisdiction by adding the LLC as a plaintiff, filing articles of dissolution pursuant to which the assets of the LLC (including the claims in the suit) were distributed to the Trustee, and dropping the LLC from the suit. The court concluded that these actions did not cure the standing and jurisdiction problems. The court stated that jurisdiction is determined at the time of the filing of the action, and the action did not involve the Trustee in that capacity or property of the estate. When the Trustee chose to take the property rights he received in the settlement and place them in a separate entity, only the ownership interest in the LLC remained property of the estate. Thus, the Trustee lacked standing, and the court lacked jurisdiction.

**Pawnee Petroleum Products, LLC v. Crawford**, No. 01-1314-WEB, 2003 WL 21659665 (D. Kan. April 18, 2003) (holding that plaintiff lacked standing to bring various claims arising out of agreements with corporations and LLCs under which plaintiff was not an intended third party beneficiary and which rightfully belonged to the corporations and LLCs, but that plaintiff’s fraud claims were personal to plaintiff and plaintiff had standing to assert them).


**Geyser v. Excel Legacy Corp.**, No. B159194, 2003 WL 21054762 (Cal.App. 2 Dist. May 12, 2003) (holding that trial court erred when it found individual was not a party to or third party beneficiary of LLC operating agreement and lacked standing to sue; fact issues existed with respect to whether operating agreement had been amended in connection with change in ownership of member of LLC, and individual’s tort claims were not dependent on existence of standing under the agreement).

**Likert v. Ryder Systems, Inc.**, No.Civ.A. 01-3754, 2003 WL 1751462 (E.D. La. 2003) (holding that individuals were not proper plaintiffs to sue for breach of contract in name of LLC but that there were fact issues as to what entity was represented by LLC that entered contract).

**Yew Prospect, LLC v. Szulman**, 759 N.Y.S.2d 351(N.Y.A.D. 2 Dept. 2003) (holding that executor for deceased sole member of LLC plaintiff should be joined as plaintiff because executor of deceased sole member was authorized to wind up the affairs of the LLC pursuant to the New York LLC act and the terms of the LLC operating agreement).

**Block v. Block**, No. CV20078857S, 2002 WL 31888203 (Conn.Super. Dec. 10, 2002). A fifty-percent member of an LLC brought suit, individually and on behalf of the LLC, against the other member of the LLC alleging that the defendant member breached his fiduciary duty and committed waste by mismanagement and theft. The defendant argued that the other member did not have authority to bring the suit on behalf of the LLC because the suit was not authorized by a majority in interest of the members. The court rejected the defendant’s argument based on the Connecticut LLC act. The court pointed out that the Connecticut LLC statutes generally require a majority in interest of the members to authorize a suit in the name of the LLC but exclude the vote of any member who has an interest in the outcome of the suit that is adverse to the interest of the LLC. Based on that provision, the court found that the plaintiff was the only member with a voting interest and had authority to bring the suit on behalf of the LLC.

**Kogut v. Church Homes, Inc.**, No. CV000436717S, 2002 WL 31662388 (Conn.Super. Nov. 6, 2002)(noting entity nature of LLC and concluding that member did not have standing to bring suit on LLC’s contract in absence of any allegation that member was bringing action as third party beneficiary).

**Starr v. Levin**, No.02 C 2258, 2002 WL1941375 (N.D. Ill. Aug. 21, 2002)(staying fraud, breach of fiduciary duty, and breach of contract action by one LLC member against another pending resolution of concurrent derivative suit pending in Florida state court).

**McGee v. Best**, 106 S.W.3d 48 (Tenn.Ct.App. 2002) (dismissing member’s fraud claim against other members on the basis that the allegations stated a claim that was essentially derivative and thus member did not have standing to pursue it individually).

**NSJ Investors, LLC v. TH/North San Jose, LLC**, No. CIV. O1-1932PAMSRN, 2002 WL 1347588 (D. Minn. June 17, 2002)(finding subsequent action filed by LLC members in Southern District of New York alleging breach of fiduciary duty and breach of operating agreement did not violate court’s injunction against instituting litigation involving interpleaded funds (as to which there was disagreement regarding distribution) in another forum).


**Giuliano v. Pastina**, 793 A.2d 1035 (R.I. 2002)(dismissing plaintiff’s claims that actions of defendant agent/employee of LLC damaged plaintiff’s ownership interest in the LLC because such claims were derivative claims and plaintiff had not complied with procedural requirements for a derivative suit).

**Holmes Development, LLC v. Cook**, 48 P.3d 895 (Utah 2002)(stating in footnote that, although LLC claimant and related LLC may have the same management and be practically indistinguishable, they are legally separate entities, and court would not treat the LLCs as the same entity for purposes of standing to sue on a contract).
ME Corp., S.A. v. Cohen Brothers LLC, 739 N.Y.S.2d 133 (N.Y. A.D. 1 Dept. 2002) (holding that whether LLC had been dissolved and liquidated was disputed and thus it was premature to dismiss causes of action brought directly by individual members that were derivative in nature on basis that LLC had not been dissolved prior to commencement of the action).

Forum Financial Group v. President and Fellows of Harvard College, 173 F. Supp.2d 72 (D. Maine 2001) (questioning standing of individual member of LLC in case brought by LLC and member arising out of failed business transaction, but making no disposition on issue since it had not been raised).

Association of Merger Dealers, LLC v. Tosco Corporation, 167 F. Supp.2d 65 (D. D.C. 2001) (finding nonprofit LLC formed to promote interests of Mobil retail service station dealers in Mobil-Exxon merger did not have standing to sue on its own behalf and lacked associational standing to sue as a representative under state law).

A member of an LLC appealed an order to substitute the LLC as party plaintiff in a case arising out of the defendant’s alleged breach of a contract with the plaintiff for the construction of a facility on property owned by the LLC. The court concluded that the individual member was a real party in interest because the claims did not allege injury to the LLC and, even assuming the LLC suffered injuries, the plaintiff’s individual contract with the defendants created a “special duty” to the plaintiff.

Two LLCs and the individual who was the member and manager of both sued the defendants for breach of contract and fraud for failing to disclose a landfill on property bought by the LLC. The individual had entered the contract of sale but assigned his interest under the contract to an LLC. After the sale, the first LLC transferred the property to the second LLC, and the member made a “mental assignment” of the chose in action from the first LLC to the second. The court analyzed whether a single individual authorized on behalf of two separate entities may make a “mental assignment” of a chose in action from the first to the second. The court recognized the validity of the mental assignment because it said that mutual assent is undisputed where there is a “mental assignment” by a single individual, and the claims asserted were legally assignable.

Randolph Foundation v. Appeal from Probate Court of Westport, No. X05CV980167903S, 2001 WL 418059 (Conn. Super. April 3, 2001) (noting in dicta that an LLC is an entity with capacity to sue and be sued and that individual members may not bring LLC claims in their individual names).

St. Raymond v. City of New Orleans, 775 So.2d 31 (La. App. 2000) (permitting sole member of LLC that owned property that was subject matter of suit to amend petition filed in member’s own name to make LLC a plaintiff in the case).

A suit was mistakenly filed in the name of a corporation rather than an affiliated LLC. The suit was dismissed due to the corporation’s lack of capacity, and (after various missed opportunities to cure) the LLC ended up being barred by res judicata from pursuing the complaint refiled in its name because the LLC was in privity with the corporation that filed the initial complaint. In finding privity, the court relied in part upon the failure of the LLC and the corporation to comply with the formalities necessary to maintain separate existences. The court commented that the LLC’s own counsel was confused about which entity was his client.

Crozier v. Gatto, 28 Conn. L. Rptr. 320, 2000 WL 1682616 (Conn. Super. Oct. 5, 2000) (holding that LLC member did not have standing to bring suit for breach of contract and other claims arising out of LLC’s contract).

Industrial Electronics Corp. of Wisconsin v. iPower Distribution Group, Inc., 215 F.3d 677 (7th Cir. 2000).
The plaintiff and seven other companies, including the defendant iPower Distribution Group, Inc. (iPower), formed an LLC to develop an integrated marketing and distribution consortium using iPower software. Once the LLC was formed, it entered a franchise agreement with iPower to allow the LLC to purchase, install, and use the iPower software. The franchise agreement contained an arbitration clause, but the LLC agreement did not. When the plaintiff...
later sued iPower alleging that iPower had made material misrepresentations to induce the plaintiff to join the LLC, iPower argued that the claim was subject to the arbitration clause in the franchise agreement. The court acknowledged that an LLC cannot bind its members or subject them to liability through contracts between the LLC and third parties but said that this principle did not resolve the case. The court explained that the plaintiff was like a corporate shareholder who would not have standing to sue or enforce a contract of the corporation; however, the court went on to address the possibility that the plaintiff was a third party beneficiary of the franchise agreement. The court did not have to resolve this issue because it determined that the injuries alleged did not arise under or relate to the franchise agreement. The alleged fraud related to the inducement of the plaintiff to join the LLC by entering the LLC agreement, and the arbitration provision in the franchise agreement did not affect disputes arising out of the LLC agreement.


Four individuals purchased some realty and one week later transferred ownership of the property to an LLC wholly owned by them. Later, the individuals and the LLC filed suit to rescind the purchase based upon fraudulent misrepresentations made during negotiations for the purchase of the property. The defendants argued that the individuals had no right to rescission because they transferred the property to the LLC. The court concluded that the individuals, but not the LLC, could maintain the action for fraud. According to the court, the legal effect of the fraud was to vitiate the formation of the contract of sale, and the domino effect rendered the transfer to the LLC a nullity. As for the LLC’s standing, the court noted that the LLC was a “separate and distinct legal entity” that did not participate in the negotiations with the defendants leading to the sale of the property. Only the individual plaintiffs contracted with the defendants; the LLC, a legal entity that they owned, acquired the property by subsequent transfer. Thus, the court concluded the right of action arising out of the fraud was personal to the individuals.


In this declaratory judgment action over a consulting agreement and an LLC operating agreement, the court held that a justiciable controversy did not exist and that, even if it did, the plaintiff would not have standing to bring the suit because the plaintiff was not a party to either agreement.


An LLC and its two members filed suit alleging breach of a lease agreement. The court held that the members were not parties to the lease agreement and thus could not recover individually. The members’ names appeared on the lease only on the signature page where they signed on behalf of the LLC, and they acknowledged that they negotiated the lease on behalf of the LLC. The court rejected the members’ argument that they were entitled to recover individually on a detrimental reliance theory.

Midland Food Services, LLC v. Castle Holdings V, LLC, 792 A.2d 920 (Del. Ch. 1999).

Several LLCs sued their previous member and principal operating officer for breach of the fiduciary duties of care and loyalty, alleging that the member caused the LLC to enter leases on commercially unreasonable terms so as to advantage the member and other entities owned by him. Ownership of the LLCs had been transferred by the original member to certain creditors after the LLCs got into financial difficulty. The court held that the Bangor Punta doctrine barred the claims since the current owner of the LLCs acquired the LLCs after the alleged wrongdoing occurred. As explained by the court, “[t]he Bangor Punta doctrine ensures that a purchaser who obtains a controlling interest in a corporation after potential claims arose against those persons from whom the purchaser obtained his shares cannot use his control of the corporate machinery to cause the corporation to assert those claims directly.” The purpose of the doctrine, according to the court, is to prevent persons from being able to re-trade arms-length transactions by using the corporation to sue the parties from whom they obtained their shares. The court found the doctrine applicable in this case. In a footnote, the court expressed doubt that the prior member could breach fiduciary duties owed to companies he wholly owned.


The court stated that the petitioners owned membership interests in the LLCs that were the subject of a proceeding for judicial dissolution, thus they had standing to bring the proceeding under New York law.

McConnell v. Hunt Sport Enterprises, 725 N.E.2d 1193 (Ohio App. 1999)(finding member’s breach of operating agreement by unilaterally bringing suit on behalf of LLC without requisite member approval was willful misconduct).

The court in this case ordered the plaintiffs to file a Second Amended Complaint to address certain deficiencies in their pleadings. The case involved a dispute over proceeds from the sale of albums, but the facts of the case apparently were far from clear from the pleadings. The court noted that members of an LLC had sued in their individual capacities notwithstanding the Louisiana statutory provision that a member of an LLC is not a proper party in a case by or against an LLC except when the object is to enforce rights against or liability to the LLC. The court stated that it was unclear how the individuals had a cause of action for breach of contract, and the court admonished the parties to make clear, with respect to each claim, which party asserts liability and upon what basis of law. Apparently, the LLC was a successor to an LLP which was a party to the contracts in issue, and the court also ordered the plaintiffs to provide a clear chronology of events, including how and when the LLP became an LLC.


Members of an LLC sued the LLC and other members asking for dissolution and damages for breach of fiduciary duty and violation of a non-competition agreement. The parties entered a consent order dissolving the company and reserving the issues involving breach of fiduciary duty and breach of the non-competition agreement. The trial court rendered summary judgment in favor of the defendants. The court first determined that the trial court had erred in implicitly rendering summary judgment on the breach of fiduciary duty claims because the claims were not properly raised in the summary judgment motions. The court next determined that the LLC’s claim for breach of the non-competition agreement was not assigned to the members in the consent order dissolving the LLC. While the court agreed with the trial court that the members were not third party beneficiaries of the non-competition agreement, the court found that the members had standing to sue on the agreement because they were parties individually to the contract. Finally, the court found that the trial court had erred in ruling on the issue of whether the breach of non-competition agreement claim was derivative in nature because the parties had not had a full opportunity to be heard on the issue.


JM Avalon Investments, LLC and one of its members, Gaspero, sued Nischan, the other member of the LLC, and her husband for conversion, fraud, negligence, breach of contract, and unjust enrichment. Nischan sought to have the case dismissed on the basis that the LLC lacked standing to sue. Nischan argued first that the LLC was not authorized to bring the suit because Nischan, a fifty percent owner of the LLC, had not consented to the suit. The Connecticut LLC act provides that suit may be brought in the name of an LLC by any member or members who are authorized to sue by the vote of a majority in interest of the members. However, the court relied on another provision of the act that states that the vote of any member who has an interest in the outcome of the suit that is adverse to the LLC shall be excluded. Since the suit alleged wrongdoing by Nischan, the court determined that the remaining member, Gaspero, had authority to bring the suit in the name of the LLC without the vote of Nischan. Nischan next argued that her resignation as a member of the LLC dissolved the LLC and left it without standing to sue. The court relied on various provisions of the LLC act in concluding that the remaining member, Gaspero, had authority to wind up the LLC, which included bringing suit on its behalf.


The plaintiffs, Taurus Advisory Group, Inc. (“TAG”) and Taurus Advisory Group, LLC (“Taurus LLC”), sued several parties for breach of contract, negligent misrepresentation, breach of the duty of good faith and fiduciary relationship, and other claims arising from an agreement among TAG and the defendants to form Taurus LLC. The defendants sought dismissal of the case on the grounds that the complaint asserted derivative claims that TAG attempted to bring individually and that TAG lacked the authority to commence an action in the name of Taurus LLC. The court first noted that Delaware law applied since the LLC was formed under Delaware law (citing Restatement (Second) of Conflict of Laws § 302). The court then accepted the parties' analogy of an LLC to a corporation, finding members to be similar to stockholders. The court accepted this analogy based on case law analogizing limited partners in a limited partnership (which the court referred to as a limited liability partnership) to corporate shareholders. The court determined that TAG's claims relating to the defendants' failure to make agreed contributions of capital and services alleged a direct injury and TAG could bring the suit on its own behalf. The court further decided that the complaint did not state an individual cause of action in favor of TAG for breach of fiduciary relationship because the only articulated harm was to the LLC (which the court mistakenly referred to at that point as a corporation), and because the complaint
did not set out a relationship comparable to that involving a majority shareholder's duties toward the minority shareholders since the capital contributions were in equal amounts. Subsequent related decisions appear at 1997 WL 241153, 1998 WL 381883 and 1998 WL 199353.

G. Derivative Suits

Metro Communication Corp., BVI v. Advanced Mobilecomm Technologies, Inc., __ A.2d __, 2004 WL 1043728 (Del.Ch. 2004) (treating claims based on allegedly improper distributions as derivative based on facts in pleadings indicating demand was excused, but stating claims that survived Rule 12(b)(6) motion should be pled again in proper form as derivative claims with formal allegation of demand futility).

Albers v. Guthy-Renker Corp., 92 Fed.Appx. 497 (9th Cir. 2004) (applying Texas law and holding that members of Texas LLC did not have standing in their individual capacities to sue for injuries to LLC, that LLC did not have capacity to sue in California because it was a foreign LLC transacting business in California and was not registered to do so, and that members must first make demand under Texas law before bringing derivative action on behalf of LLC).

Denevi v. LGCC, No. H025401, 2004 WL 363313 (Cal. App. Feb. 27. 2004). The plaintiffs had previously sued derivatively on behalf of their LLC and were awarded judgment in that action. They then sought to recover on individual claims. The court stated that maintenance of a derivative action is not in the abstract inconsistent with maintenance of an individual action, but concluded that the injury from the derivative action and individual action in this case were the same. Thus, the prior judgment in the derivative action precluded recovery in the individual action.

Schindler v. Niche Media Holdings, LLC, 772 N.Y.S.2d 781, (N.Y.Sup. 2003). A minority member of a New York LLC filed suit asserting various “personal” and “derivative” claims and asking for injunctive relief. The court concluded that the New York LLC statute does not permit derivative actions because it does not contain any provision authorizing such actions.

Glod v. Baker, 851 So.2d 1255 (La.App. 2003) (dismiss ing various claims asserted by individual members of LLCs because claims belonged to LLCs and members had no right to bring the claims in a direct action).

Mills v. Baugher, No. 21528-8-III, 2003 WL 21761817 (Wash.App. July 31, 2003) (finding allegation that defendant member holds the majority of the LLC membership interests and would not allow LLC to pursue the action against the defendant member was sufficient to meet the statutory requirement that a derivative plaintiff plead the reasons for not making a demand, and concluding that it is not always necessary to name the LLC as a party in a derivative action enforcing the LLC’s rights).

Leshine v. Goodrich, No. CV010448323, 2003 WL 21235483 (Conn.Super. May 15, 2003). Two members of an LLC sued the LLC’s chairman for breach of fiduciary duty, and the chairman argued that the plaintiffs did not have standing because the claims were derivative in nature. The court found that the allegations, construed liberally in favor of the plaintiffs, alleged personal, rather than derivative, injuries. The court found that the facts alleged in the complaint alleged a scheme to strip the plaintiffs of their personal interests and rights, apart from the rights of the LLC. The complaint alleged that the chairman caused the LLC to purport to terminate various LLC agreements to which the plaintiffs were parties, improperly purported to terminate for cause one of the plaintiffs as president, improperly purported to terminate a license agreement that was to be the LLC’s core asset, embarked on a business venture with a third party to use the LLC’s product and related information and trade secrets, and schemed “to take complete control of [the LLC] and strip [the plaintiffs] of their contract and common-law rights in and to [the LLC], its governance and its income, its assets, its business opportunities and its business operations.”

VGS, Inc. v. Castiel, No. C.A. 17995, 2003 WL 723285 (Del.Ch. Feb. 28, 2003) (stating that case law governing corporate derivative suits is equally applicable to LLCs and concluding that breach of fiduciary duty claims (based on waste, mismanagement, and self-dealing) failed because they were derivative in nature and no demand had been made on LLC’s board nor had plaintiff demonstrated futility of demand).
**Sumlin Construction Co., L.L.C. v. Taylor,** 850 So.2d 303 (Ala. 2002) (holding that plaintiff, who was divested of member status by virtue of prior bankruptcy, did not have standing to bring derivative suit on behalf of LLC).

**Excimer Associates, Inc. v. LCA Vision, Inc.**, 292 F.3d 134 (2nd Cir. 2002) (granting opportunity to amend to plead claims of direct injury with greater particularity where complaint could be construed to indicate existence of direct claim by LLC member based upon direct injury incurred as a result of additional contributions required after breach of operating agreement by other member).

**McLeod v. Albanese,** 815 So.2d 472 (Miss. App. 2002) (noting that statute determining who is proper plaintiff in LLC derivative suit requires that plaintiff be member at the time of the act or omission complained of (thus termination of member’s membership by subsequent bankruptcy would not deprive member of standing to pursue derivative claim) and that fair and adequate representation requirement would likely be satisfied if all remaining members are alleged wrongdoers).

**Giuliano v. Pastina,** 793 A.2d 1035 (R.I. 2002) (dismissing plaintiff’s claims that actions of defendant agent/employee of LLC damaged plaintiff’s ownership interest in the LLC because such claims were derivative claims and plaintiff had not complied with procedural requirements for a derivative suit).

**McGee v. Best,** 106 S.W.3d 48 (Tenn.Ct.App. 2002) (dismissing fraud claim because the allegations stated a claim that was essentially derivative and the plaintiff thus did not have standing to pursue it individually).

**ME Corp., S.A. v. Cohen Brothers LLC,** 739 N.Y.S.2d 133 (N.Y. A.D. 1 Dept. 2002) (holding that whether LLC had been dissolved and liquidated was disputed and thus it was premature to dismiss causes of action brought directly by individual members that were derivative in nature on basis that LLC had not been dissolved prior to commencement of the action).


Three members of an eight-member LLC sued in their individual capacities alleging various causes of action arising out of the transfer of the LLC’s assets without their knowledge or consent and for no consideration. The court held that the claims belonged to the LLC and that the plaintiffs lacked standing to bring the claims in their individual capacities because the gravamen of the complaint was injury to the LLC based upon the fraudulent transfer of the LLC’s assets. Thus, the claims must be brought by the LLC or derivatively by the members.


In this consolidated appeal of three actions between two 50% members of an LLC, the Kansas Supreme Court held that the provisions of the new Kansas LLC act authorizing member derivative suits are procedural in nature and thus retroactive in effect such that they apply to litigation initiated prior to the effective date of the new act. The court noted the effective date provisions of the new Kansas LLC act, which took effect January 1, 2000, and provide that the new act is applicable to all LLCs whether formed before or after the effective date. The court also noted the Kansas Bar Association’s commentary contrasting the effective date provisions of the new LLC act with the transition provisions of the Kansas Revised Uniform Partnership Act. Finding the provisions relating to derivative suits to be completely procedural in nature, the court concluded they applied to the actions pending in the three appealed cases. The court rejected the argument that the statutory provision in the old LLC act providing for limited liability of members and managers precludes derivative suits against members or managers. The court stated that the provision is not a shield from liability of a member or manager who commits actionable conduct against the LLC, but is a codification of the limited liability of managers and members for debts owed by the LLC. The court pointed out that the same limitation on liability was included in the new act along with the derivative suit provisions.


**Harbor Hospital Services, Inc. v. GEM Laundry Services, L.L.C.**, Nos. 4830, 0207, 2001 WL 1808556 (Pa. Com. Pl. July 18, 2001) (stating that the court could treat as direct a derivative claim by the complaining member since
they were the only two members of the LLC but concluding that the complaining member’s principal was too far removed to bring a breach of fiduciary duty claim against the other member because the duty, if any, would be between the members of the LLC, not individual shareholders of the members).


The court concluded that a minority member’s breach of fiduciary duty claim against the majority member, managers, and individual who allegedly controlled the managers was derivative and that the complaint must therefore address the demand requirement under Federal Rule 23.1 The court found that futility of demand was adequately reflected in the complaint.

**Cabrini Development Council v. LCA Vision, Inc.**, 197 F.R.D. 90 (S.D. N.Y. 2000) judgm’t vacated, appeal dism’d, 292 F.3d 134 (2nd Cir. 2002) (following Weber v. King (E.D. N.Y. 2000) and concluding that members of a New York LLC have a common law right to bring a derivative action and that the LLC is an indispensable party in such a suit).


Two members of Kathleen’s Bake Shop, LLC sued the third member alleging various acts of past and ongoing breach of contract, unfair competition, and interference with the LLC’s business. The court concluded that the LLC was a necessary and indispensable party whose joinder was not feasible because it would destroy diversity jurisdiction. Additionally, the court recognized a common law right to bring a derivative action even though the New York LLC law does not include provisions expressly permitting derivative lawsuits. The court then concluded that many of the plaintiffs’ claims were more appropriately characterized as claims of the LLC that should be brought derivatively. In the course of its analysis, the court discussed the nature of an LLC as a separate entity and the analogies that should be made to partnerships and corporations.

**Walker v. Virtual Packaging, LLC**, 493 S.E.2d 551 (Ga. App. 1997) (finding that the trial court erred in ruling on the issue of whether a claim based on the breach of a non-competition agreement was derivative in nature because the parties had not had a full opportunity to be heard on the issue).


The plaintiffs, Taurus Advisory Group, Inc. (“TAG”) and Taurus Advisory Group, LLC (“Taurus LLC”), sued several parties for breach of contract, negligent misrepresentation, breach of the duty of good faith and fiduciary relationship, and other claims arising from an agreement among TAG and the defendants to form Taurus LLC. The defendants sought dismissal of the case on the grounds that the complaint asserted derivative claims that TAG attempted to bring individually and that TAG lacked the authority to commence an action in the name of Taurus LLC. The court first noted that Delaware law applied since the LLC was formed under Delaware law (citing Restatement (Second) of Conflict of Laws § 302). The court then accepted the parties' analogy of an LLC to a corporation, finding members to be similar to stockholders. The court accepted this analogy based on case law analogizing limited partners in a limited partnership to corporate shareholders. The court determined that TAG's claims relating to the defendants' failure to make agreed contributions of capital and services alleged a direct injury and TAG could bring the suit on its own behalf. The court further decided that the complaint did not state an individual cause of action in favor of TAG for breach of fiduciary relationship because the only articulated harm was to the LLC (which the court mistakenly referred to at that point as a corporation), and because the complaint did not set out a relationship comparable to that involving a majority shareholder's duties toward the minority shareholders since the capital contributions were in equal amounts. Subsequent related decisions appear at 1997 WL 241153, 1998 WL 381883 and 1998 WL 199353.

**H. Indispensable Parties**


**Sykes v. Hengel**, 220 F.R.D.593 (S.D. Iowa 2004) (concluding LLC was not indispensable party in ex-employee’s defamation case against LLC’s managers, even though LLC might be obligated to indemnify managers,
because LLC’s interests were sufficiently identical to managers that managers could represent LLC’s interests and there was no risk that LLC’s absence might impair its interests).

_Holland v. Fahnestock & Co., Inc.,_ 210 F.R.D. 487 (S.D. N.Y. 2002) (adopting magistrate’s report (see _Holland v. Fahnestock & Co., Inc_, No. 01CIV.2462RMBAJP, 2002 WL 1774230 (S.D. N.Y. Aug. 2, 2002) finding that LLC was not indispensable party because its interest was adequately represented by defendant and LLC was no more than co-obligor and joint tortfeasor with respect to pre-organization contract assigned to LLC by defendant).


One of two founding members of an LLC alleged that the other member unilaterally caused membership interests to be transferred to two individuals, reducing the interests of the founding members and adding the two individuals as new members, without the approval required under the operating agreement. The plaintiff also complained of modifications of his employment relationship with the LLC. The court determined that the individuals to whom the membership interests were transferred, who were residents of Connecticut without any connection to Delaware other than their disputed ownership in a Delaware LLC, were necessary and indispensable parties with respect to the issue of their ownership in the LLC. The parties did not dispute the court’s lack of personal jurisdiction over these parties. Most of the issues in the suit were dependent, directly or indirectly, on resolution of the dispute regarding ownership, and the court dismissed the claims involving these issues. The remaining two claims that did not turn on resolution of the ownership dispute were dismissed for other reasons.

_Trademark Retail, Inc. v. Apple Glen Investors, LP_, 196 F.R.D. 535 (N.D. Ind. 2000) (holding that LLC was an indispensable party in a suit by one member against another for breach of fiduciary duty and interference with contractual and business relations).

_Cabrini Development Council v. LCA Vision, Inc.,_ 197 F.R.D. 90 (S.D. N.Y. 2000), judgm’t vacated, appeal dism’d, 292 F.3d 134 (2nd Cir. 2002) (following _Weber v. King_ (E.D. N.Y. 2000) in concluding that members of New York LLC have a common law right to bring a derivative action and that LLC is an indispensable party in such a suit).


Two members of Kathleen’s Bake Shop, LLC sued the third member alleging various acts of past and ongoing breach of contract, unfair competition, and interference with the LLC’s business. The court concluded that the LLC was a necessary and indispensable party whose joinder was not feasible because it would destroy diversity jurisdiction. Additionally, the court recognized a common law right to bring a derivative action even though the New York LLC law does not include provisions expressly permitting derivative lawsuits. The court then concluded that many of the plaintiffs’ claims were more appropriately characterized as claims of the LLC that should be brought derivatively. In the course of its analysis, the court discussed the nature of an LLC as a separate entity and the analogies that should be made to partnerships and corporations.

I. Scope of Expert Testimony

_Amster v. River Capital Int’l Group LLC_, No. 00 Civ. 9708(DC), 2003 WL 1571593 (S.D.N.Y. March 26, 2003).

In this dispute related to an LLC dissolution, the court addressed the permitted scope of the testimony of the plaintiff’s expert. The court said the expert would not be permitted to make “findings of fact,” to opine as to the intent or credibility of the parties or witnesses, to opine as to what the law is, or to interpret provisions of the LLC agreement. The court said the expert would be allowed to explain the terms of the LLC agreement and to explain concepts applicable to partnerships and LLCs. The court said the expert would also be permitted to testify as to “indicia” or “badges” of fraud and as to tax matters.

J. Claim Preclusion

_Mancuso v. Kinchla_, 806 N.E.2d 427 (Mass. App. Ct. 2004) (holding non-mutual claim preclusion barred claims of former members against remaining member of LLC where claim could have been resolved in prior action between LLC and former members arising out of same nucleus of operative facts, and remaining member, who assumed
total control of LLC by virtue of redemption of former members’ interests, had requisite “close and significant relationship” to support claim preclusion).

Maxemus Entertainment, LLC v. Josey, No. CV030822764, 2003 WL 22205931 (Conn.Super. Sept. 10, 2003) (finding LLC and its sole member were in privity for purposes of collateral estoppel and res judicata analysis, and LLC was thus barred from relitigating issues that were litigated or could have been litigated in prior suit to which member was a party).

Direct Marketing Concepts, Inc. v. Trudeau, 266 F.Supp.2d 794 (N.D. Ill. 2003) (characterizing as “disingenuous” the effort of individual to separate himself from the manager-managed LLCs of which he was the designated manager and in which he held direct or indirect ownership interests, and concluding that the LLCs were in privity with the individual for purposes of claim preclusion stemming from individual’s earlier lawsuit).

K. Arbitration

Braham v. Barton of Redlands, Inc., Nos. B168121, B168883, 2004 WL 886889 (Cal.App. April 27, 2004) (holding arbitrator’s interpretation of LLC operating agreement was not subject to judicial review, and removal of manager and decision that LLC’s business had come to an end was not a decree of dissolution).

In re XO Communications, Inc. (XO Communications, Inc. v. Start Investments, Inc.), No. 02-12947 (AJG). 03 Civ. 1898(DC), 2004 WL 360437 (S.D. N.Y. Feb. 26, 2004) (concluding bankruptcy judge’s order abstaining from determining severability of put provision in LLC agreement in favor of ADR procedure in LLC agreement was interlocutory order not subject to immediate appeal).

Williams v. Litton, 865 So.2d 838 (La.App. 2003) (holding that plaintiffs failed to allege facts sufficient to support claim that their agreement to arbitrate was fraudulently induced and further holding that plaintiffs’ claims for return of capital contributions, loans, and lost profits, as well as claims based upon alleged breach of fiduciary duty of LLC manager, were sufficiently related to the LLC operating agreement to be subject to the arbitration clause in the operating agreement which encompassed “[a]ny controversy or claim arising out of or relating to this Agreement”).

Clement Contracting Group, Inc. v. Coating Systems, L.L.C., __ So.2d __, 2003 WL 22064233 (Ala. 2003) (holding that sole member of LLC who signed contract with third party in his capacity as member of the LLC was not individually subject to arbitration clause contained in contract).

Sloan Financial Group, Inc. v. Beckett, 583 S.E.2d (N.C. App. 2003) (concluding that various claims against LLC general partner of private equity fund arose out of alleged violations of the fund’s limited partnership agreement, which did not contain an arbitration clause, rather than the operating agreement of the LLC general partner).

Cambio Health Solutions, LLC v. Sloate, No. 02-6392, 2003 WL 21698883 (6th Cir. July 17, 2003) (affirming district court’s decision that arbitration clause in LLC agreement did not apply to dispute under severance agreement and that, in any event, plaintiff waived its right to arbitration).

Alexander v. Minton, 855 So.2d 94 (Fla.App. 2003) (holding that dispute regarding member’s right to inspect LLC books and records was arbitrable under arbitration clause of LLC operating agreement and that member did not waive right to compel arbitration).


In re Application of Donald J. Trump, 755 N.Y.S.2d 618 (N.Y.A.D. 1 Dept. 2003) (stating that “artificial distinction” sought to be drawn between individual petitioner and his wholly-owned LLC did not preclude arbitration under arbitration clause in agreement to which LLC was a party).
The appeals court held that the trial court should retain jurisdiction over an LLC issue of first impression notwithstanding the arbitration clause in the operating agreement. “An arbitrator dealing with the complex facts of this case would have no guidance on the proper interpretation of the Limited Liability Company Act, and would have to expend a great deal of time and energy to reach a well-considered conclusion, but his ultimate decision would have no precedential value.” It thus appeared reasonable to the court for the trial court to retain jurisdiction over the declaratory judgment claim relating to the retroactive effect of reinstatement after administrative dissolution of an LLC that was a member of another LLC.

Cambio Health Solutions, LLC v. Reardon, 228 F.Supp.2d 883 (M.D. Tenn. 2002)(holding that appeal of order, insofar as it denied motion to compel arbitration, divested district court of jurisdiction pending appeal in case where district court granted order compelling arbitration as to claims related to LLC agreement but declined to order arbitration of claims related to separate consulting agreement).


MTS Communications Company, Inc. v. Mosaic Capital, No. B141818, 2002 WL 1788948 (Cal.App. 2 Dist. Aug. 5, 2002)(reviewing arbitration award based on sale of business opportunity by LLC that did not hold required license on basis that entire transaction was alleged to be illegal and therefore could not be sanctioned by court even in context of confirmation of arbitration award).

Addison v. Everest Connections Corporation, 37 Fed.Appx. 841 (8th Cir. June 20, 2002)(affirming denial of motion to compel arbitration in suit by former employees of LLC because employees were not parties to LLC agreement containing arbitration clause).

Mississippi Fleet Card, L.L.C. v. Bilstat, Inc., 175 F.Supp.2d 894 (S.D. Miss. 2001)(holding that members of LLC were bound by arbitration clause in processing agreement entered by LLC where members were third party beneficiaries of agreement and asserted claims arising under or related to the agreement).

Metro Riverboat Associates, Inc. v. Bally’s Louisiana, Inc., 817 So.2d 1275 (La. App. 2002)(affirming trial court’s grant of preliminary injunction where arbitration clause permitted one member to invoke arbitration without vote of membership in dispute over cash call and alleged transfer of interest inasmuch as penalty for refusal to arbitrate was forced sale of member’s interest, which would constitute irreparable injury).


Two LLCs in the business of making payday loans were sued by borrowers who asserted that the loans violated state lending laws. The LLCs moved to enforce arbitration provisions in the contracts with the borrowers. The court did not find relevant the fact that the LLCs were organized under the law of another state or the fact that the LLC’s owners resided in another state for purposes of determining whether the payday loan transactions substantially affected interstate commerce under the Federal Arbitration Act.

Rice entered into a Subscription Agreement with an LLC that contained an arbitration clause. Rice also entered a Member Control Agreement that provided for repurchase of membership units under certain circumstances on specified terms. The Subscription Agreement incorporated by reference the Member Control Agreement. Rice filed suit seeking dissolution of the LLC as well as equitable relief against two LLC officers for misapplication of LLC assets and fraud. The officers demanded arbitration although they were not parties to the Subscription Agreement. The arbitrator awarded Rice an amount for his interest in the LLC, for which the LLC and one of the officers were made jointly and severally liable, and the arbitrator also awarded fees and expenses to Rice, for which he made the LLC and the two officers jointly and severally liable. The district court upheld the arbitrator’s award, and the two officers appealed, claiming that the arbitrator exceeded the scope of his authority. The court of appeals held that the arbitrator
did not exceed his authority based upon the broad language of the arbitration clause, Rice’s allegations and claims, and the content of the officers’ demand for arbitration.


The court held that the arbitration clause in a two-member LLC’s operating agreement did not require arbitration of claims against a separate corporation that contracted to manage the apartment complex owned by the LLC even though the corporation was owned by the members of the LLC and its only activity was managing the sole asset of the LLC.


The court held that the plaintiff’s claims against the defendant were not within the scope of the arbitration clause in the operating agreement of an LLC they formed together because the plaintiff’s claims related to the plaintiff’s and defendant’s employment in another investment firm.

**Sordoni Skanska Construction Company, Inc. v. Swanson**, 30 Conn.L.Rptr. 188, 2001 WL 985056 (Conn. Super. 2001)(holding that arbitration clause in construction management agreement between plaintiff and LLC required arbitration of claims against LLC and its members.)


The plaintiff sought to avoid arbitration required by an arbitration clause in an Amended and Restated LLC Agreement on the basis that the plaintiff did not intend a separate signature page that was subsequently attached to the Amended and Restated LLC Agreement to be an execution of that agreement. Various documents were involved in the acquisition of one LLC by another LLC. The plaintiff argued that he was misled into believing that the signature page referred to an earlier executed LLC agreement or to the operating agreement. The court rejected these arguments and found that the evidence indicated the plaintiff understood what he executed to be the signature page to the Amended and Restated LLC Agreement.

**Industrial Electronics Corp. of Wisconsin v. iPower Distribution Group, Inc.**, 215 F.3d 677 (7th Cir. 2000).

The plaintiff and seven other companies, including the defendant iPower Distribution Group, Inc. (iPower), formed an LLC to develop an integrated marketing and distribution consortium using iPower software. Once the LLC was formed, it entered a franchise agreement with iPower to allow the LLC to purchase, install and use the iPower software. The franchise agreement contained an arbitration clause, but the LLC agreement did not. When the plaintiff later sued iPower alleging that iPower had made material misrepresentations to induce the plaintiff to join the LLC, iPower argued that the claim was subject to the arbitration clause in the franchise agreement. The court determined that the injuries alleged did not arise under or relate to the franchise agreement. The alleged fraud related to the inducement of the plaintiff to join the LLC by entering the LLC agreement, and the arbitration provision in the franchise agreement did not affect disputes arising out of the LLC agreement.


The opinion in this case was originally available on Westlaw but was removed and is now only referenced in a table at 744 So.2d 238. Two members of an LLC sued the other two members and a third party alleging that a merger of the LLC into one of the defendant members and then into the third party constituted a conversion of the plaintiffs’ assets. The LLC operating agreement had an arbitration clause that required “a dispute arising between the Members concerning the operation, management or buyout of the interest of the LLC” to be submitted to arbitration. The court held that the plaintiffs’ claim fell within the scope of the arbitration clause. The court also found that the dispute must
be arbitrated even though one of the defendants was not a party to the operating agreement. The court stated that the plaintiffs’ allegations were directed primarily against the member who controlled the entities with which the LLC merged. The court concluded that the first merger (between the LLC and one of its members) was certainly arbitrable and, if found improper, would make any complaint against the company involved in the second merger moot.


Two former members of an LLC sued the LLC to enforce the terms of the operating agreement entitling them to be bought out after they resigned as members, and the remaining members voted to continue the operation of the LLC. After the former members filed suit, the LLC sought to require the matter to be submitted to arbitration. The operating agreement had a clause requiring “any dispute, controversy or claim arising out of or in connection with or relating to” the operating agreement to be submitted to arbitration. The former members argued that the arbitration clause was unenforceable because of the LLC’s breach of the agreement or, alternatively, because the LLC had waived its right to arbitration. The court rejected both arguments and held that the trial court erred in denying the application for arbitration.


An LLC operating agreement contained an arbitration clause the validity of which was not disputed. The issue in the case was whether the right to arbitrate had been waived. The court held that it had not and ordered the trial court to compel arbitration.


One member of a two-member LLC brought suit against the other member, individually and derivatively on behalf of the LLC, seeking equitable damages for breach of fiduciary duty and various other claims. The Chancery Court dismissed the case for lack of subject matter jurisdiction because the LLC agreement contained a choice of forum provision directing that disputes be arbitrated or litigated in California. The Delaware Supreme Court addressed the following questions: (1) whether the LLC, which did not itself execute the LLC agreement, was bound by the provisions of the agreement, and (2) whether contractual provisions requiring all disputes be resolved by arbitration or litigation in California were valid under the Delaware LLC act. The court held that the LLC agreement was binding upon the LLC as well as its members and that the contractual forum selection provisions were valid. The court’s opinion goes into the background and policy of the Delaware LLC act and the principle of freedom of contract under the act. The court rejected the argument that, because the LLC itself had not signed the LLC agreement, the LLC was not bound by the provisions of the agreement. According to the court, “It is the members who are the real parties in interest. The LLC is simply their joint business vehicle.” The court also held that the Delaware LLC act permits parties to agree to vest exclusive jurisdiction of disputes (including derivative claims) in courts outside Delaware. The act expressly permits LLC members or managers to consent to the nonexclusive jurisdiction of litigation or arbitration in a state other than Delaware, to the exclusive jurisdiction of litigation in Delaware, or to the exclusivity of arbitration in a state other than Delaware. The court noted that the act is silent with regard to agreements vesting exclusive jurisdiction of litigation in courts outside of Delaware and concluded that the General Assembly would have prohibited such provisions if it had desired to do so.


Simitar Entertainment, Inc. (“Simitar”) and Silva Entertainment, Inc. (“Silva Entertainment”) formed a Minnesota LLC for the purpose of producing and promoting Tejano music. Simitar and the LLC sued Silva Entertainment and Silva, an individual, alleging breach of contract and numerous other causes of action such as RICO violations, deceptive trade practices, fraud, and breach of fiduciary duty. In a Member Control Agreement governing management of the LLC, an arbitration provision required “any controversy or claim arising out of this Agreement” to be resolved through arbitration. An Employment Agreement between the LLC and Silva also contained an arbitration clause. That clause required arbitration of disputes “of any nature” between Silva and the LLC that “may arise under” the Employment Agreement. The powers of the arbitrator differed under the two agreements in that the Employment Agreement empowered the arbitrator to offer the same degree of relief available through the courts while the Member Control Agreement did not apply to claims involving injunctive relief and only empowered the arbitrator to interpret and apply the provisions of the Member Control Agreement. The Employment Agreement stated that the Member Control Agreement would control any conflict between the two agreements. At the outset, the court noted that it addressed only the motion of Silva, the individual, to compel arbitration, because no motion had effectively been filed on behalf of Silva Entertainment. The court found the scope of the arbitration provisions was limited to damages for
Thus, only the plaintiffs’ breach of contract claim against Silva was referred to arbitration. The court did not question whether the LLC itself was bound by the arbitration provisions in the Member Control Agreement, which was apparently executed by only the two members, Simitar and Silva Entertainment. The court did note in a footnote that the standing of Silva (an individual who was officer, director, and majority shareholder of Silva Entertainment) to enforce the Member Control Agreement was not entirely clear. The court concluded that Silva was entitled to enforce the Member Control Agreement arbitration provision because of his close relationship to Silva Entertainment and because the Complaint alleged that the misconduct of Silva and Silva Entertainment was not only intertwined but imputed from Silva to Silva Entertainment.


This case involved the interpretation of arbitration, change of control, and non-competition provisions of an LLC operating agreement. Two corporations, Metro Riverboat Associates, Inc. (“Metro”) and Bally’s Louisiana, Inc. (“Bally’s”), were the members of an LLC formed to own and operate a gambling riverboat. Although Metro had a majority interest, the LLC operating agreement essentially required consent of both members for significant business decisions. When Bally’s merged with Hilton Hotels Corporation, Metro claimed there was a “change of control” under the operating agreement that permitted most decisions to be made by a simple majority in interest. In addition, Metro claimed that Bally’s was in violation of the non-competition provision of the operating agreement because Hilton Hotels had an ownership interest in another riverboat casino. Eventually, Bally’s made demand on Metro for binding arbitration of their disputes, claiming that arbitration was required by the operating agreement. Metro filed suit asking for injunctive relief against Bally’s. The court examined the arbitration provision of the operating agreement and concluded that the parties’ disagreement was not within the scope of the arbitration clause covering “a dispute. . .with respect to the management and operation of the Company.” Rather, their disagreement was over interpretation of contractual provisions that affected their respective management rights. The court next considered the meaning of the change in control and non-competition provisions and concluded that the limited evidence failed to meet the heightened burden of proof imposed on Metro to obtain injunctive relief.


The court determined that an arbitration clause in an LLC’s operating agreement was not binding on the individual members of the LLC. Faye Becker (“Becker”), the managing member of Bubbles & Bleach, LLC (“B & B”), misappropriated funds of B & B. B & B brought suit in Illinois against Becker under the authority of one of its members for conversion, breach of fiduciary duty, and fraud. The Operating Agreement of B & B and the First Amended and Restated Limited Liability Company Agreement of B & B each contained an arbitration clause that required that arbitration of “any matters arising out of the terms and conditions of the underlying agreement” take place in Wisconsin and be governed by Wisconsin law. Becker moved for dismissal based upon the arbitration clause. The court concluded that neither the Operating Agreement nor the Amended and Restated Limited Liability Company Agreement of B & B was binding upon B & B. The agreements provided that they were binding upon the "parties" to such agreement; however, the term "parties" was not defined. The court noted that the LLC Agreement provided that it was by and among the members of the LLC and that the signatories to each agreement were the members. Further, it noted that the Wisconsin LLC statute defines the term "operation agreement" as a written agreement among the members. The court found that there was no indication that the legislature intended to bind LLCs as entities distinct from their constituent members. According to the court, the fact that B & B was a beneficiary of and subordinate to some of the terms of the agreements did not bind B & B under the arbitration clause. Rather, the arbitration clause was binding only upon the parties to the agreement.

L. Nature of LLC; Mischaracterization of LLC (What’s In A Name?)

DeGeorge v. Warheit, No. 231953, 2003 WL 1879934 (Mich.App. April 15, 2003) (upholding sanctions imposed on plaintiff for asserting frivolous claims without reasonable basis to believe facts in complaint were true, citing as an example the drafting of the complaint as though “T & T Land Clearing, L.L.C., were a corporation, representing to the court the plaintiff and defendant Philip Warheit formed a corporation and filed its articles of incorporation with a state department, when in fact no such document exists for a limited liability company”).

First National Bank of Chicago v. Maynard, 815 A.2d 1244 (Conn.App. 2003) (finding that issuance of bond for deed to LLC rather than individual member who was qualified bidder was irregularity in foreclosure sale because the LLC and its sole member are not the same legal entity, but concluding that irregularity did not cause any harm).
Locascio v. Erie Insurance Group, No. 2002CA00317, 2003 WL 746437 (Ohio App. March 3, 2003) (concluding that insurance policy insured LLC notwithstanding erroneous reference to LLC as partnership where it was clear policy was intended to insure LLC).


Fact issues regarding the type of business entity the parties to an agreement intended to form when they agreed to discharge a corporation’s obligations by forming a “limited liability corporation” precluded summary judgment to recover on the corporation’s obligations. The court found that the erroneous term did not render the agreement invalid or unenforceable, but it did create an ambiguity and a fact question.


The plaintiff sued her employer for hostile work environment and related claims. The complaint inaccurately identified the employer as a partnership rather than an LLC. The LLC’s lawyer contacted the plaintiff’s lawyer informing her of the mistake and offering to accept service of an amended complaint. The complaint was not amended, and the court dismissed it. A year and half later, an amended complaint was filed. In the new complaint, the plaintiff misidentified the LLC as a corporation. Two months later, after limitations had run, the defendant moved to dismiss the complaint, and the plaintiff moved to amend. The trial court denied the motion to amend and granted the motion to dismiss. The plaintiff appealed, arguing the trial court abused its discretion in finding inexcusable neglect on the part of the plaintiff. The plaintiff’s lawyer explained that her files had been moved to off-site storage during the time the plaintiff was deciding whether to pursue a second lawsuit, and she did not have access to the documents showing the defendant was an LLC. The court took issue with this argument, stating that the plaintiff’s lawyer chose not to access her files and to use the Washington Secretary of State’s web site instead. The court acknowledged that the information in the web site is confusing in that LLC information is contained in the corporations database and refers to the “state of incorporation” and “date of incorporation.” Under “category,” the site indicated the defendant was a “limited liability regular.” The plaintiff’s lawyer assumed that LLC meant limited liability corporation. The court stated that the plaintiff’s lawyer had no justification for assuming that the defendant was a corporation given the notice she received in the first lawsuit, the information obtained in the database search, and the availability of the LLC statute. The court concluded the failure to name the defendant as an LLC was inexcusable neglect and that the trial court’s dismissal of the suit and award of attorney’s fees to the defendant was proper.

Housing 21, L.L.C. v. Atlantic Home Builders Company, 289 F.3d 1050 (8th Cir. 2002)(holding that identities of LLC investors, among which were several charities, were irrelevant in suit where LLC, a distinct legal entity, was the sole plaintiff, and informing jurors of identities in response to inquiry from jury during deliberations was reversible error).

Board of Education v. Franklin County Board of Revision, Nos. 01AP-878, 01AP-879, 2002 WL 416953 (Ohio App. March 19, 2002)(distinguishing LLC from partnership, an aggregate of individuals, and characterizing LLC as separate legal entity like corporation for purposes of requirement that it be represented by attorney in property tax valuation dispute, and holding statute permitting LLC member to file a complaint on behalf of LLC unconstitutional insofar as it permits persons who are not attorneys or owners of property to file a complaint before a board of revision on behalf of the owner).


When the relationship between three members of an LLC soured, two of the members sued the third for various breaches of duty and violations of law. One of the claims was for breach of contract. The three members had failed to agree upon and execute an operating agreement, and the defendant argued that the relationship was thus not contractual. The court, however, determined that the claim withstood dismissal at the preliminary stage of the litigation based upon the permissive provisions of the Illinois Act regarding actions by members. The court cited the provision of the Illinois Act that authorizes members to bring an action against the LLC or other members to enforce their rights under the operating agreement or the Act or other rights and interests. The court noted that the statutory provision might not be directly on point but suggested that the breach of contract claim would not offend the spirit of the Act. The court indicated that whether the claim was ultimately viable would depend upon the specifics of how the LLC was structured, i.e., whether it was more like a corporation or a partnership. The court indicated that co-shareholders are not ordinarily
contractually bound to each other while partners are bound by a contract of mutual agency. The court stated that it did not have sufficient information regarding the organizational structure to determine which principle would apply.


The court found that a Delaware LLC falsely represented itself as a joint venture in a bid proposal submitted in connection with construction of a county hospital. The ordinances and the instructions to bidders apparently addressed partnerships and/or joint ventures and corporations but not LLCs. The LLC identified itself as a joint venture and submitted the execution form for a joint venture. The court found that the LLC was not a joint venture for purposes of meeting certain requirements regarding participation in minority and women’s business enterprises and failed to meet certain other requirements. The court stated that the LLC, as a corporate entity, failed to comply with the requirements for corporate bidders. The court found that the LLC encouraged the county to believe that one of the LLC members would be personally responsible as a member of a joint venture when in fact the member would have no liability for the LLC’s obligations.

**Royal Mortgage Corporation v. Montague**, 41 S.W.3d 721 (Tex. App. 2001) (rejecting the argument that an LLC’s partnership returns established that the LLC was a partnership and pointing out that the K-1’s as well as other documentation indicated the company was an LLC).


In this action between two brothers for dissolution of a partnership and partition, the spouse of the plaintiff brother was allowed to intervene for the purpose of asserting that the partnership was actually an LLC. The two brothers had purchased several parcels of real estate and conveyed title to Morelli Properties, LLC. Although the plaintiff’s spouse produced evidence that articles of organization had been filed with the Ohio Secretary of State, her husband alleged that the articles of organization were never filed, that the LLC had never operated as an LLC, and that it had no separate existence apart from the brothers as an implied-in-fact partnership. The brothers argued that the plaintiff’s spouse had at best a dower interest in the properties allegedly transferred to the LLC. The court concluded that the spouse had the right to intervene because she possessed a significantly protectable interest, a decision on the merits would impact her interest, and her interest would not be adequately protected by the existing parties. Additionally, the court concluded that the spouse met the standards governing permissive intervention.


Three members of an LLC submitted a statement during the pre-qualification process associated with bidding on an airport construction project. In the statement, the members identified their entity as “Frontier/Traylor/Shea joint venture” and identified it as a “joint-and-several joint partnership.” Subsequently, the LLC submitted the lowest bid, but the airport commission rejected the bid on the basis that the entity was not pre-qualified since it was an LLC rather than a joint venture partnership, the status indicated by the Frontier entity that was pre-qualified. The LLC sought injunctive relief and argued that it was a joint venture, citing a treatise and some cases referring to an LLC as a joint venture. The airport argued that a joint venture is a form of partnership and cannot take the form of an LLC. The court concluded that the airport commission’s decision was not illegal, arbitrary, capricious, or unreasonable “[g]iven the lack of clarity in the status of when a limited liability corporation [sic] is legally a joint venture and the conflicting documents presented” to the airport commission.

**All Comp Construction Company, LLC v. Ford**, 999 P.2d 1122 (Okla. App. 2000) (stating that an LLC is a fictional “person” for legal purposes and, as such, is not entitled to recover damages for mental stress and anguish as a natural person would).


An LLC defendant was awarded Rule 11 sanctions against the plaintiff and its lawyer based upon their failure to make the reasonable inquiry required under Rule 11. The plaintiff’s repeated erroneous references to the LLC as a limited partnership were among numerous factors the court felt demonstrated the plaintiff’s lack of reasonable inquiry. The court pointed out that certificates of formation and certificates of limited partnership are public records. Furthermore, the plaintiff continued to refer to the LLC as a limited partnership even after the LLC filed motions making it clear it was an LLC. The court gave various other examples of erroneous or unsubstantiated allegations and ordered both the plaintiff and the plaintiff’s lawyers to pay monetary sanctions and write letters of apology.
M. Limited Liability of Members and Managers; Personal Liability Under Agency or Other Law

_Estate of Countryman v. Farmers Cooperative Association_, 679 N.W.2d 598 (Iowa 2004).
The court held that a member or manager of an LLC is not protected from liability for tortious conduct of the LLC if the member or manager participates in the tortious conduct of the LLC. The plaintiffs brought suit for damages arising out of an explosion that killed seven people and injured several others. The LLC supplied the propane gas, and the plaintiffs claimed the LLC’s 95% member, a cooperative association that provided management services under a management agreement with the LLC, participated in the LLC’s wrongdoing through decisions it made in consumer safety matters. Specifically, the plaintiffs claimed that the member/manager’s supervising employee was negligent in various respects. The court concluded that the LLC statute clearly imposes liability on members and managers who participate in tortious conduct. The court compared this approach to the “longstanding approach to liability in corporate settings, where, under general agency principals, corporate officers and directors can be liable for their torts even when committed in their capacity as officer.” The court rejected the argument that an LLC member or manager is liable only for conduct outside the member’s or manager’s role, stating that such an approach is contrary to the corporate model and agency principles upon which the liability of LLC members and managers is based and cannot be found in the language of the statute. The court also distinguished the Louisiana case of _Curole v. Ochsner Clinic LLC_ (summarized below) on the basis that the Iowa statute differs substantially from the Louisiana statute.

_IPO II v. Comm’r of Internal Revenue_, 122 T.C. No. 17, 2004 WL 870256 (U.S. Tax Ct. April 23, 2004) (interpreting Illinois LLC act and finding that it does not impose on LLC member any obligation to contribute towards LLC liability absent provision in articles of organization or written agreement).

_Stanley Weiss Associates, LLC v. Energy Management Inc._, No.Civ.A. 02-1794, 2004 WL 877540 (R.I.Super. April 7, 2004) (concluding that sophisticated businessman, who was aware that tenant was LLC and that there were no guarantors, could not have reasonably relied upon alleged representations and assurances regarding defendants’ liability under lease).

The court granted a pre-judgment remedy based on a showing of probable cause that the individual defendant was personally liable for breach of an agreement with the plaintiff. The individual argued that he had no personal liability, stating that he believed he had formed an LLC and that he took immediate corrective action to properly form the LLC when, after the lawsuit commenced, he found it had not been done. The court pointed out that the agreement was on a form headed by the name of an LLC but designating the individual as the “owner” within the body. Further, the agreement was signed by the individual without any designation that he was a member of the LLC, and the plaintiff was under the impression that he was dealing with the individual.

_County Electric Construction, Inc. v. Zakkar_, No. CV040408889, 2004 WL 970656 (Conn.Super. March 31, 2004) (finding probable cause to sustain pre-judgment remedy against individual who claimed to have made agreement on behalf of LLC where plaintiff presented evidence of bona fide belief that agreement was made with individual defendant rather than LLC).

_Gelinas v. Fuss_, No. CV030070629, 2004 WL 728536 (Conn.Super. March 19, 2004) (stating individual sole member of LLC would not be liable on LLC contracts but may be held liable for his own negligent acts while working on behalf of the LLC).

_Wood v. Hampton-Porter Inv. Bankers_, No. C-02-5367 MMC, 2004 WL 546888 (N.D. Cal. March 11, 2004) (refusing to enter judgment against LLC officers in action to confirm arbitration award because arbitration award was against LLC only, officers were not identified as respondents in petition, and LLC officers are not personally liable for LLC debts and obligations under California law).

_Dygert v. Collier_, No. 20020878-CA, 2004 WL 253554 (Utah App. Feb. 12, 2004) (holding members who acted on behalf of LLC in sale of property by LLC were not personally liable for such acts where plaintiff did not attempt to pierce veil and there was no factual basis for any individual tort liability).

protecting members, managers, and agents from personal liability for debts and obligations of the LLC) because plaintiff failed to allege any facts from which court could conclude that “corporate veil” could be pierced).

American Realty Trust Inc. v. Matisse Capital Partners LLC, No. 02-1148, 2003 WL 22965577 (5th Cir. Dec. 17, 2003) (holding that, under Texas law, truism that business entity may only breach contract through actions of its officers, employees, and agents does not create individual liability on part of those agents nor does it make the agents parties to the contract where party to the contract was LLC).

Hoang v. Arbess, 80 P.3d 863 (Col.App. 2003) (holding that LLC manager’s personal liability for his own negligence or violation of the Colorado Consumer Protection Act in connection with LLC’s construction of residence was issues for the jury, that statutes requiring information disclosure to home purchasers applied to manager personally while manager was acting on behalf of LLC, and that standard of care established by home purchasers applied to manager personally).

Damaska v. Kandemir, 767 N.Y.S.2d 569 (N.Y. App. Div. 1st Dept. 2003) (stating that it could not be determined at pre-discovery stage whether defendant’s role in LLC and/or knowledge or conduct with regard to the alleged sexual harassment and abuse might result in personal liability even though LLC form would generally preclude personal liability).

Young v. Hamilton, No. 01-56557, 01-56573, D.C. No. CV-97-01962-RMB, 2003 WL 22508213 (9th Cir. Oct. 31, 2003) (stating that manager of Utah LLC who relied upon provisions of Utah LLC act limiting liability of LLC managers offered no explanation as to why Utah law would apply in a suit in federal court in California, but that, assuming Utah law applied, Utah courts have imposed personal tort liability on corporate directors and officers for fraudulent acts committed in furtherance of corporate business).

Zukel v. Great West Managers, LLC, 78 P.3d 480 (Kan.App. 2003) (holding that form of execution of contract by LLC manager, which was “curious” in that it did not have either the clear characteristics of an individual execution nor those of a representative execution, unambiguously obligated manager as guarantor considering all the provisions of the contract in a manner to provide consistency and harmony).

Algorithms for Behavioral Care, Inc. v. Reisinger, No. Civ. 3:02CV23 (PCD), 2002 WL 32255507 (D.Conn. July 8, 2002) (noting that a member or manager is not generally liable for the acts of the LLC nor a proper party to an action against an LLC, but further noting that the complaint alleged conduct on the part of the individual defendants creative of liability on their part individually).

Dugan v. Quanstrom, No. 03 C 0254, 2003 WL 22326581 (N.D. Ill. Oct. 9, 2003) (holding that defendant who operated business as sole proprietorship and then as LLC may be held personally liable for acts occurring before formation of LLC pursuant to contract entered by predecessor business and on which he and the LLC became successors, but could not be held liable for acts after formation of the LLC inasmuch as there were no allegations that the member was the alter ego of the LLC).

Nielsen-Allen v. Industrial Maintenance Corp., 285 F.Supp.2d 671 (D.Virgin Islands 2002) (granting LLC member’s motion to dismiss plaintiff’s claims against LLC member based on alleged discrimination and wrongful discharge by LLC because Uniform Limited Liability Company Act protects LLC members and managers from personal liability based solely on status as a member or manager).

Clement Contracting Group, Inc. v. Coating Systems, L.L.C., So.2d ____, 2003 WL 22064233 (Ala. 2003) (holding that sole member/manager of LLC who signed contract with third party in his capacity as member was not personally liable on the contract though he should have signed in his capacity as manager since the LLC was manager-managed).

Glydon v. Conway, No. 01-P-1414, 2003 WL 21665004 (Mass.App. July 16, 2003) (stating that Delaware LLC act governed liability of members of Delaware LLC and holding that members of LLC were shielded from potential liability of LLC as general partner of limited partnership which allegedly breached its fiduciary duty as majority shareholder to minority shareholder of closely held corporation).
Longview Aluminum, L.L.C. v. Industrial General, L.L.C., No. 02 C 0168, 2003 WL 21518585 (N.D. Ill. July 2, 2003) (holding members of LLC were not liable under partnership by estoppel theory, and individual member of LLC who signed contracts as “Chairman” or “Authorized Principal” was not personally liable under LLC or agency law, even though contracts and correspondence failed to identify the LLC as an LLC, because biography of individual furnished to plaintiff identified the LLC as an LLC and articles of organization provide notice under Illinois law).

Mossy Motors, Inc. v. Cameras America, 851 So.2d 336 (La.App. 2003) (holding that plaintiff who contracted with LLC offered no proof of any agreement with or duty owed by individual defendants (who were alleged to be “agents and/or officers and/or principals” of an LLC), and it was thus error to include the individual defendants in the default judgment entered when the defendants failed to answer).

Chaz Concrete Company, LLC v. Lechner, No. 2002-CA-001555-MR, 2003 WL 21361580 (Ky.App. June 13, 2003) (concluding that individual defendants were not entitled to summary judgment because there were fact issues as to whether the individuals acted in such a way as to incur personal liability for materials supplied to their LLCs).


Kobrine, L.L.C. v. Metzger, 824 A.2d 1031 (Md.App. 2003) (reversing lower court’s order that LLC member pay cost of removing rip rap erected by LLC landowner because court has no power to enforce a judgment against a non-party).

Simms v. First Management, Inc., No. Civ.A. 01-2574-CM, 2003 WL 21313928 (D. Kan. May 20, 2003) (granting summary judgment in favor of individual defendant whose only connection to plaintiff’s Fair Housing Act claims was his status as an investor in the LLC that owned the apartment complex, citing case law holding that the Fair Housing Act “imposes liability without fault upon the employer in accordance with traditional agency principles, i.e., it normally imposes vicarious liability upon the corporation but not upon its officers or owners”).

Evans v. Testa Development Assoc., No. CV010806425, 2003 WL 21101307 (Conn.Super. April 24, 2003) (holding that individual who acted only in his capacity as manager/member of LLC was not personally liable for LLC’s wrongful prosecution of prior lawsuit and stating that elementary principle of corporate law that corporation and its stockholders are separate entities also applies to LLCs).

Hoang v. Arbess, 80 P.2d 863 (Colo.App. 2003) (holding that LLC manager, like officer of a corporation, may be held personally liable for approving, directing, actively participating in, or cooperating in negligent conduct and that there was evidence sufficient to hold manager liable so that directed verdict in favor of manager was improper).

Black v. Bruner, No. 04-02-00733-CV, 2003 WL 724312 (Tex.App. March 5, 2003) (concluding that LLC member was not personally liable for LLC’s contractual indemnity obligation in the absence of any evidence that the regulations provided that its members were individually liable for the LLC’s debts).

Imperial Trading Co., Inc. v. Uter, 837 So.2d 663 (La.App. 2002) (affirming trial court’s finding that supplier knew or reasonably should have known that LLC managers were acting in representative capacity and that members had refuted claim of undisclosed agency).

Rothstein v. Equity Ventures, LLC, 750 N.Y.S.2d 625 (N.Y. A.D. 2 Dept. 2002) (stating that LLC members may be held liable if they personally participate in the commission of a tort in furtherance of company business, but finding that allegations did not state viable claim because there were no allegations that defendants knowingly made any false representations inducing plaintiffs to purchase house and allegations regarding improper construction sounded in breach of contract rather than tort).

**Lexington Land Company, LLC v. Howell**, 567 S.E.2d 654 (W. Va. 2002)(referring to LLC and its member interchangeably, but acknowledging in footnote that LLC is separate from its members and that creation of LLC offers its members liability protection).


The plaintiffs, employees of an LLC, sued the LLC, its manager, and certain transferees of the LLC’s property for unpaid wages and losses from unlawful distributions. The plaintiffs obtained a judgment holding the manager liable on these claims. The court of appeals cited the statutory provisions regarding the limited liability of members and managers and reversed the judgment because the manager was merely an agent of the LLC and not a party to the employment contracts with the plaintiffs. The trial court made no findings that the manager itself had agreed to be bound by the employment contracts with the plaintiffs or that the manager employed, terminated, failed to make wage payments to, or was indebted to the plaintiffs. Rather, it was the LLC that employed, failed to pay wages to, and was indebted to the plaintiffs. The trial court also made no findings that the manager was involved in the unlawful distribution of assets so as to support imposing liability based on the distributions.


Members of an LLC who were sued individually moved to dismiss on the basis that the building in question was owned by the LLC, that any contracts with the plaintiff were with the LLC, that the members did not sign any contracts in their individual capacity or guarantee any of the LLC’s debts to plaintiff, and the New York LLC law provides that members are not personally liable for LLC debts. The court denied the motion to dismiss because the statute provides that the articles of organization may provide for personal liability of members, and the members failed to provide a certified copy of the articles organization from which the court could ascertain whether the members had personal liability.


A member of an LLC appealed a judgment holding him personally liable for the LLC’s debt. The basis of the judgment against the member was that he had signed a credit application in the guaranty portion with the designation “member” after the signature. The member argued that the guaranty was ambiguous for various reasons, including the fact that the document was only signed in one place (the credit application portion itself was not signed) and the signature was qualified with the notation “member.” The court held that the document was not ambiguous because the member did not disclose his principal, and the court upheld the trial court’s imposition of personal liability without considering parol evidence.

**Neato, LLC v. Soundview Partners,** 32 Conn.L.Rptr. 219, 2002 WL 145579 (Conn.Super.2002)(construing complaint as alleging fraudulent conduct on part of member individually (for which member would have personal liability regardless of liability protection provided by LLC) rather than an attempt to pierce the veil).

**Fleet One, LLC v. Cook,** No. 4618, 2002 WL 1189559 (Tenn. Ct. App. June 5, 2002)(analyzing agency principles and language of contract in concluding that individual who signed credit application as “operations manager”of LLC did not have personal liability as guarantor).

**Way v. Andries,** 819 So.2d 465 (La. App. 2002)(holding that statutes did not impose personal liability on LLC members or managers for parish taxes).

**Alexander Company, Inc. v. Bensaid,** No. 01-1309, 2002 WL 1034037 (Wis. App. May 23, 2002)(affirming judgment imposing personal liability on member of two-member LLC on basis that members were partnership by estoppel where LLC members did not disclose form of their business to creditor, members used phrases such as “we are going to do this” and “we are going to do that” in meeting with creditor, payment required by creditor before beginning work was check drawn on personal account of member, and letter regarding financial capability from bank indicated that individual member had been approved for loan).

**Christensen v. Rostand Associates,** No.CV010075818S, 2002 WL 1042149 (Conn. Super. May 2, 2002)(denying summary judgment in favor of LLC members with regard to injury occurring on premises owned by LLC because material fact of members’ possession, maintenance, or control of property was disputed).
Kline v. Keystar One, L.L.C., No. 99-1649, 2002 WL 681237 (Iowa App. April 24, 2002)(affirming judgment imposing personal liability on LLC member because issue was not preserved for review).

Quantum Color Graphics, LLC v. The Fan Association Event Photo GmbH, 185 F.Supp.2d 897 (N.D. Ill. 2002)(holding that allegations were sufficient to state claim for personal liability of individual owner of German companies and California LLC on basis that individual acted for partially disclosed principals).

Ehle v. Williams & Boshea, L.L.C., No. Civ.A. 01-3757, 2002 WL 373271 (E.D. La. March 7, 2002)(finding joinder of individual who claimed he could not be liable because he was member of LLC was not fraudulent where there was evidence LLC was never formed and plaintiff asserted claims based upon negotiations to form LLC).

The plaintiff, a doctor employed by an LLC clinic, sued the LLC and several doctors affiliated with the clinic after the plaintiff was terminated, alleging various claims based on tortious interference with business relationship, unfair competition, and defamation. The plaintiff argued that the CEO of the LLC was personally liable for these acts. The court found the CEO was protected under the statutory provision protecting an LLC member, manager, employee, or agent from personal liability. The plaintiff argued that liability could be premised on the language of the statute preserving liability for any negligent or wrongful act of a member, manager, employee, or agent. The court stated that, to give the statute meaning, the phrase would have to refer to acts done outside one’s capacity as a member, manager, employee, or agent, and the allegations did not set forth facts showing the CEO acted outside his capacity as an LLC officer.

First Fairfield Funding, LLC v. SSMLN, LLC, No. X06CV000167489S, 2002 WL 194538 (Conn. Super. Jan. 15, 2002)(seeking to hold LLC manager and member liable based on individual’s own participation in commission of tort rather than status as a member or manager).

The lessor of premises occupied by an LLC sought to hold the individual who signed the lease on behalf of an LLC personally liable on the lease, arguing that the individual signed the lease in his personal capacity. Though the signature form was somewhat ambiguous, the court found the lease as a whole did not indicate that the individual was signing in his personal capacity. The lease stated that it was between two LLCs, a space for the individual to sign as surety was left blank, and the court construed the ambiguity against the plaintiff since the words under the signature lines were provided by the plaintiff.

Two individuals signed a construction contract on behalf of a business that was not designated as an LLC. The individuals claimed that the other parties knew of the agency relationship and understood the individuals were signing in a representative capacity. The court found that there was a triable issue of fact in this regard.

Magara v. Pepitone, No. CV000441504S, 2001 WL 1420664 (Conn. Super. Oct. 26, 2001) (refusing to allow collateral attack on default judgment against individuals who claimed that they were members of an LLC and not personally liable to the plaintiff).

An LLC member appealed a judgment against him personally in the amount of the plaintiff’s earnest money down payment on the purchase of a lot. The court stated that the judgment was proper because the defendant had signed documents relating to the sale without indicating that he was acting as an agent of the LLC.

Harold Cohn & Co., Inc. v. Harco International, LLC, No. CV990089169, 2001 WL 523540 (Conn. Super. May 2, 2001) (relying upon cases in the corporate context holding that an officer or shareholder who commits a tort is liable regardless of whether the corporation is liable and stating that it was unnecessary to pierce the veil of the LLC because the individual himself committed the fraud).

The Kansas Supreme Court held that a member of a Utah LLC was personally liable for unpaid wages under Utah’s wage payment laws, which provided for such personal liability. The court analyzed the Kansas Wage Payment
Law and concluded that it did not provide for personal liability of LLC members because the definition of employer had not been amended to include LLCs along with corporations, partnerships, etc.; however, the court concluded that the Utah wage payment law rather than the Kansas law governed the liability of the members of the Utah LLC for unpaid wages arising out of its business in Kansas. With respect to the interpretation of Kansas law, the court acknowledged that a corporate officer who knowingly permits the corporation to violate the wage payment law would have personal liability under the Kansas Wage Payment Law, but the court pointed out that the wage payment law did not address LLCs, and the Kansas LLC Act not only provided for limited liability of members and managers but specifically provided that an LLC was not to be construed as a corporation. The court concluded, however, that the Utah wage payment law (which is more broadly drafted and under which the LLC member would have liability for unpaid wages) applied even though the LLC was an employer in Kansas because the Kansas LLC Act provides that the laws of the jurisdiction of organization govern the internal affairs and the liability of members. The court construed these provisions to include not only the LLC act but other laws bearing on member liability.

**Rodale Press, Inc. v. Salm**, No. CV000374983S, 2001 WL 496895 (Conn. Super. April 25, 2001) (holding that a member of an LLC was personally liable on the basis that the LLC did business under a trade name without filing a trade name certificate as required by Connecticut law).


The plaintiff sought to hold the individual owner and manager of an LLC liable for breach of contract, but the court determined that the plaintiff’s contract was with the LLC and that the contract adequately disclosed the representative capacity of the individual who signed as “manager.” The court emphasized that the LLC statutes give the term “manager” a special connotation and protect managers from liability to third parties. The court rejected the plaintiff’s arguments that the court should disregard the liability shield of the LLC under the instrumentality or identity rule because the plaintiff failed to plead either theory.

**450 West 14th St. Corp. v. 40-56 Tenth Ave. L.L.C.**, 724 N.Y.S.2d 273 (N.Y. Sup. 2001) (dismissing executrix of the deceased sole member of the LLC on the basis that a member of an LLC is not a proper party to an action against the LLC).


Two individuals who signed a lease on behalf of an LLC argued that the lessor should not recover against them personally because the name of the LLC was incorrect. It is unclear why the defendants thought that the discrepancy in the name protected them from personal liability. It is also unclear whether the discrepancy in the name turned out to be the basis on which they were held liable. In any event, the court refused to modify the lease and entered judgment in the amount of the balance due on the lease.


Whitmore was employed to be the chief operating officer of an LLC. Hawkins, an individual, recruited Whitmore and signed the employment agreement on behalf of the LLC. Hawkins did not sign in an individual capacity, but the employment agreement’s initial paragraph recited that the parties were the LLC, Whitmore and Hawkins. When Whitmore was later terminated, he sought to hold Hawkins personally liable for the severance pay to which he was entitled under the contract. The court found that the agreement was ambiguous with respect to the liability of Hawkins since he did not sign in an individual capacity but was referred to as a party in the contract. The court examined the extrinsic evidence and concluded it was sufficient to create an issue for the jury as to personal liability of Hawkins under the contract. Thus, the court reversed the trial court’s dismissal of Hawkins from the case.


Referring to an LLC member as a controlling shareholder of the LLC’s stock, the court concluded that such status was not alone sufficient to impose liability on the LLC member for the LLC’s copyright or trademark infringement. The court also found that ownership of a significant interest in the controlling member and a position on what the court referred to as the board of directors of the LLC did not amount to a showing of any direct participation and control over the LLC’s activities sufficient to impose liability for the copyright and trademark violations. A corporation that leased employees to the LLC and certain individual officers of the corporation as well as the CEO of the LLC were found to have sufficient involvement in the LLC’s activities to be liable for some or all of the violations.
ABC, LLC v. State Ethics Commission, No. CV 00-0504071S, 2000 WL 1701226 (Conn. Super. Oct. 11, 2000) (mentioning Commission ruling that individual members of an LLC can be subjected to civil penalties with respect to prohibited contingent fee lobbying agreements entered by the LLC).

Addy v. Myers, 616 N.W.2d 359 (N.D. 2000).

The court rejected the plaintiffs’ claim that a member of an LLC agreed to assume personal liability for the LLC’s debt. The LLC involved had four members, consisting of two individuals and two entities. Informally, the group consisted of four families. When the LLC experienced financial difficulties, two individuals in the group personally signed for several lines of credit over a period of months. These individuals argued that the defendant member of the LLC and her husband agreed to assume personal liability for a portion of the debt. The court concluded that the defendant was not liable as a guarantor because she did not sign a written guaranty (as required by the North Dakota Statute of Frauds to enforce a guaranty). The plaintiffs argued that the defendant was liable as a member of the LLC because a majority of the members voted to borrow the funds for the LLC and to assume equally the debt. The court discussed the principle that an LLC is a separate legal entity whose members are not liable for its debts and obligations and concluded that the defendant member was not liable because she did not agree to be liable for any part of the loan. The court of appeals also upheld the trial court’s dismissal of the member’s husband because there was no evidence that he was a named owner or manager of the LLC or had done anything to personally obligate himself on the borrowing in issue.


The plaintiff sued two individuals for breach of contract, and the individuals asserted that they were not personally liable because they were “limited liability partners in an entity known as Windstar Publications, Ltd.” Later in the opinion, Windstar Publications, Ltd. is identified as an Ohio limited liability company. The court noted that the plaintiff had named the individuals as parties, not the LLC, and that the complaint alleged that the individuals had breached their contract with the plaintiff. The court concluded that the complaint stated a claim against the individuals.


The defendants, three individuals, were held personally liable on a contract executed on behalf of “Reo Harvest” without any language or abbreviation indicating that Reo Harvest was an LLC. On appeal, the defendant complained of the trial court’s exclusion of evidence that Reo Harvest was a New Mexico LLC and that the plaintiff had notice of that fact prior to the signing of the contract. The appeals court held that it was not error to exclude the evidence because the defendants had failed to properly plead the defenses that would support their claim of non-liability as members of an LLC. The applicable defenses required verified pleas which the defendants failed to present.


A creditor sued a member of an LLC construction company for payment on a project, and the trial court found in the creditor’s favor. On appeal, the court held that the defendant’s statement of the issues was inadequate, but the court went on to note that the evidence did not preponderate against the trial judge’s findings. The opinion gives little insight into the facts but does note the creditor’s contentions that the creditor was never told of the LLC, that the defendant represented the entity as a joint venture, and that the defendant told the creditor that he and the other LLC member were involved in a partnership.


The plaintiff sought to hold a member of an LLC law firm liable on a promissory note executed by the LLC. The promissory note was executed to repay the plaintiff for negligent legal services provided by the member. The court acknowledged statutory provisions making clear that a member is liable for his own negligent or wrongful acts; however the member in this case was not liable since the action was a breach of contract action for payment of the note and not a malpractice action against the member. The member signed the note as a member of the LLC and on behalf of the LLC, and the contractual obligation represented by the note was an LLC debt from which the member was protected by the statutory limitation of liability of members.


An individual signed a contract as president of an LLC. The court recognized that personal liability of LLC officers, members, and other agents is limited by the Tennessee LLC act and that ordinarily a signature of a corporate officer preceded by the corporation’s name and followed by a designation of corporate capacity is a signature in a
representative rather than individual capacity. However, the contract in question contained personal guarantee language, and the court concluded that the language could not refer to the LLC. According to the court, the language had to reflect the personal guarantee of the individual who signed the agreement.

The plaintiff sued the defendant, an individual, for past due rent the plaintiff claimed was owed under an oral agreement for the sublease of office space from the plaintiff. The same month the defendant arranged for the use of the office space and moved into the space, the defendant formed an LLC. The defendant gave the plaintiff business cards for the LLC and showed the plaintiff his new stationery. The defendant denied that any rent was owed and argued that, if any rent was owed, it was owed by the LLC. The court stated that whether the agreement was entered into by the defendant in his individual or representative capacity was a question of fact, and the court found that the agreement was entered by the defendant individually. The court noted the defendant’s testimony that he did not specifically say he would be renting as an LLC. That the plaintiff may have known the defendant was forming an LLC was insufficient to charge the plaintiff with knowledge that he was dealing with an LLC. As an aside, the court indicated that an LLC could become liable for pre-formation debts just as a corporation may become liable for pre-incorporation debts by acceptance of the benefits of a transaction.

In this case, the court found that the plaintiff's naming of an individual member of an LLC in a nuisance suit was improper and was a basis for sanctions under Rule 11 of the North Carolina Rules of Civil Procedure. The plaintiffs brought a nuisance action against an LLC and a member of the LLC based upon the LLC's plan to build a gas storage facility. The plaintiffs eventually dismissed all of their claims, and the LLC and its member sought Rule 11 sanctions. The court found that the plaintiffs' allegations against the LLC were sufficient to avoid Rule 11 sanctions; however, the court found that the allegations against the individual member were not well-grounded in law and violated Rule 11. The court cited provisions of the North Carolina LLC act providing that an LLC member is not liable for the obligations of the LLC solely by reason of being a member and that a member is not a proper party to a proceeding against an LLC. Since the plaintiffs' complaint did not allege any acts on the part of the member individually, the naming of the individual member was not well-grounded in law and violated Rule 11.

In this case, two individuals who were members and managers of an LLC were held personally liable on a contract with a third party under the partially-disclosed principal doctrine. Under well established common law agency principles, if an agent contracts for a partially-disclosed principal (i.e., the third party knows of the existence of the principal but does not know the principal's identity), the agent is personally liable on the contract as a general rule. In this case, Preferred Income Investors, L.L.C. was identified only as P.I.I. to the third party. The court rejected the argument that the constructive notice provisions of the Colorado LLC act protected the individuals from liability since they failed to adequately identify the LLC principal.

The FTC and State of New Jersey brought an action against an LLC and its member/officers for violation of federal and state consumer protection laws. The court found that the individual defendants were liable under provisions of the Federal Trade Commission Act that make individuals liable for acts of a corporation where the individuals exercise certain control or authority related to the violations. The court concluded that the same standard should apply to determine the liability of LLC members.

An administrative law judge decided that a member of an LLC had personal liability for the tax liability of the LLC, but the Alabama Department of Revenue was not entitled to collect the LLC’s outstanding tax assessment from the member because the member was not assessed in his individual capacity. The Department had twice contacted the LLC about outstanding W-2 forms. When the LLC failed to respond, the Department issued a penalty assessment for each missing W-2. The judge stated that an LLC is treated as a partnership for tax purposes in Alabama, and a member is thus individually liable for the tax (citing the partnership act provision on partner joint and several liability). However, the member was not liable because he was not assessed in his individual capacity (citing the partnership act provision that a judgment against a partnership is not itself a judgment against a partner).
Six parties agreed to enter a venture to build a residential golf course development. Two of the parties, John Zaugg and Marion Zaugg, had an architectural partnership. At the initial meeting of the group, the Zauggs were employed to do architectural work for the project. Part of their payment was to be in the form of an ownership interest in the venture, but no written agreement was entered, and details regarding the arrangement were left unresolved. Ultimately, about a year after the Zauggs began working on the venture, the parties formed an LLC. When the Zauggs submitted their bill to the LLC a few months later, it was a source of contention. The Zauggs and two other members of the LLC signed a statement of understanding in which they agreed that the Zauggs would accept a specified amount in payment for their services. The court upheld the trial court’s judgment imposing personal liability for the Zauggs’ architectural fees upon the other two members who signed the statement of understanding. The court noted that the document did not indicate that the debt was owed by the LLC, and the members signed the document without indicating representative capacity.

N. Veil Piercing

1. Piercing to Impose Liability


The plaintiff sought to pierce the LLC veil of a Delaware LLC and hold its members liable in a breach of contract action. The court held that the question of whether the plaintiff was entitled to a jury trial on the alter ego veil piercing issue was governed by Pennsylvania law. The court concluded that there is no constitutional right to a jury trial on a piercing claim under Pennsylvania law, and it rejected the plaintiff’s argument that the trial court abused its discretion in deciding the piercing claim rather than submitting it to a jury. Finally, the court determined that the trial court did not abuse its discretion in refusing to pierce the LLC veil. The court noted that there was some evidence of lack of formalities, but stated that the lack of formalities must lead to some misuse of the corporate form to justify piercing. The court adopted certain statements by the trial court noting that the plaintiff knew it was dealing with an LLC and failed to obtain any guaranties.

In re Crowe Rope Industries, LLC (Turner v. JPB Enterprises, Inc.), 307 B.R 1 (D. Me. 2004) (noting standard for piercing LLC veil under Maine law is same as for corporation, and concluding Maine law would not permit corporation to pierce its own veil (based on Maine Supreme Court’s rejection of “reverse piercing” by shareholder of corporation to assert corporation’s rights) and thus Trustee could not assert alter ego claim on behalf of estate).


The consignor of an antique table brought an action against the consignee LLC and two of its members. The court held that the consignor failed to prove that the members disregarded “corporate formalities” to such an extent that the entity should be disregarded. The court noted that the trial court found that “some of the corporate formalities were not strictly followed, such as formal Board of Directors meetings and the keeping of minutes. However, there was evidence that other corporate formalities were followed, like filing corporate papers, making corporate loans, having a corporate bank account and operating in the corporate name.”


LaSalle Bank N.A. v. Mobile Hotel Properties, LLC, 274 F.Supp.2d 1293 (S.D. Ala. 2003) (concluding that plaintiff had not alleged sufficient facts for the court to find that LLC which entered the transaction in question was the alter ego of its parent LLC for purposes of holding the parent responsible for the contacts of the subsidiary LLC).

Lester Associates, LLC v. Entertainment Group Fund, Inc., No.00 Civ.3759 LTS MHD, 2003 WL 21750211 (S.D. N.Y. July 29, 2003) (applying Delaware alter ego doctrine to Delaware LLCs and concluding that there were fact issues as to whether the LLCs were alter egos during the events at issue in the case based on evidence of lack of formalities and commingling of funds).

Bonner v. Brunson, 585 S.E.2d 917 (Ga.App. 2003) (holding that evidence did not support piercing LLC veil to hold member personally liable because payments to member, member’s wife, and member’s corporation did not amount to abuse of LLC form by commingling or confusing LLC business with member’s personal affairs).

Rowland v. Franklin Career Services, LLC, 272 F.Supp.2d 1188 (D. Kan. 2003) (holding that plaintiff’s evidence of interrelated operations, centralized control of labor relations, common management, and common ownership gave rise to fact issue as to whether LLC was part of an integrated enterprise with LLC that employed plaintiff so as to constitute a “single employer” for purposes of plaintiff’s Title VII discrimination claim).

Longview Aluminum, L.L.C. v. Industrial General, L.L.C., No. 02 C 0168, 2003 WL 21518585 (N.D. Ill. July 2, 2003) (characterizing failure to use LLC designator as a failure to follow company formalities that does not result in loss of protection of limited liability).

Long v. Pannell, No. E-2002-01792-COA-R3-CV, 2003 WL 21276540 (Tenn.Ct.App. May 30, 2003) (holding that Long and Pannell, individuals who were each limited partners and owned single-member LLC general partners of a limited partnership, dealt with each other through their LLCs and as limited partners and that Long was thus not liable for debts of the limited partnership, apparently rejecting Pannell’s allegations that Long had personal liability on the basis that Long’s LLC was a sham, that the LLC was grossly undercapitalized, that the LLC had the sole purpose of shielding Long from liability, and that Long failed to observe necessary requirements as an officer or agent of the LLC).

In re Trexler (Trexler v. I.P., L.L.C), 259 B.R.573 (Bankr.D. S.C. 2003) (holding that allegation that LLC filed annual reports with Secretary of State and evidence of minutes of meetings indicated that LLC adhered to some formalities and established meritorious defense to veil piercing allegations for purposes of challenge to default judgment, but affirming default judgment because defendants failed to show excusable neglect or other equitable basis for relief).

McGovern Capital, LLC v. Papic, No. CV02190931S, 2003 WL 21267436 (Conn.Super. May 21, 2003) (holding that managing members were not liable under identity or instrumentality rules where members “followed the corporate rules,” did not mingle their funds with the LLC’s, did not borrow or use LLC assets for their own purposes, and did not exercise any greater control than any managing members of an LLC).

KLM Industries, Inc. v. Tylutki, 815 A.2d 688 (Conn.App. 2003) (noting that trial court’s reference to corporate defendant as LLC was incorrect and disagreeing with trial court’s decision to pierce the corporate veil, but agreeing with trial court that the determination of whether to pierce the corporate veil of a stock corporation or to disregard the LLC requires the same analysis).

Advanced Telephone Systems Inc. v. Com-Net Professional Mobile Radio LLC, 59 Pa. D & C.4th 286 (Pa.Ct.Com.Pl. May 15, 2003) (concluding that plaintiff in breach of contract action was not entitled to pierce the veil of an LLC where plaintiff (which was run by sophisticated businessmen) knew it was dealing with an LLC and sought no guaranties).

Dornfried v. Granquist, No. CV000502628, 2003 WL 1996024 (Conn.Super. March 27, 2003) (holding that evidence was not sufficient to pierce veil of single-member LLC and hold member liable for LLC’s breach of contract).

Imperial Trading Co., Inc. v. Uter, 837 So.2d 663 (La.App. 2002) (affirming trial court’s finding that plaintiff failed to prove LLCs were disregarded to extent that they were indistinguishable from their members under corporate
veil-piercing standards, and noting that such ruling did not constitute any opinion as to whether veil piercing is available in the case of LLCs as it is in the case of corporations).

Warburton/Buttner v. Superior Court (Tunica-Biloxi Tribe of Louisiana, real party in interest), 127 Cal.Rptr.2d 706 (Cal.App. 2002).

The plaintiff, a casino developer, contracted with a Delaware LLC controlled by the Tunica-Biloxi Tribe. The Tribe was a 51% member of the LLC when the suit was filed and subsequently became 100% member. The plaintiff sued the LLC for breach of contract and alleged that the Tribe was the LLC’s alter ego. Whether the Tribe had waived its sovereign immunity was in dispute in the case. The trial court denied the plaintiff’s motion to compel discovery and granted the Tribe’s motion for summary judgment on the basis of Tribal sovereign immunity. The appellate court granted the plaintiff’s petition for mandamus, finding that the plaintiff was entitled to proceed with discovery on matters bearing on subject matter jurisdiction/Tribal sovereign immunity. In setting forth the rules regarding liability of LLC members, the court relied upon California law, noting that it had not been provided with any references to how Delaware law may differ from California law in this respect. The court cited the provisions of the California LLC act that provide for limited liability of members and that adopt the common law of alter ego liability. The court appeared to accept the possibility that alter ego liability might be established in reaching its conclusion that discovery should be allowed to proceed. The court referred to allegations of commingling of funds, lack of corporate formalities, and undercapitalization of the corporate entity.


The plaintiff sought to hold an LLC’s member liable for attorney’s fees for breach of a contract between the plaintiff and the LLC. While the jury found that improper undercapitalization of the LLC caused the LLC to breach its contract, the jury found no damages from the undercapitalization. According to the court, the damages resulted from the member’s own breach of its separate contract with the plaintiff (under which the member assumed payment of the LLC’s debts) not from a breach of contract by the LLC for which it might be responsible as an alter ego.


The plaintiff moved for pre-trial equitable attachment of the assets of an LLC member, alleging that the LLC member was liable for the LLC’s breach of contract based on veil-piercing principles. The court denied the motion. The court found that the plaintiff failed to establish he was likely to prevail on the piercing claim. The court cited corporate veil-piercing cases and set forth the following factors considered in a corporate veil-piercing case: insufficient capitalization, non-observance of corporate formalities, nonpayment of dividends, insolvency of the corporation at the time of the litigated transactions, siphoning of corporate funds by dominant shareholders, non-functioning officers and directors other than shareholders, absence of corporate records, use of the corporation for transactions of dominant shareholders, and use of the corporation in promoting fraud. The court acknowledged that the plaintiff’s evidence portended some indicia of control by the member over the LLC but pointed to a dearth of evidence with respect to most of the factors listed above.

Emma Rosina, LLC v. Bilides Building & Excavating, LLC, No. CV020462976S, 2002 WL 31898066 (Conn.Super. Dec. 10, 2002)(striking conclusory allegations of unity of interest, lack of separateness, alter ego, and instrumentality because complaint did not set forth factual basis to support such allegations where plaintiff sought to pierce LLC veil and hold member personally liable).

Iron Workers Local 58 v. Citizens Bank, No. Civ.A. 02-1848, 2002 WL 31427329 (E.D. La. Oct. 25, 2002)(holding allegations that LLC was formed to evade paying plaintiffs moneys owed under collective bargaining agreement, when liberally construed, were sufficient to avoid motion Rule 12(b)(6) motion to dismiss, and individual organizer of LLC might have personal liability under alter ego or successor liability theories).

Mowles v. Predictive Control Systems, LLC, Nos. Civ.A. CV-02-355, CV 02-356, 2002 WL 31546164 (Me.Super. Oct. 22, 2002)(finding veil-piercing allegations were sufficient to state a cause of action against LLC’s 75% member where plaintiff alleged that member “dominates the managerial and financial affairs of [the LLC] in such a way that makes it unjust for him to benefit from [the LLC’s] limited liability”).

landlord and hold members liable for overcharge because corporate status or nature of the business organization must be used to perpetrate fraud, and LLC status of landlord was irrelevant to tenant’s payment of rent).


The plaintiffs sued for breach of a collective bargaining agreement of Universal Music and Video Distribution, Inc. (“Universal”) and sought to hold an LLC in which Universal was a member and the LLC’s other corporate member (“Panasonic”) liable under various theories, including alter ego. The court applied the alter ego doctrine as it has developed in the labor law context and concluded that neither the LLC nor Panasonic were the alter egos of Universal.

**United Automobile, Aerospace & Agricultural Implement Workers of America Local v. OEM/Erie Westland, LLC,** 203 F.Supp.2d 825 (E.D. Mich. 2002)(applying DOL five-factor list and factors from case law regarding corporate “sameness” to determine genuine issues of fact existed with respect to whether LLC and member constituted “single employer” for purposes of WARN Act and breach of collective bargaining agreement claims).


This was a dispute regarding land use, and Pinebrook Properties, Ltd., a Texas limited partnership, owned the lake, dam, roadways, and recreational areas at issue in the case. Pinebrook Properties Management, L.L.C., a Texas limited liability company, was the general partner. The court identified Musgrave, an individual, as the “president and general managing partner”of the LLC. The trial court found that the LLC and the partnership were alter egos of Musgrave and entered judgment against Musgrave individually. The court held that the alter ego doctrine is inapplicable to a partnership, stating that “there is no veil that needs piercing, even when dealing with a limited partnership, because the general partner is always liable for the debts and obligations of the partnership to third parties.” With regard to the finding that the LLC was the alter ego of Musgrave, the court acknowledged that an LLC is a legal entity separate from its members and managers, who are by statute protected from personal liability for the liabilities of the LLC. However, the court did not question the application of the alter ego doctrine to the LLC. The court cited a Texas corporate veil-piercing case in declaring that it would examine the evidence to see if there is such unity between Musgrave and the LLC that separateness had ceased to exist and holding only the LLC as the general partner liable would result in injustice. The evidence of alter ego presented was that the LLC had no checking account, had not filed a tax return, and that Musgrave had sent a letter under his own signature without designating that he signed it in any other capacity. A second letter signed without any designation of a representative capacity was also argued to show lack of regard for the “corporate” structure. However, the court cited the Texas Business Corporation Act and Texas corporate veil-piercing cases for the principle that failure to follow corporate formalities is no longer a factor in determining alter ego under Texas law. The court concluded that there was no evidence of alter ego, pointing to the fact that there was no evidence of commingling of funds or that Musgrave disregarded the corporate structure. The court noted that the evidence revealed that Musgrave was not the sole manager of the LLC (there being two other managers involved) and that there was no evidence that Musgrave used the LLC for personal purposes.


The Wyoming Supreme Court addressed a certified question from the district court in an LLC veil piercing case asking if, in the absence of fraud, the remedy of piercing the LLC veil is available in the same manner as piercing the corporate veil under Wyoming law. The court first reviewed the circumstances under which the corporate veil may be pierced under Wyoming law. The court then turned to the Wyoming LLC act, which states that the members and managers of an LLC do not have liability for the LLC’s debts, obligations, or liabilities, but is silent as to veil piercing. The court concluded that applying veil-piercing principles would not run counter to legislative intent. The court could discern no policy or legal reason to treat LLCs differently from corporations in this regard although the court did note that the various factors which would justify piercing an LLC veil would not be identical to the corporate situation for the “obvious reason that many of the organizational formalities applicable to corporations do not apply to LLCs.” The court found it inadvisable in the absence of a complete factual context to articulate all possible factors to be applied to Wyoming LLCs in the future. The court concluded by clarifying that fraud or an intent to defraud is not required to disregard a corporate or LLC entity.

**In re Securities Investor Protection Corporation v. R.D. Kushnir & Co. (R.D. Kushnir & Co. v. Adler Drobny Fischer LLC),** 274 B.R. 768 (Bankr. N.D. Ill. 2002)(concluding that, while Illinois LLC act precludes piercing LLC veil to hold members and managers liable based on failure to observe formalities, nothing in statute bars piercing the LLC veil on other grounds applicable to corporations).
Collins v. E-magine, LLC, 739 N.Y.S.2d 15 (N.Y. A.D. 1 Dept. 2002)(recognizing statutory liability protection of LLC members and managers and holding plaintiff failed to raise triable issue on alter ego theory in view of “heavy burden to be met if the corporate veil is to be pierced”).

Curule v. Ochsner Clinic, LLC, 811 So.2d 92 (La. App. 2002)(finding allegations insufficient to require an inquiry into whether LLC veil should be pierced to hold CEO of LLC personally liable).


Hesni v. Williams & Boshea, L.L.C., No. Civ.A. 01-3745, 2002 WL 373273 (E.D. La. March 7, 2002)(in context of considering fraudulent joinder assertion, court could not conclude that there was no possibility of personal liability of LLC member given evidence of commingling of funds and failure to follow statutory formalities required for formation).

ABC, LLC v. State Ethics Commission, No. CV 00-0504071S, 2001 WL 1669371 (Conn. Super. Dec. 12, 2001) rev’d for lack of jurisdiction, 826 A.2d 1077 (Conn. 2003) (acknowledging that there are circumstances under which Connecticut law allows disregard of the separate identity of a corporation or LLC but finding no evidence that would permit disregard of the separate LLC existence in this case).


The plaintiffs in this environmental tort action sought to pierce the veil of a Delaware LLC wholly owned by a Delaware corporation. The court looked to the Delaware law on veil piercing because the Mississippi LLC act provides that liability of an LLC member is governed by the law of the state of organization. The court stated that two elements were required under Delaware law to disregard the separate legal existence of the LLC: (1) complete domination and control by the member such that the LLC and its parent operated as a single economic entity, and (2) deliberate and purposeful misuse of the corporate form that results in unfairness, injustice, and injury to the plaintiff. The court found that the plaintiffs had made no allegations regarding the second element. The court stated that intentional undercapitalization is one of the primary ways to satisfy the second element and noted that the plaintiffs had not raised any issue in this regard. Thus, the court granted the defendant’s motion for summary judgment on the veil-piercing claim.

Wisconsin Gas Company v. Bauer, No. 01-0369, 2001 WL 1510625 (Wis. App. Nov. 20, 2001)(rejecting argument that LLC and corporation were actually one company on basis of several common owners and alleged fraudulent concealment of relationship between companies).


The court affirmed an administrative law judge’s conclusion that the alter ego doctrine applied to a single member LLC that acted as a contractor without the required license. The evidence relied upon by the court to establish alter ego included the fact that the California LLC was required to have at least two members and only had one. The court stated that the LLC was thus not legally constituted when it was formed. In addition, the court characterized the LLC’s failure to file the required statement of information with the Secretary of State as a disregard of legal formalities and a failure to maintain adequate records. The court pointed to a unity of interest based upon the sole ownership and control of the member. Finally, the court noted that the member and LLC used the same address.


The plaintiff brought breach of contract, copyright infringement, and unfair competition claims against an LLC and the individual who was president and a member of the LLC. The plaintiff sought to pierce the LLC’s veil to hold the individual personally liable, and the individual sought to have these claims dismissed. The court discussed the corporate alter ego doctrine under New York law and concluded that there were facts to suggest that the individual exercised complete domination and control over all matters concerning the LLC and that such domination was used to commit a wrong. The court noted that the other members of the LLC were the individual’s wife and two daughters, and there were no employees. The LLC’s sole business was to invest the proceeds from business with one of the plaintiffs. The court stated that if the LLC did breach the agreement it had with the plaintiff by misappropriating
confidential and proprietary information, there was little doubt that the individual used his control over the LLC to commit the wrong. Thus, the court declined to dismiss the breach of contract claim against the individual. With respect to the copyright infringement and unfair competition claims, the court stated that the test was whether a corporate officer is a moving, active, conscious force behind the infringement. Characterizing the individual as a corporate officer of the LLC, the court found the plaintiffs had alleged sufficient facts to avoid dismissal of the copyright infringement and unfair competition claims against the individual.


The individual sole member of an LLC argued that there can be no equitable piercing in the context of a member-managed LLC. The defendant relied on the statutory authorization of member-managed LLCs and several law review articles stating that it would be difficult to pierce member-managed LLCs. The court rejected the defendant’s argument, stating that the argument overlooked the “considerable structure” required in the formation and operation of LLCs. The court concluded that the plaintiff had alleged facts that would support a conclusion that the limitation on a member’s liability would not apply in this case.


The court found that there was sufficient evidence to allow the plaintiffs to pursue their alter ego and instrumentality veil-piercing claims against the members of an LLC and a commonly owned LLC. The court discussed various examples of failure to follow corporate formalities and concluded that the standard under Connecticut law did not require any actual fraud to pierce the veil of the LLC on a breach of contract claim. One piece of evidence the court noted in support of the contention that the LLC form was improperly used as a shield to avoid responsibility for contractual obligations was the statement of an attorney for the defendants during a meeting between the parties in which the attorney told the plaintiffs to “go ahead and sue [the LLC]. There is no money in [the LLC]. Why do you think we set it up as an LLC in the first place?”


The members of an LLC that owned property that created a public nuisance were convicted of maintaining a public nuisance. The Commonwealth acknowledged that title to the property was held in the LLC but argued that the defendants should be deemed the owners of the property because they were the sole members in the LLC, shared its profits, and represented themselves to be the owners. The court of appeals recognized the status of the LLC as a separate legal entity and found that the public nuisance offense, placed in its ancient common law context, only authorizes prosecution of the person or entity that holds actual title to the property on which a nuisance continues. Since the evidence established that the LLC and not the individual members were the owners of the property, the convictions were reversed.


The plaintiff sued two LLCs and individuals who were “officers and directors” for breach of contract and conversion. The individual defendants alleged that they were not liable because they executed the contracts as officers and directors of the LLCs. The plaintiff claimed that it would be able to prove that the “corporate” veils should be pierced. The court held that the individual defendants were probably correct in their contention that the complaint failed to allege enough facts to warrant veil piercing, but that the complaints contained adequate allegations that the individuals breached the contracts and had personal liability for conversion, which the court characterized as a possible predicate to veil piercing.


The court stated that the protection afforded by the LLC is not absolute and may be disregarded, as in the case of a corporation, when the LLC is the alter ego or business conduit of individuals. The defendants’ motion to strike on the basis that the action could not be maintained against individuals who were not parties to the contract in issue was denied because the plaintiffs had pleaded alter ego.

**Hollowell v. Orleans Regional Hospital LLC**, 217 F.3d 379 (5th Cir. 2000).

The district court’s opinion denying summary judgment in this case is summarized *infra*. In this WARN Act case, the plaintiffs sued an LLC and various other individuals and entities seeking to pierce the veil of the LLC as well as two corporate members of the LLC on alter ego grounds. The plaintiffs also sought to establish that the LLC and various related entities constituted a single business enterprise. The jury found for the plaintiffs on both the alter ego and single business enterprise issues. On appeal, the defendants argued that there was insufficient evidence to support these findings. The court of appeals noted that neither party challenged the district court’s conclusion that Louisiana would treat an LLC in the same manner as a corporation for veil-piercing purposes. (In an earlier footnote, the court described LLCs as “essentially corporations which the Louisiana tax code taxes as partnerships.”) The court rejected the defendants’ attack on the jury’s findings. With respect to the alter ego finding, the defendants’ challenged the jury’s findings of undercapitalization of the LLC and commingling of funds. The court stated that, even if the court were to accept the defendants’ arguments, the defendants had failed to present a challenge to the jury’s finding of alter ego based upon the “totality of the circumstances.” The court of appeals also rejected a challenge to the jury’s finding of single business enterprise, citing evidence of common ownership, common management, a unified employment policy, and disregard for corporate separateness of the entities.


The court granted a motion to strike allegations that two LLC members and two individuals referred to as directors of the LLC were personally liable under veil-piercing alter ego theories because the allegations were mere conclusions of law rather than facts that would demonstrate the veil should be pierced if proven true.

**Hamilton v. AAI Ventures, L.L.C.**, 768 So.2d 298 (La. App. 2000) (applying corporate veil-piercing principles and upholding the trial court’s piercing of the LLC veil to impose personal liability on an LLC member for breach of the LLC’s contract).


In this employment discrimination case, the plaintiffs sued their employer, a Louisiana LLC. The plaintiffs also sought to hold liable the sole owner of the LLC, a corporation, and an affiliated LLC that served as the manager of the employer LLC. The plaintiffs argued that the three entities satisfied the “single employer” test for Title VII purposes. The court concluded that the plaintiffs failed to demonstrate a sufficient departure from the ordinary relationship between a parent and subsidiary to meet the “single employer” standard. The court listed a number of factors it deemed relevant and concluded that the plaintiffs had not demonstrated that the three entities were “so interrelated, without observing ordinary formalities” or that the LLC was “so dominated, particularly as to its employment decisions” as to justify treating either or both of the affiliates as a single employer with the LLC employer. The court specifically went on to conclude that performance of administrative services and duties by the LLC that served as manager of the employer LLC was not irregular and did not evidence single employer status by the manager LLC.

**Trustees of the Village of Arden v. Unity Construction Company**, No. C.A. 15025, 2000 WL 130627 (Del. Ch. Jan. 26, 2000) (discussing the possibility of piercing the “corporate” veils of an LLC and related corporation on alter ego grounds and finding that similar ownership was insufficient to justify disregarding the business forms).


GMAC sued a real estate development LLC and its sole member for breach of a loan contract. GMAC sought to hold the individual member liable under corporate veil piercing theories. The court referred to the LLC and its member in corporate terms throughout most of the opinion and applied corporate veil piercing principles. The court concluded that GMAC’s pleadings were sufficient to allege a “misuse of corporate form” and an “inequitable outcome if the Court recognizes [the LLC’s] corporate form.” Thus, GMAC survived the member’s Rule 12(c) motion to dismiss the claim. The alleged misuse of “corporate form” was the member’s announced intent to dissolve the LLC after repudiation of the contract. GMAC alleged that a dissolution would deprive it of its ability to recover damages, which the court found to satisfy the requirement that GMAC allege that an “inequitable result” would flow from recognition of the “corporate form.” GMAC also survived the member’s motion for summary judgment. The court said that some of the evidence GMAC produced to show the member’s improper use of the LLC’s “corporate form” included: undercapitalization of the LLC on formation, payment of a deposit by a related company controlled by the member, and methods by which the LLC distributed funds.

In this sexual harassment case against two LLC stock brokerage firms, the plaintiff sought to hold two corporations alleged to be controlling members of the LLCs as well as the ultimate parent and another affiliate liable for the conduct of the LLCs. The court discussed corporate veil-piercing principles and concluded that the plaintiff had failed to plead facts warranting a “piercing of the corporate shield.” The court thus dismissed the action as to the defendants other than the LLCs.


The court held that the plaintiff failed to establish a breach of contract, thus arguments regarding veil piercing to make the members of the LLC personally liable were moot.


The trial court in this case held a member of an LLC personally liable for a debt of the LLC. On appeal, the court reversed. The trial court’s comments are worth noting. The judge started out by stating that it was a problem that no one had filed any documents to show what the LLC agreement stated. The court went on to note that “the rules of dissolution apparently were not followed” because creditors were not notified and articles of dissolution were not filed. In awarding the plaintiff judgment on its claim, the judge stated:

Haack signed . . . an agreement for Kickapoo Valley Freight LLC, but it would appear to me that the corporation was just a shell around which there were no real intentions to operate like a corporation because there was no intent even to dissolve the corporation, and the court’s going to find that the corporate veil is pierced by the fact that the people were acting like a partnership, being taxed like a partnership, and haven’t even dissolved the–

. . . . I’m treating this as a partnership and assessing liability to the remaining partner . . . That’s the evidence that’s before me, and unless I would have some other evidence that was not presented, I have to treat this matter as a partnership and assume that the limited liability agreement did not alter the normal partnership liability situation.

(The opinion refers to the judgment as a “small claims judgment,” and presumably the individual was not represented by counsel at the trial.) On appeal, the court first noted that the Wisconsin LLC act imports corporate veil-piercing principles. However, the appeals court found that there was insufficient evidence to pierce the veil of the LLC. The appeals court stated that the trial court’s comments implied that it “erroneously deemed Kickapoo Valley’s treatment as a partnership for tax purposes to be conclusive.” The court noted the lack of evidence to support a conclusion that the member dominated the LLC such that it had no separate existence or was an instrumentality for injustice. The court of appeals upheld the judgment against the member, however, on the basis that she did not take appropriate steps to shield herself from liability upon dissolution and distribution of the LLC’s assets. The court noted that filing articles of dissolution and notifying creditors are apparently optional under the Wisconsin statute, but the rules for distribution of assets on dissolution and the priority of creditors are fixed by statute. LLC creditors whose claims are not otherwise barred under the statute may pursue LLC members to the extent of the member’s proportionate share of the claim or the assets of the LLC distributed to the member in liquidation. Since the member did not prove that the plaintiff’s claim exceeded the value of any assets she received, the court affirmed the judgment.


The plaintiff sued its LLC landlord and sought to pierce the LLC veil to hold liable the member who signed the lease on behalf of the LLC. The trial court concluded that the member was personally liable. The court of appeals reversed. The court of appeals first noted that the Minnesota LLC act makes the corporate veil-piercing cases applicable to LLCs. After reciting the conditions under which Minnesota courts will pierce the corporate veil, the court concluded that the record did not establish the injustice or fundamental unfairness required to pierce the veil. The member did not intentionally mislead the plaintiff, and the plaintiff did not come with clean hands because its own conduct contributed to the breach of the lease.

The bankruptcy court cited Arizona corporate veil-piercing cases in concluding that the founder and manager of the LLC defendant had no personal liability on the claims against the LLC. The bankruptcy trustee argued that it was not necessary to pierce the veil of the LLC because the individual was a party to a plan to engage in collusive bidding under Section 363(n) and was liable for his own conduct. However, the court characterized this argument as “an attempt to make an end run around the protections afforded shareholders, directors, and officers by the corporate form” and as unsupported by the evidence. In addition, the agreement in question was signed on behalf of the LLC in a representative capacity rather than an individual capacity.


In this breach of contract action by Burton against an LLC and its sole member, the appeals court upheld the trial court's refusal to pierce the LLC veil. The appeals court also found no error in the trial court's refusal to hold the member liable for misrepresenting that a number of other individuals were also members of the LLC. Burton argued that the LLC's veil should be pierced because the LLC was undercapitalized and inadequately financed. However, the court noted that Burton was aware the LLC was a new entity and that the financing of the project was to be accomplished through a bank loan. The court was not convinced under these facts that it should disturb the trial court's ruling. The court found that Burton's misrepresentation claim against the member failed because there was evidence to support the trial court's finding that Burton had not reasonably relied on the member's misrepresentations regarding membership in the LLC. In this regard, the court pointed out that Burton acknowledged that he was aware LLCs were designed to limit an investor's liability. Further, apparently satisfied with having a mortgage on the land that was the subject of the contract, Burton testified that the financial capability of the individuals listed as members was none of his business.


In this WARN Act class action against various individuals and health care organizations, the court discussed veil piercing under Louisiana limited liability company law. After discussing corporate veil piercing and citing numerous commentators on LLC veil piercing, the court concluded that the veil of the defendant LLC could be pierced if the LLC acted as the "alter ego" of its members or if the LLC's members committed fraud or deceit on third parties through the LLC. The court concluded that there were fact issues precluding summary judgment on the veil-piercing claims. The court also discussed the application of the WARN Act single business enterprise doctrine to the LLC and related co-defendants. The court recognized that the analysis overlapped somewhat with that involved in veil piercing and concluded that summary judgment was inappropriate on this claim as well.


The court considered the United States' "Motion to Set Aside as Fraudulent Conveyance Forfeited Property or in the Alternative a Determination That K & J Limited Liability Company is the Alter Ego of the Defendant Beryle Johnston." The court concluded that a transfer of certain real property from a partnership to an LLC was fraudulent and thus did not reach the alter ego question.


In this Fair Debt Collection Practices Act suit, the plaintiffs attempted to hold Mr. Deloney, who was apparently the sole member and manager of an LLC law firm (the plaintiff alleged that Deloney was the "sole shareholder, sole director and president"), personally liable for the actions of his firm on the basis that he was the alter ego of the LLC. The court noted that most commentators assume that veil-piercing theories apply to LLCs, and the court analyzed the claim applying the traditional corporate alter ego doctrine. The court concluded that the plaintiffs had not produced sufficient evidence at the summary judgment stage to pierce the LLC veil and hold Deloney liable as a matter of law.

In re Multimedia Communications Group Wireless Assoc.s of Liberty County (Mills v. Webster), 212 B.R. 1006 (Bankr. M.D. Fla. 1997).

Two individuals formed a corporation and an LLC to offer Direct TV services to rural areas. Later, the LLC filed a Chapter 7 bankruptcy petition. The trustee filed a complaint against the individuals and several related corporations and LLCs, seeking a declaratory judgment that the affiliated companies were alter egos and instrumentalities of one another. The court discussed and applied corporate veil piercing principles but concluded that the circumstances did not warrant piercing the veil in this case.

In this federal maritime veil piercing case, the court pierced the veil of a number of entities, but it is unclear whether the LLCs mentioned in the case were among these entities. The plaintiff in the case sought to hold two individuals, Backstrom and Lindholm, and various related entities liable for a judgment the plaintiff had obtained against a shipping company controlled by Backstrom and Lindholm. The court identified "53 individual, corporate, partnership and trust defendants." In fact, two of the defendants were Colorado LLCs. The court applied federal common law to pierce the corporate veil of numerous shipping and real estate corporations, holding that these corporations were merely alter egos of Backstrom and Lindholm. Additionally, the court stated that it was piercing the "corporate veil of various other entities" that were fraudulently created for Lindholm personally. This is an apparent reference to part or all of a group of entities that owned substantial real and personal property in Colorado. This group consisted of a grantor trust, two corporations, a limited partnership and two LLCs. These entities were not directly part of the shipping and real estate enterprise operated by Backstrom and Lindholm but were personal investment vehicles of Lindholm. Although the two LLC defendants were identified by the court as part of this latter group of entities, it is unclear from the opinion whether the LLC veils were actually pierced. The court specifically found that the limited partnership and its corporate general partner were alter egos of Lindholm and expressly disregarded their "corporate" existence. The court did not specifically address the LLCs in this way. The opinion does not indicate the basis for exercising jurisdiction over the LLCs, but it appears that jurisdiction may have been premised upon the fact that the LLCs were alter egos of Lindholm. The court noted that the LLCs were among defendants that had contested jurisdiction, and the court adopted a special master's recommended ruling that jurisdiction was present. In an earlier reported decision, the court had postponed deciding whether the LLCs and certain other defendants were subject to jurisdiction based upon their alter ego status to provide the plaintiff an opportunity to engage in discovery on the alter ego issue. See Northern Tankers (Cyprus), Ltd. v. Backstrom, 901 F. Supp. 72 (D. Conn. 1995).

2. Reverse Piercing

Devan Lowe, Inc. v. Stephens, 842 So.2d 703 (Ala.Civ.App. June 14, 2002)(permitting garnishment of payments to LLC to satisfy judgment against member on basis that LLC was sham established for fraudulent and illegal purpose of evading judgment creditor).


The court upheld the trial court’s reverse piercing of the LLC veil of two LLCs under the instrumentality and identity theories. After a default judgment was taken against Mary Ann Howell, she reorganized her business into two new LLCs. Howell’s husband and daughters had small interests in the parent LLC, but the evidence showed that only Howell was active in the business. The evidence also showed that Howell never drew a salary or regular distributions, but she used LLC funds to pay personal expenses and provide substantial, interest-free loans to family members. The court reviewed policy arguments for and against reverse piercing and concluded that reverse piercing to allow the judgment creditor to reach the assets of the LLCs was appropriate. The court rejected the argument that the plaintiff was required to prove fraud to pierce the LLC veil. The court found that Howell had used her control of the LLCs to unjustly avoid her personal debt to the plaintiff because the LLC’s payment of her personal expenses directly rather than paying salary or regular distributions deprived the plaintiff of any means of collecting the judgment against Howell.


A judgment creditor garnished the bank account of an LLC after obtaining a judgment against two corporations affiliated with the LLC. The LLC was formed after the creditor initiated its lawsuit against the corporations. The LLC was funded by all of the assets of one of the corporations, which became the sole member of the LLC, and the revenues from the business that had been operated by the corporation thereafter went to the LLC. The court found that the LLC and related corporations were alter egos of one another, that fraudulent conveyances had occurred, and that the judgment debtors and related parties had acted in concert to insulate assets from the judgment. The entities were set up in a tiered structure, but one individual was the ultimate owner and was the president or manager of all the entities. The court noted that assets were moved “gymnastically” among the entities for what were claimed to be tax reasons unsupported by the evidence. Since the LLC was the alter ego of an entity named in the garnishment, the court held that the garnishment of the LLC’s account was proper.


The defendants filed several counterclaims against Trans Union LLC and Acxiom Corporation. The defendants sought to hold Acxiom liable for the acts of Trans Union, Acxiom’s largest shareholder, on the basis that Acxiom was
Trans Union’s alter ego. The court noted that recovering from a subsidiary for a parent’s wrong is somewhat unorthodox, but, because the court ultimately found that alter ego was not sufficiently pled, the court stated that it expressed no opinion on whether such a reverse-piercing is tenable. The court discussed and applied corporate veil piercing principles, equating an LLC to a corporation for these purposes. (After stating that both Acxiom and Trans Union were Delaware corporations, the court explained in a footnote that “Trans Union is technically a limited liability company, not a corporation, but the corporate form is still defined by Delaware law.”) The only allegations to support the conclusory allegation of alter ego in the complaint were that Trans Union was the largest shareholder of Acxiom and that Trans Union placed two directors on Acxiom’s board. The court stated that these allegations were insufficient to support a veil piercing claim. The court pointed to the absence of any allegations about corporate formalities, capitalization, solvency, or how there was any facade.

3. Piercing to Enable LLC to Enforce Contract of Member or Another

*Holmes Development, LLC v. Cook*, 48 P.3d 895 (Utah 2002)(stating in footnote that, although LLC claimant and related LLC may have the same management and be practically indistinguishable, they are legally separate entities, and court would not treat the LLCs as the same entity for purposes of standing to sue on a contract).


In this case, a construction contractor operating as a sole proprietor entered a construction contract with an arbitration clause. During the course of the construction work, the sole proprietor reorganized as an LLC. The contract contained a clause prohibiting assignment of any monies due under the contract without consent of the owner. The court held that the LLC could enforce the arbitration clause of the contract because the individual sole proprietor and the LLC were "practically identical." The court began its discussion of the "identity rule" with references to the concept of piercing the corporate veil. The court recognized that the rule "is more often applied in cases where an individual attempts to hide behind the corporate veil to avoid his legal obligations;" however, the court then stated that "there is no conceptual reason not to apply the rule to avoid injustice here." (The Connecticut Supreme Court affirmed the result in this case but did so by treating the organization of the LLC as a conversion rather than relying on veil piercing principles.)

4. Piercing to Obtain Jurisdiction Over Members or LLC

*XL Vision, LLC v. Holloway*, 850 So.2d 1063 (Fla. App. 2003) (exercising personal jurisdiction over LLC’s president and foreign parent where complaint alleged that parent and president were personally liable as alter egos of LLC and that they formed, operated, and manipulated the LLC to defraud creditors, that they commingled funds, that they failed to maintain other corporate formalities, that the parent directly paid for liabilities of the LLC, and that the LLC was run by the parent and president for their benefit).

*Benson v. City Finance Co.*, No. 1:02CV242-D-D, 2003 WL 21517998 (N.D. Miss. May 16, 2003) (concluding that, under Mississippi LLC act, Delaware law controlled determination of whether the plaintiffs could pierce the veil of a Delaware LLC to exercise personal jurisdiction over the LLC’s member based on the LLC’s contacts with the state of Mississippi, and holding that the plaintiffs failed to allege sufficient facts to show deliberate and purposeful misuse of the LLC’s corporate form resulting in unfairness, injustice, and injury to the plaintiffs as required under Delaware veil piercing test).

*Nadler v. Grayson Construction Co., Inc.*, 34 Conn. L. Rptr. 482, 2003 WL 1963158 (Conn.Super. 2003) (concluding that allegations that LLCs and various affiliates, members, and managers were alter egos of one another supported subject matter jurisdiction over the parties).

*Yukon Partners, Inc. v. The Lodge Keeper Group, Inc.*, 572 S.E.2d 647 (Ga. App. 2002)(holding, in context of challenge to personal jurisdiction, that existence of unspecified affiliation was insufficient to pierce veil of numerous hotel LLCs in absence of showing that entities were sham or used to defeat public convenience, justify wrong, protect fraud, defend crime or any other reason which would in equity or good conscience justify disregard of entities).

*International Bancorp, L.L.C. v. Societe des Bains de Mer et du Cercle des Entrangers a Monaco*, 192 F.Supp.2d 467 (E.D. Va. 2002)(holding that record did not support piercing LLC veil to subject member to court’s
personal jurisdiction under “stringent” Virginia veil piercing standard requiring “proof that the alleged alter ego used the corporation to disguise some legal wrong”).

*Quantum Color Graphics, LLC v. The Fan Association Event Photo GmbH*, 185 F.Supp.2d 897 (N.D. Ill. 2002)(holding that claims against two German companies and California LLC may be aggregated for jurisdictional purposes, and contacts could be imputed among defendants, on basis of allegations that companies were all alter egos of one another and individual defendant owner).

*Stauffacher v. Lone Star Mud, Inc.*, 54 S.W.3d 810 (Tex.App. 2001)(holding that individual failed to negate plaintiff’s theory that individual was alter ego of a Wisconsin LLC for purposes of court’s exercise of personal jurisdiction over individual).


The court stated it need not decide whether the fiduciary shield doctrine should apply in Minnesota so as to protect the sole owner and president of an LLC from the court’s exercise of personal jurisdiction because the actions of the individual fell outside the protections of the doctrine. In this regard, the court concluded that the plaintiff alleged facts sufficient to pierce the veil of the LLC.

*Royal Mortgage Corporation v. Montague*, 41 S.W.3d 721 (Tex. App. 2001)(concluding there was no evidence that LLC was acting as alter ego of its members for purposes of personal jurisdiction over members).

*Oliver v. Boston University*, No. 16570, 2000 WL 1038197 (Del. Ch. July 18, 2000)(concluding that LLC was Boston University’s alter ego for purposes of personal jurisdiction assuming truth of allegations that LLC was formed by BU solely to serve its interest and was completely dominated by BU).


The plaintiffs sued Kabro of East Lyme, LLC (“East Lyme, LLC”), a New York LLC, for breach of a contract to purchase real estate from the defendants. Additionally, the plaintiffs sought to pierce the veil of East Lyme, LLC and hold several other non-resident parties personally liable under veil piercing theories. Initially, the plaintiffs relied upon veil-piercing principles to give the court personal jurisdiction over the other non-resident parties. The court concluded it had jurisdiction over one LLC member who was instrumental in the negotiations of the real estate transaction in issue but found that the plaintiffs had not alleged sufficient facts to pierce the veil to obtain jurisdiction over the other members of the LLC under either the instrumentality or identity test. The plaintiffs also failed to convince the court that it had jurisdiction over another New York LLC that allegedly provided funds to East Lyme, LLC.


The court described the defendants as limited liability companies organized under the laws of Hong Kong and the People’s Republic of China. The court found the companies lacked sufficient contacts with the State of Texas to support general or specific jurisdiction. The court also rejected the plaintiff’s argument that the companies were alter egos of one another and of a Texas corporation such that the Texas corporation’s contacts should be imputed to the foreign companies. The court noted both a lack of evidence and a lack of cited authority for the alter ego argument.


The court determined that it lacked personal jurisdiction over LLC members based upon the fiduciary shield doctrine (described by the court as prohibiting the exercise of personal jurisdiction over a nonresident whose only contacts with the forum state were "solely on behalf of his employer or other principal"). The plaintiff attempted to avoid the effect of the fiduciary shield doctrine by relying on the corporate alter ego doctrine. The defendants countered with an affidavit reciting that the LLC’s assets were not treated as the assets of the individual defendants, that the LLC maintained necessary corporate records, that the LLC did not commingle its assets with those of the individual defendants, and that the LLC maintained a separate banking account. The affidavit was uncontradicted, and the court rejected the alter ego argument.
5. Piercing in Other Contexts

In re Application of Donald J. Trump, 755 N.Y.S.2d 618 (N.Y.A.D. 1 Dept. 2003) (stating that “artificial distinction” sought to be drawn between individual petitioner and his wholly-owned LLC did not preclude arbitration under arbitration clause in agreement to which LLC was a party).

Somerville S Trust v. USV Partners, LLC, No. Civ.A. 19446-NC, 2002 WL1832830 (Del. Ch. Aug. 2, 2002) (finding credible evidence of mismanagement of LLC in action to inspect books and records of LLC based in part on evidence that individual who was sole member of LLC’s manager used LLC as his alter ego).


Abrahim & Sons Enterprises v. Equilon Enterprises, LLC, 292 F.3d 958 (9th Cir. 2002)(rejecting argument of franchisors that LLC jointly owned by franchisors was not separate entity for purposes of California franchise law that gives right of first refusal to franchisees before franchisor may sell or transfer to another person premises leased to franchisee).

Egle v. Egle, 817 So.2d 136 (La. App. 2002) (finding ex-wife raised possibility that defendants were solidarily liable with ex-husband so as to interrupt prescription in case where ex-wife alleged ex-husband hid community assets and diverted them to a number of corporations and LLCs owned and controlled by him as a single business enterprise).

Robinson v. Geo Licensing Company, LLC, 173 F. Supp.2d 419 (D. Md. 2001) (rejecting attempt to treat majority member and LLC as a single entity and recognizing member’s ability to sue LLC on contract made with LLC).


In this Chapter 11 case in which a mortgageholder sought relief from the automatic stay to foreclose a mortgage, the court found as facts the mortgageholder’s unchallenged assertions that the debtor LLC and a related corporation were “for all intents and purposes one entity.”

In re Lake Country Investments, L.L.C. (Agnicourt, L.L.C. v. Stewart), Nos. 99-20287, 00-6064, 2001 WL 267475 (Bankr. D. Idaho March 19, 2001) (stating that there were fact issues regarding whether the managing and majority member of an LLC was the alter ego of the LLC in the context of an equitable subordination claim).


A suit was mistakenly filed in the name of a corporation rather than an affiliated LLC. The suit was dismissed due to the corporation’s lack of capacity, and (after various missed opportunities to cure) the LLC ended up being barred by res judicata from pursuing the complaint refiled in its name because the LLC was in privity with the corporation that filed the initial complaint. In finding privity, the court relied in part upon the failure of the LLC and the corporation to comply with the formalities necessary to maintain separate existences. The court commented that the LLC’s own counsel was confused about which entity was his client.


In the course of responding to a creditor’s complaint regarding the debtor’s valuation of stocks and interests in incorporated and unincorporated businesses, the court noted that there was no evidence to pierce the respective “corporate veils” of the separate corporate, partnership, and limited liability company entities involved.
O. Legal Notice Requirement


P. Formation of (or Failure to Form) LLC

Three individuals agreed that the business they were forming would be an LLC but never finalized a draft operating agreement and never signed any written agreement. One of the individuals wrote a letter confirming the terms of the partnership agreement that he alleged existed among them, and the defendant called this individual the same day and expressly recognized the terms of the partnership agreement set out in the letter were correct. There was other evidence that the parties carried on the business as a partnership. The defendant claimed, however, that he was the sole owner of the business. The jury found that a partnership existed between the two plaintiffs and that the defendant’s failure to acknowledge the partnership was a breach of fiduciary duty. The trial court entered judgment for the plaintiffs, and the court of appeals affirmed the judgment.

Lester Associates v. Commonwealth, 816 A.2d 394 (Pa.Cmwlth.Ct. 2003) (concluding that there was no legal transfer of title on which transfer tax could be imposed based on deeds into and out of LLC where LLC did not exist at the time of the purported conveyance to it).

Ehle v. Williams & Boshea, L.L.C., No. Civ.A. 01-3757, 2002 WL 373271 (E.D. La. March 7, 2002) (finding that joinder of individual who claimed he could not be liable because he was member of LLC was not fraudulent where there was evidence the LLC was never formed and plaintiff stated claims based upon negotiations to form LLC).

Two parties signed a “Pre Organization Agreement” in which they agreed to form an LLC and then to form an S corporation or LLP within 60 days of the contract. The contract stated that the LLC would pay specified sums to the S corporation or LLP, and the sums were set out by the names of each party and referred to as “contributions.” Each party was to be issued a certificate to reflect a specified percentage of ownership in the new S corporation or LLP. The contract had a “pullout” clause allowing any member to withdraw and be reimbursed his initial capital contribution. The contract also provided for reorganization of the S corporation or LLP to reflect equal ownership when all initial capital contributions were refunded. The court held that this contract unambiguously obligated the parties to contribute the sums specified to the LLC.

This dispute arose out of an agreement between the parties to refinance, renovate, sell, and divide the proceeds of the residence of one of the parties. The original agreement contemplated that an LLC would be formed to hold the property, with ownership of the LLC equally divided between the parties in “shares of stock.” Title to the property was transferred to the party who obtained the financing but was not transferred to an LLC. The court found that the failure to transfer title to the property to the LLC did not involve any fraud or unjust enrichment. The court found that the party who took title and obtained the financing had intended to convey title to an LLC, but the parties abandoned this plan when they discovered that the transfer would involve another transfer tax. The court went on to find that the parties owed each other only limited fiduciary duties in connection with their partnership or joint venture arrangement.

Two individuals signed a letter of intent to create an LLC. Each of them took certain steps toward operating the business such as applying for a credit card, requesting an employer identification number, and opening a bank account, but the LLC was never formed. The court concluded that the business was a partnership and that the defendant’s fraud in failing to organize the LLC as promised, converting business funds, and defrauding the plaintiff out of the funds entitled the plaintiff to rescission of the partnership.

According to the plaintiff Nystrom, in February 1998, Nystrom and Ward agreed to form an LLC to which Nystrom would devote 75% of his time acting as “President” and in which Nystrom would receive in exchange for his
services a 25% ownership interest. In October 1998, articles of organization were prepared (and apparently filed). An operating agreement was also prepared, but Ward repudiated the agreement and denied promising a 25% interest to Nystrom. In December 1998, Ward, acting as “chairman” of the LLC, fired Nystrom as president. The court concluded that the facts as pled by Nystrom stated a cause of action for fraud in the inducement, breach of contract, and quantum meruit.


The issue in this case was whether the court should grant injunctive relief requiring removal of a lis pendens obtained by the plaintiff in the case. The underlying dispute involved breach of contract, breach of fiduciary, and related claims based upon the plaintiff’s contention that the defendants refused to sign a proposed operating agreement that would have formed an LLC to develop certain real property. The court did not address the plaintiff’s contention that the parties had a joint venture agreement that was violated when the defendants refused to sign the operating agreement. The court only examined whether the standard for the preliminary injunctive relief sought by the defendants had been met, and the court determined that it had.


Two individuals, Holmes and Lerner, came up with a novel idea for cosmetics and agreed to go into business together to develop and market their “Urban Decay” line of cosmetics. Without informing Holmes or including her in the ownership, however, Lerner and her business consultant, Soward, formed an LLC to produce and market Urban Decay. Holmes was included in periodic “board meetings” of the business both before and after formation of the LLC, and she worked in the business on a day to day basis, but her inquiries regarding her role in the business were met with vague answers. Eventually, Holmes learned that the business was being conducted as an LLC. She continued to participate in the business for a few months after learning of the LLC, but the relationship finally went completely sour, and Soward told her she was no longer welcome. The case was tried and decided under partnership law, and the court only mentions the LLC in the course of discussing the facts. Holmes sued Lerner and Soward and prevailed on various causes of action including breach of an oral partnership agreement between Holmes and Lerner. The appeals court upheld the trial court’s determination that a partnership was formed between Lerner and Soward. The court discussed the Uniform Partnership Act and case law relevant to formation of partnerships and concluded that no express agreement to share profits is necessary to form a partnership. According to the court, an understanding to share in profits and losses was implicit in the Holmes-Lerner agreement. The court also found that the agreement was sufficiently definite. Soward was found liable for conspiracy and aiding and abetting fraud and breach of fiduciary duty. Holmes was awarded compensatory damages for the loss of her partnership interest. In this regard, the jury was instructed that the appropriate measure of damages was half the value of Urban Decay at the date of the breach of the agreement. The case was apparently tried under the theory that the date of the breach was the date on which Holmes was told she was no longer welcome. The jury also awarded punitive damages.


The court of appeals affirmed the decision of the district court rescinding an operating agreement on the basis of unilateral mistake and constructive fraud. A partnership converted to an LLC, but the managing partner did not inform the others that he did not intend to continue in his management role after the conversion. The LLC operating agreement did not appoint the individual as managing member, but the other members assumed he would take on the position consistent with his role in the partnership. The court found the concealment amounted to constructive fraud because it breached the fiduciary duty of the managing partner to disclose material information. Thus, the court upheld the trial court’s rescission of the LLC operating agreement. (The district court’s opinion is available at 1997 WL 150052 (D. Kan. Jan. 29, 1997)).


In litigation involving an alleged breach of a joint venture agreement, the court held that the attorney-client privilege as to documents relevant to the formation of an LLC had been waived when the client injected as a new issue in the case the argument that formation of the LLC was a condition precedent to formation of the joint venture. Two businesses allegedly agreed to enter into a joint venture agreement which involved formation of a new LLC. One of the prospective members brought suit. The LLC was never created, and the other prospective member argued that formation of the LLC was a condition precedent to the formation of the joint venture. Ruling on a discovery dispute, the court held that documents relevant to formation of the LLC were not protected by the attorney-client privilege and must be produced. Because it had already ordered the documents produced, the court did not find it necessary to address
the plaintiff’s argument that the law firm which undertook the responsibility of filing the articles of organization (referred to by the court as “articles of incorporation”) owed the plaintiff, as a prospective one-half owner, a duty of full disclosure of all instructions and communications relating to the endeavor.


Two individuals, Heath and Moon, established a business called "Advanced Orthopedics, L.L.C." Heath filed LLC articles of organization and an initial report with the Secretary of State's office, and a certificate of organization for Advanced Orthopedics, L.L.C. ("Advanced") was issued. Heath and Moon had a falling out. Moon established his own competitive business and then resigned from Advanced. Litigation ensued. The specific issues addressed by the court in this opinion were essentially (1) whether Advanced constituted a legally formed LLC and (2) whether Moon had made a capital contribution which should be returned.

Moon argued that he did not have the subjective intent to form an LLC, that he did not adequately understand the concept of an LLC and that, because he did not sign an operating agreement, he rejected the formation of an LLC. The court rejected these arguments. The court noted that Moon did not question the viability of the LLC during the year of its operation and observed that the statute provides that a certificate of organization is conclusive evidence that an LLC has been duly organized. The court stated that "[a]ttaining a certain level of understanding regarding L.L.C.s is not a prerequisite to the formation of and participation in one." Further, the court stated that it was aware of no requirement in the law that an LLC have an operating agreement to be viable.

Moon also argued that he was entitled to reimbursement for a capital contribution. Moon contended that he made his agreed upon $10,000 capital contribution in the form of past experience, good will, services rendered, and equipment. While the court acknowledged that capital contributions do not have to be in cash, it concluded that there was no evidence that Moon made a non-cash capital contribution.

**Q. Pre-Formation Contracts or Dealings**


The court granted a pre-judgment remedy based on a showing of probable cause that the individual defendant was personally liable for breach of an agreement with the plaintiff. The individual argued that he had no personal liability, stating that he believed he had formed an LLC and that he took immediate corrective action to properly form the LLC when, after the lawsuit commenced, he found it had not been done. The court pointed out that the agreement was on a form headed by the name of an LLC but designating the individual as the “owner” within the body. Further, the agreement was signed by the individual without any designation that he was a member of the LLC, and the plaintiff was under the impression that he was dealing with the individual.

**Balmer v. Anderson Creek, Inc.**, No. COA02-1620, 2003 WL 22845367 (N.C.App. 2003) (holding that individual who signed as agent for nonexistent LLC rendered himself personally liable on the contract and, in turn, had right to maintain suit to enforce the contract).

**Sysco Food Services of Austin, Inc. v. Miller,** No. 03-03-00078-CV, 2003 WL 21940009 (Tex.App. 2003) (holding that member of LLC who did not sign pre-formation credit application with supplier was not personally liable to supplier as general partner of implied partnership or otherwise).

**Lester Associates, LLC v. Entertainment Group Fund, Inc.**, No.00 Civ.3759 LTS MHD, 2003 WL 21750211 (S.D. N.Y. July 29, 2003) (holding that merely instructing attorney to form LLC did not constitute a colorable attempt to comply with statutory formation requirements for purposes of establishing de facto existence of LLC under Delaware de facto corporation doctrine, but fact issues precluded determination of whether defendants should be estopped to deny the existence of LLC which was attempting to enforce claims arising under pre-formation contract).

**Urda v. Sahl,** No. CV020468800S, 2003 WL 21007160 (Conn.Super. April 17, 2003) (concluding that the defendant promised to convey a 50% interest in real estate, rather than an interest in an LLC later formed to hold the real estate, in exchange for the plaintiff’s management of the real estate, and thus the oral agreement was subject to the Statute of Frauds).

**Schawk, Inc. v. City Brewing Co.**, LLC, No. 02-1833, 2003 WL 1563767 (Wis.App. March 27, 2003) (questioning the import of an alleged offer made on behalf of an as-yet-unformed LLC).
Holland v. Fahnestock & Co., Inc., 210 F.R.D. 487 (S.D. N.Y. 2002) (adopting magistrate’s report finding LLC was not indispensable party because its interest was adequately represented by defendant, and LLC was no more than co-obligor and joint tortfeasor with respect to pre-organization contract assigned to LLC by defendant).

Holland v. Fahnestock & Co., Inc., No. 01CIV.2462RMBAJP, 2002 WL 1774230 (S.D. N.Y. Aug. 2, 2002) (finding that individual sole proprietor was not discharged from liability when LLC was formed and succeeded to liability on pre-formation contract and that individual and LLC were thereafter joint obligors on the contract).

Johnson v. King Media, Inc., No. Civ.A. 01-2311, 2002 WL 1372363 (E.D. Pa. June 24, 2002). King Media sued on a contract with Zebra Marketing.com. King Media alleged that Zebra Marketing.com was a partnership, and it sued the partnership and its three alleged partners. One of the alleged partners sought dismissal on the basis that Zebra Marketing.com was an LLC, and the contract was not with the individual personally. The court denied the motion to dismiss, stating that the contract was entered four months prior to formation of the LLC and the subsequent formation of the LLC could not protect the partners from personal liability arising out of the contract with the partnership.


Ehle v. Williams & Boshea, L.L.C., No. Civ.A. 01-3757, 2002 WL 373271 (E.D. La. March 7, 2002) (finding that joinder of individual who claimed he could not be liable because he was member of LLC was not fraudulent where there was evidence the LLC was never formed and plaintiff stated claims based upon negotiations to form LLC).


A short-term lease was signed by an individual on behalf of an LLC shortly after the LLC was formed. The LLC asserted promissory estoppel claims based upon promises made before the LLC was formed. The defendant argued that the LLC was a third party to the lease and without standing to assert promissory estoppel. The court applied principles applied to corporate promoters to conclude that the LLC could assert promissory estoppel even though it did not exist at the time of the promises.


Four individuals formed a business (ADA Engineering, L.L.C. or “ADA”) they intended to be an LLC. Their attorney failed to file the articles of organization, and the failure was not discovered until after a corporation agreed to acquire ADA. A memo written on the acquiring corporation’s stationery stated that because the secretary of state had no record of ADA as an LLC, the corporation would treat ADA as a partnership and purchase its assets and assume its liabilities as a partnership. One of the owners of ADA was an officer and major shareholder of the acquiring corporation. Although the assets of ADA were transferred and its business assumed by the acquiring corporation, the terms of the acquisition were never finalized, no consideration was paid, and litigation against the acquiring corporation and the majority shareholder who was also an owner of ADA ensued. Among the issues addressed in this appeal was whether the trial court erred in finding that ADA was a partnership and not a de facto LLC. The court of appeals relied upon case law dealing with defective incorporation as well as the common law and statutory definition of a partnership to conclude that ADA was a partnership. The court also held that the other owners were not estopped to deny ADA’s status as an LLC.


The court determined that the members of an LLC were not protected from liability by the Delaware LLC act because the claims against the members were based upon fraudulent acts committed by the members before the LLC was formed. The court phrased the issue as follows: “if a person makes material misrepresentations to induce a purchaser to purchase a parcel of land at a price far above the fair market value, and thereafter forms an LLC to purchase and hold the land, can that person later claim that his status as an LLC member protects him from liability to the purchaser under § 18-303 [of the Delaware LLC Act]?” Not surprisingly, the court answered the question in the negative. The court did not find it necessary to reach the argument that veil piercing is the only way to hold an LLC member liable other than a claim based upon an improper distribution under § 18-607 of the Delaware LLC Act since
the members were being sued for conduct that occurred before the formation of the LLC and thus were not being sued in their capacities as members of an LLC.

**Ruggio v. Vining, 755 So.2d 792 (Fla. App. 2000).**

Prior to the filing of articles of organization for an LLC, Ruggio signed a $100,000 promissory note on behalf of the LLC payable to Vining. Ruggio claimed that Vining knew the LLC had not yet been formed, but Vining claimed that Ruggio represented the LLC had already been formed. The note was somewhat unusual in that it provided for the issuance of a 1% ownership interest in the LLC (referred to as “1% of all shares of stock authorized to be issued by the articles of incorporation filed in the State of Florida by the obligor”) in lieu of payment at the election of the holder. At the time the note was executed, the Florida LLC act provided that “[a]ll persons who assume to act as a limited liability company without authority to do so shall be jointly and severally liable for all debts and liabilities.” (Later the act was amended to add an exception for any liability to a person who also had actual knowledge that there was no organization of an LLC.) The act also provides that an LLC shall not transact business or incur indebtedness, except that which is incidental to its organization or to obtaining subscriptions for or payment of contributions, until the articles of organization have been filed. The court explained the purpose of provisions like this as protection of innocent third parties who have dealings with an entity that does not exist and never becomes adequately capitalized. The court ultimately determined that fact issues remained. The court questioned whether Vining himself might have been assuming to act as the LLC. The court stated that the record did not establish whether the unusual note was “incidental” to the LLC’s organization or a “subscription” or a “contribution.” In a footnote the court chastised Ruggio’s counsel for continued reliance on provisions from the corporation statute and limited argument regarding the applicable provision in the LLC act.

**In re Bernstein (Bernstein Ranch, LLC v. U.S.), 230 B.R. 144 (Bankr. D. N.D. 1999).**

An LLC claimed an agricultural lien on cattle proceeds by virtue of feed and care provided the cattle. Two brothers who owned the cattle executed a bill of sale to the LLC, in which they were members, and the LLC later reconveyed the cattle to the brothers. The lien was challenged with respect to the period of time during which title to the cattle was held by the LLC on the basis that, under North Dakota law, an owner of crops or livestock cannot claim a supplier’s lien for inputs the owner himself provides to the crop or livestock. The court compared the transfer to the LLC to a case in which a family created a partnership for the purpose of raising potatoes. A company owned by the mother provided services and claimed a lien, but it was disallowed on the basis that the mother, as a participant in the joint venture, had an interest in the crops themselves, and the expenses for which she claimed a lien constituted a contribution to the common undertaking of the joint venture. The court stated that the circumstances surrounding the LLC were similar to those in that case. If the cattle were owned by the LLC during the time in question, said the court, the logic of that case would preclude recognition of the lien. The court analyzed the circumstances of the transfer to the LLC and determined that the sale was absolute and effective upon the signing of the bill of sale. Since the cattle were owned by the LLC, it could not claim a lien for its expenses for feed and services.


An LLC sought to enforce an agreement to purchase and sell property that was executed on behalf of the LLC prior to the filing of articles of organization with the Oklahoma Secretary of State. The court applied an Oklahoma statute that provided that a person or corporation may not deny the validity of a contract relating to real property if the person or corporation has knowingly received and accepted benefits under the contract. The court concluded that the seller was estopped under this provision to assert the LLC’s lack of capacity. In a subsequent opinion on rehearing, the court concluded that there had been no fraud on the part of the individual who represented that the LLC was in existence.


The plaintiff LLC sought to bring suit on a contract entered on the LLC’s behalf prior to the LLC’s formation, and the defendant defended on the basis that the LLC lacked capacity to enter and enforce the contract. The contract was signed by the organizer as president of the LLC and, upon its formation, the LLC ratified or adopted the organizer’s pre-formation activities. In the contract, the defendant acknowledged that the LLC was in the process of being formed as a Nevada LLC. The defendant argued that it was not bound because it withdrew prior to the LLC’s ratification of the contract. The court held, however, that under the circumstances in this case the defendant was estopped to deny the existence of the LLC.
R. Fraudulent Inducement in Formation of LLC

*VGS, Inc. v. Castiel*, No. C.A. 17995, 2003 WL 723285 (Del.Ch. Feb. 28, 2003) (applying New York law pursuant to choice of law clauses in agreements and rejecting claim of misrepresentation and fraudulent inducement relating to investment in LLC where the transaction was a multi-million dollar transaction executed following negotiations among sophisticated parties and the complaining party had the opportunity to discover information making reliance unwarranted).


The court rescinded an operating agreement of an LLC on the grounds that Lloyd, one of the members, committed fraud in the formation of the LLC, and the court concluded that Lloyd's rights were governed by the partnership agreement under which the parties had operated before organizing as an LLC. However, the court concluded that it could not determine Lloyd's rights under the partnership agreement by summary judgment and scheduled the matter for trial. The court referred to confusion between the terms "capital account" and "capital contribution" and as to whether Lloyd should be treated as a withdrawing or expelled partner under the provisions of the partnership agreement.


Two members of an LLC sued the third member, Bullock, seeking injunctive relief barring Bullock from operating the LLC and permitting them to carry on the business. Bullock sought dissolution and an accounting. The court found that Bullock made fraudulent representations when she claimed to have sole ownership of an existing business into which she induced the plaintiffs to invest and when she promised to sign an operating agreement giving the plaintiffs a fifty-one percent controlling interest in their newly formed LLC. In fact, another individual had a substantial interest in the business Bullock claimed to own, and Bullock later refused to sign the operating agreement for the new LLC. Ultimately, Bullock locked the other two members out of the business premises and transferred the assets of the LLC to a new corporation formed by Bullock and yet another investor. The court concluded that the LLC dissolved when Bullock wrongfully excluded/expelled the other two members from the business and that the LLC could only continue for winding up purposes. Thus, the court denied the plaintiffs' requested injunctive relief. The court went on to discuss the fraudulent nature of the transfer of the LLC's assets to Bullock's new corporation under Rhode Island's Uniform Fraudulent Transfer Act. Finally, the court appointed an attorney to conduct the winding up of the LLC because Bullock, having wrongfully caused the dissolution of the LLC, was not entitled to participate in the winding up of the LLC's affairs.

S. LLC Property and Interest of Members


A judgment creditor of the husband of an LLC member sought to reach the LLC interest of the wife. The creditor argued the LLC interest was joint management community property that could be levied on to satisfy her husband’s debts. The wife argued the LLC interest was sole management community property and thus not subject to the husband’s non-tortious liabilities incurred during marriage. The wife relied upon the inception of title rule and claimed her interest was sole management community property because she purchased it with funds from her personal bank account. The creditor urged the court to look at the totality of the circumstances, noting various ways in which the husband was involved in the formation and operation of the LLC. The court concluded that fact issues precluded summary judgment.

*In re Ealy*, 307 B.R. 653 (Bankr. E.D. Ark. 2004) (acknowledging that property of LLC is not property of member under Arkansas law, but finding debtor had equitable interest in property held by debtor’s LLC, and automatic stay thus protected property, where creation of LLC resulted from misunderstanding and intent was for debtor to own property).

*In re Mulder (Baker Dev. Corp. v. Mulder)*, 307 B.R. 637 (Bankr. N.D. Ill. 2004) (stating in footnote that, even if debtor owned interest in LLC that allegedly fraudulently conveyed property, only LLC interest would be property of bankruptcy estate and not property of LLC itself).

The court upheld a TRO that restrained an LLC in which a divorcing spouse was a 50% member from disposing of real property of the LLC. The court relied on a domestic relations statute permitting a court to issue an order concerning the possession of real or personal property to prevent the disposition or dissipation of marital assets pending a matrimonial action. The court acknowledged that LLC members have no interest in specific real property of the LLC but stated that non-parties to a matrimonial action may be bound by an injunction if they act in collusion or combination with a party. The court stated there was sufficient evidence that the divorcing spouse and the LLC and its other member were acting in combination. The court found the members failed to establish that the LLC operated independently of the divorcing spouse with respect to the disposition of the LLC’s assets since a majority of the members was required for the LLC to take certain action, including the sale or disposition of McCleary v. McCleary, 822 A.2d 460 (Md.App. 2002) (agreeing with trial court that spouse’s LLC was marital property, but holding that trial court erred in characterizing the LLC’s debt as spouse’s non-marital debt, thus overstating the value of spouse’s marital property by the amount of the debt).

Parking Deck LLC v. Anvil Corp., 576 S.E.2d 24 (Ga.App. 2002) (imputing sole member’s knowledge of easement to LLC notwithstanding subsequent sale of member’s interest because property owner was LLC, not the members of the LLC).


A judgment creditor argued that the bank account of an LLC was subject to attachment to satisfy the judgment against the individuals who were members of the LLC. The court cited the provisions of the Maine LLC act that specify that property transferred to or acquired by an LLC becomes LLC property and that a member has no specific interest in LLC property. The judgment creditor argued that the account was a joint account because it was used for personal expenses and the bank treated the account as a joint account. The court rejected this argument, pointing out that the account was in the name of the LLC only and that various aspects of the documentation indicated the account was a commercial or business account.

Hutson v. Young, 564 S.E.2d 780 (Ga. App. 2002) (stating that an action to compel specific performance of two LLCs which own land involves the sale of personalty, and such a suit indirectly involving land does not permit the filing of a lis pendens).


The plaintiff obtained a default judgment against the defendant (Interlab Robotics, Inc.), and pursued money in a bank account in the name of H-Square Engraving Systems, which was allegedly a fictitious name under which the defendant and its president did business as a joint venture. The plaintiff obtained the funds after obtaining a partnership charging order and an order freezing the bank account of H-Square Engraving Systems (“H-Square”) followed by appointment of a receiver who was directed to seize the assets of H-Square, determine the interest of the defendant in the assets, and distribute the assets. H-Square then apparently argued (the court characterized its briefing as “less than clear”) that it was an LLC and it was not liable for the judgment because it was not the judgment debtor. The court acknowledged that, if H-Square was an LLC, it was “arguably correct” that it was not the judgment debtor and could not be charged with the defendant’s debt to the plaintiff. However, the court stated that if H-Square was a joint venture, its argument was to no avail because the defendant’s interest in it could be charged to satisfy the defendant’s debt to the plaintiff. (The court cited the charging order provisions of the partnership statute and equated a joint venture to a partnership, but did not explain how these provisions would entitle the receiver to directly reach the assets of the alleged joint venture.) The court cited conflicting evidence as to whether H-Square was an LLC, a joint venture, or a fictitious name. Ultimately, the court found that the evidence supported the receiver’s implicit conclusions that H-Square was a fictitious business name for the defendant and no allocation of the money in the bank account was necessary.


A real estate listing agent sought to collect its commission under its brokerage agreement when the owner of the property conveyed the property to a newly formed LLC in which the owner of the property and three other individuals were the members. The member who contributed the property received a 40% membership interest and a 9% preferential return on the future profits from the property. Further, the property could not be encumbered without the consent of the member who contributed the property to the LLC. The court determined that the contribution of the
property was not a sale or exchange under the brokerage agreement. The court reasoned that the owner of the property retained an ownership interest in the property that caused him to assume the risks of an investor rather than the risks of a seller. The court stated that whether a sale or exchange for consideration occurred is a fact-intensive inquiry that requires more than a mere showing that an owner transferred his property to a separate legal entity. “Where the owner retains essentially the same ownership interest in the property as he had prior to the conveyance, with plans to develop the property by improving it with the possibility of future gains or losses, and can prevent the record owner from encumbering the property without his permission, such a transaction is not a sale or exchange,” said the court. Under this test, the court concluded that the conveyance to the LLC was not a sale or exchange.


The debtor in this bankruptcy proceeding claimed that he had equitable rights in a tractor owned by an LLC of which he was a member. The court rejected this argument, finding it clear that the debtor’s membership interest was property of the estate but the LLC’s property was not. Thus, the holder of a security interest in the tractor was allowed to foreclose its interest.


The issue in this case was whether a title insurance policy continued in effect for property transferred by a husband and wife to their wholly owned LLC. The court held that the transfer terminated the policy. The Gebhardts conveyed the real property to a Virginia LLC of which they were the only members. The deed recited that the LLC paid $160,990 for the property, but Mr. Gebhardt testified that this recitation was for transfer tax purposes and that the LLC did not pay anything for the property. The Gebhardts argued that the conveyance was in effect a conveyance to themselves because they were the sole members of the LLC. The court, however, stressed that an LLC is a separate entity and that there was indeed a transfer from one entity or person to another. The court stated that there was a real conveyance even if no money changed hands because the Gebhardts obtained benefits conferred by a Virginia LLC, including limited liability and estate planning benefits. Finally, the court rejected the argument that, because they had already reported the cloud on the title before the transfer to the LLC, the Gebhardts should be able to recover under the title policy. The court rejected this argument on the basis that any loss suffered by virtue of the cloud on the title would be suffered by the LLC, not the Gebhardts, because the Gebhardts successfully conveyed the entire property under a special warranty deed.


The court held that the manager of an LLC is competent to testify as to the value of LLC property even though the manager is not an expert so long as the manager is in fact familiar with the value of the realty. The court reached this conclusion based upon Missouri case law recognizing that a managing officer of a corporation is competent to testify on the value of corporate property.


In this divorce action, Mr. Jennette claimed that he had no interest in an LLC he formed, but the court found that he did have an interest. Although Mr. Jennette was the organizer of the LLC, chose the lawyers and accountants for the company, and signed the operating agreement as one of the members, Mr. Jennette claimed that he was only an employee of the LLC. The LLC did not withhold taxes on the money he drew, however, and the court pointed out, as “the most telling piece of circumstantial evidence,” that Mr. Jennette had listed a 49% interest in the LLC, valued at $450,000, in a financial statement he provided a bank. The trial court concluded that Mr. Jennette’s testimony was not truthful and viewed the paper trail as indicating that Mr. Jennette owned a valuable interest in the LLC. The court of appeals upheld the trial court’s conclusion.


The plaintiff brought a bill of discovery action against a member of an LLC seeking sworn copies of the member’s membership certificate giving notice of a pledge of the membership interest. Under an agreement between the member and the plaintiff, the member was to pledge a 20% LLC interest as partial security for a promissory note. The agreement also required the member to place a legend on the certificate indicating that the interest had been pledged. When the member refused to provide the plaintiff proof that the language had been placed on the certificate, the plaintiff brought this action. The court found that the plaintiff was entitled to maintain the bill of discovery seeking proof of compliance with the agreement.
Graves v. Graves, 967 S.W.2d 632 (Mo. App. 1998).

This divorce action included an issue as to the propriety of the trial court's order that one spouse, who was awarded all interest in the couple's LLC, execute a lease on behalf of the LLC. Mr. and Mrs. Graves owned an LLC which operated on a tract of land it leased from the Graves. The trial court awarded Mr. Graves all right, title and interest in the LLC and awarded Mrs. Graves the land on which the LLC operated. The court also ordered Mr. and Mrs. Graves to sign a twelve month lease of the land to the LLC at a specified rent. The lease included a signature line for the LLC to be signed by Mr. Graves as president. Mr. Graves complained that the court did not have jurisdiction over the LLC and that the order to execute the lease was thus improper. The court acknowledged the difference between a member's interest in an LLC and property of the LLC itself, but analogized the situation to that of a sole shareholder corporation where a court may order the shareholder spouse to cause the corporation to undertake certain acts. The court concluded that the trial court was within its authority to cause the LLC to lease the property from Mrs. Graves since it did not order the LLC to distribute any property and did not directly order the LLC to sign the lease.


The debtor in this bankruptcy case claimed that his interest in an LLC was exempt because it was held in a tenancy by the entirety. The court noted that an ownership interest in an LLC is intangible personal property. The court stated that there must be a clear manifestation of intent on the face of the instrument of conveyance to support the existence of a tenancy by the entirety. The court concluded that the articles of organization, the only evidence of the ownership interests of the debtor and his spouse, did not demonstrate an intent to hold ownership in the LLC in a tenancy by the entirety.


In this case, the plaintiffs, Ralph and Maureen Hagan (the Hagans), executed an agreement with the defendant, Adams Property Associates, Inc. (Adams), giving Adams the exclusive right to sell the Hagans' apartment complex for $1,600,000. The agreement provided that if the property was "sold or exchanged" within one year, with or without Adams' assistance, the Hagans would pay Adams a fee of six percent of the "gross sales amount." Before the year had expired, the Hagans and two other parties formed an LLC, and Hagan transferred the property to the LLC in exchange for an interest in the LLC, the LLC's assumption of debt on the property, and a promissory note from the LLC secured by a second deed of trust on the property. Adams sought its commission on the basis that the transfer of property to the LLC constituted a sale of the property. The Hagans argued that transfer of legal title to the property represented their contribution to the capitalization of a new company, and not a sale of the property. The Hagans added that they did not receive any present valuable consideration for the contribution. The Virginia Supreme Court found that the benefits received by the Hagans by virtue of the transfer of the property constituted valid consideration. It further distinguished the cases cited by the Hagans for the proposition that the transfer was capitalization on the basis that those cases involved the capitalization of a partnership rather than an LLC. The court stated that a partnership is not an entity separate from its partners, thus a partner's transfer of property to the partnership is "only a change in the form of ownership." The court characterized an LLC as an entity separate from its members and concluded that the member's transfer of the property to the LLC thus amounted to a sale.


This proceeding arose out of a dispute between Gattoni and Zaccarro, 49% and 51% members, respectively, of an LLC. Gattoni alleged various misdeeds and breaches of contract by Zaccaro and sought an accounting and judicial dissolution of the LLC. The specific matter before the court was the request of Zaccaro and the LLC for discharge of a lis pendens filed by Gattoni on real property owned by the LLC. The court granted the request inasmuch as the claims did not involve the real property within the meaning of the relevant Connecticut statute. The court pointed out that Gattoni did not have an interest in specific LLC property. Rather, Gattoni had a membership interest in the LLC, and the membership interest was personal property. The court rejected the argument that his claim for dissolution involved a claim for partition of the real property owned by the LLC. The court also addressed a request by Gattoni for a preliminary injunction that would essentially order preservation of the real property and prohibit its transfer. The court denied the request for injunctive relief based upon its conclusions that Gattoni failed to establish likelihood of success on the merits of his claims and did not show that Zaccaro was likely to dispose of the property in a way that would thwart winding up and dissolution of the LLC. A subsequent related opinion is published at 727 A.2d 706 (Conn. App. 1999).

The plaintiff was denied a building permit to build a house on a lot he owned. He appealed the decision of the Hebron Conservation Commission, claiming that the decision deprived him of any reasonable use or practical value of his property and amounted to a taking of the property without just compensation. During the course of the appeal, the plaintiff transferred his interest in the lot to an LLC in which he owned a fifty percent interest. The defendant argued that the plaintiff was not a party aggrieved by the denial of the permit and thus could not pursue the appeal because he did not sustain his interest in the property at issue throughout the course of the proceedings. The plaintiff relied on his ownership in the LLC to establish his aggrievement. The court quoted the LLC statute to the effect that property transferred to or otherwise acquired by an LLC is property of the LLC and not of the members individually. The court held that, because the property was transferred to another party who was not a party before the Commission and not a party to the appeal, the plaintiff was not aggrieved and had no standing to appeal. (Had the plaintiff been the sole member of the LLC, it appears the court would have treated him as the beneficial owner of the property based upon a prior case in which the court treated the sole stockholder of a corporation as beneficial owner of land owned by the corporation.)


This case involved the application of Colorado receivership law in the context of an LLC. The court allowed an LLC member to pursue appointment of a receiver for the LLC because an LLC member has a personal property interest in the LLC and thus may satisfy the Colorado rule which provides for the appointment of a receiver when the moving party establishes "a prima facie right to the property, or to an interest therein, which is the subject of the action and is in possession of an adverse party and such property, or its . . . profits are in danger of being lost . . . or materially injured or impaired."

T. Authority of Members and Managers


An LLC entered a contract to sell potatoes, and the buyer issued a check to a member of the LLC. The member deposited the check into his personal account and subsequently declared bankruptcy. The court looked to partnership law for guidance on interpretation of the Washington LLC act regarding authority of the LLC member as agent of the LLC and concluded that fact issues precluded summary judgment in favor of the buyer. Specifically, the court concluded there were fact issues regarding the buyer’s reasonable reliance on the member’s authority to accept payment on a debt to the LLC by a check made out to the member.


The court concluded that an LLC member who embezzled funds by cashing customer checks was authorized under the New Jersey LLC act to endorse checks. The court distinguished the partnership context, noting that limitations on the authority of partners under the Uniform Partnership Act were not included in the broadly worded provisions of the LLC statute. Furthermore, even if the member did not have actual authority, the court concluded the member had apparent authority as a member and general manager.

Chase Manhattan Bank v. Iridium Africa Corp., 307 F.Supp.2d 608 (D.Del. 2004) (finding representations in LLC assistant secretary’s certificate to bank were made on behalf of LLC and its members, and LLC members were thus estopped from denying representations in certificate that LLC agreement attached to certificate was “true and correct”).


Apple Glen Crossing, LLC v. Trademark Retail, Inc., 784 N.E.2d 484 (Ind. 2003) (stating that a principal who honors an obligation wrongfully incurred by its agent may nevertheless enforce its remedies against the agent for the wrongful action, but holding that “change orders” approved by LLC manager did not constitute “Major Decisions” requiring unanimous consent of members under LLC operating agreement and thus change orders were not a basis for the majority member to remove the minority member as manager).
Connecticut Car Rental, Inc. v. Prime One Capital Co., LLC, 247 F.Supp.2d 158 (D.Conn. 2003) (holding that member had actual authority to assign car lease agreements pursuant to the LLC formation agreement (under which the assignments were not “major decisions”), and that, alternatively, even assuming actual authority was lacking, the assignments were binding under the Washington LLC act (as acts of a member of a member-managed LLC apparently acting in the usual way of business) and common law apparent authority).

TIC Holdings, LLC v. HR Software Acquisitions Group, Inc., 750 N.Y.S.2d 425 (N.Y. Sup. 2002), aff’d, 2003 WL 116115 (N.Y. A.D. 1 Dept., Jan. 13, 2003) (concluding LLC manager did not have authority under New York LLC act or operating agreement to execute agreement obligating LLC to transfer assets that constituted all or substantially all of the LLC’s assets insomuch as operating agreement’s broad grant of authority was “subject ... to the requirements of applicable law” and the failure of the other members to object did not satisfy the requisite “affirmative vote” of a majority in interest of the members).


After the individual who was manager of an LLC was terminated as manager, the LLC designated a new manager, but the individual continued to operate the LLC with the knowledge of the members, who took no steps to stop the individual from doing so. The court held under these circumstances that the terminated manager was acting with apparent authority.


The plaintiff sought to hold an LLC liable on a transaction by the manager (Marks) on the LLC’s behalf. The LLC argued that Marks had been removed as manager at a meeting of the members and lacked authority to bind the LLC. The LLC was designated as manager-managed in its articles of organization and Marks was named the initial manager in the articles of organization. The court reviewed the statutory provisions dealing with actual and apparent authority of managers of manager-managed LLCs as well as the provisions of the articles of organization and regulations of the LLC and concluded that the evidence conclusively established that Marks was the initial manager with actual authority to act for the LLC. The question was whether Marks continued to have actual authority at the time in question. The court noted that there was evidence that proper notice required under the regulations had not been given to all members of the meeting at which Marks was removed. The court stated that the plaintiff did not have standing to directly challenge the irregularity in the meeting, but the failure to give notice of the meeting to Marks, who was also a member of the LLC, did impact the analysis of his authority. The court stated that an agent has actual authority where a principal intentionally confers it or intentionally or negligently allows the agent to believe he has authority. Since the evidence did not show that Marks was dispossessed of the belief that he was authorized to continue to act on the LLC’s behalf, he continued to have actual authority to bind the LLC.

Taghipour v. Jerez, 52 P.3d 1252 (Utah 2002).

The Utah Supreme Court affirmed the holding of the court of appeals that a loan agreement signed by the manager of an LLC was binding on the LLC under the provisions of the Utah LLC act in effect at the time. Although the loan agreement was signed by the manager without approval of the members as required by the operating agreement, the court held that the loan agreement was binding on the LLC because the Utah act provided: “Instruments and documents providing for the acquisition, mortgage, or disposition of property of the limited liability company shall be valid and binding upon the limited liability company if they are executed by one or more managers.” The court concluded this specific provision controlled over a more general statutory provision stating that a manager has authority to bind the LLC unless otherwise provided in the articles of organization or operating agreement. The manager was identified as such in the articles of organization, and, though the operating agreement limited his authority, the lender did not have a due diligence obligation to determine the manager’s authority and was not responsible for the fact that the manager absconded with the funds.

This case involved a dispute as to the authority of Stephen Bandi to obligate R & R Landholding, LLC (“R & R”) on certain transactions. Michael and Darlene Reed owned 50% of R & R. The other 50% of R & R was owned by another LLC, Regatta Investment Group, LLC (“Regatta”). Bandi was the managing member of Regatta. Regatta also owned a 50% interest in Construction and Environmental Management, LLC (“CEM”), which was the general contractor for R & R’s project to renovate an apartment complex. The dispute involved Bandi’s authority to approve change orders and borrowing on behalf of R & R. The Reeds claimed that Bandi was not the managing member of R & R and that, in any event, all decisions required an oral or written vote of a majority of all members. The court found that there were no such votes taken at any time, no meetings held, and no minutes recorded. Michael Reed testified that he left decisions regarding the construction project to Bandi. The Reeds did not object to the work performed. Based on such evidence, the court refused to disturb the trial court’s finding that Bandi had actual or apparent authority to approve the change orders. In the course of reaching this conclusion, the appeals court dismissed R & R’s argument that the Louisiana LLC statute’s interested member/manager provision nullified Bandi’s execution of the change orders to CEM. While the trial court found that Bandi had authority to obligate R & R on the change orders, it concluded that Bandi did not have authority to obligate R & R on a $32,000 loan. There was no testimony that decisions regarding financial obligations were delegated to Bandi; thus, the appeals court upheld this finding as well.


The plaintiff relied upon the agency power of an LLC member to bind the LLC to the plaintiff for parts and labor in connection with the repair of a bulldozer. The charges in question were incurred at the request of one member of a two member LLC. The court relied upon the provisions of the Connecticut LLC act that make members of an LLC agents of the LLC for any act apparently carrying on in the usual way the business of the LLC absent a lack of authority known to the third party. The court examined the facts surrounding the transaction and concluded that the member had apparent authority to bind the LLC.


This opinion is unpublished and is not available on Westlaw or Lexis. The issue in the proceeding was the authority or apparent authority of LLC managers to execute deeds of trust against the LLC’s assets and obligate the LLC for repayment of certain loans to the managers. Robert and Marilyn DeLuca were members and managers of D&B Countryside, L.L.C., a Virginia LLC. Newell loaned the DeLucas substantial amounts of money secured by various deeds of trust on property owned by the LLC. Eventually, the DeLucas also executed a note on behalf of the LLC. The deeds of trust and note were executed by the DeLucas without the consent of the other members of the LLC. The court examined the operating agreement of the LLC and concluded that it did not confer actual authority on the DeLucas to execute the deeds of trust or the note. The court then considered whether the DeLucas had apparent authority to bind the LLC. Relying on common law principles and provisions of the Virginia LLC act, the court concluded that the DeLucas did not have apparent authority to execute the deeds of trust or the note.

U. Admission of Members

Jundt v. Jurassic Resources Development North America, L.L.C., 677 N.W.2d 209 (N.D. 2004) (holding trial court’s finding as to when member’s membership began was law of the case because it was not challenged in prior appeal).


Sosa agreed to loan money to an LLC in two installments in exchange for a 1/3 membership in the LLC. Sosa made an initial advance to the LLC but did not make the second advance. The trial court concluded that Sosa first breached the agreement by failing to pay the second installment, but the court of appeals held that it was the other parties to the agreement who first breached by failing to take immediate action to admit Sosa as a member in accordance with the agreement.


Four individuals entered an operating agreement for an LLC that listed them as members and required that each of them contribute $5,000 as an initial capital contribution. One of the individuals did not make the required
contribution. The issue addressed by the court was whether the individual who failed to make the contribution was a member, and the court held that he was. The other members argued that he never became a member because of his failure to make the required contribution. The court, however, found that he was a member under the clear and unambiguous language of the operating agreement. The court pointed out that the operating agreement listed the individual as a member and presupposed that the person required to make the capital contribution was a member when it provided that “each Member shall contribute $5,000 as the initial Capital Contribution.”


In this suit by a member to challenge the member’s termination as employee and manager of the LLC, the court refused to disturb the finding that the member’s written consent to admission of new members required by the Colorado LLC Act was established by various writings, taken together, including a proxy request sent to investors by the member.

V. Fiduciary Duties of Members and Managers

**Bishop of Victoria Corporation Sole v. Finley**, No. 29321-8-II, 2004 WL 1053215 (Wash. App. May 11, 2004) (stating that the role of members in a member-managed LLC is analogous to partners in a general partnership and that partners are accountable to each other and the partnership, but declining to rule on breach of fiduciary duty claim because trial court did not rule on it).


A former member of a dissolved LLC sued the LLC, its other former members, its managers, and a related corporate entity alleging, *inter alia*, common law fraud, equitable fraud, and breach of fiduciary duty. The LLC was formed to invest in the South American telecommunications industry, and the plaintiff lost most of its investment after bribery of Brazilian officials by LLC employees came to light. The essence of the plaintiff’s theory was that all of the defendants either participated in or knew about the bribery scheme and were not candid with the plaintiff about the bribery or its effect on the LLC’s business. The plaintiff claimed that it was not sufficiently informed about the bribery scandal and its consequences until it had already responded to numerous capital calls and poured millions of additional dollars into the LLC. Based on alleged non-disclosure and misrepresentation of material information regarding the bribery scheme, the plaintiff asserted common law and equitable fraud claims against all the defendants and breach of fiduciary duty claims against the LLC managers.

In a lengthy opinion, Vice Chancellor Strine analyzed the plaintiff’s claims and found that the plaintiff’s pleadings were sufficient to state claims for common law fraud and breach of the fiduciary duties of disclosure and loyalty, but not equitable fraud. The court analyzed these claims in light of *Malone v. Brincat*, which the court stated “applies when individuals on the governing board of a Delaware entity ‘knowingly disseminate false information that results in corporate injury or damage to an individual [owner].’” The court concluded that the complaint stated claims for common law fraud based on alleged misrepresentations and non-disclosure in the face of a duty to speak. Since common law fraud requires scienter, the court carefully differentiated the sufficiency of the pleadings with respect to the various defendants based on when the allegations indicated the defendants learned of the bribery scheme.

In considering the tort non-disclosure and breach of fiduciary duty claims, the court relied upon the allegation that the plaintiff’s original co-members remained managers of the LLC even after a reorganization that the defendants claimed terminated their membership. Since their positions as managers imposed on them fiduciary duties, the court did not have to consider the effect of the reorganization. The court rejected the argument that the requests for capital calls constituted a request for owner action that triggered a disclosure requirement upon each capital call, but the court found that the provisions of the LLC agreement requiring the LLC to make affirmative disclosures of material information supported claims against the managers for breach of fiduciary duty as well as the tort of non-disclosure in the face of a duty to speak. The court stated that a manager’s duties of loyalty and care to the LLC obviously included the requirement to make good faith efforts to ensure the LLC fulfilled its contractual duties of disclosure to the members. More importantly, said the court, the managers’ fiduciary duties included the duty under *Malone* not to knowingly mislead the plaintiff. The court observed that the non-disclosure common law fraud claims and breach of fiduciary duty claims were “inevitably linked” and questioned whether it really makes sense for an LLC member to be able to sue for both, but the court did not pursue the issue since the defendants did not raise it.

The court concluded that permitting the claims for equitable fraud to proceed would undercut the policy choice made by the Delaware Supreme Court in *Malone v. Brincat* because equitable fraud does not require scienter. Outside the context of a request for owner action, the court explained, *Malone* sets a very high bar for breach of fiduciary duty claims based on misleading disclosures. Permitting claims for equitable fraud would “threaten the *Malone* policy choice
in a major way,” according to the court. Applying the Malone standard, the court concluded that the plaintiff’s pleadings contained sufficient allegations with respect to certain defendants but not others.

Finally, the court concluded that allegations certain managers participated in the bribery scheme were sufficient to state a claim for breach of the fiduciary duty of loyalty.

*Leisher v. Alfred*, No. D041303, 2004 WL 693207 (Cal. App. April 3, 2004) (noting that California LLC act imposes on LLC manager fiduciary obligations to members that are the same as those of partner to other partners, and concluding there was ample evidence that LLC member and manager breached his duties to other member by paying his personal expenses out of LLC funds).

*Gonzalez v. Ward*, No. 253,2003, 2004 WL 77862 (Del. 2004). The court found that LLC members who acted as operating managers during the winding up of the LLC acted properly in increasing their compensation inasmuch as their workload increased substantially in the winding up and they applied and stayed within the parameters of the compensation formula approved by the LLC’s initial managers. The court concluded the managers acted fairly even if the entire fairness standard applied.

*Vaughn v. Electronic Technologies International, LLC*, No. 03-0717, 2004 WL 169594 (Wis. App. 2004). An LLC member asserted that he agreed to sell his membership interest back to the LLC under economic duress because the LLC threatened to terminate a manufacturer’s representative agreement under which the member acted as the LLC’s representative in the southeast. The court concluded the LLC had the legal right to terminate the manufacturer’s representative agreement, and the pressure applied by threatening to do so was not wrongful. The plaintiff member argued that the president and CEO of the LLC breached a fiduciary duty owed to the plaintiff as a minority member by coercing him to sell his interest at an inadequate price without regard to the valuation formula under buy-out provisions in the operating agreement. (The plaintiff did not actually bring a breach of fiduciary duty claim, but relied on breach of fiduciary duty to satisfy the wrongful conduct element of economic duress.) The court characterized the breach of fiduciary argument as “not fully developed” but noted that, to the extent the claim rested on the threat to terminate the manufacturer’s representative agreement, the court had already concluded that it was not wrongful conduct on the part of the LLC to do so. The plaintiff member offered no argument for a different conclusion with respect to the president and CEO, who was acting on behalf of the LLC in the transaction. While the court acknowledged that there were fact issues regarding the adequacy of the consideration, the court could not see how the inadequacy of the consideration satisfied the first two elements of economic duress – a wrongful act that deprived the plaintiff of his unfettered free will and so compelled him to accept the inadequate consideration.

*Froelich v. Senior Campus Living LLC*, 355 F.3d 802 (4th Cir. 2004) (noting determination that LLC’s board was protected by business judgment rule was not a determination that the board’s decision was correct; rather, the business judgment rule merely requires deference to a board’s decision absent fraud, bad faith, or gross negligence).


An LLC member who had been removed as president of the LLC asserted that the amendments to the operating agreement effecting his removal should be rescinded. The court stated that the LLC and its members “made the legitimate decision to eliminate the office of the presidency and their decision was protected by the ‘business judgment rule.’” Discussing and applying the corporate business judgment rule, the court concluded that the request to rescind the amendments to the operating agreement should be denied under the business judgment rule absent fraud or bad faith. The court pointed out that the member had not even alleged fraud and that the court had found cause to remove him as president because he was stealing from the LLC.


Two of three members of a Wisconsin LLC formed another LLC and caused the property of the first LLC to be transferred to the second for the same price the first LLC had paid for the property three years earlier. The court held that the conflict of interest of the two members who owned the second LLC did not preclude them from voting on the transaction but did require them to deal fairly with the LLC and its other member. The property was not marketed to
any third party, was not appraised to determine its fair value, was conveyed without any written offer to purchase, and was not subject to a new mortgage. The court said these facts demonstrated unfair dealings in two respects: the transaction was not an arm’s length transaction (nor was it made under “normal conditions”), and the sale of the property made it impracticable for the LLC to carry on its intended business, thus functionally dissolving the LLC without the other member’s consent. The court upheld the trial court’s order that the second LLC return the property to the original LLC.

Grace v. Morgan, No. Civ.A. 03C05260JEB, 2004 WL 26858 (Del.Super. Jan. 6, 2004) (concluding that breach of fiduciary duty claims against LLC manager were subject to exclusive jurisdiction of Chancery Court, but Superior Court could retain jurisdiction over breach of contract and unjust enrichment claims for money damages).


The plaintiffs, expelled members of an LLC, alleged that the defendant members, who owned 53% of the LLC units, breached their fiduciary duty and duty of good faith to the plaintiffs. After their expulsion, the plaintiffs were bought out at a price of $150 per unit pursuant to the terms of the operating agreement. Shortly after that, the defendants sold 49.9% of the LLC to a third party at a price of $250 per unit. The defendants argued that their actions were expressly permitted by the operating agreement and that they acted in good faith in expelling the plaintiffs, and the trial court granted summary judgment in favor of the defendants. The court of appeals first addressed whether the majority members owed a fiduciary duty to the minority. The defendants argued that the majority members owed no fiduciary duty to the minority because the LLC is a “creature of statute,” and the Tennessee LLC act prescribes a fiduciary duty by members of a member-managed LLC to the LLC itself but is silent as to any fiduciary duty among members. The court relied upon cases involving closely held corporations to conclude that the majority members of an LLC owe a fiduciary duty to the minority, and the court distinguished another Tennessee LLC case, McGee v. Best, as “in essence an employment dispute” not involving “an allegation of oppression by a majority shareholder group.” The court then analyzed the question of whether the defendants’ actions, viewed in the light most favorable to the plaintiffs under the summary judgment standard, could reasonably be said to have violated their fiduciary duty of dealing fairly and honestly with, and in good faith towards, the plaintiffs. The court concluded that there was a genuine issue of material fact as to whether the expulsion of the plaintiffs was in good faith or whether it was done solely to force the acquisition of their membership units at a price of $150 per unit in order to sell them at $250 per unit.

Venditti v. Giansiracusa, No. CV030825283S, 2003 WL 22853874 (Conn.Super. Nov. 6, 2003) (stating that Connecticut LLC act sets forth the fiduciary duties in regard to an LLC and finding sufficient grounds to issue temporary injunction in suit by two LLC members against third member for breach of fiduciary duty based upon alleged diversion of LLC funds and assets, conflict of interest, and dissolution of LLC without consent of other members).

Russell/Packard Development, Inc. v. Carson, 78 P.3d 616 (Utah App. 2003) (holding that fraud claim belonging to LLC was assignable to minority member and that minority member’s allegations of fraud and breach of fiduciary duty against agent who participated with LLC manager and another agent in fraudulent land “flip purchase and sale” were sufficient to survive motion to dismiss).


An LLC and several members brought suit against a member and former manager alleging various claims, including breach of the covenant of good faith and fair dealing. In this regard, the plaintiffs alleged that the defendant failed to meet his obligations to the LLC by failing to conform to the covenant of good faith and fair dealing implied in the LLC’s operational and organizational documents and that he breached the covenant in a number of ways. The defendant moved to strike this claim on the basis that the covenant of good faith and fair dealing is one implied in a contract and the existence of a contract must thus be alleged in the complaint to support the claim. The court agreed and granted the motion to strike. The court stated: “The complaint alleges simply that Carlyle is a limited liability company organized under the laws of Delaware and that the Defendant is a member of Carlyle. The complaint does not set forth the obligations, if any, of a member of such a company either to the company or the other members under either Delaware law or the Company’s organizational and operational documents.” In the absence of such allegations, the court concluded that the claim should be stricken.

(declining to enjoin LLC’s payment of LLC manager’s legal expenses in defending against minority member’s claims, including claim for dissolution, where operating agreement indemnification provision required indemnification of LLC manager to the maximum extent permitted by the New York LLC act and there had been no final adjudication establishing that manager acted in bad faith, was dishonest, or personally gained a financial profit to which he was not entitled as the LLC’s CEO).

DeSarbo v. Reichert, No. CV010456013S, 2003 WL 22245426 (Conn.Super. Sept. 24, 2003) (concluding that dominant member failed to prove his claim that the other members appropriated an LLC opportunity (stating that LLC member has no individual, personal duty to sacrifice individual economic interests in another arena to promote a sale of the LLC business), and holding that dominant member owed a fiduciary obligation to the other two members and that he put his self-interest ahead of the LLC and its other members, but concluding that the other members proved no damages resulting from the conduct).

Landskroner v. Landskroner, 797 N.E.2d 1002 (Ohio App. 2003) (acknowledging that parties owed one another fiduciary duties during the period they were both members of the LLC, but holding that current member did not owe former minority member any fiduciary duty).


Lynch v. Carriage Ridge, LLC, No. 02-0528, 2003 WL 21706305 (Wis.App. July 24, 2003) (concluding that transactions alleged to be improper self-dealing by the defendant LLC members were “fair” to the LLC and thus not improper, but concluding that action by the defendant members in making capital call against plaintiffs was “a subterfuge by a managing member intended to influence a minority member to sell” and thus violated the “rules of ‘fair play’” and amounted to “oppressive” conduct).


The plaintiff sued three individuals who, along with the plaintiff, were members of an LLC. The court referred to the LLC operating agreement and two related agreements collectively as a “partnership agreement” and referred to the members of the LLC as “partners.” Relying on Delaware LLC cases and New York partnership cases, the court rejected the individual defendants’ argument that they owed a duty only to the LLC and not to each other member. The court stated that it is well-settled that “a partner in an organization owes a fiduciary duty of loyalty to fellow partners in that organization” and that the “partners of [the LLC] owe each other a fiduciary duty.”

Triple Rock, LLC v. Rainey, No. M2000-01115-COA-R3-CV, 2003 WL 21338702 (Tenn.Ct.App. June 10, 2003) (holding that, while payment of LLC commissions to LLC member’s spouse in repayment of loan might raise a preference issue, there was no evidence of breach of fiduciary duty by member where LLC and remaining members did not dispute that they received a receipt for the full value of the notes paid and could show no loss or present injury, and failure to contribute toward losses of LLC did not constitute a breach of fiduciary duty where the operating agreement did not provide for additional capital contributions).

Brazil v. Rickerson, 268 F.Supp.2d 1091 (W.D. Mo. 2003) (stating that under Missouri law all LLC members owe a duty of good faith in conducting LLC affairs, and majority interest owners owe a fiduciary duty to minority, but finding that fact issues precluded summary judgment for expelled minority member).


Two members of an LLC sued Goodrich, the LLC’s chairman, for breach of fiduciary duty. The court found that the allegations stated a claim for breach of fiduciary duty. The court stated that Goodrich did not contest that as chairman he owed the plaintiffs a fiduciary duty. The court pointed to allegations that Goodrich was beginning a business venture with a third party in which he planned to divulge LLC trade secrets and manufacture the LLC’s product for his own benefit to the exclusion of the plaintiffs. The court also pointed to the allegation that Goodrich schemed “to take complete control of [the LLC] and strip [the plaintiffs] of their contract and common-law rights in and to [the LLC], its governance and its income, its assets, its business opportunities and its business operations.” The court stated that these allegations would establish a breach of the duty of honesty and a breach of the duty of loyalty to the plaintiffs.
obtaining a copy of the articles before agreeing to their terms. The court also found that the entity member had not set
articles of organization, and the Texa s LLC act are not rendered inoperative by the failure to exercise diligence in
of organization), and the articles were on file with the Secretary of State. The court stated that the regulations, the
evidence that it sought to obtain a copy (even though it signed regulations that were expressly subordinate to the articles
given a copy of the articles until two years after the regulations were signed, but the court stated that there was no
controlled. Under the Texas LLC act, the regulations may contain any provisions for the regulation or management of
individuals (Max and Morris Horton) owned the other 50% of the LLC. (The court noted in a footnote that the Hortons
were apparently under the impression that they had the right to participate in management although they were not
technically members of the LLC.) Disagreements over management developed, and Gillen proposed amending the
LLC’s articles of organization to change it to a manager-managed LLC and electing Gillen as manager. The regulations
(the Texas equivalent of an operating agreement) provided that amendment of the articles of organization required the
affirmative vote of at least 66 2/3% of the ownership interest while the articles of organization provided for amendment
by the affirmative vote of two-thirds of the members. Gillen and Baldridge voted for the proposed changes and relieved
the Hortons of their duties with the LLC. The entity member brought suit for declaratory relief, unjust enrichment, and
member oppression. The trial court granted summary judgment to Gillen, Baldridge, and the LLC. The declaratory
relief hinged on the determination of whether the voting provisions of the articles of organization or the regulations
controlled. Under the Texas LLC act, the regulations may contain any provisions for the regulation or management of
the LLC not inconsistent with law or the articles of organization. Thus, the court determined that the articles of
organization controlled, and the amendment received the requisite vote. The entity member claimed that it was not
given a copy of the articles until two years after the regulations were signed, but the court stated that there was no
evidence that it sought to obtain a copy (even though it signed regulations that were expressly subordinate to the articles
of organization), and the articles were on file with the Secretary of State. The court stated that the regulations, the
articles of organization, and the Texas LLC act are not rendered inoperative by the failure to exercise diligence in
obtaining a copy of the articles before agreeing to their terms. The court also found that the entity member had not set
forth any evidence that Gillen, Baldridge, or the LLC obtained any benefit through fraud, duress, or taking undue
advantage of the entity, and thus the trial court did not err in granting summary judgment on the unjust enrichment
claim. The court cited shareholder oppression cases for the definition of “member oppression,” but held that the entity
did not set forth any evidence in support of its member oppression claim. The court found the determination that the
articles of organization control disposed of the breach of contract claim but not the remaining reformation and breach
of fiduciary duty-based claims. The defendants claimed that the claim for breach of fiduciary duty was without merit
because the action taken complied with the articles of organization, but the court concluded that compliance with the
articles was not dispositive of such claims. The court’s opinion implies that the duties of the LLC members equate to
those of corporate officers and directors, but the opinion is not entirely clear in this regard.


Pinnacle Data Services, Inc. v. Gillen, 104 S.W.3d 188 (Tex.App. 2003). Four individuals formed a Texas LLC designated as member-managed by its articles of organization. Two of the individuals, Gillen and Baldridge, each owned a 25% interest, and an entity owned and operated by the other two individuals (Max and Morris Horton) owned the other 50% of the LLC. (The court noted in a footnote that the Hortons were apparently under the impression that they had the right to participate in management although they were not technically members of the LLC.) Disagreements over management developed, and Gillen proposed amending the LLC’s articles of organization to change it to a manager-managed LLC and electing Gillen as manager. The regulations (the Texas equivalent of an operating agreement) provided that amendment of the articles of organization required the affirmative vote of at least 66 2/3% of the ownership interest while the articles of organization provided for amendment by the affirmative vote of two-thirds of the members. Gillen and Baldridge voted for the proposed changes and relieved the Hortons of their duties with the LLC. The entity member brought suit for declaratory relief, unjust enrichment, and member oppression. The trial court granted summary judgment to Gillen, Baldridge, and the LLC. The declaratory relief hinged on the determination of whether the voting provisions of the articles of organization or the regulations controlled. Under the Texas LLC act, the regulations may contain any provisions for the regulation or management of the LLC not inconsistent with law or the articles of organization. Thus, the court determined that the articles of organization controlled, and the amendment received the requisite vote. The entity member claimed that it was not given a copy of the articles until two years after the regulations were signed, but the court stated that there was no evidence that it sought to obtain a copy (even though it signed regulations that were expressly subordinate to the articles of organization), and the articles were on file with the Secretary of State. The court stated that the regulations, the articles of organization, and the Texas LLC act are not rendered inoperative by the failure to exercise diligence in obtaining a copy of the articles before agreeing to their terms. The court also found that the entity member had not set forth any evidence that Gillen, Baldridge, or the LLC obtained any benefit through fraud, duress, or taking undue advantage of the entity, and thus the trial court did not err in granting summary judgment on the unjust enrichment claim. The court cited shareholder oppression cases for the definition of “member oppression,” but held that the entity did not set forth any evidence in support of its member oppression claim. The court found the determination that the articles of organization control disposed of the breach of contract claim but not the remaining reformation and breach of fiduciary duty-based claims. The defendants claimed that the claim for breach of fiduciary duty was without merit because the action taken complied with the articles of organization, but the court concluded that compliance with the articles was not dispositive of such claims. The court’s opinion implies that the duties of the LLC members equate to those of corporate officers and directors, but the opinion is not entirely clear in this regard.


In the context of a dispute over the coverage provided by an “Executive Safeguard” insurance policy providing “Directors and Officers Liability & Company Reimbursement Insurance,” the president of two South Dakota LLCs argued that South Dakota and California law, as well as the LLC operating agreement, required the LLCs to indemnify him. The court stated that South Dakota law permits South Dakota LLCs to indemnify officers and agents but does not mandate indemnification. Similarly, the court said California law permits, but does not require, LLCs to indemnify officers. The court pointed out that California law prohibits LLCs from indemnifying officers for breach of fiduciary duty. The court also determined that the terms of the operating agreement did not require indemnity because the LLC was required to do so only on advice of counsel and only after approving such an action.

The Chapter 7 trustee brought an adversary proceeding to set aside alleged fraudulent transfers. The court held that certain distributions to the members were fraudulent transfers. The court also addressed breach of fiduciary duty claims against members of the LLC who were officers. The court discussed the fiduciary duties of the LLC’s officers as if they were officers of a corporation. The court stated that the officers of a corporation owe a fiduciary duty to the corporation and its shareholders. Further, the court stated that the officers owe a fiduciary duty to the creditors of the corporation when the corporation is insolvent. According to the court, “[o]fficers of an insolvent corporation breach their fiduciary duty by transferring funds to themselves, in effect, as equity holders, to the detriment of the corporation’s creditors.” The court determined, however, that the trustee and the LLC’s major creditor were estopped from pursuing the breach of fiduciary duty claim. The noteholder was a “sophisticated player” and understood companies in the LLC’s
business. It conducted its own assessment of the LLC’s assets and concluded that the LLC’s assets supported its debt structure. The excess cash distributions were permitted under the terms of the note. The court thus applied the equitable estoppel doctrine to the fiduciary duty claim related to the excess cash distributions. The court also concluded that the officers of the LLC did not breach a fiduciary duty when they resigned from the LLC, formed another LLC, and transferred some business to the new LLC. The court stressed that the officers did not have a non-competition or non-solicitation agreement. Additionally, the agreement under which the LLC was acquired from the noteholder recognized that the officers had fiduciary duties to other interest holders in the real estate they controlled and permitted the officers to exercise discretion regarding property management contracts when their fiduciary duty to other interest holders required. (This case is further summarized below under the headings “Distributions” and “Fraudulent Transfer.”)

VGS, Inc. v. Castiel, No. C.A. 17995, 2003 WL 723285 (Del.Ch. Feb. 28, 2003) (applying “law of the case” doctrine and entering summary judgment on breach of fiduciary duty claim against two managers who orchestrated clandestine written consent to merger for purpose of eliminating majority control by third manager inasmuch as prior trial on corporate governance issue had already determined that the two managers owed a duty of loyalty to majority member and fellow manager and that attempted merger constituted a breach of that duty).

An LLC member asserted that other members breached their fiduciary duty to the LLC by diverting an LLC business opportunity to an entity owned by the defendant members. The court noted that it had not previously ruled on the corporate opportunity doctrine but identified four tests established as standards for identifying a corporate opportunity: the “line of business” test, the “interest or expectancy test,” the “fairness” test, and the “ALI” test. The court concluded that the plaintiff failed to meet his burden under any of the theories because the defendants owned two-thirds of the LLC membership interests and controlled business decisions under the operating agreement. According to the court, “[t]he majority owners impliedly disclosed to themselves and to [the LLC] all of the relevant facts about [the LLC’s] asserted corporate opportunity ... and elected to forego the opportunity.” The court also stated that financial inability justifies a corporation in rejecting an opportunity. The court found the plaintiff had made no showing that the LLC had the financial ability to take advantage of the opportunity and that there was evidence supporting the trial court’s finding that the LLC’s debts exceeded the appraised value of its assets.

Weiss, Cullinan, and others formed an LLC to market a device invented by Weiss. Acrimonious relations developed between Cullinan and the other members. The LLC eventually collapsed, and Weiss ultimately assumed management. Weiss informed Cullinan that he intended to dissolve the LLC and disburse the assets as required by law. Cullinan accused Weiss of wrongdoing in connection with certain payments and Weiss’s commencing work for a company with which the LLC had previously contracted for marketing of the device. Cullinan brought suit for dissolution of the LLC and accused Weiss of breach of fiduciary duty. Weiss counterclaimed and joined in the request for dissolution. Cullinan filed an amended complaint alleging sole ownership of the LLC and waiving any further winding up. The court upheld the lower court’s finding that Cullinan acted arbitrarily, vexatiously, or not in good faith on the basis of various actions disruptive to the LLC’s business. The court also upheld the lower court’s determination that Weiss did not breach his fiduciary duties to the LLC. Cullinan offered no evidence that Weiss’s handling of payments was improper, and the court held that a resolution authorizing Weiss to make certain disbursements that was allegedly signed by one of the members after his withdrawal from the LLC was not deceptive and indicated a good faith attempt to formalize an arrangement in the midst of confusing circumstances. Finally, the court did not agree with Cullinan that Weiss had breached his fiduciary duty by forming a sole proprietorship and competing with the LLC. The court said the LLC was breaking up and the contract between the LLC and the company with whom Weiss subsequently contracted had expired. Weiss contracted with the company as an independent contractor after disclosing his intentions to the other members of the LLC. The court concluded that payments to Weiss were payments to him as an independent contractor, and Weiss did not convert property of the LLC. The court also upheld the accounting made by Weiss to the members in connection with the winding up of the LLC.

Calderone was a member and the sole officer and operating employee of an Indiana LLC providing physician credentialing services. Prior to her departure from the LLC, she registered a domain name for a competing company. After her departure, while she was still a member in the LLC, she incorporated her new business and solicited customers. A few months later she sold her interest in the LLC to her father. The court addressed the LLC’s breach of fiduciary duty claims under both contract and common law principles. The court determined that Calderone violated
a covenant not to compete contained in a letter agreement between the members. The agreement prohibited a “shareholder” from competing with the business of the LLC without approval of the other “shareholders.” The court concluded that Calderone’s activities before she sold her “shares” to her father violated the agreement. The court also concluded that Calderone’s conduct violated common law fiduciary duties. The court discussed fiduciary duties in partnerships and close corporations and concluded that “Indiana LLCs, being similar to Indiana partnerships and corporations, impose a common law fiduciary duty on their officers and members in the absence of contrary provisions in LLC operating agreements.” The court concluded that Calderone owed a fiduciary duty even though she herself was not a member but owned her interest in the LLC through a single-member LLC. The court said she would nevertheless owe a duty not to seize business opportunities as the LLC’s sole officer and operating employee and she had admitted in responses filed with the court that she owed a duty to the other members “to deal fairly, honestly and openly with them.”


The plaintiff sold its 50% interest in a venture (the sole asset of which was a building) to the defendants, who controlled the managing member/remaining 50% owner, based on an $80 million valuation of the venture’s property. Two weeks later, the defendants contracted to sell the property to a third party for $200 million. The “venture” involved in this case was apparently an LLC (it is identified in the case as Cepetto Enterprises, LLC), but the court referred to it throughout as a venture or joint venture. The court noted that the venture was organized under Delaware law but did not refer to a specific statute. The court relied on case law on the fiduciary duties of “venturers” and “managing co-venturers” (including Meinhard v. Salmon) and concluded that the contractual disclaimers relied upon would be void as the fruit of the fiduciary’s breach of its obligation to make full disclosure in the context of a buy-out. The court stated: “Defendants have not brought to our attention any authority, from either New York or Delaware (the state under whose law the Venture was organized), that would give effect to a waiver of a fiduciary’s duty of full disclosure that the fiduciary obtained by means of its breach of that very duty, even where the party that gave the waiver was ... commercially sophisticated and advised by its own counsel.” The provisions in issue were provisions of the buy-out agreement in which the plaintiff acknowledged that it had been afforded an opportunity to conduct its own due diligence and was satisfied with the information made available to it in conducting the due diligence and provisions in which the plaintiff disclaimed any profits realized by the defendants on the future sale of the venture property and any claim for fraud, breach of loyalty, or fiduciary duty arising out of the venture with one specific exception. The court stated that “a fiduciary cannot by contract relieve itself of the fiduciary obligation of full disclosure by withholding the very information the beneficiary needs in order to make a reasoned judgment whether to agree to the proposed contract.” The court refused to dismiss the claim.


The manager of a New York LLC executed an agreement obligating the LLC to transfer the LLC’s assets to a new company being formed by one of the LLC’s members. After rejecting the argument that the manager was authorized to take the action under the operating agreement, the court addressed the claims of the manager and member that they were entitled to summary judgment under release and indemnification provisions of the operating agreement. The member relied upon a release relating to actions involving conflict of interests and breach of fiduciary duty. The court found, however, that the language indicated the scope of the release was confined to matters related to actions taken in connection with the member’s dual involvement in the LLC and a specified company in which the LLC invested. Further, the court found the release would be ineffective if it was intended to release the member from all actions taken in his self-interest. For example, the court said, a release cannot reach willful and intentional misconduct. The court noted that certain alleged misconduct of the member might fall within this realm, e.g., alleged breaches of fiduciary duty, intentional interference with the LLC’s ability to obtain financing, and attempted misappropriation of an LLC business opportunity. With respect to the manager’s release claim, the court found that the complaint alleged liability based on actions outside the scope of the operating agreement’s release of the manager because it involved conduct not properly within the capacity of manager (e.g., his attempt to bind the LLC to transfer its assets without authority). Further, the New York LLC act provides that an operating agreement may not eliminate or limit liability if a judgment establishes bad faith, intentional misconduct, or a knowing violation of law, which the allegations indicated. The court stated that the manager’s alleged breaches of fiduciary duty involved misconduct that might result in a judgment based on bad faith, intentional misconduct, or knowing violations of the LLC act. The manager’s summary judgment claim for indemnification was rejected for similar reasons. The operating agreement provided for indemnification of the manager to the fullest extent permitted by law, but the New York LLC act precludes indemnification if a judgment establishes bad faith or deliberate dishonesty. The member’s claim for indemnification was rejected because he cited no provision of the operating agreement providing for his indemnification.

Through a series of transactions, Anest invested in an insolvent LLC and became a member. At the time of his investment, the management structure was changed from manager-management to member-management. The LLC sold a beer line cleaning device called the BLM 2000. The LLC exhausted its capital infusion, and an emergency meeting of the LLC’s members was called, the stated purpose of which was “to discuss changing the business relationship of the company from a non-exclusive distributor to an importer and the ramifications thereof.” The notice was faxed three days before the meeting. The operating agreement required five days’ notice of a meeting and did not address facsimile notice. Four of the five members attended the meeting. Audino, a 5% member, did not attend. At the meeting, the members discussed an offer for a five-year exclusive distributorship of the BLM 2000 from the patent holder of the device. The members at the meeting voted not to make the substantial capital contributions that would be required to secure the exclusive distributorship offer. After the meeting, these four members formed a new LLC to obtain the exclusive distributorship offer. When Anest, one of these four members, sued Audino to recover on another debt, Audino counterclaimed against Anest for breach of fiduciary duty and tortious interference with Audino’s business expectancy. The trial court granted Anest’s motion for directed findings. The trial court held that Anest did not owe Audino a fiduciary duty because Anest did not have control over the daily operations of the LLC or otherwise have management-like responsibilities. The trial court also held that, even if there was a duty owed, Anest did not breach it because the LLC did not have the financial ability to act upon the business opportunity in issue. The appeals court reversed. The appeals court held that the Illinois LLC act in effect at the time required the court to look to the law of corporations to determine the existence of any fiduciary duties. The court cited Hagshenas v. Gaylord, which held that shareholders in a closely held Illinois corporation owe one another partner-type fiduciary duties. The court stated that Anest’s capacity as a 12% member in a member-managed LLC made him more than a minority shareholder; rather, he was akin to an officer or director of a corporation who owes fiduciary duties to shareholders and the corporation. The court found that the BLM 2000 distributorship opportunity was a business opportunity of the LLC and that the financial inability of the LLC was not controlling since the assets of the LLC were used to develop it. The court also noted that the opportunity was not properly disclosed and tendered to the LLC because the notice violated the requirements of the operating agreement.


The plaintiff was a one-third member and the Chief Manager of a Tennessee LLC. After disagreements arose, the members of the LLC other than the plaintiff took action by written consent to terminate the employment of the plaintiff and to exercise a buy-out right on the part of the LLC triggered by the termination of employment of a member. The plaintiff brought suit alleging various causes of action, including breach of fiduciary duty, fraud, breach of the operating agreement, and breach of the duty of good faith and fair dealing. The court of appeals upheld the trial court’s conclusion that members of a member-managed LLC do not owe one another fiduciary duties under the Tennessee LLC act. The Tennessee act provides that members of a member-managed LLC must account to the LLC for any benefit, and hold as trustee for it any profits derived by the member without consent of the other members, from any transaction connected with the formation, conduct, or liquidation of the LLC or any use of its property. The act goes on to provide that a member’s duties must be discharged in good faith, with the care of an ordinarily prudent person in a like position under similar circumstances, and in a manner the member reasonably believes to be in the best interest of the LLC. The court stated that the statute defines the fiduciary duty of a member of a member-managed LLC as one owing to the LLC, not to individual members. The court stated that it could not “contravene the intent of the Legislature.” The court also dismissed the fraud claim on the basis that the allegations stated a claim that was essentially derivative, and thus the plaintiff did not have standing to pursue it individually. The court stated that the general rule of at-will employment in Tennessee was not altered by the operating agreement and that there is no implied covenant of good faith and fair dealing in an employment at will contract. (The trial court based its dismissal of the good faith and fair dealing claim on its conclusion that “performance of a contract by its terms cannot be characterized as bad faith” and its assessment that the operating agreement allowed the very actions taken in terminating the plaintiff’s employment.) The court found that the plaintiff waived his argument that there had been a breach of contract based upon a conflict of interest in violation of the operating agreement. The court did conclude that there was a fact issue as to whether there was “cause” to terminate the employment of the plaintiff under the operating agreement, an issue that was relevant to the valuation of the plaintiff’s membership interest under the terms of the operating agreement.


In this dispute between the members of an Arkansas LLC, a member whose employment was terminated alleged that the managing member breached his fiduciary duty in terminating the member and attempting to force the terminated member to sell his units back to the LLC under a repurchase provision in the operating agreement. The
managing member terminated the member “for cause” and notified the member that the LLC would exercise its option to buy the member’s units. Under the operating agreement, a member terminated for cause was entitled only to the value of the member’s capital account. Ultimately, the district court found that the managing member was within his authority to terminate the member’s services but that the termination was without cause. Thus, the member was entitled to the fair market value of his units rather than the value of his capital account. The terminated member argued that the repurchase provision in the operating agreement did not apply to his situation, but the district court and the court of appeals determined that the repurchase provision was applicable. In response to the terminated member’s argument that the managing member breached his fiduciary duty, the court of appeals stated that, under Arkansas law, a manager of an LLC is not liable to the LLC or another member unless he engages in gross negligence or willful misconduct. The court stated that the operating agreement gave the managing member broad authority to make all decisions regarding the management of the LLC and responsibility for all administrative matters; thus, the managing member acted well within his authority in terminating Ault. Moreover, said the court, the managing member’s conduct in attempting to reacquire the terminated member’s units was permissible under the operating agreement.

**Disola Development, LLC v. Mancuso,** 291 F.3d 83 (1st Cir. 2002) (construing Massachusetts prejudgment interest statute in context of judgment against former members of LLC for conversion, breach of fiduciary duty, and wrongful distribution).


The plaintiff LLC obtained a default judgment against one of its members for injunctive relief and damages for breach of fiduciary duty. The pleadings alleged that the defendant instructed an LLC customer to make payments totaling $70,000 to the member rather than to the LLC’s lender as required by the LLC’s loan agreement. The LLC alleged that such action would irreparably damage the goodwill of the LLC, prevent the LLC from fulfilling its obligations to its customer, impair the LLC’s ability to finance the acquisition of additional goods to fill future orders, and impair the LLC’s ability to obtain or satisfy future orders. The petition further alleged that the member, “as a director” of the LLC, owed the LLC fiduciary duties which were breached by the acts described above. The court held that the petition was sufficient to put the member on fair notice that the LLC claimed a breach of fiduciary duty, and there was no error in entering a default judgment for breach of fiduciary duty. The court reversed and remanded for a new trial on the issue of unliquidated damages because the record lacked evidence to support the trial court’s award of damages.


A member of an LLC whose interest would decrease from 50% of the voting units to 5% of the voting units in a proposed merger of the LLC sought a preliminary injunction on the basis that the other member and managers appointed by it acted in bad faith in approving the proposed merger and that the defendants would be unable to prove the entire fairness of the merger. First Solar, LLC (the “LLC”), a Delaware LLC, was formed by True North Partners, LLC (“True North”) and Solar Cells, Inc. (“Solar Cells”) to commercialize solar power technology. Solar Cell contributed the technology, and True North contributed and loaned money to the LLC. Solar Cells and True North each received 50% of the voting membership units, and True North received 100% of the non-voting units. True North had the right to elect three of the five managers, and Solar Cells had the right to elect the other two. The LLC’s initial funding was depleted, and the members unsuccessfully negotiated various alternatives for financing and restructuring. Without notice to Solar Cells, the True North managers executed a written consent approving the proposed merger of the LLC into an LLC wholly owned by True North. Solar Cells received notice of the proposed merger four days before it was to close. Under the terms of the merger, the balance of True North’s loan to the LLC would be converted into equity, and Solar Cells would end up with 5% of the voting units in the surviving LLC. The court found that there was a reasonable likelihood that Solar Cells would prevail on the merits, that is, that True North would be required to establish the entire fairness of the merger and would be unable to do so. True North argued that the actions taken to authorize the merger were clearly authorized by the operating agreement and that the operating agreement limited fiduciary duties owed by the True North managers. The court noted that the provisions of the operating agreement limited liability stemming from a conflict of interest but that the limitation on the managers’ liability did not bear on the request for injunctive relief. Further, the provisions of the operating agreement protected the managers so long as they acted in good faith. With respect to fair dealing, the court was critical of the lack of an independent bargaining mechanism and failure to give Solar Cells advance notice. (“[I]t is not an unassailable defense to say that what was done was in technical compliance with the law... . The fact that the Operating Agreement permits action by written consent of a majority of the Managers and permits interested transactions free from personal liability does not give a fiduciary free reign to approve any transaction he sees fit regardless of the impact on those to whom he owes a fiduciary duty.”)
The court also found that the valuation used to establish the price was likely not fair because it was irreconcilable with valuations only a few months before True North decided to proceed with the merger. Finally, the court found that irreparable harm was threatened because of the dilution of the equity and voting position of Solar Cells, the difficulty in valuing the LLC, and the limitation of True North’s liability for conflicts arising from its fiduciary obligations.


The Chancery Court addressed the fiduciary duties of members of a Michigan LLC in order to determine the validity of the actions of one of the members in voting the LLC’s shares of stock in a Delaware corporation. Citing the Michigan LLC act, the court stated that members of the LLC owed the LLC and one another fiduciary duties. More specifically, the court referred to a duty of complete candor and an obligation to provide full and fair disclosure of all material facts relating to any matter involving the LLC. With respect to the delegation of authority to vote the shares of stock in issue, the court stated the member seeking to enforce her rights must show all material facts relating to its execution were disclosed. The court cited two Delaware cases involving corporations, *Malone v. Brincat* and *Rosenblatt v. Getty Oil Co.*, in support of the duty of full candor and disclosure. The court concluded that the member had obtained the delegation of authority to vote the shares by a breach of her fiduciary duty, if not outright fraud, and that the delegation was thus invalid.

**RT Gilbane Corp. v. Neighborhood House, LLC**, No. 00-1973, 2002 WL 774992 (Mass. Super. Feb. 15, 2002)(granting summary judgment in favor of members of LLC who were not active in LLC’s management on breach of fiduciary duty claim by non-member project manager who claimed that the LLC and project manager were “joint venturers” and sought to characterize the individual LLC members as partners/fiduciaries of the project manager)


The court held that the obligations of LLC members and managers are clearly established by the Connecticut LLC act, citing a provision requiring a member or manager to discharge his duties in good faith, with the care of an ordinarily prudent person under similar circumstances, and in a manner he reasonably believes to be in the best interests of the LLC. The court also cited provisions requiring a member or manager to account for any benefit received without disinterested manager or member approval. The court concluded that the defendant breached his fiduciary duties when the defendant unilaterally amended the LLC operating agreement of Tower Business Center, LLC (“Center”) to permit it to have only one member, and dissolved Associates, LLC (“Associates”), Center’s 99% member. The defendant owned the other 1% of Center and was the majority member of Associates. The plaintiff was the minority member of Associates. At the time Center was formed, Connecticut law required an LLC to have two or more members, and the operating agreement required Center to have two members. The court stated that by dissolving Associates and empowering Center to have only one member, the defendant averted dissolution of Center by dissociation of Associates and became the sole member of Center, a single purpose LLC owning a parcel of commercial real estate. The court characterized the defendant’s conduct as a “scheme to obtain sole ownership of the subject property to the exclusion of the plaintiff.”


The plaintiffs and the debtor were investors who entered a joint venture agreement and formed an LLC to secure financing and manage a real estate project. The debtor was also the attorney for the LLC (referred to in the case as the joint venture) and a member of the management committee. The plaintiffs alleged that the debtor owed them a fiduciary duty as a co-venturer, management committee member, and attorney for the venture, and that his liability for the venture’s debt was non-dischargeable because it arose from a defalcation of fiduciary duty when he obligated the venture to loan amounts in excess of borrowing authorizations. The court found that there must be an express or technical trust, not merely a general fiduciary relationship like that arising out of an attorney-client, joint venture, or partnership relationship in order for a fiduciary relationship to exist under section 523(a)(4) (the dischargeability exception for defalcation in a fiduciary capacity). Additionally, the court found that the bankruptcy court was in error in concluding a defalcation had occurred.


The minority interest holders of an LLC claimed that the 51% interest holder (“Moneta”) breached its fiduciary duty to the minority by scheming to financially cripple the LLC so that the LLC would default on its loan and its assets could be acquired and developed by Moneta. Although provisions of the operating agreement quoted in one footnote of the opinion indicate that it was a manager-managed LLC and that Moneta was the manager, the court couched the
fiduciary duty of Moneta in terms of its majority ownership. The court referred to Moneta as the “Majority Shareholder” and the minority members as the “Minority Shareholders” and stated that Moneta, as a majority shareholder, owed a duty to the minority under Rhode Island law. The court quoted a Rhode Island Supreme Court opinion in which the court held that shareholders in a closely held (“less-than-thirty-shareholder”) corporation assume fiduciary duties to one another and the corporation when they act as partners, noting that this duty was imposed on the basis of the small number of shareholders, active participation of shareholders in management, close and intimate working relations, and the fact that the shareholders acted as if they were partners. When the court analyzed the evidence regarding the conduct of Moneta, however, it concluded that the minority owners had failed to prove their allegations that Moneta breached its fiduciary duty.


The dispute in this case related to the affairs of a Pennsylvania LLC formed to provide laundry services to the hospital customers of one of the members of the LLC. The parties to the litigation included the LLC, its two members, and various individuals and entities affiliated with the members. The court interpreted various provisions of the Pennsylvania LLC law as authorizing the court to look to principles of partnership and/or corporate law in analyzing fiduciary duties of LLC members. The operating agreement of the LLC in issue provided for management of the LLC to be vested in the members. Therefore, the court concluded that it should treat the members like partners and that a member who failed to properly run the daily operations of the LLC may ultimately be liable for breach of fiduciary duty as a co-member of the LLC. In the course of its decision, the court quoted from commentary to the Pennsylvania LLC law stating that members who do not act as managers, like corporate shareholders or limited partners, would not have the fiduciary duty of managers. The quoted comment went on to note, however, that a non-managing member would have no right to appropriate LLC property for personal use, and that courts should fashion rules in appropriate circumstances by analogy to corporate or partnership law principles to deal with situations such as oppression of minority members, actions taken in bad faith, etc. With respect to standing, the court stated that if the complaining circumstances by analogy to corporate or partnership law principles to deal with situations such as oppression of minority members, actions taken in bad faith, etc. With respect to standing, the court stated that if the complaining member’s claim against the other member were construed as a derivative claim, the court could treat it as direct since they were the only two members of the LLC. However, the court concluded that the complaining member’s principal was too far removed to bring a breach of fiduciary duty claim against the other member. The duty, if any, said the court, would be between the members of the LLC, not individual shareholders of the members. Similarly, the shareholders of the allegedly breaching member could not be held liable for breach of fiduciary duty.


The issue in this adversary proceeding was whether, for purposes of § 523(a)(4) of the Bankruptcy Code, the debtor was acting in a fiduciary capacity in his role as manager of a Virginia LLC. The court recognized that an LLC manager has a fiduciary duty to the LLC based upon statutory provisions obligating the manager to exercise good faith business judgment, but found that an LLC manager is not a fiduciary for purposes of § 523(a)(4). The court ultimately determined that the manager’s excess withdrawals from the LLC amounted to a non-dischargeable claim for embezzlement. The court concluded that this conduct was “willful misconduct” such that the Virginia $100,000 liability cap was not applicable. The case is further discussed below under the heading “Bankruptcy.”


The court found that the breach of fiduciary duty by two managers to Castiel in pursuing a merger eliminating Castiel’s control without prior notice to Castiel (the subject of a prior opinion summarized below) was not so egregious as to justify awarding Castiel attorney’s fees. The court noted that the process followed by the two managers (which was held to be a breach of the managers’ duty of loyalty in the prior opinion) complied with the LLC’s operating agreement and the Delaware LLC act. Further, the court noted that the prior opinion did not reflect any conclusion that the two managers were not motivated by an honestly held view that Castiel’s continued control threatened the interests of the LLC. (The court went on to find that the repeated failure of one of the managers to appear for deposition justified a partial award of expenses and attorney’s fees.)


The court in this case held that there were no fiduciary duties owed by one member of an LLC to the other member, and the court of appeals upheld this conclusion because the LLC agreement on which the plaintiff based the breach of fiduciary duty argument was found to be unenforceable due to lack of an essential term. On appeal, the court noted that the plaintiff had relied solely on the terms of the written agreement in asserting his breach of fiduciary duty claims. Although the plaintiff attempted to raise a joint venture theory on appeal to argue that fiduciary duties were
owed independently of the written agreement, the court restricted its review to the theory relied upon by the plaintiff at trial. The court of appeals found no error in the trial court’s conclusion that the membership agreement was unenforceable for lack of an essential term.


In this case involving a Delaware LLC, breach of fiduciary duty was not an issue, but the court made the passing comment that the majority interest holder of an LLC owes a fiduciary duty to the LLC’s minority interest holder. The court cited Froelich v. Erickson (a case summarized below). In Froelich v. Erickson, the governing documents of the LLC used corporate terms and expressly incorporated Maryland law regarding corporate fiduciary duties.


The Virginia Supreme Court affirmed a trial court judgment holding the manager of Flippo Land & Timber Co., LLC, a family-owned LLC (Flippo LLC) liable for breach of fiduciary duty to the LLC and barring the manager and his brother from serving as managers. Flippo LLC held timberlands and had three members: Carter Flippo, who was also manager, Carter’s brother Arthur Flippo, and CSC Associates III, L.L.C. (“CSC”), an LLC owned by the three children of Carter’s and Arthur’s sister. In response to the refusal of CSC to allow Carter and Arthur to transfer their interests in Flippo LLC to individual LLCs for estate planning purposes, Carter consulted a law firm and chose a course of action suggested by the law firm that would allow Carter and Arthur to satisfy their estate planning goals by holding their interests in the timberland business in LLCs. Pursuant to the advice received by Carter from his lawyers, Carter, as manager of Flippo LLC, caused the LLC to transfer all of its non-cash assets to a new LLC. The transfer of Flippo LLC’s assets dissolved Flippo LLC under the operating agreement, and CSC was given the option of joining the new LLC if it agreed to the terms of its operating agreement, under which Carter and Arthur could hold their interests through LLCs. (Prior to trial, the new LLC dissolved and returned the assets to Flippo LLC, rendering claims against the new LLC moot.) Carter was found liable for breach of fiduciary duty based upon his orchestration of the transfer of Flippo LLC’s assets to the new LLC. He appealed, arguing that he was entitled to a defense based upon his reliance on the law firm’s advice. His defense was based upon a provision of the Virginia LLC act protecting a manager who acts in good faith reliance on legal counsel or other professionals. The court found that this provision was not applicable in the instant case. The court pointed out that a manager, like a corporate director, is required by statute to discharge his duties in accordance with his good faith business judgment in the best interests of the LLC. Additionally, the LLC and corporate statutes contain nearly identical provisions protecting managers and corporate directors from liability in the exercise of that judgment under certain circumstances. The court found, however, that Carter was receiving advice in his personal capacity for his own personal interests when he consulted with the law firm, and he was therefore not protected by these provisions. Further, the court rejected the argument that reliance on advice of counsel was a defense to punitive damages, and the award of punitive damages was upheld. The court also upheld the removal of Carter as manager and the prohibition of his brother Arthur’s serving as manager on the basis that this point was not properly preserved for appeal. The court finally rejected the claims of Carter and Arthur for dissolution of Flippo LLC and for rescission of the operating agreement based on fraud and mutual mistake, and the court upheld sanctions against Carter and Arthur based upon their allegations of mutual mistake and fraud.


The plaintiff, the parent company of a member of an LLC with two other entity members, sued the LLC and its other two members for breach of contract and negligent misrepresentation based upon certain representations and warranties in the LLC operating agreement and an energy services agreement between the LLC and the plaintiff. The court had occasion to briefly address fiduciary duties between the plaintiff and the two defendant members of the LLC in connection with the negligent misrepresentation claim. The plaintiff’s allegations relating to fiduciary duties were vague, but the court made the point that fiduciary duties generally are owed by LLC members to one another. The plaintiff had not relied upon this principle, but the court noted that this principle alone would not have been enough because the plaintiff was not itself a member of the LLC. It was not at all apparent to the court that fiduciary duties would flow from the defendant members of the LLC to the parent of the other member, and the plaintiff failed to pursue the argument.

In re Larry’s Apartment, L.L.C. (Galam v. Carmel), 249 F.3d 832 (9th Cir. 2001).

An LLC member was found liable for breach of fiduciary duty to the LLC for his actions in purchasing a parking lot adjacent to the LLC’s business and refusing to allow the LLC to continue its use of the lot. The court imposed a constructive trust on the lot for the benefit of the LLC without compensation to the member because the
member had improperly caused the LLC to pay personal expenses exceeding the amount he paid for the land. The issue was whether an award of attorney’s fees, based upon an Arizona statute providing for recovery of attorney’s fees in an action arising out of a contract, was proper. The court concluded that this action did not arise out of a contract. The only contract the court identified as being related to the action was the peripheral contract the LLC member entered into with the seller of the land. The relationship of that contract to the action was insufficient to support the fee award.


The court rejected the argument that a 50% member of an LLC breached its fiduciary duties by purchasing a note and secured position on real estate of the LLC rather than making an additional capital contribution to the LLC so the LLC could discharge the obligation. The Chapter 11 debtor in this case was Lake Country Investments, LLC (“Lake Country, LLC”). Agincourt, LLC was one of two 50% members of Lake Country, LLC. The managing and majority member of Agincourt, LLC was West Wood Investments, Inc. (“West Wood”). Noyes, a creditor of Lake Country, LLC, argued that West Wood and Agincourt, LLC were alter egos so that the conduct of West Wood was attributable to Agincourt, LLC. Noyes claimed that West Wood’s secured claim against Lake Country, LLC should be equitably subordinated because the failure of Agincourt, LLC to advance funds to Lake Country, LLC and the purchase of the note and secured position by West Wood breached the fiduciary duties of West Wood/Agincourt, LLC. The court stated there were genuine issues of material fact on the alter ego contention, but the breach of fiduciary duty allegation was rejected as a matter of law, thus the court granted summary judgment dismissing the equitable subordination claim. The court noted that, under the operating agreement, neither member was obligated to contribute additional capital or make loans to the LLC. The court said that Noyes did not show how a member of an LLC breaches a fiduciary duty by acting (or not acting) in a manner specifically permitted by the operating agreement. Further, the court rejected the argument that statutory law created a fiduciary duty between the members. Noyes relied upon the provision of the Idaho LLC act requiring a member to account to an LLC for any benefit received without consent of a majority of disinterested members or managers. The court stated that an LLC is distinct from a corporation or partnership and viewed the case law applicable to partnerships as having “limited utility.” Further, the court noted that the Idaho LLC act recognizes the primacy of the structural and organizational documents and concluded that nothing in the statutory provision relied upon by Noyes required that the court ignore the limits the parties themselves structured in the operating agreement. In a footnote, the court indicated that it considered significant the fact that the dispute involved “a close quarters fight among those who were most intimately involved with the LLC” rather than the interests of the LLC or its unsecured creditors. The court noted that the parties were all sophisticated and assisted by expert counsel and that the causes of action sought to recharacterize or alter the effect of prior transactions.


A trial court used the language of Section 404 of the Kansas Revised Uniform Partnership Act to define for the jury the fiduciary duties of LLC members. The court of appeals concluded that the trial court’s use of language from the partnership statute was not error. The court stated that the trial court did not apply the partnership act but merely utilized the language for guidance on the breach of fiduciary duty issue.


The Robert C. Carson Revocable Trust (the “Carson Trust”) owned a 20% interest in an LLC, and Robert C. Carson was the president and general manager of the LLC. The LLC was retained under a management agreement to manage Carson Communications. After a dispute over whether Carson took a business opportunity without first offering it to the LLC, the LLC’s board of managers voted to terminate Robert Carson as president and general manager. The new president and general manager then terminated the management agreement between the LLC and Carson Communications. Carson and the Carson Trust sued the majority member, the three individual managers appointed by the majority member, and an individual who allegedly influenced and controlled the managers for breach of fiduciary duty in terminating Carson and the management agreement. The defendants moved to dismiss on the basis that the plaintiffs failed to state a claim. The court refused to dismiss the breach of fiduciary duty claim against Gabelli, the individual who allegedly influenced and controlled a majority of the managers, concluding that the allegations of influence and control over a majority of the LLC managers was sufficient to permit the plaintiffs to go forward in their attempt to prove an implied or imputed fiduciary duty. The court also rejected the defendants’ argument that the business judgment rule required dismissal. The court stated that the business judgment rule presupposes that directors act on an informed basis and in the honest belief that their actions are in the best interest of the company, and the court pointed out that the complaint alleged that the actions were taken for reasons wholly unrelated to the business of the LLC. The court also rejected the defendant’s argument that the LLC act protected the defendants from liability for
breach of fiduciary duty or minority oppression because of the provision that no member or manager is liable for the debts and obligations of the LLC. Contrary to the defendants’ assertion that the operating agreement must provide for any remedy for breach of fiduciary duty, the court stated that the act recognizes that a manager or member may owe fiduciary duties and allows the operating agreement to expand or restrict those duties. The court distinguished liability for the debts and obligations of the LLC from liability for breach of fiduciary duty.


Walker, a first cousin of former President Bush, was brought in as a member of a Delaware LLC in order to utilize his connections and reputation to help the LLC secure needed financing. After Walker failed to secure financing and the other members became concerned about Walker’s drinking problem, financial irresponsibility, and other matters, he was relieved of his official duties for a period of time. He was later given his job back, and the members entered into a formal operating agreement designating Walker as an 18% member. Ultimately, however, the relationship soured completely, and the other members purported to remove him as a member and terminate his ownership interest. The members referred to Walker’s poor performance and misconduct in the written notice of his removal, but there was also a dispute over whether Walker had a side deal that constituted a conflict of interest. The court concluded that the other members had no authority to remove Walker as a member either under the Delaware LLC act or the operating agreement. The court rejected the argument that the members had the inherent power to remove Walker and deprive him of his ownership interest based upon his alleged breach of fiduciary duty. Although the court recognized that there was a relationship of sufficient trust and confidence to impose on Walker a duty to disclose a material fact as such a conflict of interest, the court concluded that the members did not rely on any understanding that Walker was independent in entering into the operating agreement. Thus, the court rejected the members’ misrepresentation claim against Walker. The court also rejected the members’ claim that they were protected from liability for their effort to appropriate Walker’s interest based upon a good faith reliance on the operating agreement. After purporting to remove Walker, a series of financing transactions led to the exchange of the members’ membership interests in the LLC into shares of a Canadian corporation. Walker failed to prove the value of his 18% interest in the LLC, thus there was no basis for an award of damages; however, the court imposed a constructive trust in Walker’s favor upon 18% of the shares the other members had received in the Canadian corporation.

In the course of discussing whether the operating agreement of an LLC was an executory contract for purposes of the Bankruptcy Code provisions preventing enforcement of certain ipso facto clauses, the court made some observations about fiduciary duties. The court described the provisions of the operating agreement regarding management and noted that a member was not obligated to participate in management or provide any personal expertise or service to the LLC, and a member was permitted to resign from all offices and committee positions without breaching the operating agreement. In such a case, the court said, the member would be analogous to a shareholder in a corporation. In a footnote, the court stated that, unlike partnerships, there are no fiduciary obligations among members of an LLC. The court noted that the Virginia LLC act imposes a duty of good faith business judgment on managers but is silent as to members. (In fact, the Virginia LLC act imposes this duty on any member who is participating in management.) The court went on to cite the provision of the Virginia LLC act permitting a member to transact business with the LLC on the same basis as a non-member. The court found the absence of statutory provisions imposing fiduciary obligations on one member to another or the LLC significant, noting that LLCs are statutory creations, not common law creations like partnerships, and pointing to the express provisions on fiduciary duties in the Virginia partnership statutes.


The minority member of a Texas LLC claimed that the majority member owed it a fiduciary duty as a matter of law. The case does not state whether the LLC was member-managed or manager-managed, but the articles of organization provided as follows: “Members of this Company have a duty of undivided loyalty to this Company in all matters affecting this Company’s interest.” The Texas LLC act provides: “To the extent that at law or in equity, a member, manager, officer, or other person has duties (including fiduciary duties) and liabilities relating thereto to a limited liability company or to another member or manager, such duties and liabilities may be expanded or restricted by provisions in the regulations.” The court noted the absence of Texas case law on fiduciary duties of LLC members and looked to case law regarding fiduciary duties of shareholders of a closely held corporation. In prior cases, the court had held that co-shareholders of closely held corporations are not necessarily in a fiduciary relationship. Rather, the existence of a fiduciary relationship is a question of fact. The court applied the same reasoning and stated that its conclusion was not affected by the fact that the defendant was the majority member. The court pointed out the provision in the LLC’s articles of organization provided for a duty of loyalty to the LLC rather than between the members. The court said that neither the statute nor the provision in the articles authorized the court to find that there was a fiduciary relationship between the members as a matter of law, and the issue was remanded for determination by the factfinder.


One of the members of a Kansas LLC sued another member and the member’s owners and agent for breach of the operating agreement and breach of fiduciary duty when they acquired other cable franchises rather than securing them for the LLC. The LLC operated a television cable system, and the operating agreement specified that if an opportunity to purchase certain cable television systems came to the attention of a member, the opportunity must first be offered to the LLC. Another provision in the operating agreement stated that any member or manager was permitted to engage in other business ventures, and the LLC would have no rights in such regard. Robert Carson was trustee of the Robert Carson Trust, a 20% member of the LLC, as well as president and a manager of the LLC. In 1997, Carson informed representatives of Lynch Multimedia Corporation (Lynch), a 60% owner of the LLC, of the potential availability of certain cable systems. Lynch was receptive to exploring the opportunities. Over the next year, discussions and negotiations continued. At one point, a Lynch representative rejected the acquisition of the cable systems, but a couple of proposals were made a few months later in the fall of 1998. In the spring of 1999, Carson acquired the cable systems through his own entity. Lynch sued for breach of the operating agreement and breach of fiduciary duty. The court held that the operating agreement’s requirement that certain opportunities be “offered” to the LLC contemplated only that the LLC be made aware of such opportunities, not that a formal offer be presented. The court concluded that Carson satisfied this requirement by making Lynch aware of the opportunities. The court rejected Lynch’s claims that a formal meeting was required, noting that the LLC at all times operated on an informal basis with Lynch’s acquiescence. The court also stated that the operating agreement’s requirement that certain opportunities be offered to the LLC must be read in conjunction with the provision permitting members to engage in other ventures; therefore, it plainly was directed at permitting members to enter separate and additional business relations in the cable TV industry. The court thus granted summary judgment in favor of the defendants on both the breach of operating agreement and breach of fiduciary duty claims. The court said that Lynch had not articulated how the breach of fiduciary duty claims were distinguishable from the breach of operating agreement claims. The court cited the provision
The factual background of this case is rather complicated, but the claims involved assertions of fraud, breach of fiduciary duty, and breach of contract by Froelich, an ousted CEO and board member of a Maryland LLC. Froelich was also a member of the LLC who, along with other minority members, was cashed out in a squeeze-out merger following a reclassification of interests of the LLC approved by all members except Froelich. Two documents primarily governed the LLC’s operations as an LLC. These documents were an Operating Agreement, which the court characterized as the LLC equivalent of a corporate charter, and a Members Agreement, which the court described as the equivalent of a stockholders’ agreement. The operating agreement defined classes of preferred and common interests, the role and responsibility of the board, and the rights and duties of the members. The member agreement supplemented the operating agreement by specifically defining rights of members and restrictions on alienation of interests. The court summed up Froelich’s claims as a challenge to “a handful of corporate actions taken by [the LLC’s] Board and its Members.” The court summed up the key issues in the case as follows: “(i) Did the corporate documents or Maryland corporate law authorize the Board to take the actions that Froelich challenges? (ii) If the Board or the Members had the power to act, by what standard (e.g., business judgment rule or fiduciary duty) should the Court review the Board’s exercise of that power? and (iii) Did the Board meet the appropriate standard?” The court characterized the case as arising in the context of corporate decisions by the LLC’s board of directors and applied the business judgment rule. The court noted that the LLC’s operating agreement stated that the LLC’s directors “are subject to the duties of a corporate fiduciary as defined by Maryland law;” thus, the court continued, the LLC board’s decisions are measured against the business judgment rule “just as if [the LLC] were a traditional corporation, rather than an LLC.” The court also concluded as follows: the LLC and majority member did not breach a duty of good faith and fair dealing (noting uncertainty under Maryland law as to whether there is a separate cause of action in this regard and stating that the duty in any event only prohibits a party from preventing the other party from performing under the contract); the majority member did not breach a fiduciary duty to Froelich by usurping a business opportunity (stating that a majority interest holder clearly owes the minority a fiduciary duty but finding no breach in view of the board’s independent approval of the transaction); the reclassification did not breach the operating agreement or the member agreement (finding that the transaction fell outside a provision in the member agreement restricting redemptions and was governed by the operating agreement, which was amended in accordance with its terms to permit the reclassification). In Froelich’s favor, the court found that the LLC owed Froelich severance pay under an employment agreement between the LLC and Froelich and that the reclassification and squeeze-out were related parts of a transaction in which Froelich had properly preserved his statutory right to an appraisal. The court explained that the Maryland LLC statute grants a member the same appraisal rights as an objecting stockholder under corporate law. Maryland corporate law provides appraisal rights in connection with a parentsubsidiary merger, and Froelich properly objected to the squeeze-out merger. The court viewed the reclassification and subsequent squeeze-out merger as a single transaction rather than separate events such that Froelich was entitled to appraisal of his interests immediately prior to the reclassification rather than appraisal of his reclassified interests immediately prior to the merger that occurred five months later.


This was the first case to address the fiduciary duties of members of an LLC to any significant degree. In this case, the court stated that members of an LLC are in a fiduciary relationship that would generally prohibit competition with the business of the LLC. (The court did not directly address the management structure, but it appears that the LLC was member-managed. The opinion notes at one point that the operating agreement did not name any person or entity the operating or managing member of the LLC.) The court concluded, however, that members may contractually limit or define the scope of the fiduciary duties. Specifically, the court recognized the validity of a provision in the operating agreement of an Ohio LLC that permitted members to compete with the LLC. When some of the members of an LLC formed to obtain a hockey franchise objected to the terms of a lease that was necessary to obtain the franchise, other members formed a separate group that agreed to the lease and obtained the franchise. The court found the operating agreement clearly and unambiguously permitted members to compete against the LLC and thus obtaining the franchise did not breach a fiduciary duty. The court indicated that “the method of competing” might constitute a breach of fiduciary duty if it amounted to “dirty pool” but found no willful misconduct, misrepresentation, or concealment by the
members who formed the other group. Further, the court found that the non-competing member breached the operating agreement by unilaterally undertaking litigation on behalf of the LLC without the requisite approval of the members. The member argued his actions did not constitute willful misconduct and that his actions were protected under the exculpation and indemnity provisions of the operating agreement. The court, however, found that the exculpation and indemnity provisions applied in the context of members’ carrying out their duties under the operating agreement and that there was no duty to unilaterally bring the litigation. The court concluded that the member engaged in willful misconduct in filing the suit without asking even one other member for permission when the agreement required a majority vote. The member argued that the litigation was undertaken upon advice of counsel and therefore in good faith. The court stated that the evidence did not show that the member relied upon advice that the member was acting within the scope of authority conferred by the agreement. The evidence showed only that the member caused the suit to be filed and that the member’s general counsel had responsibility for the litigation.

W. Inspection Rights and Access to Information

Metro Communication Corp., BVI v. Advanced Mobilecomm Technologies, Inc., __ A.2d __, 2004 WL 1043728 (Del.Ch. 2004) (finding plaintiff stated claim against LLC and certain managers for breach of provisions of LLC agreement requiring disclosure of material adverse events, access to books and records, and access to LLC managers and officers).

Alexander v. Minton, 855 So.2d 94 (Fla.App. 2003) (holding that operating agreement did not “unreasonably restrict” member’s right to information or access to records and that statutory inspection right did not trump operating agreement or render dispute over member’s right to inspect LLC books and records non-arbitrable under arbitration clause of LLC operating agreement).

Somerville S Trust v. USV Partners, LLC, No. Civ.A. 19446-NC, 2002 WL1832830 (Del. Ch. Aug. 2, 2002) (concluding that member’s stated purposes (to investigate allegations of wrongdoing and mismanagement of the LLC and to value its membership interest) were proper purposes for books and records inspection, that plaintiff proffered credible evidence of mismanagement that would adversely affect the member’s interest, and that various specified documents and records were subject to inspection).


A member of two Delaware LLCs sought to inspect the books and records of the LLCs, and the managing member of the LLC argued it need only produce the LLC’s general ledger accounts transactions histories, continuity schedules, annual reports, bank account ledger cards, and trial balances. The court interpreted the Delaware LLC act and LLC agreements (which gave access to “all books and records” of the LLCs) and concluded that the member also had the right to inspect the tax returns and member lists of the LLC. The court rejected the argument that disclosure of the member lists would violate the privacy provisions of the Gramm-Leach-Bliley Act because there is an exception to the prohibition on disclosure where disclosure is necessary to comply with other laws and legal requirements, and the court found disclosure was required to comply with Delaware law and other legal requirements. The LLC members also sought access to records of two Cayman Island corporations that were investment funds in which the LLCs invested member funds, but the court rejected this request on the basis that the members were not shareholders in the corporations and there was no basis to disregard the separate existence of the entities.


A member of a New Jersey LLC sought to inspect the LLC’s financial records. The LLC’s operating agreement contained provisions requiring the LLC to maintain books and records and permitting members to visit the properties of the LLC and discuss the business and affairs of the LLC with the managers. The operating agreement also required the managers to prepare and provide to LLC members certain financial reports. The operating agreement did not recite that the members had any right to inspect the LLC’s financial records. The court found that furnishing the reports was all that was required (and thus the member did not have the right to inspect the LLC’s financial records) since the New Jersey LLC act states that a member may obtain “true and full information regarding the status of the business and financial condition” of the LLC “subject to such reasonable standards ... as may be set forth in an operating agreement.”
X. Interpretation of Operating Agreement, Articles of Organization


The plaintiffs’ fraud claims in this case were not barred by the integration clause in the LLC agreement, and the plaintiffs were not liable for breach of a confidentiality clause in the LLC agreement based on their filing of the lawsuit without seeking to place it under seal.

The plaintiffs invested in a Delaware LLC promoted by Katz, the mayor of Philadelphia. The LLC was run by Robins, whom Katz represented was a trusted employee with a good business track record. In fact, Robins had a history of criminal convictions and bankruptcies, but these facts were not disclosed to the plaintiffs. Within a couple of years after the LLC agreement was signed, Robins had burned through most of the $2 million the plaintiffs invested, and it came to light that he had diverted several hundred thousand dollars of the LLC’s funds to himself. In addition, it turned out the “independent feasibility studies” that had been shown to the plaintiffs were mostly written by Katz and Robins.

The plaintiffs sued for rescission alleging fraud in the inducement and securities fraud under the Pennsylvania Securities Act. The court was inclined to conclude that Delaware law governed the common law and equitable fraud claims in the case, but sidestepped the issue by accepting the parties’ view that Delaware and Pennsylvania law are the same for all relevant purposes. The court concluded that the integration clause in the LLC agreement did not bar the plaintiffs’ fraud claims. The clause provided as follows: “This Agreement ... constitutes the entire agreement and understanding of the parties hereto with respect to the subject matter hereof and supersedes all prior or contemporaneous agreements, understandings, inducements, or conditions, oral or written, express or implied.” The court pointed out that the clause was a standard integration clause of the type incorporated into various forms and model agreements. The court relied upon the commentary to these model agreements as well as authorities on the law of contracts to conclude that this type of clause does not bar a fraud claim. According to the court, to bar a fraud in the inducement claim, a contract must contain clear anti-reliance language by which a party contractually promises that he has not relied upon statements outside the contract’s four corners. The court was satisfied that this approach appropriately balances the competing policy concerns presented by the law’s intolerance of fraud and the freedom of parties to contract under both Delaware and Pennsylvania law. The court granted the plaintiffs’ motion for summary judgment on the fraud claims, holding that the plaintiff had conclusively established a right to rescission based on fraud in the inducement and the anti-fraud provision of the Pennsylvania Securities Act.

The other clause of the LLC agreement that was in issue was a broadly-worded confidentiality clause. Katz claimed that the plaintiffs violated the clause by filing the lawsuit without seeking to place it under seal. The court rejected Katz’ claim for several reasons. First, Katz himself was not a party to the LLC agreement, but rather an entity controlled by Katz. The LLC agreement provided that it did not confer any third party rights, and the court concluded Katz did not have standing to assert a breach of the confidentiality provision. Katz’s entity also asserted a claim for breach of the confidentiality provision, but the court concluded there was no evidence of any cognizable damages. The court called the confidentiality clause “facially absurd” inasmuch as it purported to make even the existence of a dispute of any nature “Sensitive Information” that the parties must endeavor to conceal from the public. “[A] court ... cannot indulge the desire of private parties to be self-created ‘secret citizens’ who can litigate in courts of public record behind a judicially enforced screen,” said the court. Because the dispute did not involve truly sensitive and confidential information, the court would not have permitted the case to remain under seal even if it had been sought. In addition, Katz and his entity failed to provide relevant discovery regarding their damages claim and asserted wholly conclusory and speculative allegations of injury. The court thus granted the plaintiffs’ motion for summary judgment on this claim.


A former member of a dissolved LLC sued the LLC, its other former members, its managers, and a related corporate entity alleging various claims of fraud, breach of the LLC agreement, and breach of fiduciary duty. The LLC was formed to invest in the South American telecommunications industry, and the plaintiff lost most of its investment after bribery of Brazilian officials by LLC employees came to light. The essence of the plaintiff’s theory was that all of the defendants either participated in or knew about the bribery scheme and were not candid with the plaintiff about the bribery or its effect on the LLC’s business.

The breach of LLC agreement claims were based on information and inspection provisions of the LLC agreement. Section 5(e) of the LLC agreement required the LLC to provide prompt notice and a description of any event which could reasonably be expected to have a material adverse effect upon the LLC. The court held the complaint stated a claim against the LLC based on its failure to inform the plaintiff of the bribery. Section 5(f) required the LLC to permit the members’ representatives to inspect and copy books and records and to discuss the LLC’s affairs with the
LLC’s officers, managers, and independent accountants. The court held that the complaint was sufficient to state a claim against the LLC based on allegations of instances in which the plaintiff was denied access to company information and prohibited from contacting LLC executives.

The court also found the complaint stated potentially viable contract claims against the plaintiff’s original co-members, who were parties to the LLC agreement and were also managers of the LLC. Although these parties claimed they were no longer members of the LLC after a reorganization of the LLC, the plaintiff alleged, and the court assumed, that they continued to act as managers. The plaintiff alleged that these managers knowingly caused the LLC to violate Sections 5(e) and (f). (The court noted that the breach of contract claims were not asserted against other managers who were not parties to the LLC agreement.) The managers argued the breach of contract claim against them failed because Sections 5(e) and (f) only mentioned the LLC. In concluding the complaint stated potentially viable breach of contract claims against the managers as well as the LLC, the court relied upon an “oddly written” introductory provision of Section 5 of the agreement, which provided “[e]xcept as otherwise specifically provided herein ... the Company and each Member and Manager shall comply with the covenants set forth in Section 5.” The court rejected the argument that provisions of the LLC agreement and the Delaware LLC act protecting members and managers from personal liability for liabilities and obligations of the LLC precluded holding the managers personally liable for breach of the LLC agreement. The court read the term “comply” to incorporate a knowledge requirement in the sense that a manager would be culpable if it knew the LLC was taking action inconsistent with a covenant in Section 5 and did not act to ensure compliance. The court thus recognized the claims against the managers from the time they were alleged to have known of the bribery scheme. The court rejected the plaintiff’s breach of implied covenant of good faith and fair dealing claim because the introductory clause of Section 5 left no room for the implied covenant to apply if the effect of the clause is make the managers directly liable. On the other hand, if the introductory clause does not have that effect, the failure of Sections 5(e) and (f) to mention managers precludes application of any contractual theory of recovery against the managers.

The court rejected several other claims that the defendants breached specific provisions of the LLC agreement as well as the plaintiff’s claim that the defendants breached an implied contractual duty by operating the LLC in an illegal manner. The court indicated that knowingly operating the LLC in an illegal manner would constitute a breach of fiduciary duty and stated that the public policy purpose that would be served by replicating that recognized fiduciary duty as a contractual duty inherent in every LLC agreement would be minimal. The court stated its understanding that this fiduciary principle cannot be contracted away by private parties since it involves an important public interest.


After an LLC dissolved by virtue of the withdrawal of one faction of members, the withdrawing members claimed that they were not required to share in post-dissolution expenses incurred by the LLC. In a prior opinion, the court interpreted the LLC operating agreement to provide that the withdrawing members remained members during the winding up of the LLC. In the instant case, the withdrawing members argued that post-dissolution expenses should be charged against the share of the assets to be distributed to the remaining members. The court examined various provisions of the operating agreement on which the withdrawing members relied. The withdrawing members argued that the operating agreement indicated that they did not have to share in the post-dissolution expenses because the expenses were ultra vires. The court rejected the ultra vires argument for several reasons. First, the withdrawing members did not dispute that the expenses were binding on the LLC. Additionally, the withdrawing members did not argue the LLC was without the power to incur the expenses, merely that they were not authorized. The withdrawing members argued that the operating agreement required managers, including managers, to indemnify the LLC for obligations incurred without authority, but the court pointed out that another provision of the operating agreement required managers to indemnify the LLC or members only when the managers were guilty of fraud, gross negligence, misconduct, or reckless disregard of duty. The withdrawing members made no such claim, and there was no evidence to support such a claim. Further, there was no evidence to indicate the remaining members acted outside the scope of their authority. The court also rejected the withdrawing members’ argument that fairness and equity required the remaining members to bear all of the post-dissolution expenses. The court stressed the freedom of contract the members had under the Kansas LLC act to deal with the specific situation, and the court refused to “rewrite the agreement for the withdrawing members or otherwise save them from their own agreement.” The members, including the withdrawing members, were bound by their operating agreement, which dictated how liquidation proceeds should be applied and distributed.

**TriState Courier and Carriage, Inc. v. Berryman**, No. C.A. 20574-NC, 2004 WL 835886 (Del.Ch. April 15, 2004) (noting difficulty of determining ownership of LLC in absence of written operating agreement, and concluding evidence showed that individual whose ownership was in question had at most a future equity interest in LLC).

Leisher and Alfred formed an LLC with Alfred as the manager. Alfred paid himself unauthorized commissions and used LLC funds to pay personal expenses. The LLC’s bank account became overdrawn and Leisher removed Alfred as manager. As a result of adverse developments in the business in which the LLC was engaged (viatical settlements), Leisher ultimately filed suit to dissolve the LLC. Leisher also sought an accounting and damages from Alfred. Alfred asserted various cross-claims against Leisher. The court interpreted the operating agreement in various respects. The court held that the removal of Alfred did not dissolve the LLC because neither the California LLC act nor the operating agreement provided for dissolution in the event of the expulsion of a member. The court held that Leisher was justified in removing Alfred as manager because the evidence supported the conclusion that Alfred breached his fiduciary duties and the operating agreement by taking excess compensation and paying personal expenses with LLC funds. In addition to being subject to statutory fiduciary duties comparable to a partner’s duties, Alfred was required by the operating agreement to perform his duties as the LLC’s manager “‘in good faith, in a manner [he] reasonably believe[d] to be in the best interest of the [the LLC], and with such care as an ordinarily prudent person in a like position would use under similar circumstances.’” The court also applied the operating agreement to resolve disputes over various distributions and payments.


The court found that LLC members who acted as operating managers during the winding up of the LLC acted properly in increasing their compensation inasmuch as their workload increased substantially in the winding up and they applied and stayed within the parameters of the compensation formula approved by the LLC’s initial managers. The court concluded the managers acted fairly even if the entire fairness standard applied.

Senior Tour Players 207 Management Co., LLC v. Golfstown 207 Holding Co., LLC, No. Civ.A. 20116-NC, 2004 WL 440465 (Del.Ch. March 10, 2004) (interpreting advancement of expenses provision of LLC operating agreement and concluding no written undertaking to repay was required because none was specified in operating agreement, but indicating that repayment would in fact be required if defendant is ultimately adjudged to be unindemnifiable).

Lehmer v. Rockefeller, Nos. G030523, G030985, 2004 WL 925759 (Cal.App. April 29, 2004) (rejecting members’ claims for contribution and equitable indemnity against co-member and granting prevailing member’s claim for attorney’s fees without apportionment under provision of operating agreement awarding attorney’s fees to the prevailing party in any dispute among the members).

Derges v. Hellweg, 128 S.W.3d 186 (Mo. App. 2004) (finding trial court erred in declaring rights and obligations of members under member guaranties based on operating agreement rather than guaranties, which were not before the court).

Palmer v. Moffat, No. Civ.A.01-C-03-114JEB, 2004 WL 397051 (Del. Super. Feb. 27, 2004) (granting summary judgment to managers on member’s claims for breach of operating agreement and related acts of wrongdoing because plaintiff was not able to show loss or damages).

LCA-Vision, Inc. v. New York Refractive Eye Associates, P.C., No. 98 Civ.8387 DC, 2004 WL 213027 (S.D. N.Y. Feb. 3, 2004) (holding that defendant member met its capital contribution requirement under clear language of operating agreement where member made initial required contribution, operating agreement required unanimous consent of members to create additional capital contribution obligations, and there was no evidence member consented to making additional contributions).


After an attempt to remove the LLC’s president (who was stealing money from the LLC) failed because it did not comply with the LLC’s operating agreement, the members sought advice of counsel and amended the operating agreement to eliminate the office of president. All of the members except the member who was president (Booty) and his wife approved the amendment, and the court found that the requisite vote to amend the operating agreement was obtained. The members made a number of changes to the operating agreement in addition to doing away with the office of president. Booty argued that his consent was required to amend the operating agreement based on general unanimous written consent provisions of the agreement. The court stated that the specific provision permitting the operating
agreement to be amended upon written consent of 75% of the members controlled over the more general provision. The
court also stated that the members had a common law right to remove Booty as a member and an officer, irrespective
of the operating agreement, in order to protect the LLC from his theft. The court relied on the principle of corporate
law that “a corporation possess[es] the power to remove a member, officer, or director for cause regardless of the
existence of a provision in the charter or bylaws providing for such removal.” The court interpreted the indemnification
provisions of the operating agreement and concluded that Booty was not entitled to indemnification for numerous
reasons. The court also found Booty was not entitled to reimbursement under other provisions of the operating
agreement providing for reimbursement of legitimate business expenses because he had not followed the LLC’s process
for submitting claims for reimbursement. Additionally, some of the expenses were not business expenses associated
with the LLC. Finally, Booty was not entitled to reimbursement for amounts he admitted represented his initial capital
contribution because the operating agreement stated that members were not entitled to a return of any capital
contribution.

A withdrawn member of a Wyoming LLC demanded payment of the value of his share of the current value
of the LLC. Because the Wyoming LLC act does not provide for the fate of a withdrawn member’s equity interest in
an LLC, the court looked to the operating agreement to determine if it contained provisions relevant to the withdrawn
member’s interest. The court reviewed provisions addressing capital accounts, distributions, membership certificates,
transfer, and voting and concluded that there simply was no provision mandating a liquidation or buy-out of a withdrawn
member’s interest. The court noted that the transfer provisions in the operating agreement clearly contemplated a
situation where a person could be an equity owner but not a member and found no reason to treat a withdrawing member
any differently. Thus, the withdrawn member was no longer a member but retained his equity interest in the LLC.

Williams v. Litton, 865 So.2d. 838 (La.App. 2003) (addressing scope of arbitration clause in LLC operating
agreement which encompassed “[a]ny controversy or claim arising out of or relating to this Agreement” and rejecting
argument that operating agreement was void as against public policy because it eliminated rights of LLC members
afforded by statute, pointing out that rights provided by statute are merely default rights and thus, even assuming the
operating agreement eliminated or restricted all of the rights granted to members by statute, it would not violate public
policy).

17, 2003) (granting motion to dismiss for improper venue and holding that forum selection clause in LLC operating
agreement was not against Louisiana public policy inasmuch as it was contained in an operating agreement for a
professional LLC rather than an employment contract).

2003)(concluding that there was genuine issue of material fact as to whether transfer of members’ LLC units violated
right of first refusal provision in LLC operating agreement).

The court determined that the chapter 11 bankruptcy of an Oregon LLC was outside the ordinary course of
business, even for an entity in dissolution; therefore, the decision to file bankruptcy was a “Major Decision” requiring
approval of members holding “in excess of 75% of the Ownership Interests” under the operating agreement. The
adoption of a resolution by the LLC’s manager was thus insufficient to authorize the filing. The bankruptcy filing was
ratified, however, by a subsequent consent resolution approved by members holding more than 75% in interest. (The
operating agreement originally provided that consent resolutions must be approved by all members to be effective, but
the agreement was subject to amendment by the written consent of 75% in interest of the members, and it was so
amended to authorize LLC action by consent resolutions approved by the appropriate percentage of members required
for action under the operating agreement.) The court rejected the argument that the members had lost their voting rights
under the operating agreement based upon their failure to make capital contributions. The court stated that “losing the
right to vote on LLC governance issues is such a draconian penalty to impose on LLC members that its imposition must
be based on the application of clear standards, with adequate notice.” Under the operating agreement, loss of voting
rights was tied to a failure to make agreed capital contributions “60 days after the Contribution Date.” There was no
evidence of any written notice setting a specific Contribution Date. Furthermore, the court pointed out that the party
who argued that the members lost their voting rights had assumed that the members retained their voting rights on
several occasions. The court was unwilling to find that the members lost their voting rights under such circumstances.

Members of two LLCs sought a determination that they were entitled to advancement of legal fees in connection with a pending civil action brought against them by another member in Delaware Superior Court. The court noted that the Delaware statute broadly enables LLCs to indemnify members and allows the contracting parties to address the extent of indemnification in their agreements. The court found the operating agreements to be clear and unambiguous. The court concluded that the operating agreement of one of the LLCs clearly provided for the advancement of expenses. The provision required advancement to the “fullest extent permitted by applicable law” upon receipt of an undertaking to repay the amounts advanced if it were later determined that the person was not entitled to be indemnified. Thus, the LLC was required to advance the fees although it claimed that the members would not be entitled to indemnification if the allegations in the Superior Court action were eventually proven to be true. The operating agreement had an unusual provision requiring a plaintiff member to bear all the litigation costs of both sides in a suit brought against another member, but the court rejected the argument that the member who was the plaintiff in the Superior Court action was personally liable for the advancement of expenses. The operating agreement of the second LLC contained indemnification provisions but was silent on advancement; therefore, the court held that there was no obligation to advance expenses under that operating agreement.

Schindler v. Niche Media Holdings, LLC, 772 N.Y.S.2d 781, (N.Y.Sup. 2003). (declining to enjoin LLC’s payment of LLC manager’s legal expenses in defending against minority member’s claims, including claim for dissolution, where operating agreement indemnification provision required indemnification of LLC manager to the maximum extent permitted by the New York LLC act and there had been no final adjudication establishing that manager acted in bad faith, was dishonest, or personally gained a financial profit to which he was not entitled as the LLC’s CEO).


Love v. Fleetway Air Freight & Delivery Service, L.L.C., __ So.2d __, 2003 WL 21995308 (Ala. 2003) (interpreting term “withdrawal” in LLC member agreement and LLC operating agreement and concluding that termination of manager’s employment did not constitute withdrawal as a member).

Wisdom Import Sales Co., LLC v. Labatt Brewing Co., Ltd., 339 F.3d. 101 (2nd Cir. 2003) (upholding injunctive relief in favor of minority member of Delaware LLC based upon provision of LLC agreement granting veto power with respect to certain fundamental matters).

Weinstock v. Lazard Debt Recovery GP, LLC, No.Civ.A. 20048, 2003 WL 21843254 (Del.Ch. Aug. 8, 2003) (interpreting indemnification and advancement of expenses provisions of LLC agreements of LLC general partner of limited partnership fund and LLC investment manager and concluding that individual former managers were entitled to advancement under both agreements).

Lamprecht v. Jordan, LLC, 75 P.3d 743 (Idaho 2003) (interpreting withdrawal and buy-out provisions in operating agreement and concluding that former member was entitled only to the balance in his capital account as of the date his employment with the LLC terminated, but concluding LLC was not entitled to recover attorney’s fees from former member who did not prevail because operating agreement provided for recovery of attorney’s fees in suits between members rather than between the LLC and a member).


Lynch v. Carriage Ridge, LLC, No. 02-0528, 2003 WL 21706305 (Wis.App. July 24, 2003) (concluding that Management Fee Agreement did not violate provisions of LLC operating agreement prohibiting payment of compensation for management to managing members because Management Fee Agreement did not provide for compensation for management but rather provided for payment of commissions for development and sale of lots consistent with listing agreement referred to in operating agreement).

Brazil was a member of three LLCs, two of which were governed by identical operating agreements. The third LLC was governed by a slightly different operating agreement. Although there was some overlap in ownership, the members and ownership interests in the three LLCs varied. The defendants sent a notice of termination of Brazil’s membership in the LLCs pursuant to Article 7 of each operating agreement. The provisions of Article 7 of each agreement were not identical. Article 7 of two of the operating agreements provided for expulsion of a member, when, in the opinion of a majority in interest of the members, a member had been “guilty of misconduct or act in any manner inconsistent with the good faith observable between Members to such an extent as to render it impracticable for the then members to carry on the Company business together.” Although an early draft of the third operating agreement contained identical language, that language was removed, and Article 7 of the third operating agreement only provided for expulsion of a “Designated Managing Member.” Brazil filed suit alleging various causes of action based on what he alleged was his wrongful expulsion from the LLCs. The court determined that the members had the power to expel Brazil under two of the operating agreements and that the requisite determination by the majority interest did not require a meeting or a vote. However, the court concluded that fact questions remained as to whether the majority in interest believed it was “impracticable” to continue to operate with Brazil; therefore, the court could not determine as a matter of law that the expulsion was wrongful or that fiduciary duties were breached. With respect to the third LLC, the court determined that the members did not have the power to expel Brazil. The operating agreement did not confer the power to expel a member in Brazil’s position, and the court concluded that oblique references to expulsion of a member in another agreement were not sufficient to provide for the affirmative power to expel members. Thus, the court concluded that Brazil’s expulsion from that LLC was wrongful.

Alexander v. Minton, 855 So.2d 94 (Fla.App. 2003) (holding that operating agreement did not “unreasonably restrict” member’s right to information or access to records and that dispute regarding member’s right to inspect LLC books and records was arbitrable under arbitration clause of LLC operating agreement providing for arbitration of “any controversy or dispute arising out of or relating to this Agreement or the breach thereof”).


An LLC established a production bonus and profit-sharing program for certain of its employees including the plaintiff. The plaintiff executed certain documents in connection with the program and was provided copies of the LLC operating agreement and an amendment to the operating agreement listing the plaintiff and five other new members. The operating agreement stated that no member would be entitled to receive income from the production bonus or profit-sharing programs until the member had been a member for one full calendar year. The amendment to the operating agreement listing the plaintiff as a member was dated December 12, 1995, and the plaintiff signed other related documents in late December, 1995. On December 13, 1996, the plaintiff and the LLC’s principal owner had an argument that resulted in plaintiff’s termination of employment. The plaintiff’s right to remuneration under the bonus and profit-sharing program hinged on the effective date of the plaintiff’s admission as a member. The court analyzed the statutory provisions regarding admission of LLC members, the terms of the operating agreement, and the documents signed by the plaintiff and rejected the argument that the plaintiff’s admission was not effective until the plaintiff signed the documents related to his admission. The court held that the plaintiff became a member as of the date of the amendment to the operating agreement reflecting plaintiff’s admission as a member. The court also concluded that the plaintiff did not cease to be a member when his employment was terminated. The court examined the operating agreement and the statutory provisions regarding cessation of membership and concluded that the majority member’s removal of the plaintiff’s name from the operating agreement schedule of members did not constitute a vote by the majority member because it was not done in accordance with the voting procedures set forth in the operating agreement.


In an action for an accounting and dissolution of an LLC, the court determined that the managing member, who contributed only services rather than cash to the LLC, had no proprietary or financial interest in the LLC because the operating agreement required the members’ initial contributions to be made in the form of cash. The court construed ambiguities in the agreement regarding contributions against the managing member because he drafted the agreement. The managing member argued that he was to be compensated for his services and that such amount would be credited to his initial capital contribution; however, the operating agreement stated that the managing member was to be compensated in an amount to be determined from time to time by the members, and the record contained no evidence that the members consented to compensation at any time or in any amount.

The articles of organization of a Texas LLC provided that the articles of organization (which provided for member-management) could be amended by the vote of two-thirds of the members while the regulations (operating agreement) provided that amendment of the articles of organization required the vote of 66 2/3% in interest. Two of the three members (constituting 50% in interest) voted to amend the articles of organization to change the LLC to a manager-managed LLC. The court held that the provision in the articles of organization controlled because the Texas LLC act provides that the regulations may contain any provisions for the regulation or management of the LLC not inconsistent with law or the articles of organization.

Fillmore LLC v. Fillmore Machine & Tool Co., 783 N.E.2d 1169 (Ind.App. 2003) (concluding that there was no agreement that member transfer equipment and other assets to LLC, even though accountant prepared tax returns reflecting such transfer, where terms of written agreements, including operating agreement, made no mention of such transfer and reflected contributions of members consisting only of cash and accounts receivable).

Cunningham Group Development Services, L.L.C. v. Richardson, No. Civ. 03-2233 MJD/JGL, 2003 WL 1572010 (D.Minn. March 19, 2003) (concluding that plaintiffs had shown reasonable probability that they would prevail on merits of claims involving struggle for control of LLC and buy-out of interests of defaulting members under terms of operating agreement, but that plaintiffs had not shown imminent and irreparable harm so as to satisfy standard for injunctive relief).

Apple Glen Crossing, LLC v. Trademark Retail, Inc., 784 N.E.2d 484 (Ind. 2003) (holding that “change orders” approved by LLC manager did not constitute “Major Decisions” requiring unanimous consent of members under LLC operating agreement).

Connecticut Car Rental, Inc. v. Prime One Capital Co., LLC, 247 F.Supp.2d 158 (D.Conn. 2003) (holding that member had actual authority to assign car lease agreements pursuant to the LLC formation agreement because the assignments did not fall within types of decisions requiring governing board approval).

Jundt v. Jurassic Resources Development, North America, L.L.C., 656 N.W.2d 15 (N.D. 2003) (concluding that trial court erred in interpreting member control agreement when it found that member who invested no money in LLC was not entitled to any tax write-offs and that money investors were entitled to all the tax write-offs).

Seed v. Astra Genstar Partnership, No. C2-02-1143, 2003 WL 178790 (Minn.App. Jan. 28, 2003) (holding that change in ownership of 100% of membership interests in LLC which was member of second LLC was not “change in direct ownership of 50% or more of the voting and equity interests” of second LLC so as to trigger option under change in control clause of agreement because the owner of the membership interest in the second LLC did not change).

Dover Place, LLC v. Coffey, No. A098399, 2003 WL 178832 (Cal.App. Jan. 28, 2003) (concluding that member was not required to return distribution because it did not violate statutory restrictions and operating agreement could not reasonably be interpreted to impose greater restrictions than statute).

Chase Manhattan Bank v. Iridium Africa Corp., 239 F.Supp.2d 402 (D. Del. 2002) (holding that lender could not sue members of an LLC on the basis that there were implied-in-fact contracts between the members and the LLC to make additional capital contributions upon lender’s demand when there was an express contract in the LLC agreement between the LLC and the members allegedly imposing the same obligation on the members).

Imprimis Investors, LLC v. Insight Venture Management, Inc., 752 N.Y.S.2d 26 (N.Y.A.D. 1 Dept. 2002) (concluding that denial of summary judgment was proper because there were fact issues as to whether member’s right to profits under LLC agreement was dependent upon compliance by related entity (which was alleged to be alter ego of member) with consulting agreement).


A member of a Georgia LLC pledged all of his interest as an LLC member to secure a bank loan. When the bank attempted to foreclose its security interest, the member argued that the operating agreement required consent of the other members for transfer of an interest in the LLC and that the bank had no security interest because of the bank’s failure to obtain consent of the other members. The operating agreement was quoted by the court as follows:
11.01 General. Except as otherwise provided herein, neither a Member nor an Economic Interest Owner shall have a right to:
(a) sell, assign, pledge, hypothecate, transfer, exchange or otherwise transfer for consideration, (collectively, “Sale”) …

11.02 Transferee Not Member in Absence of Unanimous Consent.
(a) Notwithstanding anything contained herein to the contrary, if all of the remaining Members do not approve by unanimous written consent the proposed Sale or Gift of the Transferring Member’s Membership Interest or Economic Interest to a transferee or donee which is not a Member immediately prior to the Sale or Gift, then the proposed transferee or donee shall have no right to participate in the management of the business and affairs of the Company or to become a Member. The transferee or donee shall be merely an Economic Interest Owner. No transfer of a Member’s interest in the Company (including any transfer of an Economic Interest or any other transfer which has not been approved by unanimous written consent of the Members) shall be effective unless and until written notice … has been provided to the Company and the non-transferring Member.

The court concluded that the operating agreement permitted the transfer of the economic interest and that the bank obtained a security interest in the member’s economic interest which it was entitled to foreclose.


The manager of a New York LLC executed an agreement obligating the LLC to transfer the LLC’s assets to a new company being formed by one of the LLC’s members. The manager took the position that he was authorized to execute the agreement based on the authority conferred in the operating agreement and the fact that he had e-mailed the members of the LLC that he would execute such an agreement if the members did not object in writing by a specified date. (The e-mail was sent on December 22, 2000, the Friday before a Christmas holiday weekend, and the deadline for objecting was December 28, 2000. The 87% member had advised the manager that he would be away on a family vacation and could not be reached between December 20th and 30th.) The court rejected the argument that the broad authority conferred in the operating agreement authorized the manager to transfer the assets because the manager’s authority under the operating agreement was “subject in all cases to ... the requirements of applicable law.” The New York LLC act requires a majority in interest of the members to approve a transfer of all or substantially all of an LLC’s assets unless otherwise provided in the operating agreement. The only specific authority to transfer assets under the operating agreement was to dispose of assets in the ordinary course of business, and the transfer agreement in question was not in the ordinary course. The court rejected the argument that the manager was authorized to act by virtue of the failure of the members to object to the transfer. The court said the members’ failure to object did not satisfy the provision of the operating agreement that approval for any matter coming before the members required the “affirmative vote” of a majority in interest of the members. Finally, the court rejected the argument of the manager and the member who sought to acquire the LLC assets through a new company that the operating agreement released them from any liability related to their action as a matter of law. The member relied upon a release relating to actions involving conflict of interests and breach of fiduciary duty. The court found, however, that the language indicated the scope of the release was confined to matters related to actions taken in connection with the member’s dual involvement in the LLC and a specified company in which the LLC invested. Further, the court found the release would be ineffective if it was intended to release the member from all actions taken in his self-interest. For example, the court said, a release cannot reach willful and intentional misconduct. With respect to the manager’s release claim, the court found that the manager’s alleged misconduct fell outside the scope of the operating agreement’s release of the manager because it involved conduct not properly within the capacity of manager (e.g., his attempt to bind the LLC to transfer its assets without authority). Further, the New York LLC act provides that an operating agreement may not eliminate or limit liability if a judgment establishes bad faith, intentional misconduct, or a knowing violation of law, which the allegations indicated. The manager’s summary judgment claim for indemnification was rejected for similar reasons. The member’s claim for indemnification was rejected because he cited no provision of the operating agreement providing for indemnification.


Zanker sought to enforce rights under the operating agreements of two LLCs formed to develop and operate managed care facilities. The court first found that LLC common units issued to Zanker subject to forfeiture in the event additional projects were not identified by Zanker became fully vested because Zanker identified such projects or was excused from doing so by the other member’s repudiation of its agreement with Zanker. The court next determined that Zanker was entitled to a placement distribution based on the number of its vested common units. The operating
agreement provided for the distribution “through an appropriate withdrawal from the funds of the Facility,” and the facilities had operated at a loss. The court stated that Zanker was not entitled to payment if there were no available funds but would be entitled to a distribution based on its vested units when funds were available. Finally, the court interpreted a provision of the operating and development agreements that entitled Zanker to a distribution of 1% of the gross revenues in return for the provision of consulting services. The other member argued that a sentence describing consulting services as “professional consultation, marketing, and other clinical and administrative services, as requested by [the other member]” limited payment to requested services. The court disagreed and found that the fee was owed whether services were requested or not.

Valinote v. Ballis, 295 F.3d 666 (7th Cir. 2002).

The Seventh Circuit Court of Appeals affirmed the district court’s interpretation of the buy-sell provisions of an LLC’s operating agreement. (The district court’s opinion is found at 2001 WL 1135871.) In brief, Valinote exited the LLC pursuant to a push-pull buy-sell provision under which Ballis, the other member of the LLC, set the price of the 50% interest that each held at a negative $79,064. At the time, the LLC owed Valinote exactly that amount so that no money changed hands, and Ballis became the sole member of the LLC. When a bank pursued Valinote on his guaranty of LLC indebtedness, Valinote argued that he should be indemnified by Ballis. The court cited and discussed the terms of the operating agreement, contrasting the push-pull buy-sell provisions with provisions dealing with buy-out upon resignation of a member, and concluded that Valinote had no implied right of indemnification against Ballis. Valinote had a right against the LLC, but not against the other member. The court concluded that Valinote, as a former member, was not covered by a clause in the operating agreement that imposed cross-indemnity obligations between the members (interpreting “members” to include only current members). The court explained the negative price in terms of the increased risk each took by giving up the right of indemnification against the other.


The plaintiff was a one-third member and the Chief Manager of a Tennessee LLC. After disagreements arose, the members of the LLC other than the plaintiff took action by written consent to terminate the employment of the plaintiff and to exercise a buy-out right on the part of the LLC triggered by the termination of employment of a member. The members relied on a provision of the operating agreement under which a member’s employment could be terminated for “cause” (as defined in the agreement) and asserted the LLC’s right to repurchase the member’s interest under a valuation that applied when employment was terminated for cause. The plaintiff brought suit alleging various causes of action, including breach of fiduciary duty, fraud, breach of the operating agreement, and breach of the duty of good faith and fair dealing. The plaintiff alleged that the other members breached the operating agreement and the covenant of good faith and fair dealing by purporting to terminate him for cause when no cause existed and by attempting to acquire his membership interest. The court examined provisions of the LLC operating agreement and an employment agreement between the plaintiff and the LLC and concluded that these agreements did not alter the general rule of at-will employment in Tennessee. The court also noted that there is no implied covenant of good faith and fair dealing in an at-will employment contract in Tennessee. Thus, the court granted the defendants summary judgment on these claims. (The trial court based its dismissal of the good faith and fair dealing claim on its conclusion that “performance of a contract by its terms cannot be characterized as bad faith” and its assessment that the operating agreement allowed the very actions taken in terminating the plaintiff’s employment.) The court found that the plaintiff waived his argument that there had been a breach of contract based upon a conflict of interest in violation of the operating agreement. The court did conclude that there was a fact issue as to whether there was “cause” to terminate the employment of the plaintiff under the operating agreement, an issue that was relevant to the valuation of the plaintiff’s membership interest under the terms of the operating agreement.


In this dispute between the members of an Arkansas LLC, the court interpreted provisions of the operating agreement regarding transfer of units and buy-out in connection with the termination of employment of the member. The three members of the LLC were Brady, Pierce, Ault, and an entity owned by Brady and Pierce. In the course of a power struggle between Brady and Pierce, Pierce transferred his units to Ault. Subsequent to the transfer, Brady notified Pierce that he was terminated and the LLC would exercise its option to purchase his units. When Ault revealed to Brady that he now owned Pierce’s units, Brady demanded Ault turn the units over to the LLC. Ault refused, and Brady terminated Ault and informed him that the LLC would buy back his units pursuant to the operating agreement. Ault took the position that the repurchase provision in the operating agreement did not apply to him because he was an independent contractor rather than an employee. The operating agreement provided that the LLC had the option to purchase a member’s units “upon the termination of employment” of a member. Ault also argued that the transfer of
Pierce’s units to Ault was not subject to a provision of the operating agreement that restricted transfer and provided that a transferee who received units in violation of the restriction was not a “substituted member” and had only economic rights. Ault argued that, since he was already a member, the provision was inapplicable. The court of appeals held that the provision applied to any transfer, and the term “substituted member” could only logically be viewed in terms of units, i.e., a substituted member with respect to particular units. The court of appeals also rejected Ault’s interpretation of the repurchase provision. The court stated that whether Ault was an independent contractor rather than an employee was irrelevant to the application of the provision. In either case, he was “employed” by the LLC, and the provision applied whenever the “employment” of a member was terminated. Finally, the court rejected Ault’s challenge to the valuation of his units. Following the district court’s decision that the LLC had the right to purchase Ault’s units, the parties stipulated to a procedure for valuation. The procedure specified that each party would select a CPA, and the two CPAs chosen by the parties would select a third. The appraisal most different from the other two would be disregarded, and the value would be an average of the remaining two. Two of the CPAs valued Ault’s units at zero, and the CPA chosen by Ault valued his units at $2 million. Ault conceded that he was bound by the stipulation but argued the agreement carried with it an implied duty of good faith and fair dealing, which included the duty to follow customary and usual accounting standards. The court characterized Ault’s argument as nothing more than an attack on the CPAs’ methodology and concluded that Ault was bound by the stipulation under both contract and estoppel principles.


Metro Riverboat Associates, Inc. v. Bally’s Louisiana, Inc., 817 So.2d 1275 (La. App. 2002) (affirming trial court’s grant of preliminary injunction where arbitration clause permitted one member to invoke arbitration without vote of membership in dispute over cash call and alleged transfer of interest inasmuch as penalty for refusal to arbitrate was forced sale of member’s interest, which would constitute irreparable injury).


Estate of Murray, No. 2000-T-0152, 2002 WL 550071 (Ohio App. April 12, 2002) (interpreting provisions of operating agreement governing buy-out of deceased member’s interest and concluding that date of withdrawal was date of personal representative’s distribution of the estate’s interest in the LLC and that valuation of interest as recorded in “last regular accounting period” should be based on last monthly record preceding withdrawal, as phrase was ambiguous and extrinsic evidence indicated books were kept on monthly basis).

Chase Manhattan Bank v. Iridium Africa Corporation, No. 00-564-RRM(JJF)(MPT), 2002 WL 732070 (D. Del. April 5, 2002) (discussing reserve capital call provisions and provisions waiving objections to jurisdiction contained in Iridium LLC agreement in context of member’s motion to set aside default judgment).

Weinmann v. Duhon, 818 So.2d 206 (La. App. 2002) (finding nothing unlawful in provision admitting persons as members on condition that they not vote to expel original members, provision that transfer of interest to spouse automatically conveys membership in LLC, provision requiring unanimous vote for expulsion, or provisions that effectively permitted one faction of members to fire general manager while other faction could re-hire him, but concluding that impasse created by such provisions justified judicial dissolution).

NSJ Investors, LLC v. TH/North San Jose, LLC, No. CIV. 01-1932PAMSRN, 2002 WL 334413 (D. Minn. Feb. 22, 2002) (interpreting provisions of operating agreement regarding approval required for commencement of litigation and employment of counsel and concluding that interpleader action to determine how to make distributions was in “ordinary course of business” thus not requiring approval of non-managing members to hire lawyer to pursue suit even though employment of counsel generally required approval of non-managing members under agreement).

Concrete Company, Inc. v. MMC Holdings, Inc., 201 F.Supp.2d 1192 (M.D. Ala. 2001) (denying LLC member’s requested stay of judgment pending appeal of court’s interpretation of buy/sell provision, finding no indication that refusal to stay judgment would inflict irreparable harm on member).

The court held that the membership agreement on which the plaintiff based his claims was unenforceable due to lack of an essential term. The defendant (Martin) filed documentation with the Connecticut Secretary of State to establish an LLC, and the plaintiff (Coady) and Martin entered a written membership and subscription agreement. Under the agreement, Coady received a 50% interest in the LLC from Martin, but the agreement acknowledged that two other individuals involved in the project would receive interests in a lesser proportion at a later date. Prior to the agreement, discussions had been held, but the parties had been unable to agree on the precise percentages to which the other two individuals were entitled based upon their prior role in the project. The trial court held that the membership agreement was unenforceable because there had been no meeting of the minds and there was a lack of consideration. The court of appeals upheld the trial court’s conclusion that the membership agreement was unenforceable for lack of an essential term, that is, delineation of the percentage of ownership interests of all of the parties. (Having upheld this conclusion, the court of appeals did not reach the issue of lack of consideration.)

Pine Creek, LLC v. Pine Mount, LLC, 558 S.E.2d 44 (Ga. App. 2001) (examining transfer restrictions in LLC operating agreement and concluding that there were fact issues as to whether operating agreement was violated).

ESCA of Baltimore, LLC v. Colkitt, 164 F. Supp.2d 584 (D. Md. 2001) (finding that there were fact issues as to whether an LLC member made a transfer of his membership interest for consideration in violation of transfer restrictions contained in the operating agreement).


Members representing 60% of the interests in an LLC attempted to remove the member who was serving as manager and appoint a new manager. The operating agreement (and Ohio LLC act) did not address the vote required to remove the manager. The incumbent manager argued that his removal required a unanimous vote of the members because the operating agreement appointed him as manager. The incumbent manager based his position on contract principles, arguing that the operating agreement was a contract that could only be modified with unanimous assent. The members who were trying to remove the manager argued that interpreting the agreement to require unanimous consent would defeat the provisions of the operating agreement that contemplated and referred to removal and election of managers and officers. The agreement had a provision that required the doctrine of cy pres to be applied to give effect as near as possible to the intent of the parties, and the court concluded that the only reasonable voting method that would give effect to the provisions on removal and election was a simple majority vote rule. The court also construed the agreement against the manager because he was the drafter.


The debtor was one of approximately 180 members of an LLC that operated as a conduit for its members and was responsible for the bulk electric power system in a multi-state area. The LLC filed an involuntary petition of bankruptcy against the debtor based upon an unpaid obligation for goods sold and delivered. Issues included whether the claim asserted by the LLC was subject to a bona fide dispute and whether fellow members of the LLC could qualify as holders of claims against the debtor. The court discussed provisions of the LLC operating agreement regarding enforcement of obligations and concluded that the joining petitioners did not have “claims” and that conversations at a members committee meeting did not amount to a de facto amendment of the operating agreement.


In addition to addressing breach of fiduciary duty and other issues in this case, the Virginia Supreme Court examined the meaning of two provisions in an LLC operating agreement relating to dissolution, continuation, and purchase of a member’s interest. Article 13 of the operating agreement provided for dissolution on the death, resignation, bankruptcy, or dissolution of a member unless the procedures of Article 9 were followed resulting in an election to continue the LLC. Article 9 provided that, on the death of a member, the remaining members could elect to purchase the interest of the deceased member or elect to continue the LLC. If the remaining members did not make “either of these elections” the LLC was dissolved. The court rejected the defendants’ argument that the “election” referred to in Article 13 referred only to the election to continue and did not include the election to buy the departed member’s interest. The supreme court rejected this argument and agreed with the trial court that either of the two elections referred to in Article 9 resulted in continuation of the LLC. The court relied upon general rules of contract construction and considered the purposes of the parties and the circumstances surrounding execution of the operating agreement, including the terms of a restated partnership agreement drafted for the partnership that was the predecessor to the LLC. (The court went on to uphold sanctions imposed upon the parties who alleged fraud and mutual mistake.
with respect to the inclusion of these terms in the operating agreement. The sanctions were based upon the fact that the parties who claimed they were misled had the assistance of “experienced” and “sophisticated” attorneys who specialize in this type of work. According to the trial court, it was “ridiculous” to say that the plaintiff could mislead such attorneys.


The plaintiff contracted with the defendant LLC for the defendant to provide an electric power facility at plaintiff’s mill, and the plaintiff argued that certain representations and warranties contained in the LLC operating agreement as well as a separate energy services agreement between the plaintiff and the LLC were false. The plaintiff, which was the parent company of one of three entity members of the LLC, sought to hold the other two members of the LLC liable for the alleged misrepresentations. The representations and warranties related to pending and threatened legal proceedings and compliance with laws and contracts. The court concluded that the representations and warranties in the operating agreement were not false, and the plaintiff could not rely on the LLC’s representations and obligations under the separate agreement to hold the other two members of the LLC liable under the operating agreement.


A member of an engineering firm LLC sued for wrongful termination after the other members voted to terminate his employment and demanded he resell his membership interest. The plaintiff argued that termination of his employment was wrongful because the operating agreement and membership interest subscription agreement contractually obligated the LLC to retain him. The member based this argument on the inclusion of the phrase “long-term investment” in each of these agreements, which the member asserted was evidence that a member was entitled to employment until he voluntarily left the firm or retired. The court concluded that there was no evidence of an express or implied contract in this regard. The court also rejected other arguments based upon promissory estoppel, public policy and fraud.


Four individuals entered an operating agreement for an LLC that listed them as members and required that each of them contribute $5,000 as an initial capital contribution. One of the individuals did not make the required contribution. The issue addressed by the court was whether the individual who failed to make the contribution was a member, and the court held that he was. The other members argued that he never became a member because of his failure to make the required contribution. The court, however, found that he was a member under the clear and unambiguous language of the operating agreement. The court pointed out that the operating agreement listed the individual as a member and presupposed that the person required to make the capital contribution was a member when it provided that “each Member shall contribute $5,000 as the initial Capital Contribution.”


The court interpreted the Wyoming LLC act and the operating agreement of a Wyoming LLC to determine the rights of Lieberman, a dissociated member. Lieberman’s contribution upon formation of the LLC was documented at $20,000, consisting of services rendered and to be rendered. When Lieberman was terminated as vice-president of the LLC, he served a notice of withdrawal and demand for the return of his share of the current value of the company, which he estimated at $400,000. The remaining members avoided dissolution of the LLC by electing to continue the LLC and approved the return of Lieberman’s $20,000 capital contribution. The court discussed a provision of the Wyoming LLC act that entitles a member to demand the return of the member’s capital contribution if the operating agreement does not prohibit or restrict the right. Since the LLC operating agreement did not restrict this right, Lieberman was entitled to the return of his $20,000 contribution. The question remained whether he was entitled to receive any further distribution. A provision permitting a member to compel dissolution upon an unsuccessful demand for the return of the member’s contribution was not applicable since the LLC agreed to return Lieberman’s contribution. Noting the absence of a provision in the Wyoming LLC act governing dissociation, the court turned to various provisions of the operating agreement dealing with membership certificates, transfer of interest, quorum and voting and concluded that it remained unclear what became of Lieberman’s ownership interest beyond his capital contribution. Thus, the court remanded for a further determination in this regard.
Lynch argued this provision did not apply because it was passed after the LLC in this case was formed, but the court of the Kansas LLC act that permits members of an LLC to expand or restrict their duties and liabilities by agreement. The court said that Lynch had not articulated how the breach of fiduciary duty claims. The court thus granted summary judgment in favor of the defendants on both the breach of operating agreement and breach of fiduciary duty. The court concluded that Carson satisfied this requirement by making Lynch aware of the opportunities. The court rejected Lynch's acquiescence. The court also stated that the operating agreement's requirement that certain opportunities be "offered" to the LLC contemplated only that the LLC be made aware of such opportunities, not that a formal offer be presented. The court held that the operating agreement's requirement that certain opportunities be "offered" to the LLC contemplated only that the LLC be made aware of such opportunities, not that a formal offer be presented. The court rejected Lynch's claims that a formal meeting was required, noting that the LLC at all times operated on an informal basis with Lynch's acquiescence. The court also stated that the operating agreement's requirement that certain opportunities be offered to the LLC must be read in conjunction with the provision permitting members to engage in other ventures; therefore, it plainly was directed at permitting members to enter separate and additional business relations in the cable TV industry. The court thus granted summary judgment in favor of the defendants on both the breach of operating agreement and breach of fiduciary duty claims. The court said that Lynch had not articulated how the breach of fiduciary duty claims were distinguishable from the breach of operating agreement claims. The court cited the provision of the Kansas LLC act that permits members of an LLC to expand or restrict their duties and liabilities by agreement. Lynch argued this provision did not apply because it was passed after the LLC in this case was formed, but the court held otherwise, citing the legislature's intent that from January 1, 2000, the act shall apply to all LLCs formed in Kansas, whether formed before or after that date.


The factual background of this case is rather complicated, but the claims involved assertions of fraud, breach of fiduciary duty, and breach of contract by Froelich, an ousted CEO and board member of a Maryland LLC. Froelich was also a member of the LLC who, along with other minority members, was cashed out in a squeeze-out merger following a reclassification of interests of the LLC approved by all members except Froelich. Two documents primarily governed the LLC's operations as an LLC. These documents were an Operating Agreement, which the court characterized as the LLC equivalent of a corporate charter, and a Members Agreement, which the court described as the equivalent of a stockholders' agreement. The operating agreement defined classes of preferred and common interests, the role and responsibility of the board, and the rights and duties of the members. The member agreement supplemented the operating agreement by specifically defining rights of members and restrictions on alienation of interests. The court summed up Froelich's claims as a challenge to "a handful of corporate actions taken by [the LLC's]
Board and its Members.” The court summed up the key issues in the case as follows: “(i) Did the corporate documents or Maryland corporate law authorize the Board to take the actions that Froelich challenges? (ii) If the Board or the Members had the power to act, by what standard (e.g., business judgment rule or fiduciary duty) should the Court review the Board’s exercise of that power? and (iii) Did the Board meet the appropriate standard?” The court characterized the case as arising in the context of corporate decisions by the LLC’s board of directors and applied the business judgment rule. The court noted that the LLC’s operating agreement stated that the LLC’s directors “are subject to the duties of a corporate fiduciary as defined by Maryland law;” thus, the court continued, the LLC board’s decisions are measured against the business judgment rule “just as if [the LLC] were a traditional corporation, rather than an LLC.” The court found no evidence that the board had acted in bad faith and concluded that the board’s actions were protected by the business judgment rule. The court also concluded as follows: the LLC and majority member did not breach a duty of good faith and fair dealing (noting uncertainty under Maryland law as to whether there is a separate cause of action in this regard and stating that the duty in any event only prohibits a party from preventing the other party from performing under the contract); the majority member did not breach a fiduciary duty to Froelich by usurping a business opportunity (stating that a majority interest holder clearly owes the minority a fiduciary duty but finding no breach in view of the board’s independent approval of the transaction); the reclassification did not breach the operating agreement or the member agreement (finding that the transaction fell outside a provision in the member agreement restricting redemptions and was governed by the operating agreement, which was amended in accordance with its terms to permit the reclassification). In Froelich’s favor, the court found that the LLC owed Froelich severance pay under an employment agreement between the LLC and Froelich and that the reclassification and squeeze-out were related parts of a transaction in which Froelich had properly preserved his statutory right to an appraisal.


The court interpreted the provisions of an LLC agreement to determine what vote of the managers was required to authorize a merger. The LLC agreement did not expressly state whether the managers must act unanimously or by majority vote. Under the LLC agreement the initial board of managers consisted of three managers, one of which the minority member had the right to appoint. The individual controlling the members owning a majority of the membership units had the right to appoint the other two managers. The agreement had language addressing how many managers the minority member could appoint if the size of the board was increased. The court noted that, if unanimity were required, the number of managers appointed by the minority member would be irrelevant because just one would suffice to veto any action. Further, the court noted that the agreement contained provisions requiring the consent of the minority member for certain transactions, a provision that would be unnecessary if unanimity of managers were required. The court also considered a provision permitting dissolution by vote of the managers or members holding 2/3 of the units. The court said it seemed unlikely the members designed the LLC agreement to permit members holding 2/3 of the units to dissolve the LLC but denied their appointed managers the power to reach the same result unless the minority manager agreed. The court rejected the argument that the members could generally act by majority vote while unanimity of managers was required. The practical effect of such an arrangement would have been that any matter on which the minority member disagreed would then be approved by a vote of the members. The court was confident such a result was not intended. Ultimately, the court determined, however, that the merger approved by a majority of managers should be rescinded because, while the merger was approved in accordance with the procedures required by the LLC agreement, it was in breach of the managers’ fiduciary duties.


Whitmore was hired as chief operating officer of an LLC that operated fast food restaurants. He also received a 5% membership interest in the LLC and a 5% interest in a second LLC that was being formed to acquire additional fast food franchises. When Whitmore’s employment was terminated, he claimed that he was entitled to receive the value of his membership interests under provisions of the Maryland LLC act in effect at the time. The court pointed out that the statutory provisions relied upon by Whitmore were default provisions and that the operating agreements of the two LLCs had provisions addressing withdrawal and buy-out. The court concluded that the termination of Whitmore’s employment did not amount to a withdrawal or entitle Whitmore to receive the value of his interest under either of the operating agreements, thus Whitmore was not entitled to be bought out.

A receiver was appointed for Medicare Supply Co. of New England ("Medicare"), a member of a Rhode Island LLC. Medicare argued that appointment of the receiver constituted an event of dissociation under the LLC agreement which in turn entitled Medicare to be bought out under the agreement. Events of dissociation included a change in control of a member of the LLC. Control was defined under the agreement as an ownership interest sufficient to carry any motion, the right to elect or appoint directors or managers, or the right to manage. The court concluded that a change in control had occurred because the shareholders, directors, and officers of Medicare no longer controlled Medicare. The court stated that control did not have to shift to the receiver for a change in control to occur; it was sufficient that those formerly in control no longer had control. The court rejected the argument that the receiver was an assignee but did accept that the receiver was analogous to a judgment or lien creditor of Medicare. As a type of lien creditor, the court said the receiver succeeded to the rights of the dissociated member to be bought out.

Lindsay, Marcel, Harris & Pugh, L.L.C. v. Harris, 752 So.2d 335 (La. App. 2000).

Lindsay and Pugh gave notice of their withdrawal from their four-member law firm LLC and formed their own law firm. When the LLC filed suit against the withdrawn members, the withdrawn members answered and sought dissolution. The court of appeals determined that the withdrawn members had no right to seek judicial dissolution because the statute conferred no such right on former members. In addition, the court found no basis in the operating agreement for the withdrawn members to obtain dissolution. Included among the causes of dissolution listed in the operating agreement was "reduction in the number of Members to 1," but the court pointed out that two members remained after the withdrawal of the other members.


This was the first case to address the fiduciary duties of members of an LLC to any significant degree. In this case, the court stated that members of an LLC are in a fiduciary relationship that would generally prohibit competition with the business of the LLC. (The court did not directly address the management structure, but it appears that the LLC was member-managed. The opinion notes at one point that the operating agreement did not name any person or entity the operating or managing member of the LLC.) The court concluded, however, that members may contractually limit or define the scope of the fiduciary duties. Specifically, the court recognized the validity of a provision in the operating agreement of an Ohio LLC that permitted members to compete with the LLC. The court found support for its conclusion in the case law regarding partnerships and close corporations. The case involved a dispute between members of an LLC formed to pursue a professional hockey franchise for Columbus, Ohio. When some of the members objected to the proposed terms of a lease that was necessary to obtain ownership of the franchise, other members formed a separate ownership group that agreed to the lease and obtained the franchise. The court found the operating agreement clearly and unambiguously allowed the members to compete against the LLC and obtain the hockey franchise. The court rejected the argument that the provision in issue only allowed members to engage in other types of businesses. The court did indicate at a couple of points that action related to obtaining the franchise or "the method of competing" could constitute a breach of fiduciary duty if it amounted to "dirty pool," but the court noted the trial court’s finding that the competing members had not engaged in any kind of willful misconduct, misrepresentation, or concealment. The court discussed several other provisions of the operating agreement as noted below.

The court concluded that the competing member’s conduct did not breach a provision of the operating agreement requiring unanimous consent of the members to do any act “that would make it impossible to carry on the ordinary business of the Company” because the provision only applied to actions taken “on behalf of the Company.” Forming the competing ownership group was not an action taken on behalf of the LLC.

The court also addressed provisions of the operating agreement regarding additional capital contributions. The operating agreement required consent of all members to call for additional capital and stated that members would have the opportunity, but not the obligation, to contribute if the members determined that additional capital was required to preserve and maintain the business. The court found that the competing member’s actions, including allegedly stating that he would attempt to block an effort to raise additional capital, did not breach the agreement.

The court found that the non-competing member breached the operating agreement by unilaterally undertaking litigation on behalf of the LLC without the requisite approval of the members. The member argued that his actions did not constitute willful misconduct and that the exculpation and indemnity provisions of the LLC protected him. However, the court found that the exculpation and indemnity provisions applied in the context of members carrying out their duties under the operating agreement and that there was no duty on the member’s part to unilaterally file the actions at issue. Furthermore, the court found the evidence indicated willful misconduct on the member’s part.
Finally, the court determined that the judicial dissolution of the LLC on the basis that it was no longer reasonably practicable to carry on the business in conformity with the LLC’s articles of organization and operating agreement was not “wrongfully caused” by the member who acted wrongfully in breaching the operating agreement and usurping control of the LLC. The reason it was no longer practicable to carry on the business was the LLC’s failure to obtain the hockey franchise rather than the wrongful conduct of a member. Thus, no member was precluded from participating in the winding up by the terms of the operating agreement that allowed only members who have not wrongfully caused dissolution to participate in winding up. The issue was moot, however, because there was a liquidating trustee appointed by the court.

**Fausel v. JRJ Enterprises, Inc.**, 603 N.W.2d 612 (Iowa 1999).

JRJ Enterprises, Inc. (“JRJ”), a member of a Wyoming LLC involved in a Colorado casino operation, sued for anticipatory breach of a contract for the sale of JRJ’s membership interest in the LLC. The contract for the sale of the membership interest was captioned “Agreement for Sale of Stock” (“Stock Agreement”), and it contained a provision wherein JRJ warranted its membership units were not subject to any restrictions on transfer other than those set forth in the operating agreement or articles of organization of the LLC. This, the court concluded, incorporated by reference the provisions of the operating agreement restricting transfer of JRJ’s membership interest. Thus, interpretation of the Stock Agreement required the court to interpret restrictions on transfer in the LLC operating agreement as well. At issue were timing requirements of right of first refusal provisions in the operating agreement and requirements in the Stock Agreement regarding approval of the Colorado Gaming Division and closing of the sale. The court concluded that the deadline for closing the sale under the right of first refusal provisions did not constitute a deadline for purposes of the Stock Agreement because failure to close by that date would simply require that the membership interest would have to be offered to the LLC and remaining members again under the right of first refusal provision. Since the trial court had viewed the deadline under the right of first refusal provisions as the final deadline for performance of the sale under the Stock Agreement, the court remanded for further determinations relating to the anticipatory breach claim.


A lawyer left his firm (a professional LLC) and went to another firm, and there was a dispute over the provision of the operating agreement dealing with benefits to be paid to a retiring member. The specific issue on appeal was whether the “continuation payments” under the operating agreement qualified as “retirement benefits” under Iowa DR 2-108(A). The payments were conditioned on the lawyer’s termination of the private practice of law in Iowa. The lawyer argued that this was an impermissible covenant not to compete. The court concluded that the provisions in this case (requiring ten years of service and sixty years of age or twenty-five years of service) clearly constituted a retirement plan, and the restriction on future practice was therefore valid, even though the plan applied to situations involving less than full retirement.


An LLC member (“Elliott”) assigned his 99% interest in the LLC to a family trust, and the 1% member (“Lusk”) claimed that he was the sole remaining member and manager on the basis that the assignment was not effective to transfer membership rights. The court determined that the assignment transferred Elliott’s membership along with his 99% financial interest. The operating agreement prohibited assignment of a member’s interest other than to another member; however, both members signed a consent to the transfer of Elliott’s 99% membership interest and agreed that the assignment would not constitute a prohibited assignment under the operating agreement. The parties agreed that the consent amended the prohibition on transfer in the operating agreement but disagreed as to whether the consent authorized the conveyance of Elliott’s membership along with the financial interest. Lusk relied upon the Delaware LLC act provisions that characterize an assignment as carrying only the financial interest of the member. The court concluded that this language encompassed Elliott’s membership as well as his 99% ownership interest.


An LLC member who was bought out pursuant to a push-pull provision in the LLC operating agreement claimed that he was entitled to a portion of net rental income held by a third party under a property management agreement at the time of the closing of the sale of the member’s interest. The court examined the provisions of the operating agreement and the property management agreement and agreed that the member was entitled to recover a
portion of the net rental. The court viewed the member as a third party beneficiary of the property management contract executed by the LLC and disagreed with the defendant’s argument that the member assigned his interest in the disputed funds when he sold his interest in the LLC.


This case was a dispute over who were the managers of a Delaware LLC, and the determinative issue was whether the transfer of all of the shares of a corporate member of the LLC to a trust was a “transfer” of an LLC interest within the meaning of the operating agreement. Plaintiff Clark, the sole shareholder of one of the members of the LLC claimed to be the sole manager of the LLC. The other member of the LLC was La Empresa De La Mar D’Oro, Inc. (“La Empresa”), a California corporation. The stock of La Empresa was titled in Danis at the time La Empresa became a member of the LLC. After formation of the LLC, Danis transferred the stock of La Empresa to a living trust of which Danis and his wife were the trustees and co-trustees. The issue was whether the transfer of the shares to the trust triggered a provision of the operating agreement requiring consent. If the transfer requiring consent occurred without such consent, the transferee’s status was that of a mere assignee. The definition of “transfer” under the operating agreement included a transaction whereby the equity owners of a member as of the date of the member’s admission to the LLC own less than 90% of the equity securities of the member after the transaction. The court determined that the transfer of the shares of La Empresa to the trust did not fall within the definition of a transfer under the operating agreement because the shares were community property under California law and Danis’s wife therefore had a 50% equitable interest in the shares before the transfer to the trust. The court rejected the plaintiff’s argument that the Delaware choice of law clause in the operating agreement, together with the internal affairs doctrine, required Delaware law to apply to the determination of ownership of the shares of La Empresa. According to the court, “Even if the choice of law provision in the Operating Agreement were found to govern, the internal affairs doctrine – which is a well-established principle of Delaware substantive law – requires this Court to look to the law of the state of incorporation to determine the relationships between the corporate entity and its directors, officers, and stockholders. . . . Because La Empresa is a California corporation, . . . this Court would be required to look to California law in all events to determine who are the equity owners of La Empresa.”


The members of a family-held Kansas LLC deadlocked on important management issues, and several members withdrew to effect a dissolution of the LLC. The withdrawing members claimed that they were entitled to participate in the LLC’s winding up under the operating agreement. The LLC’s remaining members argued that the withdrawing members were no longer members and thus had no right to participate in the LLC’s winding up. Both factions relied on the operating agreement, which provided for the “members” to wind up and liquidate the LLC and defined “members” as “those persons who are members of the Company from time to time, including any Substitute Members.” The district court found that the withdrawing members were not entitled to participate in the dissolution process. The Kansas Supreme Court, however, examined the use of the term “member” and “remaining member” in other provisions of the operating agreement and concluded that “[t]he many references to ‘member’ in the Act when coupled with the operating agreement suggest that the better view is that, in dissolution, ‘member’ includes a withdrawing member having a financial interest in the Company’s assets.” The court went on to state that control of the dissolution process resided in the managers of the LLC under the operating agreement and the Kansas act.


One member of a two-member LLC brought suit against the other member, individually and derivatively on behalf of the LLC, seeking equitable damages for breach of fiduciary duty and various other claims. The Chancery Court dismissed the case for lack of subject matter jurisdiction because the LLC agreement contained a choice of forum provision directing that disputes be arbitrated or litigated in California. The Delaware Supreme Court addressed the following questions: (1) whether the LLC, which did not itself execute the LLC agreement, is bound by the provisions of the agreement, and (2) whether contractual provisions requiring all disputes be resolved by arbitration or litigation in California are valid under the Delaware LLC act. The court held that the LLC agreement was binding upon the LLC as well as its members and that the contractual forum selection provisions were valid. The court’s opinion goes into the background and policy of the Delaware LLC act and the principle of freedom of contract under the act. The court rejected the argument that, because the LLC itself had not signed the LLC agreement, the LLC was not bound by the provisions of the agreement. According to the court, “It is the members who are the real parties in interest. The LLC is simply their joint business vehicle.” The court also held that the Delaware LLC act permits parties to agree to vest exclusive jurisdiction of disputes (including derivative claims) in courts outside Delaware. The act expressly permits LLC members or managers to consent to the nonexclusive jurisdiction of litigation or arbitration in a state other than
Delaware, to the exclusive jurisdiction of litigation in Delaware, or to the exclusivity of arbitration in a state other than Delaware. The court noted that the act is silent with regard to agreements vesting exclusive jurisdiction of litigation in courts outside of Delaware and concluded that the General Assembly would have prohibited such provisions if it had desired to do so.


Several parties entered various agreements concerning the sale and marketing of long distance services. It was contemplated that two of the parties would enter a purchase and sale agreement, but one of the parties decided against consummating the acquisition. The parties had executed an LLC operating agreement that referred to a letter of intent contemplated that two of the parties would enter a purchase and sale agreement, but one of the parties decided against considering the pleadings at an early stage in the proceedings, the court concluded that it was possible that the LLC agreement incorporated by reference the purchase and sale agreement or was at least ambiguous in such respect. Considering the pleadings at an early stage in the proceedings, the court concluded that it was possible that the LLC agreement incorporated by reference the purchase and sale agreement or was at least ambiguous in such respect. Considering the pleadings at an early stage in the proceedings, the court concluded that it was possible that the LLC agreement incorporated by reference the purchase and sale agreement or was at least ambiguous in such respect. Considering the pleadings at an early stage in the proceedings, the court concluded that it was possible that the LLC agreement incorporated by reference the purchase and sale agreement or was at least ambiguous in such respect. Considering the pleadings at an early stage in the proceedings, the court concluded that it was possible that the LLC agreement incorporated by reference the purchase and sale agreement or was at least ambiguous in such respect. Considering the pleadings at an early stage in the proceedings, the court concluded that it was possible that the LLC agreement incorporated by reference the purchase and sale agreement or was at least ambiguous in such respect. Considering the pleadings at an early stage in the proceedings, the court concluded that it was possible that the LLC agreement incorporated by reference the purchase and sale agreement or was at least ambiguous in such respect.


This case involved the interpretation of arbitration, change of control, and non-competition provisions of an LLC operating agreement. Two corporations, Metro Riverboat Associates, Inc. (“Metro”) and Bally’s Louisiana, Inc. (“Bally’s”), were the members of an LLC formed to own and operate a gambling riverboat. Although Metro had a majority interest, the LLC operating agreement essentially required consent of both members for significant business decisions. When Bally’s merged with Hilton Hotels Corporation, Metro claimed there was a “change of control” under the operating agreement that permitted most decisions to be made by a simple majority in interest. In addition, Metro claimed that Bally’s was in violation of the non-competition provision of the operating agreement because Hilton Hotels had an ownership interest in another riverboat casino. Eventually, Bally’s made demand on Metro for binding arbitration of their disputes, claiming that arbitration was required by the operating agreement. Metro filed suit asking for injunctive relief against Bally’s. The court examined the arbitration provision of the operating agreement and concluded that the parties’ disagreement was not within the scope of the arbitration clause covering “a dispute . . . with respect to the management and operation of the Company.” Rather, their disagreement was over interpretation of contractual provisions that affected their respective management rights. The court next considered the meaning of the change in control and non-competition provisions and concluded that the limited evidence failed to meet the heightened burden of proof imposed on Metro to obtain injunctive relief. On appeal after remand, the court of appeals upheld the trial court’s grant of preliminary injunctive relief. **Metro Riverboat Associates, Inc. v. Bally’s Louisiana, Inc.,** 777 So.2d 578 (La. App. 2000). The Louisiana Supreme Court reversed, holding that Metro had failed to establish its injury could not be compensated by money damages. **Metro Riverboat Associates, Inc. v. Bally’s Louisiana, Inc.,** 789 So.2d 565 (La. 2001).

**Five Star Concrete, LLC. v. Klink,** 693 N.E.2d 583 (Ind. App. 1998).

The court in this case determined that a dissociating member of an LLC had no right under the LLC’s operating agreement or the Indiana LLC act to receive a distribution of income allocated to the member for tax purposes, but the court refused to render summary judgment on the issue of whether the buy-out of the dissociating member divested the member of its entire economic interest in the LLC, in part because the meaning of the term “units” was not clear under the operating agreement. Klink, Inc. (“Klink”) and four other corporations formed an LLC. Klink withdrew from the LLC, and the remaining members decided to purchase Klink's ownership units and continue the business. The members agreed that Klink would receive $61,047.22 for the value of Klink's "units." After the end of Klink's fiscal year, Klink was allocated its share of the LLC's income for the portion of the year that Klink was a member. Klink asserted that it was entitled to a distribution in this amount. The court concluded that neither Indiana law nor the operating agreement gave a member a right to a distribution of income allocated to the member for income tax purposes. The remaining issue involved the meaning of the term "units" inasmuch as Klink's units were bought out on its withdrawal. The LLC contended that Klink divested itself of its entire interest when it sold its units to the LLC. Klink argued that it sold less than all of its economic rights. Klink pointed to the operating agreement reference to a unit as "an interest in the Company representing a contribution to capital." The LLC pointed out, however, that the operating agreement generally entitled each unit to a vote and a proportionate share of the LLC's net income, gains, losses, deductions, and credits. The court concluded that fact issues precluded resolution of this issue by summary judgment. The court
addressed as a separate issue the valuation method and whether it represented the fair market value of Klink's entire interest. The court concluded that summary judgment was not appropriate on this issue either.

**Child Care of Irvine, L.L.C. v. Facchina**, No. Civ. A. 16227, 1998 WL 409363 (Del. Ch. July 15, 1998). This case involved a dispute between LLC members in which it was unclear whether the parties’ rights were governed by the shareholder agreement of the predecessor corporation, the default provisions of the Delaware LLC act, the merger agreement by which the predecessor corporation was converted to an LLC, or a draft LLC agreement never signed by the members. The plaintiff members of the LLC sought to remove the defendant member, Facchina, as manager of the LLC. The parties had originally formed the business as a Delaware corporation. The corporation was subsequently converted into an LLC by virtue of a merger of the corporation into a newly formed Delaware LLC which survived the merger. An LLC agreement for the new LLC was never signed. The plaintiffs claimed that the shareholder agreement of the predecessor corporation reflected the terms of the members’ agreement for the operation of the LLC. Alternatively, the plaintiffs relied upon the default right to remove a manager under the Delaware LLC act. Facchina claimed that a draft LLC agreement never signed by the members governed their relationship. Alternatively, Facchina claimed that the merger agreement itself was the LLC agreement. The court concluded that summary judgment for either side was inappropriate because there were sharply disputed facts and insufficient undisputed facts to support a legal ruling on the issues before the court. The court noted that both the shareholder agreement and the draft LLC agreement contained arbitration provisions and encouraged the parties to pursue arbitration in California.

**Goldstein and Price, L.C. v. Tonkin & Mondl, L.C.**, 974 S.W.2d 543 (Mo. App.1998). This case involved interpretation of an LLC law firm’s operating agreement in order to resolve a dispute over the effective date of a member’s withdrawal and the withdrawn member’s rights with respect to certain fees received by the firm after the member’s withdrawal. The LLC in this case converted from a partnership in January 1994 and adopted the partnership agreement as the operating agreement until a new operating agreement could be prepared. In November 1994, before a new operating agreement was adopted, one of the members, Tonkin, advised other members of the firm that he intended to withdraw. He provided a written notice of withdrawal stating an effective date of December 31, 1994. The managing members concluded that the partnership agreement that served as the LLC’s operating agreement required Tonkin’s withdrawal on November 30, 1994. The agreement stated that “withdrawal shall become effective on the last day of the calendar month after service of the withdrawal notice. . .” The court found this language by itself to be ambiguous but interpreted it with reference to other parts of the agreement and concluded that withdrawal was effective November 30, 1994. The parties also had a disagreement as to the withdrawn member’s share of certain fees received by the firm after Tonkin’s withdrawal. The court looked to the operating agreement as controlling but found no provision addressing work in progress in the withdrawal context. Thus, under the terms of the written agreement, Tonkin was not entitled to any portion of the disputed fee. However, the court concluded that the parties orally modified the operating agreement regarding the fee in question by agreeing to treat the fee as an account receivable. The agreement provided for allocation of accounts receivable, and Tonkin was awarded his share under the agreement. The court rejected Tonkin’s claims against the firm for breach of fiduciary duty. The court stated that the record supported the trial court’s findings that the firm did not conceal assets, interfere with client relationships, defame members of the withdrawing member’s new firm, or “act in other ways that would warrant a finding of breach of fiduciary duty.”

**Zaugg & Zaugg Architects v. Wagner**, No. 96-CA-117-2, 1997 Ohio App. LEXIS 3987 (Ohio App. Aug. 8, 1997). Six parties embarked on a venture to build a residential golf course development. Two of the parties, John Zaugg and Marion Zaugg, had an architectural partnership and rendered substantial architectural services toward development of the project. A year after a draft agreement was circulated among the members but was not signed. A few months later, the parties met to sign the latest draft of the operating agreement, but only three members signed it. The Zauggs’ bill for architectural services became a source of contention, and the Zauggs withdrew from the LLC. The LLC claimed that the withdrawal was wrongful under the terms of the operating agreement. The Zauggs were among the members who signed the operating agreement, thus the LLC argued the Zauggs were bound. The court found, however, that the agreement was not a final, binding agreement since all of the members had not agreed to its terms. Thus, the Zauggs were permitted to withdraw by the default provisions of the Ohio LLC act.

The court determined that an arbitration clause in an LLC’s operating agreement was not binding on the individual members of the LLC. Faye Becker (“Becker”), the managing member of Bubbles & Bleach, LLC (“B & B”), misappropriated funds of B & B. B & B brought suit in Illinois against Becker under the authority of one of its members for conversion, breach of fiduciary duty, and fraud. The Operating Agreement of B & B and the First Amended and Restated Limited Liability Company Agreement of B & B each contained an arbitration clause that required that arbitration of "any matters arising out of the terms and conditions of the underlying agreement" take place in Wisconsin and be governed by Wisconsin law. Becker moved for dismissal based upon the arbitration clause. The court concluded that neither the Operating Agreement nor the Amended and Restated Limited Liability Company Agreement of B & B was binding upon B & B. The agreements provided that they were binding upon the "parties" to such agreement; however, the term "parties" was not defined. The court noted that the LLC Agreement provided that it was by and among the members of the LLC and that the signatories to each agreement were the members. Further, it noted that the Wisconsin LLC act defines the term "operating agreement" as a written agreement among the members. The court found that there was no indication that the legislature intended to bind LLCs as entities distinct from their constituent members. According to the court, the fact that B & B was a beneficiary of and subordinate to some of the terms of the agreements did not bind B & B under the arbitration clause. Rather, the arbitration clause was binding only upon the parties to the agreement.


The plaintiff sold its interest in an LLC to the parent company of the other member of the LLC. The plaintiff claimed that the terms of the LLC agreement and another agreement regarding the LLC entitled it to a pro rata payment of LLC funds for the portion of the month before the close of the sale of its interest in the LLC. The defendant claimed that the terms of the agreements precluded such a distribution. The court examined various provisions of the agreements and concluded that one of the provisions required a distribution to be made to the plaintiff for its pro rata share of the LLC's net cash flow for the month at issue.

**Y. Transfer of Interest; Buy-Out of Member**


An LLC member asserted that he agreed to sell his membership interest back to the LLC under economic duress because the LLC threatened to terminate a manufacturer’s representative agreement under which the member acted as the LLC’s representative in the southeast. The court concluded the LLC had the legal right to terminate the manufacturer’s representative agreement, and the pressure applied by threatening to do so was not wrongful. Whether the operating agreement conferred the right to redeem the member’s interest was not material to the member’s claim of duress because the member testified his reason for selling his membership interest was the threat of termination of the manufacturer’s representative agreement. The involuntary redemption provision of the operating agreement thus never became applicable.


A withdrawn member of a Wyoming LLC demanded payment of the value of his share of the current value of the LLC. Because the Wyoming LLC act does not provide for the fate of a withdrawn member’s equity interest in an LLC, the court looked to the operating agreement to determine if it contained provisions relevant to the withdrawn member’s interest. The court reviewed provisions addressing capital accounts, distributions, membership certificates, transfer, and voting and concluded that there simply was no provision mandating a liquidation or buy-out of a withdrawn member’s interest. The court noted that the transfer provisions in the operating agreement clearly contemplated a situation where a person could be an equity owner but not a member and found no reason to treat a withdrawing member any differently. Thus, the withdrawn member was no longer a member but retained his equity interest in the LLC.

**In re The IT Group, Inc., Co. (The IT Group, Inc., Co. v. The Shaw Group Inc.),** 302 B.R. 483 (D.Del. 2003). After filing bankruptcy, the debtors, members of a Delaware LLC, attempted to transfer their rights under the LLC operating agreement to another member. The court upheld the bankruptcy court’s conclusion that the debtors could not transfer their membership rights without the consent of the other members, that the debtors could assign their economic rights subject to a right of first refusal of the members in the operating agreement, and that a default provision under the operating agreement was unenforceable as an ipso facto clause. The default provision in issue affected the
debtor’s economic interest in the LLC. If the clause providing that the debtor’s bankruptcy constituted a default was enforceable, another member was entitled to buy out the debtor’s interest at an amount equivalent to the value of their accrued capital account on the date of their bankruptcy petition. If the debtor were not in default, the other member was not entitled to exercise its buy out rights, and the debtor’s economic interest would be their ongoing rights to profits and losses from the LLC. The court rejected the argument that the default provision was enforceable under Section 365(e)(2)(A). Because the Delaware LLC act permits the assignment of a member’s economic interest and does not excuse the members from rendering performance to an assignee, the court concluded that Section 365(e)(2)(a) did not apply and the default provision was unenforceable as an ipso facto clause. The court concluded that the right of first refusal provision was enforceable and was not an ipso facto clause because it was triggered by a transfer and not by bankruptcy. The court also rejected the argument that the right of first refusal was an unenforceable restraint on assignment under Section 365(f). Finally, the court rejected the argument that public policy militated against enforcement of the right of first refusal because the procedures implicated by the right of first refusal were too onerous. The court did not regard the issues related to allocation of the purchase price of the debtor’s economic interest as rendering the right of first refusal unenforceable.

*Anderson v. Wilder*, No.E2003-00460-COA-R3-CV, 2003 WL 22768666 (Tenn.Ct.App. Nov. 21, 2003)(concluding that there was genuine issue of material fact as to whether transfer of members’ LLC units violated right of first refusal provision in LLC operating agreement).

*Lamprecht v. Jordan, LLC*, 75 P.3d 743 (Idaho 2003) (interpreting withdrawal and buy-out provisions in operating agreement and concluding that former member was entitled only to the balance in his capital account as of the date his employment with the LLC terminated).


Two groups of entities, Lone Star and Eikon, were members of an LLC with a push-pull buy-sell provision. Either party could invoke the provision by notice to the other member in which the invoking member set forth an amount (the “Stated Amount”) which represented the price at which the invoking member would be willing to purchase all the assets of the LLC as if the invoking member were the hypothetical third party proposing to purchase the assets of the LLC. The agreement set forth a formula for calculating the value of each member’s interest based on the Stated Amount. After the invoking member gave notice to the other member, the other member could elect to buy the invoking member’s interest or sell its own interest to the invoking member. Eikon invoked the buy-sell provision, and Lone Star accepted the Stated Amount proffered by Eikon but believed that Eikon had miscalculated the price. Lone Star agreed to buy Eikon’s interest and tendered a check for the full amount claimed by Eikon for its interest, but reserved its right to contest the amount. While the LLC agreement required Lone Star to provide a 10% cash deposit on acceptance of the offer, Lone Star placed a cashier’s check in escrow for a portion of the deposit and a letter of credit for the remainder of the deposit. Eikon brought suit alleging that Lone Star had breached the agreement by failing to deliver the cash deposit and seeking liquidated damages under the agreement and attorney’s fees. Lone Star counterclaimed for declaratory judgment requiring Eikon to sell its interest pursuant to the agreement. The court concluded that Lone Star’s interpretation of the purchase price provisions of the agreement was correct and that Lone Star had the right to accept the offer and reserve its rights as it had done. The court concluded that Eikon did not have the right to liquidated damages. With respect to the deposit requirement, the court determined that questions regarding compliance with this requirement were only relevant in the event that the purchase of the interest did not close. Since the closing occurred, the question did not need to be addressed.

*Seed v. Astra Genstar Partnership*, No. C2-02-1143, 2003 WL 178790 (Minn.App. Jan. 28, 2003) (holding that change in ownership of 100% of membership interests in LLC which was member of second LLC was not “change in direct ownership of 50% or more of the voting and equity interests” of second LLC so as to trigger option under change in control clause of agreement because the owner of the membership interest in the second LLC did not change).


In the context of certain disputes among the members of an LLC the members told the trial court that they wanted to sever their relationship. At a hearing, an attorney for one of the defendants stated that the members did not want the LLC liquidated because it would cause tax problems for all the members. The trial court found that the members could no longer work together and that liquidation and partition were not appropriate equitable remedies. The court concluded that cancellation of the plaintiff’s minority interest in the LLC in exchange for payment of $300,000 by the defendant members was the appropriate equitable remedy. The defendants appealed the judgment requiring them
to buy out the plaintiff. The court of appeals reversed, holding that none of the statutory grounds for equitable relief or court-ordered sale of membership interests had been established and the trial court was thus without authority to grant such relief.


Three radiologists who had been practicing together formed a Louisiana LLC and apparently continued their practice in the LLC. The court stated that the LLC adopted no operating agreement, and the members paid nothing for their interests. The members received monthly distributions based on a number of factors. Several years later, one of the members withdrew and demanded a distribution in the amount of the fair market value of his interest, which was the default statutory measure of the distribution owed a withdrawing member at the time of the member’s withdrawal. However, on the date the LLC was formed, the LLC act provided that a withdrawing member was entitled to a distribution in the amount of the “fair market value as of the date contributed of the member’s capital contribution.” The LLC argued that the law in effect at the time the LLC was formed governed the amount of the withdrawing member’s distribution and that the member was not entitled to any distribution because his contribution was zero. The court agreed that the law in effect at the time of the formation of the LLC controlled. The court reasoned that the amendment was a substantive change that should be given prospective effect only because it changed the existing rights and interests of a withdrawing member. Further, the court concluded that application of the amended law would impair the obligations created under the contract entered by the members when they formed the LLC, and the Louisiana LLC act provides that amendments will not impair the obligations of any contract existing when the amendment goes into effect.


A member of a Georgia LLC pledged all of his interest as an LLC member to secure a bank loan. When the bank attempted to foreclose its security interest, the member argued that the operating agreement required consent of the other members for transfer of an interest in the LLC and that the bank had no security interest because of the bank’s failure to obtain consent of the other members. The operating agreement was quoted by the court as follows:

11.01 General. Except as otherwise provided herein, neither a Member nor an Economic Interest Owner shall have a right to:

(a) sell, assign, pledge, hypothecate, transfer, exchange or otherwise transfer for consideration, (collectively, “Sale”) ...

11.02 Transferee Not Member in Absence of Unanimous Consent.

(a) Notwithstanding anything contained herein to the contrary, if all of the remaining Members do not approve by unanimous written consent the proposed Sale or Gift of the Transferring Member’s Membership Interest or Economic Interest to a transferee or donee which is not a Member immediately prior to the Sale or Gift, then the proposed transferee or donee shall no right to participate in the management of the business and affairs of the Company or to become a Member. The transferee or donee shall be merely an Economic Interest Owner. No transfer of a Member’s interest in the Company (including any transfer of an Economic Interest or any other transfer which has not been approved by unanimous written consent of the Members) shall be effective unless and until written notice ... has been provided to the Company and the non-transferring Member.

The court found that the operating agreement permitted the transfer of the economic interest and concluded that the bank obtained a security interest in the member’s economic interest which it was entitled to foreclose.


Schwegman sued Howard for breach of an agreement to assign 10% of Howard’s interest in an Indiana LLC to Schwegman. Howard executed an assignment of 10% of his interest in the LLC to Schwegman, and Schwegman received a copy of the LLC operating agreement and a consent to membership. The consent to membership was signed by Howard but not the other two members of the LLC. The operating agreement did not alter the Indiana default rule requiring unanimous consent to admit an assignee as a member. Howard argued that the contemporaneous documents rule required the assignment and consent be read together and that unanimous consent of the members was a condition precedent for Schwegman to receive an interest in the LLC. Schwegman argued that there is a difference between assignment (pursuant to which an assignee is entitled only to receive distributions) and transfer of an LLC interest (pursuant to which the transferee is admitted as a member) and that assignment is allowed under the Indiana LLC act
unless prohibited by the operating agreement. The court concluded that whether the agreement was an assignment or
transfer could only be determined after a hearing on the merits.


An LLC member (Kosoy) sued a third party (Kieselstein-Cord) who allegedly orally agreed that he would
purchase a membership interest from Kosoy and assume responsibility for managing the LLC’s business. The LLC
operating agreement had a push-pull buy-sell provision, and Kieselstein-Cord allegedly agreed that if Kosoy would buy
the membership interest of the other member, Kieselstein-Cord would then purchase the interest from Kosoy. The court
concluded the agreement lacked essential terms, in particular, a purchase price or a mechanism for its determination.
(As put by the court, the agreement was no more than an offer to purchase what was formerly the other member’s
interest “at an unspecified time, in an unspecified manner, and for an unspecified price, and then at an unspecified time,
assume responsibility for operating the boutique” operated by the LLC.)


Petit worked at Burns Clinic Medical Center, P.C. (the “P.C.”) and was a member of an LLC that owned the
real property where the clinic operated. Pettit sued the LLC for amounts he claimed were owed for the buy-back of his
interest in the LLC and compensation for the discounting of his interest in the LLC’s predecessor partnership. The court
upheld summary judgment in favor of Pettit. First, the court determined that, while there was evidence of financial
difficulties of the LLC at a later date, there was no evidence that the buy-out payment would have violated the statutory
restriction on distributions at the time it was owed. Next the court interpreted an arrangement whereby the P.C. made
two of three payments recommended by the LLC to compensate physicians who had bought into the LLC at a greater
price than physicians who were subsequently admitted. The court interpreted this arrangement to involve a legal
obligation on the part of the LLC to make the payments.


In this dispute between the members of an Arkansas LLC, the court interpreted provisions of the operating
agreement regarding transfer of units and buy-out in connection with the termination of employment of the member.
The three members of the LLC were Brady, Pierce, Ault, and an entity owned by Brady and Pierce. In the course of
a power struggle between Brady and Pierce, Pierce transferred his units to Ault. Subsequent to the transfer, Brady
notified Pierce that he was terminated and that the LLC would exercise its option to purchase his units. When Ault
revealed to Brady that he now owned Pierce’s units, Brady demanded Ault turn the units over to the LLC. Ault refused,
and Brady terminated Ault and informed him that the LLC would buy back his units pursuant to the operating
agreement. Ault took the position that the repurchase provision in the operating agreement did not apply to him because
he was an independent contractor rather than an employee. The operating agreement provided that the LLC had the
option to purchase a member’s units “upon the termination of employment” of a member. Ault also argued that the
transfer of Pierce’s units to Ault was not subject to a provision of the operating agreement that restricted transfer and
provided that a transferee who received units in violation of the restriction was not a “substituted member” and had only
economic rights. Ault argued that, since he was already a member, the provision was inapplicable. The court of appeals
held that the provision applied to any transfer, and the term “substituted member” could only logically be viewed in
terms of units, i.e., a substituted member with respect to particular units. The court of appeals also rejected Ault’s
interpretation of the repurchase provision. The court stated that whether Ault was an independent contractor rather than
an employee was irrelevant to the application of the provision. In either case, he was “employed” by the LLC, and the
provision applied whenever the “employment” of a member was terminated. Finally, the court rejected Ault’s challenge
to the valuation of his units. Following the district court’s decision that the LLC had the right to purchase Ault’s units,
the parties stipulated to a procedure for valuation. The procedure specified that each party would select a CPA, and
the two CPAs chosen by the parties would select a third. The appraisal most different from the other two would be
disregarded, and the value would be an average of the remaining two. Two of the CPAs valued Ault’s units at zero,
and the CPA chosen by Ault valued his units at $2 million. Ault conceded that he was bound by the stipulation but
argued the agreement carried with it an implied duty of good faith and fair dealing, which included the duty to follow
customary and usual accounting standards. The court characterized Ault’s argument as nothing more than an attack on the
CPAs’ methodology and concluded that Ault was bound by the stipulation under both contract and estoppel
principles.

**Valinote v. Ballis,** 295 F.3d 666 (7th Cir. 2002).

The Seventh Circuit Court of Appeals affirmed the district court’s interpretation of the buy-sell provisions of
an LLC’s operating agreement. In brief, Valinote exited the LLC pursuant to a push-pull buy-sell provision under which
Ballis, the other member of the LLC, set the price of the 50% interest that each held at a negative $79,064. At the time, the LLC owed Valinote exactly that amount so that no money changed hands, and Ballis became the sole member of the LLC. When a bank pursued Valinote on his guaranty of LLC indebtedness, Valinote argued that he should be indemnified by Ballis. The court cited and discussed at length the terms of the operating agreement, contrasting the push-pull buy-sell provisions with provisions dealing with buy-out upon resignation of a member, and concluded that Valinote had no implied right of indemnification against Ballis. Valinote had a right against the LLC, but not against the other member. The court concluded that Valinote, as a former member, was not covered by a clause in the operating agreement that imposed cross-indemnity obligations between the members (interpreting “members” to include only current members). The court explained the negative price in terms of the increased risk each took by giving up the right of indemnification against the other.


In this dissent and appraisal proceeding, the court examined the transfer restrictions in an LLC operating agreement and concluded that there were fact issues as to whether the operating agreement was violated.

_ESCA of Baltimore, LLC v. Colkitt_, 164 F. Supp.2d 584 (D. Md. 2001) (finding that there were fact issues as to whether an LLC member made a transfer of his membership interest for consideration in violation of transfer restrictions contained in the operating agreement).


In addition to addressing breach of fiduciary duty and other issues in this case, the Virginia Supreme Court examined the meaning of two provisions in an LLC operating agreement relating to dissolution, continuation and purchase of a member’s interest. Article 13 of the operating agreement provided for dissolution on the death, resignation, bankruptcy, or dissolution of a member unless the procedures of Article 9 were followed resulting in an election to continue the LLC. Article 9 provided that, on the death of a member, the remaining members could elect to purchase the interest of the deceased member or elect to continue the LLC. If the remaining members did not make “either of these elections” the LLC was dissolved. The court rejected the defendants’ argument that the “election” referred to in Article 13 referred only to the election to continue and did not include the election to buy the departed member’s interest. The court agreed with the trial court that either of the two elections referred to in Article 9 would result in continuation of the LLC. The court relied upon general rules of contract construction and considered the purposes of the parties and the circumstances surrounding execution of the operating agreement, including the terms of a restated partnership agreement drafted for the partnership that was the predecessor to the LLC. (The court went on to uphold sanctions imposed upon the parties who alleged fraud and mutual mistake with respect to the inclusion of these terms in the operating agreement. The sanctions were based upon the fact that the parties who claimed they were misled had the assistance of “experienced” and “sophisticated” attorneys who specialize in this type of work. According to the trial court, it was “ridiculous” to say that the plaintiff could mislead such attorneys.)


Whitmore was hired as chief operating officer of an LLC that operated fast food restaurants. He also received a 5% membership interest in the LLC and a 5% interest in a second LLC that was being formed to acquire additional fast food franchises. When Whitmore’s employment was terminated, he claimed that he was entitled to receive the value of his membership interests under provisions of the Maryland LLC act in effect at the time. The court pointed out that the statutory provisions relied upon by Whitmore were default provisions and that the operating agreements of the two LLCs had provisions addressing withdrawal and buy-out. The court concluded that the termination of Whitmore’s employment did not amount to a withdrawal or entitle Whitmore to receive the value of his interest under either of the operating agreements; therefore, Whitmore was not entitled to be bought out.


A receiver was appointed for Medicare Supply Co. of New England (“Medicare”), a member of a Rhode Island LLC. Medicare argued that appointment of the receiver constituted an event of dissociation under the LLC agreement which in turn entitled Medicare to be bought out under the agreement. Events of dissociation included a change in control of a member of the LLC. Control was defined under the agreement as an ownership interest sufficient to carry any motion, the right to elect or appoint directors or managers, or the right to manage. The court concluded that a change in control had occurred because the shareholders, directors, and officers of Medicare no longer controlled Medicare. The court stated that control did not have to shift to the receiver for a change in control to occur; it was
sufficient that those formerly in control no longer had control. The court rejected the argument that the receiver was an assignee but did accept that the receiver was analogous to a judgment or lien creditor of Medicare. As a type of lien creditor, the court said the receiver succeeded to the rights of the dissociated member to be bought out.

_Fausel v. JRJ Enterprises, Inc.,_ 603 N.W.2d 612 (Iowa 1999).

JRJ Enterprises, Inc. (“JRJ”), a member of a Wyoming LLC involved in a Colorado casino operation, sued for anticipatory breach of a contract for the sale of JRJ’s membership interest in the LLC. The contract for the sale of the membership interest was captioned “Agreement for Sale of Stock” (“Stock Agreement”) and it contained a provision wherein JRJ warranted its membership units were not subject to any restrictions on transfer other than those set forth in the operating agreement or articles of organization of the LLC. This, the court concluded, incorporated by reference the provisions of the operating agreement restricting transfer of JRJ’s membership interest. Thus, interpretation of the Stock Agreement required the court to interpret restrictions on transfer in the LLC operating agreement as well. At issue were timing requirements of right of first refusal provisions in the operating agreement and requirements in the Stock Agreement regarding approval of the Colorado Gaming Division and closing of the sale. The court concluded that the deadline for closing the sale under the right of first refusal provisions did not constitute a deadline for purposes of the Stock Agreement because failure to close by that date would simply require that the membership interest would have to be offered to the LLC and remaining members again under the right of first refusal provision. Since the trial court had viewed the deadline under the right of first refusal provisions as the final deadline for performance of the sale under the Stock Agreement, the court remanded for further determinations relating to the anticipatory breach claim.


A lawyer left his firm (a professional LLC) and went to another firm, and there was a dispute over the provision of the operating agreement dealing with benefits to be paid to a retiring member. The specific issue on appeal was whether the “continuation payments” under the operating agreement qualified as “retirement benefits” under Iowa DR 2-108(A). The payments were conditioned on the lawyer’s termination of the private practice of law in Iowa. The lawyer argued that this was an impermissible covenant not to compete. The court concluded that the provisions in this case (requiring ten years of service and sixty years of age or twenty-five years of service) clearly constituted a retirement plan, and the restriction on future practice was therefore valid, even though the plan applied to situations involving less than full retirement.


An LLC member (“Elliott”) assigned his 99% interest in the LLC to a family trust, and the 1% member (“Lusk”) claimed that he was the sole remaining member and manager on the basis that the assignment was not effective to transfer membership rights. The court determined that the assignment transferred Elliott’s membership along with his 99% financial interest. The operating agreement prohibited assignment of a member’s interest other than to another member; however, both members signed a consent to the transfer of Elliott’s 99% membership interest and agreed that the assignment would not constitute a prohibited assignment under the operating agreement. The parties agreed that the consent amended the prohibition on transfer in the operating agreement but disagreed as to whether the consent authorized the conveyance of Elliott’s membership along with the financial interest. Lusk relied upon the Delaware LLC act provisions that characterize an assignment as carrying only the financial interest of the member. Since the operating agreement did not define “assignment,” Lusk argued the court should look to the Delaware act for the effect of an assignment. The court disagreed. The court said that the consent and assignment indicated what was meant by the term “assignment” since the instruments referred to assignment of Elliott’s “entire undivided membership interest.” The court concluded that this language encompassed Elliott’s membership as well as his 99% ownership interest.


An LLC member who was bought out pursuant to a push-pull provision in the LLC operating agreement claimed that he was entitled to a portion of net rental income held by a third party under a property management agreement at the time of the closing of the sale of the member’s interest. The court examined the provisions of the operating agreement and the property management agreement and agreed that the member was entitled to recover a portion of the net rental. The court viewed the member as a third party beneficiary of the property management contract executed by the LLC and disagreed with the defendant’s argument that the member assigned his interest in the disputed funds when he sold his interest in the LLC.

This case was a dispute over who were the managers of a Delaware LLC, and the determinative issue was whether the transfer of all of the shares of a corporate member of the LLC to a trust was a “transfer” of an LLC interest within the meaning of the operating agreement. Plaintiff Clark, the sole shareholder of one of the members of the LLC claimed to be the sole manager of the LLC. The other member of the LLC was La Empresa De La Mar D’Oro, Inc. (“La Empresa”), a California corporation. The stock of La Empresa was titled in Danis at the time La Empresa became a member of the LLC. After formation of the LLC, Danis transferred the stock of La Empresa to a living trust of which Danis and his wife were the trustors and co-trustees. The issue was whether the transfer of the shares to the trust triggered a provision of the operating agreement requiring consent. If the transfer requiring consent occurred without such consent, the transferee’s status was that of a mere assignee. The definition of “transfer” under the operating agreement included a transaction whereby the equity owners of a member as of the date of the member’s admission to the LLC own less than 90% of the equity securities of the member after the transaction. The court determined that the transfer of the shares of La Empresa to the trust did not fall within the definition of a transfer under the operating agreement because the shares were community property under California law and Danis’s wife therefore had a 50% equitable interest in the shares before the transfer to the trust. The court rejected the plaintiff’s argument that the Delaware choice of law clause in the operating agreement, together with the internal affairs doctrine, required Delaware law to apply to the determination of ownership of the shares of La Empresa. According to the court, “Even if the choice of law provision in the Operating Agreement were found to govern, the internal affairs doctrine – which is a well-established principle of Delaware substantive law – requires this Court to look to the law of the state of incorporation to determine the relationships between the corporate entity and its directors, officers, and stockholders. . . . Because La Empresa is a California corporation, . . . this Court would be required to look to California law in all events to determine who are the equity owners of La Empresa.”


The plaintiff brought a bill of discovery action against a member of an LLC seeking sworn copies of the member’s membership certificate giving notice of a pledge of the membership interest. Under an agreement between the member and the plaintiff, the member was to pledge a 20% LLC interest as partial security for a promissory note. The agreement also required the member to place a legend on the certificate indicating that the interest had been pledged. When the member refused to provide the plaintiff proof that the language had been placed on the certificate, the plaintiff brought this action. The court found that the plaintiff was entitled to maintain the bill of discovery seeking proof of compliance with the agreement.


The court determined that a dissociating member of an LLC had no right under the LLC’s operating agreement or the Indiana LLC act to receive a distribution of income allocated to the member for tax purposes, but the court refused to render summary judgment on the issue of whether the buy-out of the dissociating member divested the member of its entire economic interest in the LLC, in part because the meaning of the term “units” was not clear under the operating agreement. Klink, Inc. (“Klink”) and four other corporations formed an LLC. Klink withdrew from the LLC, and the remaining members decided to purchase Klink’s ownership units and continue the business. The members agreed that Klink would receive $61,047.22 for the value of Klink's "units." After the end of Klink's fiscal year, Klink was allocated its share of the LLC's income for the portion of the year that Klink was a member. Klink asserted that it was entitled to a distribution in this amount. The court concluded that neither Indiana law nor the operating agreement gave a member a right to a distribution of income allocated to the member for income tax purposes. The remaining issue involved the meaning of the term "units" inasmuch as Klink's units were bought out on its withdrawal. The LLC contended that Klink divested itself of its entire interest when it sold its units to the LLC. Klink argued that it sold less than all of its economic rights. Klink pointed to the operating agreement reference to a unit as "an interest in the Company representing a contribution to capital." The LLC pointed out, however, that the operating agreement generally entitled each unit to a vote and a proportionate share of the LLC’s net income, gains, losses, deductions, and credits. The court concluded that fact issues precluded resolution of this issue by summary judgment. The court addressed as a separate issue the valuation method and whether it represented the fair market value of Klink's entire interest. The court concluded that summary judgment was not appropriate on this issue either.
Z. Improper Distributions

Metro Communication Corp., BVI v. Advanced Mobilecomm Technologies, Inc., __ A.2d __, 2004 WL 1043728 (Del.Ch. 2004) (refusing to dismiss derivative claim under Section 18-804 of Delaware LLC act for improper winding up distribution to entity that became sole member of LLC and received all of LLC’s assets in connection with reorganization and dissolution of LLC, but dismissing derivative claims based on improper distributions to original members because (i) claims were barred by limitations provision of Section 18-804, (ii) distributions in issue did not occur during LLC’s winding up, and (iii) complaint did not allege distributions were received from LLC itself, but rather alleged that members received shares in another entity pursuant to a plan of reorganization).


A bankrupt LLC, in its capacity as debtor-in-possession, sought to recover a distribution made to its dominant member (Madsen) in connection with the sale of substantially all of the LLC’s assets. The LLC was insolvent at the time of the sale, and all of the proceeds of the sale (consisting of shares of stock in the purchaser) were distributed to the members in accordance with their interests. The LLC’s members had an agreement about the distribution of the proceeds of the sale whereby the members pledged some of the shares they received for the benefit of certain LLC creditors and Madsen agreed to dismiss a pending lawsuit against one of the LLC’s suppliers and another member. The LLC claimed that the distribution violated the Connecticut LLC act, was a fraudulent transfer under the Bankruptcy Code and the Connecticut Uniform Fraudulent Transfer Act, was a voidable preference under the Bankruptcy Code, and was a breach of Madsen’s fiduciary duty as a member of the LLC to its creditors. Madsen argued the transfer was supported by consideration and that he was entitled to summary judgment. The LLC argued that Madsen’s receipt of the shares violated the provisions of the Connecticut LLC act regarding the distribution of assets on a winding up. However, the court found this provision inapplicable because the LLC had not dissolved and was not in the process of winding up. The LLC conceded that the Connecticut LLC act does not prohibit an insolvent LLC from distributing its assets to its members, but the LLC argued that the court was permitted to apply corporate law restrictions under the provision of the LLC act that provides the principles of law and equity supplement the act. The court concluded that it need not address this argument because the LLC conceded that it had never actually dissolved. Thus, the court granted Madsen summary judgment on the claim that the distribution violated the Connecticut LLC statutes. The court found that there were fact issues regarding whether the distributions were made with intent to hinder or delay LLC creditors and whether Madsen gave reasonably equivalent value. Madsen argued that the distribution could not be a voidable preference because he was only an equity owner and not a creditor or claim holder. The court concluded that Madsen was a creditor by virtue of the distribution agreement and the Connecticut LLC act, which states that a member has the status of a creditor at the time a member becomes entitled to a distribution. Finally, the court applied case law from the corporate context to conclude that Madsen owed a fiduciary duty to LLC creditors when the LLC became insolvent.


The Chapter 7 trustee brought an adversary proceeding to set aside alleged fraudulent transfers. The court held that certain excess cash flow distributions to the members of an LLC engaged in the property management business were fraudulent transfers because they were made with the intent to hinder and delay collection of a note owed by the LLC. The court rejected the argument that the distributions were in the nature of compensation for services of the members. The court noted that there were no employment contracts providing that excess cash flow distributions would be part of their salary or bonus, no funds withheld from the distributions for income tax purposes, and no board resolutions treating the excess cash flow as salary or bonus. The LLC’s major creditor, which held a note permitting the excess cash flow distributions, did not consider the distributions as compensation, but rather considered the distributions to be dividends or payments on account of the equity interests of the members. The court thus concluded that the LLC did not receive reasonably equivalent value for the distributions. (This case is further summarized above under the heading “Fiduciary Duties” and below under the heading “Fraudulent Transfer.”)

Dover Place, LLC v. Coffey, No. A098399, 2003 WL 178832 (Cal.App. Jan. 28, 2003) (concluding that member was not required to return distribution because it did not violate statutory restrictions and operating agreement could not reasonably be interpreted to impose greater restrictions than statute).

Imperial Trading Co., Inc. v. Uter, 837 So.2d 663 (La.App. 2002)(affirming trial court’s finding that manager was personally liable, along with member, for assenting, without reasonable care or inquiry, to distribution to member while LLC was unable to pay its debts as they came due and that other manager was not liable where evidence supported his lack of knowledge of the distribution, but reversing trial court’s finding on other payments on basis record did not
support imposing liability for checks payable to manager without evidence that they were distributions or that such a
distribution violated the statutory restrictions).


A bankruptcy trustee sued an LLC and its members seeking to recover from the members improper
distributions made during the winding up of the LLC. The parties agreed that under Illinois law an LLC member may
be liable for a dissolved LLC’s debts to the extent of any improper distributions received. The trustee argued that he
had a direct cause of action against the LLC members resulting from improper distributions, but the court agreed with
one of the LLC members that the trustee could only recover in supplementary proceedings after obtaining a judgment
against the LLC. Since the trustee had not obtained a judgment against the LLC, the claim against the member failed.
Additionally, the court stated that the trustee would have to identify property of the debtor held by the member and the
value of the property.


The trial court pierced the veil of a Wisconsin LLC and held the member personally liable for an LLC debt. The appeals court found there was insufficient evidence to pierce the veil of the LLC. The court of appeals upheld the judgment against the member, however, on the basis that she did not take appropriate steps to shield herself from liability upon dissolution and distribution of the LLC’s assets. The court noted that filing articles of dissolution and notifying creditors are apparently optional under the Wisconsin statute, but the rules for distribution of assets on dissolution and the priority of creditors are fixed by statute. LLC creditors whose claims are not otherwise barred under the statute may pursue LLC members to the extent of the member’s proportionate share of the claim or the assets of the LLC distributed to the member in liquidation. Since the member did not prove that the plaintiff’s claim exceeded the value of any assets she received, the court affirmed the judgment.

AA. Equity Compensation Agreements

An LLC employer sought summary judgment against an at-will employee on the employee’s breach of
covenant of good faith and fair dealing claim. On three occasions, the employee was granted shares in the LLC subject
to certain conditions and a vesting schedule under an Equity Incentive Plan. Shortly before the date on which some of
the shares would have vested, the employee was terminated. The court found that these shares, as well as shares that
were apparently awarded for past work on a patent, were compensation already earned that could support a claim for
breach of the implied covenant of good faith and fair dealing. The court concluded that other shares could not be
considered compensation for past services and would not support a claim for breach of the covenant of good faith and
fair dealing.

BB. Dissolution and Dissociation

1. Accounting

cases on accounting may not be applicable in LLC context, but declining to decide issue because cases relied upon were
distinguishable in any event).

Three doctors formed an LLC. When disputes arose, two of them voted to remove the third, Khan, as president
and Chief Clinical Officer. Khan tried to persuade the employee doctors that they were employed by him personally
rather than the LLC and had the locks changed at the clinic where the records and assets of the LLC were located. He
instructed the employees not to allow the other two members or the employee doctors on the premises. The other two
members brought suit seeking an injunction and damages and removal of Khan as a member. The court upheld an injunction against Khan enjoining him from harassing the doctors, taking payments for services rendered by the LLC, and obstructing access to patient charts, other records, and medical equipment. The court also found that the trial court did not err in the date it used for an accounting. Khan argued that the trial court should have used the date on which he was removed from the LLC as president, but the court pointed out that he was not dissociated as a member on that date, and the Washington LLC act does not specify how a final accounting date for an LLC is determined. The court said the act indicates that a member is dissociated either 90 or 120 days after legal action is taken. Although the date the trial court used was earlier than this, the court found it was nevertheless appropriate under the circumstances. The court stated that Khan had suggested a final accounting date that preceded legal action for dissociation, and the documents available to the court valued the assets as of the date used by the court. The court indicated that Khan’s activities after that date negatively impacted the LLC and its profitability and stated that he had not shown the court’s determination was error.

2. Bankruptcy

In re Farmland Industries, Inc., 296 B.R. 497 (Bankr. W.D. Mo. 2003) (vacating prior order and holding on reconsideration that the determination of the effect of a member’s bankruptcy on the member’s membership in the LLC is a core bankruptcy proceeding, and that counterclaim for judicial dissolution, being closely intertwined with the issues in the core proceeding, should also be heard by the bankruptcy court).

In this case, a member of a Virginia LLC filed bankruptcy, and the court concluded that the LLC operating agreement was not an executory contract and thus not within the provisions of Bankruptcy Code § 365(c) and (e) preventing enforcement of certain ipso facto clauses. The court explained the history of and reasons for amendments to the Virginia LLC act that eliminated reference to events that would automatically dissolve an LLC. Pursuant to the amendments, events that formerly triggered dissolution became events of dissociation. Under the amended statute, the bankruptcy of a member results in dissociation, and the dissociated member stands in the same relationship to the LLC as an assignee of a membership interest. The court distinguished the DeLuca and Broyhill cases as having been decided prior to the check the box regulations and changes to the Virginia statute. The court pointed out that this case did not involve an entity whose organic documents or enabling statute dissolved the LLC on the member’s bankruptcy, and the operating agreement merely provided for the management structure of the LLC. It imposed no additional duties or responsibilities on members and permitted a member to resign from all offices and committees at any time without breaching the agreement. The court stated that such a person would stand in an analogous position to the LLC as a shareholder to a corporation. Under these circumstances, the court said, there is no executory contract.

The DeLucas were real estate developers who were members of D & B Countryside, L.L.C., a Virginia LLC. The LLC operating agreement provided, consistent with the Virginia LLC statute, that bankruptcy of a member dissolved the LLC unless the remaining members elected to continue the business of the LLC. If the bankrupt member were also the only manager, the remaining members could elect a new manager. After the DeLucas filed bankruptcy, the remaining members voted to continue and replaced them as managers. The DeLucas claimed that the provisions of the operating agreement permitting this action were unenforceable under the United States Bankruptcy Code. The court, like the court in Daugherty, concluded that the operating agreement was an executory contract. However, the court found that the provisions triggering dissolution upon a member's bankruptcy and granting remaining members the right to continue the business and elect a new manager were enforceable because the operating agreement was a personal service contract that could not be assumed over the objections of the other members under Section 365 of the Bankruptcy Code. (In In re Garrison - Ashburn, LC, 253 B.R. 700 (Bankr. E.D. Va. 2001), the court distinguished this case as having been decided prior to changes to the Virginia LLC act.)

The second DeLuca decision addressed the ramifications of the DeLuca bankruptcy with respect to D & B Venture, L.C. ("D & B"), a Virginia LLC whose members were two other LLCs, R & M Kiln Creek, L.C. ("R & M") and JTB Enterprises, L.C. ("JTB"). R & M was the manager of D & B, and the sole members of R & M were Robert and Marilyn DeLuca. JTB argued that the bankruptcy of the DeLucas dissolved R & M, which in turn dissolved D & B, and conferred upon JTB, as the sole remaining member, the right to wind up D & B's affairs. The D & B operating agreement provided that D & B would be dissolved upon certain events, including dissolution or bankruptcy of either
of its members, and that the manager would liquidate the affairs of D & B upon dissolution. The court agreed with JTB that the bankruptcy of the DeLucas dissolved R & M. The dissolution of R & M in turn dissolved D & B. However, the court determined that the terms of the operating agreement vesting the right to liquidate D & B in the manager should control and that R & M thus had the right to wind up D & B's affairs as well as its own affairs. (Though R & M, rather than the DeLucas, held the membership interest in D & B, the court engaged in its analysis, at least in part, as if the DeLucas owned their interest in D & B directly, stating that it was appropriate to "disregard the form of the DeLucas' interest in D & B Venture and to look to the substance." The court noted that the DeLucas did not even list their interest in R & M on their schedules, and the court characterized R & M as little more than a "conduit or shell" of the DeLucas whose function was holding "technical title to what [was] in substance the DeLucas' interest in D & B Venture." The R & M operating agreement provided that R & M would be dissolved upon the bankruptcy of a member, and there were no other members to object to the assumption of its management by the DeLucas regardless of whether the operating agreement was considered a personal service contract. Though the DeLucas had not taken any steps to assume the R & M operating agreement, the only purpose of doing so would be to continue, through it, the management of D & B. The court found no policy that protected R & M from its own dissolution since it was not itself in bankruptcy.) (In In Re Garrison - Ashburn, LC, 253 B.R. 700 (Bankr. E.D. Va. 2001), the court distinguished this case as having been decided prior to changes to the Virginia LLC act.)


The bankruptcy court held that a Chapter 11 bankruptcy filing by a member of two Nebraska LLCs did not terminate the membership of the debtor member and dissolve the LLCs even though the Nebraska LLC statute and the articles of organization and operating agreements of each LLC provided that the LLC would be dissolved upon the bankruptcy of a member. The court first concluded that the LLC membership interests constituted property of the bankruptcy estate and that any provisions of state law or the LLC articles of organization or operating agreements purporting to dissolve the LLC and terminate the debtor's membership interest were unenforceable under Section 541(l) of the Bankruptcy Code. The court also found Section 365(l) of the Bankruptcy Code applicable. That provision voids any provision in a contract or applicable state law that forfeits, modifies, or terminates the debtor's interest in property based upon the insolvency or financial condition of the debtor or the commencement of a bankruptcy case. Finally, the court found that the articles of organization and operating agreements were executory contracts that could be assumed by the debtor in possession under Section 365 of the Bankruptcy Code and that Section 365(e) prevented the termination or modification of the articles of organization and operating agreements any time after the commencement of the bankruptcy solely because of a provision conditioned upon insolvency or bankruptcy.

3. **Expulsion or Termination of Member**


Leisher and Alfred formed an LLC with Alfred as the manager. Alfred engaged in misconduct as manager and Leisher removed him as manager. The business declined, and Leisher ultimately filed suit to dissolve the LLC. Leisher also sought an accounting and damages from Alfred. The court held that the removal of Alfred did not dissolve the LLC because neither the California LLC act nor the operating agreement provided for dissolution in the event of the expulsion of a member. The court also applied the operating agreement to resolve disputes over various distributions and payments.


An LLC obtained a judgment against one of its members who had stolen from the LLC while acting as president of the LLC. The court held the member’s interest was properly forfeited under Maryland law when the member failed to pay the judgment against him. The court relied upon a provision of the Maryland LLC act stating that a member who fails to make a payment that the member is required to make to the LLC may be subject to specified remedies or consequences such as forfeiture of the defaulting member’s interest. The members adopted a resolution reducing the member’s interest to zero after obtaining valuations from an independent accounting firm, and the value of the interest was offset against the judgment. The court also held the member forfeited his membership by seeking dissolution and “partition” of the LLC. The court relied upon a provision of the Maryland LLC act that states a person ceases to be a member if the person files a petition or answer seeking for that person any reorganization, arrangement, composition, readjustment, liquidation, dissolution, or similar relief under any statute, law, or regulation. (The court did not explain why this provision would apply to a request to dissolve the LLC itself rather than the person who is the member.)
Love v. Fleetway Air Freight & Delivery Service, L.L.C., __ So.2d __, 2003 WL 21995308 ( Ala. 2003) (interpreting term “withdrawal” in LLC member agreement and LLC operating agreement and concluding that termination of manager’s employment did not constitute withdrawal as a member).

Lamprecht v. Jordan, LLC, 75 P.3d 743 (Idaho 2003) (interpreting withdrawal and buy-out provisions in operating agreement and concluding that former member was entitled only to the balance in his capital account as of the date his employment with the LLC terminated).

Brazil v. Rickerson, 268 F.Supp.2d 1091 (W.D. Mo. 2003). Brazil was a member of three LLCs, two of which were governed by identical operating agreements. The third LLC was governed by a slightly different operating agreement. Although there was some overlap in ownership, the members and ownership interests in the three LLCs varied. The defendants sent a notice of termination of Brazil’s membership in the LLCs pursuant to Article 7 of each operating agreement. The provisions of Article 7 of each agreement were not identical. Article 7 of two of the operating agreements provided for expulsion of a member, when, in the opinion of a majority in interest of the members, a member has been “guilty of misconduct or act in any manner inconsistent with the good faith observable between Members to such an extent as to render it impracticable for the then members to carry on the Company business together.” Although an early draft of the third operating agreement contained identical language, that language was removed, and Article 7 of the third operating agreement only provided for expulsion of a “Designated Managing Member.” Brazil filed suit alleging various causes of action based on what he alleged was his wrongful expulsion from the LLCs. The court determined that the members had the power to expel Brazil under two of the operating agreements and that the requisite determination by the majority interest did not require a meeting or a vote. However, the court concluded that fact questions remained as to whether the majority in interest believed it was “impracticable” to continue to operate with Brazil; therefore, the court could not determine as a matter of law that the expulsion was wrongful or that fiduciary duties were breached. With respect to the third LLC, the court determined that the members did not have the power to expel Brazil. The operating agreement did not confer the power to expel a member in Brazil’s position, and the court concluded that oblique references to expulsion of a member in another agreement were not sufficient to provide for the affirmative power to expel members. Thus, the court concluded that Brazil’s expulsion from that LLC was wrongful.


Under the terms of its operating agreement, River Links at Deer Creek, LLC (“River Links”) dissolved upon the administrative dissolution of Deer Creek Golf Interests, LLC (“Deer Creek”), a member of River Links, for failure to file required annual reports. After the administrative dissolution, the remaining members of River Links voted to continue its business, amend the operating agreement, redeem the interest of Deer Creek, and remove Melz (Deer Creek’s “principal”) from the Board of Managers of River Links. After these actions, Deer Creek was reinstated. Melz argued that the retroactive nature of the reinstatement rendered the actions taken by the other members of River Links after the administrative dissolution invalid. Melz also sought to arbitrate the claims because the operating agreement of River Links contained an arbitration clause. The court held that the trial court should retain jurisdiction of the issue because of the lack of LLC case law. “An arbitrator dealing with the complex facts of this case would have no guidance on the proper interpretation of the Limited Liability Company Act, and would have to expend a great deal of time and energy to reach a well-considered conclusion, but his ultimate decision would have no precedential value.” It thus appeared reasonable to the court for the trial court to retain jurisdiction over the declaratory judgment claim.


A member of an engineering firm LLC sued for wrongful termination after the other members voted to terminate his employment and demanded he resell his membership interest. The plaintiff argued that termination of his employment was wrongful because the operating agreement and membership interest subscription agreement contractually obligated the LLC to retain him. The member based this argument on the inclusion of the phrase “long-term investment” in each of these agreements, which the member asserted was evidence that a member was entitled to employment until he voluntarily left the firm or retired. The court concluded that there was no evidence of an express or implied contract in this regard. The court also rejected other arguments based upon promissory estoppel, public policy, and fraud.

Walker, a first cousin of former President Bush, was brought in as a member of a Delaware LLC in order to utilize his connections and reputation to help the LLC secure needed financing. After Walker failed to secure financing and the other members became concerned about Walker’s drinking problem, financial irresponsibility, and other matters, he was relieved of his official duties for a period of time. He was later given his job back, and the members entered into a formal operating agreement designating Walker as an 18% member. Ultimately, however, the relationship soured completely, and the other members purported to remove him as a member and terminate his ownership interest. The members referred to Walker’s poor performance and misconduct in the written notice of his removal, but there was also a dispute over whether Walker had a side deal that constituted a conflict of interest. The court concluded that the other members had no authority to remove Walker as a member either under the Delaware LLC act or the operating agreement. The court rejected the argument that the members had the inherent power to remove Walker and deprive him of his ownership interest based upon his alleged breach of fiduciary duty. Although the court recognized that there was a relationship of sufficient trust and confidence to impose on Walker a duty to disclose a material fact such as a conflict of interest, the court concluded that the members did not rely on any understanding that Walker was independent in entering into the operating agreement. Thus, the court rejected the members’ misrepresentation claim against Walker. The court also rejected the members’ claim that they were protected from liability for their effort to appropriate Walker’s interest based upon a good faith reliance on the operating agreement. After purporting to remove Walker, a series of financing transactions led to the exchange of the members’ membership interests in the LLC into shares of a Canadian corporation. Walker failed to prove the value of his 18% interest in the LLC, thus there was no basis for an award of damages; however, the court imposed a constructive trust in Walker’s favor upon 18% of the shares the other members had received in the Canadian corporation.


Whitmore was hired as chief operating officer of an LLC that operated fast food restaurants. He also received a 5% membership interest in the LLC and a 5% interest in a second LLC that was being formed to acquire additional fast food franchises. When Whitmore’s employment was terminated, he claimed that he was entitled to receive the value of his membership interests under provisions of the Maryland LLC act in effect at the time. The court pointed out that the statutory provisions relied upon by Whitmore were default provisions and that the operating agreements of the two LLCs had provisions addressing withdrawal and buy-out. The court concluded that the termination of Whitmore’s employment did not amount to a withdrawal or entitle Whitmore to receive the value of his interest under either of the operating agreements, thus Whitmore was not entitled to be bought out.


Two members of an LLC sued the third member, Bullock, seeking injunctive relief barring Bullock from operating the LLC and permitting them to carry on the business. Bullock sought dissolution and an accounting. The court found that Bullock made fraudulent representations when she claimed to have sole ownership of an existing business into which she induced the plaintiffs to invest and when she promised to sign an operating agreement giving the plaintiffs a fifty-one percent controlling interest in their newly formed LLC. In fact, another individual had a substantial interest in the business Bullock claimed to own, and Bullock later refused to sign the operating agreement for the new LLC. Ultimately, Bullock locked the other two members out of the business premises and transferred the assets of the LLC to a new corporation formed by Bullock and yet another investor. The court concluded that the LLC dissolved when Bullock wrongfully excluded/expelled the other two members from the business and that the LLC could only continue for winding up purposes. Thus, the court denied the plaintiffs’ requested injunctive relief. The court went on to discuss the fraudulent nature of the transfer of the LLC’s assets to Bullock’s new corporation under Rhode Island’s Uniform Fraudulent Transfer Act. Finally, the court appointed an attorney to conduct the winding up of the LLC because Bullock, having wrongfully caused the dissolution of the LLC, was not entitled to participate in the winding up of the LLC’s affairs.

4. Sharing of Post-Dissolution Profits and Losses

Investcorp, L.P. v. Simpson Investment Co., LLC, 85 P.3d 1140 (Kan. 2004) (applying Kansas LLC act and LLC operating agreement and concluding that withdrawn members were required to share in post-withdrawal dissolution expenses incurred by the LLC).

The court in this case applied partnership law to determine how fees from contingent fee files should be divided between the members of a dissolved LLC law firm. Hurwitz and Padden formed a two-person law firm in 1991. In 1993, articles of organization were filed, and the firm became a limited liability company. In 1996, the parties dissolved the firm and successfully resolved all issues except the division of fees from several contingent fee cases. The parties had no written agreement on the allocation of fees, but prior to dissolution the parties shared all firm proceeds on a 50-50 basis. Since the Minnesota LLC act borrowed the concept of dissolution from the UPA, the court concluded that it was appropriate to apply partnership law to resolve the issue at hand. Specifically, the court concluded that “partnership principles, including the ‘no-compensation’ rule [under which partner other than surviving partner has no right to compensation for services rendered in furtherance of partnership business in winding up stage], govern the division of fees obtained from pre-dissolution contingency files.” Thus, the court held that the fees should be split equally, consistent with the pre-dissolution method of allocation of fees. The court noted by way of footnote the change to Minnesota partnership law made by RUPA effective 1/1/99 whereby a partner is entitled to reasonable compensation for services rendered in winding up the business of the partnership.

5. Judicial Dissolution/Appointment of Liquidator

Braham v. Barton of Redlands, Inc., Nos. B168121, B168883, 2004 WL 886889 (Cal.App. April 27, 2004) (holding arbitrator’s interpretation of LLC operating agreement was not subject to judicial review, and removal of manager and decision that LLC’s business had come to an end was not a decree of dissolution).

The Dunbar Group, LLC v. Tignor, 593 S.E.2d 216 (Va. 2004).

Tignor and Dunbar were equal members of an LLC. Dunbar brought an action for judicial expulsion of Tignor based on Tignor’s wrongful conduct, and Tignor filed an application for judicial dissolution. After a hearing on both pleadings, the chancellor ordered that Tignor be expelled. The chancellor also ordered that the LLC be dissolved. Dunbar appealed the chancellor’s order that the LLC be dissolved. The Virginia Supreme Court applied the standard for judicial dissolution and concluded that the evidence did not support the dissolution of the LLC. Tignor sought dissolution on the grounds that, because of “serious differences of opinion” and “deadlock,” it was “not reasonably practicable to carry on the business of [the LLC] in conformity with the Articles of Organization and Operating Agreement.” Tignor’s judicial expulsion, however, made it reasonably practicable for the LLC to continue.

In re Tufs Oil and Gas III, 871 So.2d 476 (La. App. 2004) (holding president of corporate general partner of limited partnership did not have authority to seek judicial dissolution of LLC owned by limited partnership).


A minority member of a New York LLC filed suit asserting various “personal” and “derivative” claims and asking for injunctive relief. Among the claims was a “personal” and “derivative” demand for dissolution of the LLC and its wholly owned subsidiary LLC. The court concluded that there was virtually no likelihood of success on the merits on the cause of action for dissolution. First the court concluded that the New York LLC statute does not permit derivative actions because it does not contain any provision authorizing such actions. Next the court concluded that the standard for judicial dissolution – that “it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement” – requires proof that the business sought to be dissolved is unable to function as intended or is failing financially. The court found the complaining member’s allegations insufficient to meet the standard since there were no allegations that the business could not be carried on in accordance with the articles of organization or operating agreement, or that any internal deadlock impeded its smooth operation. The court also noted that the business was flourishing financially, and that the plaintiff’s complaint fell short even assuming the corporate standard for judicial dissolution applied. The court refused to enjoin the LLC from paying the legal expenses of the defendant member/manager since the operating agreement contained a broad indemnification clause and there had been no final adjudication that the manager had engaged in conduct disqualifying him from indemnification. The plaintiff argued that it is well-settled that a corporate owner may not pay attorney’s fees out of corporate funds in the context of a dissolution proceeding, but the court concluded it was not bound by rules regarding derivative lawsuits for judicial dissolutions of corporations, having already concluded that a member may not sue derivatively for dissolution under the New York LLC act.

Landskroner v. Landskroner, 797 N.E.2d 1002 (Ohio App. 2003) (holding that former member had no standing to seek judicial dissolution because statute provides for judicial dissolution upon application of “any member”).
Lindsay v. Pacific Topsoils, Inc., Nos. 50558-1-I, 50593-9-I, 2003 WL 22121055 (Wash.App. Sept. 15, 2003) (affirming judicial dissolution of LLC on the grounds that it was not reasonably practicable to carry on the LLC in conformity with its purpose and was reasonable, practical, and equitable to dissolve the LLC because of animosity between the two co-managers).

Rubin v. Wright, No. 398112, 2002 WL 31954879 (Conn.Super. Dec. 30, 2002) (denying LLC member’s application for injunction to prevent dissolution of LLC investment banking firm where plaintiff conceded dissolution was inevitable, and there was no reason to believe the plaintiff’s interest in the LLC would not be protected in judicial dissolution).

In re Extreme Wireless, LLC, 750 N.Y.S.2d 520  (N.Y.A.D. 2 Dept. 2002). The court stated that the appropriateness of an order of dissolution of an LLC is a matter vested in the sound discretion of the trial court and that the lower court had properly exercised its discretion in granting the petition for dissolution on the basis that it was no longer reasonably practicable to carry on the business of the LLC in conformity with the articles of organization or operating agreement. The court also upheld the trial court’s denial of an injunction prohibiting the petitioner from opening a competing business in violation of the LLC operating agreement’s covenant not to compete. The court stated that the dissolution rendered the injunctive relief academic because “there is no longer a company in existence with which to compete.”

In re Pontchartrain Plaza, No. 02-CA-54, 2002 WL 1066924 (5th Cir. May 29, 2002) (looking to corporate dissolution provisions for guidance on effect of initial ex parte order ordering LLC’s dissolution (which court concluded merely commenced the dissolution process) and rejecting member’s challenge to ex parte order where member was then served with petition and order, had opportunity to present defenses to dissolution at hearing, and did not contest factual allegations that LLC had failed to achieve its objective, LLC was out of money and members could not agree on how to carry out business, thus rendering it not practicable to carry on the business).

Reig v. Amore II, L.L.C., 31 Conn. L. Rptr. 620, 2002 WL 819080 (Conn. Super. 2002) (granting member’s request for dissolution and appointment of person to wind up LLC’s affairs over other member’s objections, concluding that inability of equal members to work together constituted “other cause” for judicial winding up under the statute).

Cogniplex, Inc. v. Ross, Nos. 00 C 7463, 00 C 7933, 2002 WL 483411 (N.D. Ill. March 29, 2002) (interpreting Illinois LLC act provisions providing for LLC’s opportunity to buy out dissociating member’s interest and requiring dissolution of LLC if LLC fails to comply with buy out procedures and concluding that claim for dissolution was stated where purchase offer was not made within time-frame required by statute).

Weinmann v. Duhon, 818 So.2d 206 (La. App. 2002) (interpreting operating agreement provisions that created impasse (because one faction could fire general manager while other faction could re-hire him) and stating such a situation was precisely one where judicial dissolution is authorized on basis that it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement).

Lindsay, Marcel, Harris & Pugh, L.L.C. v. Harris, 752 So.2d 335 (La. App. 2000). Harris and Pugh gave notice of their withdrawal from their four member law firm LLC and formed their own law firm. When the LLC filed suit against the withdrawn members, the withdrawn members answered and sought dissolution. The court of appeals determined that the withdrawn members had no right to seek judicial dissolution because the statute conferred no such right on former members. In addition, the court found no basis in the operating agreement for the withdrawn members to obtain dissolution. Included among the causes of dissolution listed in the operating agreement was “reduction in the number of Members to 1,” but the court pointed out that two members remained after the withdrawal of the other members.

McConnell v. Hunt Sport Enterprises, 725 N.E.2d 1193 (Ohio App. 1999). The court determined that judicial dissolution of the LLC in this case on the basis that it was no longer reasonably practicable to carry on the business in conformity with the LLC’s articles of organization and operating agreement was not “wrongfully caused” by the member who acted wrongfully in breaching the operating agreement and usurping control of the LLC. The reason it was no longer practicable to carry on the business was the LLC’s failure to obtain the hockey franchise it sought rather than the wrongful conduct of a member. Thus, no member was precluded from participating in the winding up by the terms of the operating agreement that allowed only members who have not
wrongfully caused dissolution to participate in winding up. The issue was moot, however, because there was a liquidating trustee appointed by the court.


The court’s analysis of the meaning of the term “member” in the operating agreement is discussed *supra*. After concluding that “members” entitled to participate in winding up included withdrawing members, the court addressed the request of the withdrawing members for appointment of a receiver. The withdrawing members claimed that the current members were incompetent to conduct the liquidation of the LLC. The court denied the withdrawing members’ request for a receiver, characterizing the allegations of incompetence as “minor” and insufficient, even if proved, to warrant appointment of a receiver. The court noted that there were no allegations of fraud, breach of fiduciary duty or waste, nor a showing of “good cause.”


In this case, a member of two LLCs claimed that a proposed transfer of funds by one LLC to the other would constitute a fraudulent transfer. The trial court in the case entered an injunction against the payment and ordered the LLCs dissolved under the statutory provision that an LLC may be judicially dissolved if it is not reasonably practicable to carry on the business of the LLC in conformity with its articles of organization or regulations. The trial court appointed a liquidator under another statutory provision authorizing the court to wind up an LLC’s affairs or appoint a person to carry out the liquidation. The liquidator was given control of the two LLCs and had essentially all of the powers of a receiver. The court of appeals concluded that the order appointing a “liquidator” was an order appointing a “receiver;” therefore, the court had jurisdiction over the interlocutory appeal. The court held that the order of judicial dissolution and appointment of a liquidator was improper in this case as it did not properly preserve the subject matter of the suit until the trial court could finally determine whether the payment would be a fraudulent transfer. In other words, the court found the trial court’s order was improper because it gave the LLC member its ultimate relief.

6. Winding Up

*In the Matter of the Estate of Bender*, 806 N.E.2d 59 (Ind. App. 2004) (concluding dissolved LLC’s exercise of option to purchase property was appropriate act in connection with LLC’s winding up because the option was exercised in order to facilitate the sale of adjacent LLC property that was not to be distributed in kind to members).


A former member of a dissolved LLC sued the LLC for breach of certain provisions of the LLC agreement. Although claims against a Delaware LLC generally may be brought only until the certificate of cancellation is filed, the court held that the complaint was sufficient to support an application to nullify the LLC’s certificate of cancellation based upon the failure to wind up in compliance with the Delaware LLC act. The Delaware LLC act requires a dissolved LLC to make provision for claims that, based on facts known to the LLC, are likely to arise or to become known to the LLC within 10 years of its dissolution. The court held the allegations of the complaint were sufficient to support the inference that the LLC was wound up in contravention of these provisions and thus to support an application for nullification of the certificate of cancellation.

*Investcorp, L.P. v. Simpson Investment Co., LLC*, 85 P.3d 1140 (Kan. 2004) (applying Kansas LLC act and LLC operating agreement and concluding that withdrawing members were required to share in post-withdrawal dissolution expenses incurred by the LLC).


*Nadler v. Grayson Construction Co., Inc.*, 34 Conn. L. Rptr. 482, 2003 WL 1963158 (Conn.Super. 2003) (holding that members of two dissolved LLCs were proper parties in suit based on claims against the dissolved LLCs because the LLC statute permits enforcement of claims against members to the extent of assets distributed to them in liquidation).

Rubin v. Wright, No. 398112, 2002 WL 31954879 (Conn.Super. Dec. 30, 2002) (denying LLC member’s application for injunction to prevent dissolution of LLC investment banking firm where plaintiff conceded dissolution was inevitable, and there was no reason to believe the plaintiff’s interest in the LLC would not be protected in judicial dissolution).


Weiss, Cullinan, and others formed an LLC to market a device invented by Weiss. Acrimonious relations developed between Cullinan and the other members. The LLC eventually collapsed, and Weiss ultimately assumed management. Weiss informed Cullinan that he intended to dissolve the LLC and disburse the assets as required by law. Cullinan accused Weiss of wrongdoing in connection with certain payments and Weiss’s commencing work for a company with which the LLC had previously contracted for marketing of the device. Cullinan brought suit for dissolution of the LLC and accused Weiss of breach of fiduciary duty. Weiss counterclaimed and joined in the request for dissolution. Cullinan filed an amended complaint alleging sole ownership to the LLC and waiving any further winding up. The court found that Weiss had acted properly in the winding up pursuant to agreements made by the members. Cullinan challenged the lower court’s finding that an experimental prototype unit produced by the LLC belonged to Cullinan and was the responsibility of Cullinan. The court upheld the lower court’s action, as it was consistent with positions taken by both Cullinan and Weiss in the proceedings.

Newman v. McLean, No. B152794, 2002 WL 31117064 (Cal. App. Sept. 25, 2002) (dismissing member’s cross-claim for indemnity against co-defendant and former co-member of dissolved LLC in suit by other members on basis that member from whom indemnity was sought entered good faith settlement with plaintiffs, and dismissing breach of contract and fraud claims on basis of release executed at time of dissolution of LLC).

Benchmark Investments, LLC v. Elms at Mystic, LLC, No. 555579, 2002 WL 194492 (Conn. Super. Jan. 11, 2002) (striking claim against LLC and member based on statute permitting claims against dissolved LLC or member of dissolved LLC to extent of assets distributed in liquidation where plaintiff failed to allege LLC was dissolved but rather alleged that LLC was “at all relevant times a Connecticut limited liability company”).


The two members of a dissolved LLC asserted various claims against each other. As the court summed up the relevant events, “[T]he defendant advised the plaintiff of her decision to immediately dissolve or terminate the company, and thereafter both parties embarked on courses of conduct aimed at maximizing their own personal interests instead of engaging in an orderly and cooperative winding down of the company.” The court declined to apportion blame between the two parties and merely divided the remaining funds of the LLC between the two members in accordance with their percentage ownership interests. (At least, this appears to be what the court intended. There was an apparent typographical error in the percentages recited in dividing the remaining funds.)


A bankruptcy trustee sued an LLC and its members seeking to recover from the members improper distributions made during the winding up of the LLC. The parties agreed that under Illinois law an LLC member may be liable for a dissolved LLC’s debts to the extent of any improper distributions received. The trustee argued that he had a direct cause of action against the LLC members resulting from improper distributions, but the court agreed with one of the LLC members that the trustee could only recover in supplementary proceedings after obtaining a judgment against the LLC. Since the trustee had not obtained a judgment against the LLC, the claim against the member failed. Additionally, the court stated that the trustee would have to identify property of the debtor held by the member and the value of the property.


This case involved a dispute as to whether an LLC’s claim against a deceased member was timely presented to the administratrix of the deceased member’s estate. In the course of the court’s opinion, the court notes that, while
the member’s death dissolved the LLC, the LLC had authority to wind up its affairs, including the ability to make payments to creditors required by the deceased member’s actions.


The members of a family-held Kansas LLC deadlocked on important management issues, and several members withdrew to effect a dissolution of the LLC. The withdrawing members claimed that they were entitled to participate in the LLC’s winding up under the operating agreement. The LLC’s remaining members argued that the withdrawing members were no longer members and thus had no right to participate in the LLC’s winding up. Both factions relied on the operating agreement, which provided for the “members” to wind up and liquidate the LLC and defined “members” as “those persons who are members of the Company from time to time, including any Substitute Members.” The district court found that the withdrawing members were not entitled to participate in the dissolution process. The Kansas Supreme Court, however, examined the use of the term “member” and “remaining member” in other provisions of the operating agreement and concluded that “[t]he many references to ‘member’ in the Act when coupled with the operating agreement suggest that the better view is that, in dissolution, ‘member’ includes a withdrawing member having a financial interest in the Company’s assets.” The court went on to state that control of the dissolution process resided in the managers of the LLC under the operating agreement and the Kansas act.

CC. Rights of Dissociated Members

_Lieberman v. Wyoming.com LLC_, 82 P.3d 274 (Wyo. 2004) (holding that withdrawn member of a Wyoming LLC retained his equity interest in the LLC because the Wyoming LLC act does not address the fate of a member’s equity interest upon the member’s dissociation and the operating agreement contained no provision regarding the equity interest of a withdrawn member).

_Branca v. Conley_, 2001 WL 1807403 (Oct. 30, 2001) (finding member’s claims for fraud, breach of fiduciary duty, and conspiracy in connection with buy-out of member’s interest were released in settlement agreement executed in connection with buy-out).


The court interpreted the Wyoming LLC act and the operating agreement of a Wyoming LLC to determine the rights of Lieberman, a dissociated member. Lieberman’s contribution upon formation of the LLC was documented at $20,000, consisting of services rendered and to be rendered. When Lieberman was terminated as vice-president of the LLC, he served a notice of withdrawal and demand for the return of his share of the current value of the company, which he estimated at $400,000. The remaining members avoided dissolution of the LLC by electing to continue the LLC and approved the return of Lieberman’s $20,000 capital contribution. The court discussed a provision of the Wyoming LLC act that entitles a member to demand the return of the member’s capital contribution if the operating agreement does not prohibit or restrict the right. Since the LLC operating agreement did not restrict this right, Lieberman was entitled to the return of his $20,000 contribution. The question remained whether he was entitled to receive any further distribution. A provision permitting a member to compel dissolution upon an unsuccessful demand for the return of the member’s contribution was not applicable since the LLC agreed to return Lieberman’s contribution. Noting the absence of a provision in the Wyoming LLC act governing dissociation, the court turned to various provisions of the operating agreement dealing with membership certificates, transfer of interest, quorum, and voting and concluded that it remained unclear what became of Lieberman’s ownership interest beyond his capital contribution. Thus, the court remanded for a further determination in this regard.

_Lindsay, Marcel, Harris & Pugh, L.L.C. v. Harris_, 752 So.2d 335 (La. App. 2000).

Harris and Pugh gave notice of their withdrawal from their four-member law firm LLC and formed their own law firm. When the LLC filed suit against the withdrawn members, the withdrawn members answered and sought dissolution. The court of appeals determined that the withdrawn members had no right to seek judicial dissolution because the statute conferred no such right on former members. In addition, the court found no basis in the operating agreement for the withdrawn members to obtain dissolution. Included among the causes of dissolution listed in the operating agreement was “reduction in the number of Members to 1,” but the court pointed out that two members remained after the withdrawal of the other members.
A lawyer left his firm (a professional LLC) and went to another firm, and there was a dispute over the provision of the operating agreement dealing with benefits to be paid to a retiring member. The specific issue on appeal was whether the "continuation payments" under the operating agreement qualified as "retirement benefits" under Iowa DR 2-108(A). The payments were conditioned on the lawyer’s termination of the private practice of law in Iowa. The lawyer argued that this was an impermissible covenant not to compete. The court concluded that the provisions in this case (requiring ten years of service and sixty years of age or twenty-five years of service) clearly constituted a retirement plan, and the restriction on future practice was therefore valid, even though the plan applied to situations involving less than full retirement.


The members of a family-held Kansas LLC deadlocked on important management issues, and several members withdrew to effect a dissolution of the LLC. The withdrawing members claimed that they were entitled to participate in the LLC’s winding up under the operating agreement. The LLC’s remaining members argued that the withdrawing members were no longer members and thus had no right to participate in the LLC’s winding up. Both factions relied on the operating agreement, which provided for the “members” to wind up and liquidate the LLC and defined “members” as “those persons who are members of the Company from time to time, including any Substitute Members.” The district court found that the withdrawing members were not entitled to participate in the dissolution process. The Kansas Supreme Court, however, examined the use of the term “member” and “remaining member” in other provisions of the operating agreement and concluded that “[t]he many references to ‘member’ in the Act when coupled with the operating agreement suggest that the better view is that, in dissolution, ‘member’ includes a withdrawing member having a financial interest in the Company’s assets.” The court went on to state that control of the dissolution process resided in the managers of the LLC under the operating agreement and the Kansas act.


The court in this case determined that a dissociating member of an LLC had no right to receive a distribution of income allocated to the member for tax purposes and that there were fact issues precluding summary judgment on the issue of whether the buy-out of the dissociating member divested the member of its entire economic interest in the LLC. Klink, Inc. ("Klink") and four other corporations formed an LLC. Klink withdrew from the LLC, and the remaining members decided to purchase Klink's ownership units and continue the business. The members agreed that Klink would receive $61,047.22 for the value of Klink's "units." After the end of Klink's fiscal year, Klink was allocated its share of the LLC's income for the portion of the year that Klink was a member. Klink asserted that it was entitled to a distribution in this amount. The court concluded that neither Indiana law nor the operating agreement gave a member a right to a distribution of income allocated to the member for income tax purposes. The remaining issue involved the meaning of the term "units" inasmuch as Klink's units were bought out on its withdrawal. The LLC contended that Klink divested itself of its entire interest when it sold its units to the LLC. Klink argued that it sold less than all of its economic rights. Klink pointed to the operating agreement reference to a unit as "an interest in the Company representing a contribution to capital." The LLC pointed out, however, that the operating agreement generally entitled each unit to a vote and a proportionate share of the LLC's net income, gains, losses, deductions, and credits. The court concluded that fact issues precluded resolution of this issue by summary judgment. The court addressed as a separate issue the valuation method and whether it represented the fair market value of Klink's entire interest. The court concluded that summary judgment was not appropriate on this issue either.


The LLC in this case converted from a partnership in January 1994 and adopted the partnership agreement as the operating agreement until a new operating agreement could be prepared. In November 1994, before a new operating agreement was adopted, one of the members, Tonkin, advised other members of the firm that he intended to withdraw. He provided a written notice of withdrawal stating an effective date of December 31, 1994. The managing members concluded that the partnership agreement that served as the LLC's operating agreement required Tonkin’s withdrawal on November 30, 1994. The agreement stated that “withdrawal shall become effective on the last day of the calendar month after service of the withdrawal notice.” The court found this language by itself to be ambiguous but interpreted it with reference to other parts of the agreement and concluded that withdrawal was effective November 30, 1994. The parties also had a disagreement as to the withdrawn member’s share of certain fees received by the firm after Tonkin’s withdrawal. The court looked to the operating agreement as controlling but found no provision addressing work in progress in the withdrawal context. Thus, under the terms of the written agreement, Tonkin was not entitled to any
portion of the disputed fee. However, the court concluded that the parties orally modified the operating agreement regarding the fee in question by agreeing to treat the fee as an account receivable. The agreement provided for allocation of accounts receivable, and Tonkin was awarded his share under the agreement.


The court rescinded an operating agreement of an LLC on the grounds that Lloyd, one of the members, committed fraud in the formation of the LLC, and the court concluded that Lloyd's rights were governed by the partnership agreement under which the parties had operated before organizing as an LLC. However, the court concluded that it could not determine Lloyd's rights under the partnership agreement by summary judgment and scheduled the matter for trial. The court referred to confusion between the terms "capital account" and "capital contribution" and as to whether Lloyd should be treated as a withdrawing or expelled partner under the provisions of the partnership agreement.


The members of an LLC had a falling out, and one member, Moon, formed a competitive business and resigned from the LLC. Moon’s attacks on the formation of the LLC were rejected by the court. Moon also argued that he was entitled to reimbursement for a capital contribution. He contended that he had made his agreed upon capital contribution of $10,000 in the form of past experience, good will, services rendered, and equipment. While the court acknowledged that capital contributions do not have to be in the form of cash, it concluded that there was no evidence that Moon made a non-cash capital contribution.

**DD. Dissenters’ Rights**

**Froelich v. Senior Campus Living LLC,** 355 F.3d 802 (4th Cir. 2004).

In this appraisal proceeding arising out of an LLC merger in which the plaintiff was squeezed out, the LLC challenged the valuation of the dissenting member’s membership interest as determined by the statutory appraisal procedure provided by Maryland law. The LLC argued that the valuation should be adjusted downward because the dissenting member presented evidence conflicting with earlier rulings of the district court relative to fraud and breach of fiduciary duty claims of the plaintiff. The LLC further argued that the appraisers improperly took into account appreciation resulting from the contested reclassification. The court rejected these arguments and affirmed the judgment of the magistrate based on the recommendation of the court-appointed appraisers. The court rejected the notion that an earlier finding that the board of the LLC was protected by the business judgment rule precluded the dissenting member from presenting evidence that the appraisal obtained and relied upon by the board of the LLC in the reclassification transaction was flawed because the LLC’s appraiser did not receive accurate information from the board. The court stated that the earlier finding that the board was protected by the business judgment rule with respect to the terms of the reclassification did not equate to a finding that the board was correct; rather, the business judgment rule merely requires deference to a board’s decision absent fraud, bad faith, or gross negligence. The court stated that the statutory appraisal process virtually required the court-appointed appraisers to consider all evidence, including any shortcomings in the board-obtained appraisal, in determining the fair value of the dissenting member’s interest. The court also rejected the argument that the appraisers’ consideration of certain events occurring subsequent to the valuation date resulted in the improper inclusion of appreciation in value resulting from the reclassification.


A Georgia LLC sought to restrict a member to the remedy of dissent and appraisal under the provisions of the Georgia LLC act upon the sale of the LLC’s sole asset. The court held that there were fact issues as to whether the procedural requirements of the operating agreement were met. The issues revolved around certain transfers of interests that the dissenting member claimed were in violation of transfer restrictions in the operating agreement.


The factual background of this case is rather complicated, but the claims involved assertions of fraud, breach of fiduciary duty, and breach of contract by Froelich, an ousted CEO and board member of a Maryland LLC. Froelich was also a member of the LLC who, along with other minority members, was cashed out in a squeeze-out merger following a reclassification of interests of the LLC approved by all members except Froelich. The court found that the reclassification and squeeze out were related parts of a transaction in which Froelich had properly preserved his statutory
right to an appraisal. The court explained that the Maryland LLC statute grants a member the same appraisal rights as an objecting stockholder under corporate law. Maryland corporate law provides appraisal rights in connection with a parent-subsidiary merger, and Froelich properly objected to the squeeze-out merger. The court viewed the reclassification and subsequent squeeze-out merger as a single transaction rather than separate events such that Froelich was entitled to appraisal of his interests immediately prior to the reclassification rather than appraisal of his reclassified interests immediately prior to the merger that occurred five months later.

EE. Professional LLCs

Walker v. Virginia Housing Development Authority, No. CH03-253, 2003 WL 23018817 (Va. Cir. Ct. Nov. 5, 2003) (interpreting statutory authority of professional LLCs to act in fiduciary capacity and holding that statute recognizes that acting as trustee under deed of trust is part of the practice of law and that statute permits professional LLCs to use other attorneys as agents to fulfill the necessary fiduciary duties).

Selective Ins. Co. of America v. Medical Alliances, LLC, 827 A.2d 1188 (N.J.Super.L. 2003). The issue in this case was the legality of the structure of the defendant LLCs and their ability to practice medicine in New Jersey. The plaintiff, an insurer, asserted that several Illinois LLCs involved in rendering neurodiagnostic services were illegal because the practice of medicine in a corporate format is prohibited in New Jersey except as permitted in specific legislative or regulatory provisions. The preliminary relief sought by the plaintiff was an order requiring the defendants to respond to discovery requests regarding the ownership of the LLCs. The court discussed at some length the provisions of the New Jersey Business Corporation Act and the Professional Service Corporation Act. The court stated that the underlying issues with respect to the practice of a profession in an LLC are the same as with respect to corporations. The court noted that, although the New Jersey Supreme Court has adopted a rule with regard to the practice of law in the LLC form, the Board of Medical Examiners and Board of Chiropractor Examiners have not adopted a rule permitting or prohibiting LLCs. The court also observed that the Legislature never considered whether licensed professionals could form and practice through an LLC when the Legislature passed the New Jersey LLC act. The court apparently concluded that an LLC might be able to engage in the practice of medicine in New Jersey if all of its members are licensed to practice medicine. The court concluded that the insurer was entitled to discovery to determine the ownership of the LLCs to learn if they were actually owned by medical doctors, chiropractors, corporations, or lay persons and whether they were actually practicing medicine in New Jersey. According to the court, “whether or not licensed medical professionals or entities can practice as a LLC, be they domestic or foreign, is a matter that can only be determined through discovery.”

FF. Imputed Fiduciary Duties


Greengrass Management LLC (“Management”) and Greengrass Capital (“Capital”) formed a general partnership, Greengrass Holdings (“Holdings”). Management was organized by several senior officers of Swing-N-Slide Corp., including Mueller, a director and the president and CEO of Swing-N-Slide. Holdings executed a two-step tender offer to acquire a majority stake in Swing-N-Slide. Barbieri, a Swing-N-Slide shareholder, brought an action challenging the transaction. He argued that because Mueller had an ownership interest in Management, and Management was one of the two general partners of Holdings, Management and Holdings owed fiduciary duties to the Swing-N-Slide shareholders. The court found that the persons who formed Management, as senior officers of Swing-N-Slide, owed fiduciary duties to Swing-N-Slide. Thus, the issue of apparent first impression was whether a legal entity must take on the pre-existing fiduciary duties of those who form and control it. The court determined that the fiduciary duties of the Swing-N-Slide director and officers must be imputed to the LLC they formed because "[n]either Mueller nor the others would escape their fiduciary obligations to [Swing-N-Slide] had they not formed Management. To allow them to use this State's laws allowing the formation of the limited liability company as a vehicle to avoid those very duties would be unconscionable." As to Holdings' liability, the court found that Holdings was made up of two partners, Management and Capital. Capital had no pre-existing fiduciary duties to Swing-N-Slide or its shareholders, and the court refused to assume that Management "so controls or otherwise so dominates the affairs of the partnership that the partnership itself must take on the fiduciary obligations of a single partner." Thus, the court determined that Holdings need not take on the imputed fiduciary duties of Management.
GG. Foreign LLCs

1. Personal Jurisdiction


_MCNC Oil & Gas Company v. IBEX Resources Company, L.L.C_, 23 F. Supp.2d 729 (E.D. Mich. 1998) (applying Michigan long-arm statute regarding specific jurisdiction over unincorporated associations to conclude that Oklahoma LLC was subject to personal jurisdiction).

2. Failure to Qualify to Do Business

_Albers v. Guthy-Renker Corp_, 92 Fed.Appx. 497 (9th Cir. 2004) (holding LLC did not have capacity to sue in California because it was foreign LLC transacting business in California and was not registered to do so).


The defendant sought to have the plaintiff LLC’s claims dismissed for failure to comply with the New Jersey registration requirements applicable to foreign LLCs doing business in New Jersey. The plaintiff was a New York LLC which was not registered in New Jersey at the time it filed suit. It had previously been registered, but the registration had lapsed. It subsequently re-registered after the suit was filed. The court followed corporate cases to the effect that a company’s failure to register does not require dismissal so long as the company corrects the deficiency during the proceedings. The defendant argued that these cases should not apply in this case because the defendant filed suit in another jurisdiction before the LLC re-registered. The court disagreed and held that the registration related back for purposes of the first to file rule.

3. Foreign Non-Professional LLC (in Jurisdiction Limiting LLCs to Professionals)


The plaintiff, as successor-in-interest to an LLC, sued for payment for respiratory therapy services rendered under a contract with the defendant. The defendant moved to dismiss on the basis that the contract was void as against public policy. Specifically, the defendant argued that the LLC was a foreign non-professional LLC which was not permitted to provide or contract to provide professional services in New York. The court construed this contention as an illegality defense that could not support dismissal at this stage in the proceedings. The court noted that there was no absolute or per se rule of illegality of such contracts in New York and stated that a number of factors would have to be addressed to resolve whether the contract in issue was enforceable.

4. Law Governing Foreign LLC


The Kansas Supreme Court held that the law governing a foreign LLC operating a nursing home in Kansas included not only the LLC act of the LLC’s state of organization but also provisions of the wage payment law of the state of organization under which a member of an LLC could be held personally liable for unpaid wages. The court analyzed the Kansas Wage Payment Law and concluded that it did not provide for personal liability of LLC members because the definition of employer has not been amended to include LLCs along with corporations, partnerships, etc.; however, the court concluded that the Utah wage payment law rather than the Kansas law governed the liability of the members of the Utah LLC for unpaid wages arising out of its business in Kansas. The court relied upon provisions of the Kansas LLC act that provide the laws of the jurisdiction of organization govern the internal affairs and the liability of members. The court construed these provisions to include not only the LLC act but other laws bearing on member liability.
HH. Charging Order


The assignee of a judgment sought a charging order against the judgment debtor’s interests in three LLCs and a corporation. The court held that the assignee of the judgment presented sufficient evidence to show that it was the current holder of the judgment and thus had standing to seek a charging order without being substituted as a party plaintiff. The court went on to hold that the charging order remedy was not available with respect to the judgment debtor’s interest in a corporation. Further, the court declined to issue a nunc pro tunc order to retroactively reach LLC interests sold by the judgment debtor after the application for charging order was made. The judgment creditor argued that the court’s failure to schedule an immediate hearing allowed the judgment debtor to sell his interests in two LLCs. The court stated that the judgment creditor had not been prejudiced by an act of the court or judicial procedure; rather any unjust prejudice was caused by the judgment debtor when he sold his LLC interests. Further, the judgment creditor did not seek to correct a prior court order, as is generally the purpose of a nunc pro tunc order, but simply to make the court’s order retroactive. The court charged the LLC interest still owned by the judgment debtor, ordering the LLC to remit to the judgment creditor any distributions of cash, profits, and assets to which the judgment debtor would otherwise be entitled until the judgment was satisfied.


The sole member of a Colorado LLC filed bankruptcy, and the court held that the Chapter 7 trustee became a “substituted member” and could cause the LLC to sell the LLC’s real property and distribute the proceeds to the estate. The court reasoned that the trustee acquired the governance rights of the bankrupt member of the LLC because the trustee succeeded to the debtor’s membership interest and there were no other members whose approval was required for admission of the trustee as a member. The court quoted provisions of the Colorado LLC act that refer to consent or approval by the “other members” for admission of an assignee as a member. The debtor argued that the trustee represented creditors’ interests and was only entitled to a charging order, but the court concluded that the charging order is for the protection of other members and thus serves no purpose in a single-member LLC. The court noted in a footnote that a non-debtor member, even one with an infinitesimal interest, would be able to prevent a bankrupt member’s trustee from acquiring the bankrupt member’s rights to govern and vote; however, the court also noted that creditors or a bankruptcy trustee would have recourse under bankruptcy avoidance provisions or fraudulent transfer laws where a “peppercorn” member is employed for purposes of hindering, delaying, or defrauding creditors.


Yeh, an officer and director of a corporation formed to develop real estate, misappropriated money from the corporation and invested in other properties. The court imposed a constructive trust in favor of the corporation on Yeh’s two-thirds interest in a real estate development LLC, describing it as an interest in real property. After imposition of the constructive trust, Yeh, who had been managing the property, transferred management to MacLean, the other member of the LLC. The corporation asked for a receiver to manage the property owned by the LLC. MacLean intervened and argued that the nature of an LLC prevented the corporation from becoming a member without MacLean’s consent and from reaching the LLC’s real property. The court noted that an LLC is a separate entity from its members and that the decree of constructive trust failed to recognize the distinction but characterized the error as no more than “mere form.” The court said McLean was arguing that, even if the court had correctly characterized Yeh’s interest in the LLC as personal property, the corporation would not have been entitled to a management role as a mere assignee. The court distinguished a judgment creditor and the charging order remedy from a beneficiary of a constructive trust because the judgment is not monetary. The court stated that the statute does not rule out the possibility that a member’s interest can be reached by constructive trust where the judgment is not for a particular amount. Having concluded that the corporation was not a “judgment creditor” limited to non-managerial rights of an assignee under the charging order statute, the court accepted the substantive effect of the judgment substituting the corporation for Yeh as the owner of the two-thirds LLC interest with all the rights, privileges, and benefits associated with ownership of the interest including the right to participate in management. The court remanded for the sole purpose of correcting the technical error of referring to the interest the corporation received as an interest in real property. The court noted in a footnote that it was not addressing MacLean’s newly raised argument that the corporation was an assignee as the transferee of the interest held by Yeh as constructive trustee because it was not presented in the opening brief.
partnership and LLC interests. The order generally gave the receiver authority to take possession and control of, and including voting rights, but the order did not mention specifically the rights of the receiver with respect to the limited request for the charging order, the court upheld the magistrate’s finding that the charging order was “unnecessary” gave the receiver authority to exercise all powers and rights exercisable by the defendant with respect to his stock, because the receivership included the limited partnership and LLC interests. (The court’s receivership order specifically and property interests and to sell the assets and property interests in satisfaction of the judgment. With respect to the request for the charging order, the court upheld the magistrate’s finding that the charging order was “unnecessary” because the receivership included the limited partnership and LLC interests. (The court’s receivership order specifically gave the receiver authority to exercise all powers and rights exercisable by the defendant with respect to his stock, bonds, warrants, debentures, and options in corporations in which the defendant had any legal or beneficial interest, including voting rights, but the order did not mention specifically the rights of the receiver with respect to the limited partnership and LLC interests. The order generally gave the receiver authority to take possession and control of, and to sell, all the defendant’s non-exempt assets and to perform any and all acts necessary and appropriate in order to take possession and control of, and to sell, the defendant’s assets.)


The plaintiff registered a foreign judgment in Texas and sought a turnover order and receivership with respect to the defendant’s non-exempt assets. Included in these assets were stocks, bonds, debentures, options, accounts receivable, and other property interests pledged to various third parties. The plaintiff also sought a charging order against the defendant’s interest in two limited partnerships and an LLC. The court upheld the magistrate’s issuance of a turnover order and appointment of a receiver to take possession and control of all the defendant’s non-exempt assets and property interests and to sell the assets and property interests in satisfaction of the judgment. With respect to the request for the charging order, the court upheld the magistrate’s finding that the charging order was “unnecessary” because the receivership included the limited partnership and LLC interests. (The court’s receivership order specifically gave the receiver authority to exercise all powers and rights exercisable by the defendant with respect to his stock, bonds, warrants, debentures, and options in corporations in which the defendant had any legal or beneficial interest, including voting rights, but the order did not mention specifically the rights of the receiver with respect to the limited partnership and LLC interests. The order generally gave the receiver authority to take possession and control of, and to sell, all the defendant’s non-exempt assets and to perform any and all acts necessary and appropriate in order to take possession and control of, and to sell, the defendant’s assets.)


This opinion is merely the court’s order charging the interest of the defendant with payment of the judgment entered in the action. The court’s opinion analyzing why a charging order was appropriate is at 2002 WL 725500 and is summarized below.


The plaintiff obtained a judgment against the defendant and applied for a charging order against the defendant’s interest in Jai Alai Associates, LLC. The defendant objected to issuance of the charging order claiming that the LLC and IRS must be made parties and that issuing a charging order would violate state law by allowing an unlicensed individual to hold an interest in a jai alai business. The court rejected the argument that the LLC must be made a party, citing the LLC provisions detailing the process and effect of obtaining a charging order (explaining that a charging order merely gives the judgment creditor the rights of an assignee to distributions and does not dissolve the LLC or entitle the judgment creditor to participate in the affairs of the LLC or become a member) and concluding that a charging order does not impact the rights of an LLC to the degree necessary to require it to be a party. The court also rejected the argument that the IRS, which allegedly had or might claim a lien on the interest, should be made a party, stating that any charging order would be subject to any superior rights of the IRS in the defendant’s interest. Finally, the court rejected the argument that the charging order would violate state licensing laws. The court found the state statute requiring an individual or business engaging in jai alai to obtain a license did not preclude issuance of the charging order, which would only give the judgment creditor the rights of an assignee and would not entitle the creditor to participate in management or become or exercise the rights of a member.


A judgment creditor of an LLC member sought a charging order and an order directing that the member’s interest be sold and proceeds applied towards the judgment. The court granted the charging order, but the court concluded that the North Carolina LLC act did not authorize the forced sale of the interest. The court quoted from the statute to the effect that a charging order entitles the judgment creditor to receive distributions and allocations to which the judgment debtor would be entitled but does not dissolve the LLC or entitle the judgment creditor to become or
exercise any rights of a member. The court’s reasoning for finding forced sale was not permitted was that the forced sale of a membership interest to satisfy a debt would “necessarily entail the transfer of a member’s ownership interest to another, thus permitting the purchaser to become a member” in violation of statutory provisions that require consent of all members to admit a person as a member.


Baker obtained a judgment against David Dorfman for legal malpractice and fraud. Subsequently, Dorfman formed a professional LLC and began to operate his law practice through the PLLC. In this action, Baker sought to hold the PLLC liable on the judgment against Dorfman as a successor in interest. The court concluded that the PLLC was liable as a successor in interest. Baker also sought assignment of a 75% interest in the PLLC and appointment of himself as receiver for the LLC. (The court explained that the request for assignment of a 75% interest was to permit Baker to receive 75% of the profits of the PLLC while leaving Dorfman an incentive to generate future profits.) The court relied upon the charging order provisions of the New York LLC act to grant Baker’s request for assignment of an interest in the LLC. The court relied upon general receivership provisions to conclude that the circumstances warranted appointment of a receiver, and the court appointed Baker, through his attorney, receiver of the PLLC. In a per curiam opinion, the court of appeals generally affirmed the district court’s judgment, including the assignment of 75% of the profits of the PLLC, but raised _sua sponte_ a concern regarding the breadth of the receivership order granting sweeping authority with regard to the PLLC’s affairs. The court remanded for further consideration of the impact of the order on confidentiality and other obligations involved in the attorney-client relationship between Dorfman and his clients.


Two judgment creditors of a 50% member in an LLC obtained a charging order against the member’s membership interest. One of the creditors was the other 50% member. The LLC leased a building on which it held an option to purchase. The creditors valued the option at $500,000. The creditors attempted to exercise the option, and the debtor member complained that the trial court had improperly transferred his governance rights in the LLC and the option itself to the judgment creditors. The court found no evidence that the trial court’s order reached the option itself or the member’s governance rights. The court pointed out that the order stated that the member’s “membership interest” in the LLC “shall be charged and transferred to” the creditors, and the order did not reference the option itself. However, the court did characterize the member as having a 50% financial interest in the option itself by virtue of his membership interest in the LLC. The court stated that the trial court’s order did not reach the member’s governance rights but that the other member could exercise the option under his statutory agency power. The court acknowledged that it was improper for the trial court’s order to state that the interest was charged “and transferred,” but found the error inconsequential.


A judgment creditor of two lawyers obtained a charging order against the LLC law firm of the judgment debtors. The order directed the LLC to pay to the plaintiff “present and future shares of any and all distributions, credits, drawings, or payments due to the defendant[s] . . . until the judgment is satisfied in full . . . .” The plaintiff applied for a turnover order claiming the LLC had failed to fully comply with the order. The challenges to the turnover order basically turned on whether certain payments were “distributions” subject to the charging order. The defendants claimed that the payments in issue were merely compensation for services as lawyers and were similar to the wages paid other employees of the firm. The defendants argued they never authorized any distributions. The court rejected the defendants’ arguments and held the payments were distributions subject to the charging order.

II.  _Tortious Interference With Contract  


The plaintiff sued an LLC and three individuals who, along with the plaintiff, were members of the LLC. The plaintiff and the three individual defendants were all signatories to the LLC operating agreement and an Equity Reallocation Agreement (the “Equity Agreement”) whereby the parties agreed to the equity interest that the members would hold in the LLC. In a Services and Collaboration Agreement (“Services Agreement”), the plaintiff agreed to manage an investment fund for the LLC. Only one of the three individual defendants was a signatory to the Services Agreement. The court referred to the LLC operating agreement, the Equity Agreement, and the Services Agreement collectively as a “partnership agreement” and referred to the members of the LLC as “partners.” The plaintiff alleged
that the individual defendants tortiously interfered with the plaintiff’s partnership agreement with the LLC and caused the LLC to breach the contract. The court stated that only a stranger to the contract, such as a third party, can be liable for tortious interference with the contract and that one cannot state a claim for tortious interference against one of the contracting parties. The court concluded that the plaintiff failed to state a claim against the defendant who was a party to all three of the agreements making up the “partnership agreement.” Because two of the individuals were not signatories to the Services Agreement, the court said that there was a fact issue as to whether they were parties to that agreement and to the partnership agreement as a whole. These two defendants argued that the plaintiff did not state a claim against them in any event because officers and directors cannot be held liable for inducing a breach of contract by their corporations when they act within the scope of employment. The court concluded that the complaint alleged facts that indicated the plaintiff might be able to show that these members acted out of favoritism and in bad faith, and thus outside the scope of their employment, in causing the plaintiff to be terminated from the company and replaced by a close friend of one of the defendants.


Two members of an LLC sued Goodrich, the LLC’s chairman, for breach of fiduciary duty and tortious interference with certain contracts between the LLC and the plaintiffs. Goodrich sought to strike these claims on the basis that a party or indirect party to a contract cannot tortiously interfere with that contract. The court cited case law to the effect that a corporate officer may be liable for tortiously interfering with the corporation’s contract if the officer acts outside of the officer’s authority. The plaintiffs alleged that Goodrich acted in his individual capacity in improperly purporting to terminate LLC contracts with the plaintiffs. The plaintiffs also alleged that Goodrich was beginning a business venture with a third party in which he planned to divulge LLC trade secrets and manufacture the LLC’s product for his own benefit to the exclusion of the plaintiffs and that Goodrich schemed “to take complete control of [the LLC] and strip [the plaintiffs] of their contract and common-law rights in and to [the LLC], its governance and its income, its assets, its business opportunities and its business operations.” The court concluded that these allegations sufficiently alleged malicious or bad faith conduct outside the authority of Goodrich as chairman of the LLC such that Goodrich would be an outsider liable for tortious interference with the contracts between the LLC and the plaintiffs.


The plaintiff, Tam, invested $73,000 in an Illinois LLC, and was offered a management position. Plaintiff’s brother-in-law, Tang, invested $20,000 in the LLC. The plaintiff was subsequently asked to resign, which he agreed to do if he and his brother-in-law were paid the amount of their investments. They never received their money back, and the plaintiff's brother-in-law assigned his interest to the plaintiff. The plaintiff sued the LLC and three individuals whom the court referred to as "also part of [the LLC's] management." The plaintiff alleged breach of contract, fraud/misrepresentation, tortious interference with contract, and violation of the Illinois Limited Liability Company Act. This opinion addressed the defendants' Rule 12(b)(6) motion to dismiss. Among the conclusions reached by the court was the conclusion that the LLC could not logically be liable for tortiously interfering with an employment contract between the plaintiff and the LLC because a party cannot be held liable for inducing itself to breach a contract. Further, the court seemed to invite the individual defendants to argue that they could not be liable either. The court stated, "Whether corporate managers/officers can be held liable for inducing the corporation to breach a contract is another issue…. Because Defendants failed to address this issue, the Court will not address it—perhaps Defendants will address it when attacking Plaintiff's amended complaint." With respect to the plaintiff's allegation that the defendants violated the Illinois Limited Liability Company Act, the court concluded that the count could only be brought against the LLC (which the court referred to as a "corporation"), not the individuals. The court's opinion does not specify what acts constituted the alleged violation nor the provision(s) of the statute that were allegedly violated.

**J.J. Treatment of LLC Under Other Statutes or Contracts**

1. **Alcoholic Beverage Laws**


The issue in this case was whether an Oklahoma LLC is permitted to hold a liquor license under Oklahoma law. The Oklahoma Constitution prohibits licensing of "corporations, business trusts, and secret partnerships." The court rejected the argument that an LLC is in essence a partnership and concluded that an LLC falls within the constitutional prohibition because of the limited liability of members. The court did not view the provision in the Oklahoma LLC act permitting LLCs to be organized for any lawful purpose as indicative of a legislative intent to
override other specific statutory prohibitions and noted that the provision would be ineffective to override a constitutional prohibition in any event.


The New Jersey Supreme Court reversed and remanded to the Director of the Division of Alcoholic Beverage Control (“ABC”) the New Jersey appeals court’s decision that the formation of an LLC by two liquor wholesalers was in substance a merger in which the statutory anti-discrimination protection of the two wholesalers’ franchise rights was preserved. The appeals court had reversed the Director’s decision that the statutory anti-discrimination protection was lost by the transfer of the business to the LLC. Each of the wholesaler members of the LLC was authorized to distribute distilled spirits for Brown-Forman prior to the formation of the LLC. The two members hoped to transfer their supplier authorizations to the LLC with supplier consent. Alternatively, they agreed that they would purchase the alcoholic beverages and transfer them to the LLC at cost. Brown-Forman refused to fill orders by the wholesalers. ABC found that the plan to transfer products to the LLC at cost was a “sham” and that the formation of the LLC was not equivalent to a merger. The appeals court reversed ABC. It noted that the protection of the statute would have continued had the two distributors effectuated a corporate merger and concluded that the protection of the anti-discrimination statute would not defeat the purpose of that statute and would advance New Jersey’s goal in promoting formation of LLCs. The supreme court essentially agreed with the appeals court that the economic reality rather than the form of a reorganization transaction should govern a wholesaler’s rights under the anti-discrimination law but remanded the matter to ABC to reconsider the status of the parties in view of the economic reality of the restructured organization. The court felt that various economic issues were unclear in the record. Additionally, pending the appeal, one of the LLC members had acquired the other. The court assumed that the acquirer would be entitled to retain any protection previously afforded the acquired wholesaler. The court also instructed ABC to articulate the relationship between its findings in the case to the policy of the anti-discrimination law. The court admonished ABC to provide guidance through regulation, directive, or policy statement that would enable parties to shape future transactions to the law’s policies.

2. **Receivership Laws**


Baker obtained a judgment against David Dorfman for legal malpractice and fraud. Subsequently, Dorfman formed a professional LLC and began to operate his law practice through the PLLC. In this action, Baker sought to hold the PLLC liable on the judgment against Dorfman as a successor in interest. The district court held that the PLLC law firm had successor liability on the judgment against the member, assigned the judgment creditor a 75% interest in the LLC, and appointed the judgment creditor’s attorney receiver of the PLLC. The order appointing the receiver granted sweeping authority over the PLLC’s operations, and the court of appeals raised *sua sponte* a concern regarding protection of the attorney-client relationship between the judgment debtor and his clients. The court felt that various economic issues were unclear in the record. Additionally, pending the appeal, one of the LLC members had acquired the other. The court assumed that the acquirer would be entitled to retain any protection previously afforded the acquired wholesaler. The court also instructed ABC to articulate the relationship between its findings in the case to the policy of the anti-discrimination law. The court admonished ABC to provide guidance through regulation, directive, or policy statement that would enable parties to shape future transactions to the law’s policies.


A receiver was appointed for Medicare Supply Co. of New England (“Medicare”), a member of a Rhode Island LLC. Medicare argued that appointment of the receiver constituted an event of dissociation under the LLC agreement which in turn entitled Medicare to be bought out under the agreement. Events of dissociation included a change in control of a member of the LLC. Control was defined under the agreement as an ownership interest sufficient to carry any motion, the right to elect or appoint directors or managers, or the right to manage. The court concluded that a change in control had occurred because the shareholders, directors, and officers of Medicare no longer controlled Medicare. The court stated that control did not have to shift to the receiver for a change in control to occur; it was sufficient that those formerly in control no longer had control. The court rejected the argument that the receiver was an assignee but did accept that the receiver was analogous to a judgment or lien creditor of Medicare. As a type of lien creditor, the court said the receiver succeeded to the rights of the dissociated member to be bought out.


A member of two LLCs claimed that a proposed transfer of funds by one LLC to the other would constitute a fraudulent transfer. The trial court in the case entered an injunction against the payment and ordered the LLCs dissolved under the statutory provision that an LLC may be judicially dissolved if it is not reasonably practicable to
carry on the business of the LLC in conformity with its articles of organization or regulations. The trial court appointed a liquidator under another statutory provision authorizing the court to wind up an LLC’s affairs or appoint a person to carry out the liquidation. The liquidator was given control of the two LLCs and had essentially all of the powers of a receiver. The court of appeals concluded that the order appointing a “liquidator” was an order appointing a “receiver;” therefore, the court had jurisdiction over the interlocutory appeal. The court held that the order of judicial dissolution and appointment of a liquidator was improper in this case as it did not properly preserve the subject matter of the suit until the trial court could finally determine whether the payment would be a fraudulent transfer. In other words, the court found the trial court’s order was improper because it gave the LLC member its ultimate relief.


Two members with a 49% interest in a Colorado LLC sought appointment of a receiver for the LLC. The Colorado Rules of Civil Procedure provide for the appointment of a receiver when the moving party establishes "a prima facie right to the property, or to an interest therein, which is the subject of the action and is in possession of an adverse party and such property, or its... profits are in danger of being lost... or materially injured or impaired." The court first held that a receivership was authorized under appropriate circumstances without a pending request for dissolution since a member of an LLC has a personal property interest in the LLC. The court then discussed the standard for appointment of a receiver and concluded that the member in this case was entitled to an evidentiary hearing on the appointment of a receiver based upon a CPA's affidavit that there were deficiencies in various aspects of the LLC's records and financial operations, that the LLC was insolvent or in danger of insolvency, that wage related taxes, withholding and garnished amounts had not been paid, and that there were unusual related party transactions outside the ordinary course of business.

3. Securities Laws


The plaintiffs invested in a Delaware LLC promoted by Katz, the mayor of Philadelphia. The LLC was run by Robins, whom Katz represented was a trusted employee with a good business track record. In fact, Robins had a history of criminal convictions and bankruptcies, but these facts were not disclosed to the plaintiffs. Within a couple of years after the LLC agreement was signed, Robins had burned through most of the $2 million the plaintiffs invested, and it came to light that he had diverted several hundred thousand dollars of the LLC’s funds to himself. In addition, it turned out the “independent feasibility studies” that had been shown to the plaintiffs were mostly written by Katz and Robins. The plaintiffs sued for rescission alleging violation of the anti-fraud provision of the Pennsylvania Securities Act. (The Pennsylvania Securities Act defines a “security” to include an LLC membership interest subject to an exception not relevant in this case.) Katz argued that the fraud claim was barred by an integration clause in the LLC agreement. The court concluded that the integration clause did not bar the plaintiffs’ claim even if reliance is an element under the Pennsylvania securities fraud provision. The court stated it was likely the Pennsylvania Supreme Court would not interpret the provision to require reliance. The court also concluded that scienter is not required under the Pennsylvania securities fraud provision. The defendants could only escape summary judgment if they could point to evidence suggesting that they could not have known about the false and misleading nature of their statements had they exercised reasonable care. This they were unable to do, and the court granted the plaintiffs judgment for rescission.

_Robinson v. Glynn_, 349 F.3d 166 (4th Cir. 2003).

An LLC member alleged that the defendant committed federal securities fraud when he sold the plaintiff an interest in the LLC. The court of appeals upheld the district court’s summary judgment for the defendant on the basis that the LLC interest was not a security because the plaintiff was an active and knowledgeable executive of the LLC rather than a mere passive investor. The court applied the _Howey_ test and focused on the “economic reality” of the investment to analyze whether the LLC interest was an “investment contract” within the meaning of the securities laws. The court examined the powers accorded the plaintiff under the LLC operating agreement and concluded that he was not a passive investor heavily dependent on the efforts of others. The plaintiff had the power to appoint two managers to the seven person board of managers, and he occupied one of those positions. He was the vice-chairman of the board of managers and a member of the four person executive committee to whom the board further delegated management. The plaintiff was also the treasurer of the LLC and had various powers associated with that office. Though the plaintiff lacked the technological expertise of others at the company, the court rejected the argument that his lack of technological expertise prevented him from meaningfully asserting his rights. The court stated that the references to the plaintiff’s interest as “shares” and “securities” in the purchase agreement, operating agreement, and the certificates representing the interest might indicate that the parties believed the securities laws to apply, but were not effective to invoke the
securities laws. The court also rejected the argument that the plaintiff’s LLC interest constituted “stock” under the securities laws because it was neither denominated stock by the parties nor did it possess all the characteristics of stock (finding that the LLC interest lacked several of the five characteristics typically associated with stock). The court said that the plaintiff was not misled into believing he was purchasing stock because the LLC documents all termed his investment as a “membership interest” rather than “stock,” noting that even the share certificate he received referred to him as a holder of “membership interests in GeoPhone Company, L.L.C., within the meaning of the Delaware Limited Liability Company Act.” The court concluded by specifically declining to declare a general rule that LLC interests are either investment contracts or non-securities. The court noted that LLCs lack standardized membership rights or organizational structures and can assume an almost unlimited variety of forms. “Even drawing firm lines between member-managed and manager-managed LLCs threatens impermissibly to elevate form over substance,” the court concluded.

**Securities and Exchange Commission v. Phoenix Telecom, L.L.C.,** 231 F.Supp.2d 1223 (N.D. Ga. 2001) (ordering disgorgement and “third tier” civil penalty against former vice-president and co-founder of LLC who, knowing the LLC was operating at a loss and with a negative net worth, marketed LLC’s pay-telephone plan as a safe investment and without disclosing his previous criminal history or securities laws violations).

**Tirapelli v. Advanced Equities, Inc.,** 215 F.Supp.2d 964 (N.D. Ill. 2002) (dismissing 10b-5 securities fraud claim based upon alleged oral misrepresentations in connection with sale of preferred LLC membership interests where subscription documents contained non-reliance and integration clauses and reasonable reliance on alleged oral misrepresentations thus could not be established).

**Nelson v. Stahl,** 173 F. Supp.2d 153 (S.D. N.Y. 2001). The plaintiffs alleged securities fraud in connection with the sale of their stock in a corporation and their interests in several LLCs. Applying the Howey test, the court concluded that the interests in the LLC were not securities. The court stated that, whether or not the members in fact abdicated their authority, the legal structure they selected precluded a finding that the membership interests were securities. The plaintiffs owned, in the aggregate, 60% of the membership interests in the LLCs, and the LLC agreements vested management in the members. The members had access to information regarding the affairs of the LLC and had ultimate control over the LLC’s affairs. The court declined to treat the purchase of the LLC interests as part of the purchase of stock in a related entity so as to entertain the Rule 10b-5 action with respect to all of the transactions.

**Erickson v. Horing,** 2001 WL 1640142 (D. Minn. Sept. 21, 2001) (holding that the plaintiffs were collaterally estopped from bringing this federal securities fraud action (which was based upon the reorganization of a North Dakota LLC into a Delaware corporation) because of an adverse judgment in a parallel state fraud action).

**Great Lakes Chemical Corporation v. Pharmacia Corporation,** 788 A.2d 544 (Del. Ch. 2001). In *Great Lakes Chemical Corp. v. Monsanto Co.,* 96 F. Supp.2d 376 (D.Del. 2000), the federal district court held that the purchase of 100% of the LLC interests in a Delaware LLC was not a purchase of securities. In this case, the plaintiff alleged that the seller warranted in the purchase agreement that the ownership interests the plaintiff purchased were securities. The court held that a reference to the interests as “equity securities” in the section of the agreement warranting title to the interests did not constitute a warranty that the interests were securities under the federal securities laws.

**Dafofin Holdings S.A. v. Hotelworks.com, Inc.,** No. 00 CIV. 7861(LAP), 2001 WL 940632 (S.D. N.Y. Aug. 17, 2001). The plaintiffs brought securities fraud claims in connection with an investment in a hotel enterprise. The investment involved receipt by Dafofin Holdings S.A. (“Dafofin”) of an “economic interest in connection with [a] membership interest” in an LLC that held an interest in another LLC that owned the hotel. Dafofin claimed that it relied on various misrepresentations and that the defendants refused to provide a copy of the operating agreement of the LLC that owned the hotel before the parties entered the investment agreement. The plaintiffs did not receive the operating agreement until over two years later. The alleged misrepresentations were inconsistent with provisions of the investment agreement and the LLC operating agreement. The court determined that the plaintiffs’ 10b-5 claims were barred by limitations because the investment agreement put the plaintiffs on notice that at least one misrepresentation had been made. The court also dismissed the plaintiffs’ claims under Section 12(a)(2) of the Exchange Act (because the
transaction was made pursuant to a private transaction rather than a public offering) and under Section 17(a) of the Securities Act (because the Second Circuit does not recognize a private right of action under Section 17(a)).


This case apparently involved the same LLC interests that were determined to be securities in _Nutek Information Systems, Inc. v. Arizona Corporation Commission_, 977 P.2d 826 (Ariz. Ct. App. 1998). The Maryland Court of Appeals applied the _Howey_ test in determining that the LLC interests were investment contract securities. The court rejected the argument that the _Williamson v. Tucker_ presumption (that general partners’ interests are not securities) applies to LLC membership interests. The court viewed the presumption as inappropriate in the LLC context given that LLC members ordinarily have limited liability and may be less involved in management than general partners.


Three individuals formed an LLC in which each was a 1/3 owner, but they never agreed on or executed an operating agreement. When the relationship soured, two of the members sued the third member for, inter alia, securities fraud and failure to register under the securities laws. From the LLC’s inception, the defendant member had managed and exercised control over the LLC, and the court concluded that the membership interests of the plaintiffs were investment contract securities under the federal and Illinois securities laws. The defendant argued that the membership interests were not investment contracts because the default rules of the Illinois LLC act that applied in the absence of an operating agreement gave each member equal rights of management and control. The court stated that it would look to the particulars of the situation rather than the generalized default rules and concluded that the plaintiffs’ interests were securities since the defendant assumed control over the LLC and its profits while the plaintiffs were passive investors. The court found that it could not perform at such an early stage of the litigation the intensive factual analysis necessary to determine whether the sale of the membership interests fell within the private placement exemption under 4(2) of the Securities Act of 1933, but the court did determine as a matter of law that the sale of the membership interests met the requirements for an exemption under Illinois law.


The South Dakota Supreme Court applied the _Howey_ and _Williamson_ tests to conclude that the plaintiffs’ membership interests in the LLC in question (a restaurant) were not securities under South Dakota law. The court pointed out that the operating agreement vested management in the members and gave the members substantial power and authority. The court also stated that the record established that the plaintiffs were informed and active in the affairs of the LLC and were aware of and capable of exercising their powers as members. Although the LLC’s management was contracted out to another entity, the court said the LLC retained the ability to terminate the management contract upon a failure to perform as required, and the members retained substantial power and the ability to conduct the necessary oversight of the LLC’s operations. A dissenting opinion characterized the situation as one in which the plaintiffs had very little control and concluded that a question of fact existed as to whether the membership interests were securities.


The issue in this case was whether the plaintiff’s LLC membership interest was a security under federal securities laws. In response to the defendants’ motion for failure to state a claim for securities fraud, the court held that it was possible that the plaintiff’s membership interest was a security. The focus was upon whether the investment involved an expectation of profits to be derived solely from the efforts of others. The LLC in question was manager-managed, and the operating agreement gave the manager full power and discretion to manage the affairs of the LLC. The operating agreement did not permit a member to act as the LLC’s agent and largely limited the member’s role to voting on extraordinary matters such as dissolution. The manager was also an 85% member of the LLC. Thus, the court concluded the membership interest might be a security. However, the plaintiff’s allegations of fraud lacked particularity, and the court dismissed the claims subject to fifteen days leave for the plaintiff to amend and plead with sufficient particularity.


The plaintiff purchased a Delaware LLC from the defendants and brought a securities fraud suit alleging that the defendants failed to disclose material information in connection with the sale. The defendants moved to dismiss for failure to state a claim, arguing that the interests sold to the plaintiff were not securities. The plaintiff argued that the
LLC membership interests were either “stock,” an “investment contract,” or “any interest or instrument commonly known as a ‘security’.” After reviewing various seminal cases in the securities area as well as recent decisions specifically addressing whether LLC membership interests constituted securities, the court addressed the plaintiff’s arguments that the membership interests in issue were securities. First, the court rejected the argument that the membership interests in issue were “stock” although the court acknowledged that the interests were “stock-like” in nature. To determine whether the membership interests were investment contracts, the court applied Howey. The court concluded that the plaintiff did not invest in a “common enterprise” because it bought 100% of the LLC membership interests from the defendants. The plaintiffs pointed out that when the LLC was formed it involved a pooling of contributions by the two defendants; however, the court focused on the challenged transaction, which was the sale of the defendants’ interests to the plaintiff, rather than the formation of the LLC. The court also concluded that the plaintiff’s expectation of profits did not depend solely on the efforts of others. While the LLC was manager-managed, the operating agreement gave members the power to remove managers, with or without cause, and to dissolve the LLC. The court pointed out that the plaintiff’s ownership of 100% of the LLC meant that its power to remove managers was not diluted by the presence of other ownership interests. Finally, although the purchase agreement referred to the interests as “equity securities,” the court rejected the argument that the membership interests were “any interest or instrument commonly known as a security” because the interests did not satisfy the Howey test. Relying on Supreme Court and lower court cases, the court refused to distinguish between an “investment contract” and “any interest or instrument commonly known as a security.”


The plaintiff brought a Rule 10b-5 securities fraud claim in connection with his purchase of membership interests in a New York LLC. The court found that the plaintiff’s membership interests were not securities because the fourth element of the Howey test, an expectation of profit from the managerial or entrepreneurial efforts of others, was not met. The LLC was member-managed, and the plaintiff had a broad range of rights and powers.


The court employed a Howey analysis to determine that membership interests in Texas LLCs involved in telecommunications were investment contract securities under Arizona law. The focus was, predictably, on the element of the Howey analysis that inquires into whether the investors were led to expect profits based upon the efforts of others. The court relied heavily upon Williamson v. Tucker, a Fifth Circuit case addressing whether interests in a general partnership may be considered securities. Although the LLCs were member-managed, the court concluded that the membership interests were securities. The members did not exercise meaningful control and were dependent upon others for the management of the LLC. Management was contractually delegated to another LLC, and it was practically impossible to replace the manager. The members were numerous and geographically dispersed. Additionally, the members lacked technical expertise in the specific business of the LLCs. The court declined to give the LLCs the “strong presumption” that an interest in a general partnership is not a security. The court noted that limitation of liability of LLC members gives members less incentive to be informed about, and active in, the business of the LLC.


The court determined that there was a genuine issue of material fact as to whether partnership interests in two general partnerships and membership interests in a Louisiana wireless cable LLC were securities under federal securities laws, and the court thus denied the defendants’ motion for summary judgment on the question. The defendants claimed that the investors did not purchase the LLC interests with the expectation that the efforts of others would generate the profits because they purchased interests in two general partnerships along with the LLC. The court treated the general partnership interests and LLC interests as the same kind of interest in its analysis because the powers granted to the investors under the partnership agreements and the LLC agreement were the same. To determine whether the interests were investment contracts under Howey, the court relied upon Williamson v. Tucker. The SEC argued that (1) the agreements left so little power in the hands of the partners that power was in fact distributed as in a limited partnership, or (2) the partners were so dependent upon the unique entrepreneurial or management ability of the manager that they could not replace the manager or otherwise exercise meaningful power. The court examined the agreements and concluded that they appeared to confer no more responsibility on the partners or members than those of limited partners or shareholders. Thus, the court could not conclude, based upon the agreements alone, that the interests were not securities as a matter of law. The SEC argued that the interests were such diluted fractional interests that they
constituted stock or limited partnership interests. The SEC also pointed to the promoters’ performance of substantial post-purchase services upon which the future profits of the enterprise depended. The court noted that investors with the powers of general partners may choose to delegate their powers and remain passive without their interests becoming securities. The court found, however, that there was a fact issue as to the extent and date on which the partners controlled the enterprise.


This case was not selected for publication and is not available on Westlaw or Lexis. The following summary is based on information supplied to the author by Robert Keatinge. The defendant in this case appealed a jury verdict finding him guilty of selling unregistered securities and employing unlicensed sales representatives under Colorado law for selling interests in a Nevada LLC (a wireless cable deal). The Colorado Court of Appeals held that the facts permitted the jury to find that the interests being sold in the Nevada manager-managed LLC were securities, but the appeals court reversed the verdict because the jury was not provided with a requested clarifying instruction regarding the definition of a security. The court appeared to acknowledge that the same presumption of non-security status applicable to general partners applies to members who have the right by a majority vote to remove the manager and assume management functions themselves. However, the court stated that a factfinder might find that (1) the number of members necessary to remove the manager would make removing the manager impractical, (2) the number of members would make management impractical, and (3) the business in which the LLC was to engage was very specialized and the operating agreement provided that it was in the members' best interest to engage a manager. On this basis, the court determined that there was sufficient evidence to support the jury's finding that the interests were investment contracts and therefore securities. The court of appeals reversed, however, because the trial court refused to respond to the jury's request for clarifying instructions on the definition of a security and the **Howey** test.


A group that included LLCs filed a Schedule 13D with the SEC, and the court was called upon to interpret the "control" disclosure requirements as applied to the LLCs. The IBSF Committee to Maximize Shareholder Value (the "Committee"), a group of shareholders of IBS Financial Corporation ("IBSF"), filed a Schedule 13D which IBSF contended did not conform with the requirements of the Securities Exchange Act and SEC regulations. With respect to the LLC members of the Committee, IBSF argued that the Schedule 13D did not report information regarding the persons "controlling" the LLCs. In general, the defendants argued that it was sufficient to provide information about certain managers of the LLCs whereas IBSF argued that information about certain members and others must also be included. For those LLCs in which a majority in interest of the members had the power to remove the manager, the court held that the majority member was a person "controlling" the LLCs. Thus, information regarding the majority member should have been included in the Schedule 13D. One of the LLCs had an investment manager and an administrative manager. The Committee argued that only the investment manager was a "controlling" person while IBSF argued that the administrative manager, the majority member, and the majority member's general partner were all "controlling" persons of the LLC. The administrative manager had the power to remove the investment manager and to make management decisions. The court thus concluded that the administrative manager was a "controlling" person. However, since the operating agreement of this LLC made no provision for removal of the administrative manager, the court concluded that the Committee was not required to include information regarding the majority member or its general partner.


The court held that membership interests in a wireless cable limited liability company were "securities" subject to the Securities Act of 1933 and the Securities Exchange Act of 1934. The court found that the membership interests fit the definition of an "investment contract" security under the **Howey** test. The court found that the LLC members shared "horizontal commonality" because they were told that they would receive a pro rata share of revenues from the operation. The court also found the members had "vertical commonality" with the entity, meaning that the investors’ success was inextricably linked to the success or failure of the entity (which the court referred to as a "corporation"). Finally, the investors’ profits were to be derived from the efforts of others because the investors had little, if any, input into the company. The court rejected the argument that the members exercised the ultimate power over the LLC. The court noted that they may have theoretically possessed the right to manage the affairs of the LLC under the terms of the operating agreement, but the court stated that the inexperience and geographic diversity of the more than 700 investors essentially precluded exercise of such rights.

The court imposed Rule 11 sanctions on the plaintiff for failure to make an adequate pre-filing investigation as to whether certain defendants were “sellers” of securities. The plaintiff sought damages for violations of federal and state securities laws in connection with the sale of membership interests in a Colorado LLC. The court did not discuss why the membership interests would be securities but assumed that to be the case in discussing the Rule 11 sanctions issue. The plaintiff named certain individuals as defendants on the basis that they were identified as promoters, but the court pointed out that to be a “seller” more is required than simply being a promoter. The plaintiff argued that consent of the members of the LLC to admission of new members, as required under the LLC subscription agreement, amounted to an act of solicitation. The court rejected this argument, pointing to case law holding directors’ authorization of the sale of a corporation’s securities insufficient to make them liable as statutory sellers.

4. Bankruptcy

See also cases under heading “Dissolution and Dissociation-Bankruptcy.”

*In re Ealy*, 307 B.R. 653 (Bankr. E.D. Ark. 2004) (acknowledging that property of LLC is not property of member under Arkansas law, but finding debtor had equitable interest in property held by debtor’s LLC, and automatic stay thus protected property, where creation of LLC resulted from misunderstanding and intent was for debtor to own property).

*In re Mulder (Baker Dev. Corp. v. Mulder)*, 307 B.R. 637 (Bankr. N.D. Ill. 2004) (stating in footnote that even if debtor owned interest in LLC that allegedly fraudulently conveyed property, only LLC interest would be property of bankruptcy estate and not property of LLC itself).

*In re Crowe Rope Industries, LLC (Turner v. JPB Enterprises, Inc.)*, 307 B.R 1 (D. Me. 2004) (noting standard for piercing LLC veil under Maine law is same as for corporation, and concluding that Maine law would not permit corporation to pierce its own veil (based on Maine Supreme Court’s rejection of “reverse piercing” by shareholder of corporation to assert corporation’s rights) and thus Trustee could not assert alter ego claim on behalf of estate).

*In re XO Communications, Inc. (XO Communications, Inc. v. Start Investments, Inc.)*, No. 02-12947 (AJG), 03 Civ. 1898(DC), 2004 WL 360437 (S.D. N.Y. Feb. 26, 2004) (holding bankruptcy judge’s order abstaining from determining severability of put provision in LLC agreement in favor of ADR procedure in LLC agreement was interlocutory order not subject to immediate appeal).


The Chapter 7 trustee brought an adversary proceeding to set aside alleged fraudulent transfers. The court held that certain excess cash flow distributions to the members of an LLC engaged in the property management business were fraudulent transfers because they were made with the intent to hinder and delay collection of a note owed by the LLC. The court reached this conclusion based on evidence that the LLC’s officers knew that a note payment was due shortly after the distributions, knew that the LLC would have insufficient cash to make the note payment, and viewed its business as worth less than the debt on the note. Furthermore, the LLC’s officers and board did not tell the noteholder about the distributions, had not yet provided financial information from the prior year to the noteholder, and did not tell the noteholder that it would not make the next note payment. LLC officers testified that they intended to force the noteholder to renegotiate the note and they believed the distributions and failure to make the note payment would give the LLC leverage in the negotiations. The court found intent to hinder or delay could be inferred from this evidence. The court rejected the argument that the distributions were in the nature of compensation. The court noted that there were no employment contracts providing that excess cash flow distributions would be part of their salary or bonus, no funds withheld from the distributions for income tax purposes, and no board resolutions treating the excess cash flow as salary or bonus. The noteholder did not consider excess cash flow distributions as compensation, but rather considered the distributions to be dividends or payments on account of the equity interests of the members. The court thus concluded that the LLC did not receive reasonably equivalent value for the distributions. The court analyzed whether the LLC was insolvent within the meaning of the Texas fraudulent transfer provisions and concluded that the LLC was insolvent. The court concluded that certain payments for legal and accounting services did not constitute fraudulent transfers, nor did the cancellation of certain contracts with the LLC and the formation of another entity that took over some of the contracts constitute fraudulent transfers.

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The court also addressed breach of fiduciary duty claims against members of the LLC who were officers. The court discussed the fiduciary duties of the LLC’s officers as if they were officers of a corporation. The court stated that the officers of a corporation owe a fiduciary duty to the corporation and its shareholders. Further, the court stated that the officers owe a fiduciary duty to the creditors of the corporation when the corporation is insolvent. According to the court, “[o]fficers of an insolvent corporation breach their fiduciary duty by transferring funds to themselves, in effect, as equity holders, to the detriment of the corporation’s creditors.” The court determined, however, that the trustee and the LLC’s major creditor were estopped from pursuing the breach of fiduciary duty claim. The noteholder was a “sophisticated player” and understood companies in the LLC’s business. It conducted its own assessment of the LLC’s assets and concluded that the LLC’s assets supported its debt structure. The excess cash distributions were permitted under the terms of the note. The court thus applied the equitable estoppel doctrine to the fiduciary duty claim related to the excess cash distributions. (This case is further summarized above under the headings “Fiduciary Duties of Members and Managers” and “Improper Distributions.”)


After filing bankruptcy, the debtors, members of a Delaware LLC, attempted to transfer their rights under the LLC operating agreement to another member. The court upheld the bankruptcy court’s conclusion that the debtors could not transfer their membership rights without the consent of the other members, that the debtors could assign their economic rights subject to a right of first refusal of the members in the operating agreement, and that a default provision under the operating agreement was unenforceable as an ipso facto clause. The default provision in issue affected the debtors’ economic interest in the LLC. If the clause providing that the debtors’ bankruptcy constituted a default was enforceable, another member was entitled to buy out the debtors’ interest at an amount equivalent to the value of their refusal provision was enforceable and was not an ipso facto clause because it was triggered by a transfer and not by assignment under Section 365(f). Finally, the court rejected the argument that public policy militated against enforcement of the right of first refusal because the procedures implicated by the right of first refusal were too onerous. The court did not regard the issues related to allocation of the purchase price of the debtors’ economic interest as rendering the right of first refusal unenforceable.


The bankruptcy trustee sought to set aside a judgment lien recorded by the defendant two weeks before the debtor LLC filed bankruptcy. The court appeared to agree with the trustee that the judgment lien was not properly recorded in the General Execution Docket where it was recorded under the name of a predecessor corporation rather than the LLC which survived the merger with the corporation, particularly since the judgment was recorded a year after the merger and the judgment creditor had full knowledge of the merger and the name of the surviving entity. The court concluded that the trustee did not have the power to set aside the lien under the strong-arm clause in Section 544(a)(1), even if the judgment was not properly recorded on the General Execution Docket, because the trustee did not stand in the shoes of a third party purchaser. However, the court found that the lien did not attach to the monies in the possession of the trustee because the monies were derived from a chose in action, and a judgment lien in Georgia does not attach to a chose in action.


The court determined that the chapter 11 bankruptcy of an Oregon LLC required member approval because it was a “Major Decision” requiring approval of members holding “in excess of 75% of the Ownership Interests” under the LLC operating agreement. The court also characterized the bankruptcy filing as a conversion into another type of entity requiring consent of a majority of the members under the Oregon LLC act because the bankruptcy converted the LLC into a debtor-in-possession charged with the fiduciary responsibilities of a trustee in bankruptcy. The adoption of a resolution by the LLC’s manager was thus insufficient to authorize the filing either under the operating agreement or Oregon law. The bankruptcy filing was ratified, however, by a subsequent consent resolution approved by members holding more than 75% in interest, and the court stated that such a ratification to approve a bankruptcy filing is not...
inconsistent with the Bankruptcy Code. The court refused to apply judicial estoppel to dismiss the bankruptcy although
counsel for the LLC’s manager represented in state court litigation on the day that the bankruptcy was filed that no
bankruptcy would be filed before 5:00 p.m. on that day. The court also concluded that the bankruptcy was not filed in
bad faith and that abstention was not warranted.

members of LLC formed by insiders of debtor were not “initial transferees” with respect to pre-petition transfers by
debtor to LLC and did not qualify as “entities for whose benefit such transfers were made” under Bankruptcy Code
Section 550 and that fact issues precluded summary judgment on issue of whether LLC exercised sufficient control over
debtor to be regarded as insider under Maine’s insider preference statute).

**In re Farmland Industries, Inc.,** 296 B.R. 497 (Bankr. W.D. Mo. 2003) (vacating prior order and holding on
reconsideration that the determination of the effect of a member’s bankruptcy on the member’s membership in the LLC
is a core bankruptcy proceeding, and that counterclaim for judicial dissolution, being closely intertwined with the issues
in the core proceeding, should also be heard by the bankruptcy court).

bankruptcy court’s order lifting the automatic co-debtor stay against an LLC because the LLC was a legal entity separate
from the debtor (who was a member of the LLC and guarantor of LLC indebtedness), and the debtor thus had no interest
in the LLC’s property or the proceeds of the loan guaranteed by the debtor).

**In re Condor Exploration, LLC,** 294 B.R. 370 (Bankr. D. Colo. 2003) (applying corporate test to determine
LLC’s principal place of business for purposes of proper venue of LLC’s bankruptcy and concluding that justice was
best served by transfer of venue from Colorado to Wyoming).

**In re Securities Investor Protection Corp. v. Consolidated Investment Services, Inc. (Snyder v. Floworks,
The appointed fiduciary in a Securities Investor Protection Act winding up (the “Trustee”) created an LLC to
receive assets in satisfaction of a claim asserted by the Trustee. The Trustee later filed an adversary proceeding seeking
injunctive relief with respect to the assets received in the settlement by the LLC. The Trustee sought to cure deficiencies
in the Trustee’s standing and questions as to the court’s jurisdiction by adding the LLC as a plaintiff, filing articles of
dissolution pursuant to which the assets of the LLC (including the claims in the suit) were distributed to the Trustee,
and dropping the LLC from the suit. The court concluded that these actions did not cure the standing and jurisdiction
problems. The court stated that jurisdiction is determined at the time of the filing of the action, and the action did not
involve the Trustee in that capacity or property of the estate. When the Trustee chose to take the property rights he
received in the settlement and place them in a separate entity, only the ownership interest in the LLC remained property
of the estate. Thus, the Trustee lacked standing, and the court lacked jurisdiction.

**In re Moreno (Alpine Bank v. Moreno),** 293 B.R. 777 (Bankr.D.Colo. 2003) (finding no basis to validate
defective deed of trust which erroneously identified LLC as grantor rather than actual individual owner and which was
executed by individual owner only in her representative capacity for LLC).

The sole member of a Colorado LLC filed bankruptcy, and the court held that the Chapter 7 trustee became
a “substituted member” and could cause the LLC to sell the LLC’s real property and distribute the proceeds to the estate.
The court reasoned that the trustee acquired the governance rights of the bankrupt member of the LLC because the
trustee succeeded to the debtor’s membership interest and there were no other members whose approval was required
for admission of the trustee as a member. The court quoted provisions of the Colorado LLC act that refer to consent
or approval by the “other members” for admission of an assignee as a member. The debtor argued that the trustee
represented creditors’ interests and was only entitled to a charging order, but the court concluded that the charging order
is for the protection of other members and thus serves no purpose in a single-member LLC. The court noted in a
footnote that a non-debtor member, even one with an infinitesimal interest, would be able to prevent a bankrupt
member’s trustee from acquiring the bankrupt member’s rights to govern and vote; however, the court also noted that
creditors or a bankruptcy trustee would have recourse under bankruptcy avoidance provisions or fraudulent transfer laws
where a “peppercorn” member is employed for purposes of hindering, delaying, or defrauding creditors.

A bankrupt LLC, in its capacity as debtor-in-possession, sought to recover a distribution made to its dominant member (Madsen) in connection with the sale of substantially all of the LLC’s assets. The LLC was insolvent at the time of the sale, and all of the proceeds of the sale (consisting of shares of stock in the purchaser) were distributed to the members in accordance with their interests. The LLC’s members had an agreement about the distribution of the proceeds of the sale whereby the members pledged some of the shares they received for the benefit of certain LLC creditors and Madsen agreed to dismiss a pending lawsuit against one of the LLC’s suppliers and another member. The LLC claimed that the distribution violated the Connecticut LLC act, was a fraudulent transfer under the Bankruptcy Code and the Connecticut Uniform Fraudulent Transfer Act, was a voidable preference under the Bankruptcy Code, and was a breach of Madsen’s fiduciary duty as a member of the LLC to its creditors. Madsen argued the transfer was supported by consideration and that he was entitled to summary judgment. The LLC argued that Madsen’s receipt of the shares violated the provisions of the Connecticut LLC act regarding the distribution of assets on a winding up. However, the court found this provision inapplicable because the LLC had not dissolved and was not in the process of winding up. The LLC conceded that the Connecticut LLC act does not prohibit an insolvent LLC from distributing its assets to its members, but the LLC argued that the court was permitted to apply corporate law restrictions under the provision of the LLC act that provides the principles of law and equity supplement the act. The court concluded that it need not address this argument because the LLC conceded that it had never actually dissolved. Thus, the court granted Madsen summary judgment on the claim that the distribution violated the Connecticut LLC statutes. The court found that there were fact issues regarding whether the distributions were made with intent to hinder or delay LLC creditors and whether Madsen gave reasonably equivalent value. Madsen argued that the distribution could not be a voidable preference because he was only an equity owner and not a creditor or claim holder. The court concluded that Madsen was a creditor by virtue of the distribution agreement and the Connecticut LLC act, which states that a member has the status of a creditor at the time a member becomes entitled to a distribution. Finally, the court applied case law from the corporate context to conclude that Madsen owed a fiduciary duty to LLC creditors when the LLC became insolvent.


The plaintiff sued an attorney who failed to record a deed transferring certain property to an LLC. The plaintiff and her sisters had retained the attorney to form an LLC for the purpose of holding real estate held by the sisters as general partners. The attorney formed the LLC but failed to prepare a deed transferring the properties to the newly formed LLC. The plaintiff filed bankruptcy and paid a cash settlement to her largest creditor after the creditor threatened to partition the partnership property. The attorney defended on the basis that the creditor would have reached the property in any event since the bankruptcy of the LLC member was an “involuntary withdrawal” under the operating agreement that dissolved the LLC under the terms of the operating agreement when the other sisters did not elect to continue the LLC. The court stated that the attorney’s reasoning was flawed. The court pointed out that the LLC members had no reason to continue because its purpose was to hold the property which was never transferred to it. The court concluded that the dissolution had no bearing on the viability of the plaintiff’s claim.

In re Liimatainen (Notinger v. Liimatainen), 2002 BNH 32, 2002 WL 31317182 (Bankr. D. N.H. Oct. 10, 2002) (stating that failure to list an ownership interest in an LLC may be grounds for denial of discharge but concluding claimant did not prove that debtor/manager of LLC, who signed certificate of formation and operating agreement (as manager) but was not listed as member, was actual owner of LLC).


The plaintiffs and the debtor were investors who entered a joint venture agreement and formed an LLC to secure financing and manage a real estate project. The debtor was also the attorney for the LLC (referred to in the case as the joint venture) and a member of the management committee. The plaintiffs alleged that the debtor owed them a fiduciary duty as a co-venturer, management committee member, and attorney for the venture, and that his liability for the venture’s debt was non-dischargeable because it arose from a defalcation of fiduciary duty when he obligated the venture to loan amounts in excess of borrowing authorizations. The court found that there must be an express or technical trust, not merely a general fiduciary relationship like that arising out of an attorney-client, joint venture, or partnership relationship for a fiduciary relationship to exist under section 532(a)(4) (the dischargeability exception for defalcation in a fiduciary capacity). Additionally, the court found that the bankruptcy court was in error in concluding a defalcation had occurred.

In re Interiors of Yesterday, LLC (Orsini v. Interiors of Yesterday, LLC), 284 B.R. 19 (Bankr. D. Conn. 2002)(holding that LLC must be represented by attorney in bankruptcy court but that pro se filing of Chapter 7 petition
was not void \textit{ab initio} and LLC’s failure to appear through attorney until more than three months later did not constitute “cause” for dismissal of case).


A member of an Alabama LLC filed bankruptcy and was granted a discharge. After the bankruptcy proceeding was closed, the member filed a derivative suit against the other members of the LLC. The plaintiff’s status as a member was critical to the plaintiff’s standing to bring the derivative suit, and the Alabama LLC act provides that a member ceases to be a member upon the voluntary filing of a petition in bankruptcy or an adjudication of bankruptcy. The plaintiff claimed this provision was an unenforceable ipso facto clause. The Alabama Supreme Court determined that the operating agreement (which did not address the effect of bankruptcy of a member) was an executory contract involving the significant services of the member and, thus, the other members would not have to accept performance by the trustee. It was therefore not necessary for the court to decide whether the provision of the Alabama LLC act that provides a member ceases to be a member upon bankruptcy would otherwise constitute an unenforceable ipso facto clause. Additionally, the court determined that Section 365(e) is intended only to apply during the pendency of a bankruptcy case and is inapplicable once the automatic stay against ipso facto termination has been lifted. Therefore, the member would have been divested of his membership when the bankruptcy was closed prior to the filing of the derivative suit. Since the Alabama LLC derivative suit provisions require the plaintiff to be a member, and the plaintiff was no longer a member, the plaintiff did not have standing.


As part of a financing arrangement, Iridium LLC assigned its right to certain reserve capital call obligations in the Iridium LLC agreement to Chase Manhattan Bank (Chase). Under the reserve capital call provisions, members could be called upon to purchase additional interests in the Iridium LLC. Ultimately, Iridium LLC filed bankruptcy, and Chase sought to enforce its rights against the members under the reserve capital call provisions. Whether assignment of Iridium’s rights to Chase was valid and whether certain amendments to the reserve capital call provisions were properly adopted were issues in dispute in the case, and the court determined that fact issues precluded summary judgment on these issues. Chase and the defendants also made certain arguments about the application of Section 365 of the Bankruptcy Code to the LLC agreement. The defendants argued that the obligation of Iridium LLC to issue interests under the reserve capital call provisions of the LLC agreement was an executory contract under Section 365(c). Further, the defendants argued that because Iridium LLC was in bankruptcy it could not as a matter of law assume the agreement and issue the interests, and material breach thus excused the members from the obligation to pay for the interests. Chase had several counter-arguments. First, Chase argued that because Chase had no obligations to the LLC members the Iridium LLC agreement was not executory as to Chase. The court rejected this argument. Chase also argued that the LLC’s issuance of interests pursuant to the reserve capital call provisions was not governed by Section 365(c) because the interests were not a “security” of the debtor or a “financial accommodation” under the Bankruptcy Code. The court rejected these arguments, as well. Thus, the court concluded the LLC agreement did create executory commitments under Section 365(c)(2). Finally, Chase argued that the interests to be issued would be worthless, thus there would be no material breach, and the LLC agreement could not be executory. The court found that the value of the interests presented a question of fact (it being possible that the interests were worthless, making the failure to issue them not a material breach and the agreement non-executory); therefore, the court denied summary judgment. The court also addressed Chase’s argument that the members had waived all of their defenses in broad waiver provisions in the LLC agreement (though there was a dispute as to whether the waiver provisions were properly adopted). Assuming the waiver provision was properly adopted, Chase argued the provision applied to all defenses of the members, but the court concluded that it did not waive the protections of the Bankruptcy Code. Specifically, the provisions of Section 365(c)(2) (prohibiting assumption of executory contracts covered by that provision) cannot be waived. With respect to defenses other than non-waivable defenses under the Bankruptcy Code, the court found ambiguity in the waiver provisions with respect to their application to the failure of the LLC to issue the interests.


The issue in this adversary proceeding was whether, for purposes of § 523(a)(4) of the Bankruptcy Code, the debtor was acting in a fiduciary capacity in his role as manager of a Virginia LLC. Section 523(a)(4) prohibits discharge of an individual’s debt arising from fraud or defalcation while acting in a fiduciary capacity. The proceeding involved allegations that the debtor had wrongfully withdrawn monies from the LLC in breach of his fiduciary duties as manager. The court acknowledged that other courts have held that partners or corporate officers were fiduciaries for purposes of § 523(a)(4) but noted that the question of fiduciary status of an LLC member or manager for purposes of § 523(a)(4) was an issue of first impression. The court noted the provisions of the Virginia LLC act requiring a manager
to discharge the manager’s duties in accordance with the manager’s good faith business judgment in the best interest of the company and concluded that, based upon such provisions, LLC managers have a fiduciary duty to the LLC. (The court also concluded that there are no fiduciary obligations among members in view of the lack of a similar provision for members.) However, this generalized fiduciary relationship was insufficient under the strict approach to § 523(a)(4) fiduciary status taken by the court in prior cases. Decisions in the Eastern District of Virginia restrict the term “fiduciary” for purposes of § 523(a)(4) to express or technical trusts, and the court noted that the Virginia LLC act does not impose any trust upon funds contributed to the LLC nor in any manner address the relationship between a manager and the monies of an LLC. The court rejected the argument that the alleged conduct by the manager came within the purview of § 523(a)(4) “alogizing to Virginia decisions concerning officers or directors” and on the basis that Virginia law does not suggest anything “other than a generalized fiduciary duty would be imposed upon a limited liability company manager.” The court went on to determine, however, that the manager’s excess withdrawals amounted to a non-dischargeable claim for embezzlement under § 523(a)(4). The court found that actions to obfuscate and conceal the nature and amount of the excess compensation showed fraudulent intent. In various financial reports to, and conversations with, the other members, the manager deceived them regarding the payments. Finally, the court determined that the Virginia statutory cap on a manager’s liability to the LLC did not apply because the manager’s acts amounted to “willful misconduct.”


The debtor was a 50% member in an LLC (Alma Cheese, LLC), and another LLC (Triangle Marketing, LLC) was the other 50% member. Triangle Marketing, LLC and its two members brought this adversarial proceeding complaining of fraud by the debtor in failing to disclose certain trade debts of Alma Cheese, LLC in connection with the plaintiffs’ guarantee and purchase of industrial revenue bonds of the LLC. The plaintiffs objected to the discharge of the undisclosed trade debts under § 523(a)(2)(A), which prohibits discharge of a debt obtained by fraud or misrepresentation of the debtor’s financial condition. The district court upheld the bankruptcy court’s dismissal of the proceeding on the basis that the trade debts were not the debts of the plaintiffs or the debtor, and the plaintiffs were not creditors to whom the debts were owed. The plaintiffs argued that the bankruptcy court erred in not interpreting their allegations to state a viable claim or in failing to allow the plaintiffs to amend, but the court found that the allegations were deficient and the bankruptcy court did not have a duty to find some interpretation that would avoid dismissal.


The debtor was one of approximately 180 members of an LLC that operated as a conduit for its members and was responsible for the bulk electric power system in a multi-state area. The LLC filed an involuntary petition of bankruptcy based upon an unpaid obligation for goods sold and delivered. Issues included whether the claim asserted by the LLC was subject to a bona fide dispute and whether fellow members of the LLC could qualify as holders of claims against the debtor. The court discussed provisions of the LLC operating agreement regarding enforcement of obligations and concluded that the joining petitioners did not have “claims” and that conversations at a members committee meeting did not amount to a de facto amendment of the operating agreement.


An LLC manager of an LLC prepared and filed a Chapter 7 bankruptcy petition on behalf of the LLC. The court held that an LLC comes within the definition of a “person” under the Bankruptcy Code and is eligible to be a debtor, but an LLC must be represented by counsel like a corporation or a partnership. The court further concluded that a lay person who prepares a bankruptcy petition and schedules on behalf of an LLC is engaged in the unauthorized practice of law. The court thus dismissed the case.


The court held that an LLC’s letter agreement that it would grant a membership interest to a new member in exchange for a capital contribution was not an executory contract that could be rejected by the LLC. The agreement called for James Dye to make a $350,000 capital contribution in exchange for a 25% membership interest. Dye made the contribution and was treated as a member by the LLC, though Dye never signed the operating agreement as the letter agreement required. The court found that the failure to sign the operating agreement was not a material breach and that the agreement had been substantially performed. Thus, it was not an executory contract. The court also addressed Dye’s objections to the application for fees filed by the law firm for the LLC debtor. Dye objected on the grounds that the firm was representing the interests of other members rather than the LLC in the dispute over Dye’s membership. The court upheld the bankruptcy court’s finding that the services of the law firm were rendered in an effort to clarify the debtor’s ability to reorganize and function as an ongoing entity.
An LLC debtor filed an application for authority to hire counsel. The application was granted, but the LLC sought clarification regarding the procedures for payment since the funds to be used were not property of the estate. The $5,000 retainer was paid by the general managing member of the LLC from personal funds, but the court’s original order required application for court approval of fees and set forth guidelines for compensation. In the course of modifying the original order, the court pointed out that the managing member and the LLC had a potential, though not actual, conflict of interest and cautioned counsel that he represented and served the interests of the debtor and not those of its managing member.

The LLC issue in this case was whether a South Carolina LLC was an “insider” of the Chapter 7 debtors. Mr. Barman was one of three members of the LLC. The debtors admitted that they were insiders of the LLC but disputed that the LLC was an insider of theirs. The court examined the Bankruptcy Code definitions of “insider” and “affiliate” and concluded that an LLC is sufficiently analogous to a corporation for purposes of determining insiders to consider similar principles. An “insider” includes a corporation of which the debtor is a director, officer, or person in control as well as an affiliate or insider of an affiliate. An affiliate includes a corporation if 20% or more of its voting securities are owned or controlled by the debtor. The court cited various provisions of the South Carolina LLC act reflecting that LLC members have voting rights. The court concluded that Barman was an insider because he was one of three members and thus held a position analogous to a director, officer, or person in control. The court also held Barman was an affiliate, and thus an insider, because he owned or controlled one-third of the voting rights in the LLC.

In re Heritage Leasing Corporation, No. C/A 96-75946-W, 1998 WL 2016851 (Bankr. D. S.C. Sept. 17, 1998) (declining to extend Reading Co. v. Brown to give rise to administrative priority claim where lease entered in name of LLC that was never formed allegedly resulted in lease to partnership and post-petition breach by Chapter 7 trustee, as successor to bankrupt partner, who rejected lease and left premises).

5. Antitrust

In this antitrust case brought by professional soccer players against Major League Soccer, L.L.C., a Delaware LLC, the court concluded that the LLC should be treated as a corporation for purposes of the court’s analysis of the application of Section 1 of the Sherman Act. The court cited several FTC rulings in which the FTC has treated LLCs like corporations and cited non-antitrust cases in which courts have concluded that an LLC is more closely analogous to a corporation than a partnership. The LLC argued that it was a “single entity” and thus could not violate Section 1 of the Sherman Act. Since the court determined to treat the LLC as a corporation for this analysis, the court stated that the LLC’s operations should be analyzed as the operations of a single corporation, with its operator investors treated as officers and shareholders. The court then examined the LLC and concluded that it was indeed a “single entity;” therefore, the defendants were entitled to summary judgment on the Sherman Act claim. On appeal, the First Circuit thought it doubtful that this was a case where single entity status applied, but concluded that remand was not required because the jury’s findings on the relevant market doomed the case. The district court also addressed the plaintiffs’ argument that the formation of the LLC in the first place violated Section 7 of the Clayton Act and concluded that the defendants were entitled to judgment on that claim as well. Again, the First Circuit concluded that the jury’s rejection of the plaintiff’s characterization of the market doomed this claim in any event.

6. Condominium and Cooperative Conversion Protection and Abuse Relief Act

A real estate development partnership which owned shares in an owners' corporation reorganized as a New York LLC, and the court found the successor LLC to be the same continuing entity for purposes of the statutory termination window under Section 3607(b) of the Condominium and Cooperative Conversion Protection and Abuse Relief Act. In a later released opinion, Darnet Realty Associates, LLC v. 136 East 56th Street Owners, Inc., Nos. 98 Civ. 5864 LBS, 98 Civ. 6011 LBS, 1999 WL 47328 (2nd Cir. Feb. 1, 1999), the court addressed the LLC’s subsequent sale of all of its shares and proprietary leases in 136 East Main Street Owners, Inc. to another LLC (which in turn sold the shares and leases to another LLC). The court concluded that the transferee LLC was not a successor and did not have special developer status under the Act. This determination led to the conclusion that the notice was within the two year window period provided for in Section 3607(b) of the Act.
7. Right to Financial Privacy Act


A Delaware LLC challenged a government subpoena of bank records under the Right to Financial Privacy Act (RFPA). Under RFPA, a “person” with standing to challenge such a subpoena is defined as “an individual or a partnership of five or fewer individuals.” The question was thus whether the LLC was a “person” under RFPA. The court examined the nature of an LLC and concluded that it did not have standing under RFPA. In addition to the fact that an LLC is not covered by the “plain meaning” of the words “individual” or “partnership,” the court focused heavily on the limitation of liability in an LLC and the fact that Congress did not include corporations with 5 or fewer shareholders.

8. Gramm-Leach-Bliley Privacy Act


A member of two Delaware LLCs sought to inspect the books and records of the LLCs, and the managing member of the LLC argued it need only produce the LLC’s general ledger accounts transactions histories, continuity schedules, annual reports, bank account ledger cards, and trial balances. The court interpreted the Delaware LLC act and LLC agreements (which gave access to “all books and records” of the LLCs) and concluded that the member also had the right to inspect the tax returns and member lists of the LLC. The court rejected the argument that disclosure of the member lists would violate the privacy provisions of the Gramm-Leach-Bliley Act because there is an exception to the prohibition on disclosure where disclosure is necessary to comply with other laws and legal requirements, and the court found disclosure was required to comply with Delaware law and other legal requirements.

9. Title VII

*Miller v. Bloomin’ Apple, L.L.C.*, No. 00 C 50286, 2002 WL 206541 (N.D. Ill. Feb. 11, 2002)(finding LLC that was sole member of another LLC had adequate notice of EEOC charges, though not named in EEOC charges, to be made party to Title VII suit).

10. Agricultural Lien Statute


An LLC claimed an agricultural lien on cattle proceeds by virtue of feed and care provided the cattle. Two brothers who owned the cattle executed a bill of sale to the LLC, in which they were members, and the LLC later reconveyed the cattle to the brothers. The lien was challenged with respect to the period of time during which title to the cattle was held by the LLC on the basis that, under North Dakota law, an owner of crops or livestock cannot claim a supplier’s lien for inputs the owner himself provides to the crop or livestock. The court compared the transfer to the LLC to a case in which a family created a partnership for the purpose of raising potatoes. A company owned by the mother provided services and claimed a lien, but it was disallowed on the basis that the mother, as a participant in the joint venture, had an interest in the crops themselves, and the expenses for which she claimed a lien constituted a contribution to the common undertaking of the joint venture. The court stated that the circumstances surrounding the LLC were similar to those in that case. If the cattle were owned by the LLC during the time in question, said the court, the logic of that case would preclude recognition of the lien. The court analyzed the circumstances of the transfer to the LLC and determined that the sale was absolute and effective upon the signing of the bill of sale. Since the cattle were owned by the LLC, it could not claim a lien for its expenses for feed and services.

11. Texas Franchise Tax


This case was a suit for a refund of franchise tax paid by Texas Utilities Electric Company (TUEC). TUEC claimed that it was entitled to deduct as “debt” future rental expense under certain operating agreements. The court noted that the franchise tax applies to both corporations and LLCs in Texas, even though most of the statutory provisions use only the word “corporation,” because the Tax Code defines a “corporation” to include a limited liability company. The court stated that it used the term “corporation” in its discussion for convenience even though it appeared to the court that TUEC was a limited liability company. The court concluded that the future rentals in issue were not deductible.
“debt” for franchise tax purposes. (It is clear that LLCs in Texas are subject to the Texas franchise tax, and the court’s analysis of the particular provision of the Tax Code in issue was not uniquely affected by TUEC’s status as an LLC. The court merely interpreted franchise tax provisions of the Texas Tax Code applicable to LLCs as well as corporations.)

12. Real Estate Transfer Tax

F.M. Management Company Limited Partnership v. Wisconsin Dept. of Revenue, No. 03-1536, 2003 WL 22998104 (Wis.App. Dec. 23, 2003) (holding that transfers of real estate between limited partnership and wholly owned LLC were not exempt from Wisconsin transfer tax because exemption provision in issue only applied to transfers between an LLC and a natural person member).

Crescent Miami Center, LLC v. Dept. of Revenue, 857 So.2d 904 (Fla.App. 2003) (holding documentary stamp tax applied to transfer of real property from limited partnership to newly formed LLC affiliate).

Lester Associates v. Commonwealth, 816 A.2d 394 (Pa.Cmwlth.Ct. 2003) (concluding that there was no legal transfer of title on which transfer tax could be imposed based on deeds into and out of LLC where LLC did not exist at the time of the purported conveyance to it).

Mandell v. Gavin, 816 A.2d 619 (Conn. 2003) (holding no transfer tax was due on contribution of property by individual member to wholly owned LLC under provision imposing tax where the consideration for the property conveyed equals or exceeds one thousand dollars, concluding that there was no consideration for the transfer of real property to the LLC because there was no bargained for exchange).

Ferris v. Gavin, 816 A.2d 628 (Conn. 2003) (holding that the court’s decision in Mandell v. Gavin controlled and that no transfer tax was due on conveyance of property by individual to individual’s wholly owned LLC).

Tranfo v. Gavin, 817 A.2d 88 (Conn. 2003) (holding that the court’s decision in Mandell v. Gavin controlled and that no transfer tax was due on conveyance of property by individual to individual’s 99% owned LLC).

GT, Kansas, L.L.C. v. Riley County Register of Deeds, 22 P.3d 600 (Kan. 2001) (interpreting Kansas mortgage registration statute and holding that borrowing entity’s change from general partnership to LLC after the original mortgage was filed did not cause mortgagee to lose the statutory exemption from paying a mortgage registration fee on the refinanced portion of the mortgage).

A family limited partnership which owned three parcels of land reorganized as an LLC, and the family members recorded in the deed records a “Memorandum of Organizational and Operating Agreement” giving notice of the reorganization. The Wisconsin Department of Revenue assessed a real estate transfer tax on the land, and the Tax Appeals Commission found that the transaction was a taxable transfer under Wisconsin law. The appeals court agreed. The court analyzed the Memorandum and concluded it was a “conveyance” by the partnership. Then the court concluded that the conveyance was “for value” even though no cash consideration was involved because the members received capital accounts in the LLC as well as new and more beneficial rights and privileges associated with the LLC form (quoting an article that points out advantages of an LLC over a limited partnership.)

13. Passive Activity (Material Participation) Rules


The issue in this case was the application of the material participation standard under IRC Section 469 (the passive activity loss provisions) to an LLC member. Gregg was a member of a service LLC in which capital was not a material income producing factor. The IRS audited Gregg’s return and disallowed Gregg’s characterization of a flow through loss from the LLC as an ordinary loss and re-characterized it as a passive activity loss. Gregg argued that he should be treated as a general partner for purposes of the tests determining “material participation” (thereby meeting the standard of material participation if he met any one of the seven tests in the temporary regulations under Section 469), but the IRS argued that Gregg (and any member of an LLC) should be treated as a limited partner (and thereby allowed to meet one of only three tests) because members of LLCs have limited liability. The court discussed the nature
of LLCs, the nature of limited partnerships, and the legislative history of Section 469 and concluded that the limited partnership test in Temporary Treasury Reg. 1.469-5T(e)(3)(i)(B) is obsolete when applied to LLCs and their members. In sum, it is not applicable to all LLC members because LLCs are designed to permit active involvement by LLC members in the management of the business. The court concluded that Gregg could meet the standard for material participation under any one of the seven tests and went on to analyze the application of the tests to the specifics of the case.

14. Schedule C Deduction


15. Annual Gift Tax Exclusion

_Hackl v. Commissioner of Internal Revenue_, 335 F.3d 664 (7th Cir. 2003) (affirming tax court decision (summarized below) that gifts of interests in LLC did not qualify as present interests for purposes of annual gift tax exclusion even though the donees gave up all their legal rights in the transferred interests because the interests did not confer upon the donees a substantial present economic benefit).

_Hackl v. Commissioner of Internal Revenue_, 118 T.C. No. 14, 2002 WL 467117 (U.S. Tax Ct. 2002). The Tax Court held that gifts of interests in a family LLC were not present interests that would entitle the taxpayers to the gift tax annual exclusion. The taxpayers made gifts to their children and grandchildren of membership units in an LLC organized to hold and operate tree farming properties. Under the terms of the operating agreement, members could not withdraw from the LLC without the prior consent of the manager. If a member desired to withdraw, the member could offer to sell the member’s interest to the LLC, but the manager had exclusive authority to accept or reject the offer. A member was not permitted to transfer or in any way alienate the member’s interest except with the prior written consent of the manager, which could be withheld in the manager’s sole discretion. If a transfer was made with consent, the transferee would be admitted as a substitute member; if a transfer was made in violation of the operating agreement, the transferee was not entitled to become a member, but only had the right to receive profits and distributions to which the transferor would have been entitled. The court rejected the taxpayers’ contention that when a gift takes the form of an outright transfer of an equity interest in a business or property, no further analysis is needed. The court stated that a taxpayer claiming an annual exclusion must establish that the transfer conferred on the donee an unrestricted and noncontingent right to immediate use, possession, or enjoyment of property or of income from the property, both of which demand that such immediate use, possession, or enjoyment be of a nature that substantial economic benefit is derived therefrom. The court found that the terms of the operating agreement foreclosed the ability of the donees presently to access any substantial economic or financial benefit. The court then concluded that the gifts did not confer upon the donees a right to use, possession, or enjoyment of income because the parties stipulated that the LLC was to acquire and manage timberland for long-term income and appreciation, not to produce immediate income, and that it was anticipated the LLC would operate at a loss for number of years. The court said that even if the taxpayers had shown the LLC would generate income at or near the time of the gifts, they failed to show any ascertainable portion would flow out to the donees because distributions were in the sole discretion of the manager under the operating agreement.

16. Secured Transactions


The court concluded that several flaws in the signature of a debtor LLC on a UCC-1 financing statement did not render the financing statement ineffective. The financing statement had been signed by a corporate officer of the corporation that was the manager of the LLC. The officer’s corporate title was missing, but the court indicated that it was a “hyper-technical” ground on which to void the financing statement. The court characterized the failure to indicate the name of the corporation that was the manager of the LLC as a “more serious error” but concluded that a number of factors mitigated the error, including the fact that the debtor’s signature would not even be required under Revised Article 9.
**17. Bid Submission Process**


The court found that a Delaware LLC falsely represented itself as a joint venture in a bid proposal submitted in connection with construction of a county hospital. The ordinances and the instructions to bidders apparently addressed partnerships and/or joint ventures and corporations but not LLCs. The LLC identified itself as a joint venture and submitted the execution form for a joint venture. The court found that the LLC was not a joint venture for purposes of meeting certain requirements regarding participation in minority and women’s business enterprises and failed to meet certain other requirements. The court stated that the LLC, as a corporate entity, failed to comply with the requirements for corporate bidders. The court found that the LLC encouraged the county to believe that one of the LLC members would be personally responsible as a member of a joint venture when in fact the member would have no liability for the LLC’s obligations.


Three members of an LLC submitted a statement during the pre-qualification process associated with bidding on an airport construction project. In the statement, the members identified their entity as “Frontier/Traylor/Shea joint venture” and identified it as a “joint-and-several joint partnership.” Subsequently, the LLC submitted the lowest bid, but the airport commission rejected the bid on the basis that the entity was not pre-qualified since it was an LLC rather than a joint venture partnership, the status indicated by the Frontier entity that was pre-qualified. The LLC sought injunctive relief and argued that it was a joint venture, citing a treatise and some cases referring to an LLC as a joint venture. The court concluded that the airport commission’s decision was not illegal, arbitrary, capricious, or unreasonable “[g]iven the lack of clarity in the status of when a limited liability corporation [sic] is legally a joint venture and the conflicting documents presented” to the airport commission.

**18. Workers’ Compensation/Employment Statutes**

**Smith v. State Dept. of Public Safety**, 89 P.3d 1062 (Okla. 2004) (concluding LLC member was not “self-employed” for purposes of provision of Oklahoma statute dealing with modifications of revoked driver’s license).


Two corporations formed an LLC and entered a management agreement in which one of the corporations agreed to manage and operate the LLC and cause the LLC to maintain workers’ compensation insurance. A worker was injured, and the worker sued the two members of the LLC alleging they were negligent in failing to provide certain safeguards. The members argued that they were “employers” protected from suit under the exclusive remedy provision of the Texas Workers’ Compensation Act. The court considered cases dealing with this issue in the partnership and corporate parent-subsidiary context. The court concluded that the current statutory treatment of partnerships as entities had overruled case law treating partners as employers, and analogized to the parent/subsidiary context because of the liability shield provided to members of an LLC. Since the case law in the corporate parent/subsidiary context has
recognized the separate existence of the parent and subsidiary for purposes of the workers’ compensation law, the
members were not permitted to argue they were the same entity as the LLC for such purposes.

19. Divorce of Member(s)

Powell v. Powell, 124 S.W.3d 100 (Tenn. Ct. App. 2004) (adopting standards applicable to closely held
corporations for valuation of LLC for marital property purposes).

LLC in which divorcing spouse was 50% member from disposing of real property).

The wife in a divorce action appealed the trial court’s valuation of the wife’s interest in an LLC. The wife
complained of the trial court’s failure to exclude personal goodwill, but the court of appeals faulted the wife for failing
to differentiate between enterprise and personal goodwill. The wife also complained that the trial court had not properly
considered the effect of transfer restrictions in the operating agreement on the value of her interest in the LLC, but the
court of appeals did not find the trial court’s determination to be clearly erroneous. Finally, the court upheld the equal
division of the value of the wife’s interest in the LLC. (While the opinion generally refers to an award of one-half of
the wife’s interest to the husband, it appears that the trial court actually awarded one-half of the value of the interest,
rather than one-half of the interest itself, to the husband.)

Husband and wife were equal members of an LLC. The wife brought suit seeking a distribution of profits,
accounting, past profits, and appointment of a receiver for the LLC. The court held that these matters could be properly
heard in the divorce action that was already pending between the husband and wife.

20. Creditor Rights

An LLC creditor who held a mechanic’s lien sought to have the court apply the doctrine of equitable
subordination with respect to a mortgage lien held by members of the LLC. The court held that the doctrine was not
available outside of a bankruptcy proceeding. As further support for its refusal to subordinate the mortgage, the court
noted that the LLC statutes permit members and managers to lend money and transact other business with the LLC.

21. Fraudulent Transfer

1043728 (Del.Ch. 2004) (dismissing plaintiff’s fraudulent transfer claim because pleadings failed to allege facts
suggesting the reorganization and distribution in issue involved any actual intent to hinder, delay, or defraud plaintiff).

court’s pre-judgment remedy against LLC successors to corporate defendant based upon transfer of corporate assets to
LLCs for alleged purpose of hindering collection of potential judgment against corporate defendant).

fact issues precluded summary judgment on issue of whether LLC formed by debtor/transferor’s insiders exercised
sufficient control over debtor to be regarded as insider under Maine’s insider preference statute).

the plaintiff alleged sufficient material facts to support a default judgment against an LLC on the basis that the transfer
of a corporation’s assets to the LLC without consideration was a fraudulent transfer made with the intent to avoid the
corporation’s debt to the plaintiff).

A bankrupt LLC, in its capacity as debtor-in-possession, sought to recover a distribution made to its dominant
member (Madsen) in connection with the sale of substantially all of the LLC’s assets. The LLC was insolvent at the
time of the sale, and all of the proceeds of the sale (consisting of shares of stock in the purchaser) were distributed to the members in accordance with their interests. The LLC’s members had an agreement about the distribution of the proceeds of the sale whereby the members pledged some of the shares they received for the benefit of certain LLC creditors and Madsen agreed to dismiss a pending lawsuit against one of the LLC’s suppliers and another member. The LLC claimed that the distribution violated the Connecticut LLC act, was a fraudulent transfer under the Bankruptcy Code and the Connecticut Uniform Fraudulent Transfer Act, was a voidable preference under the Bankruptcy Code, and was a breach of Madsen’s fiduciary duty as a member of the LLC to its creditors. Madsen argued the transfer was supported by consideration and that he was entitled to summary judgment. The LLC argued that Madsen’s receipt of the shares violated the provisions of the Connecticut LLC act regarding the distribution of assets on a winding up. However, the court found this provision inapplicable because the LLC had not dissolved and was not in the process of winding up. The LLC conceded that the Connecticut LLC act does not prohibit an insolvent LLC from distributing its assets to its members, but the LLC argued that the court was permitted to apply corporate law restrictions under the provision of the LLC act that provides the principles of law and equity supplement the act. The court concluded that it need not address this argument because the LLC conceded that it had never actually dissolved. Thus, the court granted Madsen summary judgment on the claim that the distribution violated the Connecticut LLC statutes. The court found that there were fact issues regarding whether the distributions were made with intent to hinder or delay LLC creditors and whether Madsen gave reasonably equivalent value. Madsen argued that the distribution could not be a voidable preference because he was only an equity owner and not a creditor or claim holder. The court concluded that Madsen was a creditor by virtue of the distribution agreement and the Connecticut LLC act, which states that a member has the status of a creditor at the time a member becomes entitled to a distribution. Finally, the court applied case law from the corporate context to conclude that Madsen owed a fiduciary duty to LLC creditors when the LLC became insolvent.


The Chapter 7 trustee brought an adversary proceeding to set aside alleged fraudulent transfers. The court held that certain excess cash flow distributions to the members of an LLC engaged in the property management business were fraudulent transfers because they were made with the intent to hinder and delay collection of a note owed by the LLC. The court reached this conclusion based on evidence that the LLC’s officers knew that a note payment was due shortly after the distributions, knew that the LLC would have insufficient cash to make the note payment, and viewed its business as worth less than the debt on the note. Furthermore, the LLC’s officers and board did not tell the noteholder about the distributions, had not yet provided financial information from the prior year to the noteholder, and did not tell the noteholder that it would not make the next note payment. LLC officers testified that they intended to force the noteholder to renegotiate the note and they believed the distributions and failure to make the note payment would give the LLC leverage in the negotiations. The court found intent to hinder or delay could be inferred from this evidence. The court rejected the argument that the distributions were in the nature of compensation for services of the members. The court noted that there were no employment contracts providing that excess cash flow distributions would be part of their salary or bonus, no funds withheld from the distributions for income tax purposes, and no board resolutions treating the excess cash flow as salary or bonus. The noteholder did not consider excess cash flow distributions as compensation, but rather considered the distributions to be dividends or payments on account of the equity interests of the members. The court thus concluded that the LLC did not receive reasonably equivalent value for the distributions. The court analyzed whether the LLC was insolvent within the meaning of the Texas fraudulent transfer provisions and concluded that the LLC was insolvent. The court concluded that certain payments for legal and accounting services did not constitute fraudulent transfers, nor did the cancellation of certain contracts with the LLC and the formation of another entity that took over some of the contracts constitute fraudulent transfers. (This case is further summarized above under the headings “Fiduciary Duties of Members and Managers” and “Improper Distributions.”)


The plaintiff sued an attorney who failed to record a deed transferring certain property to an LLC. The plaintiff and her sisters had retained the attorney to form an LLC for the purpose of holding real estate held by the sisters as general partners. The attorney formed the LLC but failed to prepare a deed transferring the properties to the newly formed LLC. The plaintiff filed bankruptcy and paid a cash settlement to her largest creditor after the creditor threatened to partition the partnership property. The attorney defended on the basis that the transfer to the LLC would have been voidable as a fraudulent transfer in any event. The court denied the attorney’s motion for summary judgment, finding that the attorney had failed to establish as a matter of law that the transfer of the property would have been a fraudulent transfer. The court found that there were fact issues involving the plaintiff’s intent and solvency at the time the transfer was to have been made. With respect to the issue of reasonably equivalent value, the court rejected the argument that the more limited rights of LLC creditors diminished the value of the LLC membership the plaintiff was
to receive in exchange for the transfer. The court stated that “[t]he fact that the transfer of the property would make it more difficult for creditors to reach does not lessen the value of the LLC interest.” (The court and the parties apparently assumed that the partner’s creditor could directly pursue the real estate held by the general partnership.)

**Lenge v. Beizer**, No. CV000802145, 2002 WL 31967553 (Conn.Super. Dec. 30, 2002) (concluding that attorney solo practitioner’s transfer of his building and law practice to LLCs during pendency of litigation against attorney was fraudulent transfer made with intent to defraud plaintiff under Uniform Fraudulent Conveyance Act and common law of fraudulent conveyance).

**National Loan Investors, L.P. v. World Properties, LLC**, No. X03CV980491738S, 2002 WL 1815906 (Conn. Super. June 27, 2002)(concluding transfer by partnership to LLC was fraudulent transfer to “insider”even though individual who was majority partner of the partnership owned only 1% of the LLC inasmuch as individual’s wife and children owned remaining interests in the LLC and individual exercised control over their interests and the entity).

**LFG, LLC v. Navarre**, No. 01C9451, 2002 WL 1379112 (N.D. Ill. June 26, 2002) (finding allegations pertaining to LLC’s fraudulent transfer claim against LLC lender satisfied particularity requirement and that pleadings also stated claims for conversion and unjust enrichment).

**Mullen and Mahon, Inc. v. Mobilmed Support Services LLC**, 773 A.2d 952 (Conn. App. 2001) (concluding transfer by corporation to LLC was transfer to “insider” for antecedent debt).

**Litchfield Asset Management Corporation v. Howell**, 799 A.2d 298 (Conn. App. 2002) (stating that judgment for damages against spouse of LLC member who allegedly conspired to fraudulently transfer assets to LLC was improper because spouse was not transferee and judgment against non-transferee was not authorized under fraudulent transfer statute).


Three brothers formed an LLC for the purpose of acquiring and developing real estate for use by non-profit entities at below market rents. The brothers intended to and did obtain tax benefits by means of deductions for charitable contributions but did not otherwise intend to profit from the endeavor. Ultimately, the LLC ended its operations by transferring its property to a non-profit organization for substantially less than the appraised value of the property. The only significant debt at the time of the transfer consisted of unpaid and disputed invoices of the project manager for the LLC. The court rejected the arguments of the project manager that the transfer was a fraudulent transfer. The court found no indication of an actual intent to hinder, delay, or defraud the creditor. The plaintiff also claimed the transfer was actionable because the LLC did not receive reasonably equivalent value and was insolvent at the time or as a result of the transfer. The court rejected this claim, as well, concluding that a debtor is not obligated to reserve funds sufficient to defend litigation arising from a disputed claim as well as to pay the claim.


A judgment creditor garnished the bank account of an LLC after obtaining a judgment against two corporations affiliated with the LLC. The court upheld the garnishment on the basis that the LLC was the alter ego of one of the judgment debtor corporations and that fraudulent transfers to the LLC had occurred. The LLC was formed after the creditor initiated its lawsuit against the corporations. The LLC was funded by all of the assets of one of the corporations, which became the sole member of the LLC, and the revenues from the business that had been operated by the corporation thereafter went to the LLC. Additionally, the individual who managed these various related entities and owned the ultimate parent of the LLC filed a UCC-1 financing statement to perfect an earlier security interest in the assets. The court found that the LLC and related corporations were alter egos of one another, that fraudulent conveyances had occurred, and that the judgment debtors and related parties had acted in concert to insulate assets from the judgment. The court found that both the transfer of assets to the LLC and the filing of the UCC-1 constituted fraudulent transfers made with actual intent to hinder, delay, or defraud a creditor. The court of appeals stated that the trial court had ample record support for its finding that a “pea in a shell game” had been taking place. The court rejected the argument that the transfers were not fraudulent in the absence of a finding by the trial court that the transfers were made without receipt of reasonably equivalent value. The court stated that such a finding was unnecessary since the trial court found actual intent to defraud.
22. Franchise Laws

*Abrahim & Sons Enterprises v. Equilon Enterprises, LLC*, 292 F.3d 958 (9th Cir. 2002).

Franchisees of Shell and Texaco alleged a violation of California franchise law when Shell and Texaco transferred title, possession, and control of leased gas stations to an LLC jointly owned by Shell and Texaco. The California provision in issue stated that a franchisor who leases premises to a franchisee may not sell, transfer, or assign to another person the franchisor’s interest in the premises unless the franchisor first offers the property to the franchisee. The court recognized the LLC as “another person,” rejecting the argument of Shell and Texaco that the LLC should not be treated as a separate and distinct entity. The court also determined that contribution of the properties to the LLC was a “transfer” under the statute.

23. Statute of Frauds

*Gora v. Drizin*, 752 N.Y.S.2d 297 (N.Y.A.D. 1 Dept. 2002) (holding that Statute of Frauds barred breach of contract claim based on oral promise of sole member of LLC to convey 50% interest in LLC to plaintiff after LLC acquired real property owned by the parties’ bankrupt partnership pursuant to partnership’s plan of reorganization).

*Urda v. Sahl*, No. CV020468800S, 2003 WL 21007160 (Conn.Super. April 17, 2003) (holding that the defendant promised to convey a 50% interest in real estate, rather than an interest in an LLC later formed to hold the real estate, in exchange for the plaintiff’s management of the real estate and thus the oral agreement was subject to the Statute of Frauds, but concluding that plaintiff’s claim survived motion to strike based on allegations of the plaintiff’s performance of the contract).

24. Land Use

*Dale Properties, LLC v. County of Hennepin*, No. 28918, 2002 WL 31895514 (Minn. Tax. Dec. 20, 2002) (holding that property transferred from individual to family general partnership to family LLC satisfied holding period and requirement that owner be “noncorporate entity” for purposes of favorable treatment under green acres statute.)


25. Mechanic’s and Materialman’s Lien

*PM Contracting Co., Inc. v. 32 AA Associates LLC*, No. 604088/02, 2003 WL 21960250 (N.Y. Sup. Aug. 7, 2003) (holding that naming parent LLC of LLC that actually owned real property in issue was mere “misdescription” of owner of property under mechanic’s lien law since parent beneficially owned property by virtue of its ownership and control of the true owner).

*Longview Production Co. v. Dubberly*, 99 S.W.3d 427 (Ark. 2003) (accepting certified question as to whether the phrase “person or persons” in mechanic’s and materialman’s lien statute includes an LLC where statutory construction provision indicates reference to a party or person includes “bodies corporate”).

26. Contractual Provision Referring to “Corporation” or “Partnership”

*Garcia v. Foulger Pratt Development, Inc.*, 845 A.2d 16 (Md.App. 2003) (holding that LLC was not “operating partnership” within meaning of agreement to establish and issue interests in operating partnerships to own buildings constructed in development project).

As part of a financial restructuring, a limited partnership transferred all its operating assets to an LLC in exchange for a membership interest in the LLC. The plaintiff, an assignee of a limited partner’s interest, claimed that the transfer dissolved the partnership under a provision of the limited partnership agreement that provided that the partnership would be dissolved and terminated upon the sale of all or substantially all of the assets of the partnership. However, the partnership agreement provided that the sale of the partnership assets to “a corporation organized solely for the purposes of continuing the business of the Partnership in exchange for the corporation’s capital stock” would not be deemed a sale of all or substantially all of the assets for purposes of the dissolution provision. Relying on this provision, the trial court concluded that the transfer to the LLC did not constitute a sale of all or substantially all of the assets. On appeal, the plaintiff raised for the first time the argument that the transfer to the LLC fell outside the provision because the transfer was made to an LLC and not a corporation. The court refused to consider this argument because the plaintiff had not raised it in the court below.

27. Directors’ and Officers’ Liability Insurance


Two South Dakota LLCs asserted various claims against the individual who had served as president, including conversion, breach of fiduciary duty, breach of contract, and trade libel. The president was an insured under an “Executive Safeguard” policy providing “Directors and Officers Liability & Company Reimbursement Insurance.” The president demanded that the insurer defend and indemnify him against the claims. The court first determined that the policy did not require the insurer to provide a defense, and the court rejected various arguments that the policy provided coverage for the claims against the president. The president argued that the policy covered negligent mismanagement, notwithstanding an “insured versus insured” exclusion, on the basis that the claim was for contribution or indemnity on a claim not otherwise excluded under the policy. The court rejected the argument that the claims against the president were for contribution or indemnity. The president argued that the contribution or indemnity exception applied because he was entitled to “direct” indemnification by the LLC for the very damages it sought. The president relied upon South Dakota law authorizing LLCs to reimburse managers for liabilities incurred in the ordinary course of business or for the preservation of the business or its property. The president also pointed out that California law has similar provisions. The president further argued that he was entitled to contractual indemnification under the operating agreements. The court rejected the argument that these provisions brought him within the contribution or indemnity exception to the insured versus insured exclusion. The court stated that the complaint was still one for damages even if the individual himself had a claim for indemnity. The president also relied upon his right to indemnification as a basis to come within a “Presumptive Indemnification” exception to certain exclusions from coverage. The president argued that South Dakota and California law, as well as the LLC operating agreement, required the LLC to indemnify him. The court stated that South Dakota law permits South Dakota LLCs to indemnify officers and agents but does not mandate indemnification. Similarly, the court said California law permits, but does not require, LLCs to indemnify officers. The court pointed out that California law prohibits LLCs from indemnifying officers for breach of fiduciary duty. The court also determined that the terms of the operating agreement did not require indemnity because the LLC was required to do so only on advice of counsel and only after approving such an action.

28. General Liability Insurance

U.S. Underwriters Insurance Co. v. City Club Hotel, LLC, 369 F.3d 102 (2d Cir. 2004) (holding that LLC members were entitled to rely on LLC’s notice of claim to insurer and that insurer’s failure to timely notify LLC of its intention to disclaim coverage was also failure to notify LLC members in timely manner).

Regency Motors of Metairie, L.L.C. v. Hibernia-Rosenthal Insurance Agency, L.L.C., 868 So.2d 905 (La. App. 2004) (holding attempted expulsion of members and threats to take legal action against them if they continued to participate in LLC’s affairs did not fall within coverage of umbrella and liability policies for “wrongful eviction” and “malicious prosecution”).


**KK. Conversion, Merger, Reorganization**


The court did not appear convinced that a post-merger judgment recorded in the name of the predecessor corporation rather than the surviving LLC was properly recorded based on the provisions of the LLC act that provide for the preservation of creditors’ rights in a merger and for the continuation of a proceeding against a constituent entity as if the merger did not occur. While the court agreed that the LLC act permitted the continuation of the litigation against the predecessor corporation as the named defendant, the court had “serious doubts” about whether the language and policies of the Georgia statutes go so far as to permit a judgment creditor to prevail against an innocent third party purchaser when the judgment creditor records a post-merger judgment against the old constituent entity rather than the new surviving entity, particularly when the judgment is recorded a year after the merger and when the judgment creditor has full knowledge of the merger and the name of the surviving entity. The court pointed out that the LLC act does not state that it is sufficient for a creditor to record a judgment lien or UCC financing statement in the name of the constituent business entity rather than the surviving entity. Furthermore, the court pointed out that the LLC merger provisions deal with the rights of the creditor or the party to the lawsuit on the one hand and the debtor or business entity being sued on the other. The court observed that the merger provisions do not address the rights of third parties or suggest that they are intended to pre-empt any state recording statutes. The issue of whether the judgment lien was properly recorded turned out to be immaterial in this case, however, because the court held the bankruptcy trustee did not stand in the shoes of a third party purchaser.

*Purina Mills, L.L.C. v. Less*, 295 F.Supp.2d 1017 (N.D. Iowa 2003) (pig seller which converted from corporation to Delaware LLC while pig purchase agreement was in effect was proper party in interest and could bring breach of contract action against buyers where both Delaware and Iowa law provided that all rights, privileges, powers, and property of an entity that converts to an LLC are vested in the LLC, the agreement permitted the assignment of rights to any parent, affiliate, or subsidiary without buyers’ consent, and the buyers had accepted performance from the LLC and treated it as a proper party in interest).


*Holland v. Fahnestock & Co., Inc.*, 210 F.R.D. 487 (S.D. N.Y. 2002) (adopting magistrate’s report stating that sole proprietor was not discharged when sole proprietorship converted to LLC because a sole proprietor retains personal liability for all pre-conversion debts and obligations when it converts to an LLC).

*Greenwich Global, LLC v. Clairvoyant Capital, LLC*, No. CV010182930S, 2002 WL 31168715 (Conn.Super. Aug. 22, 2002) (holding conversion of limited partnership to LLC was invalid under Delaware law because conversion was undertaken without authorization of the general partner, whom limited partners had attempted, but failed, to effectively remove).


A member of an LLC whose interest would decrease from 50% of the voting units to 5% of the voting units in a proposed merger of the LLC sought a preliminary injunction on the basis that the other member and managers appointed by it acted in bad faith in approving the proposed merger and that the defendants would be unable to prove the entire fairness of the merger. First Solar, LLC (the “LLC”), a Delaware LLC, was formed by True North Partners, LLC (“True North”) and Solar Cells, Inc. (“Solar Cells”) to commercialize solar power technology. Solar Cell contributed the technology, and True North contributed and loaned money to the LLC. Solar Cells and True North each received 50% of the voting membership units, and True North received 100% of the non-voting units. True North had the right to elect three of the five managers, and Solar Cells had the right to elect the other two. The LLC’s initial funding was depleted, and the members unsuccessfully negotiated various alternatives for financing and restructuring. Without notice to Solar Cells, the True North managers executed a written consent approving the proposed merger of the LLC into an LLC wholly owned by True North. Solar Cells received notice of the proposed merger four days before it was to close. Under the terms of the merger, the balance of True North’s loan to the LLC would be converted into equity, and Solar Cells would end up with 5% of the voting units in the surviving LLC. The court found that there was a reasonable likelihood that Solar Cells would prevail on the merits, that is, that True North would be required to establish the entire fairness of the merger and would be unable to do so. True North argued that the actions taken to
The court also found that the valuation used to establish the price was likely not fair because it was irreconcilable with a majority of the Managers and permits interested transactions free from personal liability does not give a fiduciary mechanism and failure to give Solar Cells advance notice. (“[I]t is not an unassailable defense to say that what was done was in technical compliance with the law… The fact that the Operating Agreement permits action by written consent of a majority of the Managers and permits interested transactions free from personal liability does not give a fiduciary free reign to approve any transaction he sees fit regardless of the impact on those to whom he owes a fiduciary duty.”) The court also found that the valuation used to establish the price was likely not fair because it was irreconcilable with valuations only a few months before True North decided to proceed with the merger. Finally, the court found that irreparable harm was threatened because of the dilution of the equity and voting position of Solar Cells, the difficulty in valuing the LLC, and the limitation of True North’s liability for conflicts arising from its fiduciary obligations.

**Shoreline Care Limited Partnership v. Jansen & Rogan Consulting Engineers, P.C.,** No. X06CV940155982S(CLD), 2002 WL 180886 (Conn. Super. Jan. 10, 2002) (finding that standing was satisfied in suit brought in limited partnership name where limited partnership had contracted with defendant and then converted to LLC, relying on language in conversion statute and case law to the effect that LLC is deemed the “same entity” and results from a “seamless transition”).


The Virginia Supreme Court affirmed a trial court judgment holding the manager of Flippo Land & Timber Co., LLC, a family-owned LLC (“Flippo LLC”) liable for breach of fiduciary duty to the LLC and barring the manager and his brother from serving as managers. Flippo LLC held timberlands and had three members: Carter Flippo, who was also manager, Carter’s brother Arthur Flippo, and CSC Associates III, L.L.C. (“CSC”), an LLC owned by the three children of Carter’s and Arthur’s sister. In response to the refusal of CSC to allow Carter and Arthur to transfer their interests in Flippo LLC to individual LLCs for estate planning purposes, Carter consulted a law firm and chose a course of action suggested by the law firm that would allow Carter and Arthur to satisfy their estate planning goals by holding their interests in the timberland business in LLCs. Pursuant to the advice received by Carter from his lawyers, Carter, as manager of Flippo LLC, caused the LLC to transfer all of its non-cash assets to a new LLC. The transfer of Flippo LLC’s assets dissolved Flippo LLC under the operating agreement, and CSC was given the option of joining the new LLC if it agreed to the terms of its operating agreement, under which Carter and Arthur could hold their interests through LLCs. (Prior to trial, the new LLC dissolved and returned the assets to Flippo LLC, rendering claims against the new LLC moot.) Carter was found liable for breach of fiduciary duty based upon his orchestration of the transfer of Flippo LLC’s assets to the new LLC. He appealed, arguing that he was entitled to a defense based upon his reliance on the law firm’s advice. His defense was based upon a provision of the Virginia LLC act protecting a manager who acts in good faith reliance on legal counsel or other professionals. The court found that this provision was not applicable in the instant case. The court pointed out that a manager, like a corporate director, is required by statute to discharge his duties in accordance with his good faith business judgment in the best interests of the LLC. Additionally, the LLC and corporate statutes contain nearly identical provisions protecting managers and corporate directors from liability in the exercise of that judgment under certain circumstances. The court found, however, that Carter was receiving advice in his personal capacity for his own personal interests when he consulted with the law firm, and he was therefore not protected by these provisions. Further, the court rejected the argument that reliance on advice of counsel was a defense to punitive damages, and the award of punitive damages was upheld. The court also upheld the removal of Carter as manager and the prohibition of his brother Arthur’s serving as manager on the basis that this point was not properly preserved for appeal. The court finally rejected the claims of Carter and Arthur for dissolution of Flippo LLC and for rescission of the operating agreement based on fraud and mutual mistake, and the court upheld sanctions against Carter and Arthur based upon their allegations of mutual mistake and fraud.


An LLC with three entities as members and three individuals as managers entered a merger approved by two of the three managers pursuant to the operating agreement. In the merger, two members with a combined 75% in the LLC were relegated to a 37.5% minority interest in the surviving corporation, and Castiel, the individual who controlled the two members with the 75% interest, was excluded from management. Castiel appointed two of the three managers of the LLC (these managers consisted of Castiel and another appointee), but the third manager (the owner of the 25%
member) convinced Castiel’s appointee to join him in a written consent to merge the LLC without notice to Castiel. The court determined that the LLC agreement permitted a merger to be approved by a vote of a majority of the managers and that Section 18-404(d) of the Delaware LLC act literally permits written majority consents without notice to other managers, but the court concluded that the two managers breached their duty of loyalty to Castiel by failing to give him notice. The following comment by the court regarding the application of Section 18-404(d) is representative of the court’s tone throughout the opinion: “The General Assembly never intended, I am quite confident, to enable two managers to deprive, clandestinely and surreptitiously, a third manager representing the majority interest in the LLC of an opportunity to protect that interest by taking an action that the third manager’s member would surely have opposed if he had knowledge of it. My reading of Section 18-404(d) is grounded in a classic maxim of equity -- ‘Equity looks to the intent rather than to the form.’” The court stated that the two managers who took the action to merge owed a duty of loyalty to the LLC, its investors and Castiel, their fellow manager. The court observed that the LLC agreement allowed the action to merge to be taken by a simple majority of managers (rather than following the default member approval requirement) because all parties understood that Castiel had the right to appoint and remove a majority of the managers. Had notice been given, Castiel of course would have attempted to remove his appointee and block the action. The court rejected the argument that the managers were protected by the business judgment rule. The court said the managers owed Castiel a duty to give him prior notice even if he would have interfered with a plan that they conscientiously believed to be in the best interest of the LLC. If Castiel was not suited to run the company, as claimed by the other two managers, this was an issue to be determined in board meetings with all managers present or in future litigation, if necessary.

Froelich v. Erickson, 96 F. Supp.2d 507 (D. Md. 2000), aff’d, 5 Fed.Appx. 287 (4th Cir. 2001). The factual background of this case is rather complicated, but the claims involved assertions of fraud, breach of fiduciary duty, and breach of contract by Froelich, an ousted CEO and board member of a Maryland LLC. Froelich was also a member of the LLC who, along with other minority members, was cashed out in a squeeze-out merger following a reclassification of interests of the LLC approved by all members except Froelich. Two documents primarily governed the LLC’s operations as an LLC. These documents were an Operating Agreement, which the court characterized as the LLC equivalent of a corporate charter, and a Members Agreement, which the court described as the equivalent of a stockholders’ agreement. The operating agreement defined classes of preferred and common interests, the role and responsibility of the board, and the rights and duties of the members. The member agreement supplemented the operating agreement by specifically defining rights of members and restrictions on alienation of interests. The court summed up Froelich’s claims as a challenge to “a handful of corporate actions taken by [the LLC’s] Board and its Members.” The court summed up the key issues in the case as follows: “(i) Did the corporate documents or Maryland corporate law authorize the Board to take the actions that Froelich challenges? (ii) If the Board or the Members had the power to act, by what standard (e.g., business judgment rule or fiduciary duty) should the Court review the Board’s exercise of that power? and (iii) Did the Board meet the appropriate standard?” The court characterized the case as arising in the context of corporate decisions by the LLC’s board of directors and applied the business judgment rule. The court noted that the LLC’s operating agreement stated that the LLC’s directors “are subject to the duties of a corporate fiduciary as defined by Maryland law;” thus, the court continued, the LLC board’s decisions are measured against the business judgment rule “just as if [the LLC] were a traditional corporation, rather than an LLC.” The court found no evidence that the board had acted in bad faith and concluded that the board’s actions were protected by the business judgment rule. The court also concluded as follows: the LLC and majority member did not breach a duty of good faith and fair dealing (noting uncertainty under Maryland law as to whether there is a separate cause of action in this regard and stating that the duty in any event only prohibits a party from preventing the other party from performing under the contract); the majority member did not breach a fiduciary duty to Froelich by usurping a business opportunity (stating that a majority interest holder clearly owes the minority a fiduciary duty but finding no breach in view of the board’s independent approval of the transaction); the reclassification did not breach the operating agreement or the member agreement (finding that the transaction fell outside a provision in the member agreement restricting redemptions and was governed by the operating agreement, which was amended in accordance with its terms to permit the reclassification). In Froelich’s favor, the court found that the LLC owed Froelich severance pay under an employment agreement between the LLC and Froelich and that the reclassification and squeeze-out were related parts of a transaction in which Froelich had properly preserved his statutory right to an appraisal. The court explained that the Maryland LLC statute grants a member the same appraisal rights as an objecting stockholder under corporate law. Maryland corporate law provides appraisal rights in connection with a parent-subsidiary merger, and Froelich properly objected to the squeeze-out merger. The court viewed the reclassification and subsequent squeeze-out merger as a single transaction rather than separate events such that Froelich was entitled to appraisal of his interests immediately prior to
the reclassification rather than appraisal of his reclassified interests immediately prior to the merger that occurred five months later.


The plaintiff, a former partner in a Delaware general partnership, challenged the 1993 merger of the partnership into a Delaware LLC. The merger eliminated the plaintiff’s interest for cash. The plaintiff claimed the merger was invalid because it was not authorized under the Delaware partnership act or the partnership agreement and, even if otherwise valid, was invalid because it was unfair to the plaintiff. While neither the Delaware partnership act nor the partnership agreement authorized merger of the partnership, the court found that the merger was authorized under the Delaware LLC act, which authorized LLCs to merge with other entities. According to the court, “If this provision, explicitly authorizing LLCs to merge with general partnerships, is to have meaning, the General Assembly must be presumed to have intended that such a merger could go in either direction, i.e., that LLCs would be allowed to merge with general partnerships, or the reverse. Therefore, the fact that the general partnership statute was silent on the subject is of no moment.” The court also found that the LLC statute was applicable even though the partnership was formed prior to the effective date of the LLC act. The court concluded that the effect of the merger was to dissolve the partnership. The court agreed with the plaintiff’s claim that the merger did not meet the entire fairness test and that the plaintiff was entitled to an award of damages measured by his proportionate share of the fair value of the partnership as of the merger date.


Edin and Sinatra formed Nite Life, Inc. to operate a night club, and each contributed $50,000 to the corporation for a $100,000 security deposit required to lease certain premises. Later Sinatra and Edin formed an LLC to take over all assets of the corporation including the lease and the rights to the deposit. Edin, Sinatra and their bookkeeper proceeded as if the lease had been transferred, but the court stated that the lease was not effectively transferred because the lease and deposit constituted substantially all of the assets of Nite Life, Inc. and the technical requirements under the corporate statute were not followed. Sinatra ultimately withdrew from the LLC pursuant to an agreement whereby he received $50,000 and released the LLC from any liabilities. The corporation was dissolved by action of Edin and Sinatra. About the same time, the lease was canceled because Edin decided to purchase the property, and the $100,000 security deposit was returned to Edin or the LLC and used as a down payment on the property. Sinatra argued that he was entitled to a distribution of $50,000 because the lease was never effectively transferred and the deposit should have been returned to the corporation and distributed to the shareholders. The court rejected Sinatra’s claim on the basis that he had failed to comply with a requirement under the corporate law that the claim be brought within 90 days of the attempted transfer of the lease. The court also rejected Sinatra’s claim for breach of fiduciary duty inasmuch as Sinatra intended that, and gave instructions for, the lease to be transferred, and he proceeded as if the transfer had been accomplished.


A sole proprietor entered an agreement with an employee, the plaintiff in the case, whereby the proprietor agreed to give the plaintiff 10% of the proceeds from the sale of the business if the plaintiff was employed at the time of the sale. After the proprietor died, his wife operated the business as a partnership in dual capacities, as the surviving spouse and trustee of a family trust. Later the wife transferred portions of her interest to two sons, and the partners converted the partnership to an LLC. The next year, the LLC terminated the plaintiff’s employment. The plaintiff sought a declaratory judgment, breach of contract damages, and imposition of an equitable lien. Later the plaintiff added a count of fraudulent conveyance. The trial court dismissed all these claims, and the plaintiff appealed. The court of appeals found that the plaintiff alleged facts that would support the existence of a contract either under successor liability theories or based upon an agreement with the wife after the proprietor’s death. The plaintiff alleged that the defendants breached the contract by terminating his employment, failing to pay him his share of the net proceeds upon sale of the business, and repudiating the agreement and offering the business for further sale. The defendants argued that the conversion of the partnership to an LLC was not a sale of the business, but the court stated that there were nevertheless disputes regarding the allegations of breach of contract. The court found that the plaintiff failed to state a claim for fraudulent conveyance in that neither the addition of two partners nor the subsequent conversion to an LLC changed the plaintiff’s rights or put the assets of the business beyond his reach. Finally, the court determined that the plaintiff had stated a cause of action for an equitable lien.

After the plaintiff invested in an S corporation, the corporation was reorganized as an LLC because the plaintiff was not a U.S. citizen. The plaintiff claimed that the restructuring was a fraudulent scheme by the other members effected without her consent to deprive her of the value of her investment, which involved not only stock in the corporation but rights under a distributorship agreement. The court concluded that the plaintiff failed to allege quantifiable damages. The fact that her interest in the corporation was extinguished was insufficient alone to show damages since the plaintiff received a proportionate interest in the LLC which acquired the assets of the corporation. In a later opinion at 2000 WL 680365 (May 25, 2000), the court held that its partial summary judgment against the plaintiff in this regard did not, under the law of the case doctrine, preclude the plaintiff from amending her complaint to include claims of waste (by means of excessive compensation paid to the managing members of the LLC), misappropriation (by inexplicable withdrawal of initial capital), and breach of fiduciary duty (by the foregoing and preparation of misleading financial statements).


A family limited partnership which owned three parcels of land reorganized as an LLC, and the family members recorded in the deed records a “Memorandum of Organizational and Operating Agreement” giving notice of the reorganization. The Wisconsin Department of Revenue assessed a real estate transfer tax on the land, and the Tax Appeals Commission found that the transaction was a taxable transfer under Wisconsin law. The appeals court agreed. The court analyzed the Memorandum and concluded it was a “conveyance” by the partnership. Then the court concluded that the conveyance was “for value” even though no cash consideration was involved because the members received capital accounts in the LLC as well as new and more beneficial rights and privileges associated with the LLC form (quoting an article that points out advantages of an LLC over a limited partnership.)


The court held that an LLC was a continuation of its predecessor sole proprietorship and, as such, entitled to enforce a construction contract entered by the sole proprietor. The defendants entered a construction contract with Stephen Devereaux, a sole proprietor doing business as Devereaux’s Carpentry Service, for construction of an addition to the defendants’ home. Thereafter, Devereaux formed Devereaux’s Carpentry Services, LLC. The LLC filed a mechanic’s lien on the defendants’ home, and the defendants claimed that they had no agreement with the LLC. The court followed the Connecticut Supreme Court’s decision in C & J Builders & Remodelers, LLC v. Geisenheimer, 733 A.2d 193 (Conn. 1999), to equate the sole proprietor’s formation of the LLC to a statutory conversion such that “all the interests and obligations incurred by, or chargeable against, the sole proprietorship or its assets are transferred by operation of law.”


The issue in this case was whether an LLC could enforce an arbitration clause in a contract entered by the LLC’s 99% owner prior to the conversion of the owner’s sole proprietorship to an LLC. Charles Pageau, doing business as a sole proprietor, entered a contract with the defendants and later formed an LLC in which he thereafter conducted his business. The operating agreement recited that the LLC was “successor to Charles Pageau [doing business as] C & J Builders and Remodelers” and that Pageau had a 99% membership ownership interest and virtually absolute control over the business. In determining whether the LLC was a “successor in interest” to the contract, the court acknowledged that the formation of the LLC was not a statutory conversion, but the court could find no reason to distinguish between the effect of a statutory conversion of a partnership to an LLC under the Connecticut conversion statute and the conversion of a sole proprietorship to an LLC. The court stated that the conversion statute in effect treats a converted LLC as the “successor in interest” to the converting partnership. The court concluded, therefore, that “where a sole proprietorship converts to a limited liability company, all of the interests and obligations incurred by, or chargeable against, the sole proprietorship or its assets are transferred to the limited liability company by operation of law.” (In the trial court’s opinion, the trial court concluded that the LLC had the benefit of the contract, but did so using veil piercing principles.)


The defendant, a partnership that had converted to an LLC and filed bankruptcy after foreclosure proceedings were instituted against it, complained that the trial court improperly awarded fees in connection with the foreclosure in violation of the automatic bankruptcy stay. After the partnership converted to an LLC, the LLC sought to be substituted in the pending foreclosure proceeding against the partnership or, alternatively, to intervene. The LLC also
filed bankruptcy. The court denied the LLC’s motion to be substituted or intervene. Thereafter, the court awarded fees and expenses against the partnership for delay of the foreclosure sale caused by the bankruptcy filing. The partnership claimed that this action violated the automatic stay in the bankruptcy. The court disagreed. The court discussed the effect of the statutory conversion of the partnership to an LLC and noted that the conversion statute allows an action or proceeding pending against the converting partnership to continue “as if the conversion had not occurred.” The court noted that the LLC did not appeal the denial of its motion to be substituted or to intervene. Thus, the court said, the converted LLC never became a party to the suit, and the bankruptcy protection did not apply when the court awarded the additional fees against the partnership.


An accounting firm organized as an LLC combined its practice with an accounting firm organized as a professional corporation pursuant to a somewhat vague letter agreement. The business continued under the auspices of the PC. The court pointed out that, while the parties used the term “merger,” Connecticut statutes do not permit an LLC to merge with a PC. The court noted that a PC is free to acquire the assets of an LLC, and apparently that was the nature of the transaction. The issue was whether the PC acquired non-compete agreements between the LLC and two of its employees who left the PC a year or so after the “merger” and solicited the firm’s clients. The court concluded that the PC did not acquire the covenants not to compete from the LLC. The court noted that restrictive covenants necessary to protect a proprietor’s business are generally deemed assigned to the purchaser of the business, but the court went on to conclude that the PC did not acquire all the assets of the LLC. Further, noted the court, the entities did not merge, and the PC assigned no value to any covenant not to compete or goodwill.


The opinion in this case was originally available on Westlaw but was removed and is now only referenced in a table at 744 So.2d 238. Two members of an LLC sued the other two members and a third party alleging that a merger of the LLC into one of the defendant members and then into the third party constituted a conversion of the plaintiffs’ assets. The LLC operating agreement had an arbitration clause that required “a dispute arising between the Members concerning the operation, management or buyout of the interest of the LLC” to be submitted to arbitration. The court held that the plaintiffs’ claim fell within the scope of the arbitration clause. The court also found that the dispute must be arbitrated even though one of the defendants was not a party to the operating agreement. The court stated that the plaintiffs’ allegations were directed primarily against the member who controlled the entities with which the LLC merged. The court concluded that the first merger (between the LLC and one of its members) was certainly arbitrable and, if found improper, would make any complaint against the company involved in the second merger moot.


An LLC mortgage company had originally been operated as a partnership, but the partnership converted to an LLC on the advice of partners who were attorneys. Neither the manager, who was also a partner, nor his wife, who was employed in the business, were attorneys. The manager and his wife alleged that two of the attorney partners were negligent in their capacities as counsel to them as follows: failing to inform them of the effect of a conversion from a partnership to an LLC; failing to inform them of the attorney partners’ potential personal gain in power in the new LLC (specifically, failing to inform them that the conversion would enable a majority of the members of the LLC to approve certain matters without consent of the minority, such as dissolution and winding up, transfer of substantially all of the assets, and amendment of the articles of organization and operating agreement); failing to advise them of potential personal financial gain to the attorney partners due to the conversion; failing to advise them to seek separate counsel; failing to advise them as to conflicts of interest; failing to obtain their consent for having a business transaction with the client and serving as counsel to the client at the same time; and failing to give advice and obtain consent regarding the conflict of interest in writing. The manager and his wife alleged that the attorneys had provided legal services to them and the LLC or its predecessor on numerous occasions. The manager and his wife phrased the issue as whether a lawyer commits legal malpractice by entering into a business transaction with a client without the written consent required under the Louisiana Rules of Professional Conduct. The court found it unnecessary to reach the issue of whether the attorneys had an attorney-client relationship with the manager and his wife because, assuming there was an attorney-client relationship, the court found that the action was time-barred.


This case involved a dispute between LLC members in which it was unclear whether the parties’ rights were governed by the shareholder agreement of the predecessor corporation, the default provisions of the Delaware LLC act,
the merger agreement by which the predecessor corporation was converted to an LLC, or a draft LLC agreement never signed by the members. The plaintiff members of the LLC sought to remove the defendant member, Facchina, as manager of the LLC. The parties had originally formed the business as a Delaware corporation. The corporation was subsequently converted into an LLC by virtue of a merger of the corporation into a newly formed Delaware LLC which survived the merger. An LLC agreement for the new LLC was never signed. The plaintiffs claimed that the shareholder agreement of the predecessor corporation reflected the terms of the members' agreement for the operation of the LLC. Alternatively, the plaintiffs relied upon the default right to remove a manager under the Delaware LLC act. Facchina claimed that a draft LLC agreement never signed by the members governed their relationship. Alternatively, Facchina claimed that the merger agreement itself was the LLC agreement. The court concluded that summary judgment for either side was inappropriate because there were sharply disputed facts and insufficient undisputed facts to support a legal ruling on the issues before the court. The court noted that both the shareholder agreement and the draft LLC agreement contained arbitration provisions and encouraged the parties to pursue arbitration in California.

The court of appeals affirmed the decision of the district court rescinding an operating agreement on the basis of unilateral mistake and constructive fraud. A partnership converted to an LLC, but the managing partner did not inform the others that he did not intend to continue in his management role after the conversion. The LLC operating agreement did not appoint the individual as managing member, but the other members assumed he would take on the position consistent with his role in the partnership. The court found the concealment amounted to constructive fraud because it breached the fiduciary duty of the managing partner to disclose material information. Thus, the court upheld the trial court’s rescission of the LLC operating agreement. (The district court’s opinion is available at 1997 WL 150052 (D. Kan. Jan. 29, 1997)).

**Darnet Realty Associates, LLC v. 136 East 56th Street Owners, Inc.**, 153 F.3d 21 (2d Cir. 1998).
A real estate development partnership which owned shares in an owners' corporation reorganized as a New York LLC, and the court found the successor LLC to be the same continuing entity for purposes of the statutory termination window under Section 3607(b) of the Condominium and Cooperative Conversion Protection and Abuse Relief Act.

This case dealt principally with corporate law issues arising when an accounting firm which was operating as a professional corporation changed its name and transferred its assets to a newly formed LLC. Capossela, Cohen, Engelson & Colman, P.C. changed its name to C.C.E. & C., P.C. and transferred its assets to a newly formed LLC which began doing business under the name Capossela, Cohen, Engelson & Colman, LLC. The plaintiff, a shareholder and former employee of the PC, asserted various causes of action against the PC, the new LLC, and individual shareholders of the PC based upon the alleged failure of the defendants to make certain buy-out payments owed to the plaintiff following his departure from the PC. This opinion dealt with the plaintiff's request that the court enjoin the dissolution of the PC or appoint a receiver for winding up the PC's affairs. As the basis for such relief, the plaintiff asserted that the PC's change of name, sale of assets, and proposed dissolution had not received shareholder approval as required by the corporate statutes. The court disagreed and denied the request for injunctive relief or appointment of a receiver. A subsequent related opinion appears at 1999 WL 171404 (Conn. Super. March 1, 1999).

**Kansas Public Employees Retirement System v. Reimer & Kroger Associates, Inc.**, 60 F.3d 1304 (8th Cir. 1995).
While the focus of this case is not on LLC issues, the court does discuss in a footnote the effect of the conversion of a partnership to an LLC. A law firm that had converted from a partnership to an LLC under Missouri law sought to intervene in a lawsuit brought by the Kansas Public Employees Retirement System (KPERS) against various defendants. KPERS had previously notified the law firm that it intended to add it as a defendant in the instant case pending in federal court but later indicated that it intended to assert its claims against the law firm in a separate suit to be filed in state court. The law firm then sought to intervene in the suit in federal court. KPERS attempted to make an issue out of the fact that its correspondence and draft pleadings all referred to the law firm as a partnership rather than an LLC. The court referred to this distinction as "disingenuous" and noted that, under the Missouri conversion provisions, the LLC acquired all of the former partnership's "rights, privileges, powers, debts, [and] causes of action" and was burdened with all of its "duties, debts, liens, liabilities and rights of creditors." Additionally, the law firm had admitted its responsibility for paying any judgment against the former partnership.
Successor Liability

Schawk, Inc. v. City Brewing Co., LLC, No. 02-1833, 2003 WL 1563767 (Wis.App. March 27, 2003) (stating that, while Wisconsin courts typically apply successor liability rules to corporate entities, the court saw no reason why the principles of successor liability should not apply to LLCs such as the purchasing LLC in question, and concluding that the plaintiff failed to place in dispute any of the exceptions to the general rule against successor liability so as to avoid summary judgment).


Leber v. Universal Music and Video Distribution, Inc., 225 F.Supp.2d 928(S.D. Ill. 2002). The plaintiffs sued for breach of a collective bargaining agreement of Universal Music and Video Distribution, Inc. (“Universal”) and sought to hold an LLC in which Universal was a member and the LLC’s other corporate member (“Panasonic”) liable under various theories, including successor liability. The court applied successor liability principles as they have developed in the labor law context and concluded that neither the LLC nor Panasonic were the alter egos of Universal.


Crane Construction Company v. Klaus Masonry, LLC, 114 F. Supp.2d 1116 (D. Kan. 2000). The court in this case acknowledged that corporate successor liability rules apply to other forms of business organizations and cited the LiButti case, in which the mere continuation doctrine was applied where the predecessor was a sole proprietorship and the successor an LLC. The court refused to apply the mere continuation doctrine to this case, in which a creditor of a deceased sole proprietor was attempting to impose liability on the LLC formed to carry on the business after the sole proprietor’s death by the sole proprietor’s son.

Kanefield v. SP Distributing Company, L.L.C., 25 S.W.3d 492 (Mo. App. 2000). A sole proprietor entered an agreement with an employee, the plaintiff in the case, whereby the proprietor agreed to give the plaintiff 10% of the proceeds from the sale of the business if the plaintiff was employed at the time of the sale. After the proprietor died, his wife operated the business as a partnership in dual capacities, as the surviving spouse and trustee of a family trust. Later the wife transferred portions of her interest to two sons, and the partners converted the partnership to an LLC. The next year, the LLC terminated the plaintiff’s employment. The plaintiff sought a declaratory judgment, breach of contract damages, and imposition of an equitable lien. Later the plaintiff added a count of fraudulent conveyance. The trial court dismissed all these claims, and the plaintiff appealed. The court of appeals found that the plaintiff alleged facts that would support the existence of a contract either under successor liability theories or based upon an agreement with the wife after the proprietor’s death. The plaintiff alleged that the defendants breached the contract by terminating his employment, failing to pay him his share of the net proceeds upon sale of the business, and repudiating the agreement and offering the business for further sale. The defendants argued that the conversion of the partnership to an LLC was not a sale of the business, but the court stated that there were nevertheless disputes regarding the allegations of breach of contract. The court found that the plaintiff failed to state a claim for fraudulent conveyance in that neither the addition of two partners nor the subsequent conversion to an LLC changed the plaintiff’s rights or put the assets of the business beyond his reach. Finally, the court determined that the plaintiff had stated a cause of action for an equitable lien.

Baker v. David A. Dorfman, P.L.L.C., No. 99Civ.9385(DLC), 2000 WL 1010285 (S.D. N.Y. July 21, 2000), aff’d, 232 F.3d 121 (2dg Cir. 2000). Baker obtained a judgment against David Dorfman for legal malpractice and fraud. Subsequently, Dorfman formed a professional LLC and began to operate his law practice through the PLLC. In this action, Baker sought to hold the PLLC liable on the judgment against Dorfman as a successor in interest. The court concluded that the PLLC was liable as a successor in interest. The court found no reason to doubt that the “traditional rules of successor liability are applicable to limited liability companies.” The court also commented that the facts of the case supported an inference that Dorfman formed the LLC as a fraudulent attempt to escape his obligation to Baker. The court of appeals affirmed the district court’s judgment imposing successor liability in a per curiam opinion in which it praised the lower court’s
well-reasoned and thorough” opinion. The court of appeals noted in particular its agreement with the lower court’s application of successor liability “regardless of whether the predecessor or successor organization was a corporation or some other form of business organization.” The court noted in a footnote that, because the defendants never raised the issue, it expressed no opinion regarding the extent to which New York income exemptions might limit the application of successor liability where the alleged successor is a single-member company formerly operated as a sole proprietorship.

*LiButti v. United States*, 178 F.3d 114 (2nd Cir. 1999).

In this tax case, the court determined that a Kentucky LLC was not subject to personal or in rem jurisdiction of the New York court under a minimum contacts analysis. The court also rejected an alternative argument by the IRS based upon Rule 25(c) and Rule 71 of the Federal Rules of Civil Procedure. The exercise of personal jurisdiction under this approach required that the LLC be a successor in interest to a sole proprietorship under New Jersey successor liability law. The court recited the four exceptions to non-liability where a company transfers assets to another company under New Jersey law and noted that the rule and its exceptions apply regardless of whether the predecessor or successor organization is a corporation or some other form of business. The LLC did not fall into any of these exceptions.

MM. Attorney Liability, Disqualification

*Exposition Partner, L.L.P. v. King, Leblanc & Bland, L.L.P.*, 869 So.2d 934 (La.App. 2004) (declining to dismiss LLC member’s cause of action against law firm and lawyer that represented LLC because fraud and related causes of action did not depend upon attorney-client relationship, and concluding LLC’s law firm and lawyer were subject to court’s jurisdiction where lawyer formed LLC under Louisiana law, 50% of ownership of LLC was based in Louisiana, LLC’s registered office was in Louisiana, lawyer made at least three trips to Louisiana in representation of LLC and had many contacts by phone and letter, and reason for formation of LLC was to create secondary market for certificates to be issued from lawsuit in Louisiana).


Creditors of an LLC alleged that the LLC fraudulently assigned its assets for the purpose of rendering the LLC insolvent, defrauding the plaintiffs, and avoiding the LLC’s obligations to the plaintiffs. The court applied corporate law to conclude that the attorney for the LLC did not owe a fiduciary duty to creditors of the LLC. The court also determined that the 10% owner of the LLC did not state a cause of action for malpractice against the LLC’s attorney. Even if the 10% owner could be considered a client, said the court, he had not sufficiently alleged causation. The court had serious doubts as to whether an attorney for a “corporation” has a duty to the “corporate shareholders.” The court also concluded that the plaintiffs failed to state a cause of action for participating in a fraudulent conveyance. The court concluded that the simple act of representing a client in a transaction should not be sufficient to state a claim against an attorney unless the creditor is aware of particular facts that show the attorney counseled the client to engage in a fraud.


McLeod hired an attorney to assist him in forming an LLC with two other members. The attorney drafted the certificate of formation and an LLC agreement. The blanks regarding the contributions of the members were never completed, and McLeod sued the attorney for malpractice. The attorney had advised that the blanks regarding contributions be filled in. One of the other persons forming the LLC stated that he did not want to fill in the information regarding contributions, and the attorney advised that it was not necessary to include the information in the certificate of formation. The court cited the requirements of the Mississippi LLC act regarding formation of an LLC and maintenance of records regarding contributions. A record of contributions is required to be maintained at the LLC’s principal place of business unless the information is contained in the certificate of formation. The attorney’s summary judgment evidence included an affidavit from an expert on formation of LLCs who stated that the attorney met his duty by pointing out to the members that the contributions needed to be set out in writing. The expert stated that once the decision was made not to include the information in the documents filed with the Secretary of State, it was for the LLC itself to complete the document and maintain the record of contributions. McLeod failed to offer any evidence to create a fact issue, and the court upheld summary judgment in favor of the attorney.

The court upheld the trial court’s denial of a motion to disqualify the law firm representing the plaintiffs. The plaintiffs and the defendant entered an oral joint venture that resulted in the formation of a corporation and several LLCs to hold title to properties involved in the venture. The defendant claimed that the plaintiffs’ lawyer represented him and the entities in matters related to the litigation and should be disqualified. The lawyer had written numerous transmittal letters which were copied to the defendant stating that the lawyer did not represent the defendant and advising that the defendant have his own counsel. The trial court found the defendant’s testimony that he did not receive these letters was not credible. The defendant did not directly challenge this finding but argued that the letters showed that the lawyer represented the joint venture and the entities formed and, by extension, the defendant. The court of appeals found ample evidence to support the trial court’s implied findings supporting its denial of the disqualification motion. Finally, the court of appeals upheld the decision of the trial court to defer decision on whether the law firm should be disqualified because the lawyer representing the plaintiff was likely to be a witness at trial. The court found that the inquiries involved with respect to this issue were appropriately deferred to a later stage of the litigation.


The plaintiff LLC sought an order disqualifying the law firm representing the defendants on the grounds that the law firm represented an individual founder, manager, and (directly and through affiliates) majority owner of the LLC plaintiff on various matters including the negotiation of the operating agreement of the predecessor to the LLC plaintiff. The law firm claimed the operating agreement of the predecessor LLC bore no similarity to the operating agreement of the plaintiff LLC, but the court concluded the law firm’s representation of the individual involved matters substantially related to the issues in the case. The motion to disqualify was granted.


The plaintiffs and the debtor were investors who entered a joint venture agreement and formed an LLC to secure financing and manage a real estate project. The debtor was also the attorney for the LLC (referred to in the case as the joint venture) and a member of the management committee. The plaintiffs alleged that the debtor owed them a fiduciary duty as a co-venturer, management committee member, and attorney for the venture, and that his liability for the venture’s debt was non-dischargeable because it arose from a defalcation of fiduciary duty when he obligated the venture to loan amounts in excess of borrowing authorizations. The court found that there must be an express or technical trust, not merely a general fiduciary relationship like that arising out of an attorney-client, joint venture or partnership relationship. Additionally, the court found that the bankruptcy court erred in concluding a defalcation had occurred.


The court reversed dismissal of a suit by three LLC members against an attorney who provided services in connection with the formation and operation of the LLC and allegedly breached his fiduciary duty and duty of care by advancing the interests of the fourth member.


The court disqualified an attorney who represented a member of an LLC against the other members in a dispute arising out of their dental practice LLC. The court found that an attorney-client relationship had existed between the attorney and the defendant members and that the current representation of one of the members was adverse to the interests of the other three. The court rejected the attorney’s argument that the services were solely for the benefit of the LLC, pointing to the fact that the individual members paid for his services. The court stated that the attorney represented the individual interests of all of the members when he prepared the agreement to associate and the subsequent operating agreements.


An LLC mortgage company sued its manager and his wife, who was an LLC employee, for mismanagement and breach of fiduciary duty. The manager, who was also a member of the LLC, and his wife impleaded other members of the LLC, who were attorneys, and alleged legal malpractice against those members. The LLC’s business had originally been operated as a partnership, but the partnership converted to an LLC on the advice of partners who were attorneys. Neither the manager nor his wife were attorneys. The manager and his wife alleged that two of the attorney members were negligent in their capacities as counsel to them as follows: failing to inform them of the effect of a conversion from a partnership to an LLC; failing to inform them of the attorney partners’ potential personal gain in power in the new LLC (specifically, failing to inform them that the conversion would enable a majority of the members
of the LLC to approve certain matters without consent of the minority, such as dissolution and winding up, transfer of substantially all of the assets, and amendment of the articles of organization and operating agreement; failing to advise them of potential personal financial gain to the attorney partners due to the conversion; failing to advise them to seek separate counsel; failing to advise them as to conflicts of interest; failing to obtain their consent for having a business transaction with the client and serving as counsel to the client at the same time; and failing to give advice and obtain consent regarding the conflict of interest in writing. The manager and his wife alleged that the attorney members had provided legal services to them and the LLC or its predecessor on numerous occasions. The manager and his wife phrased the issue as whether a lawyer commits legal malpractice by entering into a business transaction with a client without the written consent required under the Louisiana Rules of Professional Conduct. The court found it unnecessary to reach the issue of whether the attorney members had an attorney-client relationship with the manager and his wife because, assuming there was an attorney-client relationship, the court found that the action was time-barred.


Two members of an LLC sued the third member for various acts of alleged wrongdoing. The plaintiffs also sued their lawyer for malpractice in connection with his representation of them in forming the LLC. The court found that the plaintiffs’ pleading adequately stated a cause of action against the lawyer. Specifically, the complaint alleged an attorney-client relationship and breach of the duty of care by making false representations regarding a bank account for the LLC, failure to ensure the bank account was established as represented to the clients, and performance of legal work that furthered the interests of the third member of the LLC and damaged the interests of the clients while being paid with the clients’ funds.


The malpractice claim in this case arose out of a complex series of transactions related to the purchase by the plaintiff of an interest in a professional wrestling league. No significant insight regarding LLCs is provided in the case, but LLCs were formed and utilized in the course of the transactions involved. In general, the case highlights the issues involved in multi-party representation and participation in business ventures related to the client’s business. The defendant lawyer represented his son and a business associate of his son’s in their quest to purchase a professional wrestling league. The son’s business associate ultimately sued the lawyer for legal malpractice, claiming that the defendant engaged in self-dealing, favoritism toward the son to the plaintiff’s detriment, failures to disclose, and multiple client representation without effective waiver of the conflicts of interest. Among the plaintiff’s complaints was the alleged failure of the lawyer to disclose his role in forming and investing in an LLC that played a part in a merchandising arrangement among the plaintiff, the lawyer’s son, and the wrestling league they sought to purchase. Ultimately, the court granted summary judgment in favor of the lawyer on the malpractice claim. A critical factor in the lawyer’s favor was a written engagement letter signed by the plaintiff that the court deemed a sufficient waiver of the conflicts of interest.


The plaintiffs brought this lawsuit after they lost a substantial amount of their investment in an LLC. The plaintiffs sued their investment advisor for securities fraud, and the plaintiffs asserted legal malpractice, breach of fiduciary duty, and negligent misrepresentation claims against the LLC’s lawyers. The plaintiffs alleged that the LLC’s lawyers were negligent in drafting an Offering Memorandum, misrepresenting and omitting various material facts, and in various acts and omissions related to efforts to deal with a prohibition imposed on one of the LLC’s managers that prevented his trading on the Chicago Board Options Exchange. In analyzing the plaintiff’s claims, the court spoke in corporate terms and relied on case law in the corporate context. The court held that there was no attorney-client relationship between the plaintiffs and the LLC’s lawyers, nor were the plaintiffs the intended beneficiaries of the attorney-client relationship between the lawyers and the LLC. Additionally, the plaintiffs failed to establish any other duty on the part of the lawyers to communicate accurate information to them. Thus, the plaintiffs failed to state a claim against the lawyers.

**NN. Attorney Client Privilege**

**Charter One Bank, F.S.B. v. Midtown Rochester, L.L.C.**, 738 N.Y.S.2d 179 (N.Y. Sup. 2002) (referring to LLC as corporation throughout discussion of whether attorney/client privilege attached to written communication between two LLC employees containing recitation of oral legal advice rendered by attorneys and concluding that this
“written communication between corporate employees for the purpose of facilitating the rendition of legal advice in the course of the professional relationship between the attorney and the corporate client” was privileged).

Segerstrom v. United States, 87 A.F.T.R.2d 2001-1153, 2001-1 USTC ¶ 50,315, 2001 WL 283805 (N.D. Cal. 2001) (finding documents relating to attorney’s representation of mother and son in estate planning matters, including assistance in formation of LLC, fell within legal representation, rather than “business advice” not protected by privilege, that certain non-privileged facts were protected because interwoven with privileged communications, and that communications with accountants and financial advisors were protected because they were intended to be in confidence for the purpose of assisting attorney in rendering legal services).


OO. Unauthorized Practice of Law

Columbus Bar Assoc. v. Verne, 788 N.E.2d 1064 (Ohio 2003) (holding that accountant’s advising clients regarding choice of business entity and drafting LLC articles of organization constituted unauthorized practice of law).

In re ICLNDS Notes Acquisition, LLC, 259 B.R. 289 (Bankr. N.D. Ohio 2001). An LLC manager of an LLC prepared and filed a Chapter 7 bankruptcy petition on behalf of the LLC. The court held that an LLC comes within the definition of a “person” under the Bankruptcy Code and is eligible to be a debtor, but an LLC must be represented by counsel like a corporation or a partnership. The court further concluded that a lay person who prepares a bankruptcy petition and schedules on behalf of an LLC is engaged in the unauthorized practice of law. The court thus dismissed the case.
2004 ABA ANNUAL MEETING

SECTION OF BUSINESS LAW

Case Law Developments for Partnerships, Limited Liability Companies and Limited Liability Partnerships

2004 CUMULATIVE

SURVEY OF DELAWARE CASE LAW

RELATING TO

ALTERNATIVE ENTITIES

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Wilmington, Delaware

June 22, 2004

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### APPENDIX - TABLE OF CASES
I. INTRODUCTION

In recent years, there has been a marked increase in the use of limited partnerships, limited liability companies, statutory trusts and other “alternative entities” (i.e., alternative to the traditional corporate form) in a wide variety of commercial transactions. This increased use has, in turn, given rise to a predictable increase in litigation involving alternative entities in the Delaware courts. As a result, the Delaware courts have developed a substantial body of case law addressing a broad spectrum of issues arising in the alternative entity context from the scope of the fiduciary duties of general partners in a limited partnership and issues arising upon the dissolution of a limited partnership to the rights of limited partners to inspect partnership books and records and the requirements and procedures for derivative actions involving alternative entities. In certain of these areas, such as partnership derivative actions, the Delaware courts have borrowed heavily from corporate precedents. In others, however, such as the modification of fiduciary duties, the courts have recognized -- and given effect to -- the differences between entities based primarily on principles of contract, such as partnerships, and the corporate form of entity, which is based primarily on a complex statutory framework. The body of law thereby developed, and continuing to develop, is and will be a valuable guide to practitioners regarding the legal effect of the various agreements and arrangements they are creating as they continue to use alternative entities in an increasing number of transactions. This outline summarizes the principal cases decided by the Delaware courts over the past several years relating to alternative entities. The outline is organized first by the type of alternative entity involved in the case and then, within each such classification, the cases are divided by the principal issues addressed. The current version of the outline is a cumulative survey and reflects an update of the prior year’s version to include cases decided during the last year.

II. LIMITED PARTNERSHIPS

A. Fiduciary Duties

1. Duties of General Partners

The Delaware courts have consistently held that a general partner of a Delaware limited partnership owes fiduciary duties to the limited partnership and its limited partners. The courts have also held that these duties extend to the directors of a corporate general partner. As a general matter, the fiduciary duties of the general partner to limited partners have been held to be comparable to the fiduciary duties owed by directors of a Delaware corporation to its shareholders. Thus, unless modified by contract as described below, a general partner of a Delaware limited partnership owes the limited partners both a duty of loyalty and a duty of care. By the same token, absent a conflict of interest or other disqualifying factor, general partners of a limited partnership would be entitled to the benefits of the business judgment rule in connection with the management of a limited partnership.


Plaintiff was a noteholder of a Delaware limited partnership. Following the partnership’s default on the notes, plaintiff brought suit against the partnership and its general partner claiming, among other things, that the partnership and the general partner breached a fiduciary duty to creditors by failing timely to pursue a valuable litigation claim and by making false and misleading statements while soliciting the noteholders for various consents and waivers. Defendants moved for dismissal or summary judgment with respect to plaintiff’s claims.

Plaintiff alleged that prior to the default on the notes the partnership engaged in a sham transaction to avoid a restriction in the partnership agreement that precluded the partnership from selling any property to an entity affiliated with the general partner. To circumvent this requirement, James Stroud (“Stroud”) and Jeffrey Beck (“Beck”), the owners of the...
entity that owned the general partner, caused such entity to sell the stock of the general partner to an entity owned by a friend and business associate. The partnership then sold four of its five properties to another entity controlled by Stroud and Beck and paid yet another entity owned by Stroud and Beck a brokerage fee of over $1 million for the sale. A limited partner filed suit challenging the sale of the four properties, which was subsequently settled, and as part of the settlement all claims of the limited partners of the partnership arising out of the transaction were released but the settlement did not expressly release claims brought on behalf of the partnership or the noteholders.

Plaintiff alleged that when the partnership became insolvent between February and July of 2001, the general partner owed a fiduciary duty to the noteholders to preserve and pursue whatever non-operating assets the partnership possessed in an effort to ensure the maximum return to creditors and claimed that the general partner breached this fiduciary duty to the noteholders by failing to bring a claim challenging the sale of the properties before the statute of limitations with respect to such claim expired in September, 2001. Defendants contended that plaintiff’s claim was barred by the statute of limitations. Plaintiff argued that the wrong alleged in his complaint was the failure of the general partner to bring a claim challenging the sale of the properties, not the sale itself. The court rejected plaintiff’s argument, finding that the claim arose when the sale occurred. Plaintiff further argued that his claim did not arise until the partnership’s fiduciary duty to its creditors arose upon the insolvency of the partnership. The court rejected this claim as well but did acknowledge that a fiduciary duty to the creditors of the partnership arose when the partnership became insolvent. While the court did not cite any precedent for its conclusion that a fiduciary duty was owed to creditors of the partnership, it did state that the noteholders did not have standing to allege breach of fiduciary duty prior to the partnership coming within the “vicinity of insolvency,” which is an apparent reference to corporate precedent in which the Court of Chancery had held that directors of a Delaware corporation operating “in the vicinity of insolvency” owed their primary fiduciary duty to the corporate enterprise, which encompasses creditors as well as stockholders, rather to stockholders alone. (See Credit Lyonnais Bank Nederland v. Pathe Communications Corp., C.A. 12150 (Del. Ch. Dec. 30, 1991).

Plaintiff also alleged that the general partner breached its fiduciary duty of disclosure to the noteholders by failing to disclose material information to the noteholders when following the insolvency of the partnership the general partners sought the consent of the noteholders to the sale of the final property owned by the partnership and the noteholders’ waiver or release of all claims relating to the notes as a condition to a liquidating distribution by the partnership. The court stated that the general partner presumably was obligated to act with complete candor when seeking noteholder action while the partnership was insolvent and held that the existence of a fiduciary duty to disclose was sufficiently plausible to survive defendants’ motion to dismiss. After analyzing the specific aspects of the disclosure claims, the court granted defendants’ motion for dismissal or summary judgment with respect to certain aspects of the claims and denied defendant’s motion with respect to the other aspects of the claims based on the particular facts associated with each claim.


Plaintiff, a public unitholder of a Delaware limited partnership, brought an action on his own behalf and on behalf of the other public unitholders for breach of fiduciary duty against the general partner, the board of directors of the general partner and Salomon Smith Barney, Inc., the parent of the general partner, in connection with a restructuring of the partnership’s finances that occurred in 2000. The general partner and its board of directors approved the restructuring based on the recommendation of a special committee and thereafter a majority of the public unitholders of the partnership voted to approve the restructuring. Plaintiff claimed the restructuring was a self-dealing transaction that did not comport with either the fair process or fair price elements of the standard of entire fairness. Defendants moved to dismiss on the grounds that plaintiff’s complaint failed to state a claim for breach of fiduciary duty because it did not articulate a theory or basis for finding that the restructuring was unfair to plaintiff or the other unitholders or that the restructuring was even properly the subject of an entire fairness analysis.
The court stated that plaintiff had the burden of rebutting the presumption under the business judgment rule that defendants acted on an informed basis and in the honest belief that their actions were in the best interests of the partnership and the limited partners by pleading sufficient facts showing that defendants appeared on both sides of the restructuring or derived a personal benefit from the restructuring in the sense of self-dealing. The court held that plaintiff’s complaint failed to meet this burden because it only made conclusory claims about defendants’ interest in the restructuring. Plaintiff claimed that the restructuring would permit Salomon to sell the general partner and therefore cease to provide financial support to the partnership. The court found, however, that Salomon had no legal or equitable duty to provide financial support beyond the contractual terms it had satisfied in the restructuring and that the fact that the restructuring, by stabilizing the partnership’s financial situation, might have permitted Salomon to sell the general partner did not form the basis for a claim for breach of the duty of loyalty. Plaintiff also asserted claims that related to the formation of the partnership in 1996 and the management of the partnership from 1996 to the restructuring. The court found that none of these allegations stated a claim for breach of the duty of loyalty in connection with the restructuring, stating that certain of the claims were barred by a judgment of the federal district court in an earlier lawsuit brought by plaintiff and that others of these claims could only be brought derivatively on behalf of the partnership, which plaintiff refused to do. Plaintiff also claimed that the restructuring should have happened years earlier but was delayed by defendants in order to avoid alerting the public unitholders to the fact that the finances of the partnership had been impractically structured until the limitations governing claims under the federal securities laws had elapsed. The court found this claim also to be either one for mismanagement that was required to be brought derivatively or one barred by the federal district court judgment. The court thus held that plaintiff’s complaint did not state a claim upon which relief can be granted in regard to the substance of the restructuring.

Plaintiff also alleged claims for breach of the duty of disclosure in connection with the proxy materials and other public statements relating to the restructuring. While the court stated that a few of the claims had at least colorable merit, the court concluded that these claims must be dismissed as well because no possible relief with respect to such claims was available to plaintiff or the putative class. The court stated that it was too late to provide equitable or injunctive relief in the form of corrective or supplemental disclosure in connection with the vote taken in 2000 and noted that plaintiff had been aware of the disclosure claims well before the vote to approve the restructuring was held. The court also stated that the other possible form of equitable relief – an order of rescission – was impracticable in this setting and had not been requested by plaintiff. The court further stated that it would not award actual or nominal monetary damages to plaintiff or the class because they had not suffered any economic injury as a result of the vote to approve the restructuring. The court thus granted defendants’ motion to dismiss.

c.  


Limited partners sued the general partners, which were affiliated with one another, of a Delaware limited partnership for breach of fiduciary duty and breach of contract and sued an affiliate of the general partners for aiding and abetting breaches of fiduciary duty. The plaintiffs’ claims stemmed from actions taken by the general partners in connection with an offering of preferred units having superior claims to capital and income distributions, including the amendment of the partnership agreement without limited partner approval to subordinate the contractual distribution rights of the existing limited partners to those new claims and a subsequent sale of partnership property also without limited partner approval. Before the court were cross-motions for partial summary judgment. (See Sections II.I. and II.K. below for discussions of other aspects of this case.)

The court denied the defendants’ motion for summary judgment on the plaintiffs’ claim that the general partners’ affiliate aided and abetted breaches of fiduciary duty. The court stated that in order to sustain their claim, the plaintiffs must show the existence of a fiduciary relationship, a breach of duty by the general partners, the affiliate’s knowing participation in the breach and damages resulting from the concerted action. The court found that because the affiliate was formed by the general partners’ parent for the specific purpose of acting as the instrumentality through with the parent carried out its purchase of
preferred units and the only other investors in the affiliate were officers and directors of the general partners, the general partners’ knowledge regarding the offering could be fairly imputed to the affiliate and a triable issue existed regarding the affiliate’s responsibility for the plaintiffs’ injuries.

The court ordered the parties to submit an order conforming to the court’s denial of all motions for summary judgment, except as to the plaintiffs’ claim that the general partners breached the partnership agreement by purporting to amend it without limited partner approval as to which the court granted summary judgment to the plaintiffs as to liability. (See discussion in Section II.K. below.) In a later ruling in the Nantucket case that arose from the parties’ dispute over the form of such order, the court denied the defendants’ request to amend their answer to raise the statutory defense afforded by Section 17-1101(d)(1) of the Delaware Revised Uniform Limited Partnership Act, Del. Code Ann. tit. 6 §§ 17-101 et seq. (“DRULPA”). The defendants had argued that the entry of a summary judgment order as to their liability would preclude them from relying on the statutory defense that they believed in good faith that their actions were authorized by the partnership agreement and that they should be exculpated from liability as to the claims for breach of the partnership agreement and breach of fiduciary duty. The defendants had not specifically raised this defense at any prior stage of the proceedings but asserted that the denials of accusations of bad faith contained in their answer and their contention that they acted in conformity with the partnership agreement gave the plaintiffs adequate notice that the statutory defense was present in the case. The court had initially concluded that the defendants should have asserted the statutory defense earlier in the case and upon this renewed request of the defendants to raise the statutory defense at trial, the court again denied the request. The court held that the statutory defense provided by Section 17-1101(d)(1) of DRULPA clearly fell within the ambit of Court of Chancery Rule 8(c), which required a defendant responding to a complaint to set forth any matter constituting an avoidance or affirmative defense, and that on its face Section 17-1101(d)(1) itself seemed to require a showing by the defendant that it acted in good faith reliance on the partnership agreement if it was to avoid liability. The court held that putting the burden on the defendants to assert the statutory defense in the early stages of a case served the interests of fairness and efficiency and permitted the early termination of cases that fall within its protective ambit.


A limited partner filed class and derivative claims for breach of fiduciary duty and breach of contract against the general partners of three Delaware limited partnerships and certain “upstream” entities and individuals affiliated with such general partners. The partnerships were formed for the purposes of acquiring, operating and eventually selling commercial and industrial real estate. In 1993, the general partners sought the consent of the limited partners for certain amendments to the partnership agreements that allowed the partnerships to continue holding all of their real estate investments rather than liquidating such holdings by 1993 as the partnership agreement contemplated. In 1997, the general partners sought the consent of the limited partners for certain amendments to the partnership agreements that allowed the partnerships to continue holding all of their real estate investments rather than liquidating such holdings by 1993 as the partnership agreement contemplated. In 1997, the general partners sought a consent for approval of dissolution of the partnerships from the limited partners. Under the terms of the consent solicitations, if the limited partners consented to the dissolutions, they also would be deemed to have consented to any transaction undertaken to accomplish the liquidation and winding up of the partnerships and would not be entitled to disapprove of any such transactions, including any that involved the participation or involvement of the general partners. Plaintiff instituted a suit in Pennsylvania to enjoin the 1997 consent solicitations. However, a majority of the limited partners approved them and the general partners began to seek purchasers for the partnership’s properties. In the present action, plaintiff alleged various injuries to itself and other similarly situated limited partners resulting from the general partners’ efforts to sell the partnership’s properties.

This decision involved a motion to dismiss plaintiff’s claims against the “upstream” entities and individuals affiliated with the general partners. The moving defendants asserted that they were not in a fiduciary relationship with the partnerships or their limited partners and, therefore, did not owe them any fiduciary duties. In denying the motion with respect to the breach of fiduciary duty claims, the court stated that while mere ownership of a general
partner does not result in the establishment of a fiduciary relationship, affiliates of a
general partner who exercise control over the partnership’s property may find themselves
owing fiduciary duties to both the partnership and its limited partners. The court held that
plaintiff’s allegations of self-dealing and control over the partnerships and their properties
satisfied the standards set forth in Wallace v. Wood, discussed below, for imposing
potential fiduciary liability on the moving defendants.

Because the moving defendants were not parties to the consent solicitations on which
plaintiff based its breach of contract claim but merely executed such solicitations in their
capacities as representatives of a signatory, the court separately dismissed the breach of
contract claim against them.


In another action in a series of related cases, Cantor Fitzgerald, L.P., and its general
partner, sought a declaratory judgment that an exchange offer with respect to the limited
partners’ partnership units and a series of amendments to the partnership agreement did not
constitute a breach of the general partner’s fiduciary duty nor violate Delaware law and that
the amendments were valid. This decision addressed a motion to dismiss defendants’
counterclaims and a motion for judgment on the pleadings. The court denied the motion to
dismiss and entered a declaratory judgment order applicable to this action and certain
related actions (See Section II.A.3).

In its analysis of the exchange offer and the amendments, the court noted that the
partnership agreement defined the rights and duties owed by one party to another and
DRULPA merely provided the default rules with respect to fiduciary duty where the
partnership agreement was silent on the matter. Following this principle, the court
evaluated the conduct of the partnership and the general partner against the provisions of
the partnership agreement.

The exchange offer allowed limited partners to exchange their partnership units for a new
class of partnership units that would give the holder a right to a distribution of shares in a
subsidiary of the partnership. The court found that the exchange offer was structured as a
distribution of partnership property and because the partnership agreement permitted the
partnership to distribute partnership property to the limited partners, the exchange offer in
concept did not violate the provisions of the partnership agreement and, therefore, was not
a breach of the general partner’s fiduciary duty of loyalty.

The court also held that the amendments were facially valid and the amendment process
did not violate the partnership agreement and did not constitute a violation of the duty of
loyalty. The court rejected defendants’ argument that the amendments improperly
extinguished certain fiduciary duties owed by the general partner by giving the general
partner the right to take certain actions in its sole discretion. Noting the established
principle that the parties to a partnership agreement may set the duties, or lack thereof,
owed by one party to another by contract, the court found that the partnership agreement,
as amended, provided that although any particular provision may grant the general partner
authority to act in its sole discretion, the general partner’s actions remained subject to the
requirement that the general partner abide by its duty of loyalty and exercise good faith in
making all determinations. With respect to the enactment of amendments, the partnership
agreement required a two-thirds vote of all partners in favor of an amendment in the case of
an amendment that applied in a substantially similar manner to all classes of partnership
units and a two-thirds vote of each affected class in the case of all other amendments. The
court found that the amendments approved by the limited partners applied to all the limited
partners in a substantially similar manner and, thus, held that a two-thirds vote of all
partners was sufficient. The court rejected defendants’ contention that conditioning
participation in the exchange offer on approving the amendments constituted vote buying
or coercion and found that the limited partners were free at all times to weigh the benefits
and the costs of the transaction and to reject the exchange offer and vote against the
amendments if that result was their best option.

Although the court found the amendments to be facially valid, it withheld ruling on
defendants’ arguments that one amendment improperly subjected the defendants to
violation of the corporate opportunity doctrine and that certain terms of the amendments
violated the 1996 settlement agreement reached between the parties in resolution of their prior litigation. The court held that a determination on these arguments would have to await an attempted enforcement of the amendments by plaintiffs because the court could only judge the application of the amendments in specific factual settings, but the court noted that the parties’ future conduct must comply with the terms of the partnership agreement and the settlement agreement.


William Bron ("Bron") and Daniel Villanueva ("Villanueva") joined together to raise a private equity fund (the "Fund"). In establishing the Fund, Bron and Villanueva formed a Delaware limited partnership to serve as the vehicle for the Fund, a Delaware limited partnership to serve as the general partner of the Fund (the "Partnership") and a Delaware corporation to serve as the investment manager of the Fund (the "Management Company").

A few years after establishing the Fund, Bron and Villanueva brought Jan Juran ("Juran") into their business. Bron, Villanueva and Juran entered into an employment agreement (the "Employment Agreement") making Juran an employee of the Management Company and entered an amended and restated partnership agreement of the Partnership (the "Partnership Agreement") giving Juran a general partner interest and a limited partner interest in the Partnership. In addition, Juran became a stockholder of the Management Company with Bron and Villanueva. After working together for a period of time, a personality conflict developed between Bron and Juran. In light of this conflict and the fact that the Employment Agreement required a unanimous vote of Bron and Villanueva to terminate Juran, Bron and Villanueva secretly entered into a stockholders’ voting agreement that provided that they would both vote their shares of stock of the Management Company in favor of Juran’s termination as an employee of the Management Company if either of them wished to terminate Juran. After a heated argument between Bron and Juran, Bron and Villanueva signed a letter terminating Juran’s employment. Upon the termination of his employment, Juran was automatically converted from a general partner in the Partnership to a ‘special limited partner’ and was required to sell his stock in the Management Company back to the Management Company.

Following his termination, Juran brought this action alleging a myriad of claims against Bron and Villanueva and their affiliated entities including fraudulent inducement, breach of fiduciary duties and breach of contract. With respect to Juran’s allegation that Bron and Villanueva fraudulently induced him to enter into the Employment Agreement and the Partnership Agreement, the court denied the claims, which were governed by California law, because Juran failed to show that Bron or Villanueva had made a fraudulent misrepresentation or omission that satisfied the elements of either common law fraud or statutory fraud. With respect to Juran’s breach of fiduciary duty claims, Juran claimed that Bron and Villanueva breached their fiduciary duties by, among other things, entering into the voting agreement. In evaluating Juran’s claims, the court first noted that, under Riblet Products Corp. v. Nagy, 683 A.2d 37 (Del. 1996), a shareholder and/or partner who is also an employee is only owed fiduciary duties in his capacity as a shareholder and/or partner and is not owed fiduciary duties in his capacity as an employee. In this case, the court found that the voting agreement between Bron and Villanueva did not constitute culpable conduct and held that no fiduciary duties owed to Juran were violated by Bron and Villanueva in entering into the voting agreement. Juran’s breach of contract claims involved the nonpayment of various fees, bonuses and distributions that Juran believed he was owed under the Employment Agreement and the Partnership Agreement. The court made individual rulings regarding the specific disputed amounts. One of the disputed amounts involved an amount retained from a distribution to Juran by the Partnership as a reserve to cover any potential future exercise of the “claw-back” provisions in the Fund’s partnership agreement. The defendants argued that they were entitled to retain reserves from distributions in their “sole discretion” under the Partnership Agreement. The court stated that “sole discretion” does not always mean unfettered discretion and found that the defendants’ sole discretion had been exercised in bad faith because no bona fide analysis was used to determine the amount of the reserve. Juran was disproportionately affected by the retention of the reserve and no mechanism was instituted for Juran to ever recover the reserved amount. The court consequently held that Juran was entitled to receive the amount that had been reserved by Bron and Villanueva from the partnership distribution.
g.  **Wallace v. Wood,** C.A. No. 15731 (Del. Ch. Oct. 12, 1999)

Limited partners brought suit alleging, among other things, that the corporate general partner of a Delaware limited partnership, as well as its parent corporations and affiliates and officers of the general partner, breached fiduciary duties owed to the limited partners and the limited partnership. Plaintiffs claimed that the defendants used partnership funds to establish business entities which defendants wrongfully used to circumvent a provision in the partnership agreement prohibiting the limited partnership from incurring debt in excess of a specified amount. In denying defendants’ motion to dismiss, the court rejected defendants’ argument that the parent corporations, affiliates and officers of the corporate general partner did not owe fiduciary duties to the limited partners and the limited partnership and applied the parameters of fiduciary duties owed by the directors of a general partner enunciated in **In re USACafes, L.P. Litig.** (discussed below in this Section II.A.1) to plaintiffs’ claims. The court found that plaintiffs alleged adequate specific facts to support their claims that all defendants utilized partnership assets which they controlled to enrich themselves at the expense of plaintiffs and noted that precedent existed in Delaware for the extension of fiduciary duties to defendants similarly situated to the parent corporations and affiliates of the general partner. The court also declined to dismiss plaintiffs’ claim that defendants aided and abetted the general partner’s breach of its fiduciary duties. The court determined that it was more appropriate to carefully address this alternative argument, which on its face seems inconsistent with the claim that the general partners’ officers, parents and affiliates breached fiduciary duties themselves because it assumes they are “non-fiduciaries,” after fact finding had occurred rather than at the stage of proceedings involving a pre-trial dispositive motion.

h.  **In re Boston Celtics Ltd. P’ship Shareholders Litig.,** C.A. No. 16511 (Del. Ch. Aug. 6, 1999)

Plaintiff limited partners filed suit challenging the reorganization of a Delaware limited partnership into two new limited partnerships, contending that the corporate general partner and its directors engaged in a self-interested transaction and breached their fiduciary duty of loyalty by approving the reorganization which was the result of an unfair process and produced unfair terms. The defendants filed a motion to dismiss for failure to state a claim. The court applied the law regarding the fiduciary duties of a general partner and the business judgment rule to the actions of the defendants challenged by plaintiffs in each of their claims. In its discussion of fiduciary duties, the court confirmed the well settled principle that, unless limited by the partnership agreement, a general partner and the directors of a corporate general partner who control the partnership owe fiduciary duties to the limited partners of the partnership they control, similar to those duties that a corporate director owes to shareholders. The court also noted, however, that the actions of a general partner are generally protected by the business judgment rule. The plaintiffs had the burden of rebutting the presumption created by the business judgment rule -- that the defendants acted on an informed basis and in the honest belief that they acted in the best interest of the partnership and the limited partners. According to the court, when alleging a breach of the duty of loyalty, plaintiffs must sufficiently plead that the general partner appeared on both sides of a transaction or derived an improper personal benefit from a transaction, i.e. engaged in self-dealing, to rebut the presumption afforded by the business judgment rule. The plaintiffs had the burden of rebutting the presumption created by the business judgment rule -- that the defendants acted on an informed basis and in the honest belief that they acted in the best interest of the partnership and the limited partners. According to the court, when alleging a breach of the duty of loyalty, plaintiffs must sufficiently plead that the general partner appeared on both sides of a transaction or derived an improper personal benefit from a transaction, i.e. engaged in self-dealing, to rebut the presumption afforded by the business judgment rule. Also, when asserting a claim regarding the unfairness of a transaction, a plaintiff must also plead specific examples of misconduct that demonstrate the alleged unfairness. If a plaintiff satisfies this burden, then the general partner must prove the “entire fairness” of the challenged transaction by establishing that it was the result of both fair dealing and fair price.

Upon application of the foregoing principles, the court ruled that the unfairness of the reorganization and defendants’ self-interest therein as alleged by plaintiffs as well as plaintiffs’ allegation of a breach of fiduciary duties owed by the general partner and its directors to the limited partners were sufficiently pleaded. However, the court dismissed certain claims made by plaintiffs relating to the alleged dilution of the plaintiffs’ equity interests and the alleged “freeze out” purpose of the reorganization due to insufficient pleading.
i. **Dean v. Dick**, C.A. No. 16566 (Del. Ch. June 10, 1999)

Notwithstanding the fact that the court found that demand was excused in connection with defendant’s derivative claims (see *Dean* discussed in Section II.H.2.), the court dismissed all breach of fiduciary duty counterclaims brought by the defendant limited partner against plaintiff, the sole owner of the general partner of a limited partnership. The court analyzed each counterclaim to determine whether the protections of the business judgment rule applied to the general partner’s actions and whether each counterclaim survived scrutiny upon application of the rule. In regard to defendant’s claim that the general partner’s sale of the limited partnership’s primary asset for a price below market value amounted to gross negligence, the court stated that the decision when to sell and at what price was well within the general partner’s business judgment and it did not find the general partner’s decision so egregious as to warrant second-guessing that judgment in contravention of the business judgment rule. Similarly, the court held the general partner’s actions regarding the maintenance of the property’s value and vacancy levels represented decisions protected by the business judgment rule. The court also dismissed defendant’s claim that the general partner’s decision to refinance partnership debt was a breach of fiduciary duty because the court found defendant’s allegation that the terms of new financing secured by defendant for the partnership were more favorable to be improperly vague.


In one of a series of related cases that arose in connection with disputes between Cantor Fitzgerald, L.P., a leading inter-dealer and institutional broker of United States Treasury securities and other governmental securities, and several of its partners (see also Section II.A.3), the court addressed, on cross motions for summary judgment, the construction of a transfer restriction in the limited partnership agreement. The provision at issue provided, in relevant part, that no partner could transfer any of its units other than by a sale to the partnership in accordance with the partnership agreement unless the partner had received the written consent of the managing general partner “which consent may be withheld for any reason (or no reason whatsoever) in the sole and absolute discretion of the managing general partner.” In interpreting the transfer restriction, the court first noted that it provided a reasonable restraint on transfer of shares for the purpose of protecting the interest of the partnership and its limited partners’ partnership common interests. It continued, however, that, as a matter of equity, the managing general partner could not use, adversely to the interests of a partner seeking to transfer shares, the power to restrict such a transfer for the sole purpose of protecting or advancing the interests of certain limited partners or general partners in matters unrelated to their partnership interests. The court based its holding on the implied covenant of good faith and fair dealing inherent in every contract and observed that a self-interested invocation of the transfer restriction would constitute a violation by the managing general partner of such covenant. The court concluded that the language at issue removed the burden from the general partner of showing good cause when a genuine dispute arose, but added that where the managing general partner favored the interest of one partner over another for reasons unrelated to the partnership such action would be “contrary to the managing general partner’s duty of loyalty to all limited partners equally and to all partners and their common interest in the partnership itself.”


In sanctioning the removal of a general partner by the limited partners in accordance with the partnership agreement, the court expounded on the general partner’s relationship to the limited partnership and the limited partners, stating “[t]he gravamen of the General Partner’s duty to the Limited Partners and to [the partnership] itself is the obligation of loyalty to the enterprise. This duty, absent contractual modification parallels that of a corporation’s director.”


In dismissing a breach of fiduciary duty claim brought by the limited partners against the general partners in Superior Court for lack of subject matter jurisdiction, the court held that
“[t]he duties of general to limited partners are directly analogous to the fiduciary duties arising in a corporate organization.”


A limited partner brought suit challenging the conversion of the limited partnership into a corporation, contending the two general partners of the limited partnership breached their fiduciary duties in the course of the restructuring. A plan proposed by one general partner to convert the limited partnership into a corporation was approved by an independent committee and judged to be fair to all parties by an independent financial analyst, even though the analyst’s opinion was based on unverified assumptions and projections provided by the other general partner. The limited partners approved the plan at a subsequent special meeting.

In response to a motion to dismiss by the defendants for failure to state a claim, the court ruled that the apparent unfairness and self-interest in the transaction alleged by the plaintiff were sufficient to state a claim for breach of the fiduciary duties of loyalty and fair dealing but that the plaintiff had failed to adequately state a claim for breach of the duty of care since its allegations did not approach the requisite gross negligence standard.

n. *In re USACafes, L.P. Litig.*, 600 A.2d 43 (Del. Ch. 1991)

The court applied principles of trust law to hold that the directors of a corporate general partner owed fiduciary duties to the limited partnership and its limited partners. The court went on to hold that the duties owed to the partnership were in the nature of the duty of loyalty.


The court held that even though a proposed non-pro rata liquidating distribution by the liquidating partner violated the terms of the partnership agreement (and was consequently unenforceable), it would not constitute of a breach of fiduciary duty if the proposal were made in good faith and in the best interests of the partnership.


The court held that under the Uniform Partnership Act and the Uniform Limited Partnership Act (both of which had been adopted in Colorado and Delaware), it was clear that the general partners in a Colorado limited partnership owed a fiduciary duty to the limited partners and that this duty was comparable to the fiduciary duty owed by corporate directors to shareholders.

2. **Contractual Modification of Fiduciary Duties**

As noted above, the fiduciary duties of a general partner of a Delaware limited partnership to limited partners have been analogized to the fiduciary duties owed by directors of a Delaware corporation to shareholders. However, the duties of a general partner differ from those of a director in the following fundamental respect -- the fiduciary duties of a general partner can be varied by agreement while the fiduciary duties of a director cannot (although pursuant to Section 102(b)(7) of the Delaware General Corporation Law, *Del. Code Ann.* tit. 8 §§ 101 et seq. (the “DGCL”), a corporate charter may include a provision eliminating or limiting the personal liability of a director for monetary damages for breach of the fiduciary duty of care). Section 17-1101(d) of DRULPA, explicitly provides that the fiduciary duties of a partner or other person may be expanded or restricted by provisions in a partnership agreement. In a variety of settings, including conflict of interest transactions, the Delaware courts have expressly recognized the right of partners to modify traditional concepts of fiduciary duty by so providing in the partnership agreement. The Delaware courts recognition of the partners’ right to modify fiduciary duties by contract has given real meaning to the principle of freedom of contract and thereby materially increased the level of predictability in the enforcement of the complex business relationships set forth in many Delaware limited partnership agreements.


In this case involving certain defendants’ motion to dismiss for failure to state a claim upon which relief can be granted, the court addressed the defendants’ claim that the plaintiff’s claims for breach of fiduciary duty were time barred by a limitations provision in the
partnership agreement. (See Sections II.I. and II.J.2. below for discussions of other aspects of this case.) The limitations provision in the partnership agreement provided that an action could not be commenced under the partnership agreement unless the action was brought within six months after actions or circumstances giving rise to the cause of action occurred. The defendants argued that this provision included any claims brought by a limited partner including fiduciary duty claims. The court disagreed and found that the provision applied only to actions arising under the partnership agreement and not to actions for breach of fiduciary duty. The court found this reading consistent with the other provisions of the section of the partnership agreement that contained the limitations provision, which provisions were plainly related to the interpretation and enforcement of the partnership agreement and did not regulate the general partner’s duties. The court also held that even if the limitations provision were to be deemed ambiguous, the principle of *contra preferentum* would apply, and the court would resolve the ambiguities in favor of the plaintiff. Furthermore, the court held that while partners of a Delaware limited partnership are free to limit their fiduciary duties by contract, the parties must make plain their intention to do so and where there is no clear contractual language that preempts default fiduciary duty rules, courts will continue to apply such default rules. The court found no clear intention to so limit fiduciary duties in the partnership agreement in this case.


This case represents, as the court noted, yet another in which a general partner of a limited partnership contended that the partnership agreement eliminated any applicable default principles of fiduciary duty. Plaintiffs had alleged that one of the defendants, Carl Icahn, had acquired the general partner, used the general partner to make a rights offering to enable another related defendant to acquire a majority of the partnership’s units to insulate the general partner from removal, cut off all distributions so that Icahn could devote available cash to investments in which other Icahn entities were interested, placed pressure on other unitholders to sell out, amended the partnership agreement to broaden the purposes of the partnership furthering his plan to use it as a financing agency for the investment goals of his other entities and bought out additional unitholders at an allegedly unfair price through a tender offer. According to plaintiffs, the effect of these actions was to leave the public unitholders of the partnership in a profitable partnership that paid no distributions so it could instead serve as a pool of available capital that Icahn could use for his own personal purposes and traded at a corresponding low value because the capital markets had recognized Icahn’s scheme. Defendants had countered that they acted in conformity with the contractually specified standards of conduct in the partnership agreement which displaced any default fiduciary duties and that, even if they had not, the complaint did not state a claim and in either case should be dismissed. First, the court noted that several claims were time barred. It then turned to defendants’ argument on the partnership agreement. To support their claim that the partnership agreement preempted default fiduciary duties, defendants noted that the partnership agreement provided that when the general partner was permitted to make a decision in its “sole discretion” it was entitled to consider only such interest and factors as it desired and had no duty or obligation to give any consideration to any interest of or factors affecting the partnership, the operating partnership or the record holders, and when the general partner was required to make a decision in good faith, it was to act under that express standard and not be subject to any other or different standards imposed by the partnership agreement or any other agreement contemplated therein. Defendants argued that the foregoing language was “utterly inconsistent” with the default duty of loyalty which would require that the general partner treat the limited partners fairly in any conflict situation. The court noted that the language at issue was similar to the contractual provisions interpreted in two recent cases *Gotham Partners L.P. v. Hallwood Realty Partners, L.P.*, as discussed below, and *Gelfman v. Weeden Investors, L.P.*, as discussed below. However, the court further noted that each of the agreements in those cases contained critical additional language providing that when the sole discretion standard applied, any other conflicting standard in the agreements, other contracts or under law (including the DRULPA) were to give way if it would interfere with the general partner’s freedom of action under the sole discretion standard. The court observed that this explicit override of default fiduciary duties existing under law was conspicuously absent from the partnership’s agreement and concluded that the omission
was of legal significance. The court reaffirmed that it would not be “tempted by the piteous pleas of limited partners who were seeking to escape the consequences of their own decisions to become investors in a partnership whose general partner has clearly exempted itself from traditional fiduciary duties” but added that just as investors must use due care, so must the drafter of a partnership agreement which was to supplant the operation of traditional fiduciary duties, and, given the great freedom afforded to such drafters and the reality that most publicly traded limited partnerships were governed by agreements drafted exclusively by the original general partner, it was fair to expect that restrictions on fiduciary duties be set forth clearly and unambiguously -- “not addressed coyly.” Applying this standard, the court concluded that the partnership agreement failed to preclude the operation of the fiduciary duty of loyalty with sufficient clarity, even in situations where the general partner had the contractual power to act in its sole discretion. The court bolstered its conclusion by noting that other provisions of the agreement implied that concepts of fiduciary duty would apply except where the agreement clearly modified them. Finally, the court noted that its interpretation was consistent with the disclosure provided to investors when the partnership was first formed. Nevertheless, the court granted defendants’ motion to dismiss because plaintiffs had failed to make non-conclusory allegations of fact that, if true, would support an inference that defendants breached their fiduciary duty of loyalty. However, the court dismissed plaintiffs’ claim without prejudice suspecting a viable claim could be pled.

c.  

This case involved defendants’ motion to dismiss a complaint filed against the general partner and certain members of its board of directors and top management alleging breach of the partnership agreement and breach of the fiduciary duty of loyalty. Plaintiffs were certain former employees and outside investors who owned partnership units and alleged that the general partner took a series of actions designed to concentrate ownership of the partnership in the hands of employees and management. The challenged actions included creation of a new class of callable partnership units, payment of various distributions of capital to enable certain favored investors to exercise an option to subscribe for additional callable units at book value, a proposed amendment to the partnership agreement that would cause the conversion of all original partnership units to callable units and give the general partner discretion to cash out certain units at book value, and institution of a compelled redemption program whereby callable units held by outside investors would be subject to redemption.

In analyzing plaintiffs’ claims, the court noted that the drafters of the partnership agreement clearly recognized the right afforded by Section 1101(d) of DRULPA to restrict the fiduciary duties that, as a default matter, govern the general partner and its directors in managing the partnership. However, the court found that the drafters had not swept away all default fiduciary duties but rather had eliminated some and kept others. Specifically, the court found that one provision of the partnership agreement provided that where the general partner was permitted or required to take action in its sole discretion, in good faith or under any other express standard, the general partner was to act under such express standard and would not be subject to any other conflicting standard imposed by the partnership agreement or agreements contemplated therein and further provided that any default standard of care or duty imposed under applicable law (including DRULPA) would be modified, waived or limited as required to permit the general partner to act in accordance with the authority granted to it under the partnership agreement. However, this same provision also included additional language limiting the waiver of default principles of fiduciary duty to actions taken by the general partner that did not constitute gross negligence or willful or wanton misconduct and were not reasonably believed by the general partner to be inconsistent with the overall purposes of the partnership. The court determined that while these provisions did not remove all of the fiduciary duties of the general partner, they did preclude the application of the traditional entire fairness standard that would otherwise apply to a conflict transaction and substituted a scienter-based standard of loyalty that required a showing of gross negligence, wanton or willful misconduct or action in bad faith. Based upon such analysis, the court found that while the payment of the capital distributions was proper under the terms of the partnership agreement, the facts as pled by plaintiffs supported an inference that the general partner’s
decision to implement the unit subscription plans was made in bad faith and violated the retained fiduciary duties. The sheer magnitude of the subscription plans, the book value offering price and the heavy concentration of ownership of partnership units placed in affiliates of the general partner led the court to reach this conclusion.

The court also rejected defendants’ motion to dismiss plaintiffs’ challenge to the conversion amendment and the compelled redemption program finding that they involved a clear conflict between affiliates of the general partner and outside investors who held partnership units and were not governed by the sole discretion standard. Rather, they were subject to the partnership agreement’s requirement that when resolving a conflict of interest the general partner was required to consider various factors affecting the partnership and the parties to the conflict and act in good faith in reaching a resolution. The court also found that the retained fiduciary duties referenced above applied to the general partner’s decision and held that the general partner’s acts supported an inference that the general partner acted in bad faith to transfer wealth from non-employee unitholders to its control persons and to grant power to itself to determine which unitholders would be deprived of their partnership interests at less than fair market value. Finally, the court held that the general partner’s decision to make the conversion amendment subject to the approval of all holders of the original partnership units did not provide a ratification safe harbor because the vote was controlled by the employee unitholders.


Plaintiff, a limited partner in the defendant partnership, brought suit challenging an acquisition by the partnership. The target company was owned by the same company that owned and controlled the general partner of the partnership. Plaintiff alleged that the transaction was substantively unfair to the partnership. The defendants moved to dismiss the complaint because the transaction had been approved pursuant to the terms of the partnership agreement which, they argued, supplanted the traditional default fiduciary duties which would otherwise apply to the challenged transaction. The court noted that the partnership agreement contained a provision on resolution of conflicts of interest and that provision provided that whenever a potential conflict of interest existed between the general partner or any of its affiliates on the one hand and the partnership, the operating companies or any partner on the other hand, any resolution of such conflict would be deemed permitted and would not constitute a breach of the partnership agreement or any duty stated or implied by law or equity if such transaction received “Special Approval.” Under the partnership agreement, “Special Approval” meant the approval of a majority of the members of the partnership’s conflict committee and the court noted that such approval was obtained for the challenged transaction. The court observed that it had previously articulated the standard that “principles of contract preempt fiduciary principles where the parties to a limited partnership have made their intentions to do so plain” and concluded that the plain and unambiguous language of the conflict section of the partnership agreement displaced traditional fiduciary duty principles. The court acknowledged plaintiff’s argument that the members of the conflict committee had an inherent conflict of interest since as directors of the partnership’s general partner they owed fiduciary duties both to the shareholders of the general partner and the limited partners of the partnership. The court noted, however, that this on-going conflict was inherent in a corporate general partner and therefore “dissipate[d] the force of plaintiff’s argument.” The court also rejected plaintiff’s argument that the conflicts committee should be comprised of members with no relationship at all to the corporate general partner because it was intended to be a committee of the general partner’s board. Finding that neither member of the conflicts committee was beholden to the corporate parent of the general partner for material, personal reasons separate and apart from the structural conflict each inherently faced as a director of the corporate general partner, the court dismissed the complaint with prejudice.


Plaintiffs challenged an already consummated reorganization of a limited partnership which separated the ownership of a single public limited partnership into the old public limited partnership and a new privately-traded limited partnership. Plaintiffs challenged the reorganization on several grounds: first, that it did not receive the requisite approval by
the public unitholders; second, that defendants breached their fiduciary duties in structuring the reorganization in an unfair manner; and third, that the defendants made materially misleading disclosures. Plaintiffs’ first claim was based on the fact that the defendants needed to amend the partnership agreement of the existing limited partnership in order to implement the reorganization and the defendants presented the proposed amended and restated partnership agreement containing all of the proposed amendments to the public unitholders for their approval in a single vote and provided that it would be approved if it received the affirmative vote of a majority of the public unitholders. Plaintiff argued, however, that one provision of the proposed restatement of the partnership agreement could only be accomplished by a unanimous vote and that therefore the entirety of the proposed amendment, including all the remaining provisions which could otherwise have been approved by a majority vote of the public unitholders, was never validly adopted and must be declared void. The court agreed with plaintiffs that one provision of the amendment could only be put into effect by unanimous vote. However, the court rejected plaintiffs’ argument that the entirety of the amendment was therefore void. The court cited several bases for this decision including the “severability” provisions of both the original partnership agreement and the proposed amendment and restatement and the fact that the general partner removed the one provision that required unanimous approval from the final restated and amended partnership agreement. With respect to the severability issue, the court cited several legislative cases supporting the proposition that if part of one legislative bill required a majority vote and another part a supermajority vote and only the majority vote were obtained, so long as the matters were of a severable nature, the part that received the requisite approval would be valid notwithstanding the fact that the remaining part would be void. The court also rejected plaintiffs attempt to limit that principle to the legislative context finding that it applied equally in the private contract context and was consistent with the approach Delaware has historically taken to the regulation of economic activity which rests on “flexibility and efficiency, not unjustified rigidity.” In their fiduciary duty claim, plaintiffs had argued that the reorganization was motivated solely to advantage the majority unitholder and corporate parent of the general partner without conferring any benefit on the public unitholders. The defendants moved to dismiss this claim on the grounds that the public unitholders had approved the transaction in accordance with the criteria set forth in the original limited partnership agreement which displaced any default fiduciary duties that would otherwise have applied to the transaction. Plaintiffs countered that the requirements of the limited partnership agreement including the vote requirement were in addition to, not in substitution for, the general partner’s common law fiduciary obligations and pointed to the absence of any language expressly restricting the operation of default fiduciary duties in the operative section of the partnership agreement. The court held that in deciding whether default fiduciary duties were preempted by contractual provisions it was required to determine whether the application of default fiduciary duties could be reconciled with the practical and efficient operation of the terms of the limited partnership agreement; where such a reconciliation was possible, the court would apply default fiduciary duties in the absence of clear language disclaiming their applicability. “But where the use of default fiduciary duties would intrude upon the contractual rights or expectations of the general partner or be insensible in view of the contractual mechanisms governing the transactions under consideration, the court will eschew fiduciary concepts and focus on a purely contractual analysis of the dispute.” However, the court held that it did not need to answer that question for the present case because, based on corporate law principles, it concluded that if the challenged transactions received an informed, uncoerced majority vote of the public unitholders that vote would obviate any generalized fairness inquiry and insulate the general partner from contractual or fiduciary liability. Thus, the court held that plaintiffs’ fiduciary claim turned on the adequacy of the general partner’s disclosures. Plaintiffs had challenged a number of the general partner’s disclosures as false or misleading. The court dismissed a number of these claims. However, it held that certain of the claims were sufficient to withstand a motion to dismiss. Thus, the court denied defendants’ motion to dismiss those disclosure claims and the fiduciary duty claim which turned on the adequacy of the disclosure.

Plaintiff limited partner brought a derivative suit claiming that a series of unit purchases in a Delaware limited partnership by the corporate parent of the general partner and other related persons were unfair to the partnership and were designed to entrench the general partner. In this opinion, the court considered the merits of several motions for summary judgment brought by the various defendants. (In other related proceedings, the court considered a number of other actions including requirements for bringing a derivative suit and the scope of actions under Section 17-305 of DRULPA which are discussed under those topics in the survey.) The court ruled on the merits of the following claims: breach of contract claim against the defendants arising from an alleged breach of the partnership agreement; breach of fiduciary duty claims against the general partner relating to the same transactions as challenged in the breach of contract claim; and breach of fiduciary duty or aiding and abetting claims against two classes of defendants (1) those who were directors of the general partner and also affiliated with its parent corporation and (2) those who were directors of the general partner but not affiliated with its parent corporation as well as both classes of defendants’ alleged defense on the basis of the exculpatory provisions of Section 17-1101(d)(1) of DRULPA and the partnership agreement. In their breach of contract claims, plaintiffs alleged that certain requirements of the partnership agreement that apply to sales of units had not been followed in the sales to the general partner’s affiliates. The general partner countered that other provisions of the partnership agreement were applicable to the sales at issue which allowed the general partner broad discretion and entitled it to summary judgment under the facts at issue. In support of their motion, the defendants relied on (1) Section 17-1101(d) of DRULPA which provides that any partner acting under a partnership agreement shall not be liable to the limited partnership or any other partner for its good faith reliance on the provisions of such partnership agreement, (2) an alleged modification of fiduciary duties under Section 17-1101(d)(2) of DRULPA and (3) upon a provision of the partnership agreement that provided immunity to the general partner for any action taken in reliance on a legal opinion. With respect to the question of the proper interpretation of the partnership agreement, the court concluded it could properly deny summary judgment if it decided that a more thorough development of the record would clarify the law or its application and did so on this basis. It also found that there was a triable issue of fact as to the good faith of certain of the defendants and that a finding of lack of good faith would prevent them from relying on any of the provisions that they cited as affirmative defenses. With respect to the alleged breach of fiduciary duty claims against the general partner relating to the same actions supporting the breach of contract claims, however, the court granted the defendants’ motion for summary judgment. It did so based on a finding that Section 17-1101(d)(2) of DRULPA authorized the elimination, modification or enhancement of fiduciary duties and that the partnership agreement had set forth the duties owed by the general partner in self-dealing transactions between the partnership and the general partner affiliates in a comprehensive matter which left no room for the application of common law fiduciary duty principles. With respect to the other claims against the defendants who controlled the corporate parent of the general partner, the court concluded, based on the teaching of cases like In re USA Cafes, L.P. Litig. (see Section II.A.1) that the defendants could be liable for breach of fiduciary duty or as aiders or abettors if they intentionally caused the general partner to violate the partnership agreement and therefore denied summary judgment as to those claims. Finally, with respect to the directors of the general partner who were unrelated to the general partner’s corporate parent, the court concluded that since these directors did not have any special tie to the corporate parent of the general partner but were only required to balance their fiduciary duties to the shareholders of the general partner on one hand and to the limited partners of the partnership on the other, they would be entitled to the benefit of the exculpatory provisions of the partnership agreement even if they unintentionally struck a contractually improper balance between those competing interests so long as they acted in good faith and the court found that there was no record evidence that these directors acted in other than good faith.

In an appeal of the Court of Chancery’s decision in a related proceeding in this case (see Section II.K.), the Delaware Supreme Court stated that notwithstanding the fact that the scope of Section 17-1101(d)(2) of DRULPA was not before it in such related proceeding, it
felt compelled to note that the Court of Chancery’s dictum in this decision that Section 17-1101(d)(2) of DRULPA expressly authorizes the elimination of fiduciary duties in a partnership agreement was not a correct statement of law. Rather, the Supreme Court pointed out that neither Section 17-1101(d)(2) nor any other provision of DRULPA explicitly provides that a limited partnership agreement may eliminate the fiduciary duties or liabilities of a general partner and that the underlying general principle in Delaware is that scrupulous adherence to fiduciary duties is normally expected. The Supreme Court also noted the historic cautionary approach of Delaware courts that efforts by a fiduciary to escape a fiduciary duty, whether by a corporate director or officer or other type of trustee, should be scrutinized searchingly.


In this case involving cross-motions for summary judgment, the court addressed a limited partner’s claim that the general partner of a Delaware limited partnership breached its fiduciary duty of loyalty by accepting consulting or advisory fees directly from entities in which the limited partnership invested its funds. While the partners agreed that the terms of the partnership agreement modified the fiduciary duties of the general partner, they disagreed as to the scope of such alteration. Determining that it need not look beyond the plain language of the partnership agreement, the court found that while the partners’ modification of the general partner’s duty of loyalty permitted the general partner to participate in other business activities usually prohibited by the partnership opportunity doctrine, it did not remove the prohibition on engaging in self-dealing transactions. The court asked the parties to further develop facts at a trial regarding whether the actions taken by the general partner for which it received fees constituted permissible “other business activities” or self-dealing. The court also rejected the general partner’s argument that DRULPA Section 17-1101(d)(1) provided a safe harbor for its actions. The court held that while this statutory provision bars a fiduciary duty claim against a partner that acted in good faith reliance on the provisions of a partnership agreement, it does not apply when a partner relies on its own misinterpretation of an unambiguous contract clause.


This case arose from the plan of a publicly traded Delaware limited partnership to convert to a REIT through a merger. Under the terms of the merger agreement, partnership units would be converted into shares of the REIT on a one-to-one basis. The general partner of the partnership, however, in lieu of the 2% interest and certain incentive distribution rights it had in the partnership, would receive REIT shares equal to 27% of the total shares outstanding. The partnership agreement provided that the general partner had the power to structure mergers in its sole discretion, subject, however, to the requirement that a supermajority of unitholders must approve any merger. Plaintiff unitholder claimed that in addition to complying with the terms of the partnership agreement, was required to exercise common law fiduciary duties, namely the duty of loyalty, to unitholders in structuring the merger.

In dismissing the plaintiff’s claims for failure to state a claim upon which relief can be granted, the court stated that, in the limited partnership context, “principles of contract preempt fiduciary principles where the parties to a limited partnership have made their intentions to do so plain.” According to the court, “under limited partnership law a claim of breach of fiduciary duty must first be analyzed in terms of the operative governing instrument -- the partnership agreement -- and only where that document is silent or ambiguous, or where principles of equity are implicated, will a [c]ourt begin to look for guidance from the statutory default rules, traditional notions of fiduciary duties, or other extrinsic evidence.” Because the court found that the partnership agreement clearly modified the common law fiduciary duties otherwise applicable to the general partner in structuring a merger, the court concluded that the partnership had “plainly opted out of the statutory default scheme” of traditional fiduciary duties and therefore limited its review of the general partner’s conduct to an examination of the compliance of the general partner with the terms of the partnership agreement.
The plaintiff also argued, in the alternative, that the general partner had voluntarily assumed fiduciary duties outside of the partnership agreement by appointing a special committee to oversee the merger, presumably in an effort to gain the support of the partners in the vote on the merger by creating the appearance of fair dealing. In presenting this argument, the plaintiff relied on the court’s holding in the *Cencom* case (discussed below in this Section II.A.2 and in Section II.G.), in which the court held that a general partner, by circulating a disclosure statement that informed limited partners that an independent counsel had been retained to assure the integrity of a transaction, voluntarily assumed a duty to ensure that the limited partners could rely on the general partner’s representations with respect to the independent counsel. The court distinguished this case from the *Cencom* case by the fact that the general partner in this case had not made affirmative disclosures to the unitholders regarding the fairness and independence of the special committee. The court characterized the alternative claim of the plaintiff as a “potential disclosure claim” and, in the absence of affirmative disclosures, dismissed the claim as not being ripe for adjudication.

In a subsequent proceeding in which the plaintiff challenged the disclosures in the proxy statement soliciting unitholder approval of the REIT conversion (see Section II.I), the court held that because the unitholders had contracted away their right to seek judicial review of the REIT conversion based upon substantive fiduciary duty principles and had contracted for, in place of such a right, the protection of a supermajority approval of the transaction, the court would apply a most stringent disclosure standard, enforced by careful judicial scrutiny, to assure that the unitholders’ vote had meaning.

### Kahn v. Icahn, C.A. No. 15916 (Del. Ch. Nov. 12, 1998)

Plaintiffs, holders of depository units representing limited partnership interests of a Delaware limited partnership, brought a derivative action against the partnership’s general partner, the general partner’s sole shareholder and chief executive officer and certain entities affiliated with the general partner, claiming that the sole shareholder and chief executive officer of the general partner breached his fiduciary duties to the partnership and usurped for himself opportunities of the partnership by failing to make certain investments completely available to the partnership and, instead, dividing the investments between the partnership and entities owned or controlled by the general partner. The partnership agreement provided that the general partner “may compete, directly or indirectly, with the business of the [p]artnership . . . and neither the [p]artnership nor any of the Partners or Record Holders shall have any right to participate in such other business interests or ventures or to receive or share in any income derived therefrom.”

Defendants moved to dismiss for failure to state a claim and the court granted defendants’ motion. The court, citing Section 17-1101(d) of DRULPA, stated that traditional fiduciary duties among and between parties are default duties that may be modified by partnership agreements and noted that Delaware case law suggests that partnership agreements may act as safe harbors for partners’ actions that may otherwise violate traditional fiduciary duties. The court found that the defendants’ conduct had been in compliance with the provisions of the partnership agreement and refused to hold that the general partner’s actions were subject to the traditional fiduciary duty of loyalty irrespective of the clear and unambiguous modification of such duty provided in the partnership agreement. Addressing plaintiffs’ claim that defendants had usurped opportunities of the partnership, the court, relying on the reasoning developed in cases dealing with the usurpation of corporate opportunities, concluded that the partnership could not have had a legitimate interest or expectancy in the relevant investments because the partnership agreement put the partnership on notice that the partners intended to compete directly with the partnership, and, in addition, the plaintiffs had failed to allege facts that provided a reasonable inference that information or proprietary investment research had been misappropriated or that partnership resources had been unlawfully redirected.

Plaintiff limited partner claimed the general partner breached its fiduciary duty to the partnership by electing to purchase the assets of the partnership upon the liquidation of the partnership under the terms of an appraisal process in the limited partnership agreement. The court, in denying the plaintiff’s motion to enjoin the sale, held that the general partner’s actions were not a breach of its fiduciary duty because the parties to a limited partnership agreement, which is primarily contractual in nature, are permitted to expressly modify traditional concepts of fiduciary duty by allowing the fiduciary to deal directly with the limited partnership and to define the parameters of due care within the structure of the partnership.

In a later ruling in the Cencom case on the general partner’s motion for summary judgment, the court dismissed the limited partners’ claim that the general partner was obligated to fulfill a common-law fiduciary duty, beyond the bargained-for terms of the partnership agreement, showing the “entire fairness” of the sale of the partnership’s assets to the general partner, stating that it would not subject the sale process set forth in the partnership agreement to “some court-approved, after-the-fact, moralistic ‘entirely-fair’ standard, when the parties defined the desired process in the Partnership Agreement.” The court denied a subsequent motion by plaintiffs to alter, amend or reconsider the decision based on the alleged failure of the court to address certain of the plaintiffs’ claims. The court found no clear error of law in its decision and concluded that it had not overlooked a controlling principle of law or misapprehended the law or material facts.

In a further proceeding in the Cencom case, the general partner again moved for summary judgment with respect to the claims that (i) it breached its voluntary, contractually assumed fiduciary duty to assure the fairness of the sale, (ii) it did not have the authority to terminate certain distributions to the limited partners and (iii) it breached its fiduciary duties of loyalty and candor in connection with the appraisals of the partnership’s assets. The court granted the general partner’s motion with respect to one sub-issue of the breach of fiduciary duties of loyalty and candor claim, holding that the general partner had supplied equal information to each appraiser. Because the court found that genuine issues of material fact existed with respect to the other claims at issue, the court denied the remaining parts of the general partner’s motion for summary judgment.


The Supreme Court affirmed the Court of Chancery’s dismissal of a limited partner’s breach of fiduciary duty claim against the general partner, holding that under the DRULPA “a general partner acting in good faith reliance on the provisions of the partnership agreement is shielded from liability for breach of fiduciary duty.” Thus, because the limited partner’s complaint failed to assert a knowing breach of the agreement by the general partner, it was not a sufficient allegation of bad faith to support a breach of fiduciary duty claim.

James River-Pennington Inc. v. CRSS Capital, Inc., C.A. No. 13870 (Del. Ch. Mar. 6, 1995)

Plaintiff and defendant were limited partners in a partnership formed to own a chemical recovery and cogeneration facility. They also shared control of the corporate general partner with each limited partner naming three of the general partner’s six directors. Pursuant to a principal’s agreement to which plaintiff and defendant were parties, plaintiff had an option to buy-out defendant’s limited partnership interest. Upon giving notice of its intent to exercise its option, plaintiff filed an action for a declaration that it was entitled to exercise the option, and defendant filed a countersuit alleging, among other claims, that the plaintiff’s decision to exercise the option breached a fiduciary duty to the defendant and the partnership to act in good faith and in the best interests of the partnership. Defendant argued that its exercise of a bargained-for contractual right could not constitute a breach of a fiduciary duty and filed a motion to dismiss plaintiff’s countersuit.
In denying plaintiff’s motion to dismiss the fiduciary duty claim, the court held that plaintiff owed a fiduciary duty of loyalty to the defendant and the partnership “because it controls the general partner through the votes of its three of the six directors.” The court acknowledged that the “[DRULPA] expressly recognizes partners may modify their fiduciary duties through contract.” The court reserved judgment, however, on whether plaintiff’s fiduciary duty had been sufficiently modified by the principal’s agreement to negate the alleged breach until the disputed terms of the agreement could be resolved at trial. It should be noted that in reference to plaintiff’s alleged fiduciary duty, the court cited KE Prop. Mgmt. Inc. As discussed in Section II.A.3. below, the KE Prop. decision noted that a limited partner with governance responsibility may assume a related fiduciary obligation. It is unclear, however, whether the court in James River-Pennington would have held a fiduciary obligation could attach to the limited partner solely by virtue of its option if it had not shared control of the general partner.

3. Fiduciary Duties of Limited Partners

While the DRULPA contains no provision expressly addressing the subject, Delaware law relating to the fiduciary obligations of limited partners of a Delaware limited partnership has been developing based on the interplay of Section 17-1105 of the DRULPA, which provides that the provisions of the Delaware Uniform Partnership Law, Del. Code Ann. tit. 6, §§ 1501 et seq. (the “DUPL”), govern in cases not provided for in the DRULPA, and Section 1521(a) of the DUPL, which provides that “[e]very partner must account to the partnership for any benefit, and hold as trustee for it any profits, derived by the partner without the consent of the other partners from any transaction connected with the . . . conduct . . . of the partnership or from any use by him of its property.” Using this analysis, the Delaware Court of Chancery held in the RJ Associates case that the fiduciary duties set forth in DUPL Section 1521(a), unless expressly modified by the partnership agreement, would apply to a limited partner which allegedly controlled the general partner. The Delaware courts have also imposed on limited partners the duty to act in good faith when they exercise rights under a partnership agreement, even when the rights being exercised are not sufficient to carry with them a fiduciary obligation. In addition, the courts have held that where limited partners assume a fiduciary duty by contract, that duty will be enforced in accordance with its terms.


A series of related cases arose in connection with disputes between Cantor Fitzgerald L.P. (“plaintiff” or the “partnership”), a leading inter-dealer and institutional broker of United States Treasury Securities and other government securities (see also Section II.A.1), and several of its partners and other entities. The thrust of plaintiff’s complaint alleged that the defendants, who included three of plaintiff’s limited partners, working through a Delaware corporation under their control that was formerly a department of plaintiff, had breached their fiduciary duty of loyalty to the partnership and engaged in competitive activity in violation of the applicable limited partnership agreement. The court initially addressed the claims raised by plaintiff on a motion to dismiss and denied the motion as to various claims including fiduciary duty and contract claims. Plaintiff had also sought a preliminary injunction. The court initially reserved on that application until the record could be supplemented on certain issues relating to imminent and irreparable harm and the balancing of the equities. After such supplementation, the court found that plaintiff had a reasonable likelihood of establishing at trial on the merits that the defendant limited partners had breached their fiduciary duty of loyalty to the general partner and the partnership, but denied the preliminary injunction because it found that the record did not support the finding of imminent irreparable harm if the injunction were not granted. The court based its holding on the provisions of the partnership agreement whereby each partner, including each limited partner, acknowledged a duty of loyalty to the partnership and agreed to take no action to harm (or that would reasonably be expected to harm) the partnership. In

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2 Although the Delaware legislature adopted the Delaware Revised Uniform Partnership Act, 6 Del. C. §§ 15-101 et seq. (the “DRUPA”), Delaware’s version of the Uniform Partnership Act (1994) (with 1996 and 1997 amendments) promulgated by the National Conference of Commissioners on Uniform State Laws, in 1999 to replace the DUPL as the governing law with respect to general partnerships, the provisions of the DUPL remain the governing law with respect to limited partnerships in cases not provided for in the DRULPA. See DRUPA Section 15-1205.
addition, each of the partners, including the limited partners, agreed not to engage in competitive activities. The court found that the proposed new business venture of the limited partners would be competitive with the partnership and therefore was likely to result in a breach by the limited partner defendants of their contractually agreed upon fiduciary duty of loyalty and agreement not to compete. However, the court explicitly expressed no opinion as to whether a duty of loyalty might have existed in the absence of the express provisions of the partnership agreement.

After a trial on the merits of the case, the court held that partners of a Delaware limited partnership may agree in their partnership agreement that partners, including limited partners who do not participate in the management or operation of the partnership, are subject to a fiduciary duty of loyalty. Defendants argued that the language of DRULPA Section 17-1101(d), which provides that “[t]o the extent that, at law or in equity, a partner or other person has duties (including fiduciary duties) and liabilities relating thereto to a limited partnership or to another partner . . . (2) the partner’s or other person’s duties and liabilities may be expanded or restricted by provisions in a partnership agreement,” precludes partners from creating duties that do not exist separately at law or in equity. The court disagreed with defendants’ argument, citing the policy of the DRULPA to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements set forth in DRULPA Section 17-1101(c) and the lack of an express prohibition in the DRULPA against providing in a partnership agreement that limited partners are subject to duties that the common law or equity does not independently impose upon them. The court found support for its holding in its opinion in Kahn v. Icahn (see Section II.A.2), in which it held that “Delaware law permits partners to agree on their rights and obligations to each other and to the partnership. This is so even when Delaware law might impose different rights and obligations absent such agreement.” Notably, in determining the scope of the duty of loyalty, the court stated that “[t]he duty of loyalty proclaimed in the [partnership agreement] requires no dependency upon a default concept to a narrow definition derived from corporate common law. The scope of the duties owed by the parties must be determined by reference to the nature of this particular business enterprise.” The court reformed the partnership agreement to remove the provision by which plaintiff claimed that defendants agreed not to engage in competitive activities, finding that such provision was the result of a mistake in the amendment of the partnership agreement. The court went on to find that defendants breached their contractually imposed duty of loyalty and that defendants’ corporate vehicle aided and abetted in the fiduciary duty breach and tortiously interfered with the partnership agreement. Because the court did not find that plaintiff faced the threat of imminent, irreparable injury and could not quantify the monetary damages from defendants’ wrongdoing, it did not grant plaintiff’s request for equitable relief or monetary damages. The court did, however, grant plaintiff declaratory relief and an award of attorneys’ fees based on the egregious nature of the defendants’ actions.


Plaintiff, a limited partner of a Delaware limited partnership, brought suit against the partnership’s only other limited partner and its general partner charging that the other limited partner controlled the general partner and that both defendants, acting together, had breached their contractual and fiduciary duties to the plaintiff by causing the partnership to make improper deductions for certain expenses from plaintiff’s partnership distributions. The Court of Chancery’s opinion was rendered in connection with defendants’ motion to dismiss the complaint for lack of personal jurisdiction, failure to join indispensable parties and failure to state a claim. This summary focuses on the court’s ruling as to whether the plaintiff stated a claim for breach of fiduciary duty.

With respect to the breach of fiduciary duty claim against the general partner, the court observed that the partnership agreement expressly stated that the general partner “shall be under a fiduciary duty to conduct and manage the affairs for the Partnership in a prudent, businesslike and lawful manner.” The court stated that such a broad contractual undertaking incorporated and encompassed the traditional fiduciary duties recognized under Delaware law and concluded that the plaintiff’s allegation that the general partner breached its fiduciary duty by failing to adhere to the express contractual undertakings
contained in the partnership and other relevant agreements stated a claim for breach of fiduciary duty against the general partner.

As to the claims relating to the limited partner, the court noted that fiduciary duty claims regarding limited partners were more complex than those regarding general partners and looked first to Section 17-1105 of DRULPA, which states that “[i]n any case not provided for in this chapter the Delaware Uniform Partnership Law [DUPL] . . . and the rules of law and equity . . . shall govern.” Based on the foregoing language, the court concluded that “[b]ecause the DRULPA contained no provision governing the accountability of limited partners for breaches of fiduciary duty, the [c]ourt must look to the DUPL to determine what fiduciary duties are owed by and to limited partners in the limited partnership.” The court then turned to Section 1521(a) of DUPL and quoted the following language from that section: “Every partner must account to the partnership for any benefit, and hold as trustee for it any profits, derived by him without the consent of the other partners from any transaction connected with the . . . conduct . . . of the partnership or from any use by him of its property.” The court stated that unless modified by the partnership agreement at issue, the fiduciary duty set forth in Section 1521 of the DUPL applies to a limited partner.

As authority for this proposition, the court cited two Delaware cases, James River-Pennington Inc. v. CRSS Capital, Inc. and Sonet v. Timber Co., L.P. (see Section II.A.2). The relevant portion of the James River-Pennington case stands for two propositions: First, that the traditional fiduciary duties of partners in a Delaware limited partnership may be modified by contract; and second, that a limited partner of a Delaware limited partnership that controlled the general partner owed a duty of loyalty to the partnership and the other partners. The portion of the Sonet case cited by the court also stands for the proposition that the terms of a partnership agreement may preempt otherwise applicable fiduciary principles. Also relevant to this analysis are two cases cited by the James River-Pennington court, namely KE Prop. Mgmt., Inc. v. 275 Madison Mgmt. Corp. and In re USAcafes, L.P. Litig. (see Section II.A.1). The court in USAcafes, based on a trust law analysis, held that the directors of a corporate general partner owe fiduciary duties to the limited partnership and its limited partners. The KE Prop. court considered the issue of limited partner fiduciary duties in the context of a limited partner acting to remove a general partner pursuant to the terms of the partnership agreement. Significantly, the KE Prop. court also relied on Section 17-1105 of DRULPA as a basis to resort to the DUPL for the determination of a limited partner’s fiduciary duties. Citing Section 1521(a) of the DUPL as well as case law and commentary, the court noted that under DUPL all partners owe fiduciary obligations and on that basis held that “to the extent that a partnership agreement empowers a limited partner discretion to take actions affecting the governance of the limited partnership, the limited partner may be subject to the obligations of a fiduciary. . . .” However, the KE Prop. court ultimately found that the objective nature of the removal provision, only for fraud or willful conduct injurious to the partnership, circumscribed the limited partner’s discretion so that, under the facts, a fiduciary duty would not attach. Thus, the holding of the court in RJ Associates continues the development of Delaware law relating to the fiduciary obligations of a limited partner based on the interplay between Section 17-1105 of DRULPA and Section 1521(a) of DUPL and the principle that control may carry with it a fiduciary responsibility.


In a declaratory judgment action relating to the removal of the general partner of a Delaware limited partnership by the limited partners, the limited partners alleged they could remove the general partner at will and the general partner countered that the limited partners had breached their fiduciary duties to the partnership in connection with the removal. Without deciding that the limited partners were subject to a fiduciary duty in taking this action, the court held that where the limited partners’ rights and duties were expressly set forth in the partnership agreement, compliance by the limited partners with the provisions of the partnership agreement was sufficient to satisfy any fiduciary obligation that may be owed, provided the limited partners acted reasonably and in good faith.

Plaintiff and defendant were limited partners in a partnership formed to own a chemical recovery and cogeneration facility. They also shared control of the corporate general partner with each limited partner naming three of the general partner’s six directors. Pursuant to a principal’s agreement to which plaintiff and defendant were parties, plaintiff had an option to buy-out defendant’s limited partnership interest. Upon giving notice of its intent to exercise its option, plaintiff filed an action for a declaration that it was entitled to exercise the option, and defendant filed a countersuit alleging, among other claims, that the plaintiff’s decision to exercise the option breached a fiduciary duty to the defendant and the partnership to act in good faith and in the best interests of the partnership. Defendant argued that its exercise of a bargained-for contractual right could not constitute a breach of a fiduciary duty and filed a motion to dismiss plaintiff’s countersuit.

In denying plaintiff’s motion to dismiss the fiduciary duty claim, the court held that plaintiff owed a fiduciary duty of loyalty to the defendant and the partnership “because it controls the general partner through the votes of its three of the six directors.” The court acknowledged that the “[DRULPA] expressly recognizes partners may modify their fiduciary duties through contract.” The court reserved judgment, however, on whether plaintiff’s fiduciary duty had been sufficiently modified by the principal’s agreement to negate the alleged breach until the disputed terms of the agreement could be resolved at trial. It should be noted that in reference to plaintiff’s alleged fiduciary duty, the court cited *KE Prop. Mgmt. Inc.*. As discussed in Section II.A.3., the *KE Prop.* decision noted that a limited partner with governance responsibility may assume a related fiduciary obligation. It is unclear, however, whether the court in *James River-Pennington* would have held a fiduciary obligation could attach to the limited partner solely by virtue of its option if it had not shared control of the general partner.


In finding that a limited partner was justified in removing the general partner under the terms of the partnership agreement, the court discussed whether the limited partner owed a fiduciary duty to the general partner. The court held that “to the extent that a partnership agreement empowers a limited partner discretion to take actions affecting the governance of the limited partnership, the limited partner may be subject to the obligations of a fiduciary . . . .” However, in this instance no fiduciary duty was owed by the limited partner because no discretion was left to the limited partner under the partnership agreement.

B. Inspection of Partnership Books and Records

Section 17-305 of the DRULPA provides as a general matter that each limited partner of a Delaware limited partnership has the right to obtain information about the affairs of the limited partnership for any purpose reasonably related to the limited partner’s interest as a limited partner. In light of the similarity between Section 17-305 of the DRULPA and Section 220 of the DGCL, the Delaware courts have relied on the extensive body of corporate precedents developed under the latter in construing what constitutes a proper purpose under the former. Unlike the corporate context, however, many partnership agreements provide a contractual right to partnership information, and in construing such provisions, the Delaware courts have declined to imply a proper purpose requirement where none is specifically included by agreement. With respect to a general partner’s access to information, the DRULPA is silent. Under such circumstances, pursuant to Section 17-1105 of the DRULPA the Delaware courts will look to the DUPL, and, although there is no specific reference to a proper purpose test for access to information in the DUPL, the Delaware courts have implied such a test, at least under circumstances where the court found access to the information sought by a general partner would injure the partnership as a whole.


Plaintiff limited partners sought various books and records of three limited partnerships for the purpose of valuing their investments therein. When the partnerships failed to furnish plaintiffs with certain of the requested documents, plaintiffs brought suit against the partnerships and their general
partners to compel disclosure of the remaining requested documents alleging wrongful denial of
access to partnership records that constituted a breach of their inspection rights under both
DRULPA Section 17-305 and the partnership agreements and breach of fiduciary duty.

The court first analyzed whether the documents and information sought by plaintiffs were in fact
books and records of the partnerships subject to inspection under DRULPA Section 17-305. The
section of the partnership agreements dealing with limited partner inspection rights provided that
“[t]he partnerships’ books and records shall include” and listed various categories of documents. The
list of documents subject to inspection was less extensive than the books and records subject to
inspection under DRULPA Section 17-305(a) and did not contain a catch-all provision. All of the
documents in question fell outside of the scope of the documents listed in the partnership agreement.
The defendants argued that the enumeration of documents in the partnership agreements supplanted
and limited the plaintiffs rights under Section 17-305(a). The court noted that it was unclear
whether Section 17-305(a), which provides that a limited partner’s right to obtain information under
Section 17-305 is subject to “such reasonable standards (including standards governing what
information and documents are to be furnished, at what time and location and at whose expense) as
may be set forth in the partnership agreement or otherwise established by the general partners,”
permits the adoption of standards that substantively restrict a partner’s right to obtain information
but found it did not have to address the issue because it determined that the partnership agreement
did not purport to limit the scope of inspection provided under Section 17-305(a) of DRULPA. The
court further noted that the enactment of DRULPA Section 17-305(t), which expressly permits the
rights of a limited partner to obtain information under Section 17-305 to be restricted by a
partnership agreement, changes this analysis. The court then found that the documents requested by
plaintiffs fell within the list of documents subject to inspection under Section 17-305(a).

The court next addressed whether plaintiffs asserted a proper purpose for their request under Section
17-305(e) of DRULPA. Plaintiffs’ stated purpose was to properly value their investments in the
partnerships. Defendants argued that plaintiffs misstated their true purpose. Specifically, defendants asserted that plaintiffs’ stated purpose was not credible for the following reasons: (i) plaintiffs had already valued the investment in one partnership using publicly available information, (ii) plaintiffs were unable to articulate any concrete reason why the requested documents were relevant to a valuation, (iii) plaintiffs’ request was made only after the partnerships refused to repurchase plaintiffs’ units at a premium, thus suggesting that the request disguised an improper motive and (iv) the small amount of plaintiffs’ investment in two of the partnerships made it more likely that plaintiffs were seeking to determine whether to buy additional units rather than trying to value its investments. The court stated that valuation of one’s investment is a proper purpose for inspection and that once a proper purpose has been established, a secondary or ulterior motive is irrelevant and thus rejected defendants’ arguments. Recognizing defendants’ concern that plaintiffs could attempt to gain an unfair informational advantage over other investors, the court stated that its final order would condition the inspection right of plaintiffs on their execution of a satisfactory confidentiality agreement with respect to the treatment of the books and records afforded to them.

The court then addressed the proper scope of plaintiffs’ inspection rights. The court stated that plaintiffs’ inspection rights were limited to those documents “necessary, essential and sufficient” for their purpose of properly valuing their investments in the partnerships. The court noted that this “necessary, essential and sufficient” standard limits books and records inspections to those
documents shown to be reasonably required to satisfy the purpose of the request. Defendants argued, among other things, that since plaintiffs had previously valued their partnership units with publicly available information such information should continue to be sufficient for their stated purpose of inspection. The court rejected this argument, holding that the fact that a plaintiff has previously valued its investment should not limit its ability to seek additional information for a subsequent valuation and that non-public information may come within the ambit of a limited partner’s rights of review under Section 17-305. The court went on to grant plaintiffs’ inspection request with respect to several of the documents sought by plaintiffs.


Plaintiff sought to inspect books and records of SSP, Inc. (“SSP”), a Delaware corporation of which
he was a stockholder, pursuant to DGCL Section 220 and books and records of SSP Advisors, L.P.
and SSP Partners, L.P. (collectively, the “Intermediate Partnerships”), each a Delaware limited
partnership of which he was a limited partner, pursuant to DRULPA Section 17-305 and the
partnership agreements of the Intermediate Partnerships. He also sought to inspect books and records of South Street Corporate Recovery Fund I, L.P. and South Street Leveraged Corporate Recovery Fund, L.P. (collectively, the “Funds”), each a Delaware limited partnership of which SSP and the Intermediate Partnerships, respectively, served as general partners. Plaintiff was not, however, a partner of the Funds. Plaintiff also sought to inspect documents pertaining to the settlement of two lawsuits to which none of SSP or the Intermediate Partnerships was a party. Although defendants provided access to the books and records of SSP and the Intermediate Partnerships, they refused to provide him with the books and records of the Funds and the documents pertaining to the lawsuits.

In ruling on motion to dismiss by defendants, the court followed established corporate precedent that “a stockholder generally has no right to inspect the books and records of a subsidiary corporation where the stockholder merely owns shares of the parent corporation” in holding that plaintiff had no right inspect the books and records of the Funds or the documents relating to the lawsuits merely because he had a right to inspect the books and records of SSP and the Intermediate Partnerships. The court went on to state, however, that despite the fact that plaintiff had no direct right to inspect the books and records of either the Funds or the documents relating to the lawsuits, he had a right to inspect such books and records if they were in the possession, custody, or control of SSP. The court reached this conclusion based on its decision in Carapico v. Philadelphia Stock Exchange, C.A. No. 16764 (Del. Ch. Sept. 27, 2000), in which the court held that a stockholder with rights to examine books of a parent did not also have the right to inspect books of the subsidiary merely because the parent owned the subsidiary but made clear that a stockholder with the right to inspect books of the parent may access the subsidiary’s books if the parent controls or possesses them. The court thus denied defendants’ motion to dismiss insofar as it related to books and records of the Fund or documents relating to the lawsuits that were in the possession, control or custody of SSP.


Plaintiff claimed statutory and contractual rights as a limited partner to access partnership lists of two partnerships in which it owned an interest. The defendant partnerships denied access to the lists, claiming that since the general partners had not consented to the admission of the plaintiff as a substitute limited partner, the plaintiff was not a substitute limited partner but rather an assignee of the economic rights of its transferor and, as such, not entitled to access to the partner lists under either Section 17-305 of the DRULPA and the applicable partnership agreements. The interests in the limited partnerships interests were privately traded through a broker-dealer service using NASD prescribed forms and all transfers of partnership interests and requests for admission as a substitute limited partner were handled for the partnerships by an outside administrative services provider. After trial, the court determined that the general partnerships had delegated their authority to admit substitute limited partners to the outside administrative services provider, that the standard NASD forms used in the transfer constituted a request of the plaintiff for admission as a substitute limited partner and the registration and confirmation of the transfer by the services provider constituted admission of the plaintiff as a substitute limited partner. Consequently, as a substitute limited partner, the plaintiff was statutorily and contractually entitled to the partnership lists.

In a later related proceeding, plaintiff requested damages for, among other things, wrongful interference with economic advantage resulting from the defendants’ delay in providing the partnership lists. Defendants moved to dismiss, asserting res judicata barred the action. Defendants argued that plaintiff’s claim was for damages arising from a breach of the partnership agreement and should have been pursued in the earlier action in the Court of Chancery. The court denied defendants’ motion, holding that the claim for wrongful interference with economic advantage was an outside claim that presented collateral issues from a partnership list case under DRULPA Section 17-305. Quoting from the Gotham Partners, L.P. case (see Section II.J.), the court stated that it “will not entertain outside claims or collateral issues within a § 17-305 hearing, but will hear only those matters that pertain to the limited partner’s demand to inspect the books.” The court held that, because it will not entertain a wrongful interference with economic advantage claim in a DRULPA Section 17-305 action, such a claim cannot be barred by res judicata and denied the defendants’ motion to dismiss this claim.
In this case, the Court of Chancery again considered the application of Section 17-305 of DRULPA relating to the rights of limited partners to gain access to partnership books and records, as well as a provision in the limited partnership agreement at issue addressing the circumstances under which a limited partner could have access to the books and records of the partnership. The case brings together several issues arising under Section 17-305 of DRULPA as well as the prior Delaware cases addressing separate contractual rights to books and records.

The plaintiff in this case was a beneficial owner in the partnership at issue. Initially, the court concluded that the plaintiff, though not a limited partner, was entitled to exercise the rights of the nominal limited partner in the limited partnership by reason of an assignment of those rights. Thus, the plaintiff was entitled to exercise the limited partner’s rights under Section 17-305. Section 17-305 includes the so-called “proper purpose” test, which requires that the requested information be “reasonably related to the limited partner’s interest as a limited partner.” In this regard, the court concluded that the plaintiff’s desire to obtain a list of limited partners and other beneficial owners to conduct a mini-tender offer for 4.9% of the partnership’s outstanding partnership units constituted a “proper purpose” under Section 17-305(a). However, Section 17-305(b) of DRULPA gives the general partner of a Delaware limited partnership the right to keep confidential from limited partners information the disclosure of which the general partner in good faith believes is not in the best interests of the limited partnership, and the court found that the general partner had a good faith belief that disclosing the list to the plaintiff was not in the best interests of the partnership. Therefore, the court held that the partnership was entitled to deny plaintiff access to the list of beneficial owners under Section 17-305.

The court then turned to the plaintiff’s assertion that it had a contractual right to the beneficial owner list under the terms of the partnership agreement. The court quoted from the partnership agreement, which provided:

The Partnership’s books and records . . . shall be open to inspection, examination and copying by [beneficial owners] or their duly authorized representatives at all times . . . . The [beneficial owners] shall not receive copies of . . . a current list of all Partners in the Partnership unless they request in writing a copy from the General Partner and pay any necessary duplication fee.

The court rejected the partnership’s argument that the foregoing language did not grant a right separate and apart from that granted by Section 17-305 of DRULPA and held that the quoted language created a separate contractual right in beneficial owners to obtain partnership books and records. The court then found, based on the principle of adopting an interpretation that better comports with the remaining contents of the document or gives effect to all words in dispute, that the term “books and records” encompassed a list of the partnership’s partners and beneficial owners. Finally, the court addressed the partnership’s argument that it was entitled to withhold from the plaintiff access to the investor list under the “improper purpose defense” articulated by the Court of Chancery in Schwartzberg v. CRITF Assocs. Ltd. P’ship, discussed below in this Section II.B.

The court began by noting that:

Under the “improper purpose defense,” this court is warranted in denying a partner’s request for access to a partnership’s records when (i) neither an explicit contractual provision in a partnership agreement nor statutory language negate the notion that a partner must have a proper purpose and (ii) the partner denying another partner access to the partnership business records can show that the partner seeking access is doing so for a purpose personal to that partner and adverse to the interests of the partnership considered jointly.

The court further stated that the burden of proof required the partnership to show that

it is more likely than not that if the parties to a partnership agreement had thought to address the subject, they would have agreed that a partner should be denied access to a list of partners when the partner would use the list for a purpose personal to that partner and adverse to the interests of the partnership when considered jointly.
In its analysis of the application of the “improper purpose defense” to the facts present, the court first held that nothing in Section 17-305 of DRULPA nor in the relevant partnership agreement negated the notion of the “improper purpose defense.” The court then held, as the partnership alleged, that the plaintiff’s purpose -- to commence a mini-tender offer for up to 4.9% of the outstanding beneficial interest -- was indeed personal to it. Notwithstanding that the partnership had proved by a preponderance of the evidence that the general partner in good faith believed that disclosing the investor list to the plaintiff was not in the best interest of the partnership, the court held that the partnership had failed to prove by a preponderance of the evidence that disclosing the investor list to the plaintiff would in fact be adverse to the interest of the partnership. That is, the partnership had failed to prove that the adverse effect it believed disclosure of the list would have on the partnership was more likely than not to occur if the partnership disclosed the list to the plaintiff. The court noted that this test, which was distinct from, and higher than, the simple “good faith” test under Section 17-305(b) of DRULPA, was appropriate given the unqualified contract language giving beneficial owners a right of inspection. Thus, the court held that the partnership could not deny the plaintiff access to the investor list on the basis of the “improper purpose defense.”

In a later ruling in the Bond Purchase, L.L.C. case, the court denied the defendants’ motion for a stay of the court’s July 23, 1999 decision pending the defendants’ appeal. In rejecting the defendants’ claim that the court’s decision eviscerated the application of Section 17-305 of DRULPA because virtually all publicly owned limited partnerships have substantially similar provisions regarding books and records access in their partnership agreements, the court, after making reference to the existence of Delaware Supreme Court case law requiring fiduciaries in disclosure cases to be fair, frank and forthcoming in a good faith effort to keep investors for whom they manage assets informed about those assets, stated that those who draft agreements between fiduciaries and those for whom they act in trust should carefully and explicitly set forth any restrictive limitation by contract on investors’ rights to access partnership information about their investment. In light of the policy of freedom of contract that underlies the DRULPA and the policy of the court to apply settled rules of contract construction to the interpretation of partnership agreements, the court stated that if a partnership wants the benefit of the broad power to restrict investor access to partnership books and records in Section 17-305, this intent should be made manifestly clear in the partnership agreement especially where the partnership agreement on its face creates a less restrictive right to such access.


Plaintiff brought suit against a limited partnership and its general partner alleging a wrongful denial of the plaintiff’s request to inspect the partnership list. Both parties moved for summary judgment. The plaintiff, who was not an original limited partner but had purchased and sold numerous units in the defendant limited partnership, claimed that it was contractually entitled to the list under the terms of the partnership agreement. The partnership agreement, which set forth a two-tiered limited partnership participation structure of limited partners and unit holders, provided that the right to demand the partnership list could be assigned in the transfer of a partnership unit if certain prerequisites were satisfied. In granting summary judgment in favor of the defendant limited partnership and general partner, the court found that as a factual matter the plaintiff had not satisfied the applicable prerequisites under the terms of the partnership agreement and thus was not contractually entitled to the partnership list. The court did not address the applicability of a statutory right of the plaintiff to the partnership list under Section 17-305 of the DRULPA because the parties had agreed that if the plaintiff were adjudicated not to have satisfied the prerequisites for obtaining a contractual right to the list, the plaintiff would not constitute a limited partner for purposes of Section 17-305, which by its terms only applies to limited partners.


In Paine Webber Ltd. P’ships and Paine Webber Qualified Plan, plaintiff limited partners sought to assert both statutory rights under Section 17-305(a) of the DRULPA and contractual rights under the applicable partnership agreements to lists of limited partners. In each case, the court found that plaintiffs’ purpose was to obtain the lists so that a tender offer might be conducted by a separate entity in which plaintiffs’ equity participation, if any, would be minimal. The court held that such a purpose did not relate to plaintiffs’ interests as limited partners but only to an interest as a potential buyer; therefore, it was not a proper purpose under Section 17-305(a).
While the limited partners thus had no statutory right to the partner lists, one or more of the partnership agreements at issue in both cases provided a separate contractual right for the limited partners to obtain a list of the names and addresses of the limited partners of each partnership without explicitly conditioning that right on the existence of a proper purpose. In the absence of any such requirement, the court declined to incorporate by reference the proper purpose requirement from Section 17-305(a). As the court noted in *Paine Webber Ltd. P'ship*, to read such a requirement into an otherwise unrestricted contractual provision would be inconsistent with the important policy underlying the DRULPA to give maximum effect to the principle of freedom of contract and the enforceability of partnership agreements. In addition, the court noted that to do so would create an anomalous inconsistency with Delaware corporation law where it has been held that a stockholders’ agreement may expand the right of contracting stockholders to obtain a stockholder list beyond those rights conferred by Section 220 of the DGCL. Thus, the Court of Chancery in both *Paine Webber Ltd. P'ships* and *Paine Webber Qualified Plan* held that a limited partner’s unqualified contractual right to obtain a list of limited partners would not be subject to the proper purpose test of Section 17-305(a).

In each such case, however, the defendant partnerships had asserted that a separate “improper purpose defense” should be inferred into the partnership agreements based on the court’s decision in *Schwartzberg v. CRITEF Assocs. Ltd. P'ship*, discussed below in this Section II.B. While the court reaffirmed the holding of *Schwartzberg*, it found that it did not apply to the facts in either *Paine Webber Limited Partnerships* or *Paine Webber Qualified Plan*. Specifically, in both cases the court held that, since the partnership agreements at issue were adopted in 1985 when Delaware limited partnerships were legally required to include a list of limited partners in their certificate of limited partnership, it could not be argued that had the partners considered the issue they would have agreed to deny access to lists that were already a matter of public record (an element of the *Schwartzberg* test). In addition, the court in *Paine Webber Limited Partnerships* found that defendants had failed to adduce persuasive evidence that plaintiffs’ actions would harm the partners’ joint investment (a second element of the *Schwartzberg* test).

In a post-trial motion in *Paine Webber Qualified Plan*, the defendant partnerships sought to enjoin the plaintiffs from exercising their right to access the defendants’ partnership lists pending an appeal of the court’s decision. The court denied the motion finding that the potential negative effects on the plaintiffs’ ability to conduct a successful tender offer that may have resulted from an injunction outweighed any harm that a denial of the injunction would have caused the defendants. The court also suggested that the defendants’ true motive in seeking the injunction was to further delay the proceedings rather than to minimize harm.


The plaintiff was both a limited and a general partner in one partnership and a limited partner in another partnership. Each of these partnerships was, in turn, the general partner of a publicly held limited partnership, and plaintiff sought lists of the beneficial owners of these two publicly held limited partnerships. The plaintiff’s purpose was to solicit the beneficial owners of these partnerships to replace their general partners and install himself as managing general partner.

Although neither the relevant partnership agreements nor DUPL Section 1519 contained an express proper purpose requirement for granting partners access to partnership records (such as is found in Section 17-305 of the DRULPA for limited partners), the court held that an “improper purpose defense” will be inferred when under the circumstances it is more likely than not that if the parties had thought to address the subject, they would have agreed to create such a limitation. The court concluded that plaintiff’s access to the records would be denied based on its findings that the plaintiff’s purpose would have decreased the value of the partnerships and that all rational investors would have agreed to restrict access to information when it was clearly established that such access would harm the value of the partnership.

C. Removal of General Partners

The circumstances under which limited partners may remove a general partner has spawned a number of recent cases in the Delaware courts. In contrast to the DGCL, the DRULPA contains no provision providing for the removal of a general partner by the limited partners. Thus, if limited partners seek to remove a general partner, they must in general rely on a contractual right to do so provided in the partnership agreement. In construing removal provisions, the courts will require the limited partners to meet the requirements set forth in the limited partnership agreement as well as any applicable implied contractual
covenants. For example, the Delaware courts have found an implied covenant to act reasonably and in good faith under a provision that allowed limited partners to remove a general partner for unsatisfactory performance. But when the limited partners follow the required procedures, consistent with any implied covenants, the courts will not hesitate to confirm the removal of a general partner. Applying the same principles, however, in cases where a partnership agreement includes no provision for the removal of a general partner, the limited partners may be left with only a suit for judicial dissolution of the partnership, as discussed in Section II.G. below.


Limited partners of a Delaware limited partnership brought suit under Sections 17-110 and 17-111 of DRULPA seeking a determination that they properly removed the general partner. The partnership agreement required that the partnership’s advisory committee recommend removal and then two thirds in interest of the limited partners act, by written consent or vote, to remove the general partner. Under the partnership agreement, removal would become effective upon the execution by the new general partner of a counterpart signature page of the partnership agreement and the conversion of the removed general partner’s interest to a limited partner interest. While conceding that these steps were complied with, defendant contended that all of the limited partners that executed the written consents removing it as general partner were in default of a capital call made by the general partner and due to the partnership on the date that the general partner was purportedly removed. Because the written consents were not delivered to the general partner prior to the time that the capital call was due, the general partner argued that the limited partners became “defaulting partners” under the partnership agreement and, per the provisions of the partnership agreement, were not entitled to vote for the removal of the general partner.

The court found that neither the partnership agreement nor DRULPA required that partners’ written consents be delivered to become legally effective. The court found that the absence of a delivery requirement in DRULPA was particularly noteworthy because the counterpart provision of the DGCL mandated the delivery of written consents. It held that in the case of limited partnerships the legislature intended that the requirement of delivery of written consents be the subject of contract rather than of legislative mandate and found that the parties to the partnership agreement contracted not to require the delivery of written consents to make such consents effective.

The court rejected defendant’s argument that the partnership agreement gave the general partner broad “default” authority to make any determinations that were not expressly provided for in the partnership agreement, including a determination that written consents would become effective only upon their delivery to a specified person. The court found that the provision of the partnership agreement on which defendant relied for its argument that the partnership agreement granted the general partner such broad authority addressed the management authority of the general partner only and not control issues that arise outside of the business operational context. Noting that Delaware law distinguishes between “operational” issues, on the one hand, and “ownership” issues on the other, the court held that issues of “control” and related “investor rights” were addressed in a separate provision of the partnership agreement that specified the conditions for removing the general partner and delivery of written consents was not one of the conditions specified in such provision. The court also noted that even if the general partner had the default authority it claimed, absent clear language in the partnership agreement expressly permitting such action, to allow a conflicted fiduciary to exercise its power unilaterally, retroactively and self-interestedly to determine the validity of its own removal would constitute an inequitable use of its power.

The court also rejected defendant’s argument that delivery is an implied condition for the written consents to become effective. Defendant argued that without a delivery requirement, the event that triggers the legal effectiveness of a written consent is inherently not objectively verifiable. The court found that defendant’s argument failed on both the conceptual and operational levels. On a conceptual level, defendant’s argument ignored the established and narrow criteria that govern when a contractual or statutory term may be judicially implied. Absent grounds for reformation, a court may not imply a term into a contract because “it is not the proper role of a court to rewrite or supply omitted provisions to a written agreement.” With respect to implication of a statutory requirement of delivery, given that the requirement sought to be implied was expressly included in one statute (DGCL) but omitted from a separate statute (DRULPA) that deals with the identical subject and function, the court found that it was reasonable to assume that the legislature intended its omission. The court held that Section 17-302(e) of DRULPA requires only that written consents be signed by the partners and this conclusion carries with it an implied prohibition against creating any additional
requirements for effectiveness, including delivery. Defendant’s argument failed on the operational level because it ignored the reality that as a practical matter, no action to remove a general partner by written consent can occur until the general partner is notified of the consent action and any likelihood of abuse is minimized because under recognized doctrines of equity imposed on all contracts such notice must given within a reasonable time after the action is taken.


Plaintiff limited partners filed this action to determine whether they lawfully removed defendant general partner. The partnership agreement contained a provision governing removal of the general partner which stated four distinct grounds for removal -- material default under the terms of the partnership agreement, material breach of fiduciary duty, gross negligence or willful misconduct, and fraud. The court reviewed each of the limited partners’ five reasons for their removal of the general partner to ascertain whether the removal was in accordance with the criteria set forth in the partnership agreement. The court found that one of the justifications for removal -- the general partner’s self-interested loan to one of its affiliates using partnership funds -- was a material breach of its fiduciary duty of loyalty. Therefore, the court held that the limited partners acted lawfully in removing the general partner.


The transfer restrictions of a limited partnership agreement of a Delaware limited partnership provided that if the original general partner or its transferee ceased to be members of a “controlled group of corporations” within the meaning of Internal Revenue Code section 1563(a), the interest of the transferee would be subject to redemption upon the unanimous vote of the partners other than the partner whose interest was the subject of the redemption. After a combination of transfers of the general partner’s interest within the controlled group of corporations and transfer of the equity in the corporation holding the general partner’s interest, the general partner’s interest was held by a related entity but not one within the controlled group of corporations. After learning of the dissociation of the general partner’s interest and the controlled group of corporations, the limited partners unanimously voted to redeem the general partnership interest and appoint a new general partner. The holder of the general partner’s interest challenged the validity of the redemption and the plaintiff limited partners sought an order from the Delaware Court of Chancery validating their exercise of the option to redeem the general partner’s interest under the partnership agreement.

In granting the plaintiff limited partners’ motion for partial summary judgment, the court applied principles of contract construction to the partnership agreement to find that the provisions of the partnership agreement unambiguously provided the limited partners with a right to redeem the general partner’s interest under the circumstances presented. The court found that plaintiffs’ proffered interpretation of the disputed language harmonized the different sections of the partnership agreement while the general partner’s interpretation would nullify one clause of the partnership agreement, produce an incongruous result and lacked common sense. Consequently, the court concluded that the disputed provisions were not reasonably or fairly susceptible to the interpretation advocated by the general partner and because it found no ambiguity in the construction or interpretation of the language of the contract, the court declined to examine the extrinsic evidence offered by the general partner in support of its rejected interpretation. The court also rejected the general partner’s claims that the redemption of its interest were barred by the doctrines of laches, waiver and acquiescence.


In a case arising from an attempt to remove and replace the general partner of a limited partnership after the plaintiff had acquired approximately a 20% interest in the limited partnership through a tender offer (see *Vanderbilt Income* discussed in Section II.F.), the court considered (i) whether the plaintiff had acquired voting rights as a subsequent assignee of limited partnership interests and (ii) whether the general partner had breached its contractual or fiduciary duties by refusing to consent to the plaintiff’s admission as a limited partner. After trial, the court found the provisions regarding the assignment of voting rights from limited partners and assignees to subsequent assignees to be ambiguous and consequently applied the contractual construction principle of *contra proferentum* to give effect to the parties’ reasonable expectations based on the terms of the agreements. In doing so, the court determined that a reasonable investor in the limited partnership could have read the relevant provisions to provide that subsequent assignees would have voting
rights. Therefore, the court held that the plaintiff had the right to vote. With respect to the general partner’s denial of consent to the admission of the plaintiff as a limited partner, the court held that the plaintiff had failed to demonstrate that the general partner had breached its contractual or fiduciary duties. The partnership agreement permitted the general partner to grant or deny consent to the admission of a limited partner in its “sole and absolute discretion.” In light of this standard, the court concluded that the only limitation on the general partner’s discretion was the implied contractual covenant of good faith and held that the plaintiff had failed to show bad faith because the general partner had sufficient reasons to conclude that the plaintiff would not be a suitable partner.


After the court denied the plaintiff limited partners’ motion for judgment on the pleadings, a trial was held to determine whether the limited partners’ decision to remove the general partner for unsatisfactory performance was reasonable and in good faith. The plaintiffs set forth the following reasons for their dissatisfaction: (i) the partnership had made no cash distributions, (ii) the partnership continued to incur excessive overhead expenses, (iii) the partnership never concluded any significant number of anticipated transactions, and (iv) the limited partners had lost confidence and trust in the general partner.

The court found these grounds to be reasonable and in good faith and held that the limited partners had acted properly in removing the general partner. In so doing, it rejected claims by the general partner that its removal would irreparably damage the partnership or constitute a breach of the limited partners’ fiduciary duty to the partnership finding that any such duty would be co-extensive with the requirements of the removal provisions and therefore satisfied.


Plaintiff limited partners agreed to remove the general partner pursuant to a provision in the partnership agreement granting limited partners the discretion to remove the general partner based upon their determination that the general partner had failed to perform satisfactorily. The limited partners then commenced an action for a declaration that their removal of the general partner was valid and effective, arguing that the contractual right to remove the general partner was unqualified and unreviewable. The general partner argued that the determination by the limited partners that the general partner had failed to perform satisfactorily must be reasonable and in good faith.

In denying the limited partners’ motion for judgment on the pleadings, the court held that the limited partners’ contractual power to remove the general partner was subject to an implied condition that the determination be made reasonably and in good faith; otherwise the bargained-for subjective standard of “satisfactory performance” would be rendered a nullity.


Plaintiff general partner asked the court to invalidate its removal by a vote of the limited partners pursuant to the limited partnership agreement based on the general partner’s alleged breach of the agreement. The court denied the general partner’s request, finding that the general partner did materially breach the limited partnership agreement by condoning an act not authorized by the limited partnership agreement and by failing to uphold the duty of loyalty of a fiduciary expressly recited in the limited partnership agreement. Further, the court held that the limited partners had adhered to the provisions of the limited partnership agreement providing for the removal of a general partner for a material breach of the limited partnership agreement.


A general partner of a Delaware limited partnership based in New York sought a declaration that the removal of the managing general partner by a limited partner for fraud by the agent of the managing general partner was effective. Both parties agreed that New York law governed whether the agent’s fraud could be imputed to the general partner. In granting summary judgment for the plaintiff, the court held that under New York law, fraud by an agent of a general partner is imputed to the general partner, even if the general partner does not have knowledge of the fraud, if the fraud results in a violation of the fiduciary duty of the general partner to the partnership. Therefore, because the fraud by the managing general partner’s agent breached the managing general partner’s duty to safeguard partnership property, the limited partner was justified in removing the general partner under the terms of the partnership agreement.
D. partnership opportunities

While the question of usurpation of partnership opportunities has not as yet been the subject of much litigation, the Delaware courts have indicated that, as a general rule, a case involving partnership opportunities would be analyzed using concepts comparable to those applied in the corporate opportunity cases. However, since the corporate opportunity doctrine essentially implicates the corporate duty of loyalty, and unlike the corporate duty of loyalty, the partnership duty of loyalty may be varied by contract, it should be possible for the parties to a partnership agreement to modify the traditional application of the partnership opportunity doctrine.


Plaintiffs, holders of depository units representing limited partnership interests of a Delaware limited partnership, brought a derivative action against the partnership’s general partner, the general partner’s sole shareholder and chief executive officer and certain entities affiliated with the general partner, claiming that the sole shareholder and chief executive officer of the general partner breached his fiduciary duties to the partnership and usurped for himself opportunities of the partnership by failing to make certain investments completely available to the partnership and, instead, dividing the investments between the partnership and entities owned or controlled by the general partner. The partnership agreement provided that the general partner “may compete, directly or indirectly, with the business of the [p]artnership . . . and neither the [p]artnership nor any of the [p]artners or [r]ecord [h]olders shall have any right to participate in such other business interests or ventures or to receive or share in any income derived therefrom.”

Defendants moved to dismiss for failure to state a claim and the court granted defendants’ motion. The court, citing Section 17-1101(d) of DRULPA, stated that traditional fiduciary duties among and between parties are default duties that may be modified by partnership agreements and noted that Delaware case law suggests that partnership agreements may act as safe harbors for partners’ actions that may otherwise violate traditional fiduciary duties. The court found that the defendants’ conduct had been in compliance with the provisions of the partnership agreement and refused to hold that the general partner’s actions were subject to the traditional fiduciary duty of loyalty irrespective of the clear and unambiguous modification of such duty provided in the partnership agreement. Addressing plaintiffs’ claim that defendants had usurped opportunities of the partnership, the court, relying on the reasoning developed in cases dealing with the usurpation of corporate opportunities, concluded that the partnership could not have had a legitimate interest or expectancy in the relevant investments because the partnership agreement put the partnership on notice that the partners intended to compete directly with the partnership, and, in addition, the plaintiffs had failed to allege facts that provided a reasonable inference that information or proprietary investment research had been misappropriated or that partnership resources had been unlawfully redirected.


Plaintiff limited partner sought an injunction preventing the managing general partner from acquiring a competing corporation outside of its capacity as managing partner. The limited partner claimed, among other things, that the acquisition would breach the managing partner’s duty of loyalty to the partnership.

In analyzing whether the acquisition breached a fiduciary duty of loyalty, the court found that the “corporate opportunity” doctrine was generally applicable to limited partnerships based on the similarity of the fiduciary duties present in corporations and limited partnerships. The court held in this instance, however, that the doctrine was not applicable because the opportunity to acquire the competing company did not belong to the partnership. Thus the actions of the general partner did not usurp an opportunity of the partnership, and the limited partner’s claim was therefore denied.

E. Indemnification

In contrast to the detailed provisions relating to indemnification of corporate officers and directors set forth in the DGCL, Section 17-108 of the DRULPA simply provides that a limited partnership may indemnify and hold harmless any partner or other person from or against any and all claims and demands whatsoever, subject to the standards and restrictions set forth in the partnership agreement. The Delaware courts have explicitly recognized the disparate treatment accorded to indemnification by the DGCL and the DRULPA and have held that, as a general matter, general partners will be entitled to indemnification where they have satisfied the requirements set forth in the partnership agreement.
In these, the last of several related actions brought in Delaware, New Jersey and New York, Mikael Salovaara sought enforcement of the indemnification clauses of several different partnership agreements. Previously, one of Salovaara’s partners, Alfred C. Eckert, filed a complaint in the Court of Chancery, asking the court generally to interpret the indemnification provisions of the relevant partnership agreements and specifically to determine whether Salovaara was entitled to indemnification of his legal fees and expenses in connection with suits that Salovaara himself had initiated to obtain personal recovery as a plaintiff. During the pendency of Eckert’s initial action, Eckert and Salovaara were involved in related litigation in New Jersey and New York. In the New York litigation, it was determined that one of the partnerships managed by Eckert and Salovaara was an ERISA fund, which could therefore indemnify a person only “for those expenses that are incurred pursuant to his duties with the plan, and that are undertaken for the exclusive benefit of the plan.” In the New Jersey litigation, it was determined that Eckert was not entitled to indemnification because he had acted with bad faith and willful misconduct and further that the relevant partnership agreements contemplated the indemnification not of plaintiffs but only of defendants. Nonetheless, several months before the New Jersey court’s decision, Eckert sought a voluntary dismissal without prejudice of the action he had originally brought in the Court of Chancery. Salovaara argued in response that (a) it would be inequitable to dismiss the action without prejudice because Eckert had forced the issues of plaintiff indemnification to be litigated in the Chancery Court, (b) the Chancery Court should dismiss the action with prejudice because Eckert had all along asserted that Delaware had a paramount interest in the matter and (c) the Chancery Court should dismiss the action with prejudice because the parties had already expended hundreds of thousands of dollars in legal fees and the case was ready for trial. The Court of Chancery dismissed the action with prejudice, ordering Salovaara to be indemnified for past legal fees and expenses and to receive an advancement against future legal fees and expenses. This order was stayed pending the final disposition of the New York litigation, including any appeals therefrom.

In the present disposition, the court vacated the stay of its earlier order, allowing Salovaara to be indemnified for the legal fees and expenses he had incurred as a plaintiff. The dismissal with prejudice had the effect of conclusively determining that the relevant partnership agreement was drafted to encompass plaintiff indemnification. In outlining this conclusion, Chancellor Chandler emphasized the fact that Eckert had brought this outcome on himself when he moved for the dismissal of his own case without prejudice: “In essence, by asking this Court to dismiss voluntarily the Related Indemnification Action, Eckert stood before this Court and said, ‘I admit my claim has no merit. Salovaara is entitled to indemnification….’ This Court is a court of equity and Eckert cannot persuade it to disregard the voluntary circumstances under which the June 14 Order was entered, simply in order to avoid a conflict, which is the product of his own actions, in judgments between this Court and a sister court in New Jersey.” The New York decision regarding ERISA, however, prevented Salovaara from receiving indemnification from one of the partnerships. Related partnership agreements with identical indemnification clauses were read to provide indemnification for plaintiffs as well as defendants. Finally, the court refused to distinguish between plaintiff indemnification versus defendant indemnification regarding the statute of limitations, upholding the previous ruling of Scharf v. Edgcomb Corp., 1997 WL 762656 (Del. Ch. 1997), that the statute of limitations on an indemnification claim accrues on the date the indemnitee could be confident any claim against him had been resolved with reasonable certainty.

After a series of legal proceedings relating to the post-dissolution liquidation of a Delaware limited partnership, the court had granted summary judgment to the general partner on all but five of the plaintiff limited partners’ claims. The five remaining claims against the general partner included a claim for the breach of duty of loyalty by giving certain information to only one of three appraisers valuing the partnership’s assets, allegedly in order to manipulate the ultimate appraisal figures and a claim for breach of the partnership agreement by not valuing the assets on a “going concern” basis, resulting in the partnership receiving less than the assets were worth. In this proceeding, the general partner moved for judgment on the pleadings on the five remaining claims, arguing that the claims were derivative claims and that plaintiffs had not properly pleaded such claims because plaintiffs had not pleaded demand refused or, in the alternative, demand futility. Plaintiffs moved to have a class of all limited partners certified to pursue each of these claims and moved to have the general
partner enjoined from advancing itself litigation expenses from partnership funds to pay for the litigation.

The court began its discussion by reference to the corporate common law rules surrounding derivative claims and noting that while it would look to corporate precedent it recognized the need for flexibility in determining its applicability. Turning to plaintiffs’ five claims, it first held that three were clearly direct claims because they fell distinctly upon the individual participants in the business association or involved the participants’ contractual rights. The court noted that the two remaining claims, which are referenced above, at first appear derivative in nature since the alleged injury devalued the partnership’s assets. However, given the current position of the partnership in the final stages of its post-dissolution liquidation, the court found that the “purposes for classifying claims as derivative and, in particular, the reasons for its attendant demand rule, are not present here.” The court had identified the two discernable purposes for classifying claims as derivative as first, insuring that injury to a whole association is adjudicated on behalf of that whole and not just for the benefit of the individuals who have undertaken to pursue the claims, and second, carrying out the desired public policy of galvanizing a governing entity within the business association into taking action to address injury on behalf of the business. The court therefore found that “imposing derivative requirements on these two claims would only set up a legal artifice that has no justification and, therefore, put plainly, makes no sense.” The court stated the test for determining whether claims were direct or derivative in the partnership’s situation as follows:

If: (1) a business association consists of only two parties in interest, one a putative class of injured plaintiffs and the other the defendant party that controls the business association; and, (2) the business association is effectively ended, but for the winding up of its affairs; and, (3) the two sides oppose each other in the final dispute over the liquidation of that association; then a claim brought in that context is direct.

Applying the foregoing standard, the court held that plaintiffs’ claims were direct claims, and therefore denied defendant’s motion for judgment on the pleadings. In addition, since defendant’s only opposition to plaintiffs’ motion for certification of a class of limited partners was on grounds that the claims were derivative in nature, plaintiffs’ motion for class certification was granted.

With respect to plaintiffs’ motion to have defendant enjoined from advancing itself litigation expenses from the partnership funds, the partnership agreement provided, in relevant part, that “[e]xpenses incurred by an Indemnitee . . . shall be advanced . . . provided that . . . (ii) such legal action is initiated by a third party who is not a Limited Partner.” Plaintiffs argued that the limitation in such provision conditioning advances on limited partners not being plaintiffs in the litigation prohibited the payment of advances to defendant with respect to this action. Defendant claimed that the partnership agreement only specified conditions under which advances were mandatory and that, pursuant to defendant’s exclusive authority under the partnership agreement to manage the business affairs of the partnership, defendant could in the exercise of its discretion make advances to itself. The court rejected defendant’s argument because it would render the limitation on advances in the partnership agreement illusory and because it was contrary to the court’s adherence to the principle that general discretionary provisions in contracts do not negate explicit limitations found elsewhere in the contract. After finding that plaintiffs had satisfied the criteria for granting injunctive relief, the court permanently enjoined defendant from advancing itself litigation expenses from partnership funds and required defendant to return any funds it had previously advanced to itself in this action.


The general partner filed an action in Delaware seeking a judicial dissolution of a Delaware limited partnership and shortly thereafter the limited partner filed its own action in New York seeking judicial dissolution and an accounting and also asserting claims of breach of fiduciary duty, breach of contract and fraud. Following the entry of a decree of judicial dissolution of the limited partnership by the Delaware Court of Chancery, the limited partner challenged the general partner’s advancement of partnership funds to cover the legal expenses of the general partner and its affiliates in the two separate actions. Because the partners had not entered into a written limited partnership agreement and the evidence of their negotiations regarding indemnification issue was limited, the court relied upon the provisions of the DRULPA to determine whether or not it was permissible for the general partner to make the advancement of funds. Noting that no prior Delaware case has
decided whether DRULPA Section 17-108 permits a limited partnership to indemnify a partner or other person in the absence of a provision in the partnership agreement, the court held that in the absence of such a provision the best reading of Section 17-108 is that it permits a limited partnership to indemnify a partner or other person although it does not impose a duty to use such power nor create a right of partners or others to indemnification. The court also rejected the general partner's argument that DUPL Section 1518(2) provides a back-up rule in the circumstances where a limited partnership agreement does not include a provision regarding indemnification because DRULPA Section 17-108 speaks directly to the issue of indemnification. The court went on to determine that a limited partnership’s power to indemnify also includes the power to advance litigation expenses.

Although the court stated that, pursuant to 1518(6) of the DUPL, a general partner who winds up a partnership’s affairs has the right to receive reasonable compensation for this task, including the recovery of reasonable litigation expenses, the court noted that all of the general partner’s legal expenses were not necessarily recoverable because they did not all appear to be “wind up” expenses. The court held that it was fair and reasonable for the general partner to recover its reasonable core costs related to the winding up of the limited partnership, such as fees and expenses related to the accounting. However, the court found that some of the general partner's expenses related to the retention of pecuniary advantage for the general partner. In regard to the general partner's advancement of such expenses to itself, the court stated that the general partner could not rely on the protections of the business judgment rule in connection with a self-interested decision and found that the general partner failed to meet its burden of proving the fairness of such expenses. Thus, the court held that the general partner improperly advanced the litigation expenses related to its own pecuniary advantage rather than the winding up the limited partnership.


Two limited partners brought an action derivatively and individually against the general partners for improperly advancing legal fees and expenses to themselves to defend a separate claim against them by the limited partners. The court held that under DRULPA Section 17-108 limited partnerships are permitted to contract freely with regard to indemnification and advancement of expenses, unlike the narrower statutory indemnification provisions applicable to general partnerships and corporations. Therefore, because the general partners had satisfied the criterion set forth in the partnership agreement of incurring a loss in connection with the partnership that was not the result of willful misconduct, gross negligence or breach of fiduciary duty, the court held that the general partners were legally entitled to the advancements to cover legal expenses.

F. Contests for Partnership Control

The takeover area is one in which the differences in structure between corporations and partnerships can lead to significantly different treatment by the courts on certain basic issues. For example, in a case in which the corporate parent of a general partner was making a tender offer for all of the limited partnership units of the partnership, the limited partners challenged the tender offer on the ground, among others, that it constituted a change in control and the general partner was therefore required to seek the best price available, which he had not, in plaintiffs’ judgment, done. The court, however, focused on the structure of the partnership under which, as is typical, the limited partners had no management rights and therefore concluded that no control premium was at issue. Another structural difference between corporate and partnership takeovers relates to the procedure for becoming a shareholder as compared to the procedure for becoming a limited partner. The former, at least in public companies, is usually an automatic consequence of the purchase of stock, subject to valid notice to the corporate transfer agent. The latter, however, may require the satisfaction of various, sometimes onerous, conditions, which can include the delivery of legal opinions and may also require the discretionary approval of the general partner. This difference can be critical in the takeover context because many partnership agreements, as well as the DRULPA, reserve the exercise of important rights to limited partners (as opposed to assignees). Thus, those who have not been admitted as limited partners may neither be able to exercise such rights nor challenge actions by the general partner relating thereto.


Plaintiff limited partners sought to enjoin a tender offer by the corporate parent of the general partner for at least a majority of the limited partnership units, claiming, among other things, that the
tender offer constituted a change of control that brought about a fiduciary obligation of the general partner to take reasonable steps to achieve the highest price available, i.e. the corporate “Revlon” duty.

In denying injunctive relief, the court held that the general partner had no fiduciary duty to seek a control premium in the acquisition by its corporate parent of a majority of the limited partnership interests because such an acquisition would not constitute a change of control where the partnership agreement deprived the limited partners of any significant control rights. Under the agreement, the limited partners could not manage the partnership or control its assets and could not remove the general partner except for a breach of fiduciary duty. Although the limited partners were entitled to vote on designated matters such as mergers and certain acquisitions and amendments, the court held that this did not amount to control or the ability to command a control premium. Moreover, as further evidence that no control premium was applicable, the court noted that the general partner had absolute discretion to prohibit the transfer of any limited partnership units. Thus the court refused to impose a Revlon duty on the general partner which would effectively undermine the explicit terms of the limited partners’ investment as dictated by the partnership agreement.

In a subsequent decision, the court granted the plaintiffs’ motion for a voluntary dismissal of this case without prejudice in favor of parallel litigation pending in the United States District Court for the Southern District of Florida, citing judicial economy and the lack of legal prejudice to the defendants.

After the District Court in Florida dismissed the action for want of subject matter jurisdiction as a result of the defection of certain plaintiffs, the action was revived in the Court of Chancery. At this point in time, the tender offer had closed and the corporate parent of the general partner owned 50.4% of the limited partnership units of the partnership. Within months of the closing, defendant general partner, in a change from its prior distribution policy and the projections forecast in the tender offer circular, more than doubled the size of cash distributions to limited partners. Plaintiffs filed an amended class action complaint alleging breach of partnership agreement, breach of fiduciary duties and additional claims relating to the tender offer. Defendants filed a motion to dismiss several of plaintiffs’ claims and a motion for summary judgment with respect to plaintiffs’ claim that the general partner breached its fiduciary duty of loyalty by limiting pre-closing distributions to limited partners in contemplation of and to facilitate the tender offer. The court denied the defendants’ motion to dismiss with respect to the claims that the general partner’s disclosures relating to distributions were materially misleading. The court stated that “[w]here, as here, the lone source of disclosure is a fiduciary having a conflicting interest, an obligation of complete candor is imposed on the fiduciary and judicial scrutiny of the disclosure is more exacting” and, based on the timing and dramatic nature of the change in distributions policy, found that plaintiffs were entitled to an inference that defendants did not believe the projections when they made them. The court also denied defendants’ motion for summary judgment, finding that material issues of fact were in dispute with respect to the timing, motivation and effect of the general partner’s decision to change the distribution policy, noting that “the fortuitous timing of the General Partner’s change in distribution policy calls into question the good faith of the General Partner’s management decisions in the time period preceding the Offer.” The court granted the defendants’ motion to dismiss the remaining claims in the complaint. With respect to plaintiffs’ claim that the “entire fairness” standard applied to the tender offer, the court disagreed, stating that this was not a situation in which one party stood on both sides of a transaction and could have effectuated changes to the detriment of fellow investors; in this case, defendants made a voluntary tender offer directly to the limited partners. With respect to the claim that defendants breached an implied obligation in the partnership agreement to ensure fairness in any transaction involving the general partner, which obligation the plaintiffs alleged arose from provisions in the partnership agreement that set forth an independent appraisal process designed to ensure that the partnership would receive fair value in a sale of partnership assets to the general partner or its affiliates, the court found no basis for the inference in this situation due to the essentially voluntary nature of the tender offer and refused to imply an intention in the partnership agreement to subject the tender offer to an independent appraisal process. Finally, with respect to plaintiffs’ claim that defendants breached fiduciary duties of due care and good faith by not protecting the limited partners from the threat of an unfairly priced offer, the court held that it would be unreasonable and inappropriate to impose such an obligation on the defendants in relation to a voluntary tender offer which involved no act of corporate governance and found that the requirement under Delaware law that the tender offer by the defendants be made
with complete disclosure and be non-coercive provided an adequate framework to protect the interests of limited partners.


   In a case arising from an attempt to remove and replace the general partner of a limited partnership after the plaintiff had acquired approximately a 20% interest in the limited partnership through a tender offer (see *Vanderbilt Income* discussed below), the court considered (i) whether the plaintiff had acquired voting rights as a subsequent assignee of limited partnership interests and (ii) whether the general partner had breached its contractual or fiduciary duties by refusing to consent to the plaintiff’s admission as a limited partner. After trial, the court found the provisions regarding the assignment of voting rights from limited partners and assignees to subsequent assignees to be ambiguous and consequently applied the contractual construction principle of *contra proferentum* to give effect to the parties’ reasonable expectations based on the terms of the agreements. In doing so, the court determined that a reasonable investor in the limited partnership could have read the relevant provisions to provide that subsequent assignees would have voting rights. Therefore, the court held that the plaintiff had the right to vote. With respect to the general partner’s denial of consent to the admission of the plaintiff as a limited partner, the court held that the plaintiff had failed to demonstrate that the general partner had breached its contractual or fiduciary duties. The partnership agreement permitted the general partner to grant or deny consent to the admission of a limited partner in its “sole and absolute discretion.” In light of this standard, the court concluded that the only limitation on the general partner’s discretion was implied contractual covenant of good faith and held that the plaintiff had failed to show bad faith because the general partner had sufficient reasons to conclude that the plaintiff would not be a suitable partner.


   Plaintiffs sought control of a limited partnership through a tender offer for sufficient limited partner interests to remove and replace the general partner. In connection with their tender offer, plaintiffs filed a breach of fiduciary duty claim against the general partner for entering into a loan transaction that plaintiffs alleged was for the primary purpose of entrenching itself as general partner. The general partner filed a motion to dismiss the claim on the pleadings for lack of standing. The court based its ruling to dismiss and subsequent denial of plaintiffs’ motion for reargument on its holding that to have standing to pursue a breach of fiduciary duty claim, the plaintiffs were required to have the right to vote by written consent, and because none of the plaintiffs (including the assignee) had such a right. The court, however, based its holding on the disclosure in the partnership prospectus and the Supreme Court reversed on appeal, ruling that the lower court had considered matters outside of the pleadings (i.e., the partnership prospectus) in ruling on the motion to dismiss.


   Plaintiffs commenced a consent solicitation in an attempt to acquire a group of limited partnerships. The general partners of the partnerships responded by adopting amendments to the partnership agreements significantly restricting the ability of the limited partners to act by written consent. The plaintiffs then filed suit to challenge the validity of the amendments to the partnership agreements, alleging that the adoption of the amendments constituted a breach of the general partners’ fiduciary duties and seeking a declaratory judgment that the amendments were null and void. None of the plaintiffs were limited partners of any of the partnerships, although one of the plaintiffs had acquired an interest in a partnership as an assignee but had not been admitted as a substituted limited partner.

   The court dismissed the claims of the plaintiffs for lack of standing. It held that in order to maintain a claim for breach of fiduciary duty, the plaintiffs must first show that they were owed such a fiduciary duty and because none of the plaintiffs (including the assignee) had a right to vote by written consent, they had no standing to bring a claim alleging breach of a fiduciary duty relating to the exercise of a right to vote by written consent. In addition, certain aspects of the plaintiffs’ claims were found to be derivative in nature, which required, among other things, the plaintiffs to be partners at the time of bringing the action under Section 17-1002 of the DRULPA. Finally, the
request for declaratory judgment was dismissed because, after the dismissal of the fiduciary duty breach claim, no independent basis for equitable jurisdiction existed to support a declaratory judgment action in the Court of Chancery. (DRULPA Section 17-111 was adopted later in 1994 to provide jurisdiction in the Court of Chancery for all actions relative to the interpretation or enforcement of partnership agreements.)

G. Dissolution

The circumstances surrounding dissolution of a limited partnership provide another fertile area for litigation. Under the DRULPA, subject in certain cases to the contrary terms of the partnership agreement, dissolution occurs upon agreement of all the partners, upon the withdrawal of the general partner (unless continued as provided in the DRULPA), upon the withdrawal of the last remaining limited partner (unless continued as provided in the DRULPA) or as otherwise provided in the partnership agreement. In addition, the Delaware Court of Chancery may decree dissolution whenever it is not reasonably practicable to carry on the business of the partnership in conformity with the partnership agreement. In limited partnerships where the limited partners are dissatisfied with the performance of their investment but cannot liquidate their investment (either because of transfer restrictions or lack of a market) and cannot remove the general partner or cause the dissolution of the partnership (because they have no right under the partnership agreement), the limited partners’ primary or sole recourse may be to seek dissolution on the grounds that it is not reasonably practicable to carry on the business of the partnership. While the Delaware courts have found grounds that support such a conclusion, for example, where the court determined there was no reasonable opportunity for a limited partnership to fulfill its express purpose, mere dissatisfaction with the management by a general partner (even when coupled with the general partner’s refusal to sell the partnership when the limited partners considered the sale value to be greater than its operating value) has been held insufficient to satisfy the requirement for judicial dissolution. In construing the terms of partnership agreements in the context of dissolution, the courts continue to give effect to the agreed upon provisions of the contract. Thus, courts have required pro rata distributions even to a limited partner that might ultimately have been proven to owe money to the partnership, allowed a general partner to purchase the assets of a partnership, rather than sell to a third party, where such purchase was specifically provided for in the partnership agreement and nullified a limited partnership’s certificate of cancellation when the limited partnership had not been dissolved pursuant to the terms of the partnership agreement and the general partner had improperly filed the certificate.


Plaintiff limited partner claimed the general partner breached its fiduciary duty to the partnership by electing to purchase the assets of the partnership upon the liquidation of the partnership under the terms of an appraisal process in the limited partnership agreement. The court, in denying the plaintiff’s motion to enjoin the sale, held that the general partner’s actions were not a breach of its fiduciary duty because the parties to a limited partnership agreement, which is primarily contractual in nature, are permitted to expressly modify traditional concepts of fiduciary duty by allowing the fiduciary to deal directly with the limited partnership and to define the parameters of due care within the structure of the partnership.

In a later ruling in the Cencom case on the general partner’s motion for summary judgment, the court dismissed the limited partners’ claim that the general partner was obligated to fulfill a common-law fiduciary duty, beyond the bargained-for terms of the partnership agreement, showing the “entire fairness” of the sale of the partnership’s assets to the general partner, stating that it would not subject the sale process set forth in the partnership agreement to “some court-approved, after-the-fact, moralistic ‘entirely-fair’ standard, when the parties defined the desired process in the Partnership Agreement.” The court denied a subsequent motion by plaintiffs to alter, amend or reconsider the decision based on the alleged failure of the court to address certain of the plaintiffs’ claims. The court found no clear error of law in its decision and concluded that it had not overlooked a controlling principle of law or misapprehended the law or material facts.

In a further proceeding in the Cencom case, the general partner again moved for summary judgment with respect to the claims that (i) it breached its voluntary, contractually assumed fiduciary duty to assure the fairness of the sale, (ii) it did not have the authority to terminate certain distributions to the limited partners and (iii) it breached its fiduciary duties of loyalty and candor in connection with the appraisals of the partnership’s assets. The court granted the general partner’s motion with respect to one sub-issue of the breach of fiduciary duties of loyalty and candor claim, holding that the general partner had supplied equal information to each appraiser. Because the court found that
genuine issues of material fact existed with respect to the other claims at issue, the court denied the remaining parts of the general partner’s motion for summary judgment.


In connection with an action filed by plaintiff general partner seeking judicial dissolution of a Delaware limited partnership, the court had previously entered a decree of dissolution of the limited partnership. This post-trial opinion resulted from a fight between the partners regarding the accounting of the limited partnership’s assets. The court had to establish the date of dissolution in order to determine which assets should be included in the accounting. Because the partners had not entered into a formal written limited partnership agreement, the court had to establish the terms of their oral partnership agreement. To the extent that the court could not glean necessary terms from the partners’ bargaining history and conduct, the court looked to the provisions of DRULPA, as well as the provisions of DUPL and the rules of law and equity as “gap fillers” for DRULPA pursuant to DRULPA Section 17-1105. Neither party disputed that the latest date of dissolution of the limited partnership would be the date on which the decree of judicial dissolution was entered. However, the general partner argued that the limited partnership was in fact dissolved at an earlier time and asserted that the limited partnership was dissolved when the general partner fired one of the owners of the limited partner from his position with the limited partnership, i.e., the time at which it was no longer “reasonably practicable” for the partners to continue the partnership. The court rejected this argument as well as the limited partner’s assertion that the partners had no right to exit the partnership absent judicial intervention. Notwithstanding DRULPA Sections 17-602 and 17-603, which restrict the rights of general partners and limited partners to withdraw from a limited partnership, the court held that in the absence of an agreement limiting the dissolution rights of the partners, the partners retained “walk away” rights. The court further stated that Delaware public policy, as reflected in DUPL, allows partners to dissolve general partnerships by their “express will.” The court found that the date of dissolution of the limited partnership was the date on which the general partner gave express notice of its intent to dissolve the partnership to the limited partner and not the later date on which the decree of judicial dissolution was entered.


Plaintiff limited partner sought judicial dissolution of the limited partnership under Section 17-802 of the DRULPA alleging that it was not reasonably practicable to carry on the business of the partnership for its intended purpose and that the general partner had breached its fiduciary duties to the limited partners and committed gross negligence in managing the partnership. As the court noted, the partnership agreement did not provide for removal of the general partner by the limited partners.

The court rejected plaintiff’s claims that the partnership was not producing returns as great as anticipated and that the partnership was engaging in direct competition with the business of the plaintiff, holding that the partnership agreement had no set timetable for partnership profitability and did not prohibit competition between the partnership and its partners. The court also rejected plaintiff’s claim that the general partner violated its fiduciary duties by refusing to sell the partnership when the plaintiff considered the sale value of the partnership to be greater than its operating value because (i) the sale of the partnership requires the unanimous consent of all of the partners under DUPL Section 1509 and could not be accomplished unilaterally by the general partner and (ii) the general partner owned a majority interest in the partnership and had the right to manage the partnership in accordance with the partnership agreement and was under no duty to abandon the partnership and sell it simply because one partner believed it to be in its own best interests. Finally, with regard to the plaintiff’s claims of gross negligence, the court held that under the partnership agreement plaintiff had the burden of proving that the general partner acted in a recklessly uninformed manner and that plaintiff had failed to meet that burden.


After limited partners questioned certain actions taken, or omitted to be taken, by the limited partnership, the general partner filed a certificate of cancellation of the partnership without notifying the limited partners. The limited partners, without knowledge that the partnership had been terminated, made written demand on the general partner to bring a derivative action and, after

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failing to receive an adequate response from the general partner, filed a derivative action in Massachusetts. The Massachusetts’ courts dismissed the limited partners’ action because the limited partnership had not registered to do business in Massachusetts and could not register because it was no longer a legal entity. The plaintiff limited partners then brought suit in the Delaware Court of Chancery requesting that the court nullify the limited partnership’s certificate of cancellation. The court held that the certificate of cancellation was improperly filed because the limited partnership had not been dissolved under the terms of the partnership agreement. In addition, the court held that even if the partnership had been properly dissolved, the affairs of the partnership were not wound up in accordance with Section 17-804(b) of the DRULPA, which requires a limited partnership upon dissolution to pay or make reasonable provision to pay all of its claims and obligations, including all contingent, conditional or unmatured claims and obligations. The general partner had been aware of the plaintiff limited partners’ claims at the time the certificate of cancellation was filed and had not made any reasonable provisions to provide for such claims. Therefore, the court granted the plaintiffs’ motion to nullify the limited partnership’s certificate of cancellation. On a motion for rehearing, the court rejected the general partner’s argument that Section 17-804(b) only applies to creditors of a limited partnership. The court stated that Section 17-804(b), by its terms, applied to “claimants” and, absent an indication that it was intended to be limited to creditors, should be construed to protect the rights of derivative claimants as well as the rights of creditors and partners.


Plaintiff limited partners brought an action for breach of contract and breach of fiduciary duties against the corporate general partner and the general partner’s directors and sole stockholder. The plaintiffs sought to require the defendants to perform what plaintiffs considered to be their duties under the partnership agreement and related agreements, or in the alternative, they sought a judicial dissolution of the partnership and damages in an amount that reflected their share of future profits that would have been earned during the term of the partnership. The defendants moved for partial summary judgment seeking dismissal of the plaintiffs’ claim for dissolution of the partnership.

The court denied defendants’ motion for summary judgment, holding that if the plaintiffs succeeded in proving that there had been material breaches of duties arising from the partnership agreement and that these breaches were such as to make continuation of the business of the limited partnership impracticable, then dissolution of the partnership could be appropriate. However, in the trial that followed, the plaintiffs were unable to support their claims of breach of duty and their motion for dissolution was denied.


The general partner of a limited partnership sought an order directing the judicial dissolution of the partnership under DRULPA Section 17-802 or, in the alternative, a declaration that the general partner could resign from the partnership without liability upon finding itself in a position of irreconcilable conflict between the fiduciary duty owed as a general partner to the limited partners and its duty to its parent with respect to actions it might take to improve the financial conditions of the limited partnership. Because the imminent foreclosure of a plot of real estate had eliminated any reasonable opportunity for the partnership to fulfill its express purpose of using that real estate “for profit and as an investment,” the court ordered the dissolution of the limited partnership based on a finding that it was no longer reasonably practicable to carry on the business of the partnership in conformity with the partnership agreement.


Certain limited partners sought to enjoin a non-pro rata liquidating distribution proposed by the partnership’s liquidator (who had been appointed upon the withdrawal of the general partner). The proposed distribution sought to exclude the objecting limited partners from receipt of liquidating distributions based on the liquidator’s belief that they were involved in wrongdoing and would ultimately be found liable for damages to the partnership. Implementation of the non-pro rata distribution required either the adoption of an amendment of the partnership agreement or a breach of its explicit terms allegedly dictated by the liquidator’s fiduciary obligations. However, amendments to the partnership agreement were required to be approved by the “general partner,” and the court concluded that under the terms of the partnership agreement the liquidator did not
possess the power of a general partner to approve an amendment concerning distributions. Accordingly, the proposed amendment could not properly be adopted. Similarly, the court concluded that although the non-pro rata distribution did not constitute a breach of fiduciary duty, it did constitute an unenforceable breach of the partnership agreement. Consequently, the court preliminarily enjoined the making of liquidating distributions.

The court also addressed certain issues relating to creditors’ rights in connection with liquidating distributions. In this regard, it noted that prior to making distributions to partners, the DRULPA allowed a liquidator to pay creditors or establish reserves. In the absence of legislative history amplifying the procedure for establishing reserves, the court looked to the corporate law for guidance and concluded that if the liquidator established reserves, a creditor would be entitled to adequate security and such security could in appropriate cases be afforded by the general assets left in the partnership. However, if the liquidator chose to make a distribution to partners before all creditors had been paid or actually funded, dollar for dollar, in segregated reserves, the liquidator would bear the burden of proving the adequacy of the proposed security. The court also noted that in appropriate cases a promise to repay a distribution by a creditworthy limited partner if required to satisfy creditors’ claims, coupled with an undertaking by such limited partner to submit to the jurisdiction of the Delaware Court of Chancery to resolve any related disputes, could constitute adequate security for contingent, unliquidated claims against the partnership.

H. Derivative Actions

Pursuant to Section 17-1001 of the DRULPA, limited partners of a Delaware limited partnership may bring a derivative action in the Delaware Court of Chancery if the general partners have refused to bring the action or an effort to cause the general partners to do so is not likely to succeed. In interpreting and applying Section 17-1001, the Delaware courts have analogized to the Delaware corporate case law. Thus, as a general matter, the courts have applied the corporate demand futility analysis to partnership derivative suits. However, under certain circumstances the courts will modify the corporate rule to fit the partnership structure. Thus, in the case of a one-person general partner, a Delaware court has declined to apply the corporate rule that a shareholder who elects to make a demand concedes the independence of the governing body. Similarly, a Delaware court has held that a special litigation committee may function in the partnership context in a manner comparable to the manner in which it functions in the corporate context. That case provided that in the partnership context, the partnership agreement must provide for the creation of the special committee since, in contrast to the DGCL, the DRULPA made no explicit provision for committee action. Subsequent amendments to the DRULPA have statutorily sanctioned delegations of authority by general partners, absent limitations in a partnership agreement, thus presumably allowing special committees without specific authorization in the partnership agreement. See DRULPA Section 17-403(c).

1. Standing to Bring a Derivative Action


The general partner of a hedge fund withdrew over $22 million from its capital account. The limited partners took issue with this withdrawal on three bases: (i) the withdrawal overdrew the general partner’s account, (ii) the general partner was permitted by the fund agreement to withdraw funds only on the last day of a given month, which it did not do here, and (iii) the fund’s annual audited financial statement did not disclose the general partner’s withdrawal of funds. The plaintiff limited partners sued the general partner and the firm’s independent auditors for breach of contract, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, negligence, negligent misrepresentation and fraud. The defendants challenged the standing of the plaintiffs to bring the claims and moved to dismiss the complaint under Court of Chancery Rule 12(b)(6) (failure to state a claim). Delaware partnership law requires in a derivative action that the plaintiff be a partner or a partner’s assignee at the time of bringing the action and at the time of the challenged transaction. Here, the plaintiffs did not meet these requirements because they had all withdrawn from the fund by the time the instant action was filed.

Chancellor Chandler spent a good deal of the opinion discussing the defendants’ argument that all of the plaintiffs’ claims were derivative and that the plaintiffs did not have the standing to bring a derivative claim. The court noted that the test for distinguishing direct from derivative claims in the context of a limited partnership is substantially the same as that used when the underlying entity is a corporation. If the injury is one that affects all
partners proportionally to their pro rata interests in the partnership, the claim is derivative, the plaintiff sues for an injury done to the partnership and any recovery of damages is paid to the partnership. In a direct action, on the other hand, the plaintiff sues to redress an injury suffered by the individual plaintiff and damages recovered are paid directly to the plaintiff who suffered injury. But flexibility, common sense and equity predominate over formal distinctions: “[I]n some instances, the relationships among the parties and the function and structure of the partnership itself may diverge from the corporate model so dramatically that some claims, which in a corporate context might be classified as derivative, must be brought as direct claims in order to enable the injured parties to recover while preventing a windfall to individuals or entities whose interests were not injured.” Here, even though a diminution in value of business entity is a quintessentially derivative claim, the court held that circumstances required that the claims be treated as direct. Otherwise, characterizing the plaintiffs’ claims as derivative would have the perverse effect of denying both standing and recovery to the limited partners who were actually injured by the challenged transactions while granting ultimate recovery to new partners who were not harmed. Moreover, such characterization would do nothing to further the gatekeeping functions of derivative litigation requirements, which otherwise, but not in this instance, would promote corporate resolution of internal problems and deter strike suits. Such a result “makes no sense.” Similarly, the plaintiffs’ claim regarding the nondisclosure of material information, while at first glance a derivative claim, was treated here as a direct claim because of significant differences between the fund’s structure and corporate structure and also because the general partner violated the contractual rights of the limited partners to receive an annual audited financial report, which rights were not also rights of the fund.

Although the plaintiffs’ claims of fraud did not survive the defendants’ motion to dismiss because they were not pled with sufficient particularity, all of the plaintiffs’ other claims survived the motion to dismiss.

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Plaintiff limited partner brought direct and derivative claims challenging a series of unit purchases in a Delaware limited partnership by the corporate parent of the general partner and other related persons as unfair to the partnership and designed to entrench the general partner. The defendants alleged that prior to bringing the derivative action the plaintiff expressed a willingness not to pursue it if the plaintiff were given a fee-generating role to seek a financial restructuring of the partnership and that the plaintiff only pursued the action after the defendants refused the plaintiff’s offer. The defendants asserted that, because the plaintiff attempted to coerce the partnership into paying it a fee to avoid this lawsuit, the plaintiff had a conflict of interest that precluded it from serving as a derivative plaintiff and, in addition, that the doctrine of unclean hands barred the plaintiff’s right to assert its claims. The plaintiff moved for summary judgment with respect to the defendants’ affirmative defenses.

In evaluating the defendants’ claim that the plaintiff is not a proper derivative plaintiff, the court adopted the standard developed under Delaware corporate case law, which requires a show[ing] that a serious conflict of interest exists, by virtue of one factor or a combination of factors, and that the plaintiff cannot be expected to act in the interests of others because doing so would harm his other interests. In effect, the defendant[s] must show a substantial likelihood that the derivative suit is not being maintained for the benefit of the [partners of the Partnership].

The court found that even though the lawsuit may have originated from unseemly behavior of the plaintiff, there was nothing in the plaintiff’s litigation strategy that suggested that its prior behavior affected its ability to prosecute the action in a manner that was in harmony with the interests of the other unitholders. According to the court, the relief the plaintiff was seeking in the suit would benefit all of the unitholders of the partnership other than the defendants. The court stated that there was no evidence that the plaintiff’s interests were adverse to the non-defendant unitholders and that, on the contrary, granting defendants’
motion would allow the defendants’ to avoid the merits of a lawsuit that could compromise their interests and benefit the other unitholders. The court thus granted the plaintiff an award of summary judgment declaring it to be a proper, non-conflicted plaintiff with standing to pursue this derivative lawsuit on behalf of the partnership.

The court then turned to the plaintiff’s motion for summary judgment on the defendants’ unclean hands affirmative defense. The defendants did not claim that the plaintiff’s behavior in any way influenced the challenged transactions. Rather, the defendants’ argued that they would not be facing a challenge to the transactions if they had not denied the plaintiff’s extortionate offer. The court found that the plaintiff’s alleged conduct had no effect on the court’s analysis of whether or not the challenged transactions were proper. Therefore, the court held that the public policy underlying the clean hands doctrine would not be served by denying the plaintiff its right to seek relief that would benefit the other unitholders of the partnership and, in fact, the application of the clean hands doctrine in this circumstance may have the practical effect of exculpating the wrongful conduct of the defendants. The court thus granted the plaintiff’s motion for summary judgment on the issue but noted that, if the defendants prevail in the derivative suit and prove that plaintiff engaged in the alleged conduct, they may have a basis to recover their fees and expenses incurred in defending this lawsuit and, if the defendants lose, the plaintiff’s alleged conduct may be relevant in determining whether the plaintiff is entitled to recover its fees and expenses.

In a later proceeding in this action, the court addressed the plaintiff’s motion for partial summary judgment seeking a declaration (i) that the plaintiff had standing to pursue the derivative action on behalf of the partnership and (ii) that the plaintiff had been admitted as a substituted limited partner of the partnership when it first acquired units in the partnership in 1994. The plaintiff filed this motion in response to the defendants’ denial that the plaintiff was an assignee, the plaintiff had been admitted to the partnership prior to the general partner’s decision to admit the plaintiff as a limited partner in 2000 during the course of this litigation.

With respect to the plaintiff’s standing to pursue the derivative action, the court looked to Section 17-1001 of DRULPA, which provides that a limited partner or an assignee has the right to bring a derivative action. However, the provision giving an assignee the right to bring a derivative action was added to Section 17-1001 pursuant to an amendment that was not enacted until a year after this action was filed. Relying upon Section 17-1108 of DRULPA, which provides that all amendments to DRULPA shall be applied retroactively unless DRULPA expressly states otherwise, the court held that the amendment giving an assignee the right to bring a derivative action should be applied retroactively in this action and that, based on the defendants’ concession that the plaintiff was an assignee, the plaintiff had standing to pursue the derivative action.

With respect to the plaintiff’s admission as a substituted limited partner, the court examined the partnership agreement, which provided that an assignee must apply to become a substituted limited partner. Under the partnership agreement, an assignee was deemed to have applied to become a substituted limited partner by delivering a transfer application to a transfer agent or by otherwise becoming an assignee under the terms of the partnership agreement. The court determined that the plaintiff had applied to become a substituted limited partner both by becoming an assignee and by delivering a transfer application. The partnership agreement further provided that the general partner must decide whether to admit any assignees as a limited partner no later than thirty days after receiving a monthly list of the transfers by which such assignees acquired their units in the partnership, which decision must be in writing and that the general partner must consent in writing to any application for admission of a limited partner and has sole and absolute discretion to withhold or grant such consent. The partnership agreement also provided that a person is admitted as a limited partner at the time such person is listed as a limited partner on the books and records of the partnership. The court found that (i) the plaintiff had made proper application for admission as a limited partner under the partnership agreement, (ii) the partnership’s transfer agent had listed the plaintiff on the only list of limited partners maintained on behalf of the partnership, (iii) correspondence from the partnership to the plaintiff was addressed to the plaintiff as a limited partner and (iv) the general partner had essentially delegated the application process to its transfer agent. Despite these facts, the defendants argued that the general partner had breached its
contractual duty to consider any applications for admission following the formation of the partnership and thus that no assignees had been admitted to the partnership since its formation (including the defendant itself with respect to its holdings of limited partnership units). The court held that the evidence clearly demonstrated that either the general partner had exercised its discretion to grant all applications for admission received by the general partner by affirmatively including all assignees in the only list of limited partners of the partnership or the defendant had breached its contractual duty to timely consider the plaintiff’s application for admission and the proper remedy for such breach was to admit the plaintiff as a limited partner as of the date that its application should have been considered. Without determining which was the actual scenario, the court granted the plaintiff’s motion for summary judgment on its claim that it was admitted as a substituted limited partner in 1994.


Plaintiff brought a derivative action under DRULPA Section 17-1001, on behalf of a limited partnership and its general partner, claiming that defendant Bachow wrongfully misappropriated a partnership opportunity and failed to seek approval from the limited partnership’s advisory committee before he made a personal investment of more than $500,000 in an operating company, as required by the partnership agreement. Plaintiff had been a limited partner in the general partner, also a limited partnership, but had, two weeks before bringing suit, acknowledged in settlement of a separate suit that his limited partnership interest had been validly repurchased. Defendant filed a motion to dismiss alleging lack of standing to bring suit and another limited partner filed a motion to intervene.

The court first converted defendants’ motion to dismiss to a motion for summary judgment. In so doing, the court based its ruling on the conditions set forth in DRULPA Section 17-1002 for bringing a derivative suit on behalf of a Delaware limited partnership. The first predicate for standing required that the plaintiff be a partner at the time “of the bringing of the action.” The plaintiff failed to meet this prong because his limited partnership interest in the general partner was extinguished when the general partner bought back the plaintiff’s interest pursuant to a right granted to it under the general partner’s partnership agreement. Because the plaintiff did not have an interest in the general partner at the time of the bringing of the action, he could not bring a derivative claim on behalf of the general partner. Similarly, the court held that because plaintiff’s suit on behalf of the partnership would be in effect a double derivative suit brought on behalf of the partnership by the general partner, the buy-back of plaintiff’s interest in the general partner also deprived him of standing to bring claims on behalf of the partnership.

In granting the intervenor's motion to intervene in part, the court again referred to DRULPA Section 17-1002. The intervenor satisfied the first predicate for standing because it owned its limited partner interest in the limited partnership at the time it filed its motion to intervene. The court’s decision turned on the second predicate for standing -- status as a partner at the time of the transaction complained of in the derivative suit or status which had devolved upon a plaintiff by operation of law or pursuant to terms of the partnership agreement from a person who was a partner at the time of the transaction at issue. The court denied the intervenor’s motion to intervene with respect to the misappropriation of a limited partnership opportunity claim because the intervenor acquired its limited partner interest after the alleged misappropriation of the opportunity occurred and did not allege that it acquired the status of a partner pursuant to the terms of the partnership agreement from a person who was a partner at the time of the transaction. However, the court held that the intervenor did have standing to pursue the advisory committee claim because the basis for that claim may have occurred after the intervenor acquired its interest in the limited partnership.


 Plaintiffs commenced a consent solicitation in an attempt to acquire a group of limited partnerships. The general partners of the partnerships responded by adopting amendments to the partnership agreements significantly restricting the ability of the limited partners to
act by written consent. The plaintiffs then filed suit to challenge the validity of the amendments to the partnership agreements, alleging that the adoption of the amendments constituted a breach of the general partners’ fiduciary duties and seeking a declaratory judgment that the amendments were null and void. None of the plaintiffs were limited partners of any of the partnerships, although one of the limited partners had acquired an interest in a partnership as an assignee but had not been admitted as a substituted limited partner.

The court dismissed the claims of the plaintiffs for lack of standing. It held that in order to maintain a claim for breach of fiduciary duty, the plaintiffs must first show that they were owed such a fiduciary duty and because none of the plaintiffs (including the assignee) had a right to vote by written consent, they had no standing to bring a claim alleging breach of fiduciary duty relating to the exercise of a right to vote by written consent. In addition, certain aspects of the plaintiffs’ claims were found to be derivative in nature, which required, among other things, the plaintiffs to be partners at the time of bringing the action under Section 17-1002 of the DRULPA. (DRULPA Sections 17-1001 and 17-1002 were amended in 1998 to specifically authorize an assignee of a partnership interest to bring a derivative action.) Finally, the request for declaratory judgment was dismissed because, after the dismissal of the breach of fiduciary duty claim, no independent basis for equitable jurisdiction existed to support a declaratory judgment action in the Court of Chancery. (DRULPA Section 17-111 was adopted later in 1994 to provide jurisdiction in the Court of Chancery for all actions relating to the interpretation or enforcement of partnership agreements.)


The individual unitholders of a limited partnership filed a class action against the general partners for breach of the general partners’ fiduciary duties by engaging in misconduct that resulted in diminished income to the partnership, diminished distributions to the unitholders and diminished value of the units. The defendants moved to dismiss the complaint for failure to state a claim upon which relief could be granted on the grounds that the plaintiffs’ claims were derivative in nature and that the plaintiffs had failed to comply with the demand requirements for derivative suits.

In granting the defendants’ motion to dismiss, the court held that the determination of whether a fiduciary duty lawsuit is derivative or direct in nature is substantially the same for corporate cases as it is for limited partnership cases. The court concluded that the injuries for which plaintiffs sought redress did not directly injure the plaintiffs, but rather directly injured the partnership. Injuries that do not exist independently of the partnership or that are not directly inflicted on the limited partners are derivative claims. Therefore, the court held that the plaintiffs lacked standing since they failed to comply with the statutory demand requirements of the DRULPA for bringing a derivative claim.

2. **Demand Requirements**


After a series of legal proceedings relating to the post-dissolution liquidation of a Delaware limited partnership, the court had granted summary judgment to the general partner on all but five of the plaintiff limited partners’ claims. The five remaining claims against the general partner included a claim for the breach of duty of loyalty by giving certain information to only one of three appraisers valuing the partnership’s assets, allegedly in order to manipulate the ultimate appraisal figures, and a claim for breach of the partnership agreement by not valuing the assets on a “going concern” basis, resulting in the partnership receiving less than the assets were worth. In this proceeding, the general partner moved for judgment on the pleadings on the five remaining claims, arguing that the claims were derivative claims and that plaintiffs had not properly pleaded such claims because plaintiffs had not pleaded demand refused or, in the alternative, demand futility. Plaintiffs moved to have a class of all limited partners certified to pursue each of these claims and moved to have the general partner enjoined from advancing itself litigation expenses from partnership funds to pay for the litigation.
The court began its discussion by reference to the corporate common law rules surrounding derivative claims and noting that while it would look to corporate precedent it recognized the need for flexibility in determining its applicability. Turning to plaintiffs’ five claims, it first held that three were clearly direct claims because they fell distinctly upon the individual participants in the business association or involved the participants’ contractual rights. The court noted that the two remaining claims, which are referenced above, at first appear derivative in nature since the alleged injury devalued the partnership’s assets. However, given the current position of the partnership in the final stages of its post-dissolution liquidation, the court found that the “purposes for classifying claims as derivative and, in particular, the reasons for its attendant demand rule, are not present here.” The court had identified the two discernable purposes for classifying claims as derivative as first, insuring that injury to a whole association is adjudicated on behalf of that whole and not just for the benefit of the individuals who have undertaken to pursue the claims, and second, carrying out the desired public policy of galvanizing a governing entity within the business association into taking action to address injury on behalf of the business. The court therefore found that “imposing derivative requirements on these two claims would only set up a legal artifice that has no justification and, therefore, put plainly, makes no sense.” The court stated the test for determining whether claims were direct or derivative in the partnership’s situation as follows:

If: (1) a business association consists of only two parties in interest, one a putative class of injured plaintiffs and the other the defendant party that controls the business association; and, (2) the business association is effectively ended, but for the winding up of its affairs; and, (3) the two sides oppose each other in the final dispute over the liquidation of that association; then a claim brought in that context is direct.

Applying the foregoing standard, the court held that plaintiffs’ claims were direct claims, and therefore denied defendant’s motion for judgment on the pleadings. In addition, since defendant’s only opposition to plaintiffs’ motion for certification of a class of limited partners was on grounds that the claims were derivative in nature, plaintiffs’ motion for class certification was granted.

With respect to plaintiffs’ motion to have defendant enjoined from advancing itself litigation expenses from the partnership funds, the partnership agreement provided, in relevant part, that “[e]xpenses incurred by an Indemnitee . . . shall be advanced . . . provided that . . . (ii) such legal action is initiated by a third party who is not a Limited Partner.” Plaintiffs argued that the limitation in such provision conditioning advances on limited partners not being plaintiffs in the litigation prohibited the payment of advances to defendant with respect to this action. Defendant claimed that the partnership agreement only specified conditions under which advances were mandatory and that, pursuant to defendant’s exclusive authority under the partnership agreement to manage the business affairs of the partnership, defendant could in the exercise of its discretion make advances to itself. The court rejected defendant’s argument because it would render the limitation on advances in the partnership agreement illusory and because it was contrary to the court’s adherence to the principle that general discretionary provisions in contracts do not negate explicit limitations found elsewhere in the contract. After finding that plaintiffs had satisfied the criteria for granting injunctive relief, the court permanently enjoined defendant from advancing itself litigation expenses from partnership funds and required defendant to return any funds it had previously advanced to itself in this action.


Plaintiff, the sole owner of the general partner of a Delaware limited partnership, sued various persons, as co-makers on two notes, seeking contribution toward a shortfall in debt that resulted from the sale of the limited partnership’s primary asset. Defendant, a limited partner of the partnership, responded with counterclaims alleging breach of fiduciary duty, and plaintiff moved to dismiss such claims. Based on the assumption that defendant’s counterclaims were properly filed as derivative claims, the court engaged in a demand futility analysis. The court stated that the rule regarding demand futility is nearly the same in both the corporate and limited partnership contexts. Therefore, due to the paucity of
derivative suits involving limited partnerships, the court applied corporate case law concerning demand futility to the limited partnership setting. The court began with the first prong of the \textit{Aronson} test, \textit{i.e.}, whether there is a reasonable doubt that the board of directors or general partner is disinterested and independent under the circumstances. The court noted that, in the corporate context, the mere fact that a director would be required to sue himself is not sufficient to excuse demand. However, when a majority of the board is beholden to the person from who damages would be sought, demand is excused. Thus, because in the present case the only person against whom relief was sought was the 100% owner of the party that could be requested to bring suit, demand was excused as futile. Having held the first prong of the \textit{Aronson} test was satisfied, the court, therefore, did not address the second prong of the \textit{Aronson} test, namely whether the challenged transactions were otherwise the product of a valid exercise of business judgment.


In response to the allegations of a plaintiff limited partner that a series of unit purchases by the corporate general partner of a Delaware limited partnership breached fiduciary and contractual duties of the general partner by serving to entrench the general partner and enriching the general partner at the expense of the limited partners, the defendants, consisting of the limited partnership, the general partner and other controlling persons, moved to dismiss the action arguing that the limited partner's claims were derivative in nature and that the limited partner had failed to comply with the prerequisites for bringing a derivative action under Section 17-1001 of DRULPA of making a pre-suit demand on the general partner or pleading facts showing the futility of a making such a demand. The defendants claimed specifically that a limited partner derivatively challenging a corporate general partner's acts must make a pre-suit demand or plead demand-futility to the corporate general partner's board of directors.

The court denied the defendants' motion to dismiss. With respect to the limited partner's claim that the disputed transactions impinged upon the unitholders’ right to remove the general partner, the court found the injury to be specific to the unitholders as a class as opposed to a harm inflicted upon the limited partnership as a whole and consequently held such claim to be a direct claim, not a derivative claim, and, therefore, not subject to the pre-suit demand requirement or the pleading of demand-futility. With respect to the derivative claims of the limited partner, after finding nothing in DRULPA that would indicate that a pre-suit demand was required to be made on the board of directors of a corporate general partner rather than the general partner itself, the court held that a limited partner was required to make a pre-suit demand or plead demand futility to the general partner, not its board of directors. The court concluded that to hold otherwise would undermine the state’s established policy of respecting the legal fiction of the business entity and would ignore the reality that it is the general partner itself who owes the limited partners fiduciary duties, not the management of the general partner. The court then went on to hold that the limited partner’s allegations that the general partner’s interest in entrenching itself and its interest in enriching itself at the expense of the limited partners were sufficient to meet the limited partner's burden of showing demand-futility. (With respect to the suggestion that the general partner’s management did not owe a fiduciary duty to the limited partners, see discussion relating to \textit{In re USA Cafes, L.P. Litig.}, in Section II.A.1., above.)


Plaintiff limited partners brought a derivative suit against the general partner and another limited partnership controlled by the general partner alleging default on a loan agreement by the limited partnership and breach of fiduciary duty to the limited partners by the general partner. The defendants moved to dismiss for failure to state a claim upon which relief can be granted.

In denying the defendants’ motion, the court reiterated its previous holding that corporate “demand refused” requirements are applicable to derivative suits involving limited partnerships. The court, however, refused to apply the corporate rule that a shareholder that elects to make a demand concedes the independence of the board of directors because the corporate rule is premised upon the demand request receiving a reasoned vote of a
majority of the board, rather than being decided by a one-person general partner involved in a web of self-interested transactions. The allegations, therefore, were deemed sufficient to create a reasonable doubt whether the general partner had exercised valid business judgment in refusing to act on the demand of the limited partners.


Two limited partners brought suit individually, and in the alternative derivatively, against the general partners and others involved with the partnership and the partnership itself for the breach of fiduciary duties in allowing the partnership to sell off certain investments at unfairly low prices. The defendants subsequently filed a motion to dismiss all of the plaintiffs’ claims for failure to state a claim.

The plaintiffs’ individual claim against the general partners for causing the partnership to dispose of its assets at inadequate prices was dismissed because the limited partners were unable to show they were injured directly or independently of the partnership. The court, however, upheld the plaintiffs’ derivative claim regarding this issue. Although no formal demand was made on the general partners, the well-pleaded allegations of the limited partners were enough to show that one of the general partners was interested and the other lacked independence. Thus, demand was excused as being futile and the motion to dismiss was denied.


After having a class action complaint dismissed in an earlier decision, the plaintiffs filed an amended derivative complaint, which the defendants moved to dismiss for failure to comply with the demand requirements contained in DRULPA Sections 17-1001 and 17-1003. The plaintiffs did not attempt to make a pre-suit demand on the general partners and, therefore, were required to “plead with particularity” the reasons for not attempting to make such a demand. The arguments set forth by the plaintiffs were that (1) the general partners had a conflict of interest due to financial remunerations; (2) the loyalties of the general partners were split; and (3) the arguments of the defendants in previous litigation invoking the business judgment rule evinced an unwillingness of the general partners’ to act on a demand.

In analogizing to Delaware corporate case law on demand futility, the court held that the plaintiffs were required to plead with particularized facts that the business judgment rule did not apply to the challenged conduct in order to maintain a derivative action, and then concluded that the plaintiffs had failed to allege facts showing a conflict affecting the general partners’ conduct that raised a reasonable question as to their disinterestedness, independence or business judgment. The court found the fact that the directors of the corporate general partners owed fiduciary duties to both the stockholders of the corporate general partners as well as the limited partners of the partnership was not such as to render a demand futile. Moreover, because the plaintiffs had been advised of the nature of the conflict in the prospectus and had accepted the terms of the relationship in the partnership agreement, they were precluded from bringing a derivative action based on the relationships disclosed in those documents. The plaintiffs’ allegations were also found not to rise to the level of gross negligence and thus failed as a matter of law to excuse the demand requirement.

3. **The Role of Special Committees**


In the third chapter of the Katell derivative claim, after reviewing the derivative claims of the limited partners alleging that the general partners breached their fiduciary duties to the partnership by engaging in self-dealing transactions, the special committee found the suit not to be in the best interests of the partnership and moved for dismissal.

Under the corporate special committee doctrine, upon recommendation of dismissal, the corporation is required to prove that the committee was independent, conducted a good faith, reasonable investigation and had a reasonable basis for its conclusion to dismiss the lawsuit. The court had earlier ruled that whether corporate special committee procedures
apply to a derivative suit brought on behalf of a limited partnership depends on the terms of
the partnership agreement, and it then ruled that the provision in the partnership agreement
that required the special committee to request the court to carry out its recommendation
unambiguously anticipated judicial review of the special committee’s recommendation.
The court, therefore, applied the requirements of the corporate special committee doctrine
and, finding each satisfied, granted the special committee’s motion to dismiss the
derivative action.


Following the ruling referred to above that the creation of a special committee violated the
limited partnership agreement, the partnership agreement was amended according to its
terms to permit the delegation of decision-making power to a special committee. The
defendant general partners then moved to stay the derivative action pending the findings of
the special committee. The plaintiff limited partners challenged the creation of the special
committee pursuant to the amended partnership agreement and challenged the
independence of the special committee, analogizing to the corporate special committee

This time the court rejected the plaintiffs’ challenge to the creation of the special
committee, finding that its creation complied with the requirements of the amended
partnership agreement. The court also rejected the plaintiffs’ challenge to the
independence of the special committee. The court held that under the corporate special
committee doctrine, unless the plaintiffs’ allegations give rise to a conclusive presumption
of lack of independence, any challenge to the independence of a special committee is
premature if it comes prior to the special committee making a recommendation of dismissal
of the derivative action. The court thus granted the defendant general partners’ request to
stay the derivative suit pending the investigation of the special committee.


A limited partnership created a special committee, consisting solely of the lone
disinterested general partner, to investigate the plaintiff limited partners’ derivative breach
of fiduciary duty claims against the general partners and the partnership. The defendant
general partners moved to stay the derivative action pending the findings of the special
committee. The plaintiffs countered that the establishment of the special committee
violated the partnership agreement.

The court acknowledged that in the absence of existing authority in the limited partnership
context, analogues to corporate law may be applied. The court noted, however, that unlike
the demand and demand excused concept, the concept of the special litigation committee
was derived from corporate origins not reflected in Delaware partnership law. The court
held, however, that unlike other corporate law doctrines, the corporate special committee
doctrine could not be easily extended into partnership law because general corporation law
expressly provided for the delegation of managerial decision-making power while no such
express power existed in partnership law. Therefore, the court held that the applicability of
the special committee doctrine had to be evaluated on a case-by-case basis depending on
the terms of the partnership agreement. Using principles of contract construction, the court
found that the partnership agreement did not support the delegation of decision-making
power to a special committee, and thus the creation of the special committee was invalid
under the partnership agreement. The defendants’ motion to stay was denied. It should be
noted that the DRULPA was subsequently amended to sanction delegation of authority by
general partners, absent limitations in the partnership agreement, thus presumably allowing
special committees without specific authorization in the partnership agreement. See
DRULPA Section 17-403(c).

I. Disclosures


Plaintiff was a noteholder of a Delaware limited partnership. Following the partnership’s default on
the notes, plaintiff brought suit against the partnership and its general partner claiming, among other
things, that the partnership and the general partner breached a fiduciary duty to creditors by failing
timely to pursue a valuable litigation claim and by making false and misleading statements while
Plaintiff alleged that prior to the default on the notes the partnership engaged in a sham transaction to avoid a restriction in the partnership agreement that precluded the partnership from selling any property to an entity affiliated with the general partner. To circumvent this requirement, James Stroud (“Stroud”) and Jeffrey Beck (“Beck”), the owners of the entity that owned the general partner, caused such entity to sell the stock of the general partner to an entity owned by a friend and business associate. The partnership then sold four of its five properties to another entity controlled by Stroud and Beck and paid yet another entity owned by Stroud and Beck a brokerage fee of over $1 million for the sale. A limited partner filed suit challenging the sale of the four properties, which was subsequently settled, and as part of the settlement all claims of the limited partners of the partnership arising out of the transaction were released but the settlement did not expressly release claims brought on behalf of the partnership or the noteholders.

Plaintiff alleged that when the partnership became insolvent between February and July of 2001, the general partner owed a fiduciary duty to the noteholders to preserve and pursue whatever non-operating assets the partnership possessed in an effort to ensure the maximum return to creditors and claimed that the general partner breached this fiduciary duty to the noteholders by failing to bring a claim challenging the sale of the properties before the statute of limitations with respect to such claim expired in September, 2001. Defendants contended that plaintiff’s claim was barred by the statute of limitations. Plaintiff argued that the wrong alleged in his complaint was the failure of the general partner to bring a claim challenging the sale of the properties, not the sale itself. The court rejected plaintiff’s argument, finding that the claim arose when the sale occurred. Plaintiff further argued that his claim did not arise until the partnership’s fiduciary duty to its creditors arose upon the insolvency of the partnership. The court rejected this claim as well but did acknowledge that a fiduciary duty to the creditors of the partnership arose when the partnership became insolvent. While the court did not cite any precedent for its conclusion that a fiduciary duty was owed to creditors of the partnership, it did state that the noteholders did not have standing to allege breach of fiduciary duty prior to the partnership coming within the “vicinity of insolvency,” which is an apparent reference to corporate precedent in which the Court of Chancery had held that directors of a Delaware corporation operating “in the vicinity of insolvency” owed their primary fiduciary duty to the corporate enterprise, which encompasses creditors as well as stockholders, rather to stockholders alone. (See Credit Lyonnais Bank Nederland v. Pathe Communications Corp., C.A. 12150 (Del. Ch. Dec. 30, 1991).

Plaintiff also alleged that the general partner breached its fiduciary duty of disclosure to the noteholders by failing to disclose material information to the noteholders when following the insolvency of the partnership the general partners sought the consent of the noteholders to the sale of the final property owned by the partnership and the noteholders’ waiver or release of all claims relating to the notes as a condition to a liquidating distribution by the partnership. The court stated that the general partner presumably was obligated to act with complete candor when seeking noteholder action while the partnership was insolvent and held that the existence of a fiduciary duty to disclose was sufficiently plausible to survive defendants’ motion to dismiss. After analyzing the specific aspects of the disclosure claims, the court granted defendants’ motion for dismissal or summary judgment with respect to certain aspects of the claims and denied defendant’s motion with respect to the other aspects of the claims based on the particular facts associated with each claim.


Plaintiff, a public unitholder of a Delaware limited partnership, brought an action on his own behalf and on behalf of the other public unitholders for breach of fiduciary duty against the general partner, the board of directors of the general partner and Salomon Smith Barney, Inc., the parent of the general partner, in connection with a restructuring of the partnership’s finances that occurred in 2000. The general partner and its board of directors approved the restructuring based on the recommendation of a special committee and thereafter a majority of the public unitholders of the partnership voted to approve the restructuring. Plaintiff claimed the restructuring was a self-dealing transaction that did not comport with either the fair process or fair price elements of the standard of entire fairness. Defendants moved to dismiss on the grounds that plaintiff’s complaint failed to state a claim for breach of fiduciary duty because it did not articulate a theory or basis for finding that the restructuring was unfair to plaintiff or the other unitholders or that the restructuring was even properly the subject of an entire fairness analysis.
The court stated that plaintiff had the burden of rebutting the presumption under the business judgment rule that defendants acted on an informed basis and in the honest belief that their actions were in the best interests of the partnership and the limited partners by pleading sufficient facts showing that defendants appeared on both sides of the restructuring or derived a personal benefit from the restructuring in the sense of self-dealing. The court held that plaintiff’s complaint failed to meet this burden because it only made conclusory claims about defendants’ interest in the restructuring. Plaintiff claimed that the restructuring would permit Salomon to sell the general partner and therefore cease to provide financial support to the partnership. The court found, however, that Salomon had no legal or equitable duty to provide financial support beyond the contractual terms it had satisfied in the restructuring and that the fact that the restructuring, by stabilizing the partnership’s financial situation, might have permitted Salomon to sell the general partner did not form the basis for a claim for breach of the duty of loyalty. Plaintiff also asserted claims that related to the formation of the partnership in 1996 and the management of the partnership from 1996 to the restructuring. The court found that none of these allegations stated a claim for breach of the duty of loyalty in connection with the restructuring, stating that certain of the claims were barred by a judgment of the federal district court in an earlier lawsuit brought by plaintiff and that others of these claims could only be brought derivatively on behalf of the partnership, which plaintiff refused to do. Plaintiff also claimed that the restructuring should have happened years earlier but was delayed by defendants in order to avoid alerting the public unitholders to the fact that the finances of the partnership had been impractically structured until the limitations governing claims under the federal securities laws had elapsed. The court found this claim also to be either one for mismanagement that was required to be brought derivatively or one barred by the federal district court judgment. The court thus held that plaintiff’s complaint did not state a claim upon which relief can be granted in regard to the substance of the restructuring.

Plaintiff also alleged claims for breach of the duty of disclosure in connection with the proxy materials and other public statements relating to the restructuring. While the court stated that a few of the claims had at least colorable merit, the court concluded that these claims must be dismissed as well because no possible relief with respect to such claims was available to plaintiff or the putative class. The court stated that it was too late to provide equitable or injunctive relief in the form of corrective or supplemental disclosure in connection with the vote taken in 2000 and noted that plaintiff had been aware of the disclosure claims well before the vote to approve the restructuring was held. The court also stated that the other possible form of equitable relief – an order of rescission – was impracticable in this setting and had not been requested by plaintiff. The court further stated that it would not award actual or nominal monetary damages to plaintiff or the class because they had not suffered any economic injury as a result of the vote to approve the restructuring. The court thus granted defendants’ motion to dismiss.


The plaintiff, a limited partner in a Delaware limited partnership, brought an action against the partnership, its general partner, the members of an Advisory Board of the partnership comprised of limited partners, the general partner’s controlling entity and the two individuals ultimately exercising control over the general partner. *(See Section II.A.2. above and Section II.J.2. below for discussions of other aspects of this case.)* The plaintiff alleged a breach of the duty of care and the duty of disclosure against the general partner and its principals as well as a claim of aiding and abetting a breach of the fiduciary duty of loyalty and conspiracy against all defendants. The allegations centered on the plaintiff’s assertion that the general partner and its principals acted in concert with the members of the Advisory Board to cause the partnership to invest in, and make financing commitments to, companies in which they had personal stakes. The plaintiff also asserted that the general partner, its principals and the Advisory Board members engaged in a scheme to direct companies in which the partnership had significant investments to enter into lucrative consulting agreements with a consulting company controlled by them, thereby enriching themselves at the expense of the other limited partners.

Before the court was, among other things, a motion to dismiss for failure to state a claim upon which relief can be granted with respect to the plaintiff’s breach of duty of loyalty claim. The defendants argued that such claim was precluded by the disclosure of potential conflicts of interest set forth in the partnership’s private placement memorandum. Relying on *Midland Food Servs., LLC v. Castle Hill Holdings V, LLC* (see Section III.H.4. below), the defendants argued that the private placement memorandum should be considered by the court because, although it was not referenced in the plaintiff’s complaint, it was referenced in the partnership agreement, which, in
that one provision of the amendment could only be put into effect by unanimous vote. However, the
unitholders, was never validly adopted and must be declared void. The court agreed with plaintiffs
by a unanimous vote and that therefore the entirety of the proposed amendment, including all the
one provision of the proposed restatement of the partnership agreement could only be accomplished
received the affirmative vote of a majority of the public unitholders. Plaintiff argued, however, that
amended and restated partnership agreement containing all of the proposed amendments to the
partnership in order to implement the reorganization and the defendants presented the proposed
on the fact that the defendants needed to amend the partnership agreement of the existing limited
third, that the defendants made materially misleading disclosures. Plaintiffs’ first claim was based
defendants breached their fiduciary duties in structuring the reorganization in an unfair manner; and
grounds: First, that it did not receive the requisite approval by the public unitholders; second, that
purchase all preferred units not subscribed for by the limited partners and, thus, any reasonable
general partners’ affiliate that guaranteed the offering and agreed to purchase all preferred units not
plaintiffs' motion with respect to their claim that the offering prospectus omitted the material fact
development plan related to certain other sold properties as immaterial and also denied the
was immaterial. The court declined to reach a determination on the materiality of the offer prior to
The plaintiffs argued that an offer with respect to certain of the sold properties made by an
facts bearing on the limited partners’ decision whether to participate in the preferred units offering.
The plaintiffs argued that an offer with respect to certain of the sold properties made by an
anonymous third party prior to the general partners’ initiation of the preferred units offering should
have been disclosed and would have added materially to the total mix of information available to the
limited partners. The defendants countered that the anonymous offer was not a firm offer and, thus,
was immaterial. The court declined to reach a determination on the materiality of the offer prior to
trial. However, the court rejected the plaintiffs’ disclosure claim based on the failure to disclose a
development plan related to certain other sold properties as immaterial and also denied the
plaintiffs’ motion with respect to their claim that the offering prospectus omitted the material fact
that individual officers and directors of the general partners were investors in a limited partner of the
general partners’ affiliate that guaranteed the offering and agreed to purchase all preferred units not
subscribed for by the limited partners. The court held that the additional disclosure would have
added little value because the prospectus disclosed the guarantee and the fact that the affiliate would
purchase all preferred units not subscribed for by the limited partners and, thus, any reasonable
reader of the prospectus would have known that an affiliate of the general partners was willing to
put up a large sum of money to buy unsubscribed units and could reasonably infer that the general
partners believed that the offering was an attractive investment opportunity.

Limited partners sued the general partners, which were affiliated with one another, of a Delaware
limited partnership for breach of fiduciary duty and breach of contract and sued an affiliate of the
general partners for aiding and abetting breaches of fiduciary duty. Plaintiffs’ claims stemmed from
actions taken by the general partners in connection with an offering of preferred units having
superior claims to capital and income distributions, including the amendment of the partnership
agreement without limited partner approval to subordinate the contractual distribution rights of the
existing limited partners to those new claims and a subsequent sale of partnership property also
without limited partner approval. Before the court were cross-motions for partial summary
judgment. (See Section II.A. above and Section II.K. below for discussions of other aspects of this
case.)
The plaintiffs claimed that the general partners breached their fiduciary duty to disclose all material
facts bearing on the limited partners’ decision whether to participate in the preferred units offering.
The plaintiffs argued that an offer with respect to certain of the sold properties made by an
anonymous third party prior to the general partners’ initiation of the preferred units offering should
have been disclosed and would have added materially to the total mix of information available to the
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reader of the prospectus would have known that an affiliate of the general partners was willing to
put up a large sum of money to buy unsubscribed units and could reasonably infer that the general
partners believed that the offering was an attractive investment opportunity.

Plaintiffs challenged an already consummated reorganization of a limited partnership which
separated the ownership of a single public limited partnership into the old public limited partnership
and a new privately-traded limited partnership. Plaintiffs challenged the reorganization on several
grounds: First, that it did not receive the requisite approval by the public unitholders; second, that
defendants breached their fiduciary duties in structuring the reorganization in an unfair manner; and
third, that the defendants made materially misleading disclosures. Plaintiffs’ first claim was based
on the fact that the defendants needed to amend the partnership agreement of the existing limited
partnership in order to implement the reorganization and the defendants presented the proposed
amended and restated partnership agreement containing all of the proposed amendments to the
public unitholders for their approval in a single vote and provided that it would be approved if it
received the affirmative vote of a majority of the public unitholders. Plaintiff argued, however, that
one provision of the proposed restatement of the partnership agreement could only be accomplished
by a unanimous vote and that therefore the entirety of the proposed amendment, including all the
remaining provisions which could otherwise have been approved by a majority vote of the public
unitholders, was never validly adopted and must be declared void. The court agreed with plaintiffs
that one provision of the amendment could only be put into effect by unanimous vote. However, the
court rejected plaintiffs’ argument the entirety of the amendment was therefore void. The court cited several bases for this decision including the “severability” provisions of both the original partnership agreement and the proposed amendment and restatement and the fact that the general partner removed the one provision that required unanimous approval from the final restated and amended partnership agreement. With respect to the severability issue, the court cited several legislative cases supporting the proposition that if part of one legislative bill required a majority vote and another part a supermajority vote and only the majority vote were obtained, so long as the matters were of a severable nature, the part that received the requisite approval would be valid notwithstanding the fact that the remaining part would be void. The court also rejected plaintiffs attempt to limit that principle to the legislative context finding that it applied equally in the private contract context and was consistent with the approach Delaware has historically taken to the regulation of economic activity which rests on “flexibility and efficiency, not unjustified rigidity.”

In their fiduciary duty claim, plaintiffs had argued that the reorganization was motivated solely to advantage the majority unitholder and corporate parent of the general partner without conferring any benefit on the public unitholders. The defendants moved to dismiss this claim on the grounds that the public unitholders had approved the transaction in accordance with the criteria set forth in the original limited partnership agreement which displaced any default fiduciary duties that would otherwise have applied to the transaction. Plaintiffs countered that the requirements of the limited partnership agreement including the vote requirement were in addition to, not in substitution for, the general partner’s common law fiduciary obligations and pointed to the absence of any language expressly restricting the operation of default fiduciary duties in the operative section of the partnership agreement. The court held that in deciding whether default fiduciary duties were preempted by contractual provisions it was required to determine whether the application of default fiduciary duties could be reconciled with the practical and efficient operation of the terms of the limited partnership agreement; where such a reconciliation was possible, the court would apply default fiduciary duties in the absence of clear language disclaiming their applicability. “But where the use of default fiduciary duties would intrude upon the contractual rights or expectations of the general partner or be insensible in view of the contractual mechanisms governing the transactions under consideration, the court will eschew fiduciary concepts and focus on a purely contractual analysis of the dispute.” However, the court held that it did not need to answer that question for the present case because, based on corporate law principles, it concluded that if the challenged transactions received an informed, uncoerced majority vote of the public unitholders that vote would obviate any generalized fairness inquiry and insulate the general partner from contractual or fiduciary liability. Thus, the court held that plaintiffs’ fiduciary claim turned on the adequacy of the general partner’s disclosures. Plaintiffs had challenged a number of the general partner’s disclosures as false or misleading. The court dismissed a number of these claims. However, it held that certain of the claims were sufficient to withstand a motion to dismiss. Thus, the court denied defendants’ motion to dismiss those disclosure claims and the fiduciary duty claim which turned on the adequacy of the disclosure.


Plaintiff limited partners sought to enjoin a tender offer by the corporate parent of the general partner for at least a majority of the limited partnership units, claiming, among other things, that the tender offer constituted a change of control that brought about a fiduciary obligation of the general partner to take reasonable steps to achieve the highest price available, i.e. the corporate “Revlon” duty.

In denying injunctive relief, the court held that the general partner had no fiduciary duty to seek a control premium in the acquisition by its corporate parent of a majority of the limited partnership interests because such an acquisition would not constitute a change of control where the partnership agreement deprived the limited partners of any significant control rights. Under the agreement, the limited partners could not manage the partnership or control its assets and could not remove the general partner except for a breach of fiduciary duty. Although the limited partners were entitled to vote on designated matters such as mergers and certain acquisitions and amendments, the court held that this did not amount to control or the ability to command a control premium. Moreover, as further evidence that no control premium was applicable, the court noted that the general partner had absolute discretion to prohibit the transfer of any limited partnership units. Thus the court refused to impose a Revlon duty on the general partner which would effectively undermine the explicit terms of the limited partners’ investment as dictated by the partnership agreement.
In a subsequent decision, the court granted the plaintiffs’ motion for a voluntary dismissal of this case without prejudice in favor of parallel litigation pending in the United States District Court for the Southern District of Florida, citing judicial economy and the lack of legal prejudice to the defendants.

After the District Court in Florida dismissed the action for want of subject matter jurisdiction as a result of the defection of certain plaintiffs, the action was revived in the Court of Chancery. At this point in time, the tender offer had closed and the corporate parent of the general partner owned 50.4% of the limited partnership units of the partnership. Within months of the closing, defendant general partner, in a change from its prior distribution policy and the projections forecast in the tender offer circular, more than doubled the size of cash distributions to limited partners. Plaintiffs filed an amended class action complaint alleging breach of partnership agreement, breach of fiduciary duties and additional claims relating to the tender offer. Defendants filed a motion to dismiss several of plaintiffs’ claims and a motion for summary judgment with respect to plaintiffs’ claim that the general partner breached its fiduciary duty of loyalty by limiting pre-closing distributions to limited partners in contemplation of and to facilitate the tender offer. The court denied the defendants’ motion to dismiss with respect to the claims that the general partner’s disclosures relating to distributions were materially misleading. The court stated that “[w]here, as here, the lone source of disclosure is a fiduciary having a conflicting interest, an obligation of complete candor is imposed on the fiduciary and judicial scrutiny of the disclosure is more exacting” and, based on the timing and dramatic nature of the change in distributions policy, found that plaintiffs were entitled to an inference that defendants did not believe the projections when they made them. The court also denied defendants’ motion for summary judgment, finding that material issues of fact were in dispute with respect to the timing, motivation and effect of the general partner’s decision to change the distribution policy, noting that “the fortuitous timing of the General Partner’s change in distribution policy calls into question the good faith of the General Partner’s management decisions in the time period preceding the Offer.” The court granted the defendants’ motion to dismiss the remaining claims in the complaint. With respect to plaintiffs’ claim that the “entire fairness” standard applied to the tender offer, the court disagreed, stating that this was not a situation in which one party stood on both sides of a transaction and could have effectuated changes to the detriment of fellow investors; in this case, defendants made a voluntary tender offer directly to the limited partners. With respect to the claim that defendants breached an implied obligation in the partnership agreement to ensure fairness in any transaction involving the general partner, which obligation the plaintiffs alleged arose from provisions in the partnership agreement that set forth an independent appraisal process designed to ensure that the partnership would receive fair value in a sale of partnership assets to the general partner or its affiliates, the court found no basis for the inference in this situation due to the essentially voluntary nature of the tender offer and refused to imply an intention in the partnership agreement to subject the tender offer to an independent appraisal process. Finally, with respect to plaintiffs’ claim that defendants breached fiduciary duties of due care and good faith by not protecting the limited partners from the threat of an unfairly priced offer, the court held that it would be unreasonable and inappropriate to impose such an obligation on the defendants in relation to a voluntary tender offer which involved no act of corporate governance and found that the requirement under Delaware law that the tender offer by the defendants be made with complete disclosure and be non-coercive provided an adequate framework to protect the interests of limited partners.


This was the second lawsuit arising from the plan of a publicly traded Delaware limited partnership to convert to a REIT through a merger. In the first lawsuit (see Section II.A.2., above), the court dismissed a claim that the structure of the transaction violated contractual and fiduciary duties of the defendant general partner and its general partner holding that the requirement in the partnership agreement that the transaction receive the approval of the unitholders by a 66 2/3% vote replaced, by contract, the unitholders’ right to seek judicial review of the transaction under traditional fiduciary duty principles.

After the court rendered its decision in the first lawsuit, the defendants issued a proxy statement soliciting unitholder approval of the transaction. In this action, the plaintiff unitholder moved to preliminarily enjoin the upcoming unitholder vote based on claims that the disclosure documents failed fully and fairly to disclose the material facts necessary for the unitholders to make an informed decision whether to approve the REIT conversion. Specifically, the plaintiff claimed that the disclosure documents misrepresented (i) the process by which the transaction was negotiated and
agreed upon, (ii) the facts material to assessing the fairness of the transaction and (iii) the risks in converting the partnership to a REIT.

Relying on corporate precedent, the court held that (i) controlling persons seeking unitholder approval of a transaction have a fiduciary duty to honestly provide full and fair disclosure of all material facts relating to that transaction, (ii) the burden is on the fiduciary to demonstrate that all material facts were disclosed and (iii) where the lone source of the disclosure is a fiduciary having a conflicting interest, the scrutiny of the disclosures made in that context is more exacting (particularly in light of the fact that the vote and the related disclosure replaced the traditional fiduciary protections). Applying these standards, the court found that (i) the defendants did not omit to disclose or impose a misleading “spin” on the risks inherent in the REIT conversion, (ii) the defendants’ disclosure of the process leading to the decision of the defendants to proceed with the REIT conversion was materially misleading because it created a false impression that an independent negotiating committee was established to and did negotiate a fair transaction on behalf of the unitholders whereas the committee did not engage in negotiations and its members were not independent from the general partner and (iii) the defendants also failed to disclose, and disclosed in a misleading manner, material facts relating to the fairness of the transaction, including the fact that the valuation that formed the basis for the large equity interest that the defendants would receive in the REIT conversion was based on distribution levels that were kept artificially high by the defendants. The court granted the plaintiff’s request to enjoin the unitholder vote until the disclosure deficiencies were cured by the issuance of a supplemental disclosure by the defendants.

J. Procedural Issues

In the past several years, a variety of cases have arisen in the limited partnership context involving essentially procedural issues including the extent to which a Delaware court may assert personal jurisdiction over a foreign limited partnership solely by virtue of the fact that a Delaware corporation serves as the limited partnership’s general partner; the extent to which disputes among partners of a Delaware limited partnership are subject to arbitration pursuant to an agreement to arbitrate contained in a partnership agreement; and the applicability to a claim brought in the Court of Chancery for breach of a limited partnership agreement of the statute of limitations applicable to the analogous breach of contract action existing at law.

1. Subject Matter Jurisdiction


      One general partner of a limited partnership brought suit against the other general partner and a limited partner to enforce the default provisions of the partnership agreement after the defendants failed to meet a mandatory cash call. The defendants responded by filing a motion to dismiss for lack of subject matter jurisdiction and a motion to stay the proceedings pending the outcome of a suit previously filed in Pennsylvania involving substantially the same parties. In their motion to dismiss, the defendants argued that the plaintiff must allege Section 17-110 of the DRULPA (which addresses contested matters relating to general partners and contested votes) as the jurisdictional basis for the suit rather than Section 17-111 (which relates to interpretation and enforcement of partnership agreements) since the claim will ultimately determine whether a defendant may continue to serve as a general partner.

      The court denied defendants’ jurisdictional motion, holding that Section 17-111 is the correct jurisdictional basis because the parties’ dispute primarily concerned the interpretation and enforcement of the partnership agreement rather than a general partner’s right to serve in that capacity. However, the court granted defendants’ motion to stay the Delaware action in favor of the prior-filed Pennsylvania action, noting that governance issues were not significantly implicated by this suit and that the claims of the Pennsylvania action were expected to form the affirmative defenses of the Delaware action.

      DRULPA Section 17-110 was amended subsequent to the decision in Adirondack to provide that an action for removal of a general partner may be brought under that section.


      Plaintiff limited partners brought suit in Superior Court against the general partners for, among other things, breach of fiduciary duty. The defendants moved to dismiss this claim for lack of subject matter jurisdiction.
In dismissing the claim of limited partners, the court analogized to corporate precedent in holding that the fiduciary duties owed by general partners to limited partners are wholly equitable creations that are recognized and enforced exclusively by a court of equity.

2. **Personal Jurisdiction**


The plaintiff, a limited partner in a Delaware limited partnership, brought an action against the partnership, its general partner, the members of an Advisory Board of the partnership comprised of limited partners, the general partner’s controlling entity and the two individuals ultimately exercising control over the general partner. (See Sections II.A.2. and II.I. above for discussions of other aspects of this case.) The plaintiff alleged a breach of the duty of care and the duty of disclosure against the general partner and its principals as well as a claim of aiding and abetting a breach of the fiduciary duty of loyalty and conspiracy against all defendants. The allegations centered on the plaintiff’s assertion that the general partner and its principals acted in concert with the members of the Advisory Board to cause the partnership to invest in, and make financing commitments to, companies in which they had personal stakes. The plaintiff also asserted that the general partner, its principals and the Advisory Board members engaged in a scheme to direct companies in which the partnership had significant investments to enter into lucrative consulting agreements with a consulting company controlled by them, thereby enriching themselves at the expense of the other limited partners.

Before the court was, among other things, a motion by the members of the Advisory Board to dismiss the plaintiff’s complaint against them for lack of personal jurisdiction which the court granted. The plaintiff asserted that the court had jurisdiction over the members of the Advisory Board, none of whom were residents of Delaware, based on Delaware’s long-arm statute (10 Del. C. § 3104(c)(1)) establishing jurisdiction where a defendant transacts any business in Delaware. The plaintiff claimed that the members of the Advisory Board participated in the management of the partnership. The court disagreed and found that the duties of the Advisory Board as set forth in the partnership agreement and private placement memorandum of the partnership were not managerial in nature but merely consisted of assistance and advice to the general partner. Neither the partnership agreement nor the private placement memorandum contained language giving the Advisory Board power to direct the actions of the general partner. Further, the plaintiff failed to allege any facts to show that the Advisory Board exerted actual control over the partnership.

The court also rejected the plaintiff’s argument that the Advisory Board defendants were subject to personal jurisdiction under the conspiracy theory of jurisdiction. The court identified a five-part test that must be satisfied for the valid exercise of jurisdiction under the conspiracy theory: (i) the existence of a conspiracy to defraud; (ii) the defendant must be a member of that conspiracy; (iii) a substantial act or substantial effect in furtherance of the conspiracy occurs in Delaware; (iv) the defendant knows or has reason to know of the act in Delaware or that acts outside Delaware would have effect in Delaware; and (v) the act in or effect on Delaware is a direct and foreseeable result of the conduct in furtherance of the conspiracy. The court found that while the plaintiff alleged the existence of a conspiracy to which the Advisory Board members were a party, the plaintiff failed to show that a substantial act or effect of the conspiracy occurred in Delaware.

In addition, the court found that even if the complaint had satisfied Delaware’s long arm statute, the Advisory Board members did not have the requisite contacts with Delaware to allow the court to exercise personal jurisdiction consistent with due process. The Advisory Board members did not reside in Delaware, conduct business in Delaware, own any real property in Delaware or contract to supply goods or services on behalf of the partnership in Delaware. Further, no Advisory Board meetings were held in Delaware and the Advisory Board members did no act in Delaware or any act outside of Delaware that caused injury in Delaware. The court also rejected the plaintiff’s claim that the choice of law provision in the partnership agreement supported a claim of minimum contacts with Delaware. The court held that while a choice of law provision should not be ignored, such a provision does not by itself confer personal jurisdiction. Because the choice of law provision in the
partnership agreement essentially stood alone, without an attendant forum selection clause, the court found that the provision was not sufficient to bestow personal jurisdiction.


Plaintiff limited partnership filed an action in the Court of Chancery claiming that defendant limited partners breached the partnership agreement and tortiously interfered with the partnership agreement by inducing other limited partners to breach the partnership agreement. In defendants’ earlier motion to dismiss, the court found that the partnership agreement’s forum selection clause provided the court with personal jurisdiction over the defendants with respect to the breach of partnership agreement claims. Because the court did not address defendants’ claim that the forum selection clause did not confer personal jurisdiction over the defendants with respect to the tortious interference claim, the court granted defendants’ motion to reargue. Finding that the court’s exercise of personal jurisdiction over the defendants with respect to the tortious interference claim would not substantially prejudice the defendants, the court held that, where the parties are the same and the subject matter is closely related in an action alleging both contract claims and a tort claim, the close relationship of the subject matter calls for an exercise of personal jurisdiction over the tort claim in the interest of judicial economy and efficiency even though the tort claim would not by itself establish personal jurisdiction. The court found, by analogy to Delaware corporate case law, that Delaware public policy favors Delaware courts assuming personal jurisdiction over the parties in this action in order to adjudicate claims which sufficiently relate to other claims which properly give the court personal jurisdiction. The court noted that the only distinction between the corporate cases and this limited partnership case is that the fiduciary duties in the corporate cases arose directly under statute while the fiduciary duties in this case arose under the partnership agreement and found such distinction to be irrelevant since in each case the breach of fiduciary duty claims provided the court with personal jurisdiction.


Plaintiff limited partner filed suit against the non-resident general partners of a Delaware limited partnership and attempted to effect service of process upon them under Section 17-109 of the DRULPA. Section 17-109, which provides that the filing of a certificate of limited partnership with the Secretary of State constitutes the “implied consent” of the general partners to the appointment of the limited partnership’s registered agent as their own agent upon whom service of process may be made, did not become effective until 1988. Since the defendant general partners had recorded their certificate of limited partnership in 1987, they moved to dismiss the action for lack of personal jurisdiction, arguing that Section 17-109 was not applicable to them.

Significantly, the court declined to apply Section 17-109 retroactively and granted the defendants motion to dismiss on the ground that the court lacked personal jurisdiction. As explained by the court, statutory amendments that affect substantive rights do not operate retroactively unless the General Assembly explicitly so provides or the court determines that public policy requires retroactive application. The court rejected the plaintiff’s argument that Section 17-1108 of the DRULPA, which states that “[a]ll provisions of [the DRULPA] may be altered from time to time or repealed and all rights of partners are subject to this reservation,” made Section 17-109 retroactively applicable because Section 17-1108 does not explicitly provide that all future amendments to the DRULPA will operate retroactively. Further, the court found that the public policy of judicial oversight of those managing Delaware entities was not sufficient to subject the defendants to personal jurisdiction in Delaware without notice upon the filing of the limited partnership certificate. The court noted that, had the plaintiff attempted to effect service of process under the Delaware “long-arm” statute (Del. Code Ann tit. 10, § 3104), the court may have had personal jurisdiction over the general partners.


The plaintiff filed a derivative action on behalf of a corporation seeking recovery of amounts paid out by the corporation, including payments to a New York limited
partnership. Relying on *Macklowe v. Planet Hollywood, Inc.*, discussed below, the plaintiff sought personal jurisdiction in Delaware over the New York limited partnership, which was not registered in Delaware, by serving its general partner, a Delaware corporation. The New York limited partnership moved to dismiss the claim against it for lack of personal jurisdiction.

In an apparent narrowing of its holding in *Macklowe*, the court held that the mere selection of a Delaware corporation as general partner is not enough to subject a limited partnership to personal jurisdiction in Delaware. Under the “doing business” test of DRULPA Section 17-911, business must be transacted in Delaware on behalf of the unregistered foreign limited partnership in order to validate the service of process on the limited partnership through its corporate general partner. Thus, because its Delaware corporate general partner had not conducted business on its behalf in Delaware, the claim against the New York limited partnership was dismissed.


The shareholders of a Delaware corporate general partner brought a derivative suit against the corporation and the Florida limited partnership, of which it was the general partner. The limited partnership moved to dismiss the complaint against it for lack of personal jurisdiction since it was not registered to do business in Delaware and its only connection to the state was the selection of a Delaware corporation to serve as general partner. The plaintiffs argued the presence of the limited partnership’s general partner in Delaware constituted express consent to the exercise of personal jurisdiction in Delaware.

Section 17-911 of the DRULPA deems the Secretary of State to be the designated agent for service of process for unregistered foreign limited partnership’s “doing business” in Delaware. This statute does not address the situation in which an unregistered foreign limited partnership has a Delaware general partner, but the court held that the limited partnership’s selection of a Delaware corporation constituted a reasonable basis for concluding that the partnership expected that its general partner would be subject to service of process and accept service in the event that the partnership was found to be doing business in Delaware. The court then held that the selection of a Delaware general partner was sufficient to meet the “doing business” test of Section 17-911 and the “minimum contacts” test of the Fourteenth Amendment. Because the underlying cause of action was based on the interrelationship of the partnership and its general partner, the court found that the limited partnership must have anticipated answering in Delaware for complaints of this nature when it selected a Delaware general partner. Minimum contacts were also found to exist using the conspiracy theory, in which the acts of the directors of the corporate general partner were imputed to the partnership and provided evidence that it was reasonable and fair to require the partnership to defend an action in Delaware. Thus, the limited partnership’s motion to dismiss was denied.

f. *In re USACafes, L.P., Litig.*, 600 A.2d 43 (Del. Ch. 1991)

After holding that the directors of corporate general partners owe fiduciary duties to the limited partnership and its limited partners, the court found that personal jurisdiction could be properly effected over the directors through service of process in accordance with the directors’ consent statute (*Del. Code Ann.*, tit. 10, § 3114).


A Delaware limited partnership brought suit against a limited partner for failure to make payments on a promissory note reflecting the balance due on the limited partner's capital contribution. The limited partner, who was not a resident of and owned no real property in Delaware, filed a motion to dismiss for lack of personal jurisdiction. The limited partnership argued that personal jurisdiction was warranted because the limited partner had received the benefits and protections of Delaware’s forum by joining a Delaware limited partnership and the general partners had been conducting business in Delaware on the limited partner’s behalf and in his interests.

In granting the limited partner's motion to dismiss, the court held that status as a limited partner was not sufficient to confer personal jurisdiction over the limited partner. Under
the partnership agreement, the limited partner was expressly incapable of performing any of the activities that the limited partnership contended constituted “doing business” to subject the limited partner to personal jurisdiction. Also, the passage of Section 17-109 of the DRULPA, which includes provisions that permit a limited partner to consent to personal jurisdiction in Delaware, provided evidence that the General Assembly did not believe that mere status as a limited partner implied consent to personal jurisdiction.

3. Arbitration


A general partner of three Delaware limited partnerships brought an action in Delaware seeking the dissolution of the partnerships, against whom he was also litigating other issues in a Connecticut arbitration proceeding. The defendants moved to dismiss, or in the alternative stay, the Delaware action in favor of the arbitration proceeding. The court found the general partner bound to submit the dissolution claim against one limited partnership to arbitration by the all-encompassing arbitration clause in that partnership’s agreement. The other partnership agreements, however, did not contain such a clause and the dissolution claims were not first brought in the arbitration proceeding. Therefore, despite the awkward procedural consequences and Delaware’s policy of encouraging arbitration, the court did not have the power to compel the general partner to arbitrate the remaining dissolution claims in the Connecticut proceeding. The court did, however, exercise its power to stay the Delaware proceeding in the interests of judicial efficiency and consistency, pending the outcome of the arbitration proceeding.


In a prior proceeding captioned *Sorouri v. Wyshock*, the court had denied a motion by the limited partners of a Delaware limited partnership to enjoin the general partner from taking further action with respect to the partnership holding that, pursuant to a broad arbitration clause contained in the partnership agreement at issue, the limited partners had an adequate remedy and, upon the general partner’s motion, the court had compelled the limited partners to arbitrate their dispute. The general partner then moved to vacate the arbitration award on the grounds that the arbitrators exceeded statutory authority and the authority granted to them under the parties’ pre-arbitration stipulation. The court rejected the general partner’s contention, holding that the award was within the arbitrators’ grant of authority.

4. Statute of Limitations


In these, the last of several related actions brought in Delaware, New Jersey and New York, Mikael Salovaara sought enforcement of the indemnification clauses of several different partnership agreements. Previously, one of Salovaara’s partners, Alfred C. Eckert, filed a complaint in the Court of Chancery, asking the court generally to interpret the indemnification provisions of the relevant partnership agreements and specifically to determine whether Salovaara was entitled to indemnification of his legal fees and expenses in connection with suits that Salovaara himself had initiated to obtain personal recovery as a plaintiff. During the pendency of Eckert’s initial action, Eckert and Salovaara were involved in related litigation in New Jersey and New York. In the New York litigation, it was determined that one of the partnerships managed by Eckert and Salovaara was an ERISA fund, which could therefore indemnify a person only “for those expenses that are incurred pursuant to his duties with the plan, and that are undertaken for the exclusive benefit of the plan.” In the New Jersey litigation, it was determined that Eckert was not entitled to indemnification because he had acted with bad faith and willful misconduct and further that the relevant partnership agreements contemplated the indemnification not of plaintiffs but only of defendants. Nonetheless, several months before the New Jersey court’s decision, Eckert sought a voluntary dismissal without prejudice of the action he had originally brought in the Court of Chancery. Salovaara argued in response that (a) it would be inequitable to dismiss the action without prejudice because Eckert had all along asserted that
Delaware had a paramount interest in the matter and (c) the Chancery Court should dismiss the action with prejudice because the parties had already expended hundreds of thousands of dollars in legal fees and the case was ready for trial. The Court of Chancery dismissed the action with prejudice, ordering Salovaara to be indemnified for past legal fees and expenses and to receive an advancement against future legal fees and expenses. This order was stayed pending the final disposition of the New York litigation, including any appeals therefrom.

In the present disposition, the court vacated the stay of its earlier order, allowing Salovaara to be indemnified for the legal fees and expenses he had incurred as a plaintiff. The dismissal with prejudice had the effect of conclusively determining that the relevant partnership agreement was drafted to encompass plaintiff indemnification. In outlining this conclusion, Chancellor Chandler emphasized the fact that Eckert had brought this outcome on himself when he moved for the dismissal of his own case without prejudice: “In essence, by asking this Court to dismiss voluntarily the Related Indemnification Action, Eckert stood before this Court and said, ‘I admit my claim has no merit. Salovaara is entitled to indemnification….’ This Court is a court of equity and Eckert cannot persuade it to disregard the voluntary circumstances under which the June 14 Order was entered, simply in order to avoid a conflict, which is the product of his own actions, in judgments between this Court and a sister court in New Jersey.” The New York decision regarding ERISA, however, prevented Salovaara from receiving indemnification from one of the partnerships. Related partnership agreements with identical indemnification clauses were read to provide indemnification for plaintiffs as well as defendants. Finally, the court refused to distinguish between plaintiff indemnification versus defendant indemnification regarding the statute of limitations, upholding the previous ruling of Scharf v. Edgcomb Corp., 1997 WL 762656 (Del. Ch. 1997), that the statute of limitations on an indemnification claim accrues on the date the indemnitee could be confident any claim against him had been resolved with reasonable certainty.

In re Dean Witter P’ship Litig., C.A. No. 14816 (Del. Ch. July 17, 1998), aff’d, 725 A.2d 441 (Del. 1999)

Plaintiffs, unitholders in numerous Delaware limited partnerships, brought an action seeking an accounting and damages from general partners and financial advisors for breaches of the fiduciary duties of care, loyalty and candor in connection with the operation of the partnerships. Specifically, plaintiffs claimed that the defendants breached their fiduciary duties in recommending and selling to plaintiffs units in partnerships that could never achieve their promised objectives and breached their fiduciary duties by operating the partnerships to benefit themselves at the expense of the unitholders. Defendants filed a motion to dismiss claiming that, among other things, the plaintiffs’ claims were time-barred.

The court began its analysis by stating that a three-year statute of limitations is applicable to claims for breach of fiduciary duty and that, even though statutes of limitation do not generally apply directly in equity, equity follows the law and will apply a statute of limitations by analogy in appropriate circumstances. According to the court, the general law in Delaware was that the statute of limitations began to run at the time of the alleged wrongful act, even if the plaintiff was ignorant of the cause of action. The court divided the claims of the plaintiffs into two different types of injuries: (i) violation of fiduciary duties in the marketing and sale of partnership units and (ii) post-offering breaches of fiduciary duties in connection with management and oversight of the partnerships. Because partnership units were marketed and sold to the plaintiffs at least six years prior to the filing of the complaint in this action, the claims relating to the marketing and sale of the partnership units were stale, absent tolling of the statute of limitations, several years before the plaintiffs’ claim was filed. With respect to the claims relating to post-offering breaches, the alleged violations of fiduciary duty began shortly after each partnership was formed and thus the post-offering breaches also accrued at least six years before the filing of the complaint and were stale absent tolling of the statute of limitations.

Plaintiffs alleged that their claims were timely because the statute of limitations was tolled until shortly before the filing of the complaint when an article printed in the Wall Street Journal concerning the practices of the defendants put them on notice of their potential
claims. The court stated that in order for the plaintiffs to establish that the action was not time-barred, the plaintiffs must convince the court that they were not objectively aware of facts giving rise to the wrong, i.e. on inquiry notice, more than three years prior to the date on which the complaint was filed and further stated that a limitations period would be tolled until such time as persons of ordinary intelligence and prudence had facts sufficient to put them on inquiry, which, if pursued, would lead to the discovery of the injury. Because all of the plaintiffs’ claims were based on disclosures in documents that were either provided to plaintiffs contemporaneously with the wrongful conduct or publicly available in filings with the Securities and Exchange Commission, the court held that the plaintiffs were clearly on inquiry notice of their claims more than three years before the filing of their complaint and granted the defendants’ motion to dismiss on the ground that the plaintiffs’ claims were time-barred by the operation of the statute of limitations. The court acknowledged the correctness of plaintiffs’ assertion that beneficiaries are entitled to trust their fiduciaries but stated that plaintiffs still must be reasonably attentive to their interests and cannot ignore obvious signals of defendants’ mismanagement contained in publicly filed annual and quarterly reports, proxy statements and other SEC filings.


Plaintiff limited partner sued the general partner for, among other things, breach of the partnership agreement. The Supreme Court affirmed the Court of Chancery’s entry of summary judgment in favor of the general partner in the breach of partnership agreement claim on the ground that the claim was time-barred. The claim was a legal claim brought in a court of equity for which an analogous contract action existed at law with a corresponding statute of limitations. Because the claim was not filed within the analogous statutory period, relief was denied to the limited partner.

5. Attorney-Client Privilege


Plaintiffs, two limited partners of a Delaware limited partnership, moved to compel the production of certain documents related to a subordinated debt transaction proposed by the general partner in connection with the restructuring of certain partnership debt and in which all limited partners of the partnership were offered an opportunity to participate. The general partner asserted the attorney-client privilege and work-product doctrine in opposition to the motion.

In response to the general partner’s claim of attorney-client privilege, the limited partners argued that the fiduciary exception applied to the requested documents. The fiduciary exception to the attorney-client privilege is premised upon a commonality of interest and purpose between the general partner and the limited partners and permits a limited partner to gain access to otherwise privileged documents of the partnership under certain circumstances. The fiduciary exception ceases to apply once the purposes and interests of the general partner and the limited partners diverge. In order to avail themselves of the fiduciary exception, limited partners must establish a mutuality of interest between the general partner and the limited partners and make a showing of good cause. The court cited Continental Ins. Co. v. Rutledge & Co., Inc., discussed below, for the elements of a good cause showing and the additional requirement that the exception to the attorney-client privilege must not yield an inequitable result.

The court found that more than a simple disagreement between the general partner and the limited partners must exist before mutuality of interest will be deemed to have expired but that once litigation about an identified dispute can be reasonably anticipated, the general partner and the limited partners no longer share a commonality of interest. The risk of litigation with one of the plaintiff limited partners was evident before the requested documents were created. While some of the documents subject to the motion were created prior to the time that litigation could be reasonably anticipated between the general partner and the other plaintiff limited partner, the court concluded that the attorney-client privilege must prevail against both limited partners with respect to all such documents because both plaintiffs sought the same documents to assert the same claims through the same counsel.
 Plaintiffs also alleged that distribution to the limited partners of a memorandum describing the subordinated debt transaction by counsel for the partnership and the general partner constituted a waiver of the attorney-client privilege with respect to subsequent documents and communications addressing the restructuring and the subordinated debt transaction. However, the court concluded that the memorandum did not contain any information constituting a disclosure of any significant confidential communications between attorney and client and added, that even if it were characterized as a privileged attorney-client communication, based on the showing made by plaintiffs, the court could not find a waiver of the attorney-client privilege by the general partner.

Finally, plaintiffs argued that the general partner could not assert attorney-client privilege with respect to a letter from counsel for a non-plaintiff limited partner to counsel for another non-plaintiff limited partner. The court found that the letter was created and disseminated within the scope of a common interest in the transaction between the general partner and such non-plaintiff limited partners and plaintiffs failed to show why the evidentiary rule protecting confidential communications by one person’s attorney to an attorney representing another person in a matter of common interest did not apply to the letter. Therefore, the general partner remained entitled to assert the attorney-client privilege as to the letter.


Plaintiff limited partner moved to compel the production of communications between an attorney and the board of directors of the general partner relating to various transactions challenged by the limited partner. (For a further discussion of this case, see Gotham Partners, L.P., Section II.H.2., above.) The defendants asserted the attorney-client privilege in opposition to the motion.

After finding that the alleged actions of the defendants, including the inadvertent production of one memo containing legal advice, had not waived the attorney-client privilege, the court held that, unlike the general partnership context in which a partner cannot assert the attorney-client privilege to bar another partner’s access to the substance of legal counsel given to the partnership because all partners are presumed to be active managers of the partnership, for a limited partner, who is presumed to be a passive investor, to claim the right to review privileged documents provided to the general partner, the burden rests on the limited partner to show good cause. According to the court, the elements for showing good cause in the limited partnership context are: (i) the assertion of a colorable claim; (ii) the necessity of the information contained in the privileged communication and its unavailability elsewhere; (iii) the extent to which the communication is specified as opposed to a broad request fishing for information; and (iv) the requested documents do not disclose litigation strategies or theories falling under the work product doctrine. The court found that the limited partner failed to allege the need for any specific information that was material to its claims that could not be obtained elsewhere and held that the limited partner had failed to meet its burden under elements (ii) and (iii) of the above-referenced test and thus had failed to show good cause for overcoming the attorney-client privilege.


Plaintiffs had been limited partners in a Delaware limited partnership and had sued the general partner regarding their ability to withdraw from the limited partnership and the proper accounting of monies and securities due to them in light of their withdrawal. In connection with such suit, the limited partners filed a motion to compel the production of documents and deposition testimony regarding legal advice received by or on behalf of the partnership relating to (i) the formation of the partnership, (ii) advice concerning internal partnership affairs, (iii) private equity investments the partnership made and fees that the general partner may have collected, and (iv) any advice or opinions received concerning an alleged amendment of the partnership’s terms. The court stated the issue before it as when, if ever, could a litigant who at one point was involved in a fiduciary relationship with an opposing party successfully assert an attorney-client privilege. The court noted that a claim had been made that the limited partnership agreement modified the rights of the
partnership, the general partner or the limited partners to assert or waive their or any other entity’s attorney-client privilege and, consequently, concluded it was appropriate to import rules of law from the corporate context.

Under these rules, the court held that in order for the fiduciary exception to apply, a litigant must establish that a mutuality of interest existed between the parties and make a showing of good cause and the exception to the attorney-client privilege must not yield an inequitable result. The court defined “good cause” to include (i) the assertion of a colorable claim; (ii) the necessity of the information and the unavailability of the information from another source; (iii) the extent to which the communication is identified as opposed to the extent to which the limited partner is merely fishing for information; and (iv) the requested documents do not disclose strategies or theories relating to the defense of the suit, *i.e.*, documents that would qualify under the work-product doctrine.

Applying this standard to the discovery of pre-litigation advice that the partnership received regarding alleged amendments to the partnership agreement, the court held that any advice of counsel rendered to any of the parties after each party was made aware of the limited partners’ intent to withdraw remained privileged and not subject to the fiduciary exception because the interests of the general partner, the limited partners and the partnership diverged at the point in time when it was imminently clear to all parties that the limited partners were attempting to withdraw from the partnership and, thus, the parties no longer shared a mutuality of interests.

With respect to the discovery of legal advice concerning the formation of the partnership, the court denied the limited partners’ motion to compel any documents that predated the formation of the partnership based on the court’s determination that no fiduciary relationship existed at the time in question. Because no fiduciary relationship existed between the parties prior to the formation of the partnership, no fiduciary exception could apply.

Finally, with respect to the discovery of other legal advice received by the partnership at a time before the limited partners’ intention to withdraw from the partnership was known, the court concluded that although a mutuality of interest existed between the parties at the time of the documents sought in discovery, the limited partners failed to make a showing of good cause because plaintiffs either failed to make a particularized showing of necessity or the information sought was otherwise available through non-privileged sources.

6. **Attorneys Fees**


   Plaintiffs filed two actions in the Court of Chancery. Shortly thereafter, plaintiffs moved voluntarily to dismiss their suits when it became apparent that the scope of the litigation in Delaware might expand to mirror that of litigation already pending in Texas. The court granted the plaintiffs’ motions to dismiss over the defendants’ objection, but it conditioned dismissal on the payment of the defendants’ reasonable attorneys’ fees and expenses actually and necessarily incurred in the instant actions.


   In an earlier decision in this case (see Section II.A.3), the court ruled that the defendants, three of which were limited partners of a Delaware limited partnership, had committed an egregious breach of the partnership agreement and had violated their duty of loyalty to the partnership by operating a competing business venture. To remedy the breaches of the partnership agreement and the duty of loyalty, the court granted the plaintiff certain declaratory relief and an award of damages measured by the amount of money spent by the plaintiff to seek judicial redress for harm caused by the breaches. This decision related to the defendants’ motion seeking relief from judgment and reargument challenging the award of damages award based on attorneys’ fees.
The defendants argued that it was improper to award the plaintiff attorney fees’ both under
the American rule, which is the common law rule that each party involved in litigation will
bear only its own attorneys’ fees regardless of the outcome of the litigation, and under the
terms of the partnership agreement, which they argued also provided that each party would
bear its own expenses of counsel. The court, citing its broad discretion to tailor remedies
to suit the situation and the policy under Delaware law of strictly imposing penalties to
discourage disloyalty, stated that the decision to measure damages was an attempt to match
directly the cost of the wrongdoing with the clearest proof of the monetary costs to remedy
the wrongdoing and was an appropriate remedy for the egregious breach of the duty of
loyalty and therefore, reaffirmed the award of damages. The court stated that it viewed the
award of damages as distinguishable from traditional fee-shifting but went on to address
the defendants’ claims that the award of damages measured by attorneys’ fees was
improper under the American rule and under the partnership agreement and concluded that
traditional fee-shifting would have been appropriate in this case as well. With respect to
the American rule, the court stated that bad faith is an exception to the American rule and
found that the defendants’ conduct constituted bad faith that would have made an award of
attorneys’ fees appropriate under the American rule. With respect to the partnership
agreement, the court acknowledged that it provided that “[e]ach party shall bear its own
expenses for counsel and other out-of-pocket costs in connection with any judicial
resolution of a dispute, difference or controversy.” However, the court, noting that the
provision appeared in middle of a paragraph dealing with arbitration and arbitration
procedure and that the defendants themselves sought attorneys’ fees in this case, stated that
in the context of the partnership agreement it seemed disingenuous to stretch the parties’
intention to pay their own fees and expenses in a dispute over the terms of the partnership
agreement, which may be resolved by arbitration, to a multi-party controversy involving
parties not subject to the terms of the partnership agreement. The court went on to state
that even had the parties clearly intended that they bear their own fees and expenses under
these extraordinary circumstances, the facts of this case would warrant a remedy beyond
that contemplated by the parties and that based on the egregious behavior of the defendants
in this case it would have been justified in awarding attorneys’ fees and expenses to the
plaintiff under the bad faith exception to the American rule notwithstanding any contractual
provisions arguably to the contrary.

Following the announcement of a proposed merger by a Delaware limited partnership, the
plaintiff, a limited partnership unitholder, filed an action challenging the terms of the
proposed merger. The plaintiff’s motion for expedited proceedings and a preliminary
injunction prior to a meeting of unitholders to vote on the merger proposal was denied.
The merger proposal was then defeated at the meeting and the parties consented to the
dismissal of the action as moot. One of the factors in the defeat of the merger proposal
apparently was a letter from the plaintiff’s securities analyst to the other unitholders urging
them to vote against the proposed merger.

The plaintiff then applied for attorneys fees and expenses in connection with the action,
including the costs of communicating with other unitholders to inform them of the
plaintiff’s opposition to the merger proposal. According to the plaintiff, the benefit to the
partnership flowing from the defeat of the merger proposal was $17.5 million or more.

The court denied the plaintiff’s application, holding that (i) even though the counter-
solicitation was effective and brought about the defeat of the merger, there was no
Delaware authority supporting the proposition that a successful proxy combatant may seek
a court award of fees and expenses and (ii) there was no causal connection between the
litigation and the defeat of the merger proposal. According to the court, the counter-
solicitation, not the litigation, conferred the benefit on the partnership.

Limits on DRULPA Section 17-305 Actions

Plaintiff limited partner filed an action seeking to compel the general partner to provide
certain books and records of a Delaware limited partnership pursuant to Section 17-305 of
the DRULPA. In the action relating to the August 18, 1999 opinion, plaintiff sought to expedite the books and records proceeding. Defendants argued that the plaintiff was seeking the partnership’s books and records for an improper purpose -- namely, to circumvent the discovery procedures in plaintiff’s separate action for breach of contract against defendants. After finding that plaintiff’s claims in its contract action alleging that the partnership and general partner wrongly withheld amounts from plaintiff could not be brought in a books and records action under DRULPA Section 17-305, the court stated that books and records action should not circumvent the discovery in the contract action because the discovery in the books and records action would be far more limited than the discovery available in the breach of contract case and held that defendants had not provided a reasonable basis for refusing to expedite this proceeding. The Court of Chancery thus granted plaintiff’s motion to expedite the proceeding, noting that “this Court routinely accelerates summary proceedings brought pursuant to [DRULPA Section 17-305].” In the September 27, 1999 opinion, after weighing (i) the scope of the plaintiff’s request for books and records that would enable it to determine how the general partner derived profit and loss figures of the partnership, (ii) the fact that the plaintiff had not alleged fraud, embezzlement or similar malfeasance of the general partner and (iii) the breadth of access to partnership books and records provided under DRULPA Section 17-305, the court set forth a specific list of materials to be produced by defendants in response to plaintiff’s request.


After a Delaware limited partnership completed a series of transactions involving its own limited partnership units, plaintiff limited partner filed an action against the general partner and the limited partnership under DRULPA Section 17-305 to gain access to the books and records of the limited partnership. Four months later plaintiffs filed a derivative action on behalf of the limited partnership claiming that the general partner had breached its fiduciary and contractual duties to the limited partnership in carrying out the transactions. The limited partner then moved to amend and supplement the Section 17-305 action to include the fiduciary and contractual breach of duty claims. According to the court, the limited partner sought the amendment in order to tack the breach of fiduciary and contractual duty claims to the Section 17-305 action’s earlier filing date and thereby presumptively rebut any defense of laches that the defendants might raise. (Although the defendants produced the books and records sought in the initial proceeding, the parties stipulated that the initial proceeding would not be dismissed pending the resolution of the plaintiff’s motion to amend its complaint to add the breach of fiduciary and contractual duty claims.)

In determining the scope of a plaintiff’s right to amend a complaint in a Section 17-305 action, the court compared the language of and rights contained in Section 17-305 to analogous right-to-access provisions of the Delaware Uniform Partnership Law (Section 1519) and Delaware General Corporation Law (Section 220) and, based on the similarities between Section 17-305 and DGCL Section 220, including the underlying purpose of each statute of enforcing the right of a passive investor to obtain information from an uncooperative manager, concluded that case law interpreting DGCL Section 220 was the most logical and meaningful source from which to seek relevant precedent. After examining corporate precedent rejecting claims that would expand a DGCL Section 220 hearing beyond its statutory purpose, the court decided that allowing the limited partner to add complex claims of fiduciary or contractual breach of duty would overwhelm the purpose of the special proceeding granted under Section 17-305 and announced, as a general rule, that the court will not entertain outside claims or collateral issues within a Section 17-305 hearing but will hear only those matters that pertain to the limited partner's demand to inspect the books. Having established the general rule that Section 17-305 proceedings may not be amended to add collateral claims or extraneous issues, the court declined to grant plaintiff a special exception to the rule, finding the limited partner would not be unfairly prejudiced by its application because the limited partner would be fully able to attack on the merits a laches defense by the defendants against the limited partner’s claims in the derivative action.

In two related cases in which a limited partner sought access to partnership lists, the court entered an order granting the plaintiff’s motion for reasonable acceleration of the discovery and trial schedule. The court noted that a demand for a limited partnership list does not necessarily warrant the same degree of acceleration occasionally ordered in corporate stockholder list cases and indicated that sixty to ninety days would be a reasonable period of time for the defendant partnerships to conduct discovery concerning the plaintiff’s purpose for seeking access to the partner lists.

8.  *Forum Non Conveniens*


Plaintiff limited partner sought to compel production by the general partner of a Delaware limited partnership of a list of the names and addresses of the partners in the partnership. The defendant general partner sought to have the action dismissed on *forum non conveniens* grounds based on a clause in the partnership agreement selecting New York as the forum for “any dispute arising out of the terms and conditions of this Agreement.” The court denied the motion to dismiss finding that the partnership agreement was silent as to a limited partner’s right to demand a list of other partners and, thus, the right of a partner in a Delaware limited partnership to seek a list of other partners was based on the DRULPA, not the partnership agreement. Since the partnership agreement did not preclude the suit, the court held that a *forum non conveniens* dismissal would not be granted because the defendant had failed to show the inconvenience of having the case tried in Delaware imposed any real prejudice or burden on the defendant or that New York was so substantially more convenient that dismissal of the Delaware action was justified.

9.  *Prejudgment Interest*


In an earlier decision in this case (see Section II.A.3), the Court of Chancery ruled that defendants, three of which were limited partners of a Delaware limited partnership, had committed an egregious breach of the partnership agreement and had violated their duty of loyalty to the partnership by operating a competing business venture. To remedy the breach of the partnership agreement and the duty of loyalty, the court granted plaintiff certain declaratory relief and an award of damages measured by the amount of money spent by plaintiff to seek judicial redress for the harm caused by the breaches. In a subsequent decision in this case, which decision was affirmed by the Delaware Supreme Court (see Section II.J.6), the Court of Chancery granted plaintiff’s motion for attorney’s fees and expenses.

This decision related to whether plaintiff was entitled to prejudgment interest on the amount paid to plaintiff’s attorneys. The court stated that cases involving a breach of the duty of loyalty permit broad, discretionary and equitable remedies, including the award of prejudgment interest and compound interest. The court noted the egregious nature of defendants’ breach, and the expensive, expedited litigation in which plaintiff was forced to engage, finding that compounded prejudgment interest was merited in this case.

With respect to the date from which prejudgment interest should accrue, plaintiff argued that the court should award prejudgment interest from the date of the breach, whereas defendants argued that prejudgment interest (if awarded) should accrue incrementally from the date plaintiff paid each of its legal fees. The court ruled that prejudgment interest should be awarded as each bill was paid, noting that the Delaware courts have only awarded prejudgment interest from the date of the wrong in tort cases, and that awarding interest as each bill was paid fairly reflects when the damages were suffered and results in damages that are readily and demonstrably calculable.

K.  General Construction and Application of Partnership Agreements

In addition to the cases described above which are summarized under specific topic headings, the Delaware courts have decided several significant cases that do not easily lend themselves to inclusion under any of the
foregoing categories. These cases, which are described below, include an interpretation of transfer restrictions in the context of a merger, an examination of the circumstances under which a general partner may cause a limited partnership to sell all or substantially all of its assets and a review of the circumstances under which a general partner may prevent a limited partner in an existing investment partnership from exercising a right to make a pro rata contribution in a newly formed investment fund.


This case arose out of a dispute between the partners of several Delaware limited partnerships over the interpretation and enforcement of identical buy/sell provisions and related “waterfall” calculations governing the distribution of partnership proceeds in a series of partnership agreements. The partnerships were formed at various times from 1996 to 1999 to acquire, own and operate real property developed and used as recreational vehicle or mobile home communities. A different affiliate of Lehman Brothers, Inc. (“Lehman”) served as both 1% general partner and a 74% limited partner of each partnership (collectively, the “PAMI Partners”) and the other 25% limited partner was EMB/NHC, L.L.C. (“NHC”), which manages the properties.

On January 8, 2004, NHC invoked the buy/sell provisions of the partnership agreements. According to the partnerships’ books and records, NHC’s offer, in the event NHC was the buyer, would have resulted in payments to the PAMI Partners aggregating approximately $70 million for their partnership interests and, in the event NHC was the seller, would have resulted in payments to NHC aggregating $5.7 million for its partnership interests. The PAMI Partners responded on February 5, 2004 by purportedly electing to be the buyer of NHC’s partnership interests but, based on the books and records kept by Lehman, only offered to pay NHC $1.5 million for its partnership interests. On February 9, 2004, NHC notified the PAMI Partners that it considered the PAMI Partners’ election to buy a counteroffer and therefore a repudiation of the partnership agreements. NHC then purported to close on its purchase of the PAMI Partners’ partnership interests and deposited the purchase price for the PAMI Partners’ partnership interests in escrow. The PAMI Partners then filed this lawsuit seeking an order compelling NHC to perform as seller under the buy/sell provisions, and NHC counterclaimed for a declaration that its buy/sell election based on its offer price was valid and fully enforceable, thereby giving NHC the right to buy the PAMI Partners’ partnership interests.

The court found that Lehman knew that the waterfall calculations it used to respond to the NHC’s buy/sell notices did not reflect the partnership books and records and were not performed in accordance with the partnership agreements in several respects. One area of disagreement regarding the waterfall calculations was Lehman’s argument that, notwithstanding the separate structures of the partnerships, the waterfall calculations should be performed on a consolidated basis, which would allow Lehman to make up losses in one partnership from profits realized in another. The court rejected Lehman’s argument, finding that the record did not contain substantial evidence of any agreement among the partners to treat the partnerships as a single, consolidated entity for any purpose, including, in particular, the waterfall calculation.

The court concluded that NHC had the contractual right to act as buyer in accordance with the buy/sell provisions, finding that the totality of Lehman’s response to the buy/sell notices from NHC was so inconsistent with the clear terms of the partnership agreements that it constituted either a repudiation of those contracts or an improper counteroffer. The court held that Lehman repudiated the partnership agreements by stating unequivocally that it would perform only on terms different than those required by the partnership agreements and, in doing so, Lehman unilaterally sought to alter both the present and reasonably anticipated future relations created by the partnership agreements and tried to use its superior economic power to impose a non-contractual understanding on NHC in lieu of the agreements between the parties. Under the theory that once a party repudiates or breaches a contract, it cannot claim the benefits of that contract, the court held that Lehman could not enforce its elections to be the buyer under the buy/sell provisions. In addition, the court held that Lehman’s elections to be the buyer materially varied the terms of NHC’s offer and thus were ineffective acceptances. While purporting to accept, Lehman made clear that it would not abide by the explicit terms of the partnership agreements in determining what it was obligated to pay, would not recognize or base its payment on the partnerships’ books and records and would litigate and assert that NHC was entitled to nothing if NHC refused to agree to its terms. The court concluded that Lehman thereby rejected NHC’s offer and made a counteroffer and that, because the partnership agreements provided that if the recipient of a buy/sell notice does not timely accept as the buyer, the party giving the notice shall be the buyer, NHC was the buyer. The court also awarded attorneys’ fees and costs to NHC pursuant to a provision in the partnership agreements that entitled a partner to
attorneys’ fees and costs if such partner obtains a judgment against any other partner for breach of the partnership agreement.

Because the court had already found that Lehman’s conduct amounted to a repudiation of the partnership agreements, the court declined to address NHC’s claim that Lehman’s conduct constituted a breach of the implied covenant of good faith and fair dealing. The court agreed with NHC, however, that had Lehman’s conduct not been found to be in breach of a specific provision of the partnership agreements, it would have been in breach of the implied covenant, finding that Lehman’s conduct in responding to the buy/sell notices was undertaken in bad faith and in knowing disregard of NHC’s rights under the partnership agreement and was designed to exert economic coercion on NHC.

The court stated that its holding was not based on a finding of breach of fiduciary duty by Lehman because NHC chose to rely on its contractual rights under the partnership agreements instead of bringing suit to complain about Lehman’s fiduciary conduct, but the court noted that there was evidence in the record from which the court could infer that Lehman acted in breach of its duty of loyalty in its dealings with NHC and the partnerships.


Several investment funds bought partnership units in FFP Partners L.P., a Delaware limited partnership (“FFP”), whose business was managing real estate. In order to protect FFP’s tax status as a pass-through entity, FFP’s partnership agreement (the “Agreement”) imposed a 4.9% limit on the amount of partnership units any “person” could “constructively own.” According to the terms of the Agreement, investors attempting to acquire more than 4.9% of FFP’s partnership units would merely engage in void transfers with the units they attempted to acquire immediately exchanged for “excess units” to be held in an “excess unit trust.” Owners of excess units had no partnership rights except the right to name a beneficiary to the trust or to sell the excess units at a price no higher than that for which they were bought, with the express permission of the partnership. However, the investment funds colluded first in attempts to circumvent the ownership cap and then in an attempt to eliminate the ownership cap. The Agreement further provided that only limited partners holding at least a 10% ownership interest could propose amendments to the Agreement. The plaintiff investors together proposed such an amendment, and, at the request of one of the plaintiffs, Cede & Co., the nominal owner of the plaintiffs’ partnership units, submitted the same proposal. When the plaintiff investors filed a Schedule 13D in relation to their acquisition of partnership units, FFP responded by demanding information on the plaintiffs’ interrelationships and holding of units. The plaintiffs refused the request and filed suit, seeking to compel a meeting of limited partners to vote on their proposed repeal of the ownership cap.

The plaintiffs first argued that the Agreement required FFP to treat Cede & Co. as the limited partner proposing the amendment because Cede & Co. was the registered owner of the units that the plaintiffs ultimately owned. Since Cede & Co. was the nominal owner of 95% of the units of FFP, the plaintiffs claimed, the 10% threshold for proposing amendments had been satisfied. Noting the absurd results to which the plaintiffs’ arguments might lead, Vice Chancellor Lamb held that FFP was entitled to look through the agent, Cede & Co., to determine the ownership interest of its principals.

The plaintiffs further argued that their 11.6% aggregate ownership interest entitled them to propose amendments without regard to Cede & Co., denying that any one of them constructively owned more than 4.9% of outstanding FFP units or that their units were subject to the forfeiture provision embodied in the ownership cap. Although the plaintiffs admitted that they were a 13(d) group and therefore a “person”, as defined in the Agreement, they argued that, since the tax law definition of constructive ownership used in the Agreement did not attribute to a Section 13(d) group ownership of interests held by members of that group, the group here was likewise not the constructive owner of the units held by its members. Nonetheless, Vice Chancellor Lamb quickly concluded that the plaintiffs themselves remained persons under the Agreement who remained subject to the ownership cap and who together constructively owned a forbidden amount of units.

The Vice Chancellor went on to reject the plaintiffs’ arguments that (a) under the Agreement’s broad definition of constructive ownership, a unitholder might accidentally violate the ownership cap and (b) the Agreement’s broad definition of constructive ownership would prevent anyone from ever satisfying the 10% ownership threshold for proposing amendments. Talk of accidental infractions did not help these plaintiffs, who were fully aware of each other’s ownership interests.
and who knowingly colluded to avoid the membership cap. Similarly, the court indicated that any unitholder could solicit proxies or consents to reach the 10% threshold, so the plaintiffs' arguments lacked merit.

Arguments that FFP had waived its right to enforce the ownership cap were refuted both by the language of the Agreement and the facts of the case. Moreover, even if FFP had waived the relevant provision, the plaintiffs' unclean hands would bar them from a remedy. The court went on to dismiss as "insubstantial" the plaintiffs' arguments that (a) the transfer provision violated Article VIII of the Uniform Commercial Code and (b) that the excess unit trust was not a valid trust.

Summary judgment was granted to the defendants. The plaintiffs could not vote the units they held in violation of the ownership cap.


The plaintiff, Telstra Corporation Ltd. ("Telstra"), was one of three limited partners in a Delaware limited partnership. The general partner and the two other limited partners were wholly-owned subsidiaries of Dynegy, Inc. ("Dynegy"). The partnership agreement gave Telstra the right to require Dynegy or the partnership to purchase its interest in the partnership during the first two years of the partnership. The amount Telstra was entitled to receive upon the exercise of its put option was the value of Telstra’s capital account at the end of the month immediately preceding the exercise of the put option. The partnership agreement also provided that upon the occurrence of certain triggering events, the partners’ capital accounts would be increased or decreased to reflect appreciation or depreciation in the partnership’s asset values (i.e., a “book up” or “book down”). One triggering event was a disproportionate contribution of capital to the partnership by the partners.

This case arose following a capital call by the partnership in July 2000. Dynegy funded its pro rata portion of the capital call but Telstra did not make a capital contribution and claimed that the capital call was unauthorized because it had been issued without the approval of the managing board of the partnership, as required by the partnership agreement. In August 2000, Telstra exercised its put option and Dynegy accepted Telstra’s exercise of the put option and advised Telstra that the partnership had determined that Telstra’s capital account at the end of July had been “booked down” to zero based on the disproportionate capital contributions of the partners. Telstra claimed that there was no basis for “booking down” the value of its capital account and filed suit alleging breach of contract and breach of fiduciary duty. This decision was issued in connection with motions for summary judgment.

The court’s analysis of the breach of contract claim focused on whether the capital call was valid and whether the partnership was entitled to “book down” the value of Telstra’s capital account and the court found that the capital call was invalid because it had not been approved by the managing board and that in the absence of a valid capital call, the partnership could not accept Dynegy’s capital contribution. Based on this finding, the court concluded there had been no disproportionate capital contributions and thus there was no basis for a “book-down” of Telstra’s capital account. The court further stated that even if the capital call had been valid, because Telstra’s capital contribution was not due until after the end of July, there would have been no disproportionate capital contributions at the end of July and no basis to “book down” at such time. The court granted Telstra’s motion for summary judgment on the issue of whether it is entitled to the value of its capital account at the end of July without a “book down” but determined that a trial was necessary to determine the proper value of Telstra’s capital account.

Telstra also alleged breach of fiduciary duty by the general partner and demanded the equitable remedies of rescission or rescissory damages and an award of attorneys’ fees. The court found that all of Telstra’s claims related to the general partner’s performance of its contractual duties under the partnership agreement in connection with Telstra’s exercise of the put option and held that Telstra’s attempt to recover rescissory damages and attorneys fees was inappropriate in this context. The court stated that the remedies of rescission and rescissory damages were available in connection with claims such as fraudulent inducement, unjust enrichment and self-dealing but not in this case where the claims were all essentially based in contract. The court also found that there was no evidence of bad faith by Dynegy that would justify Telstra’s demand for attorneys’ fees. The court thus granted the defendants’ motion for summary judgment on Telstra’s fiduciary duty claims.
Limited partners sued the general partners, which were affiliated with one another, of a Delaware limited partnership for breach of fiduciary duty and breach of contract and sued an affiliate of the general partners for aiding and abetting breaches of fiduciary duty. Plaintiffs’ claims stemmed from actions taken by the general partners in connection with an offering of preferred units having superior claims to capital and income distributions, including the amendment of the partnership agreement without limited partner approval to subordinate the contractual distribution rights of the existing limited partners to those new claims and a subsequent sale of partnership property also without limited partner approval. Before the court were cross-motions for partial summary judgment. (See Sections II.A. and II.I. above for discussions of other aspects of this case.)

The court granted the plaintiffs’ motion with respect to their claim that the general partners breached the partnership agreement by amending it to provide a preferential right to capital and income distributions to holders of preferred units without limited partner approval. The defendants argued that a provision in the partnership agreement that permitted the general partners to sell additional partnership interests on such terms and conditions and with such rights and obligations as the general partners determined implicitly granted the general partners the authority to amend the partnership agreement as necessary to secure the rights of the new limited partners and that the amendment provision of the partnership agreement supported that interpretation. The court disagreed and held that reading the provision to empower the general partners unilaterally to create a different class of limited partner units that do not merely dilute but subordinate the rights of existing limited partners required reading into the provision a more sweeping implicit meaning than emerged from a reading of the explicit terms thereof.

The court stated that it would expect a partnership agreement to articulate clearly the general partners’ power to create a new class of units with superior rights and amend the partnership agreement unilaterally to create those rights and found that Section 17-302(a) of DRULPA, and the history of its amendments, reinforced the need for an explicit grant of authority for the exercise of such powers. The court also rejected the defendants’ reliance on the amendment provision of the partnership agreement. The amendment provision provided that any amendment which would adversely affect (other than as permitted in the additional partnership interests provision) certain rights of investor limited partners required the written consent of all investor limited partners. The court found that by its plain terms the effect of the reference to the additional partnership interests provision was solely to exempt an amendment related thereto from the unanimous written consent requirement, not permit it unilaterally.

The court also denied both cross-motions on the plaintiffs’ claim that the sale of certain real estate properties without limited partner approval violated the partnership agreement. Under the terms of the partnership agreement, limited partner approval was required to approve a sale of all or substantially all of the assets of the partnership. The defendants first argued that because the sold properties were owned by a subsidiary of the partnership, they did not constitute property of the partnership that was subject to the limited partner approval requirement. The court rejected this argument finding that when the applicable provision was interpreted in conjunction with other provisions of the partnership agreement, it was clear that the sold properties were considered a partnership asset, regardless of the fact that they were held indirectly by a partnership subsidiary and that such reading was also consistent with the language contained in the prospectus for the preferred units offering. With regard to the parties’ dispute over whether the sold properties constituted all or substantially all of the assets of the partnership, the court found that such a determination involves a subjective inquiry comprised of both qualitative and quantitative considerations and that the deficiencies in the record at the summary judgment stage precluded the court from making a decision prior to trial.

In a decision after trial, the court ruled on plaintiffs’ challenge to, and defendants purported defenses of, three transactions: a reverse split of partnership units, an option plan and an odd lot sale. The court had previously determined that the limited partnership agreement at issue supplanted the otherwise applicable default fiduciary duties relating to the challenged transactions (see discussion of that opinion in Section II A.2., above), and the court noted this meant that the limited partnership agreement therefore became the sole source of protection for the public unitholders of the


The question before the court was, in essence, whether or not the subject transactions were made in compliance with the requirements of the limited partnership agreement. The court noted that under the circumstances the general partner and other fiduciary defendants can rightly be expected to follow the partnership agreement “scrupulously.” The court also reaffirmed that where the general partner controlled the contractual drafting process, any ambiguities in the partnership agreement would be construed against the general partner. The specific question with respect to the odd lot sale (in which the general partner bought all odd lots tendered by unitholders) was whether that sale was an “issuance” with respect to which the general partner was authorized to act at its sole discretion and to consider only factors it deemed relevant or a sale or other transaction between the partnership and the general partner which had to be on substantially the same terms available from an unaffiliated third party. The court concluded, based on the nature of the transaction and on the general partner’s treatment of it prior to the litigation, that it was a sale and not an issuance and that as there was no evidence that it was on substantially third party terms it did not comply with the requirements of the partnership agreement. In addition, under the partnership agreement the general partner’s audit committee was required to review and approve the sale and the court found that although there had been an ad hoc separate vote of the outside directors, such a vote was not an adequate proxy for genuine audit committee review. However, with respect to the issuances in connection with the reverse split and option plan, the court concluded that the more deferential provisions of the partnership agreement applied, that no audit committee approval was required and that the transactions had been made in compliance with the partnership agreement. As a defense to claims relating to the odd lot sale, the defendants had attempted to rely on Section 17-1101(d)(1) of the DRULPA, which essentially provides that a general partner is not liable for its good faith reliance on the provisions of a limited partnership agreement. The court noted that it was an open question as to whether that section would protect a general partner who in good faith, but erroneously, relied on ambiguous provisions of a limited partnership agreement. But the court concluded that the provisions at issue were not ambiguous and therefore, following the teaching of Continental Ins. Co. v. Rutledge & Co., Inc. (discussed in Section II.A.2. above), the court held that Section 1101(d)(1) did not protect the general partner’s erroneous reliance on an unambiguous provision -- whether or not in good faith. The court also rejected the general partner’s reliance on counsel defense both because the general partner did not follow the advice it was given and because it had not acted in good faith. However, as to remedy, the court declined to impose rescission as requested by the plaintiff. It declined to do so because, among other things, the plaintiff had done nothing to challenge the subject transactions for over a year after they occurred and because the court was not convinced the subject transactions were a conscious scheme to entrench the general partner’s control and enrich its affiliate. Therefore, the court ordered an award of monetary damages.

In an appeal of this decision, the Delaware Supreme Court affirmed the judgment of the Court of Chancery that (a) the contractual fiduciary duties of entire fairness contained in the partnership agreement applied to the odd lot sale, (b) the defendants who controlled the general partner were jointly and severally liable with the general partner because they aided and abetted the general partner’s breach of the contractually created fiduciary duties of entire fairness, (c) the Court of Chancery has the discretion not to grant rescission where the plaintiff unjustifiably delays in seeking that remedy, provided that the court articulates and orders a reasonable alternative remedy and (d) the Court of Chancery has the discretion to award compound interest on the resulting damage remedy. The Supreme Court reversed the judgment of the Court of Chancery, however, regarding the calculation of the damages awarded to the plaintiffs. The Supreme Court determined that the value of the control of the partnership acquired by the defendants that resulted from the defendants’ wrongful conduct was not properly compensated for by the award of damages because the Court of Chancery did not account properly for a control premium in its calculation of damages. The Supreme Court remanded the case to the Court of Chancery for proceedings to quantify how the odd lot sale would have been consummated had the defendants adhered to the entire fairness standard and procedures in the partnership agreement and to award one or more various equitable remedies to compensate the plaintiffs for the control premium. The Supreme Court stated that where there is a breach of loyalty, as in this case, the scope of recovery is not to be determined narrowly because the strict imposition of penalties under Delaware law is designed to discourage disloyalty.

While the scope of Section 17-1101(d)(2) of DRULPA was not before the Supreme Court, the Court stated that notwithstanding this fact, it felt compelled to note that the Court of Chancery’s dictum in an earlier decision in this case (see Section II.A.2) that Section 17-1101(d)(2) of DRULPA expressly authorizes the elimination of fiduciary duties in a partnership agreement was not a correct
statement of law. Rather, the Supreme Court pointed out that neither Section 17-1101(d)(2) nor any other provision of DRULPA explicitly provides that a limited partnership agreement may eliminate the fiduciary duties or liabilities of a general partner and that the underlying general principle in Delaware is that scrupulous adherence to fiduciary duties is normally expected. The Supreme Court also noted the historic cautionary approach of Delaware courts that efforts by a fiduciary to escape a fiduciary duty, whether by a corporate director or officer or other type of trustee, should be scrutinized searchingly.

In the remand of this case to the Court of Chancery following the Delaware Supreme Court’s decision, the Court of Chancery awarded monetary damages to compensate the partnership for the increased security over the control of the partnership that the general partner achieved in the odd lot sale. The court arrived at the award based on comparable companies, discounted cash flow, net asset value and market value analyses of the value of the partnership and then added a control premium to the valuation, which resulted in a 154% premium over the market price paid in the odd lot sale. The court determined not to revisit its previous decision to deny rescission and, because the court had found rescission to be unwarranted, also found an award of rescissory damages to be unwarranted. The court also refused to sterilize the general partner’s voting rights with respect to the units it acquired in the odd lot sale, stating that too much time had passed for it to be equitable to strip the general partner of its voting rights with respect to these units.


In responding to cross-motions for summary judgment, the court addressed the issue of whether the partners of a Delaware limited partnership orally amended the partnership agreement to temporarily suspend a limited partner’s withdrawal rights. The limited partnership, formed to raise and invest capital, had an initial investment strategy to invest in public equity. However, in accordance with the partnership agreement, the general partner caused the partnership to change its investment strategy to invest primarily in private equity. Subsequent to the change in investment strategy, a limited partner, under new ownership, decided to divest itself of its interest in the limited partnership and sent the general partner notice of its intent to withdraw from the limited partnership, as permitted in the partnership agreement. However, the general partner claimed that at the time the investment strategy was changed, the partners had orally agreed to amend the limited partnership agreement to temporarily suspend the withdrawal rights of the limited partner in order for the limited partnership to hold its private, illiquid investments for a sufficient length of time that would allow it to sell such investments for maximum profit. The court first looked to the partnership agreement itself which contained a provision indicating that amendments of the partnership agreement required the written consent of all partners. In rejecting the general partner’s argument that the partnership agreement does not require amendments to be in writing, the court noted that while another provision of the partnership agreement seemed to authorize unilateral amendments by the general partner, a writing was required to suspend the limited partner’s withdrawal rights because such provision only permitted unilateral amendments that did not adversely affect the limited partner. The court further held that even assuming that the general partner could unilaterally amend the partnership agreement, it still would not uphold the alleged oral modification because the general partner had failed to meet its high evidentiary burden of proving the change with specificity and directness. The court then stated that even if the general partner had met its evidentiary burden, it still would not have found the oral modification binding due to lack of consideration.

Upon the general partner’s motion for reargument, the court held that its summary judgment in favor of the limited partner on the issue of the contractual right to withdraw was proper. The court found that the general partner had failed to show that the court misunderstood material facts or applied the wrong legal standard.


In a case arising from an attempt to remove and replace the general partner of a limited partnership after the plaintiff had acquired approximately a 20% interest in the limited partnership through a tender offer (see Vanderbilt Income discussed in Section II.F.), the court considered (i) whether the plaintiff had acquired voting rights as a subsequent assignee of limited partnership interests and (ii) whether the general partner had breached its contractual or fiduciary duties by refusing to consent to the plaintiff’s admission as a limited partner. After trial, the court found the provisions
regarding the assignment of voting rights from limited partners and assignees to subsequent assignees to be ambiguous and consequently applied the contractual construction principle of *contra proferentum* to give effect to the parties’ reasonable expectations based on the terms of the agreements. In doing so, the court determined that a reasonable investor in the limited partnership could have read the relevant provisions to provide that subsequent assignees would have voting rights. Therefore, the court held that the plaintiff had the right to vote. With respect to the general partner’s denial of consent to the admission of the plaintiff as a limited partner, the court held that the plaintiff had failed to demonstrate that the general partner had breached its contractual or fiduciary duties. The partnership agreement permitted the general partner to grant or deny consent to the admission of a limited partner in its “sole and absolute discretion.” In light of this standard, the court concluded that the only limitation on the general partner’s discretion was implied contractual covenant of good faith and held that the plaintiff had failed to show bad faith because the general partner had sufficient reasons to conclude that the plaintiff would not be a suitable partner.


Plaintiff limited partnership alleged that defendant limited partner, by obtaining a personal communications service (“PCS”) license through its affiliate and by entering into an agreement to resell PCS, had breached the non-competitive clause contained in the limited partnership agreement. The partnership agreement prohibited limited partners from engaging in “any and all service authorized by the FCC under Part 22 of its cellular rules as promulgated under the Cellular Radio Decisions.” PCS did not exist at the time the partners entered into the partnership agreement and when the FCC did provide for PCS regulation, it did so under part 24, not part 22, of the FCC’s cellular rules. The partnership contended that the terms of the partnership agreement were intended to preclude competition with the partnership in any form, not just competition based on the use of technologies in existence at the time of contracting. The limited partner argued that the precise terms of the partnership agreement should control and moved to dismiss the action for failure to state a claim upon which relief can be granted.

Based on fundamental principles of contract construction, the court found the non-compete clause to be unambiguous and thus subject to interpretation by its express terms without reference to extrinsic evidence. Because PCS was not regulated under part 22 of the FCC’s cellular rules, court held the partnership agreement did not prohibit limited partners from competing with the partnership in PCS. The partnership had also claimed that even if the express terms of the non-compete clause did not include PCS, the agreement contained an implicit obligation of limited partners not to compete through the use of technology such as PCS and requested that the court enforce this implicit obligation to uphold the reasonable expectations of the parties in entering into the agreement. However, the court was unable to conclude that the parties, at the time of contracting, would have proscribed the provision of PCS and thus refused to imply such an obligation and granted the defendant limited partner’s motion to dismiss.

The Supreme Court, in a *de novo* review, affirmed the holding of the Court of Chancery finding that, in light of the unambiguous terms of the partnership agreement, the court was not compelled to conclude that had the partners thought to address the subject, they more likely than not would have agreed to include PCS in the partnership agreement’s non-compete clause.


A Delaware limited partnership was formed for the purpose of acquiring and did acquire all the stock of a certain corporation. Approximately 1850 investors became limited partners in the limited partnership by executing the limited partnership agreement. The limited partnership’s ownership of stock in the corporation dropped from 100% to approximately 67% after an initial public offering of the corporation’s stock. The plaintiff limited partners sued the general partner and related entities for breach of fiduciary duty for failing either to attempt to sell the limited partnership’s stock in the corporation or the corporation as a whole for a control premium. The defendants then proposed a plan of withdrawal and dissolution, which would give each limited partner the option of either exchanging all or part of its interest in the partnership for cash through a public offering of the corporation’s stock or receiving at a later date its proportionate interest in the stock of the corporation. Implementation of the plan required certain amendments to the partnership agreements, and the defendants filed proxy materials with the Securities and Exchange Commission
and began soliciting proxies in support of the plan. The plaintiffs then amended their complaint to
allege that the proposed amendments to the partnership agreement necessary to carry out the plan
did not comply with the requirements for amendment contained in the partnership agreement. The
defendants countered that they were complying with the amendment procedures under the
partnership agreement and offered the original offering memorandum for the partnership interests as
extrinsic evidence supporting their interpretation of the partnership agreement.

The plaintiffs sought a preliminary injunction enjoining the general partner from implementing the
proposed plan of withdrawal and dissolution. The Court of Chancery granted the preliminary
injunction, and the defendants made an interlocutory appeal of the preliminary injunction to the
Supreme Court.

The Supreme Court found that the provisions of the limited partnership agreement addressing the
amendment process were ambiguous, at best, and held that the case raised the following question of
first impression in Delaware: whether an ambiguity in a partnership agreement between a general
partner and 1850 limited partners should be construed against the general partner as in the case of
certain corporate documents involving the rights of investors or insurance contracts involving the
rights of insureds, or whether extrinsic evidence should be considered to resolve the ambiguity as in
the case of an ambiguous, bilateral contract.

In this case, the court concluded on the record presented that the limited partners were presented
with a “take it or leave it” offer with no opportunity to negotiate the provisions of the partnership
agreement and therefore found that the partnership agreement was not a negotiated bilateral
contract. As a result, the court affirmed the decision of the Court of Chancery, holding that, based
on the principle of contra proferentem, any ambiguous terms in the partnership agreement should be
construed against the general partner as the entity solely responsible for the articulation of those
terms. The court added that the consideration of extrinsic evidence assumes there is some
connection between the expectations of the contracting parties revealed by that evidence and the
way contract terms were articulated by those parties. Therefore, unless extrinsic evidence can speak
to the intent of all parties to a contract, it provides an incomplete guide with which to interpret
contractual language.

A limited partner sought an injunction preventing the managing general partner from acquiring a
competing corporation outside of its capacity as managing partner. The limited partner claimed that
(i) the acquisition would breach a non-competition provision of the partnership agreement; (ii) the
acquisition would breach the managing partner’s duty of loyalty to the partnership; and (iii) that it
was fraudulently induced to invest in the partnership by the non-disclosure of material information
at the time of its investment.

The court found that the non-competition provision was ambiguous but interpreted it in such a
manner that the acquisition by the managing partner was not violative of the provision, based on the
reasonable construction of the provision relied upon by the managing partner and the fact that the
limited partner knew, or should have known, of this construction. The fiduciary duty of loyalty was
not breached because the acquisition did not foreclose an opportunity of the partnership and the
managing partner was making a good faith attempt to meet its obligation of loyalty. Finally, the
limited partner failed to prove that the managing partner consciously intended to mislead it by not
disclosing the information in question and failed to prove that the disclosure of such information
would have been a material factor in the limited partner’s decision to invest in the partnership. For
these reasons, the limited partner’s claim was dismissed with prejudice.

The general partner and owner of 99% of the limited partnership units of a Delaware limited
partnership sought a judicial declaration that it had the legal power to enter into a transaction by
which substantially all of the assets of the partnership would be exchanged for the assets of an
unrelated partnership engaged in a comparable business. The 1% limited partner of the partnership
filed a counterclaim asserting that under the DRULPA the exchange transaction required a
unanimous vote of all the partners unless the partnership agreement provided otherwise and asserted
that the partnership agreement at issue did not. Both parties then moved for summary judgment.

The court held that, unlike the DGCL which affords the holders of a majority of the corporation’s
voting securities a right to authorize the sale of substantially all assets, in the partnership context,
absent a contrary provision in the partnership agreement, if the sale of all or substantially all the partnership’s assets is outside the partnership’s usual course of business the default rule under DUPL Section 1509(b), which governs the rights of general partners in the absence of governing law in the DRULPA, requires unanimous action of the partners. Finding the question of whether the proposed transaction was within the partnership’s usual course of business to be a question of fact requiring a trial on its merits, the court denied the summary judgment motions of both parties.


Two limited partners brought an action claiming that the merger of the former general partner into the present general partner effected an impermissible transfer of the general partner’s interest under the limited partnership agreement. The limited partnership agreement, however, did not specifically include mergers in the anti-transfer clause, and the court found that the word “transfer” had no generally prevailing meaning and that the extrinsic evidence proffered by the parties did not support either's interpretation. Turning to the law relating to anti-assignment provisions, the court noted that such provisions were usually intended to prevent the nonconsensual introduction of a stranger into the transaction which the court found had not occurred in the challenged merger. The court also found that the merger did not materially increase the risks to or otherwise harm the limited partners, and, based on the foregoing, the court declined to attribute to the contracting parties an intent to include the merger within the class of prohibited transfers.


Plaintiff was a limited partner in two investment partnerships organized by Morgan Stanley (referred to as Fund I and Fund II). Prior to an investment by Fund II, the limited partners would make capital contributions to Fund II usually on a pro rata basis according to the limited partners’ capital commitment to Fund II. Fund II then would use the contributed capital to make the investment. The plaintiff and another Fund I limited partner commenced actions in New York and then Delaware challenging Fund I’s liquidation of its investments in certain companies. Following the commencement of the Fund I suits, the general partner of Fund II notified plaintiff on three occasions that it had decided to exclude the plaintiff from participating in certain new investments by Fund II based on a provision in the partnership agreement vesting the general partner with that power if in the general partner’s discretion the limited partner’s participation could have a material adverse effect on the entity in which the investment was being made, Fund II or Morgan Stanley. Plaintiff brought suit alleging that the general partner’s actions were retaliatory and in bad faith and, hence, breached the partnership agreement and the fiduciary duty of the general partner.

The court granted the defendant’s motion for judgment on the pleadings. In so doing, it ruled that the general partner, in order to exclude the plaintiff from further investment opportunities, must have made a reasonable and good faith determination that such participation would have a material adverse effect. The court then concluded that the general partner had met this standard because it had acted in good faith and because plaintiff’s participation could cause Fund II to be considered less valuable as an investment vehicle since other entities might become reluctant to invest with Fund II based on plaintiff’s demonstrated willingness to sue entities involved in an investment. On appeal, however, the Delaware Supreme Court reversed on procedural grounds holding that plaintiff’s bad faith claim raised an issue of material fact which precluded judgment on the pleadings.

III. LIMITED LIABILITY COMPANIES

Due to the comparative novelty of limited liability companies, few have as yet become embroiled in litigation. However, given the numbers in which limited liability companies are being formed and the variety of uses to which they are being put, it is no doubt only a matter of time before a body of limited liability company case law develops in the Delaware courts. In the meantime, it should be noted that many of the provisions of the Delaware Limited Liability Company Act, Del. Code Ann. tit. 6 §§ 18-101 et seq., (the “LLC Act”) are based on comparable provisions found under the DRULPA and, therefore, cases construing the latter should prove useful guide in efforts to interpret the former.
A. Fiduciary Duties


Plaintiff, a former member of a Delaware LLC, brought an action against other former members and the managers of the LLC alleging, *inter alia*, breach of fiduciary duty and breach of contract. Plaintiff’s investments in the LLC were made through contractually required capital calls during and after a period in which one of the defendants, and the employees of another of the defendants, were implicated in a bribery scandal. As a result of the bribery scandal, the LLC self-referred itself to the Department of Justice for activities that may have involved violations of Federal law. These facts were not described in the management reports received by plaintiff during the course of its investment. In addition, the LLC Agreement specifically required the LLC to disclose to the members any event reasonably likely to result in a material adverse effect (an “MAE Notice”). The LLC was dissolved in 2000 in connection with a reorganization.

On a motion to dismiss filed by the defendants, the court held that the self-referral to the Department of Justice demonstrated knowledge of the bribery on the part of the managers and that defendants breached their fiduciary duty to the members in failing to give an MAE Notice as a result of the bribery. Two defendants had argued that the requirement to give the MAE Notice applied only to the LLC, not the managers, but the court stated that a manager of an LLC who knowingly permits the LLC to violate a contractual duty owed to a member breaches its fiduciary duties and found that the failure to provide an MAE Notice to the members supported a claim for breach of fiduciary duty.

With respect to fiduciary duties relating to disclosure obligations, the court ruled that the requirement of plaintiff to respond to capital calls did not trigger a duty on the part of the LLC’s managers to disclose all material facts each time a capital call was made. Rather, plaintiff was required to show that defendants acted with scienter, and that plaintiff reasonably relied on defendant’s misstatements. The court ruled that plaintiff’s allegations that one of the defendants, who had participated in the bribery and sent a misleading e-mail to plaintiff, were sufficient allegations that such defendant knowingly misled defendant, and therefore acted with scienter. With respect to the remaining defendants, the issue was the date from which such defendants could have breached their fiduciary duty of disclosure, when it was not alleged that such defendants knew of the bribery scheme prior to the LLC self-referring itself to the Department of Justice. The court found that once a fiduciary comes into knowledge of the misleading nature of a prior communication, it has a duty to correct such misleading communication. Therefore, the court ruled that plaintiff alleged a viable fiduciary duty claim based on the remaining defendants’ failure to correct the previous misleading communications once the self-referral to the Department of Justice occurred and they were aware of the bribery scheme.


Plaintiff member filed a motion for a preliminary injunction seeking to enjoin the proposed merger of a Delaware limited liability company with and into the wholly owned subsidiary of the LLC’s other member. Plaintiff alleged that the individual managers of the LLC, acting at the direction of the other member, acted in bad faith in approving the proposed merger and would be unable to prove the entire fairness of the merger. In response, defendants argued that all of the actions taken with respect to the merger were authorized by the operating agreement of the LLC and, further, that the operating agreement contained a provision that limited the fiduciary duties owed by the defendant managers. The court acknowledged that the operating agreement did include a provision limiting liability stemming from a conflict of interest but held that such a waiver did not mean that there was a waiver of all fiduciary duties. Moreover, the court observed that the limitation on liability had no bearing on the issue at hand because plaintiff sought to enjoin the proposed merger rather than impose liability on individual defendants. In this case, the defendant managers elected by the defendant member approved the proposed merger by written consent the day after a meeting of the full board of managers during which defendants did not discuss the merger; nor was notice of the merger given to plaintiff or its board representatives until the day following its approval, which was only a week before the proposed date of consummation of the merger. Based on these facts, the court found that defendants likely would be required to show the entire fairness of the proposed merger and noted that taking action in technical compliance with the law was not an unassailable defense of such action if it otherwise breached a duty.
The court then found there was a reasonable likelihood that defendants would not be able to establish that the proposed merger was the result of fair dealing or at a fair price. With respect to fair dealing, the court noted several factors including the dilution of plaintiff’s interest from a 50% stake in the LLC to only 5% ownership interest in the surviving entity and that the merger’s proposed market-reset provision that would raise plaintiff’s initial equity interest in the surviving entity in the event that such entity secured third-party financing in 2002 was illusory because defendants would have control of the surviving entity and it would be within their power to delay consummation of any third-party investment until after 2002. With respect to fair price, the court based its ruling on the difference between the valuation used as the basis for the proposed merger and valuations that had been done only a few months prior to the approval of the merger which were materially higher.

Finally, the court held that plaintiff would suffer irreparable harm if the injunction were denied based on the dilution of its equity position and voting power and the loss of its bargained-for participation in company management. The court also considered the difficulties that would be presented by the need to consider the interests of third-party investors brought into the surviving entity in formulating relief for plaintiff if it ultimately prevailed.


This case involved a Delaware limited liability company formed to build and operate a satellite system. Two of the members of the LLC, which, in the aggregate, owned a 75% equity interest in the LLC, were controlled by David Castiel (“Castiel”). The third member of the LLC was controlled by Peter Sahagen (“Sahagen”) and had a 25% equity interest in the LLC. The LLC was governed by a three member Board of Managers. The members holding the 75% interest had the right to appoint, remove and replace two of the three members of the Board of Managers while the other member had the right to appoint, remove and replace the third member of the Board. The members holding the 75% interest appointed Castiel and Tom Quinn (“Quinn”) as managers while the 25% interest member appointed Sahagen as the third manager. The Board of Managers subsequently appointed Castiel as the CEO of the LLC.

Not long after the formation of the LLC, Sahagen became dissatisfied with Castiel’s management of the LLC and offered, unsuccessfully, to buy control of the LLC from Castiel. After failing to acquire control of the LLC, Sahagen convinced Quinn that Castiel must be ousted from leadership for the LLC to prosper. Sahagen and Quinn, as managers of the LLC, then acted by written consent, without notice to Castiel, to merge the LLC under Delaware law into a Delaware corporation. The surviving corporation’s board of directors consisted of Sahagen, Quinn and a third individual. Castiel was not named a director. In addition, Sahagen purchased additional shares of the surviving corporation, which resulted in Sahagen and the former member of the LLC he controlled owning a 62.5% ownership interest in the corporation. This left Castiel, through the former members of the LLC he controlled, with a 37.5% ownership interest in the corporation.

Following the merger, Castiel brought suit alleging that (i) the Board of Managers of the LLC did not have the authority to act by majority vote in approving the merger and (ii) by failing to give him notice of their proposed action, Sahagen and Quinn failed to discharge their duty of loyalty to him in good faith. Although the LLC Agreement of the LLC did not expressly state that the Board of Managers could act by majority vote, the court found that requiring a unanimous vote of the managers would render various provisions of the LLC Agreement superfluous and that a unanimous vote requirement was inconsistent with the intent of the parties reflected in the terms of the LLC Agreement. Consequently, the court held that the Board of Managers did have the authority to approve the merger by a majority vote. With respect to Castiel’s breach of duty of loyalty claim, the court first noted that Section 18-404(d) of the LLC Act does expressly permit managers of an LLC to act by written consent without prior notice. The court went on to find, however, that the reason Sahagen and Quinn did not provide notice of their proposed action to Castiel was because they knew that if Castiel had notice, he would have attempted to remove Quinn and block the proposed merger. Applying the classic maxim of equity that “equity looks to the intent rather than to the form,” the court stated that

the [General Assembly’s] purpose of permitting action by written consent without notice is to enable LLC managers to take quick, efficient action in situations where a minority of managers could not block or adversely affect the course set by the majority even if they
were notified of the proposed action and objected to it. The General Assembly never intended . . . to enable two managers to deprive, clandestinely and surreptitiously, a third manager representing the majority interest in the LLC of an opportunity to protect that interest by taking an action that the third manager’s member would surely have opposed if he had knowledge of it.

The court thus held that Sahagen and Quinn breached their duty of loyalty to Castiel, as a manager, and to the members of the LLC he controlled by failing to provide Castiel with prior notice of their actions. Because Sahagen and Quinn knew Castiel’s protection against actions adverse to his majority interest was the right to appoint, remove and replace two of the three managers, they had a duty to give him prior notice, even if they believed that he would have interfered with a plan they conscientiously believed to be in the best interest of the LLC. Based on the court’s finding of a breach of their duty of loyalty, the court rejected Sahagen and Quinn’s assertion that their actions were entitled to the protection of the business judgment rule. The court did state in dicta that had Sahagen and Quinn given Castiel notice and then filed suit to block Castiel’s anticipated action to replace Quinn, who was allegedly serving as a disinterested and independent member of the Board, the court’s analysis might have been different.


In connection with a multi-step transaction, the defendant corporation made a self-tender for a portion of its outstanding stock and a director and several officers of the defendant corporation formed a limited liability company to act as one of two general partners in a general partnership that then made a second step tender offer for up to 60% of the stock of the corporation. Plaintiff had initially challenged the self-tender and then amended its complaint to challenge the tender offer by the general partnership. In so doing, plaintiff alleged that both the limited liability company and the general partnership owed fiduciary duties to the shareholders of the defendant corporation because each such entity had, directly or indirectly, inherited the fiduciary obligations of the director and officers who formed the limited liability company. On a motion to dismiss, in what it indicated was a case of first impression, the court held that where “the allegations of the complaint support, directly or by inference, the conclusion that an entity was formed and controlled by fiduciaries for purposes solely related to the entity to which those persons owed fiduciary duties, the entity may be considered to take on the same fiduciary obligations.” The court added that to allow fiduciaries to use Delaware’s laws “allowing the formation of the limited liability company as a vehicle to avoid those very duties would be unconscionable.” With respect to plaintiff’s claim against the general partnership, however, the court held that, based on the facts alleged, it would not assume that one of two partners so controlled or otherwise dominated the affairs the partnership that the partnership itself must take on the fiduciary obligations of a single partner. Thus, the court denied the motion to dismiss as to the limited liability company, but granted the motion to dismiss with respect to the fiduciary duty claim against the partnership.

B. Inspection of Limited Liability Company Books and Records


After an investigation of the manager of a Delaware LLC revealed potential mismanagement and wrongdoing, a member of the LLC brought an action against the LLC and the manager to inspect the LLC’s books and records for the purposes of (a) investigating the allegations of wrongdoing and mismanagement and (b) valuing its membership interest in the LLC. The court stated that in order for a request to inspect books and records to be granted, the plaintiff must establish by a preponderance of the evidence the existence of a proper purpose for inspection, which purpose must be reasonably related to the plaintiff’s interest as a member. The court also stated that in addition to showing a proper purpose, the plaintiff must show that the documents it seeks to inspect are essential and sufficient for that purpose. The defendants conceded that the plaintiff’s stated purposes were of a type that is generally considered to be proper under Delaware law but challenged the inspection request on the grounds that the stated purposes were not reasonably related to the plaintiff’s interest as a member of the LLC.

With respect to the purpose of investigating allegations of wrongdoing and mismanagement, the defendants argued that the plaintiff had not presented any credible evidence that the mismanagement adversely affected the plaintiff’s interest as a member. The court stated that the plaintiff is required only to show that wrongdoing may have occurred in the LLC, not that the plaintiff’s specific interest
in the LLC was adversely affected by the wrongdoing. Finding that the plaintiff’s evidence showed
that the manager may have (i) fraudulently induced the plaintiff to invest in the LLC, (ii) caused the
LLC to improperly incur indebtedness and pledge assets, (iii) caused the LLC to file a false
Schedule 13D with the SEC, (iv) operated the LLC in violation of its LLC agreement, (v) engaged
in a pattern of similar misconduct in other single-purpose entities controlled by the manager and (vi)
disregarded legal formalities in operating and managing the LLC, the court held that the
preponderance of the evidence supported the plaintiff’s stated purpose of investigating possible
mismanagement.

With respect to the plaintiff’s stated purpose of valuing its interest in the LLC, the defendants
argued that inspection of the LLC’s books and records was not necessary for the plaintiff to value its
LLC interest because the LLC’s sole purpose was to hold its members’ stock in a single corporation
and, because the plaintiff knew the exact amount of stock of the corporation the LLC held for it, it
must know the value of its LLC interest. However, based on the defendants’ concession that they
and the plaintiff disputed the number of shares of the corporation held by the LLC for the plaintiff,
the court held that the plaintiff was entitled to inspect the LLC’s books and records to value its
interest in the LLC.

The court then reviewed the documents requested to be inspected by the plaintiff to determine if
they were essential and sufficient for the purposes of the plaintiff’s inspection and determined that
the plaintiff had made the required showing with respect to most of the documents requested.

2.


Plaintiff, a member in two Delaware LLCs, brought this action against the two LLCs and the
managing member of the two LLCs to inspect certain books and records. Plaintiff requested copies
of the federal tax returns of the LLCs, lists of the other members of the LLCs and certain books and
records of two subsidiary investment companies of the LLCs (the “Funds”). Each request was
based on Section 18-305 of the LLC Act and Section 9.2 of the LLC Agreements, which provided
members with the right to inspect and copy “all books and records of the [LLCs].”

Regarding plaintiff’s alleged right to inspect the federal tax returns and member lists of the LLCs,
the court found that Section 9.2 of the LLC Agreements provided members with a contractual right
to examine books and records of the LLCs and looked to Section 18-305 of the LLC Act as well as
Section 220 of the Delaware General Corporation Law and Section 17-305 of the DRULPA to
construe the term “books and records.” Finding federal tax returns and member lists among the list
of “records” set forth in Section 18-305 of the LLC Act, the court held that Section 9.2 of the LLC
Agreements provides plaintiff with a contractual right to inspect and copy the LLCs’ federal tax
returns and member lists.

Defendants had argued that Section 13.1 of the LLC Agreements, which provided that the LLC
Agreements, the transactions contemplated by the LLC Agreements and “all other matters related to
the [LLCs]” be held confidential, required that member lists be kept confidential. However, the
court rejected defendants’ argument, finding that defendants’ reading of Section 13.1 would render
Section 9.2 of the LLC Agreements meaningless. Defendants’ had also argued that the
“Confidential Subscriber Questionnaires,” which were given to all potential investors in the LLCs
and provided that all information collected “will be kept strictly confidential,” obligated defendants
not to reveal the identity of the members. The court held that once the investors qualified and
elected to invest in the LLCs, they were governed by the LLC Agreements and that any
presumption of confidentiality created by the questionnaires during the application process was
defeated by the express language of the LLC Agreements. The court also rejected defendants’
argument that under Section 18-305(c) of the LLC Act they were not required to disclose the
member lists because they had a good faith belief that disclosure of the member lists would harm the
LLCs by violating the privacy notices distributed by the LLCs pursuant to the Gramm-Leach-Bliley
Act of 1999 (the “GLBA”). The court determined, by reference to the *Bond Purchase* case (see
Section II.B) decided in the limited partnership context, that Section 18-305(c) does not apply in the
case of a contractual claim to inspect books and records and that under the “implied proper purpose”
defense, production of books and records can only be denied if it “would in fact be adverse” to the
entity. The court also noted that the GLBA would not preclude disclosure of the member lists due
to an exception for the disclosure of nonpublic personal information “[t]o comply with federal,
State, or local laws, rules and other applicable legal requirements” because the disclosure of the
member lists in this case would be required under state law and other applicable legal requirements.
Finally, the court considered plaintiff’s request for books and records of the Funds. On plaintiff’s contract claim, the court found that Section 9.2 of the LLC Agreements provided members with a contractual right to “all books and records of the [LLCs],” not the Funds, although certain records pertaining to the Funds may become records of the LLCs and thus would fall within plaintiff’s contractual right under Section 9.2. For example, the periodic financial reports and other records that would be used to produce monthly reports to members of the LLCs would constitute books and records of the LLCs. On plaintiff’s statutory claim, the court held that plaintiff had no right to inspect the books and records of the Funds under Section 18-305 because the Funds were separate companies from the LLCs and the books and records of the Funds were not the books and records of the LLCs, and plaintiff had not proven that the corporate veil of the Funds should be pierced.

C. Indemnification and Advancement


Plaintiffs, who were two former managers of a Delaware LLC, sought advancement of litigation expenses in connection with their defense of a civil action claiming that they engaged in misconduct as managers of the LLC. The relevant provisions of the operating agreement of the LLC provided that the LLC was required to advance legal expenses to the fullest extent permitted by law. Defendant argued that the limits on indemnification in the operating agreement, which precluded indemnification for, among other things, actions or omissions that were grossly negligent or involved fraud, misrepresentation, bad faith or other willful misconduct, also applied to the right to advancement. The court stated that advancement and indemnification are distinct types of legal rights and that the right to advancement is not ordinarily dependent upon a determination that the party in question will ultimately be entitled to be indemnified. The court found that the omission of a reference to advancement in the limitations on indemnification in the operating agreement evidenced the parties’ intent that such limitations did not apply to the right to advancement. Defendant also contended that plaintiffs as a condition to advancement were required to provide a written undertaking to repay the advanced amounts if it were determined plaintiffs were not entitled to indemnification, even though the LLC’s operating agreement contained no such requirement. The court noted that the LLC Act, unlike the DGCL which in Section 145(e) conditions advancement of expenses to currently serving corporate officers and directors on the receipt of an undertaking, is completely silent on the issue of advancement but does in Section 108 give broad authority to members of LLCs to set the terms for indemnification in their operating agreements and does in general support freedom of contract. The court thus found that the members of the LLC clearly had the authority to require a written undertaking as a condition to advancement in the operating agreement. The court further noted that it had held on other occasions that the advancement implies a general obligation to repay if the underlying conduct is ultimately judged to be not indemnifiable but that an obligation to repay does not necessarily imply a precondition of giving a written undertaking to do so. The court thus refused to imply an obligation to provide a written undertaking into the LLC’s operating agreement. The court held that plaintiffs were entitled to advancement and also held that plaintiffs were entitled to their fees for bringing this action to enforce a contractual right to advancement.


Plaintiffs, who were members of two Delaware LLCs -- 4000 Associates, L.L.C. (“4000 Associates”) and Gramor, L.L.C. (“Gramor”) -- brought an action against the LLCs and the only other member of both LLCs for advancement of legal fees in connection with a pending civil action against the plaintiffs brought by such other member in the Superior Court of Delaware. Defendants argued that plaintiffs were not entitled to advancement of legal expenses because the conduct at issue in the civil action was expressly precluded from indemnification in the LLC agreements of both LLCs.

The LLC agreement of 4000 Associates provided that 4000 Associates was required to advance legal fees to the fullest extent permitted by applicable law subject to the requirement that person requesting advancement undertake to repay the advanced amounts if it were determined such person was not entitled to indemnification. The court rejected defendants’ argument that the no advancement was due because plaintiffs would not be entitled to be indemnified if the conduct alleged in the civil action were eventually proven true, stating that this argument is fallacious because it conflates the indemnification and advancement sections of the LLC agreement and blurs
the distinct purpose of advancement provisions. The court held that the determination whether plaintiffs are entitled to indemnification in connection with the civil action can only be made after the civil action has been adjudicated and that, in the meantime, 4000 Associates must advance expenses to plaintiffs subject to a suitable undertaking. The court also held that plaintiffs were entitled to an award of their fees for prosecuting this claim.

The LLC Agreement of 4000 Associates also contained an unusual provision that required, except to the extent otherwise provided by law, all attorneys’ fees and costs incurred in connection with the prosecution and defense of any action brought by a member against another member or members of 4000 Associates to be borne by the member bringing the action, regardless of the outcome of any such proceeding. Plaintiffs argued that the other member of 4000 Associates was personally liable to them for advancement of their expenses in the civil action under such provision. The court held that the provision speaks to an obligation for the eventual payment of legal expenses but does not address advancement of legal fees and therefore is not applicable to the issues before the court. The court also noted that there would most likely be legal limitations on the obligation created by such provision that depend on the nature of the conduct involved.

The LLC agreement of Gramor provided for indemnification but was silent on the issue of advancement. The court, noting that Delaware law is well settled that the right to indemnification and the right to advancement are distinct, found that the absence of a right to advancement in the Gramor LLC agreement reflected the intent of the parties not to provide for advancement and denied plaintiffs’ claim for advancement.


Plaintiffs were co-portfolio managers of two investment funds operated by Lazard Frères & Co. LLC. Plaintiffs severed their relations with the investment funds very abruptly by terminating their employment without prior notice and then allegedly put pressure on Lazard to transfer the assets of the investment funds to a new fund that plaintiffs intended to form at a competitor of Lazard. Lazard filed two lawsuits against plaintiffs in response to their conduct, and plaintiffs brought this action seeking advancement of the litigation expenses in such lawsuits under the operating agreements of the investment funds’ general partner and investment manager, each of which was a Delaware LLC. Although it was undisputed that plaintiffs were entitled to indemnification under the operating agreements of the general partner and the investment manager, defendants claimed that the operating agreements limited advancement to persons currently serving in specified official capacities and, because plaintiffs had resigned, they were not entitled to advancement.

In each case, the indemnification provisions of the operating agreement expressly applied to individuals who had ceased to serve in the covered capacities but the advancement provisions did not include the same clear language with respect to individuals who had ceased to serve in such capacities. The court closely analyzed the language of the indemnification and advancement provisions of the operating agreements and held that when read contextually the relevant provisions of both operating agreements did not make the right to advancement dependent on current service in a covered capacity. The court thus held that plaintiffs were entitled advancement and, in addition, held that plaintiffs were entitled to their reasonable fees for prosecuting this action.

D. Distributions


In this case, one of the individual defendants contracted to purchase property with the intent of forming a Delaware LLC with the two other individual defendants for the purpose of constructing a residential community on the property. After discovering that the property contained wetlands that adversely affected the property’s development potential, the three individual defendants abandoned construction plans and decided to attempt to sell the property. One of the individual defendants negotiated an option with the plaintiff to purchase the property. The three individual defendants then formed the defendant Delaware LLC and took title to the property through the LLC pursuant to the purchase contract. Four months later the plaintiff exercised its option to purchase the property from the LLC, paying over twice the amount of the purchase price. The defendants never disclosed the existence of wetlands on the property. After the plaintiff learned that the property contained wetlands, plaintiff brought this action for rescission and damages based on, among other claims, fraud and unjust enrichment.
The individual defendants moved to dismiss the case against them claiming that plaintiff could not recover directly against them as LLC members because they never directly held legal or equitable title to the property. They argued that a plaintiff could recover distributions to members of an LLC only if (i) the plaintiff pierced the LLC’s “corporate” veil or (ii) Section 18-607 of the LLC Act was applicable. Section 18-607(b) provides that if a member receives a distribution that results in the LLC becoming insolvent, and the member knew at the time of the distribution that the distribution would render the LLC insolvent, the member is liable to the LLC for the amount of the distribution. The individual defendants argued that because neither of those two circumstances was alleged, the case must be dismissed against them.

The individual defendants first argued that they were protected from liability by Section 18-303(a) of the LLC Act, which provides in relevant part that “no member or manager of a limited liability company shall be obligated personally for any . . . debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.” However, the court rejected this argument because the LLC was not formed and the property was not acquired by the LLC until after the allegedly wrongful acts had been committed and, therefore, the individual defendants could not have been acting solely as members of the LLC when they committed those acts and thus were not protected by Section 18-303. The individual defendants then claimed that they were protected from liability by Section 18-607(b) of the LLC Act. They argued that Section 18-607 is the only provision by which a third party can recover from an LLC member without piercing the LLC’s corporate veil and, because the complaint did not allege a claim under Section 18-607, they could not be held personally liable. The court also rejected this argument finding the individual defendants’ expansive reading of Section 18-607 of shielding LLC members against all claims except those that arise under Section 18-607 incorrect and inconsistent with the provisions of Section 18-303 noted above. Finally, the court held that it did not need to address veil piercing because the LLC Act did not protect the liability of LLC members who (as in this case) are sued in capacities other than as members of the LLC, and, therefore, denied the individual defendants’ motion to dismiss the case against them.


Plaintiff brought suit alleging a right to a pro rata distribution based on the time it had owned its limited liability company interests. Plaintiff had sold its interest in a Delaware limited liability company on March 20, 1995 and claimed an entitlement under the terms of the limited liability company agreement, and other agreements relating to the distribution of profits, to a pro rata distribution of its ownership interest for the first twenty days of March, 1995. After examining the agreements, the court found that the limited liability company agreement provided for the requested pro rata distribution and that such interpretation was supported by the relevant provisions of the other agreements. The court interpreted provisions of the limited liability company agreement limiting the purchaser of ownership interest to allocable distributions from the date of purchase to logically entitle the seller of such interest to the allocable distributions up until the time of the sale and held that if a less natural result was contemplated, it should have been expressly provided for in the agreement. Accordingly, a motion for summary judgment by the plaintiff was granted and the defendant’s cross-motion for summary judgment was denied.

E. Removal of Managing Member


Plaintiffs moved for summary judgment on their claim that they validly removed the defendant as the managing member of a Delaware limited liability company. Defendant, in turn, also moved for summary judgment, asserting that the plaintiffs did not have the authority to remove him as managing member. The individual plaintiffs and the defendant had organized a California corporation and entered into a shareholder agreement that appointed the defendant “to manage the corporation in a professional and efficient manner.” When the California corporation was unable to obtain “S” corporation status, the plaintiffs and defendant agreed to convert the corporation to a Delaware LLC through a merger solely for the tax benefits. The shareholders of the corporation entered into a shareholder consent in which they approved the merger and a merger agreement, which stated that the LLC would be governed by the LLC agreement in effect immediately prior to the merger, and authorized the defendant to take the actions necessary to effectuate the merger of the California corporation into the Delaware LLC. The defendant formed the Delaware LLC but the
plaintiffs and defendant never executed an LLC agreement. The defendant then effected the merger and managed the business of the LLC. The plaintiffs became dissatisfied with the management of the defendant and purported to remove him as manager through the delivery of two resolutions signed by the individual plaintiffs.

The issue before the court was whether a majority of the members of the LLC had the authority to remove the defendant as the managing member. The plaintiffs argued that the parties orally agreed that the provisions of the shareholder agreement would govern the LLC and that the manager could thus be removed if he acted “unprofessionally” or “inefficiently.” In the alternative, the plaintiffs argued that there was no LLC agreement and that, under Section 18-402 of the LLC Act, the management of the LLC was vested in the members and, therefore, a majority of the members could remove the defendant. The defendant argued that the plaintiffs had accepted a draft LLC agreement he claimed to have circulated that appointed himself manager and contained no provision for removing the manager. He claimed that under Section 18-402 of the LLC Act, a manager may only be removed as specified in the LLC agreement and, absent a provision for removal, a manager is unable to be removed except through judicial dissolution of the LLC. In the alternative, the defendant argued that the merger agreement, which appointed himself as manager and did not include a removal provision, was the operative LLC agreement. Because facts necessary to resolve the issue were in dispute, the court denied the cross-motions for summary judgment. The court also noted that either of the agreements proffered by the parties as the rightful LLC agreement would require arbitration of the dispute and encouraged the parties to seek arbitration rather than to litigate the case further to determine the rightful LLC agreement and then have the court direct the parties to arbitrate the dispute in accordance with such agreement.

F. Removal of Members and Forfeitures of Interests


In a post trial opinion, the court considered whether members who comprised a majority in interest of a Delaware LLC had the power to remove the entity’s other member and declare his interest forfeit under either the LLC agreement or the LLC Act and, if not, did those members show that their consent to the terms of the LLC agreement was the product of fraud. With respect to the defendants’ claim that the LLC agreement authorized them to remove the fourth member and forfeit his interest, the court noted that although members may put virtually any provision in their LLC agreements with confidence that it will be enforced, the LLC agreement at issue included no provision that could be read to allow the members holding a majority in interest to deprive the fourth member of his ownership interest in the circumstances presented. While the LLC agreement authorized the removal of the manager, it specifically said “removal shall be without prejudice to the [Manager’s] contract rights” which the court held “implicitly include[d] his ownership rights.” The court acknowledged that the absence of a provision allowing the removal of the plaintiff was surprising considering what the other members knew about him at the time they entered into the LLC agreement and noted that the other members could have easily protected themselves in the LLC agreement. However, the court found that they failed to do so because the LLC agreement did not justify plaintiff’s removal. With respect to defendants’ argument that under applicable law they had the inherent power to remove plaintiff as a member and take away his membership interest due to an alleged breach of fiduciary duty, the court first noted that defendants identified virtually no legal support for that proposition. The court added that none of the authorities cited by defendants varied the “fundamental principle under Delaware law that a majority of members (or stockholders) of a business entity, unless expressly granted such power by contract, have no right to take the property of other members (or stockholders).” The court went on to say that “[o]ther mechanisms may be available to them to recast their business relations to eliminate persons from the enterprise, such as the merger provisions of the various business entity laws. But, these provisions do not provide the forfeiture of economic rights, requiring instead that persons whose interests are eliminated are entitled to receive fair value therefor.” The court also rejected defendants’ argument that plaintiff’s failure to make capital contributions warranted his removal finding, among other things, that the letter from defendants notifying him of his removal did not mention his failure to honor a promise to make a capital contribution as a basis for removal but rather alleged a “breach of trust.” As for defendants’ fraud claim, the court found that it failed because defendants had not proven the required misrepresentation element. Finally, the court rejected defendants’ argument that since they had relied in good faith on the provisions of the LLC agreement, albeit incorrectly, under Section 18-1101 of the LLC Act they were protected from liability. The court held that while Section 18-1101 of the LLC Act was intended to make clear that an apparent limit on liability for
breach of fiduciary duty was to be interpreted broadly, “the legislature never intended this provision to allow members of an LLC to misappropriate property from another member and avoid returning that property or otherwise compensating the wronged member.” Thus, the court concluded that plaintiff was entitled to 18% of the shares of a corporation that was the successor to the LLC interest and imposed a constructive trust on those shares in favor of plaintiff subject to payment by plaintiff of certain liabilities of the LLC.

G. Dissolution


Plaintiff, a former member of a Delaware LLC, brought an action against other former members and the managers of the LLC alleging, *inter alia*, breach of fiduciary duty and breach of contract. Plaintiff’s investments in the LLC were made through contractually required capital calls during and after a period in which one of the defendants, and the employees of another of the defendants, were implicated in a bribery scandal. As a result of the bribery scandal, the LLC self-referred itself to the Department of Justice for activities that may have involved violations of Federal law. These facts were not described in the management reports received by plaintiff during the course of its investment. In addition, the LLC Agreement specifically required the LLC to disclose to the members any event reasonably likely to result in a material adverse effect (an “MAE Notice”). The LLC was dissolved in 2000 in connection with a reorganization.

Plaintiff asserted breach of contract claims against certain of defendants, based on both express provisions of the LLC Agreement and implied contractual duties allegedly owed to plaintiff. The court noted that, pursuant to the language in Section 18-803(b) stating that “until the filing of a certificate of cancellation . . . the persons winding up the limited liability company’s affairs may . . . defend suits,” no claim may be brought against an LLC once the certificate of cancellation has been filed. Plaintiff sought to have the certificate of cancellation previously filed in connection with the dissolution of the LLC nullified on the grounds that the LLC’s affairs were not wound up in compliance with the LLC Act. More specifically, plaintiff asserted that defendants were aware of the bribery allegations and failed to make such provision as would be reasonably likely to be sufficient to provide compensation for that claim, as required by Section 18-804(b)(3). The court found, consistent with the holding in *In re CC&F Fox Hill Assocs. Ltd. P’ship* (See Section II.G.4) (nullifying a certificate of cancellation in part because the affairs of the partnership were not wound up in compliance with Section 17-804 of the DRULPA), that the complaint plead facts that supported an application to nullify the certificate of cancellation, and denied defendants’ motion to dismiss plaintiff’s breach of contract claim.

H. Derivative Actions


This case is a subsequent proceeding in the case in which the court, after trial, voided a merger by which Peter Sahagen (“Sahagen”), the controlling person of one of the three members of a Delaware limited liability company and a manager of the LLC, attempted to take control of the LLC from its founder, David Castiel (“Castiel”), who controlled the other members. (See discussion in Section III.A. above.) In this subsequent proceeding, the court addressed various counter-claims and cross-counterclaims brought by the parties that were not resolved in the original action. The two members of the LLC controlled by Castiel had filed a counterclaim alleging that Sahagen and Tom Quinn (“Quinn”), another manager, had breached their duty of loyalty when they attempted to take control of the LLC without Castiel’s consent through the merger with an entity controlled by Sahagen. In response, Sahagen and the member that he controlled (the “Sahagen Parties”) filed cross-counterclaims alleging, among other things, breach of fiduciary duties.

The Sahagen Parties brought direct claims against Castiel for breach of his fiduciary duties of loyalty and care and against Castiel, the two members controlled by Castiel and one of Castiel’s affiliated entities (the “Castiel Parties”) for aiding andabetting Castiel. The court determined that the claims amounted to claims for waste, mismanagement and self-dealing and that such claims were derivative, rather than direct, in nature. In reaching its determination, the court looked to Delaware corporate law principles and found that “[t]o maintain a direct lawsuit, the injury alleged must affect a stockholder alone or affect a particular stockholder right ‘such as his preemptive rights as a stockholder, rights involving control of the corporation, or a wrong affecting the stockholders
and not the corporation”’ and that claims of waste and self-dealing have been held to be derivative in nature. In the LLC context, the right of a member to bring a derivative claim is governed by Section 18-1001 of the LLC Act and an individual plaintiff may only bring a derivative claim against an LLC without first making a demand on the managers if such demand would be futile. “A demand is considered futile when a reasonable doubt exists as to whether ‘(a) the [managers] were disinterested or independent, [or] (b) the challenged transaction was the product of a valid exercise of business judgment.” In the instant case, the Sahagen Parties conceded that they did not make a demand on the LLC’s board of managers. Thus, the court had to determine whether the making of a demand by them on the board of managers would have been futile. The sole issue relating to whether the making of a demand on the board would have been futile depended upon whether Quinn’s successor as the one remaining manager other than Castiel and Sahagen would be disinterested and independent in a demand made by the Sahagen Parties to pursue an action against Castiel for breach of fiduciary duty. The Sahagen Parties argued that such manager would not have been disinterested and independent because he was entirely dependent upon Castiel for his only other employment opportunity as an officer in a company controlled by Castiel. However, the court found that the evidence showed that the manager had other substantial sources of income and that the Sahagen Parties’ other arguments were insufficient to demonstrate the futility of bringing a derivative claim on behalf of the LLC, and granted summary judgment in favor of the Castiel Parties based on the Sahagen Parties’ failure to seek a demand and inability to demonstrate that such demand would have been futile.

With respect to Castiel’s breach of duty of loyalty claim against Sahagen and Quinn, the court noted that in the June 2000 trial Vice Chancellor Steele held that “Sahagen and Quinn ‘owed a duty of loyalty to [the LLC], its investors and Castiel, their fellow manager,’ and ‘that the actions of Sahagen and Quinn, in their capacity as managers constituted a breach of their duty of loyalty.’” Relying upon the fact that there had been no changed circumstances since Vice Chancellor Steele issued his opinion and that his opinion was affirmed by the Delaware Supreme Court, the court concluded that the “law of the case” doctrine applied to the facts at hand and that there would be no injustice if the doctrine were applied only with respect to whether or not Sahagen and Quinn breached their fiduciary duty of loyalty and, thus, the court entered summary judgment in favor of the Castiel Parties with respect to that issue.


Plaintiff and defendant were the two members of a Delaware LLC in the process of being liquidated. Control of the LLC was divided equally between plaintiff and defendant. Plaintiff alleged that defendant owed the LLC payment for services rendered by the LLC to defendant. Plaintiff brought this action as a derivative claim on behalf of the LLC under Section 18-1001 of the LLC Act and as an individual or direct claim on behalf of plaintiff against defendant. The services were provided by plaintiff for the LLC’s benefit to defendant.

Plaintiff brought this action as a derivative claim on behalf of the LLC under Section 18-1001 of the LLC Act and as an individual or direct claim on behalf of plaintiff against defendant. Defendant moved to dismiss the action for lack of subject of matter jurisdiction. The court stated that if this action were simply a direct contract claim for damages arising out of a breach of contract, then there would be an adequate remedy at law and the Court of Chancery would not have subject matter jurisdiction over the claim, but if the claim were derivative, then the Court of Chancery would have subject matter jurisdiction pursuant to the grant of such jurisdiction in Section 18-1001.

Section 18-1001 provides that:

[a] member … of a limited liability company interest may bring an action in the Court of Chancery in the right of a limited liability company to recover a judgment in its favor if managers or members with authority to do so have refused to bring the action or if an effort to cause those managers or members to bring the action is not likely to succeed.

The court stated that because plaintiff sought judgment for the LLC on a claim that the LLC had against defendant and alleged that the LLC could not or was not likely to bring the action because one half of the control of the LLC was held by the entity that was alleged to owe the money, the action appeared to fit within the standards of Section 18-1001.
Defendant argued that the action was not a derivative action based on the Court of Chancery’s decision in the In re Cencom Cable Income Partners, L.P. Litig. case (see Section II.H.2), in which the court held that a claim is direct where:

If:  (1) a business association consists of only two parties in interest, one a putative class of injured plaintiffs and the other the defendant party that controls the business association; and, (2) the business association is effectively ended, but for the winding up of its affairs; and, (3) the two sides oppose each other in the final dispute over the liquidation of that association.

The court held, however, that the rule set forth in the Cencom case did not apply to this action. The court noted the recognition by the court in Cencom that direct claims seek relief for injuries that fall distinctly upon individual participants or involve participants’ contractual rights while derivative claims involve injury to the business association as a whole. The court stated that the collection of a business debt is a critical function of the business association in the liquidation process and is more appropriately considered within the context of what the business association itself should be doing and thus is more closely in line with the standard notions of derivative actions. In addition, the court stated that the decision in Cencom was driven by practical considerations and that the practical considerations in this case favor allowing the derivative action to proceed because, for example, if plaintiff had filed this action as a direct action in Superior Court, defendant could have argued that plaintiff had no claim and instead that any claim was a claim of the LLC. Further, the court stated that it was reluctant to apply the rule in Cencom to this situation because, although not an issue in this case, it was concerned about potential impairment of the rights of creditors if any asset of the LLC were treated as belonging to one of the members and that, as a general rule, the assets of the LLC should be treated as one normally treats efforts to recover on assets of entities and that would be as a derivative action. Therefore, the court denied defendant’s motion to dismiss for lack of subject matter jurisdiction.

I. Disclosures


Plaintiff, a former member of a Delaware LLC, brought an action against other former members and the managers of the LLC alleging, inter alia, breach of fiduciary duty and breach of contract. Plaintiff’s investments in the LLC were made through contractually required capital calls during and after a period in which one of the defendants, and the employees of another of the defendants, were implicated in a bribery scandal. As a result of the bribery scandal, the LLC self-referred itself to the Department of Justice for activities that may have involved violations of Federal law. These facts were not described in the management reports received by plaintiff during the course of its investment. In addition, the LLC Agreement specifically required the LLC to disclose to the members any event reasonably likely to result in a material adverse effect (an “MAE Notice”). The LLC was dissolved in 2000 in connection with a reorganization.

On a motion to dismiss filed by the defendants, the court held that the self-referral to the Department of Justice demonstrated knowledge of the bribery on the part of the managers and that defendants breached their fiduciary duty to the members in failing to give an MAE Notice as a result of the bribery. Two defendants had argued that the requirement to give the MAE Notice applied only to the LLC, not the managers, but the court stated that a manager of an LLC who knowingly permits the LLC to violate a contractual duty owed to a member breaches its fiduciary duties and found that the failure to provide an MAE Notice to the members supported a claim for breach of fiduciary duty.

With respect to fiduciary duties relating to disclosure obligations, the court ruled that the requirement of plaintiff to respond to capital calls did not trigger a duty on the part of the LLC’s managers to disclose all material facts each time a capital call was made. Rather, plaintiff was required to show that defendants acted with scienter, and that plaintiff reasonably relied on defendant’s misstatements. The court ruled that plaintiff’s allegations that one of the defendants, who had participated in the bribery and sent a misleading e-mail to plaintiff, were sufficient allegations that such defendant knowingly misled defendant, and therefore acted with scienter. With respect to the remaining defendants, the issue was the date from which such defendants could have breached their fiduciary duty of disclosure, when it was not alleged that such defendants knew of the
bribery scheme prior to the LLC self-referring itself to the Department of Justice. The court found that once a fiduciary comes into knowledge of the misleading nature of a prior communication, it has a duty to correct such misleading communication. Therefore, the court ruled that plaintiff alleged a viable fiduciary duty claim based on the remaining defendants’ failure to correct the previous misleading communications once the self-referral to the Department of Justice occurred and they were aware of the bribery scheme.

J. Liability of Members


In this case, one of the individual defendants contracted to purchase property with the intent of forming a Delaware LLC with the two other individual defendants for the purpose of constructing a residential community on the property. After discovering that the property contained wetlands that adversely affected the property’s development potential, the three individual defendants abandoned construction plans and decided to attempt to sell the property. One of the individual defendants negotiated an option with the plaintiff to purchase the property. The three individual defendants then formed the defendant Delaware LLC and took title to the property through the LLC pursuant to the purchase contract. Four months later the plaintiff exercised its option to purchase the property from the LLC, paying over twice the amount of the purchase price. The defendants never disclosed the existence of wetlands on the property. After the plaintiff learned that the property contained wetlands, the plaintiff brought this action for rescission and damages based on, among other claims, fraud and unjust enrichment.

The individual defendants moved to dismiss the case against them claiming that the plaintiff could not recover directly against them as LLC members because they never directly held legal or equitable title to the property. They argued that a plaintiff could recover distributions to members of an LLC only if (i) the plaintiff pierced the LLC’s “corporate” veil or (ii) Section 18-607 of the LLC Act was applicable. Section 18-607(b) provides that if a member receives a distribution that results in the LLC becoming insolvent, and the member knew at the time of the distribution that the distribution would render the LLC insolvent, the member is liable to the LLC for the amount of the distribution. The individual defendants argued that because neither of those two circumstances was alleged, the case must be dismissed against them.

The individual defendants first argued that they were protected from liability by Section 18-303(a) of the LLC Act, which provides in relevant part that “no member or manager of a limited liability company shall be obligated personally for any . . . debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.” However, the court rejected this argument because the LLC was not formed and the property was not acquired by the LLC until after the allegedly wrongful acts had been committed and, therefore, the individual defendants could not have been acting solely as members of the LLC when they committed those acts and thus were not protected by Section 18-303. The individual defendants then claimed that they were protected from liability by Section 18-607(b) of the LLC Act. They argued that Section 18-607 is the only provision by which a third party can recover from an LLC member without piercing the LLC’s corporate veil and, because the complaint did not allege a claim under Section 18-607, they could not be held personally liable. The court also rejected this argument finding the individual defendants’ expansive reading of Section 18-607 of shielding LLC members against all claims except those that arise under Section 18-607 incorrect and inconsistent with the provisions of Section 18-303 noted above. Finally, the court held that it did not need to address veil piercing because the LLC Act did not protect the liability of LLC members who (as in this case) are sued in capacities other than as members of the LLC, and, therefore, denied the individual defendants’ motion to dismiss the case against them.

K. Procedural Issues

1. Arbitration


Plaintiff was a member and an executive of a Delaware LLC. On January 15, 1999, plaintiff and the other members of the LLC amended the original LLC agreement of the LLC and plaintiff entered into a management agreement with, among others, the LLC. The management agreement contained provisions for the repurchase by the LLC of membership units from departing executives. Under the management agreement, when an executive
was terminated for any reason, the executive’s membership units were subject to repurchase at “fair market value.” Although no correlative repurchase provisions were included in the LLC agreement, the LLC agreement was relevant to the repurchase of an executive’s membership units because, pursuant to the management agreement, a person determining the fair market value of the membership units was first required to calculate the “total equity value” of the LLC as that amount was defined in the LLC agreement. Under the management agreement, disputes were permitted to be litigated in court but, under the LLC agreement, disputes “arising out of or relating to” the LLC agreement were subject to a broad and binding arbitration clause. Additionally, the LLC agreement provided that in the event of a conflict between the LLC agreement and any other agreement, the LLC agreement controlled but solely to the extent of the conflict.

In March, 2001, plaintiff’s responsibilities were dramatically reduced and plaintiff alleged he was constructively terminated. The LLC then sought to repurchase plaintiff’s membership units pursuant to the management agreement. When plaintiff disputed the valuation of his membership units, the LLC filed an arbitration claim pursuant to the LLC agreement to resolve the dispute. Plaintiff responded by filing an action seeking a stay of arbitration in the Delaware Court of Chancery which named the LLC and certain affiliated persons as defendants.

Defendants filed a motion to dismiss the action for lack of subject matter jurisdiction, claiming that any dispute concerning the valuation of plaintiff’s membership units subject to repurchase under the management agreement must be arbitrated because the valuation required a determination of the “total equity value” of the LLC under the LLC agreement and thus arose out of or was related to the LLC agreement. Citing the interrelationship between the LLC agreement and the management agreement and the fact that they were executed on the same day, the court sided with defendants, holding that the two agreements must be read together as forming one agreement between the parties. The court then held that, pursuant to the provision of the LLC agreement providing that it controlled in the event of a conflict between the LLC agreement and any other agreement, whenever a claim asserted under the management agreement also fell within the scope of the LLC agreement’s arbitration clause, the arbitration clause would control. The court next held that, assuming plaintiff’s claim did not arise out of the LLC agreement because the valuation of an executive’s units was not specifically mentioned in that agreement, plaintiff’s claim related to the LLC agreement because it required interpretation and application of the provisions of the LLC agreement and thus fell within the scope of the LLC agreement’s arbitration clause. The court thus denied plaintiff’s motion to stay the arbitration and granted defendants’ motion to dismiss for lack of subject matter jurisdiction.


Plaintiffs moved for summary judgment on their claim that they validly removed the defendant as the managing member of a Delaware limited liability company. Defendant, in turn, also moved for summary judgment, asserting that the plaintiffs did not have the authority to remove him as managing member. The individual plaintiffs and the defendant had organized a California corporation and entered into a shareholder agreement that appointed the defendant “to manage the corporation in a professional and efficient manner.” When the California corporation was unable to obtain “S” corporation status, the plaintiffs and defendant agreed to convert the corporation to a Delaware LLC through a merger solely for the tax benefits. The shareholders of the corporation entered into a shareholder consent in which they approved the merger and a merger agreement, which stated that the LLC would be governed by the LLC agreement in effect immediately prior to the merger, and authorized the defendant to take the actions necessary to effectuate the merger of the California corporation into the Delaware LLC. The defendant formed the Delaware LLC but the plaintiffs and defendant never executed an LLC agreement. The defendant then effected the merger and managed the business of the LLC. The plaintiffs became dissatisfied with the management of the defendant and purported to remove him as manager through the delivery of two resolutions signed by the individual plaintiffs.

The issue before the court was whether a majority of the members of the LLC had the authority to remove the defendant as the managing member. The plaintiffs argued that the
parties orally agreed that the provisions of the shareholder agreement would govern the LLC and that the manager could thus be removed if he acted “unprofessionally” or “inefficiently.” In the alternative, the plaintiffs argued that there was no LLC agreement and that, under Section 18-402 of the LLC Act, the management of the LLC was vested in the members and, therefore, a majority of the members could remove the defendant. The defendant argued that the plaintiffs had accepted a draft LLC agreement he claimed to have circulated that appointed himself manager and contained no provision for removing the manager. He claimed that under Section 18-402 of the LLC Act, a manager may only be removed as specified in the LLC agreement and, absent a provision for removal, a manager is unable to be removed except through judicial dissolution of the LLC. In the alternative, the defendant argued that the merger agreement, which appointed himself as manager and did not include a removal provision, was the operative LLC agreement. Because facts necessary to resolve the issue were in dispute, the court denied the cross-motions for summary judgment. The court also noted that either of the agreements proffered by the partners as the rightful LLC agreement would require arbitration of the dispute and encouraged the parties to seek arbitration rather than to litigate the case further to determine the rightful LLC agreement and then have the court direct the parties to arbitrate the dispute in accordance with such agreement.

c.  

A member of a limited liability company filed suit against the manager and the company, individually and derivatively, on behalf of the company, asserting various claims including breach of the fiduciary duties of loyalty and care. The company’s limited liability company agreement included a jurisdictional provision stating that the courts of California had exclusive jurisdiction over any action on a claim arising out of, under or in connection with the LLC agreement or the transactions contemplated therein; provided that the claim was not required to be arbitrated pursuant to another provision in the LLC agreement. Claims to be submitted to arbitration were those involving any controversy or dispute arising out of the LLC agreement, the interpretation of any of the provisions of the LLC agreement or the action or inaction of any member of manager. The Court of Chancery granted defendants’ motion to dismiss for lack of subject matter jurisdiction finding that it was clear that plaintiff’s claims arose under the LLC agreement or the transactions contemplated therein and were directly related to the manager’s action or inaction in connection with his role as manager. As a result, the court held that the LLC agreement governed the question of jurisdiction, that plaintiff’s claims must be decided in California either by a court of law or an arbitrator and that the Court of Chancery did not have subject matter jurisdiction to consider plaintiff’s claims. In affirming the Court of Chancery’s holding, the Supreme Court began with a review of the history of the LLC Act noting that its architecture and much of its wording are almost identical to the DRULPA and that the policy of freedom of contract underlies both the LLC Act and the DRULPA. Specifically, the court noted that Section 18-1101(b) of the LLC Act, like the essentially identical Section 17-1101(c) of the DRULPA, provides that “[i]t is the policy of [the LLC Act] to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.” The Supreme Court first dealt with an argument not addressed in the lower court’s opinion that the LLC itself could not be compelled to arbitrate since it had not signed the LLC agreement. The court rejected this argument, however, noting that the members of the LLC were the “real parties in interest” and that the LLC was “simply their joint business vehicle.” The court also rejected plaintiff’s argument that its claims were derivative in nature and therefore should not be subject to the forum selection clauses. In rejecting this claim, the court held that plaintiff had contracted away its right to bring a derivative action in Delaware when it agreed instead to dispute resolution in California and noted that the dispute resolution provisions in the LLC agreement did not distinguish between direct and derivative claims. The court concluded that because of the policy of the LLC Act to give maximum effect to the principle of freedom of contract and to the enforceability of LLC agreements, the parties may contract away their right to file suit in Delaware and may agree to exclusive jurisdiction in California. In so holding, the court rejected plaintiff’s argument that Section 18-109(d) of the LLC Act prohibited granting exclusive jurisdiction to the courts of any state other than Delaware. The court noted that Section 18-109(d) used the word “may” rather than “shall”
and thus held it to be permissive and not intended to restrict the parties to a LLC agreement from agreeing to exclusive jurisdiction of a foreign jurisdiction. The court bolstered this finding by reference to Delaware’s strong public policy in favor of arbitration noting that California was the exclusive jurisdiction in which any action at law or in equity relating to the LLC agreement could be brought but only to enforce arbitration in California.

2. **Representation**

   The Superior Court held limited liability companies to be prohibited from representing themselves in Delaware courts. Based on the contractual nature of, and the limited liability inherent in, limited liability companies, the court found that the Delaware Legislature did not intend that a member or manager of an LLC could represent the entity in court without representation by Delaware legal counsel, and thus held the rule prohibiting the appearance of corporations in Delaware courts by anyone other than a Delaware attorney applicable to the representation of limited liability companies.

3. **Jurisdiction**

   A dispute arose among the members of two Delaware LLCs, Cornerstone Technologies, LLC (“Cornerstone”) and Arastra, LLC (“Arastra”). The plaintiffs, two members of the LLCs, brought suit (i) seeking a judicial declaration that Bruce Conrad, one of the founding members (“Conrad”), owned a 20% interest in each of the LLCs and that Thomas Unger (“Unger”) had no ownership stake in either LLC (the “Ownership Claim”), (ii) claiming that Conrad violated a provision of the operating agreement of each LLC that required a member to first offer his interest in the LLC to the other members and if the members declined, to offer his interest to the LLC itself prior to offering such interest to any third person (the “Buy-Out Claim”), and (iii) seeking judicial confirmation of Conrad’s removal as a manager and officer of each LLC (the “Removal Claim”). Conrad and Unger filed motions to dismiss the complaint for lack of personal jurisdiction. The court stated that in order to determine whether it may exercise personal jurisdiction over a nonresident defendant, the court must first determine whether a Delaware statute authorizes the exercise of personal jurisdiction and, if so, whether the exercise of personal jurisdiction pursuant to that statute would comply with the requirements of the to the United States Constitution that a nonresident defendant have certain “minimum contacts” with the forum jurisdiction “such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice.”

   The plaintiffs claimed that the exercise of personal jurisdiction over Conrad was appropriate under Sections 18-110(a) and 18-109 of the LLC Act and under Delaware’s long-arm statute (10 Del. C. § 3104(c)(1)). Section 18-109 of the LLC Act provides personal jurisdiction over a manager “in all civil actions or proceedings brought in the State of Delaware involving or relating to the business of a limited liability company or a violation by the manager . . . of a duty to the limited liability company, or any member of the limited liability company.” The court held that the Removal Claim, the Ownership Claim and the Buy-Out Claim related to the business of the LLCs and fell within the terms of Section 18-109. The court noted that its holding was consistent with the holding of the court in *Assist Stock Mgmt. L.L.C. v. Rosheim.* (See below.) In *Assist,* the court concluded that Section 18-109 of the LLC Act was intended to have broad application and that protection against any unconstitutional application of Section 18-109 would be provided by the “minimum contacts” analysis. The court stated that the test for determining whether there are sufficient minimum contacts is: first, whether “the defendant’s conduct and connection with the forum state are such that he should reasonably anticipate being hauled into court there;” and second, once it has been determined that a defendant should reasonably anticipate being sued in the forum state, whether there are any issues concerning fairness and justice. In the instant case, the court noted that Conrad and the other members of the LLCs, although located in Pennsylvania, purposely chose to avail themselves of the benefits and protections of Delaware law by forming the LLCs in Delaware and that Conrad took on the position of manager, CEO and president of the Delaware LLCs knowing that as a manager he would be subject to jurisdiction in Delaware.
for disputes relating to the business of the LLCs. Based on these facts, the court concluded that Conrad should not be surprised to face a lawsuit in Delaware. Having determined that Conrad’s conduct in connection with Delaware was such that he should reasonably anticipate being sued in Delaware, the court looked to issues of fairness and justice. Noting that Conrad was a resident of Pennsylvania, the court found that there was nothing unfair or unjust about exercising personal jurisdiction over Conrad as he would only face a slight inconvenience by being sued in Delaware.

The plaintiffs also argued there was personal jurisdiction over Conrad on the Removal Claim under Section 18-110 of the LLC Act. Section 18-110(a) allows the Delaware Court of Chancery upon the application of a member or manager of an LLC to “determine the validity of any admission, election, appointment, removal or resignation of a manager…and the right of any person to become or continue to be a manager…and, in case the right to serve as a manager is claimed by more than one person, [to] determine the person or persons entitled to serve as managers.” Based on the express language of Section 18-110 and the plaintiffs’ ability to produce sufficient evidence to meet their prima facie burden to show that Conrad was a manager, the court concluded that Section 18-110 was sufficient to allow the plaintiffs to exercise personal jurisdiction over Conrad on the Removal Claim. The court further noted that Section 18-110(a) may cover the Buy-Out Claim and the Ownership Claim as Section 18-110(a) should be read “to sweep in sufficiently related claims against an LLC manager so long as their would be no constitutional offense.” The court stated, however, that if there was any question with respect to whether Section 18-110 was a sufficient basis for the exercise of personal jurisdiction on the Buy-Out Claim and Ownership Claim, Section 18-109 clearly provided a basis for the court’s exercise of personal jurisdiction over Conrad on all counts.

With respect to Unger’s motion to dismiss for lack of personal jurisdiction, the court noted that Unger was not a founding member of either of the LLCs and was only alleged to have become a member after the formation of the LLCs. The plaintiffs argued that Delaware’s long-arm statute provided personal jurisdiction over Unger. Delaware’s long-arm statute provides personal jurisdiction over a person who “transacts any business or performs any character of work or service in the State.” The court noted that the only potential transaction of business in Delaware had been the filing of the certificates of formation to form the LLCs. The plaintiffs argued that even though Unger allegedly became a member after the formation of the LLCs, he should be treated for jurisdictional purposes as if he had earlier authorized the acts involved in the formation of the LLCs. The court held that the plaintiffs had not met their burden under Delaware’s long-arm statute to show that Unger transacted business in Delaware and granted Unger’s motion to dismiss for lack of personal jurisdiction.


Plaintiff, a former member of a Delaware LLC, filed suit in Superior Court alleging that the managers and other members of the LLC conspired to defraud him of the value of his equity interest by failing to make mandatory capital contributions that resulted in the forced sale of the LLC following its default on certain financing obligations. This decision addresses the motion of four of the defendants to dismiss the suit against them for lack of personal jurisdiction. Three of the defendants (the “Spencer Defendants”) argued that dismissal was appropriate as to them because Section 18-109 of the LLC Act, the implied consent statute for service of process in a Delaware LLC case, applies only to managers and they were not managers of the LLC for purposes of Section 18-109.

Section 18-109(a) of the LLC Act establishes jurisdiction over a manager of an LLC and provides that “the term ‘manager’ refers (i) to a person who is a manager as defined in § 18-101(10) of [the LLC Act] 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 [the LLC Act], participates materially in the management of the limited liability company . . . .” Plaintiff conceded that the Spencer Defendants did not participate materially in the management of the LLC but contended that the Spencer Defendants were managers under Section 18-101(10) of the LLC Act, which defines a manager as “a person who is named as a manager of a limited liability company in, or designated as a manager of a limited liability company pursuant to, a limited liability company agreement . . . .” The Operating
Agreement of the LLC provided that “[t]he Members shall have full, exclusive and complete discretion, power and authority, subject in all cases to the provisions of this Agreement and the requirements of applicable law, to manage, control, administer and operate the business and affairs of the company for the purposes herein stated, to make all decisions affecting such business and affairs . . . .” However, in a subsequent section, the Operating Agreement provided that “[t]he operations of the Company shall be conducted by the Management Committee. Except as otherwise provided in this Agreement, all Company decisions shall require the affirmative vote of the majority of the members of the Management Committee.” Specific duties of the Management Committee under the Operating Agreement included, among other things, borrowing money, pledging or encumbering assets, appointing officers, issuing new classes of units and approving capital items.

The court concluded that actual authority to manage the LLC was vested in the Management Committee rather than the members and held that because none of the Spencer Defendants ever served on the Management Committee and did not participate materially in the management of the LLC, they were not managers for purposes of Section 18-109 and therefore were not subject to service of process under Section 18-109.

The fourth defendant (“Kranjac”) argued that he was not a manager at the time the complaint was filed and that he was therefore not subject to Section 18-109. Under Section 18-109(a), a manager may be served with process “whether or not the manager . . . is a manager . . . at the time the suit is commenced.” Since Kranjac was a member of the Management Committee when many of the disputed events occurred, the court held Kranjac to be subject to service of process pursuant to Section 18-109. The court then examined whether the exercise of personal jurisdiction over Kranjac pursuant to Section 18-109 offended due process. Using the case-by-case standard recommended by the Court of Chancery’s determination in the Assist Stock Mgmt. L.L.C. v. Rosheim case, discussed below, to eliminate any risk of an unconstitutionally broad application of Section 18-109, the court found, based on Kranjac’s participation on the Management Committee when many of the disputed events took place, that Kranjac could reasonably have anticipated being subject to personal jurisdiction in Delaware to answer for his actions as a manager and that the exercise of such jurisdiction did not offend traditional notions of fair play and substantial justice.


In a case of first impression, the Court of Chancery considered the constitutionality and scope of Delaware’s implied consent statute for obtaining in personam jurisdiction over managers of Delaware LLCs (6 Del. C. § 18-109). The action at issue was for declaratory judgment relating to the ownership interest and management rights in two Delaware limited liability companies, one being a subsidiary of the other. Plaintiffs were the subsidiary LLC and a member of the parent LLC. Defendant was a member of the parent LLC and one of the two members of its board of managers. After defendant filed a motion to dismiss on the basis of, among other matters, lack of personal jurisdiction, the plaintiffs amended their complaint principally to add or better articulate breach of fiduciary duty claims. The court noted that in light of the dearth of cases construing Section 18-109, it would look to cases construing Section 3114 of the Delaware General Corporation Law which provides for implied consent to jurisdiction for directors of Delaware corporations, although the court recognized that the different choice of words in Section 18-109 could warrant a different analysis. Regarding the scope of Section 18-109, the court noted that by its terms that section subjected a manager to jurisdiction in Delaware in all civil actions or proceedings “involving or relating to the business of the limited liability company or a violation by the manager . . . of a duty to the limited liability company, or any member of the limited liability company.” Given the breadth of that language, the court noted that it could be “susceptible to too broad an application.” However, the court concluded that the protection against unconstitutional application of the statute could be provided on a case-by-case basis by applying the minimum-contacts analysis mandated by due process. In applying this analysis to Section 18-109, the court noted that if the complaint were to be read as validly alleging a breach of fiduciary duty against defendant in his capacity as a manager of the LLC, “there is little doubt that § 18-109 will subject him to the jurisdiction of this court for the purpose of litigating that claim.” However, the court did not limit the scope of Section
solely to breach of fiduciary duty claims. Rather, the court held that it could properly exercise in personam jurisdiction over defendant because: “(1) the allegations against [defendant] focus essentially on his ‘rights, duties and obligations’ as a manager of a Delaware LLC; (2) the resolution of this matter is ‘inextricably bound up in Delaware law;’ and (3) Delaware has a strong interest in providing a forum for disputes relating to the ability of managers of an LLC formed under its law to properly discharge their respective managerial functions.” (Citations omitted.) Defendant had also moved to dismiss the action on the basis of forum non conveniens grounds. After reviewing the factors in such an analysis, the court concluded that defendant had not carried his difficult burden of showing that dismissal on that basis was warranted. However, although the court found jurisdiction to exist, it also found a technical defect in the original service of process and therefore quashed the original service but instructed plaintiff to re-serve defendant in accordance with the requirements of Section 18-109(b).

4. Bangor Punta Doctrine Barring Claims


This case involved an action by plaintiff limited liability companies to recover damages and obtain other relief from their prior owner-operator and certain affiliated entities. At the time of the actions complained of, defendant Ronald Saverin owned both the plaintiff limited liability companies and the defendant limited liability companies and structured various financial arrangements among these companies including leases pursuant to which the plaintiff companies were required to make payments to the defendant companies. After these arrangements were put into place by defendant Saverin, the plaintiff companies were unable to pay their debts and fell into default with their lenders and other parties. In the course of an ensuing workout, certain creditors of the plaintiff companies received all of defendant Saverin’s equity interest in the plaintiff companies in connection with a general settlement of outstanding claims. Defendant Saverin retained his ownership and management positions with the defendant companies and many of the financial arrangements between the plaintiff companies and the defendant companies remained in place. The financial situation of the plaintiff companies did not, however, improve and some time after the separation of the ownership of the plaintiff companies from the defendant companies, the plaintiff companies brought suit against defendant Saverin and the defendant companies alleging, in essence, that defendant Saverin had breached his fiduciary duties of care and loyalty by causing the plaintiff companies to enter into commercially unreasonable agreements with the defendant companies or otherwise wrongfully benefited himself and his family at the expense of the plaintiff companies thereby committing a breach of his legal obligations to the plaintiff companies during his tenure as their owner-operator. The court held that the timing of the alleged wrongs and the question of ownership of the plaintiff companies at the time of the alleged wrongs was the critical issue in the case and it concluded that because the current owner of the plaintiff companies had acquired its interest from corporations that acquired their interest in the companies directly from defendant Saverin after his alleged wrongdoing occurred, the plaintiff companies’ claims were barred by the doctrine articulated by the United States Supreme Court in Bangor Punta Operations, Inc. v. Bangor & Aroostok R.R. Co., 417 U.S. 703 (1974), which was adopted by the Court of Chancery in Courtland Manor, Inc. v. Leeds, 347 A.2d 144 (Del. Ch. 1975). The Court noted that the situation in the Courtland Manor case was very similar to that at issue and held that the policy underlying the application of the doctrine in Courtland Manor applied equally in the present case -- namely, the presumption that the purchasers of the interest in the plaintiff limited liability companies were deemed to have purchased that interest at a fair price which reflected a reasonable discount for any prior wrongs and to allow them or their successors separately to make claims for those prior wrongs would constitute a windfall to which they had no just claim and would deprive the other party of its bargained for consideration. The court noted, however, that although the Bangor Punta doctrine prohibited attempts at re-trading commercial transactions through litigation, it did not prohibit purchasers from making claims if they believed that they or their predecessors had been misled or otherwise defrauded in an acquisition.
5. **Service of Process**


   Hovde Acquisition, LLC (“Hovde”) acquired a membership interest in B&I Lending, LLC, a Delaware LLC (“B&I”), pursuant to a purchase agreement among Hovde, Mortgage Management, LP, the member of B&I selling its membership interest to Hovde, and The Bank Network, Inc. (“TBN”), the only other member of B&I. After a few years of disappointing performance by B&I, Hovde brought an action on its own behalf and on behalf of B&I against TBN and Michael R. Thomas (“Thomas”), a manager and the chairman, president and chief executive officer of B&I. The action alleged breach of the purchase agreement by TBN and breach of the purchase agreement and breach of fiduciary duty against Thomas. The court’s opinion focused on procedural issues relating to service of process on TBN and Thomas. (Since the claims against TBN were based solely on breach of contract, they are not discussed in this summary.)

   The purchase agreement included a consent to jurisdiction in Delaware but did not include a consent to service of process issued by Delaware courts and did not prescribe a mechanism for service of process. Plaintiffs initially served Thomas pursuant to Section 18-105 of the LLC Act, Delaware’s service of process statute for domestic limited liability companies. After realizing their error, plaintiffs re-served Thomas pursuant to Section 18-109 of the LLC Act, Delaware’s implied consent statute for service of process on managers of Delaware LLCs. However, the re-service on Thomas occurred nearly seven months after he was originally served, during which interval the statute of limitations had expired. Thomas moved to dismiss the action for, among other things, ineffective service of process and expiration of the statute of limitations.

   With respect to Thomas’ claim of ineffective service of process, the court held that service of process was properly effected on Thomas pursuant to Section 18-109 for the breach of fiduciary duty claims and, because the contractual claims arose out of the same nucleus of operative facts underlying the fiduciary duty claims against Thomas, that service of process under Section 18-109 was adequate to obtain personal jurisdiction over Thomas with respect to the breach of contract claims. With respect to Thomas’ statute of limitations defense, the court held that service of process on Thomas related back in time to the time that the complaint was filed based on the court’s finding that plaintiffs’ dilatory conduct in serving process on Thomas was outweighed by the fact that Thomas had actual notice of the proceeding prior to being re-served and had not been prejudiced by the delayed service of process.

6. **Failure to Join Necessary and Indispensable Parties**


   Plaintiff, a founder and manager and the vice president of a Delaware LLC, brought suit in the Delaware Court of Chancery challenging certain actions of Michael Gamache (“Gamache”), who was the president and the other founder and manager of the LLC. Prior to the challenged actions, plaintiff and Gamache each held 50% of the Class A voting interests in the LLC.

   Plaintiff asserted that Gamache unilaterally transferred 15% of the voting interests of the LLC to his brother and another person without the necessary approval under the LLC’s operating agreement; that Gamache’s reallocation of certain of plaintiff’s job responsibilities to another employee and Gamache’s decision to terminate plaintiff’s employment with the LLC violated the employment agreement between plaintiff and the LLC; and that a capital call by Gamache lacked the necessary approval of a majority interest of the members of the LLC. Plaintiff also sought injunctive relief against any effort to remove him as a member or manager of the LLC which plaintiff speculated was the ultimate purpose of Gamache and his allies.

   Defendants moved to dismiss for plaintiff’s failure to join the purported transferees as necessary and indispensable parties; for lack of subject matter jurisdiction over the claim that the modification and termination of the employment agreement constituted violations of the employment agreement; for failure to state a claim upon which relief could be granted as to the claim that the modification and termination of the employment agreement
constituted violations of the operating agreement; and for failure of plaintiff’s claim regarding defendants’ alleged effort to remove him as a member or manager of the LLC to set forth a claim ripe for judicial review.

The court first held that the purported transferees were not subject to the personal jurisdiction of the court but found that they were necessary and indispensable parties with respect to the claims relating to the validity of the transfer of the membership interests and plaintiff’s other claims that turned on whether the approval of a majority interest of the members had been obtained and thus dismissed those claims. As to the claim regarding the termination of the employment agreement, the court found that plaintiff had an adequate remedy at law and no equitable remedy and, therefore, held that the court lacked subject matter jurisdiction over any claims based on the allegedly improper termination of the employment agreement. Finally, the court found that plaintiff’s allegations regarding a general scheme to remove plaintiff from the LLC were largely speculative and thus held that claim was not yet ripe for judicial review.

7. **Damages**


Plaintiff, a former member of a Delaware LLC, filed suit in Delaware Superior Court alleging that the managers and other members of the LLC conspired to defraud him of the value of his equity interest by failing to distribute to him a portion of the proceeds from the sale of a major subsidiary of the LLC. The LLC ultimately declared bankruptcy. In an earlier decision in this case (see Section III.H.3.b), the Court of Chancery granted a motion to dismiss filed by three of the defendants who were members but not managers. Here, three other defendants moved for summary judgment based on the assertion that plaintiff suffered no damages. The court found that, because the LLC had declared bankruptcy, no one but the creditors of the LLC could have received the proceeds of the sale of the subsidiary. Accordingly, plaintiff could not prove damages, and the court granted defendants’ motion for summary judgment.

L. **General Construction and Application of Limited Liability Company Agreements**


In this case, the Court of Chancery examined the parameters of integration and confidentiality clauses in the LLC agreement of a Delaware LLC and concluded that (i) an integration clause cannot be read as barring a party from making a fraud claim unless it contains an express “anti-reliance” clause and (ii) an overly broad confidentiality clause that attempts to bar information that normally is available to the public through the court’s tradition of open proceedings is contrary to public policy and should not be strictly enforced.

Katz had contacted Kronenberg to consider a potential business venture to develop community sports facilities using tax-exempt bond financing provided by local governments. Kronenberg and the other plaintiffs agreed, and the resulting business, Community Sports Partners, LLC (“CSP”), was formed with the expectation that it would earn profits from management fees. Crucial to securing the financial support of Kronenberg and the other plaintiffs was the use of feasibility studies purportedly prepared by an experienced third party. These studies would then be given to local governments to show that CSP’s facilities could be successful. Katz misrepresented to Kronenberg that the studies were the work of a specialist in these types of sports facilities. In actuality, the studies were prepared by Katz himself and a less than reputable businessman named Mark Robins. Furthermore, Katz made very misleading claims about Robins, who was designated as the Chief Operating Officer of CSP. The court found that far from being a capable, experienced and trusted executive, Robins was a five-time convicted criminal who twice filed for personal bankruptcy. When the relationship of the CSP members inevitably went sour, the plaintiffs went to court seeking to rescind the contract.

The plaintiffs claimed that, because of Katz’s misrepresentations, they were fraudulently induced into entering the LLC agreement. The issue the court faced was whether the integration clause in the LLC agreement barred a claim of fraud against Katz. The parties used a standard integration clause that stated “[t]his Agreement … constitutes the entire agreement and understanding of the parties hereto with respect to the subject matter hereof and supersedes all prior or contemporaneous agreements, understandings, inducements, or conditions, oral or written, express or implied.” The
defendant claimed that the clause precluded the plaintiffs from relying on any statement of fact made by Katz that was not contained within the four corners of the agreement. In other words, since the agreement did not mention the feasibility studies or Robins’ background, the plaintiffs should be barred from raising those issues in court as a basis for a fraud action. The plaintiffs contended that since the integration clause was not an express “anti-reliance” clause (i.e., because the clause did not expressly provide that the parties were not relying upon any representation or statement of fact not contained within the LLC agreement), it could not be read as barring them from making a fraud claim. The court sided with the plaintiffs, stressing that Delaware has a strong interest in combating fraud, and thus, any clause that would bar a fraud claim must be very clear in its purpose. Balancing contractual freedom and efficiency concerns with public policy interests, the court arrived at the following rule for the construction of an integration clause as it relates to a fraud claim:

For a contract to bar a fraud in the inducement claim, the contract must contain language that, when read together, can be said to add up to a clear anti-reliance clause by which the plaintiff has contractually promised that it did not rely upon statements outside the contract’s four corners in deciding to sign the contract.

The integration clause at issue, because it did not clearly state that the parties were not relying on information outside of the LLC agreement, did not bar a fraud claim.

Separately, Katz argued that Kronenberg, by bringing the case to trial publicly and not attempting to file it under seal, violated a confidentiality provision in the LLC agreement. The provision dictated that “[t]he Company and each of its Members, Managers, and officers at all times … shall use all reasonable effort to cause all Sensitive Information to be maintained in strict confidence, protected and safeguarded and shall not directly or indirectly disclose, reveal or make available to any third party any Sensitive Information or use or exploit any Sensitive Information for any purpose whatsoever.” A dispute that devolved into a lawsuit was exempted from these disclosure restrictions “provided that the Person proposing to disclose or use Sensitive Information in connection with any suit … afford any other affected party the opportunity to seek an order to hold the contents of all pleadings and other documents containing Sensitive Information under seal or other reliable assurance that confidential treatment will be accorded the Sensitive Information.” The key term, “Sensitive Information”, was defined broadly in another section of the LLC agreement to mean “all information relating to the existence of or any claim made in connection with any dispute or controversy arising under this Agreement or relating to the Company.”

The court rejected Katz’s claim on a number of bases, including that Katz was not a signatory to the LLC agreement and thus the protections it afforded were not available to him personally, that he had made no immediate attempt, after the case was filed, to move to place the complaint under seal and that the type of information ultimately sought to be placed under seal by Katz was not of the type usually subject to such confidentiality agreements. Moreover, the court found the confidentiality provision to be “facially absurd” because although it recognized that the parties were free to litigate in courts of public record, the provision simultaneously made the existence of a dispute of any nature “Sensitive Information” that the parties had to conceal from the public. The court determined that it was unrealistic to read the confidentiality provision as barring information that normally is open to the public through the court’s tradition of open proceedings and would be inconsistent with strict limits placed by the Court of Chancery on parties’ ability to maintain filings under seal.


This case involved a dispute over who constituted the lawful members of a Delaware limited liability company. Plaintiff was trustee of Citation Realty Trust (“CRT”), which was a 1% owner of the LLC. Plaintiff claimed, however, that CRT was the sole member of the LLC because the managing member who owned the remaining 99% membership interest had, shortly before he died, assigned his interest to a trust for the benefit of his family and, plaintiff argued, that assignment conveyed only the former member's economic interest but did not entitle the trust to any other rights or to be admitted as a successor member. Prior to the assignment, all members of the LLC had executed a written consent consenting to the assignment of the “entire undivided membership interest” by the 99% member to the trust. On the same day that the consent was executed, the 99% member's wife, acting as his attorney-in-fact, had executed an assignment of all of the “membership interest” in the LLC to the trust. Both parties agreed that the consent effectively amended the LLC Agreement which had prohibited any assignments, but the parties differed on the extent of the interest assigned. Plaintiff argued that he had consented to an assignment of the economic interest
only and not the entire “membership interest.” In support of this position he argued that because the LLC Agreement had no provision governing “assignment” the court should look to the LLC Act. Under the Act, plaintiff argued, an assignment conveyed only a member’s economic interest not his entire membership rights and did not entitle the assignee to be admitted as a member. The court rejected plaintiff’s argument. It declined to look to the LLC Act to determine the effect of the assignment because it found that the consent executed by the members of the LLC and the subsequent assignment document unambiguously showed that the “entire undivided membership interest” was assigned to the trust, and the court concluded that as a result of that assignment the trust succeeded to the entire interest of the assignor and became the successor managing member. In so holding, the court did not require specific language relating to the admission of the trust as a member.


Plaintiffs brought suit under Section § 18-110 of the LLC Act to determine the lawful managers of a Delaware limited liability company. The limited liability company agreement of the LLC essentially provided that any direct or indirect transfers of an interest in the LLC made without obtaining the non-transferring member’s consent resulted in the transfer of economic rights only without any right to participate in the management of the business and affairs of the LLC. The stock of a California corporation, which was one of the two members of the LLC, was transferred to a trust of which the husband and wife were both the trustors and the co-trustees. Prior to the transfer, the husband had been the sole holder of record of the stock. Plaintiffs argued that the transfer of the stock of the California corporation without the consent of the other member was a restricted transfer under the limited liability company agreement resulting in a loss of management rights for the California corporate member. The court first held that the dispute turned on two issues of California law (i) whether a 100% stock interest in the California corporation was “community property” in which the non-record owner spouse had a property right when the California corporation became a member of the LLC and (ii) if so, whether the non-record owner spouse was thereby an “equity owner” of the shares of the California corporation at the time of the purported transfer. The court then concluded both that the shares of stock in the California corporation were community property and that the non-record owner spouse was thereby an equity owner of those shares with the consequence that no “transfer” had occurred within the meaning of the limited liability company agreement of the LLC and, therefore, the California corporation retained its voting interest in the LLC and its right to designate one of the co-managers.

IV. GENERAL PARTNERSHIPS & JOINT VENTSURES

Several significant cases involving general partnerships have been decided by the Delaware courts in the last several years. These include cases in which the court has strictly construed a partnership agreement to hold the partners to the benefit of their bargain even if it means forfeiture of a partnership interest as well as cases that examine the circumstances under which a cooperative or joint venture arrangement between two separate entities will or will not be held to constitute a general partnership.

A. Formation


Plaintiff, allegedly a partner in an alleged general partnership, brought an action against defendant, an alleged partner, to obtain payment of defendant’s initial capital contribution and defendant’s pro rata share of the business venture’s losses. The business venture was formed to purchase and develop a parcel of land pursuant to an alleged partnership agreement signed by the parties. Because of zoning obstacles, the parcel was sold at a substantial loss. Defendant had never made the initial capital contribution called for in the alleged partnership agreement. Plaintiff moved for summary judgment, asserting that a partnership had been formed and that defendant therefore was required to pay his initial capital contribution and share in his portion of the losses. Defendant filed a cross-motion for summary judgment, claiming that a partnership had not been formed, that his understanding was that the business venture would be in the form of a limited liability entity and that he was not to become an equity participant in the joint venture until the parcel had been successfully rezoned.

Initially, the court undertook a brief review of the parole evidence rule, which prevents the use of extrinsic evidence of an oral agreement to vary the terms of a fully integrated agreement that the parties have reduced to writing but which allows the use of evidence to show that the agreement was
rendered invalid because of fraud, illegality, duress, mutual mistake, lack of consideration or incapacity. The court found that defendant failed to provide any evidence of any of the exceptions to the parole evidence rule, and that extrinsic evidence of an oral agreement was therefore not admissible.

On the issue of whether a partnership had been formed, the court stated that a partnership is defined as an association of two or more persons to carry on a business as co-owners for profit, and that the creation of a partnership is a question of intent. The court further stated that, in demonstrating the intent of the parties and the existence of a partnership, the acts, dealings, conduct, admissions and declarations of the parties may be utilized, and that when the controversy is between two partners, as here, stricter proof of the intention to create a partnership is required. Because the attendant circumstances must be taken into consideration by the court in reaching a determination that a partnership existed, the court did not grant summary judgment to either party as to whether a partnership existed.

2. *In re Fenimore*, C.A. No. 7680 (Del. Ch. Oct. 8, 1999)

This case arose when the petitioner heirs sought to resolve a conflict between respondent judgment creditor and respondent mortgagee, each of whom claimed a right to a portion of the proceeds of a partition sale of real estate inherited from petitioners’ mother. The matter had been referred to a special master, and the court adopted the master’s findings of fact. The issue presented to the master was which would be given priority: a judgment obtained on October 9, 1990 but not filed of record until November 26, 1991 or a mortgage given on October 31, 1990 and recorded on November 7, 1990. Given the dates of filing, if the mortgage were valid, it would take priority. However, the court found that the payments that the mortgage had been given to secure were not a loan, but rather payments by one partner to another for use in partnership business. In finding a partnership existed, the court referred to Section 1507 of the DUPL and noted that the agreement pursuant to which certain monies were paid by the mortgagor to the mortgagee did not describe them as a loan but rather stated that they were “advanced . . . to conduct the business of buying and selling motor vehicles.” The agreement also provided that profits from each vehicle would be divided and that one party would pay the cost of borrowing money and the other would pay the ordinary operating expenses. Based on this agreement, the master found that as a matter of Delaware law a partnership existed. The court further found that at the time the mortgage in question was given, the mortgagor was insolvent. Thus, the holder of the mortgage had the obligation to show fair value had been given. Since she could not, the master held that the mortgage was fraudulent to the judgment debtor and that priority should therefore be given to the judgment debtor.


A subcontractor filed suit against the owner of a project to recover for the work completed on the project after the general contractor’s contract was canceled due to unsatisfactory performance. The owner counterclaimed alleging that the subcontractor was a joint venturer with the general contractor and, therefore, was liable to the owner for losses the owner incurred in completing the project.


In a suit against the Coca-Cola Company by several Coca-Cola bottlers challenging the pricing of its syrups, the bottlers argued that, because Coca-Cola had characterized its relationship with them as a “special partnership,” a partnership or joint venture had been formed that gave rise to special fiduciary duties between the parties, which had subsequently been breached. In granting Coca-Cola’s motion for summary judgment, the court concluded that the soft drink company and the bottlers were not partners or joint venturers under Delaware law because the necessary elements of integrated management, risk-sharing, and joint control or ownership of assets between the parties were not present.

In granting the owner’s motion for summary judgment on its counterclaim and on the claims against it, the court ruled that the general contractor and the subcontractor had engaged in a joint venture, even though no formal agreement had been entered into by the parties. The court found that the arrangement under which the general contractor agreed to supply property, the subcontractor agreed to provide skill and knowledge, and they both agreed to share the profits satisfied the criteria for
forming a joint venture and thereby established a joint venture by implication. The court then rejected the subcontractor’s contention that, although it may have been a joint venturer with the general contractor, the subcontractor should not be liable to the owner for damages resulting from the general contractor’s misconduct since the owner never knew of the joint venture between the general contractor and the subcontractor and, therefore, did not rely on the subcontractor as a joint venturer. The court stated, “[i]t is settled law that even undisclosed or secret partners who are not known to the third party who has contracted with the partnership or joint venture may be held liable.”

B. Fiduciary Duties


A general partnership was formed to purchase, hold and manage limited partnership interests and similar securities. The partnership had two general partners, one partner that was responsible for managing the partnership and the other partner that was responsible for providing the capital funding. When the funding partner failed to make a required capital contribution, the managing partner filed suit alleging, among other claims, breaches of contract and fiduciary duty and the funding partner moved to dismiss the action for failure to state a claim upon which relief could be granted.

The court first addressed the threshold question of whether a written, unsigned draft of the partners’ partnership agreement submitted by the defendants but disputed by the plaintiffs could be considered by the court in connection with the funding partner’s motion to dismiss. Plaintiffs had alleged certain terms of the partnership agreement but not submitted a complete copy. Because on a motion to dismiss the court was required to take the pled facts as true in deciding whether a legally valid claim is stated, the court held that it had to assume that the terms of the partnership agreement pled by the plaintiff were correct and could not consider defendants’ version.

Defendants’ also argued that the plaintiffs lacked standing to bring the breach of contract claims because the consent of all partners was required under the draft version of the partnership agreement to bring a lawsuit on behalf of the partnership under the partnership agreement. However, because the term was only included in the defendants’ version of the partnership agreement, the court rejected it on a motion to dismiss.

The court also addressed defendants’ argument that the plaintiffs’ breach of fiduciary duty claims should be dismissed. The fiduciary duty claims related to obligations that were expressly treated by the partnership agreement and were the subject of the plaintiffs’ breach of contract claims. In dismissing such fiduciary duty claims, the court upheld the general principle under Delaware law that “[t]o allow a fiduciary duty claim to coexist in parallel with [a contractual] claim, would undermine the primacy of contract law over fiduciary law in matters involving . . . contractual rights and obligations.”

C. Authority of Partners


On a motion for summary judgment filed by one partner and the general partnership, the court addressed plaintiffs’ claims that three mortgages executed by the defendant partner purportedly on behalf of the general partnership should be judicially invalidated. At the time of the entry into the challenged mortgages, the general partnership consisted of two partners with the plaintiff partner owning a 2/3 interest and the defendant partner owning a 1/3 equity interest in the partnership. Its purpose was to own and manage a specified commercial property (the “Building”) that was rented to a related corporation managed by the defendant partner. When the corporation began having financial troubles, defendant caused several mortgages to be placed on the Building, the proceeds of which were used to pay off his personal debts and debts of the corporation.

The court determined the three challenged mortgages were invalid *ab initio* based on its findings that the defendant partner lacked both actual and apparent authority to bind the partnership when he purported to execute the mortgages on its behalf and the partnership did not receive any consideration for such mortgages. The partnership agreement expressly provided that the “prior written unanimous approval of all partners” was required to “mortgage any or all of the partnership partners.” The defendant partner did not have actual authority to bind the partnership with respect to the mortgages because all partners did not authorize the partnership’s entry into the mortgages.
The court also had to address defendants’ argument that the defendant partner had apparent authority to execute the mortgages on behalf of the partnership. Because the most recent version of the partnership agreement was entered into prior to the passage of DRULPA, the court analyzed this argument under the provisions of DUPL, although it noted that the applicable provisions of DUPL (Section 1509) have been preserved in DRULPA (Section 15-301). Citing Section 1509(a) of DUPL, the court stated that the acts of a partner “for apparently carrying on in the usual way the business of the partnership” will bind the partnership, unless the partner “has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing had knowledge of the fact that he has no such authority.” Further, under Section 1509(b), “[a]n act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by the other partners.” In reaching its conclusion that none of the mortgages were within the ordinary course of the partnership’s business, the court noted that it could consider the partnership’s stated purposes, the precedent set by the partnership’s prior “custom or course of dealing” and “the general custom” of analogous partnerships. The court stated that although mortgaging the business was included within the partnership’s stated purposes, encumbering the Building to procure funds for purposes unrelated to the partnership did not fall within the ordinary course of its business. Therefore, the mortgages were invalid under DUPL Section 1509(b). The court went on to state that even if the mortgages were within the ordinary course of the partnership’s business, two of the mortgages would be invalid under DUPL Section 1509(a) because the evidence showed that the applicable mortgagees knew that the defendant partner lacked the authority to execute such mortgages on the behalf of the partnership. With respect to the third mortgage, the court reluctantly concluded that a question of material fact existed as to whether that mortgagee had inquiry notice of the fact that the partnership agreement prohibited the defendant partner from validly executing such mortgage but noted that the third mortgage was still invalid because it was not in the ordinary course or supported by consideration.

With respect to plaintiffs’ claim that the partnership was dissolved, the court held that plaintiffs were entitled to a judgment declaring that the partnership had been dissolved. The plaintiff partner duly called a partners’ meeting at which she voted her two-thirds partnership interest in favor of dissolution and the court found that such action by the plaintiff partner effectively dissolved the partnership under the terms of the partnership agreement. However, the court denied plaintiffs’ request for an order permitting the plaintiff partner to complete the winding up of the partnership without the participation of the defendant partner. The court noted that the partnership agreement required the “prior written unanimous approval of all of the partners” for any conveyance of partnership property and that the plaintiffs proffered no statutory or contractual provision upon which to ground their requested remedy.

The court also reviewed plaintiffs’ request for an adjustment of the partners’ capital accounts to credit the plaintiff partner with the amount of the expenses that she expended personally on behalf of the partnership as a result of the defendant partners’ actions with respect to the mortgages and the failure to appropriately pay certain taxes. The court found that the plaintiff partner did pay for certain partnership liabilities with her personal funds. However, the court held that plaintiffs failed to demonstrate a legal basis under either DUPL or the Partnership Agreement for making an adjustment to the partners’ capital accounts to account for the amounts expended by the plaintiff partner personally on behalf of the partnership. Rather, the court concluded, the plaintiffs in effect sought equitable indemnification or contribution from the defendant partner and should have, but did not, seek the entry of a money judgment against him personally which could have been executed against his assets including his capital account. Consequently, the court denied plaintiffs’ motion for summary judgment granting an adjustment of the partners’ capital accounts.

D. Removal of Partners


Plaintiff was a partner of a Delaware general partnership formed to purchase and develop real estate. For the first twenty-two months of the Partnership’s existence, Plaintiff paid his share of all cash calls on a current basis. Thereafter Plaintiff stopped meeting his financial obligations to the Partnership, stopped communicating with the other partners and failed to execute documents necessary to refinance a loan critical to the success of the Partnership’s business. The Partnership Agreement did not set forth the consequences for the failure of a partner to meet a cash call. After
the other partners were able to refinance the loan without the participation of Plaintiff, they decided to eliminate Plaintiff as a partner by merging the Partnership into a Delaware limited liability company whose members were all of the Partnership’s partners except Plaintiff. Plaintiff was not given notice of the merger until nine months after the merger when he received merger consideration consisting of a cash payment unilaterally determined by the other partners without any independent or expert financial advice based on an appraisal of the historical cost of the assets of the Partnership at the time Plaintiff stopped meeting his financial obligations.

Plaintiff asserted two claims for relief against the other partners of the Partnership. First, Plaintiff claimed that the merger was legally invalid because neither the DUPL nor the Partnership Agreement authorized a merger of a general partnership into an LLC and therefore, at the time of the trial, the Partnership still existed, he remained a partner and his damages should be determined as of the date of the trial. Second, in the alternative, Plaintiff claimed that the merger was equitably invalid because it was not entirely fair and was therefore a breach of fiduciary duty by Defendants to Plaintiff. Defendants raised the affirmative defenses that (i) Plaintiff had unclean hands because his egregious violations of his duties to the Partnership created the need for the merger to assure the survival of the Partnership and therefore he should be barred from seeking relief for the consequences of the merger and (ii) Plaintiff was not a partner at the time of the merger because his conduct either constituted an abandonment of the Partnership or operated legally as a dissolution of the Partnership. Defendants argued, in the alternative, that the merger was valid equitably because it was entirely fair in terms of both process and price.

The court addressed the affirmative defenses first. The court rejected the unclean hands defense because its application in this case would fill the gap in the Partnership Agreement regarding the consequences of a partner’s failure to make cash calls with the inequitable result of a forfeiture of Plaintiff’s partnership interest. The court found this to be a perverse application of the unclean hands defense, which itself is a doctrine intended to accomplish equity. The court also rejected Defendants’ contention that Plaintiff was not a partner at the time of the merger. The court failed to find that Plaintiff’s conduct constituted an abandonment of the Partnership or worked a dissolution of the Partnership under DUPL Section 1531 by constituting “a change in the relation of the partners caused by any partner ceasing to be associated in the carrying on . . . of the business.” The court thus rejected this affirmative defense, finding it to be completely inconsistent with their rationale for entering into the merger, which was to eliminate Plaintiff as a partner, and to be inequitable because Defendants had not provided Plaintiff with prior notice of their legal position or their intent to eliminate his partnership interest and had not given Plaintiff an opportunity to protect his interests.

The court then addressed Plaintiff’s claims. The court disagreed with Plaintiff’s claim that the merger was legally invalid because the DUPL did not expressly provide for a merger of a general partnership into a Delaware LLC. The court cited Section 1505 of the DUPL, which provides that “[i]n any case not provided for in [the DUPL] the rules of law and equity shall govern,” and Section 209 of the LLC Act, which is a rule of law expressly authorizing a merger of a general partnership with an LLC. With respect to Plaintiff’s claim that the merger was equitably invalid, all parties agreed that, since Defendants were on both sides of the merger, entire fairness was the applicable standard of review for the merger. The court stated that entire fairness requires fair dealing and a fair price. With respect to fair dealing, the court refused to accept Defendants’ assertion that Plaintiff was not entitled to the same level of fair treatment that would be required in different circumstances based on his egregious conduct. The court acknowledged that the requisite procedures to ensure fair process may differ in certain circumstances but held that the failure to provide advance notice to Plaintiff’s so that he could seek to protect his interests and the unilateral self-interested valuation of his partnership interest without independent or disinterested valuation advice violated fundamental requirements of fair process that cannot be dispensed with. The court also held that the price, which was based on the date Plaintiff stopped meeting his financial obligations rather than the date of the merger and which did not take future earning capacity of the assets of the Partnership into account, was unfair. The court held that Plaintiff was entitled to his proportionate share of the net worth of the Partnership on the date of the merger, with such amount being adjusted downwards to compensate the remaining partners for the loss of cash calls that Plaintiff failed to contribute and to reflect the incremental risk Plaintiff inflicted upon the remaining partners by refusing to pay his cash calls and to execute the loan refinancing documents. The court then undertook to value Plaintiff’s interest to determine Plaintiff’s damages using the testimony of the parties’ valuation experts. Following submission of supplemental memoranda by the parties, in
a subsequent opinion issued on April 2, 2001, the court determined the money judgment to which Plaintiff was entitled.

In a letter opinion issued on September 5, 2000, the court denied Plaintiff’s motion for a new trial based on newly discovered evidence, holding that such evidence was unlikely to change the outcome of the trial and was a result of Plaintiff’s own lack of diligence. The court also denied Plaintiff’s motion in the alternative for reargument based on an allegedly erroneous admission of hearsay by the court and an allegedly erroneous finding by the court that there was a statutory authorization for the merger, ruling that Plaintiff’s arguments merely rehashed contentions made in Plaintiff’s post-trial briefs that had been considered and rejected by the court.


The court rejected an expelled partner’s assertion that the general partnership must wind up its affairs and pay him his partnership interest upon his expulsion. Although dissolution of the general partnership does occur by operation of law under DUPL Section 1531 upon the expulsion of any partner, the partnership may be continued without winding up its affairs and the expelled partner’s right to receive his partnership interest may be forfeited if the partnership agreement so provides.

E. **Withdrawal of Partners**

1. **Wills v. Morris, James, Hitchens & Williams,** C.A. No. 15297 (Del. Ch. Nov. 6, 1998)

A withdrawing partner disputed the method by which the general partnership calculated her final distribution reflecting her last year’s partnership income. The partnership agreement provided that the share of undistributed net income of the partnership for a fiscal year was to be determined (i) as of the end of the month in which the withdrawal occurred and (ii) after the end of such current fiscal year. The withdrawing partner argued that the language of the partnership agreement mandates that her last year’s income be derived from the partnership’s income for the entire year in which she withdrew as a partner. The partnership argued that the partnership agreement restricted the withdrawing partner’s right to partnership income in the final year to the period up to the month in which the partner withdraws. In other words, the partnership asserted that the first phrase determines the time frame for the distribution calculation while the second phrase indicates that the calculation is to be performed subsequent to the end of the fiscal year.

In reaching its decision, the court applied the contractual construction principle that when the interpretation of one party better comports with the remaining contents of a document or gives effect to all the words in dispute, the court may resolve the meaning of the disputed term in favor of the superior interpretation without resorting to extrinsic evidence. The court then held for the partnership because it found the partnership’s interpretation allowed the two phrases at issue to coexist without impairing the meaning of either one. Specifically, the court found the use of the term “after” in the second phrase to mean that the calculation defined in the first phrase would be performed subsequent to the end of the fiscal year, as argued by the partnership, harmonizes the meaning of that phrase and the use of “after” in a third phrase which stated that the share of income shall be payable without interest within 30 days after the amount shall have been determined by the partnership’s accountants. In contrast, the court held that under the withdrawing partner’s interpretation, if the second phrase required calculation of a partner’s share of income after the end of the fiscal year, the first phrase regarding determination of share of income as of the end of the month became meaningless and further that the usage of the phrase “as of” in the first phrase flatly contradicted the argument that the partnership intended a withdrawing partner to receive a portion of the firm’s end-of-year income based on the number of months worked divided by twelve months. The court also noted that the partnership’s proposed usage of “after” and “as of” comported with the usage of those same words in other parts of the partnership agreement.

F. **Dissolution**


On a motion for summary judgment filed by one partner and the general partnership, the court addressed plaintiffs’ claims that three mortgages executed by the defendant partner purportedly on behalf of the general partnership should be judicially invalidated. At the time of the entry into the challenged mortgages, the general partnership consisted of two partners with the plaintiff partner owning a 2/3 interest and the defendant partner owning a 1/3 equity interest in the partnership. Its
purpose was to own and manage a specified commercial property (the “Building”) that was rented to a related corporation managed by the defendant partner. When the corporation began having financial troubles, defendant caused several mortgages to be placed on the Building, the proceeds of which were used to pay off his personal debts and debts of the corporation.

The court determined the three challenged mortgages were invalid ab initio based on its findings that the defendant partner lacked both actual and apparent authority to bind the partnership when he purported to execute the mortgages on its behalf and the partnership did not receive any consideration for such mortgages. The partnership agreement expressly provided that the “prior written unanimous approval of all partners” was required to “mortgage any or all of the partnership partners.” The defendant partner did not have actual authority to bind the partnership with respect to the mortgages because all partners did not authorize the partnership’s entry into the mortgages. The court also had to address defendants’ argument that the defendant partner had apparent authority to execute the mortgages on behalf of the partnership. Because the most recent version of the partnership agreement was entered into prior to the passage of DRULPA, the court analyzed this argument under the provisions of DUPL, although it noted that the applicable provisions of DUPL (Section 1509) have been preserved in DRULPA (Section 15-301). Citing Section 1509(a) of DUPL, the court stated that the acts of a partner “for apparently carrying on in the usual way the business of the partnership” will bind the partnership, unless the partner “has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing had knowledge of the fact that he has no such authority.” Further, under Section 1509(b), “[a]n act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by the other partners.” In reaching its conclusion that none of the mortgages were within the ordinary course of the partnership’s business, the court noted that it could consider the partnership’s stated purposes, the precedent set by the partnership’s prior “custom or course of dealing” and “the general custom” of analogous partnerships. The court stated that although mortgaging the business was included within the partnership’s stated purposes, encumbering the Building to procure funds for purposes unrelated to the partnership did not fall within the ordinary course of its business. Therefore, the mortgages were invalid under DUPL Section 1509(b). The court went on to state that even if the mortgages were within the ordinary course of the partnership’s business, two of the mortgages would be invalid under DUPL Section 1509(a) because the evidence showed that the applicable mortgagees knew that the defendant partner lacked the authority to execute such mortgages on the behalf of the partnership. With respect to the third mortgage, the court reluctantly concluded that a question of material fact existed as to whether that mortgagee had inquiry notice of the fact that the partnership agreement prohibited the defendant partner from validly executing such mortgage but noted that the third mortgage was still invalid because it was not in the ordinary course or supported by consideration.

With respect to plaintiffs’ claim that the partnership was dissolved, the court held that plaintiffs were entitled to a judgment declaring that the partnership had been dissolved. The plaintiff partner duly called a partners’ meeting at which she voted her two-thirds partnership interest in favor of dissolution and the court found that such action by the plaintiff partner effectively dissolved the partnership under the terms of the partnership agreement. However, the court denied plaintiffs’ request for an order permitting the plaintiff partner to complete the winding up of the partnership without the participation of the defendant partner. The court noted that the partnership agreement required the “prior written unanimous approval of all of the partners” for any conveyance of partnership property and that the plaintiffs proffered no statutory or contractual provision upon which to ground their requested remedy.

The court also reviewed plaintiffs’ request for an adjustment of the partners’ capital accounts to credit the plaintiff partner with the amount of the expenses that she expended personally on behalf of the partnership as a result of the defendant partners’ actions with respect to the mortgages and the failure to appropriately pay certain taxes. The court found that the plaintiff partner did pay for certain partnership liabilities with her personal funds. However, the court held that plaintiffs failed to demonstrate a legal basis under either DUPL or the Partnership Agreement for making an adjustment to the partners’ capital accounts to account for the amounts expended by the plaintiff partner personally on behalf of the partnership. Rather, the court concluded, the plaintiffs in effect sought equitable indemnification or contribution from the defendant partner and should have, but did not, seek the entry of a money judgment against him personally which could have been executed.
against his assets including his capital account. Consequently, the court denied plaintiffs’ motion for summary judgment granting an adjustment of the partners’ capital accounts.

G. Accountings


Plaintiff sought an accounting to establish that his partner in a Delaware general partnership was liable for half of the amounts that plaintiff had paid to creditors of the partnership since the partnership ceased operations. Defendant did not dispute that plaintiff had made the payments to creditors claimed by plaintiff but alleged that at the time he formed the partnership with plaintiff, it was agreed that plaintiff would be responsible for all pre-existing expenses and obligations of the business. Defendant also alleged that plaintiff may have improperly used assets of the partnership to pay such pre-existing expenses and obligations. Plaintiff moved for summary judgment.

The court stated that the partnership agreement of the partnership contained no agreement to exclude prior obligations incurred by plaintiff prior to the formation of the partnership and, in addition, contained an integration clause which explicitly stated that the partnership agreement set forth all agreements between plaintiff and defendant and superceded any prior agreements between them. The court also found the fact that the valuation upon which defendant had purchased his interest in the partnership was based on the value of the assets of the partnership minus the liabilities of the partnership strongly suggested that defendant recognized that pre-existing obligations were the responsibility of the partnership and not just plaintiff. The court also found that defendant failed to present any evidence to support a reasonable inference that the debts paid by plaintiff were in existence prior to the formation of the partnership. The court noted that this case had been pending for over seven years and that defendant had repeatedly delayed the case, had not used the documents he received in his request for production of documents to develop any specific allegations and had failed to take a single deposition or pursue any other type of discovery. The court thus refused to excuse defendant’s failure to present any specific evidence to support his claim that the amounts sought by plaintiff should be adjusted to account for one or more pre-existing debts paid by the partnership. The court granted plaintiff’s motion for summary judgment and held defendant liable for half of the amounts plaintiff had paid to creditors of the partnership.

H. Procedural Issues

1. Arbitration

a. *Johnson v. Foulk Road Medical Center P’ship*, C.A. No. 18984 (Del. Ch. Nov. 5, 2001)

A partner in a Delaware general partnership brought an action in the Court of Chancery asserting several claims against the other partners and the partnership, including a claim for judicial dissolution pursuant to Section 1532 of the DUPL. Defendants moved to dismiss for lack of subject matter jurisdiction asserting that a broad arbitration clause in the partnership agreement provided an adequate legal remedy. Plaintiff conceded that most of his claims were subject to the arbitration clause but argued that his claim for judicial dissolution was not arbitrable. For this proposition, plaintiff cited DUPL Section 1532, which provides that on application by or for a partner the court shall decree a dissolution whenever the circumstances specified in Section 1532 exist.

The court first determined that the arbitration clause in the partnership agreement was broad enough to cover plaintiff’s claim for judicial dissolution and that there was nothing inherent in plaintiff’s claim for judicial dissolution that could not be fully and fairly litigated in the context of an arbitration. The court then addressed the question of whether the jurisdiction of the Court of Chancery to entertain petitions to dissolve Delaware partnerships was exclusive. Pointing to the policy under Delaware law that favors arbitration of disputes, the court held that the grant of jurisdiction to the Court of Chancery in DUPL Section 1532 over claims for judicial dissolution did not mean that the court must exercise jurisdiction over such claims where there was an otherwise valid and binding agreement to arbitrate. The court thus granted defendants’ motion to dismiss.

Although this dispute was governed by the DUPL, the court went on to conclude that partners may contractually commit resolution of claims for judicial dissolution to arbitration under the DRUPA as well.

Plaintiff, a partner in a general partnership withdrew from the partnership. The remaining partners claimed that the plaintiff’s withdrawal constituted a breach of the partnership agreement and formally demanded arbitration of their claims pursuant to the broad arbitration clause in the partnership agreement. The plaintiff brought an action in the Court of Chancery for a declaration that the defendants were not entitled to arbitrate the “invalid withdrawal” claim. Both parties moved for summary judgment and the plaintiff moved for a preliminary injunction to halt the arbitration. Based on the strong public policy favoring arbitration, the court held that arbitration was appropriate in any case in which the contract could reasonably be interpreted to require arbitration and that any doubts as to whether particular issue was arbitrable must be decided in favor of arbitration. Applying this standard to the broad arbitration clause at issue, the court held that the plaintiff had a duty to arbitrate the invalid withdrawal and granted the defendants motion for summary judgment. Plaintiff appealed and the Delaware Supreme Court affirmed finding that all issues raised by plaintiff, including its defense that defendants’ invocation of arbitration was not timely, were properly left to the arbitrator.


After the Court of Chancery’s ruling that plaintiff was required to arbitrate the issue of the validity of its withdrawal from the partnership, an arbitration took place and the arbitration panel issued a decision in which it entered a judgment and award in favor of the defendants. (See \textit{SBC Interactive, Inc.} discussed above). Plaintiff then filed an action in the Court of Chancery to vacate the arbitration award and enjoin the defendant from taking any further steps to confirm the award. The defendants responded that the Court of Chancery lacked subject matter jurisdiction to rule on plaintiff’s motion to vacate the arbitration award. The question before the court was whether it had subject matter jurisdiction to enforce awards rendered under the Federal Arbitration Act. Under the partnership agreement, the parties had agreed to arbitrate any disputes in New York but to submit the enforcement, modification or vacating of any award to the non-exclusive jurisdiction of the state and federal courts located in Wilmington, Delaware. Based on the Court of Chancery’s inherent equity jurisdiction, the Court held that it did have subject matter jurisdiction over the enforcement, modification or vacating of the arbitration award rendered under the Federal Arbitration Act.

2. \textit{Attorney-Client Privilege}

a. \textit{SBC Interactive, Inc. v. Corporate Media Partners}, C.A. No. 15987 (Del Ch. Dec. 9, 1997)

During the discovery phase of the plaintiff partner’s action seeking a declaration that its withdrawal from the general partnership was not arbitrable (see \textit{SBC Interactive, Inc.} discussed in Section III.G.) the plaintiff moved to compel the production of certain documents that had been withheld on the ground of attorney-client privilege and work product immunity. The contested documents contained legal advice given by the general partnership’s attorney to the remaining partners during the sixty day period between the plaintiff’s giving notice of its intent to withdraw and the date the plaintiff’s withdrawal purportedly became effective. The plaintiff asserted that, based on its status as a partner during such period, it was a client of the attorney for the partnership and thus had a right to the documents. Citing the strong public policy favoring confidentiality of communications between lawyer and client, the court rejected the plaintiff’s assertion that an attorney-client relationship automatically arises between a partnership’s general counsel and each of its partners. The court stated that whether an attorney-client relationship exists depends upon the facts and circumstances and, in this case, the plaintiff, after giving notice of its intent to withdraw, had no reasonable expectation that it was represented by the partnership’s attorney.
3. Stay of Proceedings


A former partner brought suit in Superior Court against the general partnership and its remaining partners for breach of contract. The partnership and its partners answered the plaintiff’s claim by raising the affirmative defense of fraud in the inducement. The partnership and its partners subsequently filed a companion suit in the Court of Chancery and moved in Superior Court for dismissal or, in the alternative, a stay of the former partner’s legal claim pending resolution of the equitable action.

The Superior Court found jurisdiction to exist both at law and in equity but decided to forego its concurrent jurisdiction because the circumstances rendered an investigation by the court of equity more convenient and effectual. The paramount issue in both cases centered on the value of the former partner’s interest in the partnership, which was likely to entail an extensive evaluation of the partnership and could involve an accounting and possible rescission. Therefore, the most appropriate jurisdiction was the Court of Chancery. The Superior Court, thus, granted the defendants’ motion to stay the Superior Court proceeding pending the outcome of the claim in Chancery Court.


This accounting action involving allegations of unequal distribution of assets and breaches of fiduciary duty stemmed from the failure of a home construction business operated by the plaintiff and defendant. Although the parties had incorporated two separate corporations in connection with the conduct of their business, the court found that the business had been operated by the parties as a de facto 50-50 partnership rather than as active corporations that observed requisite corporate formalities. Under the more informal relationship of the parties, each partner was entitled to an equal share of the business and was entitled to take “draws” from business funds. After the collapse of the business, the plaintiff brought suit against the defendant seeking damages for alleged conversion of business funds and mismanagement of the business by the defendant and an accounting of amounts due to the business.

The court rejected the defendant’s argument that the accounting action should be dismissed because an accounting should be ordered only where a partner has been excluded from the books and records of the partnership. Instead, the court held that an accounting may be ordered as required by equity such as this case where the parties stood in a fiduciary relationship and intended to share the expenses, profits and losses of the partnership on an equal basis. While the court held that the plaintiff failed to support his breach of fiduciary duty claims against the defendant based on his extra draws and alleged mismanagement of the business, the court did find that the partnership assets retained by the defendant exceeded those retained by the plaintiff in contravention of the agreement of the parties that the assets were to be divided equally and that such amount must be accounted for and distributed to the plaintiff. The defendant sought to offset the amount of his greater draws against certain amounts that he had paid to satisfy partnership debt after the business became defunct. The court found that the defendant was entitled to an offset equal to the amounts paid to settle an outstanding business loan and outstanding amounts owed for supplies of certain services and materials provided to the business, the payment of which had been guaranteed by the partners, because such payments worked a direct benefit to the partners and the partnership regardless of any other benefits that may have inured to the defendant individually as well. In contrast, the defendant was not entitled to an offset with respect to certain other payments made to creditors of the business related to services provided to the business because he failed to demonstrate that those payments worked any financial benefit to the partnership or that he was legally compelled to make them on behalf of the partnership.


Plaintiffs were two minority members of a joint venture formed pursuant to a written joint venture agreement executed in 1981. In 1998, after years of losses, the joint venture agreed
to sell the commercial real property it had been formed to purchase, hold and develop. The plaintiffs sought to participate in the distribution of proceeds from the sale by seeking to have certain amounts allegedly owing under several loan agreements originating in 1981 between the joint venture and other of its members characterized as non-interest bearing capital contributions rather than loans. If the amounts were characterized as loans, the plaintiffs would not be entitled to receive any distribution of sale proceeds. However, if the amounts were recharacterized as capital contributions, plaintiffs would be entitled to some distribution of sale proceeds. Defendants moved for summary judgment. The court held that the claims relating to the loans arose at the time the loans were made and thus that those claims were barred by the three year statute of limitations. The court also found that plaintiffs’ effort to revive their claims in the context of an accounting would be unavailing. In this regard, the court, although construing the DUPL, looked for guidance to the Revised Uniform Partnership Act which addressed when a partner’s right to seek an accounting accrued for purposes of statutes of limitations. Based on that guidance, the court held that plaintiffs’ right to bring an action for an accounting under Section 1522 of the DUPL created an obligation to do so in a timely manner or else to risk forfeiture of their claims even in a post-dissolution accounting under Section 1543 of the DUPL. Thus, the court granted defendants’ motion for summary judgment.

I. General Construction and Application of Partnership Agreements


A partnership was formed by three entities to develop and sell certain medical technology. Pursuant to their joint venture agreement, one partner was obligated to provide the initial financing for the partnership and had the right to terminate the partnership if its financing obligation exceeded $2 million. When its financial contribution reached $2 million, the money partner exercised its right to terminate the partnership. Approximately two years later, the other partners and the partnership brought suit against the money partner and its parent entity asserting (i) that the partner breached the joint venture agreement and breached its fiduciary duties to the other partners, (ii) that the parent aided and abetted the partner’s breach of fiduciary duty and tortiously interfered with the joint venture agreement and (iii) that the partner and its parent wrongfully induced the plaintiffs to enter into the joint venture agreement through fraudulent or negligent misrepresentations. The defendants counterclaimed, contending that the other partners breached the joint venture agreement and wrongfully induced the defendants to enter into the joint venture agreement.

In evaluating the plaintiffs’ claims, the court held that the plaintiffs failed to meet their burden of proof with respect to their breach of contract claims. With respect to their breach of fiduciary duty claims, the court acknowledged that the money partner, as a partner in and as the managing partner of the joint venture, owed fiduciary duties to the other partners and that its parent, as the money partner’s sole shareholder, owed fiduciary duties to the money partner’s partners as well. The court, however, rejected plaintiffs’ breach of fiduciary duty claims for lack of evidentiary support. Because the court held that there had been no breach of contract and no breach of fiduciary duty by the money partner, the court also rejected the related claims of tortious interference and aiding and abetting against its parent. With respect to the plaintiffs’ wrongful inducement claims, the court found that the plaintiffs failed to establish that the defendants representations were false and, in any event, were not justified in relying on the claimed misrepresentations in entering into the joint venture agreement because all of the claimed misrepresentations were oral representations that were inconsistent with the express provisions of the joint venture agreement. Therefore, the court held that the plaintiffs were not wrongfully induced by the defendants to enter into the joint venture agreement.

Turning to the defendants’ counterclaims, the court held that the defendants’ breach of contract claims against the plaintiffs were meritless and, with respect to the defendants counterclaim of wrongful inducement, the court found that certain of the plaintiffs’ alleged misrepresentations were not actionable because the defendants were aware of the material facts underlying the representations and that the defendants’ reliance on the other alleged misrepresentations of the plaintiffs was not reasonable or justifiable because the defendants failed to take reasonable steps to protect themselves, such as through performing adequate due diligence to verify plaintiffs’ representations and through requiring plaintiffs to provide written representations and warranties in the joint venture agreement. Therefore, the court rejected defendants’ counterclaims.

John Cianci and Jeffrey Minner, through separate companies, operated commercial janitorial services franchises. In 1991, Cianci and Minner, reached an oral agreement to consolidate their operations and operate the combined enterprise as equal partners (the “1991 Agreement”). The parties never defined the exact nature of the consolidation of their businesses beyond their agreement to split profits and losses evenly, to run their operation through JEM Enterprise, Inc. (the corporation through which Minner operated his franchise), to maintain Cianci’s franchise, and to have Minner handle sales while Cianci managed operations. As time passed, tension grew between the partners and Minner was forced to take on additional responsibilities beyond those to which he agreed in the 1991 Agreement. In 1997, the parties initiated discussions and eventually reached an agreement regarding the dissolution of the partnership and payment to Cianci of a five year annuity as compensation for his partnership interest (the “1997 Agreement”). When Minner repudiated the 1997 Agreement, claiming that his assent was obtained by duress, Cianci filed this action, seeking enforcement of the 1997 Agreement or, in the alternative, half of the value of the partners’ combined business as of the date that the partnership was effectively dissolved.

The court found that when the parties entered into the 1991 Agreement, they created a 50/50 partnership without any real delineation of the partners’ rights and obligations. Based on the weight of the evidence, the court rejected the argument that the 1991 Agreement included an agreement that Cianci would retire and turn over his share of the partnership to Minner at the end of five years. Further, Minner claimed that he had a right of setoff against any amounts awarded to Cianci because Cianci was paid more than he deserved for his contributions to the combined business. The court declined to address this claim beyond its statement that no setoff based solely on inadequate productivity shall be granted because there was no contractual provision making the partners’ relative ownership percentages contingent on a certain level of performance or output by the partners.

The court also analyzed whether certain threatening remarks made by Cianci to Minner during the discussions in connection with the 1997 Agreement coerced Minner’s assent to Cianci’s demands in connection with his withdrawal from, and the dissolution of, the partnership. Although the court found Cianci’s remarks to be improper because they involved a physical threat and Cianci knew or should have known that Minner would take such remarks seriously, the court determined that under the attendant circumstances, they did not amount to wrongful duress and did not render the 1997 Agreement voidable. Taking into consideration the totality of the evidence presented by the parties, the court concluded that Minner’s assent to Cianci’s terms for Minner’s buyout of his partnership interest was driven by several external pressures and business practicalities and was a result of Cianci’s threatening remarks only to a limited extent, if at all. The court went on to hold that even if Minner’s assent was the result of duress, Minner ratified the 1997 Agreement by accepting Cianci’s performance of his obligations thereunder and Minner’s partial performance of his obligations thereunder. Thus, the 1997 Agreement was not voidable by Minner. The court found that Minner accepted all of the benefits of the parties’ bargain without asserting that the contract was tainted and even partially performed himself until it was time to begin making monthly payments for the buyout to Cianci. Thus, the court held that Minner ratified the agreement by his actions and should be bound by its terms.

V. STATUTORY TRUSTS

Due to the relative novelty of Delaware statutory trusts and their somewhat more limited use, few Delaware cases involving Delaware statutory trusts have yet arisen. However, more statutory trusts are being formed each year and, eventually, a body of case law construing the Delaware Statutory Trust Act, Del. Code Ann. tit. 12 §§ 3801 et seq. (the “DTA”), should develop. In the meantime, it should be noted that while the DTA is in many respects a unique statute, certain of its provisions are patterned on those of the DRULPA, such as the indemnification provision. Thus, cases construing analogous provisions under the DRULPA should prove useful guides in efforts to interpret such provisions in the DTA.

A. Indemnification

Following the approach of Section 17-108 of the DRULPA and Section 18-108 of the LLC Act, Section 3817 of the DTA provides that a statutory trust may indemnify and hold harmless any trustee or beneficial owner or other person from and against any and all claims and demands whatsoever, subject to the standards and restrictions set forth in the governing instrument of the statutory trust. The Delaware courts have explicitly recognized the disparate treatment accorded to
indemnification by the DGCL and the DTA, and have given effect to the breadth and flexibility inherent in the construction of the DTA.


Plaintiffs were trustees of a Delaware statutory trust who sought advance indemnification from the trust under an advancement provision in the trust’s governing instrument. A beneficiary of the trust’s parent trust objected to the advancement on the grounds that the DTA did not permit statutory trusts to advance litigation expenses and also on the grounds that plaintiffs had not satisfied the pre-conditions set forth in the trust’s advancement provision. The court acknowledged that Section 3817(a) of the DTA does not specifically address advancement of expenses but only addresses indemnification, in contrast to the DGCL which separately authorizes indemnification and advancement of expenses (Section 145). However, the court noted that there were many differences between the DGCL and the DTA and concluded that the legislature’s failure to mention “advancement” in the DTA did not indicate its intent to prohibit statutory trusts from making advancements. Rather, the court concluded, that the two statutes were different in scope, purpose and approach and that the DTA simply was intended to be more flexible than the DGCL. The court compared the DTA to the DRULPA and noted that in the *Delphi Easter Partners* case (see Section II.E.) the Court of Chancery assumed without discussion that the DRULPA authorized advancement in addition to indemnification based on language comparable to that at issue under the DTA. Thus, the court concluded that the breadth of the language of the DTA implicitly allowed statutory trusts to authorize advancement of litigation expenses. In addition, the court found that plaintiffs had satisfied all contractual conditions prerequisite to obtaining advancement under the trust’s governing instrument. However, because the plaintiffs had, prior to the court’s determination, engaged in “self help” by taking substantial sums of money from the trust to pay their legal fees, the court found that they had unclean hands and thus, were not entitled to advancement of expenses.

In a related proceeding, the court considered whether the plaintiffs could avoid the effect of the court’s initial holding of unclean hands and consequent denial of advancement of expenses by attempting to undo their improper conduct after the court’s initial adverse ruling. The plaintiffs had, after the court’s initial ruling, taken it upon themselves to return $900,000 to the statutory trust, the exact amount of money they had improperly withdrawn. However, the court concluded that plaintiffs had failed to meet the standard for relief from a judgment under paragraph (6) of Court of Chancery Rule 60(b) because they failed to demonstrate that their position either avoided manifest injustice or presented a case of extraordinary circumstances. Rather, the court concluded that the plaintiffs’ after the fact action did not alter the fact that plaintiffs came to the court with unclean hands and remained in front of the court with unclean hands even after final judgment and, therefore, the court denied plaintiffs’ request.

B. General Construction of Governing Instruments


A Delaware statutory trust moved to dismiss an action filed by a former trustee for indemnification of legal fees. The former trustee’s claim arose from a breach of fiduciary duty action brought against him and certain other trustees by several shareholders of the trust. The former trustee prevailed in the underlying action but the appeal of the jury verdict was pending in appellate court.

The trust moved for dismissal of the action based on improper venue because he trustee’s indemnification agreement with the trust provided that the courts of Reno, Nevada shall be the exclusive venue for indemnification disputes. The trustee counterargued that the venue provision contained in the indemnification agreement must be disregarded because he filed his indemnification claim pursuant to the declaration of trust, not the indemnification agreement, and the declaration of trust neither contained a venue provision nor incorporated the indemnification agreement by reference. Both agreements contained provisions regarding the trust’s responsibilities to indemnify trustees but only the indemnification agreement also contained a venue provision.

As a result of its determination that the indemnification agreement and the declaration of trust together comprised the parties’ agreement on the subject of indemnification, the court found that the only reasonable interpretation of the venue provision is that it would govern all indemnification disputes between the trust and the former trustee. In reaching this conclusion, the language of the two agreements and the objective circumstances of their execution were among the chief factors
relied upon by the court. In its analysis, the court relied on the principle that “in construing the legal obligations created by [a] document, it is appropriate for the court to consider not only the language of that document but also the language of contracts among the same parties executed or amended as of the same date that deal with related matters.” Because the two agreements were entered into contemporaneously for all relevant purposes, the court stated that they must be viewed together in their entirety to ascertain the scope and nature of the parties’ indemnification arrangements. The court also found that the indemnification agreement was a subordinate document entered into under the declaration of trust based on the language contained in the indemnification agreement stating that it was entered into “pursuant to” the declaration of trust and that the former trustee entered into the indemnification agreement “in consideration” of his agreement to act as a trustee. The court further stated that the former trustee’s indemnification claim came within indemnification agreement’s provisions for indemnification and thus within the scope of its venue provision and it held that the only reasonable construction of the venue provision was that it was devised by the parties to ensure that all indemnification disputes would be litigated in the city in which the trust’s business operations were centered and that such an objective was of obvious utility.

The court then granted the trust’s motion to dismiss premised on the argument that the former trustee’s action was not ripe for decision pending the trust’s exhaustion of its appeals in the underlying action. The court noted that as a matter of judicial efficiency, it was not practical for the court to decide claims for indemnification (in contrast to claims for advancement of legal expenses) in advance of a non-appealable final judgment. Highlighting that in the corporate context the Delaware courts have assumed that the statute of limitations for indemnification claims runs from the time that the underlying investigation or litigation was definitively resolved, the court stated that adjudication of indemnification claims only after the underlying action is definitely resolved would reduce the chance that, in the absence of a showing of undue hardship, the court engaged in a wasteful exercise.
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