RECENT CASES INVOLVING LIMITED LIABILITY COMPANIES AND LIMITED LIABILITY PARTNERSHIPS
(includes cases since the Business Law Section Spring 2008 program survey until Nov. 2008; an updated survey is available at http://law.baylor.edu)

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RECENT CASES INVOLVING
LIMITED LIABILITY COMPANIES AND
LIMITED LIABILITY PARTNERSHIPS

By Elizabeth S. Miller
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This paper summarizes cases, as of November, 2008, that have appeared since the paper prepared for the Partnerships and LLCs: Important Case Law Developments–2008 program presented at the Spring Meeting of the Business Law Section of the ABA. Additional surveys of LLP and LLC cases may be accessed at the Baylor Law School web site at http://law.baylor.edu.

I. Limited Liability Partnerships

A. Service of Process

PDM Steel Service Centers, Inc. v. Mullen & Filippi, No. F054031 (Cal. App. 5th Dist. Aug. 8, 2008). The plaintiff attempted service of process on a California LLP by serving an office employee of the LLP. The individual was not the registered agent identified in the LLP’s registration statement, and the plaintiff failed to establish that the individual had ostensible authority to accept service of process for the LLP. Therefore, the plaintiff did not comply with the procedures required for service of process on an LLP.

B. Venue

Ex parte Burr & Forman, LLP, __ So.2d __, 2008 WL 4182829 (Ala. 2008) (pointing out that fact partnership is LLP does not change its treatment for venue purposes because partnership that registers as LLP is same entity that existed before registration and continues to be partnership under Alabama law subject to LLP provisions of partnership statute).

C. Pro Se Representation


D. Limited Liability of Partners

Santos v. 304 West 56th Street Realty LLC, 862 N.Y.S.2d 435 (N.Y. Sup. 2008) (stating complaint must be dismissed as to general partner of defendant LLP in negligence action since partner of partnership which is LLP is not liable for liabilities of LLP).

Red River Wings, Inc. v. Hoot, Inc., 751 N.W.2d 206 (N.D. 2008). Two individuals who were partners in an LLP that was a limited partner in limited partnerships that owned franchised restaurants were held liable for the LLP’s breach of fiduciary duty as a limited partner in connection with seizing control of the limited partnerships and ousting the general partner. The court relied upon the veil piercing provision of the North Dakota LLP statute which states that principles of corporate veil piercing apply to LLPs. The court stated that the evidence of the participation of the LLP partners in the takeover of the limited partnership in which the LLP was a limited partner supported the trial court’s implicit finding that it would be inequitable if the LLP partners’ acts were treated as those of the LLP alone and that the trial court did not err in holding the partners of the LLP liable.

Kuslansky v. Kuslansky, Robbins, Stechel, and Cunningham, LLP, 858 N.Y.S.2d 213 (N.Y.A.D. 2 Dept. 2008). A withdrawn partner sought to recover payment from the remaining partners for the value of his partnership interest under the partnership agreement. The defendant partners argued that they were shielded from liability by the New York LLP provisions, but the court pointed out that the New York Court of Appeals held in Eederer v. Gursky that
the LLP liability shield only applies to a partner’s liability to third parties and does not shield a general partner in an LLP from breaches of the partnership’s or partner’s obligations to each other.

E. Bankruptcy

In re Rambo Imaging, L.L.P., No. 07-11190-FRM, 2008 WL 2778846 (Bankr. W.D. Tex. July 15, 2008). The issue in this case was whether an individual who was a partner of a Texas LLP was a general partner with standing to be a petitioner in an involuntary bankruptcy case. The partnership was a general partnership registered under the Texas full shield LLP statute. The court stated that it had been unable to find any case law addressing the ability of a partner in an LLP to file an involuntary action, and the court relied upon Collier on Bankruptcy in concluding that the petitioning general partner should be treated as a shareholder of a corporation under the Bankruptcy Code and thus ineligible to be a petitioning partner under Section 303(b)(3). Collier on Bankruptcy takes the position that a full shield LLP should be treated as a corporation because the definition of a “corporation” under the Bankruptcy Code broadly encompasses a “partnership association organized under a law that makes only the capital subscribed responsible for the debts of the association” and because, in view of the purpose of Section 303(b)(3), which is to protect general partners who are exposed to personal liability for partnership obligations, it makes sense that Section 303(b)(3) should not be available to LLP partners. The court went on to conclude that, even if the petitioning individual was a general partner, he should be estopped to make that claim because it was clearly inconsistent with the individual’s position in prior litigation in which he claimed to be a limited partner. The court stated that the individual’s view of what type of partner he was seemed to change as his perceived interest changed, and that is precisely the situation judicial estoppel was designed to address.

II. Limited Liability Companies

A. Diversity Jurisdiction

Federal courts of appeals and district courts continue to hold that an LLC has the citizenship of each of its members for diversity jurisdiction purposes. The district court opinions to this effect are too numerous to list. A few district court opinions raising issues of particular interest are noted below. Recent opinions in which circuit courts of appeals have applied or recognized the rule that an LLC’s citizenship is determined by that of all its members include Harvey v. Grey Wolf Drilling Co., 542 F.3d 1077 (5th Cir. 2008) and Metalmark Northwest, LLC v. Stewart, No. 06-35321, 2008 WL 361039 (9th Cir. Feb. 11, 2008).

In County of Durham v. Time Warner Entertainment Advance Newhouse Partnership, No. 1:08CV225, 2008 WL 4287943 (M.D.N.C. Sept. 16, 2008), the court rejected the argument that “Series A Members” of a Delaware LLC, who exercised no management control and were treated as holders of non-voting preferred stock for federal income tax purposes, did not represent true ownership and were not members of the LLC for purposes of determining the LLC’s citizenship in this diversity case. The court stated that it was not the province of the court to analyze the “business reality” of the LLC’s structure, and the LLC agreement unambiguously specified that Series A Members together with the “Common Equity Member” constituted the “Members” of the LLC pursuant to the Delaware Limited Liability Company Act. The court also held that it was the citizenship of the entity for whose benefit the Series A interest was held that must be considered rather than the citizenship of the nominee owner.

In Bond v. Veolia Water Indianapolis, LLC, 571 F.Supp.2d 905 (S. D. Ind. 2008), the court concluded that a Delaware LLC was an “unincorporated association” under the Class Action Fairness Act provision in 28 U.S.C. § 1332(d)(10) so that its citizenship for diversity purposes is determined by the state where its principal place of business is located and the state under whose laws it is organized (i.e., in the same manner that a corporation’s citizenship is determined). The LLC argued that it was not an “unincorporated association” under Delaware law and thus should not be treated as an unincorporated association under Section 1332(d)(10). The LLC argued that its citizenship should be determined by the citizenship of each of its members under the general rule set forth for unincorporated associations by the Supreme Court in Carden v. Arkoma Associates. The court rejected the paradox presented by the LLC’s argument that an LLC is not an “unincorporated association” under Delaware law, and thus not an unincorporated association for purposes of Section 1332(d)(10), while the LLC relied on the rule in Carden, which sets forth the rule for determining
citizenship for all kinds of unincorporated associations. The court found that the LLC’s approach would prevent Section 1332(d)(10) from achieving its clear purpose. Citing the Senate committee report on the Class Action Fairness Act, the court concluded that Congress used the phrase “unincorporated association” in Section 1332(d)(10) as broadly as the Supreme Court used it in the case law. The court then applied the same test that applies to corporations to determine the location of the LLC’s principal place of business (the “nerve center” test).

In Go Fast Sports & Beverage Company v. Buckner, Civil Action No. 08-cv-01527-MSK-MJW, 2008 WL 2852626 (D. Colo. July 23, 2008), the defendants argued that the citizenship of an LLC defendant could be disregarded for purposes of diversity jurisdiction because it was administratively dissolved and could no longer be sued. The court stated that administrative dissolution of a perpetual LLC does not destroy its citizenship for diversity purposes if the LLC continues to exist under state law. The articles of organization submitted with the notice of removal stated that the LLC was a perpetual LLC that had been administratively dissolved in March 2005. At that time, Colorado law provided that an administratively dissolved LLC continues its existence but shall not carry on any business except as appropriate to wind up and liquidate its affairs. Thus, the administrative dissolution did not terminate the LLC’s existence, and the court considered its citizenship in assessing diversity jurisdiction. Because one of the LLC’s members was a Colorado citizen as well as the plaintiff, the parties were not diverse and the court lacked jurisdiction.

A federal district court addressed the effect of administrative dissolution of an Oregon corporation that was a member of a Delaware LLC in determining the citizenship of the Delaware LLC in Tri-County Metropolitan Transportation District of Oregon v. Butler Block, LLC, Civil No. 08-259-AA, 2008 WL 2037306 (D. Or. May 7, 2008). The plaintiff, an Oregon corporation, filed suit against a Delaware LLC, and the Delaware LLC sought dismissal on the basis that the court lacked diversity jurisdiction. The court held that administrative dissolution of an Oregon LLC that was a member of the Delaware LLC did not terminate the membership of the Oregon LLC in the Delaware LLC under Delaware law. The court pointed out that neither the Delaware LLC statute nor the Delaware LLC’s operating agreement permitted the Oregon LLC to withdraw. Further, the court stated that the Delaware statute does not recognize “administrative” dissolution, and the Oregon statute provides that administrative dissolution does not prevent commencement of a proceeding by or against the LLC. Thus, the court concluded that, although the Oregon LLC was administratively dissolved at the time the complaint was filed against the Delaware LLC, the Oregon LLC’s membership had not ceased and its existence as a citizen of Oregon (its sole member was an Oregon resident) continued so that complete diversity of citizenship was lacking and the court did not have subject matter jurisdiction.

In Geismann, M.D., P.C. v. Aestheticare, LLC, Civil Action No. 07-2575-KHV, 2008 WL 961272 (D. Kan. April 9, 2008), the court pointed out that, whereas Section 1332(a) requires complete diversity between all plaintiffs and all defendants, Section 1332(d), enacted as part of the Class Action Fairness Act of 2005, requires only minimal diversity, i.e., diversity between one plaintiff and one defendant, and that Section 1332(d) changes the rules governing unincorporated associations in class actions. For purposes of Section 1332(d), an unincorporated association is a citizen of the state where it has its principal place of business and under whose laws it is organized.

In Metalmark Northwest, LLC v. Stewart, Nos. 04-682-KI, Civ 05-1920-KI, 2008 WL 803011 (D. Or. March 20, 2008), the district court analyzed the citizenship of the LLC plaintiff under circumstances where one of the two members had ceased to be a member and its interest was held by an assignee. Under the terms of the plaintiff LLC’s operating agreement, the membership of a corporation that was a member of the LLC ceased upon the corporation’s administrative dissolution, and its citizenship thus was not considered for purposes of the LLC’s citizenship when determining diversity jurisdiction. Because the holder of the former member’s interest was an assignee who had not been admitted as a member under the operating agreement and Oregon LLC statute, the LLC had only one remaining member for purposes of determining citizenship.

B. Personal Jurisdiction Over Members and Managers

EBG Holdings LLC v. Vredezicht's Gravenhage 109 B.V., Civil Action No. 3184-VCP, 2008 WL 4057745 (Del. Ch. Sept. 2, 2008). A Delaware LLC sued one of its members, a Dutch LLC ("VG 109"), and the member’s parent corporation ("NIBC"), seeking a declaration that VG 109 was NIBC’s alter ego, specific performance of provisions of the LLC agreement regarding the reimbursement of tax withholding payments made on VG 109's behalf, and a declaration that VG 109's attempted transfer of its economic interest was invalid. The LLC asserted four bases for the court’s exercise of personal jurisdiction over NIBC: (1) Delaware’s long-arm statute; (2) the terms of the LLC agreement; (3) alter ego or veil piercing theories of jurisdiction; and (4) agency theory of personal jurisdiction.

The court next discussed the agency and alter ego theories of personal jurisdiction. The court identified certain common factors but explained that the scope of the alter ego theory was broader in that only the precise conduct instigated by the parent is attributable to the parent under the agency theory whereas all of the activities of the subsidiary are attributable to the parent under the alter ego theory. Drawing all inferences in favor of the LLC, the court found that the actions of VG 109 did not provide a sufficient basis for the exercise of jurisdiction under the long-arm statute.
arguments for disregarding the separate existence of VG 109 and its parent corporation and concluded that the LLC had not made a sufficient showing of fraud or other inequity to disregard the corporate form. The court pointed out that the fraud or injustice must stem from an inequitable use of the corporate form itself, not merely from the underlying cause of action for breach of contract. A conclusory statement in the complaint that NIBC knowingly used VG 109 as an instrument to shield itself from liability for tax obligations related to ownership in the LLC was insufficient to support a reasonable inference that NIBC’s use of VG 109’s limited liability status was fraudulent or inequitable. There also was no showing that VG 109’s capitalization was so minimal as to prove it was a sham entity. The court also stated that the LLC’s inability to sue NIBC in Delaware for taxes due from VG 109 did not create the requisite inequity.


King v. Hawgwild Air, LLC, Civil Action No. 3:08-CV-0153-L, 2008 WL 2620099 (N.D. Tex. June 27, 2008) (examining activities of Arkansas LLC and holding that LLC was not subject to general or specific jurisdiction in Texas, looking to partnership law for guidance as to whether to attribute member’s contacts to LLC and concluding that member’s unrelated contacts with Texas could not be attributed to LLC to establish general jurisdiction).

Autumn Cashmere, Inc. v. IMMA, L.L.C., No. 08-CV-11593, 2008 WL 2478322 (E.D. Mich. June 17, 2008). The court stated that tortious acts committed by the sole member and officer of an LLC could be imputed to the LLC for purposes of personal jurisdiction because the New York LLC law states that “every member is an agent of the limited liability company for the purpose of its business, and the act of every member ... binds the limited liability company.” The court acknowledged that an LLC can escape liability for the acts of managers and members if the member or manager in fact has no authority to act, but the court found that the sole member and officer’s alleged complete control over the LLC vitiated that argument, and the court was convinced by the plaintiff’s alter ego argument for purposes of imputing the acts of the member to the LLC.

Renaissance Health Publishing, LLC v. Resveratrol Partners, LLC, 982 So.2d 739 (Fla. App. 2008) (holding Nevada LLC and its president who used interactive web site to sell products to Florida residents and disparage products of competitor whose headquarters were located in Florida were subject to personal jurisdiction in Florida).

Town of West Hartford v. Taubman Centers, Inc., Nos. X02UWYCV075007876S, X02UWYCV075007877S, 2008 WL 2252494 (Conn. Super. May 9, 2008) (holding that corporation’s ownership of partnership interest in limited partnership that owned partnership interest in partnership that owned membership interest in LLC that owned retail mall in Connecticut was insufficient to subject corporation to personal jurisdiction in Connecticut).

Mayville v. Glatkowski, Civil File Action No. 1:08-CV-232-TWT, 2008 WL 2037155 (N.D. Ga. May 8, 2008) (holding that defendant members of Tennessee LLCs were subject to personal jurisdiction in Georgia notwithstanding they had no physical presence in Georgia where they contacted plaintiff at her Georgia residence to induce her to purchase Tennessee land and where allegations included intentional fraud, but dismissing for improper venue since plaintiff’s residence in Georgia was sole connection of forum to transaction).

Fisk Ventures, LLC v. Segal, Civil Action No. 3017-CC, 2008 WL 1961156 (Del. Ch. May 7, 2008). Disagreements between the members of two classes of membership interest in a Delaware LLC led to a deadlock, and one of the Class B members filed a petition for dissolution. Segal, a Class A member who was the LLC’s founding member, president, and sole officer, filed counterclaims and third-party claims against the Class B members. Johnson, a Class B member, filed a motion to dismiss Segal’s claims against him for lack of personal jurisdiction, and the other Class B members filed a motion to dismiss Segal’s counterclaims and third-party claims for failure to state a claim. The court granted Johnson’s motion to dismiss for lack of personal jurisdiction as well as the motion of the other Class B members to dismiss Segal’s claims for failure to state a claim. Segal argued that Johnson was subject to the court’s jurisdiction under the Delaware long arm statute because Johnson had insisted, as a condition to investing in the LLC, that the LLC be formed under Delaware law and that its governing contracts utilize Delaware law. Also, Johnson had attended some board meetings and had appeared in TV advertising broadcast in Delaware. Segal’s claims against
Johnson, however, did not arise from or have any nexus with these contacts. In addition, the court found that Johnson was not a de facto manager and did not otherwise materially participate in the management of the LLC for purposes of the consent to jurisdiction provision of the Delaware LLC statute (which applies to managers of LLCs or those who “participate[ ] materially in the management” of the LLC). The statute explicitly distinguishes between managers and the people who appoint them, by specifying that the power to elect or otherwise select or to participate in the election or selection of a person to be a manager is not by itself participation in the management of the LLC. The court said that occasionally conferring with the representatives to the board elected by Johnson did not constitute material participation in the management of the LLC. Further, the fact that Johnson had rights as a member under the LLC agreement to affect the activities of the LLC through his representatives to the board did not mean that he was participating materially in the management of the LLC.

**American General Life Insurance Company v. Margolis Family 1, LLC**, Civil Action No. 1:07-CV-0230-JEC, 2008 WL 857436 (N.D. Ga. March 28, 2008) (finding that court had personal jurisdiction over individual who obtained Georgia insurance policy, formed Georgia LLC for purpose of paying premiums on policy, agreed to assist LLC in financing payment of life insurance policy, and entered financing agreement with another Georgia LLC to fund premium payments).

**Gonzalez v. Lehtinen**, No. 13-06-441-CV, 2008 WL 668600 (Tex. App. March 13, 2008) (noting difference between “jurisdictional veil piercing” and veil piercing for purpose of imposing liability, stating that certain issues such as fraud and undercapitalization are not assessed in jurisdictional veil piercing analysis, and concluding that Mexican citizen who was managing member of Texas LLC controlled internal business operations to such degree that individual was LLC’s alter ego for personal jurisdiction purposes).

**Venezia Amos, LLC v. Favret**, No. 3:07cv146/MCR, 2008 WL 410163 (N.D. Fla. Feb. 12, 2008). The plaintiff sued an LLC and its managing member for federal securities fraud in connection with the plaintiff’s purchase of a 40% interest in the LLC. The defendants argued that the court lacked personal jurisdiction over them. The court determined that F & F Developers, LLC (F & F), a Louisiana LLC, and its managing member (Favret), a Mississippi resident, were subject to the court’s specific and general jurisdiction. Favret owned a majority interest in F & F, which in turn owned 50% of Venezia Resort, LLC, a Mississippi LLC engaged in developing residential resort condominiums in Biloxi, Mississippi. Venezia Resort maintained an office in Florida and conducted extensive business there. Favret was the managing member of F & F, and the court found that Favret served as the agent of F & F in connection with Venezia Resort business. Favret was also the managing member of Venezia Resort. Favret attended numerous membership and operations meetings of Venezia Resort in his individual capacity, as the majority interest owner of F & F, as the agent of F & F, and as the managing member of Venezia Resort. Based on these meetings and other activities of Favret in Florida, individually and on behalf of F & F, the court concluded that there was a basis for the exercise of specific and general jurisdiction over both F & F and Favret.

**Wachovia Securities, LLC v. NOLA, LLC**, 248 F.R.D. 544 (N.D. Ill. 2008) (concluding court lacked jurisdictional power to issue sanctions against LLC member who failed to appear for deposition as designated LLC representative because personal jurisdiction does not automatically extend to members of LLC, but ordering LLC to produce for deposition its manager over whom court had jurisdiction since LLC had made previous designation of its representative in bad faith).

**M-R Logistics, LLC v. Riverside Rail, LLC**, 537 F.Supp.2d 269 (D. Mass. 2008) (applying principles regarding jurisdiction over corporate officers and holding that nonresident managing member and authorized agent of New Jersey based LLC were not subject to personal jurisdiction in breach of contract action, though LLC was subject to court’s jurisdiction, where there was no evidence that they gained any personal benefit or acted outside their employment, or that they were the alter egos of the LLC, or that they actually personally guaranteed the contract).

C. **Service of Process**

**Mobilevision Imaging Services, L.L.C. v. Lifecare Hospitals of North Texas**, 260 S.W.3d 561 (Tex. App. 2008) (reversing default judgment against foreign LLC because plaintiff did not plead facts necessary to show that Texas
Secretary of State was LLC’s agent for service of process under long-arm statute and nothing in record established strict compliance required under statute).

*Trini Realty Corp. v. Fulton Center LLC*, 861 N.Y.S.2d 743 (App. Div. 2d Dept. 2008) (holding LLC’s mere denial of receipt of summons and complaint was insufficient to rebut presumption of proper service created by affidavit regarding service by delivery of summons and complaint to Secretary of State).

*DeJesus v. CC720, LLC*, No. 6:08-cv-11-Orl-31DAB, 2008 WL 2856631 (M.D. Fla. July 22, 2008) (denying plaintiff’s motion for default judgment against LLC because plaintiff failed to cite any service of process statute regarding propriety of service, noting that it was clear that plaintiff’s counsel did not consult Division of Corporation’s website to learn identity of LLC’s managing members or correct address, and admonishing plaintiff that motions for entry of default judgment must analyze appropriate Florida service of process statutes applicable to type of entity against whom judgment is sought).

*Downey v. 610 Morrison Road, LLC*, No. 07AP-903, 2008 WL 2751214 (Ohio App. July 15, 2008) (discussing Ohio service of process provisions, commenting that LLC is neither corporation nor partnership under Ohio law, stating that procedure for serving “unincorporated associations” does not necessarily include LLCs, and noting that, while procedural rule provides specific methods of service for corporations, partnerships, and other entities, no specific method of service has been created for LLCs).

*Manzella v. Dorsey*, 258 S.W.3d 501 (Mo. App. 2008) (holding trial court did not err in quashing service or process on legal assistant of law firm LLC where statute provides for service of process on LLC by serving authorized person in lieu of registered agent and legal assistant swore in affidavit that she was not authorized agent to receive service of process for law firm LLC).


*Roylance v. ADT Security Services, Inc.*, No. C 08-1101 JF (RS), 2008 WL 2444795 (N.D. Cal. June 16, 2008) (stating that agents of LLCs appear to fall within broad catchall provision of service of process statute that includes among others, agents of corporations, agents of unincorporated associations, public entities, and any “person not otherwise specified in this article” and that agents of LLCs may be served pursuant to such statute even though not expressly listed “as are agents of corporations and unincorporated associations”).

*RJM Aviation Associates, Inc. v. GP Aviation Services, LLC*, No. 3:06-CV-2007 (CFD), 2008 WL 918538 (D. Conn. March 28, 2008) (noting that question of whether foreign LLC should be treated as partnership or corporation for purposes of Connecticut long arm statutes remains unsettled but concluding that resolution of issue was unnecessary because foreign LLC’s contractual dealings with Connecticut party satisfied standard for exercise of personal jurisdiction over foreign LLC regardless of whether LLC was treated as partnership or corporation).

*Halo Tech Holdings, Inc. v. Cooper*, Civ. No. 3:07-CV-489(AHN), 2008 WL 877156 (D. Conn. March 26, 2008) (concluding that Connecticut long arm statute applicable to foreign partnerships and voluntary associations does not apply to foreign LLCs, stating that parties did not argue that any difference existed between “limited liability company” and “limited liability corporation,” and citing case law holding that “limited liability corporation is to be treated like any other corporation for long arm purposes”).

*SS & C Technologies, Inc. v. Providence Investment Management, LLC*, 2008 WL 691702, No. 3:07 CV 484(CFD) (D. Conn. March 12, 2008) (noting unsettled nature of Connecticut law with respect to whether LLC should be treated as corporation or partnership for purposes of Connecticut long-arm statutes, but stating it was unnecessary to resolve question since court found it had jurisdiction under both statutes).
**Tunnard v. Simply Southern Homes, LLC**, 985 So.2d 166 (La. App. 2008) (holding that return of service of process on LLC was sufficient where it indicated service was made on LLC and citation was directed to LLC through its agent).

**Montana Professional Sports, LLC v. National Indoor Football League, LLC**, 180 P.3d 1142 (Mont. 2008) (holding that service upon individual who held herself out as person in charge of LLC’s only office was proper service on LLC).

**Tyco Fire & Security, LLC v. Hernandez Alcocer**, No. 04023127-CIV, 2005 WL 6104560 (S.D. Fla. Oct. 7, 2005) (concluding that substituted service was properly made on Texas LLC by service on individual who was designated registered agent of LLC and who was served at girlfriend’s residence in North Carolina where individual had stayed for four months before being served because such service complied with North Carolina rule permitting substituted service upon registered agent at agent’s usual place of abode).


**D. Venue**

**Advocate Financial, L.L.C. v. Parker Interests, L.L.C.**, Civil Action No. 07-757-FJP-CN, 2008 WL 2773650 (M.D. La. July 16, 2008) (noting that it is generally accepted that unincorporated business associations such as partnerships and LLCs are analogous to corporations for purposes of venue under Section 1391(a)(1)).


**E. Standing/Authority to Sue**

**Duneland Sand, Inc. v. Misch**, No. 45A03-0801-CV-15, 2008 WL 4456340 (Ind. App. Oct. 6, 2008) (affirming trial court’s dismissal of suit filed by individual on behalf of corporation and LLC on basis individual no longer owned any interest in entities because defendant had exercised option to purchase stock and units of such entities and transfer was intended to be complete upon creation of successor entity to hold assets excluded from sale of such entities).

**Out of the Box Promotions, LLC v. Koschitski**, 866 N.Y.S.2d 677 (N.Y. Sup. 2008). The plaintiff alleged that he and the defendant were each 50% members of an LLC, and the plaintiff brought a derivative suit alleging various acts of misconduct on the part of the defendant. The defendant sought dismissal on the grounds that the plaintiff was not a member and lacked standing, but the court found the documentation provided by the defendant failed to conclusively establish that the plaintiff was not a member.

**Bartfield v. Murphy**, 578 F.Supp.2d 638 (S.D.N.Y. 2008). The court applied the “direct injury” test to determine if an LLC member’s claims against the other member were direct or derivative claims. The court concluded that claims for breach of fiduciary duty (based on diversion of business and misuse of voting power) and unjust enrichment were derivative. The court stated that a claim based on failure to disclose certain material facts might support a direct suit because the duty of disclosure was owed by the defendant member to his fellow member. The court directed the plaintiff to file a more definite statement of this claim because the allegations were not sufficiently detailed for the court to conclude whether the plaintiff alleged harm for which he could directly recover.

Ladd v. Ladd Construction, LLC, No. TTDCCV074007051S, 2008 WL 4416048 (Conn. Super. Sept. 15, 2008). The plaintiff brought suit against his parents seeking dissolution of the family business, a construction company organized as an LLC and owned 50% by the father and 50% by the son. The son sought to add his mother as a defendant on the basis of allegations that she committed civil theft by writing checks on the LLC account for personal expenses. The court stated that the son made a sufficient showing that his mother was part of the controversy to support adding her as a party although the defendants opposed the motion on the grounds that the mother was not a member or manager of the LLC and any lost profits belonged to the LLC rather than the individual members. The court also allowed the son to add a claim of civil theft against the father. The defendants argued that the amendment should be rejected for lack of standing because the allegation stated a harm to the LLC, but the court held that liability of a member or manager who commits a tortious act in the course of company business extends to other members or managers who are injured. The court refused to dismiss the son’s claim against the father for unjust enrichment. The defendants argued that the son did not have standing to assert the unjust enrichment claim because the alleged harm was to the LLC, but the court again stated that a member or manager who commits a tortious act in the course of company business is personally liable to those injured, including other members.

Empire Financial Services, Inc. v. Todd, Civil Action No. 1:08-cv-226-WHA, 2008 WL 4277809 (M.D. Ala. Sept. 16, 2008) (recognizing separate existence of LLC and its members and holding judicial estoppel did not preclude LLC members from pursuing claims against LLC’s lender, though claims were not listed in LLC’s bankruptcy, because members alleged direct claims rather than claims belonging to LLC).

Stanziale v. Skiba, No. CV040412495, 2008 WL 4150302 (Conn. Super. Aug. 20, 2008). The court held that the proper plaintiff in an action to prosecute a claim against the defendant for payment on a construction contract with an LLC was the LLC. The LLC had been dissolved prior to the filing of the suit, and the two individuals who brought the suit alleged that they were authorized to wind up the business and affairs of the LLC. The court held that the LLC was clearly the proper plaintiff under the LLC statute. Authority to wind up the business and affairs of the LLC did not carry with it authority to bring suit in their own names or individual capacities. The court found that the mistake in naming the individual principals of the dissolved LLC rather than the LLC itself was an honest mistake and granted the motion to substitute the LLC as plaintiff.

Reid Pointe, LLC v. Stevens, No. 08 CVS 4304, 2008 WL 3846174 (N.C. Super. Aug. 18, 2008) (rejecting Unfair and Deceptive Trade Practices Act claims asserted by member because claims implicated only rights and interests of LLCs and thus belonged to LLCs).

546-552 West 146th Street LLC v. Arfa, 863 N.Y.S.2d 412 (App. Div. 1st Dept. 2008). LLC plaintiffs brought this action against member/managers who allegedly received commissions in connection with the purchase of real estate by the LLCs without disclosing the commissions to the LLCs or to prospective investors whose investments were used to fund the closings of the property acquisitions. The court held that the LLCs lacked standing to assert the claims because the alleged wrongdoers were the only members and managers at the time the agreements for the commissions were entered into and their acts and knowledge were thus imputed to the LLCs. (The court noted that the investors had brought a parallel action in which the question of whether the investors were wronged when their investments were solicited would be determined.) According to the court, the adverse interest exception did not apply because it arises if the principal’s interests have been totally abandoned; the exception cannot be invoked merely because the agents have a conflict of interest or are not acting primarily for the their principal. The pleadings did not allege or provide a basis for inferring that the original members and managers totally abandoned the interests of the LLC because they accomplished the LLCs’ main purpose of acquiring the properties. Further, the court held that application of the adverse interest exception would be barred in any event because the adverse interest exception does not apply if the alleged wrongdoers were, at the time of the misconduct, either the sole managers or sole owners of the plaintiff. Finally, the court rejected the argument that the defendants were liable as promoters because the challenged agreements were entered
into before formation of the LLCs and the promoters could not have then owed fiduciary obligations to the non-existent entities.

_Miceli v. KBRG of Statesville, LLC_, No. 5-05CV265-V, 2008 WL 2945451 (W. D.N.C. July 24, 2008) (holding that dissolution of defendant LLC did not destroy its standing to defend action under North Carolina law as part of winding up process).

_Lake State Federal Credit Union v. Tretsven_, No. A07-1542, 2008 WL 2732111 (Minn. App. July 15, 2008) (holding individual member of LLC named as mortgagee but not formed until after mortgage was executed lacked standing to pursue appeal of case involving rights to property under mortgage because LLC statute provides that member is not proper party to proceeding by or against LLC unless proceeding involves member’s right against or liability to LLC or unless proceeding involves claim of personal responsibility of member and claim has some basis other than member’s status as member; administrative termination of LLC did not affect court’s holding that individual lacked standing to pursue appeal based on mortgage naming LLC as mortgagee because, while member of terminated LLC is permitted to bring or defend claim on LLC’s behalf, claim must be brought in LLC’s name).

_Blair v. McDonagh_, 894 N.E.2d 377 (Ohio App. 2008). Blair and McDonagh formed an LLC to operate Irish pub restaurants. Disputes developed, and litigation the members asserted against each other various claims, including claims for breach of contract and breach of fiduciary duty. On appeal, Blair argued that McDonagh’s breach of fiduciary duty claim was actually the LLC’s and could only be raised by the LLC. The court stated that there are circumstances under which a shareholder in a close corporation may bring an individual action, but the court found it unnecessary to reach that issue because Blair never raised the issue until he filed his motion for JNOV. Further, Blair asserted his own claim for breach of fiduciary duty; therefore, under his logic he, too, should have brought the claim in the name of the LLC. Instead, he named the LLC as a defendant. He requested and relied upon the instructions on breach of fiduciary duty and related damages, and the court held that any error was invited error.

_Morris v. Hennon & Brown Properties, LLC_, No. 1:07CV780, 2008 WL 2704292 (M.D.N.C. July 3, 2008). The court discussed general fiduciary duty principles under North Carolina law and cited provisions of the North Carolina LLC statute dealing with duties of LLC managers, but declined to answer the question of “whether a co-manager of an LLC in North Carolina, nothing else appearing, stands in a fiduciary relationship to the members of the LLC.” The court stated that this was an unanswered question involving North Carolina law that should be avoided by a federal court if possible. Thus, the court first addressed the standing of the defendant investor to assert its breach of fiduciary duty counterclaims against the plaintiff, one of several managers of LLCs in which the defendant invested. The court stated that it was not necessary to “explore the depths of what might constitute fiduciary duties under the North Carolina Limited Liability Company Act” because, assuming the acts alleged breached a fiduciary duty, the question at the heart of the standing issue was to whom the duties were owed. The court analyzed the standing question by comparing the situation to a closely held corporation. The court stated that a derivative action is generally the appropriate vehicle where a shareholder or LLC member seeks to recover on behalf of the corporation or LLC. The court recognized an exception to the rule that shareholders have no right to bring actions in their own name where the wrongdoers are shareholders and directors who so control the corporation that recovery by the corporation would not protect the minority, but the court stated that the investor had not established that he was a minority member in the LLCs nor had he established that the manager he was suing was in control of the LLCs. Because the investor filed an individual action but did not show that he was specifically and particularly harmed or that any special duty was owed to him, the court concluded that he had no standing to bring a direct action.

_Maitland v. Int’l Registries, LLC_, Civil Action No. 3669-CC, 2008 WL 2440521 (Del. Ch. June 6, 2008). A 50% member of an LLC did not have authority to retain counsel for the LLC defendant in a case brought by the other 50% member where the plaintiff member did not consent to hiring counsel. The LLC agreement vested management in the members and provided that the decision of the members holding a majority of all interests shall be controlling. The LLC agreement also provided that the initial members were granted all rights, powers, authorities, and authorizations necessary, appropriate, advisable, and convenient to manage the LLC and carry out its affairs, but the court rejected the argument that this latter provision gave one member the power to retain counsel and file an answer for the LLC because such an interpretation would also give the other member the same authority. Since a deadlocked LLC cannot validly
retain counsel and file an answer, the court granted the plaintiff member’s motion to strike the answer filed by counsel retained by the other member and disqualify the attorney as counsel for the LLC, but the court permitted the other member to intervene as a party defendant to defend on behalf of the LLC.

_Wasko v. Farley_, 947 A.2d 978 (Conn. App. 2008). The court held that an individual member of an LLC did not have standing to sue in her individual capacity for damages incurred by her LLC when it was forced to hire an additional dental assistant as a result of injuries suffered by the individual member. Thus, the trial court properly declined to instruct the jury on damages resulting from additional costs incurred by the plaintiff’s LLC in an action brought by the plaintiff in her individual capacity.

_Hampton Island Founders v. Liberty Capital_, 658 S.E.2d 619 (Ga. 2008). An LLC that owned land (Hampton Island Founders LLC or “Founders”) and an LLC that was to secure financing (Liberty Capital LLC or “Capital”) formed an LLC (Hampton Island LLC or “Joint Venture LLC”) for developing the land into a residential retreat. Founders contributed the land to Joint Venture LLC in exchange for a 40% interest, and Capital committed to secure a certain amount of financing in exchange for a 60% interest. Hampton Island Management Inc. (“HIMI”) was the manager of Joint Venture LLC. If Capital did not obtain the specified level of funding, its interest was to be reduced to 10%, and Founders interest would increase to 90%. When Capital’s deadline for securing financing passed without its securing the specified level of funding, Shealy, the individual who formed and originally controlled Founders’ four members, declared Capital in default and took steps to terminate Joint Venture LLC’s relationship with HIMI and name himself as sole manager of Joint Venture LLC. Founders then brought suit against Capital and others seeking a declaration that Capital did not meet its obligation and an injunction prohibiting Capital from exercising any control of Joint Venture LLC. The defendants filed a motion for injunctive relief to maintain the status quo, and the court issued a temporary injunction decreeing that HIMI was the sole manager of Joint Venture LLC and that neither Shealy nor Founders were to manage Joint Venture LLC or claim that any other entity was the manager. Subsequently, the court permitted two of Founders’ member entities, as well as investors in Founders’ member entities, to intervene, and the intervenors/investors sought a mandatory injunction to allow meetings of Founders’ member entities so that a vote could be taken to determine who would manage the member entities. The intervenors/investors informed the court that, if permitted to vote, they would remove Shealy as manager of Founders’ member entities, remove him as manager of Founders, and appoint a manager of Founders who would be favorable to the defendants and cause Founders to dismiss its suit. The court granted the relief sought by the intervenors/investors. Founders appealed, and the supreme court determined that the first injunction maintaining the status quo by enabling HIMI to continue to manage Joint Venture LLC pending resolution of the lawsuit was appropriate. However, the court concluded that the second injunction permitting the vote to change management of Founders and its member entities did not balance the relative equities and was error. The court stated that denial of the injunctive relief sought by the intervenors/investors would only inconvenience them by forcing them to await the outcome of the litigation, but issuance of the injunction would result in dismissal of the plaintiff’s lawsuit without an opportunity for the plaintiff to be heard. The court also concluded that permitting intervention by Founders’ members and investors in those members was error because it was not clear how the intervenors’ ability to protect their interest (assuming they had a sufficient interest) in the transaction or subject matter of the lawsuit was impeded by the lawsuit, how it was not adequately protected by Capital and the other defendants, or why they could not pursue an independent remedy against Founders and Shealy.

_Johnson v. Booth_, 184 P.3d 289 (Mont. 2008) (holding that co-owner of corporation and LLC did not have standing to appeal appointment of receiver for corporation and LLC because claim belonged to corporation and LLC).

_Wilcox v. Webster Insurance_, N0. CV075010093S, 2008 WL 1822402 (Conn. Super. March 26, 2008) (holding that LLC members lacked standing to assert claims arising out of accident involving LLC’s dump truck against LLC’s automobile insurer because any harm suffered that was redressable under policy was traceable to their ownership in LLC).

_American Heritage, Inc. v. Nevada Gold & Casino, Inc._, 259 S.W.3d 816 (Tex. App. 2008) (holding that plaintiff had standing to sue for breach of its contract with defendant in which parties agreed to form LLC to operate casino; rejecting defendant’s argument that plaintiff must sue derivatively, explaining that party lacks standing to sue
derivatively where it has contracted with another to acquire ownership in entity but is then prevented from doing so by other’s breach of contract).

**Unidev, L.L.C. v. Housing Authority of New Orleans**, Civil Action No. -05-2649, 2008 WL 906308 (E.D. La. April 2, 2008) (holding LLC’s members did not have standing to sue for breach of construction contract entered by their LLC because they lacked contractual privity).

**Jacobs v. Baum**, No. 1:07-CV-167, 2008 WL 819037 (N.D. N.Y. March 24, 2008). The court dismissed the claims of an individual who sued “individually and d/b/a” an LLC formerly known as a corporation because an individual cannot sue “d/b/a” an LLC or corporate entity and the individual alleged no basis upon which he could individually pursue rights of the corporation or LLC. The court also dismissed the LLC’s claims on a contract to which the corporation was a party because, although an argument could be made that the LLC brought suit “formerly known as” the corporation that was the party to the contract, it is reasonable to expect plaintiffs to have knowledge and plead with precision the person, entity, and/or entities asserting a particular claim.

**Kwon v. Yun**, No. 05 Civ. 1142(GEL)(DFE), 2008 WL 190058 (S.D. N.Y. Jan. 22, 2008) (holding prima facie credible defense to dissolved Delaware LLC’s counterclaim was stated by allegation that LLC had filed certificate of cancellation because Delaware LLC is artificial entity with power to sue or be sued, and such power continues after dissolution “until the filing of a certificate of cancellation”).

**STS Gas Services, Inc. v. Seth**, No. 13-05-463-CV, 2008 WL 152229 (Tex. App. Jan. 17, 2008). Although the Texas assumed name statute states that a party shall not maintain an action arising out of a contract or act in which an assumed name was used until an assumed name certificate has been filed as required by law, and the plaintiff LLC filed suit prior to filing its assumed name certificate as required by law, the defendant failed to raise the argument in the trial court and never filed a motion to abate. Thus, the court of appeals found that the defendant waived this complaint. The court of appeals also concluded that the trial court did not err in awarding relief to Shiva Investment First, L.L.C., an assumed name of SIFCO, L.L.C., in a declaratory judgment action regarding a lease entered by an individual doing business as Shiva Investment First, L.L.C. The court pointed out that the Texas Rules of Civil Procedure permit a party to sue or be sued in its assumed name. Further, the record indicated that proper assumed name certificates were filed establishing Shiva Investment First, L.L.C. as an assumed name for SIFCO, L.L.C., and SIFCO, L.L.C. transacted business and corresponded with the defendant in its assumed name and identified itself in all pleadings as SIFCO, L.L.C. or Shiva Investment First, L.L.C. As a result, the court concluded that SIFCO, L.L.C. was a party to the lease by virtue of its assumed name, Shiva Investment First, L.L.C., and was entitled to relief.

**F. Pro Se Representation**

**Wisconsin Laborers Health Fund v. D & D Construction, LLC**, No. 08-cv-459-bbc, 2008 WL 4458148 (W.D. Wis. Sept. 30, 2008) (striking LLC’s answer because answer was not signed by licensed attorney and LLC must be represented by licensed attorney).


**Susko v. Cox Enterprises, Inc.**, Civil Action No. 5:07CV144 (STAMP), 2008 WL 4279669 (N.D.W.Va. Sept. 16, 2008) (holding LLC cannot appear pro se or represent itself through or by its officers).

**United States v. Hagerman**, 545 F.3d 579 (7th Cir. 2008) (holding that LLC can only litigate if represented by attorney).

**United States v. Flaherty**, 540 F.3d 89 (2d Cir. 2008) (noting that sole member of LLC may not represent LLC in court).


CIT Group/Commercial Services, Inc. v. Crystal Springs Apparel, LLC, No. 2:08-cv-00113-FDW, 2008 WL 2484512 (W.D. N.C. June 17, 2008) (entering default judgment against LLC because LLC failed to retain counsel and LLC may only appear in federal court through licensed counsel).

Rice v. Don Peck's Transportation LLC, No. 08-0051-DRH, 2008 WL 2224903 (S.D. Ill. May 27, 2008) (stating that LLC may appear in court only through licensed attorney).


Landmark American Insurance Company v. Green Lantern Roadhouse LLC, No. 07-cv-05350MJR, 2008 WL 2157168 (S.D. Ill. May 21, 2008). A default judgment against an LLC was entered after its pro se motion for extension of time to answer was stricken because an LLC may only appear through licensed counsel. Good cause existed for setting aside the default judgment where the action was still in early stages, the managing member mistakenly believed he could represent the LLC pro se and, when informed he must hire counsel, counsel was hired and appeared.

SNET Information Serv. v. Photopros Studio, LLC, No. CV0706001104S, 2008 WL 979937 (Conn. Super. March 19, 2008) (noting that rule prohibiting unlicensed individual from appearing on behalf of corporation or partnership has been applied to LLCs, but holding sole member of LLC may appear on behalf of LLC because it is “his own cause”).


State v. Liberty Bail Bonds, No. 1 CA-CV 06-0769, 2008 WL 4095513 (Ariz. App. Jan. 24, 2008) (noting that Arizona Supreme Court appears to treat corporations and LLCs similarly with regard to unauthorized practice of law and holding that trial court did not err in precluding LLC’s owner, who was not licensed attorney, from representing LLC).

G. Derivative Suits

Out of the Box Promotions, LLC v. Koschitski, 866 N.Y.S.2d 677 (N.Y. Sup. 2008). The plaintiff alleged that he and the defendant were each 50% members of an LLC, and the plaintiff brought a derivative suit alleging various acts of misconduct on the part of the defendant. The defendant sought dismissal on the grounds that the plaintiff was not a member and lacked standing, but the court found the documentation provided by the defendant failed to conclusively establish that the plaintiff was not a member.

Bartfield v. Murphy, 578 F.Supp.2d 638 (S.D.N.Y. 2008). The court applied the “direct injury” test to determine if an LLC member’s claims against the other member were direct or derivative claims. The court concluded that claims for breach of fiduciary duty (based on diversion of business and misuse of voting power) and unjust enrichment were derivative. The court stated that a claim based on failure to disclose certain material facts might support a direct suit because the duty of disclosure was owed by the defendant member to his fellow member. The court directed the plaintiff to file a more definite statement of this claim because the allegations were not sufficiently detailed for the court to conclude whether the plaintiff alleged harm for which he could directly recover. The court held that the LLC was a necessary party with respect to the derivative claims raised on its behalf, but its joinder would destroy diversity and thus the derivative claims had to be dismissed.
issu e before it as whether the complaint alleged with particularity that a majority of the directors knowingly engaged in that they had "actual or constructive knowledge" that their conduct was legally improper. The court characterized the threat of liability may only be found to exist if the plaintiff pleads with particularity a non-exculpated claim. Thus, the court stated that, where directors are contractually or otherwise exculpated from liability, a serious and fair dealing. The court characterized the instructions on breach of fiduciary duty and related damages, and the court held that any error was invited error.

Charles O. Bradley Trust v. Zenith Capital LLC, No. C 04-02239 JSW, 2008 WL 3400340 (N.D. Cal. Aug. 11, 2008) (commenting that principles in corporate case law for characterizing action as derivative are applicable to corporations and LLCs and are equally applicable to limited partnerships).

Pravak v. Meyer Eye Group, PLC, No. 07-2433-JPM-dkv, 2008 WL 2951101 (W.D. Tenn. July 25, 2008) (declining to dismiss claims for declaratory and injunctive relief, which defendants alleged could only be brought derivatively, because allegations appeared to comply with procedural requirements for derivative actions).

Blair v. McDonagh, 894 N.E.2d 377 (Ohio App. 2008). Blair and McDonagh formed an LLC to operate Irish pub restaurants. Disputes developed, and litigation between the members ensued. The members asserted against each other various claims, including claims for breach of contract and breach of fiduciary duty. On appeal, Blair argued that McDonagh’s breach of fiduciary duty claim was actually the LLC’s and could only be raised by the LLC. The court stated that there are circumstances under which a shareholder in a close corporation may bring an individual action, but the court found it unnecessary to reach that issue because Blair never raised the issue until he filed his motion for JNOV. Further, Blair asserted his own claim for breach of fiduciary duty; therefore, under his logic he, too, should have brought the claim in the name of the LLC. Instead, he named the LLC as a defendant. He requested and relied upon the instructions on breach of fiduciary duty and related damages, and the court held that any error was invited error.

Wood v. Baum, 953 A.2d 136 (Del. 2008). The plaintiff brought a derivative suit against the members of the board of a Delaware LLC alleging breach of fiduciary duty claims based on alleged improper valuation of certain non-performing assets, improper charitable contributions, related party transactions, and failure to maintain accounting and monitoring controls and procedures. The court of chancery dismissed the complaint for failure to allege particularized facts sufficient to establish that demand on the board would have been futile. The Delaware Supreme Court stated that the test set forth in Aronson v. Lewis applies when it is alleged that directors made a conscious business decision in breach of their fiduciary duties, and the test in Rales v. Blasband applies when the subject of the derivative suit is a violation of the board’s oversight duties. The plaintiff attempted to create a “reasonable doubt” that the board would have properly exercised its business judgment by alleging that the board was disabled because of a substantial risk of personal liability. In evaluating that claim, the court stated that the exculpation clause in the LLC’s operating agreement must be kept in mind. Under the operating agreement and the Delaware LLC statute, the directors’ liability was limited to claims of “fraudulent or illegal conduct” or “bad faith violation[s] of the implied contractual covenant of good faith and fair dealing.” The court stated that, where directors are contractually or otherwise exculpated from liability, a serious threat of liability may only be found to exist if the plaintiff pleads with particularity a non-exculpated claim. Thus, the plaintiff in this case was required to plead particularized facts demonstrating that the directors acted with scienter, i.e., that they had “actual or constructive knowledge” that their conduct was legally improper. The court characterized the issue before it as whether the complaint alleged with particularity that a majority of the directors knowingly engaged in “fraudulent” or “illegal” conduct or breached “in bad faith” the covenant of good faith and fair dealing. The court
concluded that the plaintiff failed to meet this pleading burden. The plaintiff did not plead with particularity any claim based on fraudulent conduct. Although the complaint alleged many violations of securities and tax laws, the complaint did not allege with particularity that the directors knowingly engaged in such conduct or that they knew such conduct was illegal. The court rejected the plaintiff’s argument that such knowledge should be inferred from the fact that the transactions had to be authorized by the board and because they were related party transactions. The court stated that Delaware law is clear that board approval of a transaction, even one that turns out to be improper, is not alone enough to infer culpable knowledge or bad faith. The court also stated that the plaintiff’s assertion that membership on the audit committee is a sufficient basis to infer the requisite scienter was contrary to well-settled Delaware law. The court distinguished a “bad faith violation of the implied contractual covenant of good faith and fair dealing” from the fiduciary duty breaches asserted by the plaintiff, and concluded that the complaint did not allege any contractual claims, let alone a “bad faith” breach of the implied contractual covenant of good faith and fair dealing. The court commented that the failure to allege with particularity any facts from which particular directors’ knowledge of accounting irregularities may be inferred is frequently compounded by a failure to make a statutory books and records request, and the court noted that the plaintiff in this case chose not to make a books and records request. In sum, the court concluded that, given the broad exculpation provision in the operating agreement, the plaintiff’s factual allegations were insufficient to establish demand futility.

_Hague v. Rica_, 2008 WL 2329897 (N.J. Super. A.D. June 9, 2008) (holding that trial court properly dismissed LLC member’s third party complaint because it alleged injury of LLC and no special injury suffered by members; recognizing principle that court has discretion to treat derivative claim as direct in context of closely held corporation, but concluding trial court correctly exercised discretion in declining to treat member’s claims as individual claims since member had no greater right to monies wrongfully taken than other members such as plaintiffs who brought principal derivative action).

_Stokes v. Rodda_, No. 60142-3-I, 2008 WL 2174434 (Wash. App. May 27, 2008). The court determined that Stokes, a member who had been forced out of a professional LLC by her co-member, Chamberlain, was not a “fair and adequate” representative of the LLC in a derivative suit filed by Stokes against an attorney who had assisted Chamberlain in forcing Stokes out and transferring the LLC’s anesthesiology contract with a hospital to another entity. Stokes had previously sued Chamberlain and the LLC of which she was a member for wrongful termination and had brought derivative claims against Chamberlain, his new LLC, and his co-member in the new LLC. The court stated that Stokes was inimical to the interests of the LLC and Chamberlain as evidenced by her prior lawsuit against them for wrongful termination. The court pointed out that her hostility was rooted in the same transactions that gave rise to her derivative claim against the attorney and stated that Stokes could not point to anyone other than herself who could benefit from a finding that the hospital contract should have stayed with the LLC. The court concluded that her personal antagonism made it unlikely that she would scrupulously keep the interests of Chamberlain and the LLC in mind if allowed to pursue the derivative litigation. The court also stated that Stokes was not able to articulate a coherent theory explaining how the LLC was harmed in any practical sense by losing the hospital contract and characterized her lawsuit as vexatious rather than meritorious. The court did not rule out the possibility that one member of a two-member LLC could responsibly serve as derivative plaintiff to safeguard the LLC’s interest in a proper case, but the court stated that there were no facts in this case supporting a determination that Stokes would be either “fair” or “adequate” in her representation of the LLC in this case.

_Stokes v. Anesthesia Associates of Monroe, PLLC_, No. 59304-8-I, 2008 WL 2174419 (Wash. App. May 27, 2008). After the plaintiff was forced out of a professional LLC by her co-member, she sued the LLC for wrongfully excluding her. Later she amended her complaint to add derivative claims against her co-member, his new LLC, and his new co-member. The court concluded that the plaintiff could not fairly and adequately represent the interests to be benefitted by her derivative claims. The court stated that the plaintiff could not identify any economic interest of her own or any economic benefit to the LLC or its other member that would be served by continuing the derivative litigation. The plaintiff had sued the LLC and her co-member for wrongful termination, making it unlikely that she would scrupulously keep their interests in mind if permitted to continue the derivative litigation. Additionally, the court stated that the jury’s verdict awarding her damages for wrongful termination was a finding that she was no longer a member at the time she was terminated. Thus, the court concluded that the plaintiff lacked standing for the additional reason that she was not a member at the time the derivative action was commenced.
Regions Bank v. Regional Property Development Corporation, No. 07 CVS 12469, 2008 WL 1836657 (N.C. Super. April 21, 2008). An LLC member asserted claims against the LLC’s lender for breach of contract, breach of fiduciary duty, and aiding and abetting breach of fiduciary duty in connection with the lender’s sale of the LLC’s note to the three other members of the LLC. The court concluded that the member did not have standing to bring the claim. The court stated that the rules regarding shareholder derivative actions apply as well to members of an LLC and that the member could not bring an individual cause of action for wrongs or injuries to the LLC. The LLC was composed of four members, and the member who asserted the claim did not allege that it held a minority interest; thus, the court said it could not be said that the other members owed a special duty arising solely from their control of the LLC. The complaining member alleged that the other members, with the assistance of the lender, leveraged their control over the loan to force the complaining member to agree to allow the LLC to make distributions to the other members that were not otherwise due, but a claim that distributions were unlawfully made is just another way of saying that assets were wrongfully diverted, which is a claim that would belong to the LLC and not a member.

Trivedi v. Pathak, Civil Action No. 3:08CV3-HEH, 2008 WL 1758913 (E. D. Va. April 16, 2008) (holding that fraud and mismanagement claims asserted by 2% member of Virginia LLC belonged to LLC itself and that appropriate action was thus derivative action in which LLC was necessary party that would destroy diversity of citizenship).


East Quogue Jet, LLC v. East Quogue Members, LLC, 857 N.Y.S.2d 627 (N.Y. A.D. 2 Dept. 2008) (concluding lower court should have granted summary judgment dismissing derivative claims against managing member for waste and mismanagement because, although members may bring derivative actions, conduct as managing member was consistent with obligations under LLC operating agreement and statute and plaintiffs failed to raise issue of triable fact).

Madelone v. Whitten, 18 Misc.3d 1131, No. 9929-07, 2008 WL 399175 (N.Y. Sup. 2008) (noting that argument that New York does not permit LLC member to bring derivative action is foreclosed by Tzolis v. Wolff, in which New York Court of Appeals held that LLC members may bring derivative suits notwithstanding lack of provisions in LLC statute expressly authorizing such suits).

Crouse v. Mineo, 658 S.E.2d 33 (N.C. App. 2008). The court discussed the agency and management provisions of the North Carolina LLC statute and concluded that the plaintiff, a member/manager of an LLC, did not have authority to file this action on behalf of the LLC against his co-member/manager based on alleged misappropriation of LLC assets, but the plaintiff did have standing to file a derivative action. The court found that the plaintiff satisfied the requirement that he allege with particularity the efforts made to obtain the desired action by the LLC and the reason for failure to obtain the action. The court concluded that the plaintiff’s claims for breach of fiduciary duty related to his relationship with his co-member through the LLC and did not state an individual claim for unfair and deceptive trade practices.

Segal v. Cooper, 856 N.Y.S.2d 12 (N.Y. A.D. 1 Dept. 2008) (stating that plaintiff in derivative unjust enrichment action alleged with sufficient particularity that majority of controlling members of LLC were interested in challenged transaction and that demand would thus have been futile).

Kira Inc. v. All Star Maintenance Inc., 267 Fed.Appx. 352, 2008 WL 510508 (5th Cir. 2008). A minority member of a Nevada LLC brought a derivative suit against the other two members of the LLC. The plaintiff asserted various claims based on the alleged improper use by the defendant members of the LLC’s name and the payment of management fees to affiliates of the defendants. The plaintiff argued that the district court erred in denying its motion to disqualify defense counsel due to conflicts in representing the LLC and the defendant members accused of harming the LLC’s interests. The court stated that any conflicts asserted by the plaintiff were more theoretical than real. All members were parties to the action, and the plaintiff was the only party who stood to benefit from a plaintiff’s verdict. The court could not imagine any remedy that could have been obtained by the LLC that would have been different from
a remedy in favor of the plaintiff and saw no purpose that would have been served by independent counsel for the LLC in this case. Thus, the court held that the district court did not abuse its discretion in denying the motion to disqualify.

Parsons & Whittemore Enterprises Corporation v. Cello Energy, LLC, Civil Action No. 07-0743-CG-B, 2008 WL 227952 (S.D. Ala. Jan. 25, 2008). The plaintiff entered certain agreements with an Alabama LLC regarding the use and development of technology and under which plaintiff obtained an option to acquire an interest in Alabama LLC. The plaintiff sued the LLC and other parties to prevent them from taking actions and performing under agreements in conflict with plaintiff’s agreements with the LLC. The court concluded that the plaintiff was not a member of the LLC because it was not listed as a member in either the LLC’s articles of organization or operating agreement, and a member is defined in the Alabama LLC statute as a person reflected in the LLC’s required records as an owner of some governance rights of a membership interest. The LLC sought dismissal of the lawsuit on the basis that the action was a derivative action and the plaintiff was not a member with standing to bring such an action under the Alabama LLC statute. The court declined to dismiss the action because it was not a lawsuit brought by a member to recover in the right an LLC, but a lawsuit by a non-member to prevent the LLC and other defendants from interfering with the contractual rights of the plaintiff under its agreements with the LLC.

H. Necessary Parties

Goldberg v. Stelmach, No. B199830, 2008 WL 4428650 (Cal. App. 2 Dist. Oct. 2, 2008). The court concluded that the plaintiff’s breach of fiduciary duty action based on an LLC’s failure to distribute funds to the plaintiff was not barred by res judicata because the plaintiff’s claim was based on a refusal to distribute funds and provide an accounting after funds interpled in a prior suit were returned to the LLC. The court also determined that the LLC was not a necessary party to the suit because the plaintiff sought recovery of damages not from the LLC, but from the LLC’s manager/agent (REM, LLC or “REM”) and the individual (Stelmach) who served as manager/agent of REM. Under the California LLC statute, REM, as the manager of the LLC, owed the same fiduciary duties to the LLC and to the plaintiff and other members of the LLC as a partner owes to a partnership and the partners. Further, REM, as manager of the LLC was an agent of the LLC and was liable for its own torts even though it had no liability solely by reason of being manager of the LLC. The plaintiff also alleged that Stelmach, the sole member and manager of REM, was liable as the alter ego of REM. Because the plaintiff did not seek recovery from the LLC, but instead sought to recover from the LLC’s manager/agent and the manager/agent’s alleged alter ego, the court concluded that the LLC was not a necessary party. The court distinguished claims made by the plaintiff involving other entities managed by REM and held that these entities were necessary parties.

Barfield v. Murphy, 578 F.Supp.2d 638 (S.D.N.Y. 2008). The court held that an LLC was a necessary party with respect to the derivative claims raised on its behalf, but its joinder would destroy diversity and thus the derivative claims had to be dismissed. The court also found that the LLC was indispensable to the plaintiff’s claim for declaratory judgment regarding rights of the members with respect to the LLC’s diverted business. Thus, the claim for declaratory relief also had to be dismissed.

Beane v. Beane, Civil No. 06-cv-446-Sm, 2008 WL 1787105 (D. N.H. April 18, 2008) (holding LLC plaintiff whose rights were being asserted was necessary and indispensable party and not merely nominal plaintiff whose citizenship could be disregarded for diversity purposes, and commenting that if there was any nominal party it was individual member who brought action personally and on LLC’s behalf).

I. Scope of Discovery

Maitland v. Int’l Registries, LLC, Civil Action No. 3669-CC, 2008 WL 2440521 (Del. Ch. June 6, 2008). The court denied the motion of the plaintiff, a member of an LLC, for commission requesting documents and deposition testimony from the outside auditor of the LLC. The court stated that the action at its core was an action for inspection of LLC books and records and that granting the motion for commission would effectively give the plaintiff member the relief he sought. The court stated that the plaintiff could not use the discovery process in a books and records case to gain access to the books and records ultimately at issue.
**Advanced Arm Dynamics of New England, LLC v. Comprehensive Prosthetics Services, LLC**, No. CV065004605S, 2008 WL 2502307 (Conn. Super. May 30, 2008) (denying motion to compel out-of-state resident who was president and majority owner of corporate member of LLC plaintiff to appear in state for deposition because there was no showing that individual was “managing agent” of LLC plaintiff).

**Capco Properties, LLC v. Monterey Gardens of Pinecrest Condominium**, 982 So.2d 1211 (Fla. App. 2008). The plaintiff sought discovery of financial records of an LLC in an action involving various claims against the LLC and its members, including a fraudulent transfer claim premised on the belief that the LLC had made cash distributions to its members rendering the LLC insolvent. The court concluded that the information was not discoverable because it was not relevant and would not lead to discovery of relevant information. A dissenting opinion argued that the majority’s conclusion ignored the relevance of the requested information to plaintiff’s claim regarding improper distributions.

**City of Seattle v. Professional Basketball Club, LLC**, No. CO7-1620MJP, 2008 WL 539809 (W.D. Wash. Feb. 25, 2008) (ordering LLC to produce certain email messages of members because emails of members were documents under “possession, custody, or control” of LLC by virtue of agency status of members).

**J. Arbitration**

**Andrews v. Ford**, 990 So.2d 820 (Miss. App. 2008). After one of the members of an LLC died, the deceased member’s administratrix brought suit against the remaining member for breach of contract and specific performance of a buy-sell agreement. The court construed the LLC operating agreement and buy-sell agreement between the members as part of the same transaction because the agreements were executed on the same date and the buy-sell agreement was referred to in the operating agreement. The court concluded, however, that the dispute between the deceased member’s estate and remaining member was not within the scope of the arbitration clause in the operating agreement because the deceased member’s estate was not a “member” under the operating agreement and the arbitration clause only encompassed disputes among members.

**Durina v. Filtroil**, No. 07 CO 24, 2008 WL 4307892 (Ohio App. Sept. 18, 2008). A member of a Nevada LLC filed an action seeking judicial dissolution and asserting various other causes of action. The trial court determined that it lacked jurisdiction to dissolve the Nevada LLC, and the court stayed the action on the remaining claims because the LLC’s regulations required arbitration of disputes between members. The court reviewed the arbitration clause in the LLC regulations and concluded that it encompassed the claims asserted in the case. The court found no indication that there was a delay in asserting the right to arbitration.

**Ladd v. Ladd Construction, LLC**, No. TTDCV074007051S, 2008 WL 4416048 (Conn. Super. Sept. 15, 2008). The plaintiff brought suit against his parents asserting various claims against them and seeking dissolution of the family business, a construction company organized as an LLC and owned 50% by the father and 50% by the son. The son sought to add his mother as a defendant on the basis of allegations that she committed civil theft by writing checks on the LLC account for personal expenses. The court stated that the son made a sufficient showing that his mother was part of the controversy to support adding her as a party. The defendants sought dismissal of the lawsuit based on an arbitration provision in the operating agreement. The arbitration provision named the mother as arbitrator in the event of a deadlock. The court declined to send the matter to arbitration before the mother because the court had allowed the mother to be sued and she thus had a direct interest in the outcome of the matter.


**Savanna Investors, LLC v. Vaughn**, No. X08CV084012896S, 2008 WL 4021333 (Conn. Super. July 30, 2008) (concluding that plaintiff failed to establish case presented extraordinary situation calling for judicial intervention in arbitration process or that plaintiff LLC member’s rights to security in assets or property of defendant LLC would be irretrievably lost by being required to present claims for interim relief to arbitration panel).
Open MRI of Okeechobee, LLC v. Aldana, 978 So.2d 232 (Fla. App. 2008) (holding that claims by LLC members for wrongful termination of their LLC interests, which were seized based on plaintiffs’ acquisition of ownership in competing enterprise, were not subject to arbitration clause in operating agreement because arbitration clause excepted claims pertaining to operating agreement’s non-competition provision).

Georgia Rehabilitation Center, Inc. v. Newnan Hospital, 658 S.E.2d 737 (Ga. 2008). The court held that a member’s request for judicial dissolution was not subject to arbitration because the arbitration clause in the operating agreement required arbitration of any claim arising out of, in connection with, or relating to the agreement. Though the agreement provided for certain causes of dissolution, the court concluded a request for judicial dissolution was an independent legal mechanism and did not arise out of or relate to the terms of the operating agreement.

Lutz v. Right Time Holdings, LLC, Nos. 07-1039-JTM, 07-11-6-JTM, 2008 WL 782644 (D. Kan. March 21, 2008). The court concluded that the claims of employees of two LLCs that they did not receive the proper amount of compensation under Option, Purchase, and Redemption Agreements with the LLCs were determined to be encompassed in the arbitration provision in the Option Agreement. The individual defendants, who were the principal members and managers of the LLCs, were entitled to invoke the arbitration clause although the individuals were not themselves signatories. Though the claims for accounting and breach of duty sounded in tort and would not be arbitrable under Kansas law, the court concluded that federal law governed arbitrability of the claims notwithstanding provisions in the agreement referencing Kansas as governing law.

Zebrasky v. Valdes, No. 07 MA 34, 2008 WL 927780 (Ohio App. March 17, 2008). The court analyzed language in an LLC operating agreement that provided for compensation of members in specified amounts and stated that “no other compensation” was payable to members without a vote of the members. The court concluded that the provision was ambiguous because it could reasonably be interpreted to permit the member vested with day-to-day management authority to reduce compensation or could reasonably be interpreted to prohibit any change in compensation without action by the members. The trial court thus erred in refusing to hold a trial to determine the meaning of the provision before referring the dispute to arbitration under an arbitration clause that excluded from its scope disputes arising out of the managing member’s management authority.

Tamposi v. Tamposi LLC, No. 200704283, 2008 WL 497306 (Mass. Super. Jan. 7, 2008) (concluding that arbitration provision contained in operating agreement of LLC that served as manager of second LLC did not apply to dispute regarding Red Sox shares held by second LLC).

Cohen v. Looking for Paladin, LLC, No. 07CV6359(HB), 2008 WL 544597 (S.D. N.Y. Feb. 29, 2008) (interpreting arbitration provision of operating agreement as encompassing securities claims under subscription agreement).


Delgadillo v. White, No. 1 CA-CV 06-0275, 2007 WL 5439745 (Ariz. App. July 31, 2007). White and Delgadillo settled disputes relating to a partnership and an LLC in which they were the partners and members. The settlement agreement contained an arbitration clause. Delgadillo then filed a lawsuit asserting additional claims relating to two other LLCs in which they were members, and White moved to compel arbitration to interpret the scope of the release contained in the settlement agreement. The court upheld the arbitrator’s interpretation of the settlement agreement. The arbitrator concluded that Delgadillo intended to release the claims related to the other LLCs and that derivative claims asserted by Delgadillo were encompassed by the release as well. The release covered “all rights...by and/or between the Parties,” and the court stated that Delgadillo’s derivative claims were assertions of rights by him and, as such, were released.
K. Stay of Proceedings

*Pharmalytica Services, LLC v. Agno Pharmaceuticals, LLC*, C.A. No. 3343-VCN, 2008 WL 2721742 (Del. Ch. July 9, 2008). An LLC sought a preliminary injunction prohibiting a member from taking action on behalf of the LLC or holding himself out as an authorized representative of the LLC. In 2006, after discovering that a member had formed another business that was competing with the LLC, the board of the LLC removed the member from the management team and from the positions of president and CEO by majority vote. The member objected but made no formal challenge at the time. In 2007, the LLC sued the member asserting various claims sounding in breach of fiduciary duty, equitable and legal fraud, and breach of the LLC’s operating agreement. In 2008, the LLC learned that the member was in China asserting the LLC’s rights to appoint designees to the board of a joint venture between the LLC and a Chinese entity, prompting the LLC’s motion for a preliminary injunction. The member argued that his removal required the unanimous vote of the board of directors of the LLC because the operating agreement required a unanimous vote of the board for major decisions. The LLC relied upon provisions of the operating agreement giving the board authority to remove a member of the management team with or without cause based on a majority vote and providing that senior officers and other managers could be dismissed by the board for illicitly seeking personal gain or other delinquent behavior. The court characterized the preliminary injunction sought as in the nature of a status quo order under Section 18-110 of the Delaware Limited Liability Company Act, which is comparable to Section 225 of the Delaware General Corporation Law. That provision allows for continued operation of the business, with a goal of minimal disruption, while the identities of those properly holding corporate power can be established. The court pointed out that the member did not act in a constructive or direct fashion for the benefit of the LLC for 18 months following the 2006 meeting at which he was removed from his management positions, and his appearance in China and assertion of authority on behalf of the LLC was inconsistent with his course of action since the 2006 meeting and with the expectations of a majority of the members. The court stated that the rational, ongoing governance of the LLC required certainty as to who was running the LLC and that preserving the status quo as traditionally done in the corporate setting was the proper course. The court concluded that the management that had been in control since 2006 should remain in control in the interim and that the member should be precluded from purporting to represent the interests of the LLC. The court noted that the traditional analysis for a status quo order under the corporate and LLC statues eschews the formalistic application of the preliminary injunction framework; however, because the LLC presented its claim as a request for a preliminary injunction, the court adhered to those standards and found that the LLC had demonstrated a reasonable probability of success on the merits that the member should not be acting on its behalf, that the member’s conduct in China without ongoing authority was likely to cause significant and irreparable harm, and that a balancing of harms weighed in favor of the LLC.

*EuroCapital Advisors, LLC v. Colburn*, C.A. No. 3035-VCN, 2008 WL 401352 (Del. Ch. Feb. 14, 2008). The court exercised its discretion to stay this action in Delaware brought by a Delaware LLC and an individual who claimed to be its sole member (Dyne) against an individual (Colburn) who claimed to be a member in the LLC by virtue of an oral agreement with Dyne. In the Delaware action, the LLC and Dyne sought a declaratory judgment that Colburn was not a member in the LLC, or, alternatively, rescission of her membership based on misrepresentations by Colburn. In an action in federal court previously filed against Colburn in connection with another dispute, Colburn had asserted individual and derivative claims as a member of the LLC against Dyne and another individual (Markiles) to whom she claimed profits of the LLC had been diverted. Colburn’s claims in the federal action were dismissed on grounds of improper joinder, and she then filed an action in California state court asserting the same claims against the LLC, Dyne and Markiles. The court applied the Delaware rule that a party seeking a stay must show that there is “a prior action pending elsewhere, in a court capable of doing prompt and complete justice, involving the same parties and the same issues.” If these conditions are satisfied, a court has discretion, to be “freely exercised,” to stay the proceeding. The court found that the California action would be accorded first-filed status because, although the action in California state court was filed after the Delaware action, the claims had first been filed in the federal action and would be viewed as a continuation of the earlier-filed but dismissed federal court action. The court concluded that there was substantial identity between the parties and issues, the key question in both actions being whether Colburn is a member of the LLC. The court also found that the California courts were capable of providing prompt and complete justice in the matter. The court stated that Dyne and the LLC were unable to identify any important questions in an emerging area of Delaware law. Dyne and the LLC suggested that the identity of members in a Delaware LLC would constitute such an area, but the court found no apparent novel questions relating to membership in this case. Though the judicial inquiry might be factually
complicated, the court stated that the legal issue was simply a matter of contract, i.e., to what did Colburn and Dyne agree. Dyne and the LLC also suggested that there were important questions of LLC governance, but the court stated that these questions were framed by the derivative aspects of Colburn’s complaint in California and were not squarely raised in the Delaware action. Thus, as a matter of discretion, the court stayed the Delaware action. The court noted that Dyne and the LLC had not raised, and had no basis to argue, that litigating in California would cause any hardship since Dyne and Colburn were both California residents and the events in question took place in California. The court noted that it did not need to reach the novel attempt of Dyne and the LLC to exercise personal jurisdiction over Colburn in Delaware under the provisions of the Delaware LLC statute that subject a member who participates materially in the management of the LLC to personal jurisdiction as a manager.

_Citrin Holdings LLC v. Cullen 130 LLC_, C.A. No. 2791-VCN, 2008 WL 241615 (Del. Ch. Jan. 17, 2008). The court exercised its discretion to stay this action in Delaware brought by the majority member of several Delaware LLCs against the minority member. The court found that the conditions for exercise of the court’s discretion to stay the action were satisfied, i.e., the minority member had filed a previous action in Texas involving substantially the same issues and parties, and the Texas court was capable of doing prompt and complete justice. In the Delaware action, the majority member sought a declaratory judgment that its efforts to dissolve the LLCs were proper, that the minority member was not entitled to advancement of expenses incurred in pursuing the Texas action (although the minority member had not asserted such a right), and that the Delaware court would retain jurisdiction in any disputes arising out of the dissolutions. In the Texas action, the minority member sought an accounting of the LLCs and asserted claims of fraud and misrepresentation against the majority member. After the filing of the Delaware action, the minority member amended his complaint in the Texas action to allege breaches of fiduciary duty and majority oppression based on the majority member’s actions to dissolve the LLCs and the acquisition by the majority member or its affiliates of properties the LLCs had been investigating. The court found that the Texas action did not lose its status as “first-filed” despite a three-month delay in service of the complaint on the majority member because the majority member had knowledge of the lawsuit less than five days after its filing and possession of a copy of the complaint less than a month after its filing. Additionally, nothing other than docketing and service had occurred in the Texas action prior to service of the complaint. Next the court concluded that the issues and parties in the two actions were substantially the same. Although the precise issues framed initially in the Texas action bore little resemblance to the issues posed by the Delaware action, both complaints arose from the same core conduct. Finally, the court concluded that the Texas court was capable of doing prompt and complete justice. The court acknowledged that the majority member was correct in its assertion that Delaware law with respect to dissolution and winding up of LLCs has not been fully developed, but the court stated that the majority member identified no novel or important issue that should impel a Delaware court to refrain from yielding the field. Should the issue of the Texas court’s personal jurisdiction over the majority member be resolved against the minority member, the court stated that the question of the stay could be revisited, but a mere challenge to personal jurisdiction did not demonstrate that the Texas court was unable to address fully the disputes. The court pointed out that both parties had engaged in tactics designed to secure the preferred forum and neither could lay exclusive claim to the high ground. Having determined that the prerequisites for the exercise of discretion to stay the proceeding were satisfied, the court identified two especially important considerations in weighing whether to stay the Delaware action. First, although there might be a distinction drawn between pre-dissolution and dissolution/post-dissolution conduct, any global resolution would necessarily involve both periods of time, and one comprehensive proceeding would be more efficient. Second, the court viewed the Delaware complaint as only sparsely crystallizing a ripe dispute since it only sought a declaration of non-breaches with respect to dissolution and a resolution of a right to advancement that had not been sought. The court thus concluded that there simply were no causes of action asserted in the Delaware action that called out for judicial determination in Delaware.

L. Nature of LLC


_Virginia Cellular LLC v. Virginia Department of Taxation_, 666 S.E.2d 374 (Va. 2008). A telecommunications company structured as an LLC argued that it was exempt from the minimum tax imposed on a
telecommunications company under the Virginia Tax Code. The Tax Code provides that “[a] telecommunications company shall be subject to a minimum tax, instead of the corporate tax imposed by § 58.1-400...” Section 58.1-400 imposes a six percent income tax on “every corporation organized under the laws of the Commonwealth and every foreign corporation having income from Virginia sources.” The Department of Taxation promulgated a regulation stating that “every telecommunications company certified as such by the SCC is subject to the minimum tax even though it may be exempt from, or not subject to, the corporate income tax under § 58.1-400.” The court held that the plain language of the statutes, read together, indicates that the minimum tax only applies to corporations because the minimum tax is to be paid instead of the corporate tax. The court held that the Department of Taxation’s regulation interpreting the statutory minimum tax was invalid to the extent it imposed the minimum tax on pass-through entities because the regulation was inconsistent with the statute.

**Bond v. Veolia Water Indianapolis, LLC**, 571 F.Supp.2d 905 (S. D. Ind. 2008). The court concluded that a Delaware LLC was an “unincorporated association” under the Class Action Fairness Act provision in 28 U.S.C. § 1332(d)(10) so that its citizenship for diversity purposes is determined by the state where its principal place of business is located and the state under whose laws it is organized (i.e., in the same manner that a corporation’s citizenship is determined). The LLC argued that it was not an “unincorporated association” under Delaware law and thus should not be treated as an unincorporated association under Section 1332(d)(10). The LLC argued that its citizenship should be determined by the citizenship of each of its members under the general rule set forth for unincorporated associations by the Supreme Court in *Carden v. Arkoma Associates*. The court rejected the paradox presented by the LLC’s argument that an LLC is not an “unincorporated association” under Delaware law, and thus not an unincorporated association for purposes of Section 1332(d)(10), while the LLC relied on the rule in *Carden*, which sets forth the rule for determining citizenship for all kinds of unincorporated associations. The court found that the LLC’s approach would prevent Section 1332(d)(10) from achieving its clear purpose. Citing the Senate committee report on the Class Action Fairness Act, the court concluded that Congress used the phrase “unincorporated association” in Section 1332(d)(10) as broadly as the Supreme Court used it in the case law. The court then applied the same test that applies to corporations to determine the location of the LLC’s principal place of business (the “nerve center” test).

**Interphase Garment Solutions, LLC v. Fox Television Stations, Inc.**, 566 F.Supp.2d 460 (D. Md. 2008) (dissmissing LLC’s claim for intentional infliction of emotional distress because “corporation ‘lacks cognizant ability to experience emotions’” and dismissing LLC’s claim for invasion of privacy because “‘a corporation, partnership or unincorporated association has no personal right of privacy’”).

**Advocate Financial, L.L.C. v. Parker Interests, L.L.C.,** Civil Action No. 07-757-FJP-CN, 2008 WL 2773650 (M.D. La. July 16, 2008) (noting that it is generally accepted that unincorporated business associations such as partnerships and LLCs are analogous to corporations for purposes of venue under Section 1391(a)(1)).

**Downey v. 610 Morrison Road, LLC,** No. 07AP-903, 2008 WL 2751214 (Ohio App. July 15, 2008) (discussing Ohio service of process provisions, commenting that LLC is neither corporation nor partnership under Ohio law, stating that procedure for serving “unincorporated associations” does not necessarily include LLC’s, and noting that, while procedural rule provides specific methods of service for corporations, partnerships, and other entities, no specific method of service has been created for LLCs).

**Johnson v. Wells Fargo Home Mortgage, Inc.,** 558 F.Supp.2d 1114 (D. Nev. 2008) (holding that damages suffered by LLC borrower in connection with commercial loan were not recoverable under Fair Credit Reporting Act because that Act only protects individual consumers).

**Champluvier v. Couch,** 557 F.Supp.2d 748 (N.D. Miss. 2008). The court concluded that a prosecutor did not violate the constitutional rights of a member of an LLC by prosecuting her under a state embezzlement statute in connection with her conversion of LLC assets to her own use. Although the Mississippi Supreme Court ultimately determined that an LLC was not an “incorporated company” covered by the embezzlement statute at the time, the prosecutor’s interpretation was rational, as evidenced by the fact that a majority of the Mississippi Court of Appeals and two dissenting justices of the Mississippi Supreme Court agreed with the prosecutor’s interpretation of the statute.
 Preferred Real Estate Investments, LLC v. Lucent Technologies, Inc., Civil Action No. 2:07-CV-05374 (DMC), 2008 WL 2414968 (D. N.J. June 11, 2008). The plaintiff sought a writ of attachment under a statute which permitted a writ of attachment if the defendant is a corporation created by the laws of another state and that state authorizes attachments against New Jersey corporations authorized to do business in that state. The property involved was owned by a Delaware LLC, and the court noted that a strict reading of the statute would allow business entities to shield themselves from attachment by simply transferring assets to an unincorporated entity. Thus, the court concluded that a more liberal reading of the statute encompassing LLCs was appropriate. Since Delaware has a reciprocal statute allowing for attachment against a corporation not created or existing under Delaware law, the court concluded the statutory grounds for attachment were present.


 Johnson v. Wells Fargo Home Mortgage, Inc., 558 F.Supp.2d 1114 (D. Nev. 2008) (holding that damages suffered by LLC borrower in connection with commercial loan were not recoverable under Fair Credit Reporting Act because that Act only protects individual consumers).

 In the Matter of JPMorgan Chase Bank, N.A., 852 N.Y.S.2d 718 (N.Y. Sur. 2008) (granting reformation of will to allow trustee to form LLC rather than corporation created by decedent during his lifetime to receive trust assets in view of income tax advantages of LLC over corporation; ordering that plan for structuring LLC to parallel corporate structure with respect to management and control be provided to court and parties).

 Romanowski v. RNI, LLC, No. C 06-6575 PJH, 2008 WL 361125 (N.D. Cal. Feb. 11, 2008) (commenting on hybrid nature of LLC and equating individual’s reference to himself as “shareholder” to that of “member” of LLC).

 In re Enron Creditors Recovery Corp. (Enron Corporation v. Baupost Group, LLC), 380 B.R. 307 (S.D. N.Y. 2008) (discussing nature of LLC and affirming bankruptcy court’s conclusion that indenture provision defining “senior indebtedness” as indebtedness of issuer of debentures owed to subsidiary “corporation” encompassed debt owed to LLC whose directors the issuer had voting power to elect; stating that fact that LLCs were not specifically mentioned in list of enterprises considered “corporation” under indenture was understandable in light of fact that indenture, which was governed by Texas law, was drafted in 1987, and LLCs were not recognized in Texas until 1991).

 M. Pre-Formation Transactions

 546-552 West 146th Street LLC v. Arfa, 863 N.Y.S.2d 412 (App. Div. 1st Dept. 2008). LLC plaintiffs brought this action against member/managers who allegedly received commissions in connection with the purchase of real estate by the LLCs without disclosing the commissions to the LLCs or to prospective investors whose investments were used to fund the closings of the property acquisitions. The court held that the LLCs lacked standing to assert the claims because the alleged wrongdoers were the only members and managers at the time the agreements for the commissions were entered into and their acts and knowledge were thus imputed to the LLCs. The court rejected the argument that the defendants were liable as promoters because the challenged agreements were entered into before formation of the LLCs and the promoters could not have then owed fiduciary obligations to the non-existent entities.

 Lake State Federal Credit Union v. Tretsven, No. A07-1542, 2008 WL 2732111 (Minn. App. July 15, 2008) (holding trial court did not err in determining that neither LLC named as mortgagee nor its sole member had any interest in mortgaged property because LLC was not formed until after mortgage was issued in LLC’s name; subsequent formation did not affect court’s analysis because mortgage cannot be delivered to nonexistent entity, and allowing future interest to vest in organized entities would be inconsistent with public policy of encouraging legal organization).

 B-G Investors IV, L.L.C. v. Thibaut HG Corporation, 985 So.2d 837 (La. App. 2008) (holding that member who executed contract to purchase real estate as individual “who will assign this contract to a Limited Liability Company to be formed, of which he will be a member,” but who had never assigned rights as contemplated, had sole legal right to assert claims related to violation of seller’s obligations).
In re Hausman, 858 N.Y.S.2d 330 (N.Y. A.D. 2 Dept. 2008). The court held that the de facto corporation doctrine is applicable to LLCs but that the LLC in issue was not a de facto entity capable of taking title at the time of a purported conveyance to the LLC. There was no evidence that an attempt to file the articles of organization was made prior to the execution of the deed, and there was thus no colorable attempt to comply with the statutes governing incorporation or organization as required by the de facto corporation doctrine.

Norfolk Southern Railway Company v. Jacobs, 549 F.Supp.2d 990 (N.D. Ohio 2008) (holding that parties clearly intended LLC rather than individual to be party to lease modification executed before LLC was formed and that Ohio law provided ample basis to dismiss plaintiff’s “formalist” argument for promoter liability).

Briar Road, L.L.C. v. Lezah Stenger Homes, Inc., 256 S.W.3d 131 (Mo. App. 2008) (holding that pre-formation agreement to assign rights to exercise option to LLC did not fall within Missouri LLC statute prohibiting LLC from transacting business until articles of organization have been filed because statute provided exception for acts incidental to organization of LLC and no request was made for real estate in question to be conveyed to LLC until after its articles of organization had been filed).

Mastroianni v. Fairfield County Paving, LLC, 942 A.2d 418 (Conn. App. 2008) (holding LLC that was formed after execution of lease and ultimately occupied leased premises without submitting rental payments or performing improvements was liable on lease).

02 Development, LLC v. 607 South Park, LLC, 159 Cal.App.4th 609, 71 Cal.Rptr.3d 608 (Cal. App. 2 Dist. 2008) (applying corporate law principles regarding pre-incorporation contracts and holding that LLC could enforce pre-organization contract that LLC adopted after it came into existence).

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


Alexander Building, LLC v. Queen & Crescent Hotel, LLC, Civil Action No. 08-1513, 2008 WL 437033 (E.D. La. Sept. 23, 2008). Smith signed a lease as “managing member” of “Queen & Crescent, L.L.C.” The plaintiff sued Smith, Queen & Crescent Hotel, LLC, Q & C Holding, LLC, and Q & C Holding Manager, LLC, alleging that there was no such entity as “Queen & Crescent, L.L.C.” registered with the Louisiana Secretary of State but that the Queen & Crescent Hotel used the rented space. The only LLC named as a defendant that was in existence at the time the lease was signed was Queen & Crescent Hotel, LLC. A later addendum to the lease also listed “Queen & Crescent LLC” as the lessee. The LLC defendants asserted that Smith exceeded his authority to execute the lease. The court acknowledged the limited liability of a member, manager, or other agent of an LLC, but stated that a member who exceeds his authority can be held personally liable. The court also stated that an agent who enters a contract without disclosing his principal may be liable on the contract. The court thus concluded that the plaintiff stated a claim against Smith on the basis that he acted as agent of an undisclosed principal or exceeded his authority as the manager of an LLC when signing the lease. The court held that another individual who was alleged to be a member or manager of two of the LLC defendants when he attempted to cancel the lease was not a proper party because the Louisiana LLC statute states that a member or manager is not a proper party to a proceeding against an LLC and there was no allegation that the individual committed any fraud or wrongdoing that would lead to personal liability.

Sanchez v. Mulvaney, 274 S.W.3d 708 (Tex. App. 2008). The plaintiffs sought to hold an LLC member liable for the LLC’s breach of contractual obligations on the basis that the LLC had forfeited its status as a Texas LLC. The court stated the general rule that members are not individually liable for the debts of a limited liability company. The court then stated that the LLC was a “limited liability corporation,” to which state law principles for piercing the corporate veil apply, and that the plaintiffs could hold the member liable for the LLC’s alleged breach of contract only to the extent they pierced the corporate veil. The plaintiffs relied only upon provisions of the Texas Tax Code regarding forfeiture and brought forth no evidence of fraud that would entitle them to hold the member individually liable;
therefore, the court concluded that the trial court properly granted summary judgment in favor of the member on the breach of contract claim. However, the court of appeals stated that the trial court erred in rendering summary judgment in the member’s favor with respect to certain non-contract claims. The court stated that the plaintiffs’ allegations of the member’s own tortious and fraudulent actions, including alleged Deceptive Trade Practices Act violations, did not depend upon veil piercing because a corporation’s agent is personally liable for his own fraudulent or tortious acts, even when acting within the scope of employment.

Carbon El Norteno, L.L.C. v. Sanchez, No. 13-07-00565-CV, 2008 WL 3971554 (Tex. App. Aug. 28, 2008). Micaela and Omar Alvarado owned and operated an LLC which they sold to the plaintiff. The Alvarados signed the purchase and sale agreement in their individual capacities, and Omar signed in his capacity as president and duly authorized representative of the LLC. The plaintiff obtained a summary judgment against the LLC and the Alvarados, and the Alvarados argued that they were not liable in their individual capacities. The court of appeals affirmed the summary judgment against the Alvarados because they did not raise the issue of capacity or file a verified plea challenging capacity in the trial court, and they both signed the agreement selling the LLC in their individual capacities. The court rejected the assertion that the Texas Limited Liability Company Act protected the Alvarados from individual liability because the record showed that the Alvarados sold their ownership in the LLC and thus were not members of the LLC when the suit was brought.

Bayer v. Omni Hotels Management Corporation, 995 So.2d 639 (La. App. 2008) (holding member of LLC owner of property was not liable for injuries arising from defective condition of property contributed by member to LLC because LLC members are not liable for debts, obligations, or liabilities of LLC, and former owner of property is liable for defective conditions only if former owner knew of defective conditions prior to transfer of property).

IMC, Inc. v. Gambulos, No. 05-07-00470-CV, 2008 WL 3867429 (Tex. App. Aug. 21, 2008). The president of an LLC filled out and signed a credit application for the LLC that contained a “personal guarantee” paragraph at the bottom of the second page of the application. After the LLC filed for bankruptcy, the creditor sued the president for unpaid invoices based on the personal guaranty. The president sought summary judgment and filed an affidavit with the second page of the credit application attached and swore that he signed the guaranty in his capacity as president of the LLC and was not individually bound. The court stated that a personal guaranty is not transformed into a corporate guaranty by the fact that a corporate title follows an individual signature because corporate designations appearing after signatures on personal guarranties are considered only to identify the person and not as proof that the person is acting in any particular capacity. The court could not conclude that the president was entitled to judgment as a matter of law based on only the second page of the credit application and the applicable law.

In re Lufkin (Hendon v. Lufkin), 393 B.R. 585 (Bankr. E.D. Tenn. 2008) (stating that member of professional LLC may be personally liable by reason of such person’s own acts or conduct and debtor-attorney could not escape liability by hiding behind legal fiction that PLLC was separate entity or blaming court-appointed receiver or former financial officer).

Tenable Protective Services, Inc. v. Bit E-Technologies, L.L.C., No. 89958, 2008 WL 3870666 (Ohio App. Aug. 21, 2008). The plaintiff sought to hold two individuals who were members and senior managers of a Georgia LLC personally liable on a contract with the plaintiff. The court applied Ohio law to the issue of the individual defendants’ liability based on a choice-of-law provision in the contract specifying that Ohio law would govern any disputes. Relying on the Ohio LLC statute, the court held that the individual defendants were not personally liable for the obligations of the LLC.

Echelon Homes, L.L.C. v. Carter Lumber Company, No. 277471, 2008 WL 3540210 (Mich. App. Aug. 14, 2008). The court held that the trial court did not abuse its discretion in ordering the plaintiff LLC to post a bond as security where the trial court determined that the LLC was unlikely to prevail at trial and lacked the resources to pay an award of case evaluation sanctions. The court held that the trial court erred, however, to the extent it held that the dissolved LLC’s members could be held liable for sanctions against the LLC. The court noted that the members continue to be protected from personal liability for the LLC’s debts during the winding up, but the fact that the LLC has been
dissolved and is impecunious, while its members are immune from liability, is even more reason to require the LLC to post a bond to ensure a potential award of case evaluation sanctions will be paid.

**Smith v. Riverwalk Entertainment LLC**, Civil Action No. 05-1416, 2008 WL 3285909 (W.D. La. Aug. 8, 2008). The plaintiffs sought to hold a manager of a Louisiana LLC personally liable for bad faith breach of contract and tortious conspiracy. The court acknowledged the statutory limitation of liability of LLC members and managers and the agency principle that an agent who contracts in the name of the principal within the limits of his authority does not bind himself personally on the contract. The court noted that an agent is not protected from personal liability when he commits fraud and cited the Louisiana LLC statutory provision preserving any rights a person may have against a member or manager because of fraud, breach of professional duty, or other negligent or wrongful act. The plaintiffs relied upon the rule that LLC members or managers can be held personally liable for fraud, but the court concluded that no fraud had been committed in this case. The court also considered an argument that several affiliated LLCs were part of a single business enterprise so that each was liable for the actions of the other. The court explained that the single business enterprise theory is a vehicle for holding a group of affiliated entities responsible for the obligations of one of the entities. The court concluded that the evidence in the record raised a genuine issue of material fact regarding the relationship of the LLCs so as to preclude summary judgment on this issue.

**Daines v. Vincent**, 190 P.3d 1269 (Utah 2008). The plaintiff sought to hold an individual who was a member and chairman of the board of a Utah LLC personally liable with respect to a transaction involving the services of the plaintiff and the LLC in connection with the development of a surgical center for some physicians. The supreme court agreed with the trial court that the plaintiff failed to present competent evidence that the individual defendant was acting in other than a representative capacity for the LLC in his dealings with the plaintiff. The Utah LLC statute provides that an organizer, member, manager, or employee of an LLC is not personally liable for a debt or obligation of the LLC, and the individual was thus not liable unless he entered a contract with the plaintiff in a manner indicating the contract was his liability. The court noted that a memorandum of understanding signed by the individual was signed by him directly under the name of the LLC and recited that the individual would sign on behalf of the LLC. Also, the initial term sheet indicated that the individual was acting on behalf of the LLC and that the plaintiff’s compensation would come from the surgical center being formed and not from the individual. Testimony by the plaintiff further reflected his understanding that the individual was acting on behalf of the LLC. The court thus affirmed the directed verdict in favor of the individual.

**State v. Cruz**, No. 36568-5-II, 2008 WL 2811270 (Wash. App. July 22, 2008) (stating that member of LLC is not personally liable for debt or liability of LLC under Washington law, noting that Washington LLC statute permits veil piercing but that no such claim was asserted, and concluding that LLC member was not proper party in dispute over bail bond money remitted to LLC issuer of bond).

**Mexico Construction v. Thompson**, No. CV075002988, 2008 WL 2930417 (Conn. Super. July 6, 2008). The court discussed the limitation of liability under the Connecticut LLC statute (which generally provides a shield against individual liability to a member or manager of an LLC but provides for personal liability of a member or manager for his or her negligent or wrongful acts) and stated that it parallels common law under which an officer of a corporation who commits a tort is personally liable regardless of whether the corporation is liable. Similarly, the court stated that the provision that a member or manager is not a proper party to a proceeding against an LLC does not preclude imposing liability on a member or manager who has engaged in or participated in the commission of tortious conduct. The defamation allegations against the LLC member in this case were not based solely on his status as a member or manager. Rather, the defamatory statements were allegedly made by the individual himself, and the statutory immunity provisions thus did not apply.

**Selinger Enterprises, Inc. v. Cassuto**, 860 N.Y.S.2d 533 (N.Y. A.D. 2nd Dept. 2008) (holding that individual who signed brokerage contract as agent of LLC was not personally liable on contract).

**Barone v. Perkins**, No. 2007-CA-000838-MR, 2008 WL 2468792 (Ky. App. June 20, 2008). The plaintiffs alleged several causes of action against the members of an LLC in relation to construction of the plaintiffs’ home. The LLC had been administratively dissolved but was reinstated with retroactive effect. The individuals oversaw the
construction of the home, but the trial court concluded that the individuals did not perform any work on the actual construction in issue. The court of appeals held that the statutory limitation on liability of LLC members shielded the individuals from liability. The court noted that the trial court found that neither individual engaged in any tortious activity and that they at all times were acting in their capacities as members of the LLC. The court stated that it was not the court’s role to create a public policy exception to the immunity granted by the legislature to LLC members.

**Seymour v. United States**, No. 4:06-CV-116, 2008 WL 2509831 (W.D. Ky. June 19, 2008). The court concluded that the sole member of an LLC was personally liable for employment taxes owed by the LLC. The LLC leased the restaurant and obtained a liquor license, but the member argued that she did not authorize anyone to operate a restaurant under the auspices of her LLC and that she had a “gentlemen’s agreement” with another individual who was to operate the restaurant. The court stated that whether the operation of the restaurant under the legal identity of the LLC was within the understanding of the “gentlemen’s agreement” was a matter between the member and the other individual and did not affect the member’s liability for the employment taxes. The court also found that the bookkeeper for the restaurant was personally liable although he was not the owner of the LLC and was not provided funds to pay the taxes. The bookkeeper had authority to sign checks for the LLC and was responsible for calculating payroll taxes and filing payroll tax returns; therefore, he was a “responsible person” under Section 6672(a). The court determined his conduct was “willful” because he knew about the delinquent taxes and chose to pay other creditors before paying the government.

**Hauser v. Bosman**, No. 2007 AP2865, 2008 WL 2185978 (Wis. App. May 28, 2008). The court determined that whether the plaintiff contracted with an LLC or its individual member presented a question of fact precluding summary judgment in favor of the LLC’s individual member. The plaintiff’s arguments that a negligent home inspection would support an independent tort action against the individual member of the LLC under the rule that an individual is responsible for his own tortious conduct was asserted without citing supporting legal authority, and the court of appeals refused to consider it, but stated that the trial court could address the argument on remand after proper briefing.


**Gardner v. Marcum**, 665 S.E.2d 336 (Ga. App. 2008) (acknowledging that LLC members are not liable for LLC obligations solely by reason of being members, stating that whether to pierce “corporate veil” is normally fact issue, and concluding that summary judgment holding members of LLC liable for return of funds paid to LLC must be reversed because undisputed facts did not establish as matter of law that LLC’s members were personally liable to account for funds paid by plaintiff to LLC).

**L & L Holding Company, L.L.C. v. United States**, 101 A.F.T.R.2d 2008-2081, 2008-1 USTC ¶ 50,324, 2008 WL 1908840 (W.D. La. April 30, 2008). The IRS filed tax liens against two entities, each of which was the sole member of a disregarded LLC for a period of time, to collect unpaid employment and unemployment tax owed by the LLC. Each member filed suit challenging the IRS determination that the liens were valid, and the suits were consolidated. The court rejected the plaintiffs’ argument that the employment tax statute and check-the-box regulations are in conflict. The court determined that the check-the-box regulations are actually in harmony with the employment tax statute as they resolve an ambiguity in how to treat an LLC for employment tax purposes. The court thus ruled that the IRS interpretation of the check-the-box regulations was correct as applied to the levy of employment taxes and the filing of related tax liens against successive sole owners of a single member LLC.

**State v. Tebbenhoff**, 2008 WL 1848575 (N.J. Super. A.D. April 23, 2008) (holding that individual who wrote hot check on LLC’s account could be criminally prosecuted as individual because “[t]he fact that an entity on whose behalf he acted was a limited liability company for which debts the defendant would not be personally liable [citation omitted] does not negate defendant’s criminal culpability for his issuance of a check that was dishonored multiple times.”).

**University of Kansas v. Sinks**, 565 F.Supp.2d 1216 (D. Kan. 2008) (holding that provision of Kansas LLC statute providing that LLC’s tort liabilities are solely LLC’s and that no member or manager shall have liability based
solely on member or manager status does not foreclose individual liability for member who commits tort or when veil piercing grounds are present, and sufficient evidence of member’s active and knowing participation in trademark infringement existed to preclude summary judgment in favor of member).

**Ervin v. Turner**, 662 S.E.2d 721 (Ga. App. 2008) (holding member/manager of LLC was liable, upon failure of bank venture undertaken by LLC, for severance owed individual hired to serve as bank president notwithstanding statutory limitation on member’s liability because member/manager was contractually obligated under organizer contribution agreement as personal guarantor of president’s employment contract).

**University of Kansas v. Sinks**, 565 F.Supp.2d 1216 (D. Kan. 2008) (acknowledging limited liability of member under Kansas LLC statute, but denying member’s motion for summary judgment on trademark infringement claim, based on principle that corporate officer is personally liable for his own tortious acts, where evidence was sufficient to persuade reasonable jury that individual actively and knowingly caused alleged infringement of marks).

**Porter Drywall, Inc. v. Nations Construction, LLC**, No. 07AP-726, 2008 WL 852619 (Ohio App. March 31, 2008) (holding that statutory limitation on LLC member’s liability did not protect member from liability on contract which on its face imposed personal liability on member who signed it).

**Jacobs v. Baum**, No. 1:07-CV-167, 2008 WL 819037 (N.D. N.Y. March 24, 2008) (acknowledging officers and directors of corporation may be liable for fraud if they participate or have actual knowledge of it, but dismissing fraud claims against individual who was allegedly LLC officer, director and/or member for lack of specificity).

**State v. Ratan Hospitality**, No. B194660, 2008 WL 739846 (Cal. App. 2 Dist. March 20, 2008) (acknowledging that LLC member or manager may not be held liable merely because of status as member or manager, but finding managing member of LLC was properly included in injunction in nuisance action based on managing member’s involvement in negotiation of LLC’s lease, acquisition of LLC’s business license, business operations of LLC, and proceedings arising out of complaint against LLC).

**Taylor v. Southern Belle Dairy Co., LLC**, No. 2006-CA-001830-MR, 2008 WL 682211 (Ky. App. March 14, 2008) (affirming summary judgment against individual who co-owned grocery stores with her husband where individual failed to present evidence supporting her allegation that grocery stores were LLCs).

**Kistner v. Law Offices of Michael P. Margelefsky, LLC**, 518 F.3d 433 (6th Cir. 2008). The plaintiff received a collection letter from “The Law Offices of Michael P. Margelefsky, LLC,” and the plaintiff sued the LLC and Margelefsky, its sole member, for violations of the Fair Debt Collection Practices Act. The LLC operated two separate businesses, a law practice and a debt collection agency, and the letter received by the plaintiff contained the address and phone number of the debt collection agency operating under the name of the LLC. The letter did not contain an individual’s signature, but contained a signature block for an “account representative.” Margelefsky testified that he drafted the form letter but did not review the specific letter sent to the plaintiff before it was mailed. The trial court granted Margelefsky summary judgment on the issue of his individual liability, and the plaintiff appealed. The court of appeals acknowledged that Ohio law precludes personal liability for members of an LLC on the basis of the LLC’s liability, but the court discussed a split of authority regarding individual liability under the FDCPA in the context of a corporate structure. The court characterized the Seventh Circuit and a few district courts as concluding that a shareholder, officer, or employee of a corporate debt collector may not be held personally liable without meeting the requirements to pierce the corporate veil. The court described the other side of the split as a series of district court opinions concluding that a shareholder, officer, or employee of a corporation may be held personally liable as a debt collector without piercing the corporate veil where the individual is personally involved in the debt collection at issue. The court found the case of Ditty v. CheckRite, Ltd., a Utah district court decision involving a single member LLC, to be most similar to the instant case. In that case, the court concluded that the LLC’s sole member fell within the definition of a “debt collector” and could be liable without piercing the veil of the LLC. The court rejected the Seventh Circuit’s conclusion that the FDCPA employs the same vicarious liability principles found in Title VII, and the court agreed with the Utah district court’s conclusion in another case that a person who authors collection letters, supervises collection activities, and is the sole attorney in a debt collection firm is a debt collector as defined by the FDCPA. Because
Margelefsky drafted the form letter that was sent to the plaintiff, was one of only two attorneys at the law firm, was the sole member of the LLC, was the one who negotiated the terms with the mailing service provider used in the debt collection practice, oversaw compliance with the applicable collection laws, and was the person to whom the plaintiff was directed to make her check or money order payable, the court concluded that Margelefsky was regularly engaged, directly and indirectly, in the collection of debts and was thus a “debt collector” subject to individual liability. The court found that a jury should determine whether the letter in issue was deceptive and misleading – specifically, whether the letter gave the impression that it was from an attorney when it was not. The letter was printed on law firm letterhead, made repeated reference to a law firm, and directed payment to an individual lawyer; however, it also explicitly stated that it was from a debt collector and was signed by an unnamed “account representative.” The court concluded that the letter presented a genuine issue of material fact as to whether one could reasonably conclude, under the “least sophisticated consumer” test, that the collection letter was susceptible to a belief that it was from an attorney.

*Murrin v. Fischer*, No. 07-CV-1295 (PJS/ RLE), 2008 WL 540857 (D. Minn. Feb. 25, 2008) (stating that limited liability of law firm LLC is provided by LLC statute rather than professional firm statute and neither failure to pay fee required by Professional Responsibility Board nor initial absence of required language in articles of organization specifying type of professional services rendered by firm was basis for holding individual members personally liable for firm wrongdoing).

*Castro-Vega v. Waible*, Civil No. 07-675-ST, 2008 WL 342754 (D. Or. 2008) (concluding that individual who was general manager of LLC and individual who was manager and registered agent of LLC were “employers” within meaning of Fair Labor Standards Act and thus jointly and severally liable for plaintiff’s wages).

*Metropolitan Government of Nashville v. Printer’s Alley Theater, LLC*, Nos. M2007-00329-COA-R3-CV, M2007-00391-COA-R3-CV, 2008 WL 199849 (Tenn. Ct. App. Jan. 23, 2008) (affirming trial court’s contempt punishment of individual who was organizer, chief manager, member, and registered agent of LLC, and officer, shareholder, director, and registered agent of corporation, where individual had actual notice of injunctions prohibiting businesses from providing sexually oriented entertainment, entities continued to provide such entertainment in violation of court’s order, and individual had repeatedly represented to courts that he was owner and agent of clubs with ability to control their operation).

*Mowbray v. Zumot*, 533 F.Supp.2d 554 (D. Md. Jan. 30, 2008) (relying on contract law and statutory liability protection of members of Maryland LLCs and holding that individual who signed agreement in capacity of executive officer and member of LLC was not personally liable for obligations under agreement; holding individual who signed agreement in individual capacity had personal liability on contract; holding individual who was party to contract had standing to sue on contract notwithstanding defendants’ argument that LLCs which owned property that was subject of contract suffered harm).

*Eve v. Cosmos, LLC*, Civil Action No. 06-188-DLB, 2008 WL 239604 (E.D. Ky. Jan. 29, 2008) (denying motions to strike defendant LLC members’ replies to plaintiff’s response to defendants’ joint motion for summary judgment where affidavit with certificate of existence (which was relevant because administratively dissolved status of LLC and subsequent reinstatement was relevant to members’ limited liability) furnished with reply should have been included with initial motion filing, but in court’s discretion would be accepted as supplementation because it added no new evidence not otherwise disclosed in discovery, and reply arguing member had no personal involvement in business and thus no acts or omissions on which liability for personal negligence could be premised was replying to argument made in plaintiff’s response to summary judgment motion and was based on depositions taken by plaintiff).

*Sturm v. Harb Development, LLC*, No. HHBCV07001058, 2008 WL 249220 (Conn. Super. Jan. 2, 2008) (noting that new home construction was not within definition of “professional services” for purposes of imposing liability on LLC member or manager under statutory provision for liability for negligent or wrongfull conduct while rendering professional services).

*Smith v. Teel*, 175 P.3d 960 (Ok. App. 2007). The court held that the LLC veil should not be pierced to impose liability on LLC members with regard to the duty to exercise reasonable care not to sell alcohol to a noticeably
intoxicated person. The plaintiff’s wrongful death claim against two managers/owners of an LLC based on the LLC’s sale of alcohol to an intoxicated person failed because there was no evidence that the individual defendants personally sold alcohol to the patron involved, had knowledge that any employees served alcohol to a noticeably intoxicated person, or were present on the night in question.


**Cooper v. Coldwell Banker, Civil Action No. 07-1208, 2007 WL 4792982 (W.D. La. Dec. 2, 2007)** (holding plaintiff’s mere allegations that individual was owner of LLC real estate firm and that agent who questioned transaction at issue was fired by firm did not state claim against individual for personal liability for firm’s racial discrimination because complaint did not allege any personal participation by individual in allegedly unlawful acts and did not state claim under statutory exception to limited liability afforded member of LLC where individual acts outside capacity of member, manager, employee or agent).

**Miller v. Raytheon Aircraft Co., 229 S.W.3d 358 (Tex. App. 2007)** (commenting that, under Delaware law, LLC members generally are not liable for LLC’s obligations absent showing that court should pierce veil).

**O. LLC veil piercing**

**In re DePaulis (Holland v. DePaulis), Civil No. 3:07cv75, 2008 WL 4446999 (W.D.N.C. Sept. 26, 2008)** (concluding corporate “instrumentality rule” is fair guide for proof required to disregard LLC entity in absence of North Carolina case law enunciating extent to which rule is applicable to LLCs and finding evidence supported bankruptcy court’s finding that debtor did not act dishonestly or fraudulently but rather poured virtually his entire net worth into failed business venture).

**EBG Holdings LLC v. Vredezicht’s Gravenhage 109 B.V., Civil Action No. 3184-VCP, 2008 WL 4057745 (Del. Ch. Sept. 2, 2008).** A Delaware LLC sued one of its members, a Dutch LLC (“VG 109”), and the member’s parent corporation (“NIBC”), seeking a declaration that VG 109 was NIBC’s alter ego, specific performance of provisions of the LLC agreement regarding the reimbursement of tax withholding payments made on VG 109’s behalf, and a declaration that VG 109’s attempted transfer of its economic interest was invalid. The LLC asserted four bases for the court’s exercise of personal jurisdiction over NIBC: (1) Delaware’s long-arm statute; (2) the terms of the LLC agreement; (3) alter ego or veil piercing theories of jurisdiction; and (4) agency theory of personal jurisdiction. In discussing the agency and alter ego theories of personal jurisdiction, the court identified certain common factors but explained that the scope of the alter ego theory was broader in that only the precise conduct instigated by the parent is attributable to the parent under the agency theory whereas all of the activities of the subsidiary are attributable to the parent under the alter ego theory. The court rejected the argument that NIBC was subject to personal jurisdiction under the alter ego theory. Because the court had found that there were insufficient acts of VG 109 to satisfy the long-arm statute, the court stated that it need not decide the question of whether VG 109 was the alter ego of NIBC. However, the court discussed the LLC’s arguments for disregarding the separate existence of VG 109 and its parent corporation and concluded that the LLC had not made a sufficient showing of fraud or other inequity to disregard the corporate form. The court pointed out that the fraud or injustice must stem from an inequitable use of the corporate form itself, not merely from the underlying cause of action for breach of contract. A conclusory statement in the complaint that NIBC knowingly used VG 109 as an instrument to shield itself from liability for tax obligations related to ownership in the LLC was insufficient to support a reasonable inference that NIBC’s use of VG 109’s limited liability status was fraudulent or inequitable. There also was no showing that VG 109’s capitalization was so minimal as to prove it was a sham entity. The court also stated that the LLC’s inability to sue NIBC in Delaware for taxes due from VG 109 did not create the requisite inequity.

**NetJets Aviation, Inc. v. LHC Communications, LLC, 537 F.3d 168 (2d Cir. 2008).** The plaintiffs sought to hold the sole member of a Delaware LLC liable for the breach of contract of the LLC on the basis that the member was the LLC’s alter ego. The trial court granted summary judgment in favor of the member on the ground that the plaintiffs
had not adduced sufficient evidence to pierce the veil of the LLC. The Second Circuit Court of Appeals discussed Delaware corporate veil piercing principles and concluded that such principles are generally applicable to an LLC, with the caveat that somewhat less emphasis is placed on whether the LLC observed internal formalities in an alter ego analysis of an LLC. The court stated, however, that if two entities with common ownership “failed to follow legal formalities when contracting with each other it would be tantamount to declaring that they are indeed one in the same.”

The court examined the evidence that the LLC and its sole member operated as a single entity and found that the evidence, viewed most favorably to the plaintiffs, showed that the LLC was started with a capitalization of no more than $20,100, that it proceeded to invest millions of dollars supplied by its member, and that the member put money into the LLC as needed and took money out as the member needed it. The LLC had only one officer other than its member, and the officer was paid by the member or one of his corporations. The LLC shared space with other companies owned by the member and shared employees with the member or other companies owned by the member. The member formed the LLC to be used as an investment vehicle for him to make investments, and the ultimate decisions were always made by the member. The court reviewed evidence relating to financial transactions involving the LLC, including transfers to the member or third parties on his behalf in connection with living expenses. The individual in charge of the LLC’s financial records testified that the member made the decision to treat moneys deposited into the LLC as loans so that the member could make withdrawals as he needed money without having to pay taxes on the money withdrawn. The loans were not evidenced by written agreements, and there were no set repayment programs or terms. The member decided when to put money in or take money out of the LLC. The court concluded that this evidence was ample to permit a reasonable factfinder to find that the member completely dominated the LLC and treated its bank account as one of his pockets. The court then reviewed evidence relating to fraud, illegality, or injustice and stated that there may be overlap in the proof offered to show the LLC and member operated as a single entity and the proof relating to unfairness. The court found evidence of injustice in an affidavit submitted by the member to counter the plaintiffs’ contention that the LLC was undercapitalized. The affidavit stated that the member did not intend for the monies paid to the LLC to be treated as loans and that such payments were in fact capital contributions. The court pointed out that the individual in charge of the LLC’s books testified that the member instructed him to treat the payments as loans so that the member could take money out of the LLC without tax consequences. The court pointed out that the member’s withdrawals of money from the LLC would be properly characterized as distributions if the payments to the LLC were capital contributions and that distributions to the member may well have violated the prohibition on distributions under the Delaware LLC statute given that the LLC had ceased operating and was unable to pay its debt to the plaintiffs. The court stated that a factfinder could infer that the member’s payments to the LLC were deliberately mischaracterized as loans to mask the fact that the member was making withdrawals prohibited by law. The court also stated that a reasonable factfinder could find that the member operated the LLC in his own self-interest in a manner that unfairly disregarded the rights of the LLC’s creditors given various payments and withdrawals on the member’s behalf at a time when the LLC was unable to pay its debt to the plaintiffs and evidence that the member withdrew more money from the LLC than he put in. The court concluded by finding that neither the LLC member nor the plaintiffs were entitled to summary judgment on the veil piercing claim.

**Sanchez v. Mulvaney**, 274 S.W.3d 708 (Tex. App. 2008). The plaintiffs sought to hold an LLC member liable for the LLC’s breach of contractual obligations on the basis that the LLC had forfeited its status as a Texas LLC. The court stated the general rule that members are not individually liable for the debts of a limited liability company. The court then stated that the LLC was a “limited liability corporation,” to which state law principles for piercing the corporate veil apply, and that the plaintiffs could hold the member liable for the LLC’s alleged breach of contract only to the extent they pierced the corporate veil. The plaintiffs relied only upon provisions of the Texas Tax Code regarding forfeiture and brought forth no evidence of fraud that would entitle them to hold the member individually liable; therefore, the court concluded that the trial court properly granted summary judgment in favor of the member on the breach of contract claim. However, the court of appeals stated that the trial court erred in rendering summary judgment in the member’s favor with respect to certain non-contract claims. The court stated that the plaintiffs’ allegations of the member’s own tortious and fraudulent actions, including alleged Deceptive Trade Practices Act violations, did not depend upon veil piercing because a corporation’s agent is personally liable for his own fraudulent or tortious acts, even when acting within the scope of employment.

**Smith v. Riverwalk Entertainment LLC**, Civil Action No. 05-1416, 2008 WL 3285909 (W.D. La. Aug. 8, 2008). The court considered an argument that several affiliated LLCs were part of a single business enterprise so that
each was liable for the actions of the other. The court explained that the single business enterprise theory is a vehicle for holding a group of affiliated entities responsible for the obligations of one of the entities. The court concluded that the evidence in the record raised a genuine issue of material fact regarding the relationship of the LLCs so as to preclude summary judgment on this issue.

_Waterview Site Services, Inc. v. Pay Day, Inc._, Nos. CV054004988S, CV065001330S, 2008 WL 4307871 (Conn. Super. Aug. 8, 2008) (finding that individual was acting as vice president and agent of LLC (which was identified earlier in opinion as Pay Day, Inc., and thus may actually have been corporation) and that plaintiffs failed to establish that corporate veil should be pierced to hold individual liable).

_Handam v. Wilsonville Holiday Partners, LLC_, 190 P.3d 480 (Or. App. 2008) (stating that plaintiff’s allegations might allow inference that individual who was LLC’s “principal” or “shareholder” followed poor business practices, but did not allow inference that individual’s conduct was dishonest or deceitful or intended to harm third party and thus did not justify piercing “corporate veil” to hold individual personally liable for default judgment against LLC).

_In the Matter of Athena Construction, L.L.C.,_ Civil Action No. 06-2004, 2008 WL 318743 (W.D. La. Aug. 4, 2008) (stating that corporations and LLCs are generally recognized as distinct legal entities under Louisiana law and granting summary judgment motion of LLC’s parent company because there was no evidence that parent was LLC’s alter ego or that they constituted a single business enterprise, and thus no genuine issue of material fact as to parent’s liability for damages resulting from LLC’s alleged negligence or alleged unseaworthy condition of LLC’s barge).

_Securities and Exchange Commission v. Wolfson_, 539 F.3d 1249 (10th Cir. 2008) (stating that court would consider all claims in securities fraud civil enforcement action against Colorado LLC and its managing member jointly in absence of any allegation that LLC had corporate identity separate from managing member).

_Connecticut Light and Power Company v. Westview Carlton Group, LLC_, 950 A.2d 522 (Conn. App. 2008). The court discussed the instrumentality test for piercing the corporate veil and determined that there was ample evidence to support the trial court’s determination that the veil of the defendant LLC should be pierced to hold the sole member liable for its unpaid electricity bills. The LLC lacked a registered agent, filed no annual reports with the Secretary of State, lacked any documentation required for an LLC under the LLC statute, failed to maintain any business records for its property, failed to file any tax returns for the years involved, and was undercapitalized. There was also evidence that the member commingled LLC funds for his own benefit by transferring funds from the LLC to another entity controlled by him for purported payment of undocumented and unsubstantiated loans. Finally, when the LLC sold its property, the member rather than its creditor was the beneficiary of the proceeds of the sale. The court rejected the defendants’ suggestion that this was simply a case of a single shareholder being charged with a corporate debt solely based on his ownership status. The court stated that there was ample evidence that the LLC had no separate existence and that it was used to perpetrate an unjust act in contravention of the plaintiff’s legal rights.

_Double Construction Company, LLC v. Advanced Home Builders, LLC_, No. CV065003609, 2008 WL 4050864 (Conn. Super. Aug. 6, 2008) (noting that corporate veil piercing principles apply to LLCs and finding that evidence established that father and daughter owners of LLC were liable for LLC’s breach of contract under instrumentality and alter ego theories).

_State v. Cruz_, No. 36568-5-II, 2008 WL 2811270 (Wash. App. July 22, 2008) (stating that member of LLC is not personally liable for debt or liability of LLC under Washington law, noting that Washington LLC statute permits veil piercing but that no such claim was asserted, and concluding that LLC member was not proper party in dispute over bail bond money remitted to LLC issuer of bond).

_Sentry Medical Products, LLC v. American Dental Supply, LLC_, No. 02-C-426, 2008 WL 2694897 (E.D. Wis. July 3, 2008). Four years after obtaining a judgment against an LLC for breach of contract, the plaintiff sought to amend the judgment to add non-party individuals on the basis that they were the alter egos of the LLC. The court stated that Wisconsin courts had not construed state law to permit enforcement of judgments against non-parties in supplementary proceedings and that the court thus lacked jurisdiction over the individual alter ego defendants. Further, the court said
that the plaintiff’s claim would fail even if were properly before the court because the plaintiff had been litigating essentially the same issue it sought to raise in its post-judgment motion in California, and the California court had issued a decision rejecting the plaintiff’s alter ego claim. The plaintiff’s claim was thus precluded on claim preclusion principles. Its remedy if it disagreed with the California decision was to appeal that decision, not to start a new action in another state.

_Ypsilanti Community Utilities Authority v. MeadWestvaco Air Systems, LLC_, No. 07-CV-15280, 2008 WL 2610273 (E.D. Mich. June 30, 2008) (noting that unpublished Michigan cases have applied corporate veil piercing principles to LLCs and that defendant apparently did not argue that all LLC veil piercing claims are meritless, and concluding that plaintiffs adequately alleged facts plausible on their face to state veil piercing claim against member of Delaware LLC notwithstanding limited liability of members under Delaware and Michigan law).

_Beuff Enterprises Florida, Inc. v. Villa Pizza, LLC_, Civil Action No. 07-2159 (PGS), 2008 WL 2565008 (D. N.J. June 25, 2008) (interpreting claims against LLC’s managing member to be premised on veil piercing and finding allegations sufficient to survive motion to dismiss).


_Regency Centers, L.P. v. Civic Partners Vista Village I, LLC_, No. G038095, 2008 WL 2358860 (Cal. App. 4 Dist. June 11, 2008). The court concluded the trial court did not err in finding that the sole member of an LLC was liable for the LLC obligations as the LLC’s alter ego. The court recognized that the alter ego doctrine is applied strictly and sparingly under California and Delaware law, but found the trial court’s findings and analysis more than adequate to explain its reasons in imposing liability on the LLC’s member as its alter ego. The court pointed to the trial court’s findings that the LLC had no capitalization, that funds between it and a corporation owned by the member were used interchangeably, that the entities were controlled by the member without formalities, that the LLC had no employees, no books, and no positive income, that the LLC’s money was dissipated after it was reimbursed for costs and development fees, that the LLC was used for the convenience of its member and as part of his own finances, and that it would be inequitable to allow the LLC’s status to shield the member from liability.

_DeWitt v. Sealtex Company, Inc._, Nos. 273387, 273390, 274255, 275931, 2008 WL 2312668 (Mich. App. June 5, 2008) (holding trial court erred in piercing “corporate veil” of LLC where LLC was not mere instrumentality of its members, was formed in compliance with Michigan law, maintained separate books and records, filed tax returns, and was not used to commit fraud).

_Taurus IP, LLC v. DaimlerChrysler Corporation_, 559 F.Supp.2d 947 (W.D. Wis. 2008) (expressing skepticism regarding defendant’s arguments that Texas law absolutely protects managers of LLC from veil piercing liability or at least requires actual fraud rather than constructive fraud, but finding it unnecessary to address such issues inasmuch as justice could be served without piercing veil of LLC because claimant failed to establish that LLC was not likely to satisfy judgment).

_Rual Trade Ltd. v. Viva Trade LLC_, 549 F.Supp.2d 1067 (E.D. Wis. 2008) (stating that veil piercing of LLC is generally governed by law of state of organization, that factors justifying deviation from such rule were not present, and that complaint alleged sufficient facts for plaintiff to proceed on alter ego veil piercing claim).

_State Department of Transportation v. Pilothouse 60, LLC_, 185 P.3d 487 (Or. App. 2008) (holding that unity of ownership did not exist with respect to two parcels of land involved in condemnation proceeding where one parcel was owned by LLC and one was owned by LLC’s members because Oregon Supreme Court has rejected “unity of control” theory in condemnation context).
Double G.G. Leasing, LLC v. Underwriters at Lloyds, London, No. AANCV075003003, 2008 WL 2345205 (Conn. Super. May 16, 2008) (holding insurer was not entitled to pierce veil of LLC insured to impose “duties in the event of loss or damage” on LLC’s sole member under identity theory because there was no evidence transaction was tainted by fraud, but evidence showed unity of interest such that LLC had no independent existence and adherence to fiction of separate identity would defeat justice and equity by allowing LLC and its sole member to escape duties under policy).

Construction, LLC v. Gravelroad Entertainment, LLC, Civil Action No. 6:07-155-DCR, 2008 WL 2038878 (E.D. Ky. May 12, 2008). The plaintiff sought to pierce the veil of a Tennessee LLC to hold the three members liable for breach of contract and fraud. The court stated that Kentucky had the most significant relationship to the transaction despite the fact that the LLC was organized under Tennessee law, and the court relied upon a Kentucky Supreme Court case for the proposition that Kentucky law will apply to a contract issue if there are sufficient contacts and not overwhelming interests to the contrary. The court analyzed the evidence and found that it was insufficient to pierce the veil. The court spoke in terms of corporate veil piercing and found that the evidence showed that the plaintiff knew it was dealing with the LLC, and the plaintiff failed to present evidence demonstrating the LLC was undercapitalized or that the members ignored corporate formalities or blurred the distinction between themselves and the “corporation.” The court further found that the allegations did not support a claim for fraud as a basis to pierce the veil.

Westmeyer v. Flynn, 889 N.E.2d 671 (Ill. App. 2008). The plaintiff sought to pierce the veil of a Delaware LLC in order to hold the members liable for a judgment obtained by the plaintiff in a prior suit against the LLC. The court first rejected the defendants’ res judicata argument, relying on a prior case in which the court had held that a judgment creditor may choose to file a new action to pierce the corporate veil of a judgment debtor to hold individual shareholders and directors liable for a judgment against the corporation. The court next rejected the defendants’ argument that they could not be held liable under Delaware law for the judgment against the LLC. The court stated that Delaware law applied to the veil piercing claim, relying on the rule that efforts to pierce the corporate veil are governed by the state of incorporation, and the court concluded that there was authority for the application of the doctrine of piercing the corporate veil to a Delaware LLC although the plaintiffs did not rely on any reported Delaware decisions directly dealing with veil piercing. Relying on statements by Delaware courts regarding the liability protection of a Delaware LLC, the court concluded that a limited liability company should be subject to the same treatment as a corporation for liability purposes and that the doctrine of piercing the corporate veil applies to an LLC under Delaware law. The lower court thus erred in dismissing the plaintiff’s claims on the basis that the doctrine of piercing the corporate veil did not apply to the defendants’ LLC.

Gardner v. Marcum, 665 S.E.2d 336 (Ga. App. 2008) (acknowledging that LLC members are not liable for LLC obligations solely by reason of being members, stating that whether to pierce “corporate veil” is normally fact issue, and concluding that summary judgment holding members of LLC liable for return of funds paid to LLC must be reversed because undisputed facts did not establish as matter of law that LLC’s members were personally liable to account for funds paid by plaintiff to LLC).

Haynes Construction Co. v. Martino & Card Remodeling, LLC, No. CV085005514, 2008 WL 2039596 (Conn. Super. April 28, 2008). The plaintiff brought a breach of contract action against an LLC with whom the plaintiff contracted and sought to pierce the LLC’s veil to hold an individual member liable. The court held that the plaintiff established probable cause for a prejudgment remedy against the individual based on evidence that the individual completely dominated the LLC’s finances, policies, and business practices. The only other member had withdrawn from the business, and the individual was effectively the only member. He used his control to commit wrongs on plaintiff and others. The LLC received money from the plaintiff, and the individual misappropriated the money and caused the LLC to abandon the contract and leave suppliers and employees unpaid. The court stated that there was a complete unity of interest between the individual and LLC, observing that when the individual was forced to prove that he had paid employees to obtain additional money, he paid them out of his personal checking account.

Utzler v. Braca, No. FBTCV065003257S, 2008 WL 2068200 (Conn. Super. April 25, 2008). The plaintiff, an investor in a real estate LLC sought to pierce the veil of the LLC and hold the individual who managed the LLC liable for breach of the plaintiff’s contract with the LLC. The court concluded, after a lengthy discussion of the manner in
which the individual defendant operated the LLCs formed for his real estate development activities and estate planning purposes, that the plaintiff established the LLCs were the alter egos of the defendant under the instrumentality and identity theories.

**ColtTech, LLC v. JLL Partners, Inc.**, 538 F.Supp.2d 1355 (D. Kan. 2008). The court stated that the law of the state of organization of a foreign LLC governs the liability of a member and, applying Delaware law, concluded that the sole member of a Delaware LLC was not liable for the LLC’s debt. Since the sole member was not liable, neither could the sole member’s parent, the parent’s members, or sponsors of the parent’s members be held liable. Even if the plaintiff were able to pierce the veil of the LLC’s parent to impose debt on the parent’s holding company, which was also an LLC, no evidence supported imposition of liability on a private equity firm that was not a member of the LLC but merely a sponsor of one of several member investors. The plaintiff cited no authority for the proposition that a financial sponsor of a parent LLC’s member may be held liable for the debts of the LLC, even if the court pierced the veil of the subsidiary.

**In re Polo Builders, Inc. (Brown v. Real Estate Resource Management, LLC)**, 388 B.R. 338 (Bankr. N.D. Ill. 2008) (stating that Illinois state courts and bankruptcy courts apply corporate veil piercing principles to LLCs but finding that trustee’s attempt to pierce LLC veil failed (notwithstanding LLC’s failure to follow formalities required by operating agreement) because any harm resulted from trustee’s lack of due diligence in dealing with LLC and acceptance of risk associated with shell entity rather than any abuse of LLC form by its member and manager).

**Gonzalez v. Lehtinen**, No. 13-06-441-CV, 2008 WL 668600 (Tex. App. 2008). The court of appeals concluded that the trial court was presented with sufficient evidence to make an implied finding that a Texas LLC was the alter ego of Cardenas, a prominent Mexican citizen, and that Cardenas was thus subject to the reach of the Texas long arm statute as someone who “did business” in Texas. The court noted the difference between “jurisdictional veil-piercing” and veil-piercing for the purpose of imposing liability. In a jurisdictional veil-piercing case, the court stated that it does not assess certain issues such as fraud and undercapitalization. Instead, the focus was on whether Cardenas controlled the internal business operations of the LLC to a degree “greater than that normally associated with common ownership and directorship.” The court of appeals concluded the evidence was sufficient for the trial court to find that Cardenas was the alter ego of the LLC based on testimony that Cardenas gave personal assurances that he was “well-to-do” and there would be “no money problems with this type of business,” that Cardenas was so closely involved with the LLC business that he used its mailing address as his own and could almost always be reached by telephone when calling its phone number, and that, while the articles of organization did not distinguish between Cardenas and another individual as managing members, the other individual was in practice Cardenas’s subordinate and Cardenas was in charge of the business. There was also evidence that Cardenas negotiated with the plaintiff on behalf of the LLC, was virtually always present on the premises, owned the real estate on which the business was situated, and maintained an accountant at the facility to monitor the business at all times.

**K.C. Properties of N.W. Arkansas, Inc. v. Lowell Investment Partners, LLC**, ___ S.W.3d __, 2008 WL 659825 (Ark. 2008). Ozark Mountain Water Park, LLC (“Water Park LLC”) was formed for the purpose of operating a water park on land owned by Pinnacle Hills Realty, LLC (“Realty LLC”). Pinnacle Management Services, LLC (“Management LLC”) was the manager of Water Park LLC, and the members of Realty LLC and Management LLC were three LLCs owned by the three individuals who were the managers of Management LLC. Realty LLC sold the land to another party, and the 49% member of Water Park LLC sued the 51% member, as well as Management LLC, the individual managers of Management LLC, and the members of Realty LLC and Management LLC (i.e., the LLCs owned by the individual managers of Management LLC). The trial court granted summary judgment for the defendants. The supreme court first addressed the application of the provision of the Arkansas LLC statute protecting members and managers from liability for debts and liabilities of the LLC and the provision limiting liability of a member or manager to the LLC or other members for acts or omissions not constituting gross negligence or willful misconduct. The court held that the provision limiting liability of members and managers for debts and liabilities of the LLC was intended to prohibit suits against a member by a third party, and the court held that the only parties the 49% member of Water Park LLC could sue for gross negligence or willful misconduct were the 51% member and the manager of Water Park LLC. The court stated that Realty had no fiduciary duty to the plaintiffs, and the court found no basis to hold the defendants liable for breach of the operating agreement or breach of fiduciary duties. The court also affirmed the trial court’s grant of summary judgment.
on the plaintiffs’ claim that the veil of the LLCs should be pierced. The plaintiffs argued that there were fact issues precluding summary judgment on this claim and that the individuals, as managers of Management LLC, and the individuals’ LLCs, as members of Management LLC, were liable for the actions of Management LLC and the 51% member of Water Park LLC. The plaintiffs’ relied upon answers to interrogatories by the defendants that admitted that the LLC that was the 51% member of Water Park LLC technically had no members, no operating agreement, no books, no records, and no assets, that Realty paid all its bills, and that there had been no capital contributions or loans by the members. Based on Arkansas case law in the corporate context, however, the court concluded that the 51% member of Water Park LLC, Management LLC, and the LLCs owned by the individuals were all separate and distinct legal entities regardless of whether they included the same people. According to the court, there were no facts presented upon which the individuals’ LLCs could be held liable for the actions of Management LLC or the 51% member of Water Park LLC.

_All Metals Industries, Inc. v. TD Banknorth_, No. CV075002464S, 2008 WL 731954 (Conn. Super. Feb. 27, 2008) (stating that corporate veil piercing doctrines apply to LLCs, but striking LLC creditor’s claims against individual members of LLC in absence of allegations of elements of veil piercing; granting summary judgment as to defendants).

_Taurus IP, LLC v. DaimlerChrysler Corp.,_ 534 F.Supp.2d 849 (W.D. Wisc. 2008) (stating law of “state of incorporation”of veiled entity governs whether and when its corporate form should be disregarded; applying Texas corporate veil piercing principles to Texas LLC and concluding actual fraud was not required to hold LLC manager liable under alter ego doctrine and fact issues precluded summary judgment in favor of manager; granting summary judgment to Wisconsin LLCs because Wisconsin alter ego doctrine requires proof of control over entity regarding particular inequitable transaction and Wisconsin LLCs did not engage in any conduct closely related to Texas LLC’s alleged breach of warranty).

_Smith v. Teel_, 175 P.3d 960 (Ok. App. 2007). Applying case law from the corporate context, the court held that the LLC veil should not be pierced to impose liability on LLC members with regard to the duty to exercise reasonable care not to sell alcohol to a noticeably intoxicated person. The plaintiff’s wrongful death claim against two managers/owners of an LLC based on the LLC’s sale of alcohol to an intoxicated person failed because there was no evidence that the individual defendants personally sold alcohol to the patron involved, had knowledge that any employees served alcohol to a noticeably intoxicated person, or were present on the night in question.


_Gray v. Shaw_, No. 1 CA-CV 06-0298, 2007 WL 5439746 (Ariz. App. Aug. 9, 2007). The court found that the plaintiffs failed to offer evidence supporting their claim that three Arizona LLCs were the alter egos of the members where there was no evidence that the LLCs failed to follow legal formalities or commingled their finances with those of the members. Also, the plaintiffs did not assert that they were unaware they were dealing with LLCs. Assuming, without deciding, as the parties appeared to believe, that corporate veil piercing applies to LLCs, the court concluded the trial court properly granted summary judgment in favor of the members.

_In re Derivium Capital, LLC (Campbell v. Cathcart),_ 380 B.R. 429 (Bankr. D. S.C. 2006) (addressing corporate defendant’s motion to dismiss various claims filed by trustee of LLC against entity defendants owned by individual members of LLC and finding allegations supported alter ego veil piercing and substantive consolidation claims pursuant to which trustee sought to reach assets of corporate defendant to satisfy liabilities of LLC).
P. Authority of Members and Managers

*Jack J. Morris Associates v. Mispillion Street Partners, LLC*, C.A. No. 07C-04-023-RFS, 2008 WL 3906755 (Del. Super. Aug. 26, 2008). After an LLC agreement was amended to remove an individual (Burton) as a general manager, Burton continued to hold himself out as a representative of the LLC and signed an agreement with the plaintiff on behalf of the LLC. In this suit against the LLC for payments due under the contract signed by Burton, the plaintiff sought summary judgment. The court discussed the agency concepts of actual (express and implied) authority and apparent authority and determined that various questions related to whether Burton had actual or apparent authority were for the jury to decide. Accordingly, the plaintiff’s motion for summary judgment was denied.

*Pharmalytica Services, LLC v. Agno Pharmaceuticals, LLC*, C.A. No. 3343-VCN, 2008 WL 2721742 (Del. Ch. July 9, 2008). An LLC sought a preliminary injunction prohibiting a member from taking action on behalf of the LLC or holding himself out as an authorized representative of the LLC. In 2006, after discovering that a member had formed another business that was competing with the LLC, the board of the LLC removed the member from the management team and from the positions of president and CEO by majority vote. The member objected but made no formal challenge at the time. In 2007, the LLC sued the member asserting various claims sounding in breach of fiduciary duty, equitable and legal fraud, and breach of the LLC’s operating agreement. In 2008, the LLC learned that the member was in China asserting the LLC’s rights to appoint designees to the board of a joint venture between the LLC and a Chinese entity, prompting the LLC’s motion for a preliminary injunction. The member argued that his removal required the unanimous vote of the board of directors of the LLC because the operating agreement required a unanimous vote of the board for major decisions. The LLC relied upon provisions of the operating agreement giving the board authority to remove a member of the management team with or without cause based on a majority vote and providing that senior officers and other managers could be dismissed by the board for illicitly seeking personal gain or other delinquent behavior. The court characterized the preliminary injunction sought as in the nature of a status quo order under Section 18-110 of the Delaware Limited Liability Company Act, which is comparable to Section 225 of the Delaware General Corporation Law. That provision allows for continued operation of the business, with a goal of minimal disruption, while the identities of those properly holding corporate power can be established. The court pointed out that the member did not act in a constructive or direct fashion for the benefit of the LLC for 18 months following the 2006 meeting at which he was removed from his management positions, and his appearance in China and assertion of authority on behalf of the LLC was inconsistent with his course of action since the 2006 meeting and with the expectations of a majority of the members. The court stated that the rational, ongoing governance of the LLC required certainty as to who was running the LLC and that preserving the status quo as traditionally done in the corporate setting was the proper course. The court concluded that the management that had been in control since 2006 should remain in control in the interim and that the member should be precluded from purporting to represent the interests of the LLC. The court noted that the traditional analysis for a status quo order under the corporate and LLC statutes eschews the formalistic application of the preliminary injunction framework; however, because the LLC presented its claim as a request for a preliminary injunction, the court adhered to those standards and found that the LLC had demonstrated a reasonable probability of success on the merits that the member should not be acting on its behalf, that the member’s conduct in China without ongoing authority was likely to cause significant and irreparable harm, and that a balancing of harms weighed in favor of the LLC.

*Maitland v. Int'l Registries, LLC*, Civil Action No. 3669-CC, 2008 WL 2440521 (Del. Ch. June 6, 2008). A 50% member of an LLC did not have authority to retain counsel for the LLC defendant in a case brought by the other 50% member where the plaintiff member did not consent to hiring counsel. The LLC agreement vested management in the members and provided that the decision of the members holding a majority of all interests shall be controlling. The LLC agreement also provided that the initial members were granted all rights, powers, authorities, and authorizations necessary, appropriate, advisable, and convenient to manage the LLC and carry out its affairs, but the court rejected the argument that this latter provision gave one member the power to retain counsel and file an answer for the LLC because such an interpretation would also give the other member the same authority. Since a deadlocked LLC cannot validly retain counsel and file an answer, the court granted the plaintiff member’s motion to strike the answer filed by counsel retained by the other member and disqualify the attorney as counsel for the LLC, but the court permitted the other member to intervene as a party defendant to defend on behalf of the LLC.
Cascade Falls, L.L.C. v. Henning, 143 Wash.App. 1056, 2008 WL 934074 (Wash. App. April 8, 2008). Two brothers, Scott and Greg Henning, formed a Washington LLC. A few years later, they discussed going their separate ways, and Greg withdrew. After operating the LLC as its sole member for several years, Scott learned of irregular business and accounting activities by Greg. Unbeknownst to Scott, Greg had continued to operate using the LLC’s name and one of its bank accounts. Scott filed this lawsuit, alleging breach of fiduciary duties, fraud, and conversion of the LLC’s money by Greg. Greg argued that the trial court erred by refusing to give his requested jury instruction on actual or apparent authority. Greg contended that, for Scott and the LLC to claim the funds in a bank account holding the proceeds of a project completed by Greg on behalf of the LLC prior to Greg’s withdrawal, Greg must have had actual or apparent authority to sign the contract in the LLC’s name. Absent such authority, Greg claimed Scott and the LLC could have no ownership interest in the funds. Greg failed to preserve this argument for review by failing to include the proposed instruction in the appellate record.

Halstead Brooklyn, LLC v. 96-98 Baltic, LLC, 854 N.Y.S.2d 437 (N.Y. A.D. 2 Dept. 2008) (holding that purported brokerage agreement that was not signed by managing member of LLC in accordance with its operating agreement could not be relied upon to establish amount of brokerage commission due).

Fielbon Development Company, LLC v. Colony Bank of Houston County, 660 S.E.2d 801 (Ga. App. 2008) (holding that LLC was obligated to bank on promissory note signed by owner/manager even if funds were obtained for owner’s personal use because loan was in LLC’s ordinary course of business and owner’s actions in connection therewith were not so dissimilar from acts LLC had authorized owner to perform as to make them “not apparently carrying on in the usual way the business or affairs” of LLC).

Kite Ranch, LLC v. Powell Family of Yakima, LLC, 181 P.3d 920 (Wyo. 2008) (upholding trial court’s preliminary injunction giving member with positive capital account exclusive management authority (excepting certain extraordinary actions) in LLC whose members did not execute operating agreement because trial court’s action merely enforced management rules required by Wyoming law and maintaining status quo in operating business does not mean decision cannot be made).

Old National Villages, LLC v. Lenox Pines, LLC, 659 S.E.2d 891(Ga. App. 2008) (interpreting authority of general manager under operating agreement and concluding manager had authority to enter consent judgment even though sole member had no notice of complaint or consent judgment; noting that holding otherwise would undermine separate entity status of LLC and its member).

Crouse v. Mineo, 658 S.E.2d 33 (N.C. App. 2008). The court discussed the agency and management provisions of the North Carolina LLC statute and concluded that the plaintiff, a member/manager of an LLC, did not have authority to file this action on behalf of the LLC against his co-member/manager based on alleged misappropriation of LLC assets, but the plaintiff did have standing to file a derivative action.

In re Kingsville Motors, Inc. (Almy v. Brown), No. 04-33755-DK, 2008 WL 686724 (Bankr. D. Md. March 12, 2008). Two investors in an LLC asserted an unjust enrichment claim against the debtor corporation based on funds loaned to the debtor by the LLC’s president. The investors furnished the funds by checks made payable to a name that was similar to the LLC’s but was also the name of a corporation that had been formed by the LLC’s president without the knowledge of the investors. The investors intended the funds to be used by the LLC to purchase real estate from the debtor corporation, but the president funneled the funds to the corporation through promissory notes payable to the president and the corporation with the name similar to the LLC’s. The trustee argued that the investors’ unjust enrichment claim was barred because they were negligent in failing to consult an attorney in connection with their execution of the operating agreement and investment in the LLC. The court held that the claim was not barred. In hindsight, commented the court, the investors should have consulted an attorney, but Maryland law does not require an attorney to be consulted, and the LLC’s president was a long-time colleague in whom the investors placed their trust. The trustee also argued that the LLC’s president was authorized to enter the transactions in issue. Though the LLC had broad powers under the Maryland LLC statute, and the operating agreement gave the president broad management powers to invest funds for the purposes of the LLC, the court stated that the president did not have unfettered power to
transfer the LLC’s assets where the stated purpose communicated to the investors of the invested funds was to acquire real property from the debtor corporation, not to provide operating funds to the corporation.

**Internal Medicine Alliance, LLC v. Budell,** 659 S.E.2d 668 (Ga. App. 2008). Two doctors, Verbitsky and Budell, formed a manager-managed LLC and agreed that each was a 50% member, that they would share equally in profits and losses, and that they would jointly manage the LLC. After a falling out, Budell agreed to leave and form his own practice. The members agreed that Budell was entitled to a redemption of his interest but were unable to agree on a buy out price for Budell’s interest. In litigation that ensued, the trial court awarded Budell the fair value of his interest and found that Verbitsky breached her fiduciary duty to the LLC and Budell after Budell’s departure. The trial court found that Verbitsky’s failure to repay Budell his capital contribution did not support a conversion claim. Both parties appealed. With respect to the breach of fiduciary duty claim against Verbitsky, the court stated that LLC managers have a fiduciary duty to act with the utmost good faith and loyalty. Verbitsky argued that she did not exercise management over the LLC and that, to the extent she did, it was agreed that Verbitsky and Budell would handle his or her own accounts receivable. Verbitsky argued that another individual who was not a member was the manager of the LLC, but the court concluded he was not a manager because the Georgia statute requires a non-member manager to be designated, appointed, or elected by more than one half of the members, and there was no evidence that the individual was ever chosen as a manager with the approval of both Verbitsky and Budell. The court concluded that after Budell’s departure he became a passive member and Verbitsky became the sole manager with a fiduciary duty to manage the LLC’s affairs in the manner she believed in good faith to be in the best interests of the LLC.

**Pantazopoulos v. Garden State Cardiology,** 2008 WL 509829 (N.J. Super. Ch. Feb. 25, 2008) (concluding that filing of Form 8082 in which member identified himself as representative of LLC and proposed amended return was willful violation of court’s order enjoining member from taking any action in name or on behalf of LLC or representing that he had any authority with regard to LLC).

**City of Seattle v. Professional Basketball Club, LLC,** No. CO7-1620MJP, 2008 WL 539809 (W.D. Wash. Feb. 25, 2008) (ordering LLC to produce certain email messages of members because emails of members were documents under “possession, custody, or control” of LLC by virtue of agency status of members).

**Sunflower Bank, N.A. v. Airport Red Coach Inn of Wichita, L.L.C.,** No. 95,320, 2008 WL 360641 (Kan. App. Feb. 8, 2008). An LLC operating agreement provided that the members could appoint a member as general manager of the LLC and that such person would have authority to execute instruments on behalf of the LLC. The operating agreement also required consent of all members for LLC borrowing. The members appointed a manager who signed certain promissory notes on behalf of the LLC, and the bank argued that the members must have intended for the manager to have some discretionary authority. The court held that the managing member was not authorized to execute the promissory notes because the members did not approve the loans. The court found that the term “execute” meant the power to sign loan documents on behalf of the LLC, but only once the authority to borrow had been granted by all members. The manager did not have implied authority because the LLC members had no idea he was borrowing the money. The bank could not rely on statutory provisions regarding the manager’s apparent authority because the bank had a copy of the operating agreement and thus had written notice of the limits on the manager’s authority.

**Q. Admission of Members**

**County of Durham v. Time Warner Entertainment Advance Newhouse Partnership,** No. 1:08CV225, 2008 WL 4287943 (M.D.N.C. Sept. 16, 2008). The court rejected the argument that “Series A Members” of a Delaware LLC, who exercised no management control and were treated as holders of non-voting preferred stock for federal income tax purposes, did not represent true ownership and were not members of the LLC for purposes of determining the LLC’s citizenship in this diversity case. The court stated that it was not the province of the court to analyze the “business reality” of the LLC’s structure, and the LLC agreement unambiguously specified that Series A Members together with the “Common Equity Member” constituted the “Members” of the LLC pursuant to the Delaware Limited Liability Company Act. The court also held that it was the citizenship of the entity for whose benefit the Series A interest was held that must be considered rather than the citizenship of the nominee owner.
Falgoust v. Hart Eye Center, LLC, 984 So.2d 958 (La. App. 2008). An ophthalmologist, Dr. Falgoust, entered a professional services agreement with another ophthalmologist, Dr. Hart, under which Dr. Falgoust worked for Dr. Hart’s LLC and made buy-in payments totalling over $200,000. Dr. Falgoust terminated the agreement and filed suit for breach of contract against Dr. Hart and the LLC, seeking reimbursement for the buy-in payments. The court held that Dr. Falgoust had not acquired an ownership interest under the terms of the agreement, and that his termination of the agreement prior to acquiring an ownership interest precluded him from asserting a claim for reimbursement as an owner. A dissenting judge disagreed with the majority’s interpretation and argued that the buy-in payments were made for the purpose of investing in the LLC and that Dr. Falgoust acquired an ownership interest.

Mission Primary Care Clinic, PLLC v. Director, Internal Revenue Service, Civil Action No. 5:07cv162-DCB-JMR, 2008 WL 2789504, 102 A.F.T.R.2d 2008-5256 (S.D. Miss. July 17, 2008). Stanley, a licensed physician, was a member of a professional LLC and the president and sole shareholder of an S corporation that performed services on behalf of the LLC through Stanley. The question in this case was whether payments made by the LLC to Stanley and/or his corporation were “wages or salary payable to or received by” Stanley for purposes of the continuous levy provision of Section 6331(e) of the Internal Revenue Code. The LLC argued that it was not indebted to Stanley for any undistributed profits on the date on which the LLC received the notice of levy and that Stanley was a member who received profits based upon the amount of fees he produced and not an employee to whom it paid a wage or salary. The IRS asserted that Stanley and/or his corporation should be treated as an employee or independent contractor inasmuch as they were compensated based on the amount of money collected by Mission for medical services which Stanley rendered rather than based on the membership interest of Stanley and/or his corporation in the LLC. The IRS argued that the fact that the LLC labeled Stanley and/or his corporation as its member did not change the factual nature of the relationship as that of an employee or an independent contractor. The LLC contended that the services were performed by Stanley in his own behalf as a member of the LLC and that there was no evidence that Stanley was contractually bound to provide services for the LLC. According to the LLC, it merely acted as a collection conduit (after deduction of its operating expenses) for the payments which Stanley's patients made to his corporation for medical services that Stanley had rendered and for which the corporation had billed. The LLC argued that the case law upon which the IRS relied did not support the position that profits paid to member physicians of a professional LLC constitute “wages and salary” subject to a continuing levy under the relevant federal statutes. The court cited case law construing “salary or wages” broadly for purposes of the continuing levy provision, and the court concluded that the term includes fees paid to an independent contractor as compensation for services rendered. The court concluded that there was a fact question as to whether Stanley provided services to the LLC as an independent contractor.

East Quogue Jet, LLC v. East Quogue Members, LLC, 857 N.Y.S.2d 627 (N.Y. A.D. 2 Dept. 2008) (holding that lower court erred in granting summary judgment in dispute over party’s status as member where operating agreement purportedly signed by all members reflected party’s membership interest but two investors submitted affidavits stating that their signatures were forgeries and that they never signed any agreement permitting receipt of membership interest without contributing any money).

Bank Hapoalim (Switzerland) Ltd. v. XG Technology, Inc., No. 8:07-cv-170-T-23MSS, 2008 WL 126583 (M.D. Fla. 2008). The plaintiff’s breach of fiduciary duty suit against individuals who were managers of a Delaware LLC that converted into a corporation failed because the plaintiff, an assignee of securities in the LLC, did not establish that it was admitted as a member of the LLC. The plaintiff also failed to establish that it became a shareholder in the corporation as a result of the conversion and failed to overcome the presumption that the individual defendants were protected by the business judgment rule as directors and officers of the corporation; therefore, the breach of fiduciary duty claims against the individuals as officers and directors failed as well. The plaintiff was a bank that was assigned units in the LLC by a member of the LLC prior to the conversion. At the request of the member, the LLC issued a certificate stating that the bank was the owner of four million units. A few months later, the LLC informed the bank that a pledge existed against the certificate and that the securities were null and void due to the member’s default under the pledge agreement. After the conversion, the corporation went public. The documents relating to the conversion did not account for the bank’s securities or list the bank as a shareholder of the corporation. The bank asserted that the managers of the LLC owed it a duty of loyalty and care as “legal title holders of the securities” and that the managers breached their duties by failing to safeguard the membership interest of the bank, failing to notify the bank of the conversion, failing to account for the securities in the public offering, and refusing to convert the securities of the LLC. The court stated
that the manager of a Delaware LLC owes a fiduciary duty of loyalty and care only to the company and its members. Thus, absent an allegation that the bank was a member or a party to or otherwise bound by the LLC’s agreement, the court concluded the breach of fiduciary duty claim based on the defendants’ status as managers could not stand. Because the complaint did not even mention the LLC agreement, the court stated that the key issue was whether the complaint sufficiently alleged that the bank, an assignee of a member of the LLC, assumed member status. The court pointed out that the Delaware LLC statute provides that an assignee may become a member with the approval of all the members other than the assigning member or in compliance with the LLC agreement. The court also quoted the provision of the Delaware LLC statute that provides that an assignee becomes a member when the person’s permitted admission is reflected in the records of the LLC. Since the complaint did not allege approval by the members, compliance with the agreement, or reflection of the bank’s admission as a member in the LLC records, the complaint failed to allege that the defendants owed the bank a fiduciary duty. Having failed to allege its status as a member of the LLC, the bank also failed to allege its status as a shareholder of the corporation resulting from the conversion. The bank relied upon the statutory conversion provision that states that the rights, securities, or interests in the converting LLC may be exchanged or converted into securities or interests for the converted entity, but the court stated that this provision permits, but does not require, conversion of the LLC interests, and that the statutory provision also authorizes cancellation of interests. Because the complaint failed to allege the bank’s status as a shareholder, and based on the presumption of propriety of director and officer actions under the business judgment rule, the court held that the breach of fiduciary duty claim against the defendants as corporate officers and directors failed. The court also dismissed claims seeking an order compelling conversion of the LLC securities into shares of the corporation and issuance of the converted shares as well as a claim for damages resulting from the refusal to convert the securities because the statutory conversion provision relied upon by the bank does not require conversion of the interests of the converting LLC into securities of the entity into which the LLC is being converted.

_Glasnak v. Garmo_, No. 275555, 2008 WL 466886 (Mich. App. 2008) (stating that arbitrator’s decision that member was admitted to existing LLC without being obligated to make future capital contributions as provided in LLC’s operating agreement was not error of law because Michigan LLC statute provides that member may be admitted without incurring any obligation to make capital contribution and arbitrator found there was no evidence member ever agreed to be bound by operating agreement provision regarding additional capital contributions).

_Rhodehamel v. Rhodehamel_, No. C07-0081Z, 2008 WL 249042 (W.D. Wash. Jan. 29, 2008). An individual, Emma, established an LLC in which she retained a 70% interest and assigned each of her three grown children a 10% interest. Emma funded the LLC with assets from her revocable trust. Emma’s daughter Joyce, who was 54 years old and had no children, was dissatisfied with the terms of the LLC, which restricted transfer of a member’s interest to another member or a lineal descendant or ascendant of the individual. Joyce’s attorney wrote a letter to the individual’s attorney stating that Joyce had “intentionally disclaimed the gift of LLC interest as currently structured.” After Emma’s death, Joyce sought an accounting of the LLC and asserted that the disclaimer was not valid. The court held that the disclaimer did not meet the statutory requirements for a disclaimer, but upheld Joyce’s exclusion from the LLC. The evidence showed that Emma understood Joyce to be declining the gift, and the LLC membership was thus amended from 10% for each of the individual’s three children to 25% interests for each of the other two children. The increase in the other children’s membership was accomplished by a gift of part of Emma’s interest under the LLC agreement. The court said that Emma could have made the same arrangements even if Joyce had not purported to disclaim her interest because Emma directed the transfer of assets from her trust to the LLC and made the redistribution of LLC shares via her notarized signature. In light of Emma’s understanding of Joyce’s intent, the court would not permit Joyce to be heard to complain that she should have received some share of the LLC.

_Parsons & Whittemore Enterprises Corporation v. Cello Energy, LLC_, Civil Action No. 07-0743-CG-B, 2008 WL 227952 (S.D. Ala. Jan. 25, 2008). The plaintiff entered certain agreements with an Alabama LLC regarding the use and development of technology and under which plaintiff obtained an option to acquire an interest in Alabama LLC. The plaintiff sued the LLC and other parties to prevent them from taking actions and performing under agreements in conflict with plaintiff’s agreements with the LLC. In analyzing whether the court had diversity jurisdiction, the court concluded that the plaintiff was not a member of the LLC because it was not listed as a member in either the LLC’s articles of organization or operating agreement, and a member is defined in the Alabama LLC statute as a person reflected in the LLC’s required records as an owner of some governance rights of a membership interest.
R. LLC Property/Interest of Member

*Reza v. Reza*, No. 2-07-371-CV, 2008 WL 4445619 (Tex. App. Oct. 2, 2008) (noting that membership interest in LLC is personal property and that member has no interest in specific LLC property and holding that trial court in divorce action abused its discretion when it awarded to husband all interest in entity variously referred to as corporation and LLC where mediated settlement agreement did not divide or mention entity and alter ego was neither pled nor tried).

*Hornick v. Boyce*, 280 Fed.Appx. 770 (10th Cir. (Col.) 2008) (noting absence of Colorado case law on question of whether 50% owner/passive investor in closely held business is qualified to testify regarding value of assets owned by entity, and holding it was not plain error for 50% passive owner of Colorado LLC to testify regarding value of 5,000 acre ranch which was LLC’s sole asset).

*Timm v. Montana Dept. of Public Health and Human Services*, 184 P.3d 994 (Mont. 2008) (noting potentially different treatment of property of LLCs and corporations for purposes of Medicaid eligibility and concluding that rationale for “no corporation, no trust” rule could not withstand scrutiny and violated equal protection as applied to petitioner in this case).

*Hernandez v. Hernandez*, 249 S.W.3d 885 (Mo. App. 2008) (affirming trial court’s finding that apartment buildings acquired by husband prior to marriage were transmuted into marital property by his contribution of buildings to LLC of which husband and wife were equal members and joint managers).

*VanderWerp v. Plainfield Charter Township*, 752 N.W.2d 479 (Mich. App. 2008). The homestead exemption was not available for property that was the residence of the settlor/trustee of a revocable trust that was the sole member of an LLC to which the property had been transferred. Under the Michigan statutes, only an “owner” may claim the homestead exemption. An “owner” includes a grantor who has placed the property in a revocable trust, but the property in this case was conveyed to the LLC of which the grantor trust was the member. An LLC member has no specific interest in LLC property, and the definition of “owner” for purposes of the homestead exemption was not broad enough to include an LLC.

*Ott v. L & J Holdings, LLC*, 654 S.E.2d 902 (Va. 2008). The court held that a deed to an LLC from a husband and wife, executed by the wife acting for herself and under power of attorney from the husband, was not a gift deed despite the caption designating it as such. The transfer was undertaken for legitimate business reasons, and the husband and wife received benefits, including possible future tax benefits commensurate with their percentage interests, without self-dealing on the wife’s part. The deed was thus within the power granted by the husband’s power of attorney.

*In re McGrath (Gray v. Assali)*, Bankruptcy No. 05-90165-A-7, Adversary No. 07-9002, 2008 WL 859152 (Bankr. E.D. Cal. March 31, 2008) (finding that two couples took their interests in LLC individually rather than through another LLC, that creditor did not have attached or perfected security interest in LLC interest, and enforcement of claim against debtor’s LLC interest after filing of bankruptcy petition was willful violation of automatic stay even if claimants consulted attorney and were under mistaken impression that debtor did not own LLC interest because they knew of debtor’s bankruptcy; holding that under California law, recovery for conversion is limited to cases involving tangible personal property and liability for conversion of LLC interest would only exist if defendant had taken something tangible representing interest such as shares of stock).

*Bruno v. Bruno*, No. FA054004906S, 2008 WL 907512 (Conn. Super. March 17, 2008) (finding that shares in LLC previously held by terminated employee became treasury shares, acknowledging that Delaware LLC statute does not provide for creation of “treasury shares” as such, but noting that statute permits LLC to purchase, redeem, or otherwise acquire LLC interests and that such interests are deemed cancelled unless otherwise provided in LLC agreement, and concluding that, under settlement agreement which provided for forfeiture of terminated employee’s interest in LLC, terminated employee no longer owned his interest in LLC and it had been cancelled by virtue of Delaware LLC statute).
Riverboat Development, Inc. v. Indiana Department of State Revenue, 881 N.E.2d 107 (Ind. Tax Ct. 2008). The court held that income of a Kentucky S corporation from a minority interest in an LLC that operated a gambling riverboat in Indiana was not “adjusted gross income derived from sources within Indiana” for purposes of withholding requirements on income passed through to non-resident shareholders. The LLC interest is intangible personal property, and income from intangible personal property is from an Indiana source under the Indiana tax laws if the receipt from the intangible is attributable to Indiana. Receipts in the form of dividends from investments are attributable to Indiana if the taxpayer’s commercial domicile is Indiana, and the S corporation was not domiciled in Indiana. Thus, the income the S corporation received as a result of its membership in the LLC was not “adjusted gross income derived from sources within Indiana” and was not subject to the withholding obligations applicable to such income.

Matz v. Meredith, No. 2 CA-CV 2006-0151, 2007 WL 5290465 (Ariz. App. July 25, 2007). After a falling out among the members of an LLC that operated an emergency veterinary clinic, two of the members formed a new entity to operate a new emergency clinic at the same location. The original LLC was ordered judicially dissolved in litigation between the members, and the dissolution proceeding was eventually consolidated with another action brought by one of the members (Matz) against the two members who formed the new clinic. Matz claimed that the two members who formed the new clinic “appropriated and distributed to themselves” all of the intangible assets of the LLC, including its goodwill, and that these actions violated the LLC’s operating agreement because the assets were not distributed equally to the members. The trial court concluded that the two members who appropriated the goodwill were liable under the Arizona wrongful distribution statute and that the value of Matz’s interest in the distribution was $188,000. The two members who formed the new clinic argued that a dissolved business can have no goodwill as a matter of law, but the court rejected that argument. The court of appeals concluded that the trial court did not err in finding that the dissolved LLC had goodwill and that the two former members who conducted business at the same location as the old LLC were liable for appropriating it. The court also found that the trial court’s determination of the value of the LLC’s goodwill was not clearly erroneous. The court of appeals questioned whether appropriation of an LLC’s assets by members is a “distribution” as contemplated by the distribution statute, but assumed, without deciding, that it was proper for the trial court to grant relief under the distribution statute since the members did not address the issue on appeal.

S. Fiduciary Duties of Members and Managers

M.C. Multi-Family Development, L.L.C. v. Crestdale Associates, Ltd., 193 P.3d 536 (Nev. 2008). The operating agreement of a residential real estate development LLC contained the following provision permitting members to engage in competition:

This Operating Agreement shall not preclude or limit in any respect the right of any Member or Administrative Committee Member to engage in or invest in any business activity of any nature or description, including those which may be the same or similar to the Company's business and in direct competition therewith. Any such activity may be engaged in independently or with other Members or Administrative Committee Members. No Member shall have the right, by virtue of the Articles of Organization, this Operating Agreement or the relationship created hereby, to any interest in such other ventures or activities, or to the income or proceeds derived therefrom. The pursuit of such ventures, even if competitive with the business of the Company, shall not be deemed wrongful or improper and any Member or Administrative Committee Member shall have the right to participate in or to recommend to others any investment opportunity.

Although the minority member had the right to develop other projects, the LLC and its majority member sued the minority member and the minority member’s company alleging, inter alia, that the minority member and his company converted the LLC’s contractor’s license for their own purposes when they used the LLC’s license rather than obtain a separate contractor’s license to develop competing properties. The trial court entered a directed verdict in favor of the minority member on the conversion claim, and the supreme court reversed the trial court’s judgment and remanded for a trial on that issue. The court first determined that intangible property, such as a license, can be converted under Nevada law. The court then determined that the plaintiffs had offered sufficient evidence on the issue of whether the minority member’s use of the license constituted “wrongful dominion” over the license to overcome the motion for directed verdict. There was testimony that the majority member and manager did not grant the minority member permission to
use the LLC’s license and that the operating agreement did not authorize the use of the LLC’s license on the other projects even though it permitted members to engage in other projects. Although there was testimony that other members of the LLC used the license on individual projects, the court stated that the evidence was not so overwhelming that a verdict against the minority member would be contrary to law, and the probative value of any prior course of conduct concerning the license was undermined by the fact that the use of the license by other members occurred prior to the current majority member’s acquisition of its interest in the LLC. The court noted that the fact that the jury found in favor of the minority member on the other claims of wrongful conduct (which included breach of fiduciary duty claims) did not mean there could be no “wrongful dominion” with respect to the conversion claim. The court viewed the element of “wrongful dominion” as distinct from the “wrongfulness” element of other torts, and it was for the jury to determine whether the specific elements of conversion existed.


Barfield v. Murphy, 578 F.Supp.2d 638 (S.D.N.Y. 2008) (stating that member’s claim based on failure to disclose certain material facts might support direct suit because duty of disclosure was owed by defendant member to his fellow member).

Sports Imaging of Arizona, L.L.C. v. 1993 CKC Trust, No. 1 CA-CV 05-0205, 2008 WL 4448063 (Ariz. App. Sept. 30, 2008). An LLC asserted claims for conversion, breach of fiduciary duty, and breach of contract against an entity (Omi-Omni Medical Imaging, P.L.C. or “Omni”) serving as a manager of the LLC, the trust that owned 99% of Omni, and the individuals (Dr. and Mrs. Christensen) who managed and controlled Omni and the trust that owned 99% of Omni. The court stated that the Christensens could have personal liability for their involvement in tortious acts of Omni because corporate officers and directors are liable for their involvement in a corporation’s intentional torts, and the court concluded that there were genuine issues as to the personal liability of the Christensens for their involvement in Omni’s systematic dismantling of the LLC’s business and acts of alleged conversion of LLC assets. Though the court was not convinced that a statement by Dr. Christensen acknowledging that he and Omni owed the LLC fiduciary duties amounted to a judicial admission, the statement at least demonstrated a belief that Dr. Christensen owed a fiduciary duty and assisted in the creation of a fact issue regarding whether such a duty existed. Based on the fiduciary duty owed by Omni as manager of the LLC, the control exercised by the Christensens over Omni, and facts bearing on whether the Christensens assumed a fiduciary duty and participated in actions breaching Omni’s fiduciary duty, the court found that there were fact questions regarding the breach of fiduciary duty claims against the Christensens. Additionally, the court found that a trust controlled by the Christensens owed fiduciary duties to the LLC. The trust owned 15% of the LLC and 99% of Omni, and the court relied upon corporate case law holding that shareholders who have the ability to control a corporation owe a fiduciary duty to the corporation and other shareholders. The court concluded that there were fact issues regarding whether the trust breached its fiduciary duty to the LLC. The court noted that Arizona has not adopted the Uniform Limited Liability Company Act (ULLCA), which the defendants relied upon for the proposition that a member in a manager-managed LLC does not owe the LLC or another member a fiduciary duty. However, the court went on to note that ULLCA has been revised and that its current language supported the LLC’s argument in that the revised statute merely provides that a member in a manager-managed LLC does not owe a fiduciary duty solely by reason of being a member. The court cited commentary to the revised act that suggests a controlling member of a manager-managed LLC may be understood to owe a fiduciary duty. The court reviewed the evidence regarding the breach of fiduciary duty claims against Omni itself and found the evidence sufficient to support the jury’s finding in favor of the LLC on its breach of fiduciary duty claims against Omni. The court pointed out testimony by Dr. Christensen regarding the existence of a fiduciary duty and reviewed evidence of Omni’s control over the LLC. The court concluded that the evidence supported the jury’s finding that Omni breached its fiduciary duty by effectively destroying the LLC and driving it out of business. Omni argued that it could resign its role as manager and end its fiduciary obligation at any time, but the court found that, while Omni may have taken steps to resign as manager, it never formally did so. Even if Omni resigned, the court stated that its obligations continued with respect to certain assets that it continued to control. Omni’s ongoing responsibilities gave rise to fiduciary duties, and its ability to resign or withdraw its services as a manager was limited by a fiduciary obligation to provide reasonable notification. The court rejected other arguments made by Omni, including its argument regarding the measure of breach of fiduciary duty damages and the sufficiency of the evidence regarding conversion claims against Omni.
The LLC at a designated value. The manager appointed Meder, a 10% member, as vice president and later terminated

would be served. Removal was a dissociating event requiring the member to sell his interest to the other members or be removed by the manager with or without cause whenever in the manager’s judgment the best interest of the LLC would be served. Removal was a dissociating event requiring the member to sell his interest to the other members or the LLC at a designated value. The manager appointed Meder, a 10% member, as vice president and later terminated

Out of the Box Promotions, LLC v. Koschitski, 866 N.Y.S.2d 677 (N.Y. Sup. 2008). The plaintiff alleged that he and the defendant were each 50% members of an LLC, and the plaintiff brought a derivative suit alleging various acts of misconduct on the part of the defendant. The defendant sought dismissal on the grounds that the plaintiff was not a member and lacked standing, but the court found the documentation provided by the defendant failed to conclusively establish that the plaintiff was not a member. The court also found that the plaintiff stated a cause of action for wrongful interference with prospective contractual relations because the defendant, as an LLC manager, owed a fiduciary duty to the plaintiff and the LLC, and the alleged means employed by the defendant violated the duty of fidelity and thus constituted “wrongful means.” The complaint also stated a cause of action for unfair competition based on the defendant’s alleged diversion of LLC business by purposely causing confusion or mistake and appropriation of customers by using the LLC’s credit for his own new company. Finally, although inartfully stated, the plaintiff’s cause of action for solicitation of the LLC’s customers through false statements of the financial instability of the LLC sufficiently alleged a breach of fiduciary duty.

546-552 West 146th Street LLC v. Arfa, 863 N.Y.S.2d 412 (App. Div. 1st Dept. 2008). LLC plaintiffs brought this action against member/managers who allegedly received commissions in connection with the purchase of real estate by the LLCs without disclosing the commissions to the LLCs or to prospective investors whose investments were used to fund the closings of the property acquisitions. The court held that the LLCs lacked standing to assert the claims because the alleged wrongdoers were the only members and managers at the time the agreements for the commissions were entered into and their acts and knowledge were thus imputed to the LLCs. (The court noted that the investors had brought a parallel action in which the question of whether the investors were wronged when their investments were solicited would be determined.) According to the court, the adverse interest exception did not apply because it arises if the principal’s interests have been totally abandoned; the exception cannot be invoked merely because the agents have a conflict of interest or are not acting primarily for their principal. The pleadings did not allege or provide a basis for inferring that the original members and managers totally abandoned the interests of the LLC because they accomplished the LLCs’ main purpose of acquiring the properties. Further, the court held that application of the adverse interest exception would be barred in any event because the adverse interest exception does not apply if the alleged wrongdoers were, at the time of the misconduct, either the sole managers or sole owners of the plaintiff. Finally, the court rejected the argument that the defendants were liable as promoters because the challenged agreements were entered into before formation of the LLCs and the promoters could not have then owed fiduciary obligations to the non-existent entities.

O’Dell v. O’Dell, No. E2007-02619-COA-R3-CV, 2008 WL 3875434 (Tenn. Ct. App. Aug. 21, 2008). The plaintiff and his two sons formed an LLC in which the three members ultimately held equal voting rights. The plaintiff sued his sons and other family members alleging that they conspired to deprive the plaintiff of property and his rights as a member of the LLC. Specifically, the plaintiff alleged that the defendants failed to complete or furnish certain documentation regarding the LLC; that the plaintiff was not notified of LLC meetings; that the plaintiff spent his own money on LLC business and the defendants claimed these payments as tax deductions without consulting the plaintiff; that the defendants withheld information from the plaintiff; that the defendants closed certain LLC accounts and opened new ones; that the defendants did not assist the plaintiff with the day-to-day operations of the LLC; that the defendants removed LLC property without the plaintiff’s permission; that the defendants “intimidated” the plaintiff to ensure that deadlines would be met; and that one of the defendants verbally assaulted the plaintiff with regard to the LLC. The court concluded that these allegations did not state a claim for outrageous conduct but that the complaint did state a cause of action for violations of the Tennessee Limited Liability Company Act.

Urban Hotel Development Company v. President Development Group, L.C., 535 F.3d 874 (8th Cir. 2008) (rejecting plaintiff’s argument that other members breached their duties of care and loyalty when they removed plaintiff as member, stating that, because the members relied in good faith on the operating agreement, district court did not err in concluding that there was no evidence of breach of fiduciary duty).

ULQ, LLC v. Meder, 666 S.E.2d 713 (Ga. App. 2008). Four individuals formed an LLC, and the operating agreement designated the majority member as the sole manager. The operating agreement provided that an officer could be removed by the manager with or without cause whenever in the manager’s judgment the best interest of the LLC would be served. Removal was a dissociating event requiring the member to sell his interest to the other members or the LLC at a designated value. The manager appointed Meder, a 10% member, as vice president and later terminated
him, claiming that he had abused other employees and that his termination was thus in the best interests of the LLC. The LLC exercised its right to purchase Meder’s interest. The value in effect under the operating agreement at that time was the value of a member’s capital account, and Meder’s capital account was zero due to LLC losses. Meder sued the LLC, alleging that his termination and buy out breached the operating agreement, breached fiduciary duties owed to him by the LLC, and wrongfully converted the value of his capital investment and interest. The LLC counterclaimed alleging various causes of action based on Meder’s contacting LLC clients, after his termination as an officer and before the purchase of his membership interest, to persuade them to withhold their business from the LLC. The LLC sought summary judgment on Meder’s breach of contract claim on the basis that the operating agreement permitted his termination with or without cause, but the court of appeals held that the trial court did not err in denying summary judgment because there was a fact issue with respect to the duty of good faith and fair dealing implied in all contracts. The court stated that the exercise of discretion by a party to a contract is subject to the implied duty of good faith unless the contract states that the discretion is “absolute” or within the “sole” judgment of the party. Because the operating agreement did not vest the manager with absolute discretion in terminating an officer, but rather required the manager to conclude that termination was in the best interest of the LLC, the manager was required to exercise good faith in terminating Meder. Meder presented evidence that he was not abusing other employees and that the true motive for terminating him was to allow the LLC to purchase his interest for nothing at a time when the LLC was about to take off financially, thereby raising an issue regarding the exercise of good faith by the manager. The LLC prevailed on its argument that it did not owe Meder a fiduciary duty. The court acknowledged that the majority owner as the sole manager owed a fiduciary duty to the LLC and its members, but concluded that it would make no sense to hold the LLC responsible for a manager’s breach of a fiduciary duty to the LLC and its members. The court cited case law from other jurisdictions holding that a corporation owes no fiduciary duty to its shareholders and held that an LLC owes no fiduciary duty to its members, either directly or vicariously for actions taken by its manager. The trial court thus erred in denying summary judgment in favor of the LLC on Meder’s breach of fiduciary duty claim. Relying on the Georgia LLC statute, the court rejected the LLC’s argument that Meder breached a fiduciary duty to the LLC when he convinced the LLC’s customer to withhold business from the LLC. The LLC statute requires a member or manager, when managing the affairs of the LLC, to act in a manner the member or manager believes in good faith to be in the best interest of the LLC, but the statute also specifies that a non-manager member of a manager-managed LLC has no duties to the LLC or the other members solely by reason of acting as a member unless otherwise provided by the articles of organization or a written operating agreement. Based on this statutory provision, the court held that a non-managing member in a manager-managed LLC owes no duties to the LLC or other members. The court stated that such duties may be imposed in the operating agreement or articles of organization, but neither the operating agreement nor the articles of organization in this case did so. Thus, the trial court did not err in granting Meder summary judgment on the breach of fiduciary duty claim.

**Todd v. Sullivan Construction LLC.** 191 P.3d 196 (Idaho 2008). Todd and Sullivan formed an LLC to engage in masonry and concrete construction work, and Sullivan discovered that Todd and an employee of the LLC were planning to go into business together and that the employee used the LLC’s equipment and employees to do concrete jobs on the side for a corporation whom the LLC sought as a customer. The employee resigned, and Sullivan purchased Todd’s interest in the LLC. Todd and the former employee of the LLC then formed their own concrete construction company. The former LLC employee billed for the concrete work performed for the corporation whose business the LLC had sought, and the payments for that work were deposited in the account of the new company formed by Todd and the former LLC employee. Among the claims asserted by the LLC in ensuing litigation among the parties was a claim against Todd for willful misconduct. The trial court dismissed this claim, and the LLC appealed. The LLC alleged that Todd solicited business away from the LLC or otherwise usurped opportunities of the LLC for his personal benefit while still a member of the LLC and that this conduct was “willful misconduct” under the Idaho LLC statute because it was a breach of fiduciary duty to the LLC. The Idaho LLC statute provides that a member or manager shall not be liable to the LLC or the members for any action or failure to act on behalf of the LLC unless the act or omission constitutes gross negligence or willful misconduct. The court stated that the statute does not create a cause of action but rather sets forth a burden of proof for an LLC or its members to hold another member or manager liable for acts or omissions on behalf of the LLC. Both the LLC and Todd assumed that the statute applied to the LLC’s willful misconduct claim, though the court noted that it could certainly be argued that the conduct in issue was not taken on behalf of the LLC. The court analyzed whether the evidence that Todd had breached his fiduciary duty by soliciting business away from the LLC was sufficient to amount to willful misconduct. The trial court concluded that there was no proof that Todd engaged in
“active” willful misconduct, but the court of appeals stated that the statute does not require proof of *active* willful misconduct—it only requires proof of willful misconduct. The court of appeals concluded that the trial court’s holding that there was sufficient evidence to support submission of the LLC’s tortious interference claim (which was based on the same alleged misconduct as the willful misconduct claim), and Todd’s failure to challenge the jury’s finding that Todd committed that tort, was inconsistent with the trial court’s directed verdict on the willful misconduct claim. The court stated that intentionally interfering with the LLC’s prospective business was willful misconduct, and, if there was sufficient evidence to show that Todd and the LLC’s employee were acting in concert to interfere with the LLC’s prospective business with respect to the jobs in issue, there was sufficient evidence that Todd himself usurped those business opportunities.

**Blair v. McDonagh**, 894 N.E.2d 377 (Ohio App. 2008). Blair and McDonagh formed an LLC to operate Irish pub restaurants. Disputes developed, and the members asserted against each other various claims, including claims for breach of contract and breach of fiduciary duty. The jury returned a verdict in favor of McDonagh on all claims. On appeal, Blair argued that McDonagh’s breach of fiduciary duty claim was actually the LLC’s and could only be raised by the LLC. The court stated that there are circumstances under which a shareholder in a close corporation may bring an individual action, but the court found it unnecessary to reach that issue because Blair never raised the issue until he filed his motion for JNOV. Further, Blair asserted his own claim for breach of fiduciary duty; therefore, under his logic he, too, should have brought the claim in the name of the LLC. Instead, he named the LLC as a defendant. He requested and relied upon the instructions on breach of fiduciary duty and related damages, and the court held that any error was invited error. The court also rejected Blair’s argument that the evidence established that McDonagh breached his duty of good faith and fair dealing by refusing to consent to a line of credit that Blair had negotiated for the LLC and that was necessary for the good of the LLC. The court stated that an LLC, like a partnership, involves a fiduciary relationship that imposes on the members a duty to exercise the utmost good faith and honesty in all dealings and transactions with the LLC. Similarly, the court said that the parties to a contract owe each other a duty of good faith and fair dealing. The court found that McDonagh presented substantial evidence that he had acted in good faith and that he had withheld his consent for legitimate reasons, the most important of which was that Blair had refused to provide necessary financial information to evaluate the business and the necessity for the loan. Additionally, McDonagh’s loans to the LLC would have been subordinated to the line of credit loan. The court stated that McDonagh was not acting in bad faith when he failed to consent to the line of credit loan under these circumstances.

**Savanna Investors, LLC v. Vaughn**, No. X08CV084012896S, 2008 WL 4021333 (Conn. Super. July 30, 2008) (comparing general partner’s fiduciary obligations to limited partner to those owed by LLC managing member to passive investor member and finding probable cause to conclude managing member breached fiduciary duties to plaintiff member).

**Pravak v. Meyer Eye Group, PLC**, No. 07-2433-JPM-dkv, 2008 WL 2951101 (W.D. Tenn. July 25, 2008). Three ophthalmologists agreed to form an ophthalmology practice, and Dr. Pravak signed a letter of intent in which he agreed to become a member in a newly formed LLC. The three doctors signed the LLC’s lease agreement, a membership consent form, and a loan agreement, and Dr. Pravak was paid a “draw” by the LLC until the other two doctors began characterizing themselves as the only partners and ceased to characterize Dr. Pravak’s compensation as a “draw.” The LLC’s accountant indicated that she wished to recode all Dr. Pravak’s checks as contract labor, and the other two doctors asserted that the LLC did not have formal members without an operating agreement. Dr. Pravak filed suit alleging various causes of action, including breach of contract, tortious interference with contract, breach of fiduciary duty, civil RICO violations, and injunctive and declaratory relief. The court discussed fiduciary duties under the Tennessee LLC statute and case law and stated that Tennessee courts have interpreted the statutory language to mean that members owe fiduciary duties to a member-managed LLC but not to each other. The court stated that an exception to this general rule imposes a fiduciary relationship upon a majority owner of an LLC in his relationship to the minority owner, but that this case involved uncomplicated contractual duties and not a factual situation involving oppression by the majority of the minority. The court stated that the general rule that members of a member-managed LLC do not owe one another fiduciary duties applied in this case because the case did not stem from the expulsion of a minority member through the exploitation of the majority’s status as was the case in *Anderson v. Wilder*, the only Tennessee LLC case to impose a fiduciary duty based on oppression of the minority by the majority. The court thus dismissed the breach of fiduciary duty claims. The court dismissed Dr. Pravak’s RICO claim because the LLC could not be both the “person”
and the “enterprise” in the alleged RICO violations. The court declined to dismiss the claims for declaratory and injunctive relief, which the defendants alleged could only be brought derivatively, because the allegations appeared to comply with the procedural requirements for derivative actions.

**Cosmopolitan Imports, LLC v. Pacific Funds, LLC**, No. 59896-1-L, 2008 WL 2791983 (Wash. App. July 21, 2008). McMullen formulated a business plan to buy and resell certain real property and sugar mill equipment and signed a letter of intent to purchase the property. McMullen and Monjazeb formed a new LLC to acquire, develop, and manage the property, and they signed an LLC agreement under which each had a 50% interest and Monjazeb was the manager. Monjazeb agreed to provide the initial earnest money deposit for the purchase of the property, and McMullen contributed the letter of intent. McMullen, allegedly with Monjazeb’s consent, entered a purchase and sale agreement to buy the property on behalf of the LLC, but Monjazeb argued that he had not consented and that McMullen violated the LLC agreement because Monjazeb was the sole manager with authority to enter contracts on behalf of the LLC. Monjazeb agreed to provide the additional funds required under the purchase and sale agreement if McMullen signed a loan agreement under which McMullen agreed to surrender his share of the LLC in exchange for Monjazeb’s conditional promise to loan him the funds to buy back a 49% share of the LLC. The LLC closed the purchase of the property, and Monjazeb declined to loan McMullen the funds to repurchase his interest because McMullen did not furnish the collateral required under the loan agreement. As sole owner of the LLC, Monjazeb then developed the real property and sold the sugar mill equipment for a profit. McMullen sued Monjazeb alleging misappropriation of his business plan, breach of contract, and breach of fiduciary duties. The court rejected the argument that the business plan was a legally protectable trade secret and concluded that Monjazeb acted in accordance with the loan agreement even if it was. The court also rejected McMullen’s argument that the loan agreement was void for want of consideration. The court held that Monjazeb’s discretion in loaning McMullen the funds to repurchase his interest was not so broad or unfettered as to make it illusory. The court also rejected McMullen’s argument that Monjazeb had a pre-existing duty to fund the entire acquisition of the sugar mill properties. The LLC agreement provided that no additional capital contributions beyond the initial contributions were required and that any additional contributions would be determined by all members. With respect to the breach of fiduciary duty claims, the court stated that McMullen’s arguments served only to obscure the fact that McMullen was unable to provide the collateral specified in the loan agreement in connection with the loan to repurchase his interest. The court stated that Monjazeb did not breach his duty of good faith by refusing to change the terms of the contract. The court characterized McMullen’s contention that Monjazeb “duped” him into signing the loan agreement as baseless. The court stated that it is true that members of an LLC are mutual fiduciaries, but nothing prohibits them from entering contractual business arrangements with one another. According to the court, it was not reasonable for McMullen to rely on any representations made by Monjazeb as his fiduciary that would excuse him from the general duty to read a contract before signing it. The loan agreement was only three pages long, was clear and straightforward, and was initialed on each page by McMullen.

**In re Healy (Carwin v. Healy)**, Bankruptcy No. 07-31197-B-7, Adversary No. 08-02159-B, 2008 WL 2852871 (Bankr. E.D. Cal. July 21, 2008). The plaintiff was induced to invest and become a member in an LLC based on misrepresentations made by the LLC through Healy and another individual. The plaintiff obtained a state court judgment based on the misrepresentations, and the plaintiff sought to have the judgment against Healy declared nondischargeable in Healy’s bankruptcy proceeding. The court held that the judgment did not fall within the discharge exception for fraud or defalcation while acting in a fiduciary capacity. The court acknowledged that an LLC manager owes to the LLC and its members the same fiduciary duty owed by partners in a partnership under California law, but the court said the fraud pre-dated the fiduciary relationship and Healy was not acting in a fiduciary capacity when he made the misrepresentations to the plaintiff.

**Morris v. Hennon & Brown Properties, LLC**, No. 1:07CV780, 2008 WL 2704292 (M.D.N.C. July 3, 2008). The court discussed general fiduciary duty principles under North Carolina law and cited provisions of the North Carolina LLC statute dealing with duties of LLC managers, but declined to answer the question of “whether a co-manager of an LLC in North Carolina, nothing else appearing, stands in a fiduciary relationship to the members of the LLC.” The court stated that this was an unanswered question involving North Carolina law that should be avoided by a federal court if possible. Thus, the court first addressed the standing of the defendant investor to assert its breach of fiduciary duty counterclaims against the plaintiff, one of several managers of LLCs in which the defendant invested. The court stated that it was not necessary to “explore the depths of what might constitute fiduciary duties under the North Carolina
Limited Liability Company Act” because, assuming the acts alleged breached a fiduciary duty, the question at the heart of the standing issue was to whom the duties were owed. The court analyzed the standing question by comparing the situation to a closely held corporation. The court stated that a derivative action is generally the appropriate vehicle where a shareholder or LLC member seeks to recover on behalf of the corporation or LLC. Because the investor filed an individual action but did not show that he was specifically and particularly harmed or that any special duty was owed to him, the court concluded that he had no standing to bring a direct action.

**In re Lobell (Brooke Credit Corporation v. Lobell),** 390 B.R. 206 (M.D. La. 2008) (noting that Fifth Circuit Court of Appeals has not decided if LLC members are “fiduciaries” for purposes of exception to discharge for fraud or defalcation in fiduciary capacity, and stating that no controlling authority supports creditor’s right to enforce duty even assuming duty exists).

**Wood v. Baum,** 953 A.2d 136 (Del. 2008). The plaintiff brought a derivative suit against the members of the board of a Delaware LLC alleging breach of fiduciary duty claims based on alleged improper valuation of certain non-performing assets, improper charitable contributions, related party transactions, and failure to maintain accounting and monitoring controls and procedures. The court of chancery dismissed the complaint for failure to allege particularized facts sufficient to establish that demand on the board would have been futile. The Delaware Supreme Court stated that the test set forth in *Aronson v. Lewis* applies when it is alleged that directors made a conscious business decision in breach of their fiduciary duties, and the test in *Rales v. Blasband* applies when the subject of the derivative suit is a violation of the board’s oversight duties. The plaintiff attempted to create a “reasonable doubt” that the board would have properly exercised its business judgment by alleging that the board was disabled because of a substantial risk of personal liability. In evaluating that claim, the court stated that the exculpation clause in the LLC’s operating agreement must be kept in mind. Under the operating agreement and the Delaware LLC statute, the directors’ liability was limited to claims of “fraudulent or illegal conduct” or “bad faith violation[s] of the implied contractual covenant of good faith and fair dealing.” The court stated that, where directors are contractually or otherwise excused from liability, a serious threat of liability may only be found to exist if the plaintiff pleads with particularity a non-exculpated claim. Thus, the plaintiff in this case was required to plead particularized facts demonstrating that the directors acted with scienter, i.e., that they had “actual or constructive knowledge” that their conduct was legally improper. The court characterized the issue before it as whether the complaint alleged with particularity that a majority of the directors knowingly engaged in “fraudulent” or “illegal” conduct or breached “in bad faith” the covenant of good faith and fair dealing. The court concluded that the plaintiff failed to meet this pleading burden. The plaintiff did not plead with particularity any claim based on fraudulent conduct. Although the complaint alleged many violations of securities and tax laws, the complaint did not allege with particularity that the directors knowingly engaged in such conduct or that they knew such conduct was illegal. The court rejected the plaintiff’s argument that such knowledge should be inferred from the fact that the transactions had to be authorized by the board and because they were related party transactions. The court stated that Delaware law is clear that board approval of a transaction, even one that turns out to be improper, is not alone enough to infer culpable knowledge or bad faith. The court also stated that the plaintiff’s assertion that membership on the audit committee is a sufficient basis to infer the requisite scienter was contrary to well-settled Delaware law. The court distinguished a “bad faith violation of the implied contractual covenant of good faith and fair dealing” from the fiduciary duty breaches asserted by the plaintiff, and concluded that the complaint did not allege any contractual claims, let alone a “bad faith” breach of the implied contractual covenant of good faith and fair dealing. The court commented that the failure to allege with particularity any facts from which particular directors’ knowledge of accounting irregularities may be inferred is frequently compounded by a failure to make a statutory books and records request, and the court noted that the plaintiff in this case chose not to make a books and records request. In sum, the court concluded that, given the broad exculpation provision in the operating agreement, the plaintiff’s factual allegations were insufficient to establish demand futility.

**Roemmich v. Eagle Eye Development, LLC,** 526 F.3d 343 (8th Cir. 2008). The court of appeals affirmed the district court’s grant of summary judgment on a minority member’s breach of fiduciary duty claims accruing more than six years prior to commencement of the suit on statute of limitations grounds. The court held, as a matter of first impression, that a breach of fiduciary duty claim arising under the North Dakota LLC statute is governed by North Dakota’s six year statute of limitations. The court concluded that alleged breaches of fiduciary duty were a series of discrete acts rather than a continuing wrong and that, even if the district court erred in rejecting the continuing wrong
doctrine as to claims based on commingling of personal and LLC funds, the question need not be reached because the minority member failed to provide any evidence establishing that the conduct occurred within the six year period prior to the commencement of the suit. The court held that the district court correctly allowed the parties to present evidence of events occurring more than six years prior to commencement of the suit for purposes of crafting an equitable remedy in connection with the minority member’s statutory oppression claim and concluded that the district court considered the totality of conduct in determining whether the majority’s conduct amounted to a freeze out of the minority, a breach of fiduciary obligations imposed by the LLC statute, or an unfair deprivation of the minority’s reasonable expectations. The court concluded that the district court’s findings of fact (that the majority did not breach its fiduciary duties in most respects and that the minority member did not have a reasonable expectation regarding various matters) were not clearly erroneous. The court affirmed the district court’s decision to award defendants reasonable expenses and attorney’s fees under the North Dakota LLC statute, rejecting the minority member’s claim that he could not have acted in bad faith under the statute since he prevailed on portions of his claim.

**Berman v. Sugo LLC**, 580 F.Supp.2d 191 (S.D.N.Y. 2008). In a dispute between two members of an LLC, the court refused to dismiss breach of fiduciary duty claims asserted against a member based on alleged misappropriation of business opportunities and unfair competition, relying on cases in which courts have recognized that LLC members, like partners in a partnership, owe a fiduciary duty of loyalty to fellow members. The court said that an argument that a letter of understanding permitted competition involved interpretation of the letter and would not be undertaken at the motion to dismiss stage. The court rejected a claim for conversion based on misappropriation of business opportunities because New York does not recognize a cause of action for conversion of intangible property. The court denied a motion for reconsideration of its opinion and explained that it applied the law of New York, the forum state, in the context of this dispute regarding a Connecticut LLC because there was no material conflict between the laws of New York and Connecticut with respect to formation of an oral agreement where a party has expressed intent not to be bound until the agreement is in writing.

**Tuckerbrook Alternative Investments, LP v. Banerjee**, Civil Action No. 08-10636-PBS, 2008 WL 2356349 (D. Mass. June 4, 2008). An investment advisor hired an individual to act as portfolio manager of three funds, and the two parties entered into LLC agreements for three Delaware LLCs that served as general partners of the three funds. The parties disagreed as to whether managing members of a Delaware LLC owe each other fiduciary duties, and the court stated that Delaware case law was sparse on the point but relied upon **VGS, Inc. v. Castiel** in concluding that the managing members owed a duty of loyalty to each other, the LLC general partner, and the limited partners to work together in good faith to protect the interests of the limited partnership.

**Bookhamer v. I. Karten-Bermaha Textiles Co., L.L.C.**, 859 N.Y.S.2d 172 (N.Y. A.D. 1 Dept. 2008) (holding that there were triable issues of fact as to whether fiduciary obligations owed to non-managing member, i.e., to operate LLC in good faith, to avoid self-dealing, and to make full disclosure, were breached).

**Monier v. Boral Lifetile, Inc.**, C.A. No. 3117-VCN, 2008 WL 2168334 (May 13, 2008). Monier, Inc. (Monier) and Boral Lifetile, Inc. (Boral) each owned 50% interests in a Delaware LLC that was managed by a management committee consisting of three representatives of each member. Monier sought a declaratory judgment determining the percentage of net income that must be distributed under the LLC operating agreement, and Boral sought dismissal of Monier’s claim. The operating agreement specified that 50% of the net income would be distributed each year unless the management committee approved a greater or lesser distribution without any dissenting vote. In 2000, the management committee adjusted the distribution rate to 100% of the audited net profits, and the parties disputed whether this was a change that was intended to be in effect on an ongoing basis for the indefinite future. Monier argued that making the change on an ongoing basis was a valid exercise of the management committee’s authority under the operating agreement or, alternatively, constituted an amendment of the operating agreement. Boral argued that Monier’s construction demonstrated a violation of the management committee’s fiduciary obligations as an impermissible abdication of the committee’s duty to manage. The court concluded that Boral could not demonstrate that the mere setting of the distribution rate at 100% until the management committee unanimously determined otherwise constituted an abdication and breach of fiduciary duty.
Disagreements between the members of two classes of membership interest in a Delaware LLC led to a deadlock, and one of the Class B members filed a petition for dissolution. Segal, a Class A member who was the LLC’s founding member, president, and sole officer, filed counterclaims and third-party claims against the Class B members. Johnson, a Class B member, filed a motion to dismiss Segal’s claims against him for lack of personal jurisdiction, and the other Class B members filed a motion to dismiss Segal’s counterclaims and third-party claims for failure to state a claim. The court granted Johnson’s motion to dismiss for lack of personal jurisdiction as well as the motion of the other Class B members to dismiss Segal’s claims for failure to state a claim. The court dismissed Segal’s breach of contract claim because it was based on breaches of duties not found in the LLC agreement. The court stated that the LLC agreement in no way obligated one class of members to acquiesce to the wishes of the other simply because the other believed its approach to be superior or in the best interests of the LLC. The LLC agreement contained provisions limiting the duties of members except as expressly set forth in the agreement and waiving liability absent gross negligence, fraud, or intentional misconduct. Segal argued that this provision established a duty to act without gross negligence, fraud, or intentional misconduct, but the court stated that the provision did not create a code of conduct resulting in liability for any damage caused by gross negligence, willful misconduct, or a knowing violation of law. The court stated that Segal’s arguments regarding other provisions of the agreement were “similarly tortured” and the court “decline[d] to follow Segal’s invitation to turn an expressly exculpatory provision into an all encompassing and seemingly boundless standard of conduct.” Further, even if the agreement did somehow create a code of conduct, the court stated that Segal failed to allege facts sufficient to support an inference that the members acted with gross negligence, willful misconduct, bad faith, or in knowing violation of the law. The court also dismissed Segal’s claim that the Class B members breached the implied covenant of good faith and fair dealing by blocking financing opportunities presented by Segal. The agreement expressly provided for the vote required to approve financing, and the court stated that mere exercise of one’s contractual rights, without more, cannot constitute a breach of the implied covenant of good faith and fair dealing. The court dismissed Segal’s breach of fiduciary duty claims as well. Segal relied upon the same provisions in the LLC agreement for his breach of fiduciary duty claims that he relied upon with respect to his breach of contract claims. The court stated that the agreement greatly restricted and even eliminated fiduciary duties as permitted by the Delaware LLC statute, but, even assuming the validity of Segal’s argument that there remained a duty not to act in bad faith or with gross negligence, he failed to allege facts to support such a breach of duty.

Swartz v. Deutsche Bank, No. C03-1252MJJP, 2008 WL 1968948 (W.D. Wash. May 2, 2008). The court discussed circumstances under which fiduciary relationships arise under Washington law and rejected the argument that a financial advisor/managing member of a Delaware LLC was not a fiduciary of an investing member because they dealt at arm’s length. The court stated that representations in the LLC agreement that management would be vested solely in the managing member suggested more than an arm’s length relationship and that concealment of material facts gave rise to fiduciary-like duties. The court concluded that the plaintiff sufficiently alleged the elements of a breach of fiduciary duty claim notwithstanding a provision of the LLC agreement that provided no member shall be a fiduciary of the other members and that each member waived any claim for breach of fiduciary obligations to the fullest extent permitted by law. The court noted that that Delaware law does not allow limitation or elimination of liability for a bad faith violation of the implied contractual covenant of good faith and fair dealing and that it is unclear under Delaware law whether provisions seeking to eliminate all fiduciary duties are valid when a member manages the entity in an illegal fashion. The court stated that the defendants would not be shielded by the disclaimer of a fiduciary relationship in the LLC agreement with respect to the plaintiff’s allegations of bad faith in advancing an illegal tax shelter scheme and misrepresenting several functions of the scheme.

Utzler v. Braca, No. FBTCV065003257S, 2008 WL 2068200 (Conn. Super. April 25, 2008). The plaintiff, an investor in a real estate LLC sought to pierce the veil of the LLC and hold the individual who managed the LLC liable for breach of the plaintiff’s contract with the LLC. The court, after a lengthy discussion of the manner in which the individual defendant operated the LLCs formed for his real estate development activities and estate planning purposes, concluded that the plaintiff established that the LLCs were the alter egos of the defendant under the instrumentality and identity theories. The court also concluded that there was a fiduciary relationship between the plaintiff and the individual defendant based on the efforts the defendant made to induce the plaintiff to trust him and invest his funds in a venture over which the defendant had complete control. The defendant failed to meet his burden of showing that he fairly dealt with the plaintiff. The defendant breached his duty by using funds provided by the plaintiff and the lender for purposes
other than the project, such as personal expenses and expenses related to other properties, by subjecting the project property to a third mortgage to secure a loan on other properties, and by hiring the real estate agency at which his son worked to list the project property. The court held that exceeding the construction budget for the property did not rise to the level of a breach of fiduciary duty. The court also rejected the plaintiff’s claim against the individual defendant for breach of the implied covenant of good faith and fair dealing because the agreement under which the plaintiff invested was between the plaintiff and the defendant’s LLC, and the individual defendant thus did not owe the plaintiff a duty of good faith under the agreement.

**Delgadillo v. White**, No. 1 CA-CV 07-0042, 2008 WL 4095494 (Ariz. App. April 22, 2008). Delgadillo and White formed various real estate investment LLCs. The LLCs were managed by Delgadillo, White, and Cole. Delgadillo and a third party who was a long-time client of White’s both sought to purchase property from one of the LLCs, and the members voted to accept the offer of the third party. The court held that Delgadillo was entitled to bring an individual action against White and Cole based upon their alleged breach of fiduciary duty because his complaint stemmed not only from a loss of value to the LLC for the alleged failure to obtain the maximum value of the property, but also for Delgadillo’s lost opportunity to purchase the property. Regarding the breach of fiduciary duty claim, the court stated that it was aware of no authority to support imposing a fiduciary duty on White and Cole to Delgadillo as a potential purchaser of an asset in an arm’s length transaction. The court assumed that White and Cole owed a fiduciary duty to Delgadillo as managers of the LLC for purposes of the decision, noting that the private placement memorandum and operating agreement of the LLC contemplated that managers owe members fiduciary duties. The court also stated that the operating agreement afforded Delgadillo inspection and voting rights and permitted him to transact business with the LLC, subject to applicable law and any contrary provision in the operating agreement. The court stated that it was “thus clear that a member-to-member duty existed.” To analyze whether the duties were breached, the court turned to authorities on duties owed in the context of a corporation, “an entity analogous to a limited liability company;” however, the court concluded that none of these authorities gave Delgadillo a right to purchase a company asset or receive assistance in purchasing such an asset. A majority of the LLC’s members voted to accept the other party’s offer, and Delgadillo’s counsel admitted at oral argument that the defendants had no obligation to favor Delgadillo over the other party. Delgadillo asserted, however, that a letter to investors misled them about the other party’s offer and that Cole and White failed to achieve the best value for the LLC’s members. The court reviewed the communications received by the members and concluded there was no evidence any investor was actually misled. Regarding the argument that White and Cole failed to achieve the best value for the LLC’s members, the court stated that Delgadillo’s reliance on the Delaware case of *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* was misplaced because the instant case involved the sale of a corporate asset rather than any fundamental change of control of the LLC. Further, the court stated that *Revlon* is irrelevant and imposes no heightened duties when the majority shareholders are making the decisions. The court stated that it had no evidence to conclude that the price was not a fair price at the time of the sale and that it would not second guess the decision of the members on appeal where they used their judgment to determine which offer would best serve the LLC. Delgadillo argued that White and Cole failed to adequately investigate his offer, but Delgadillo failed to specify what information was needed and what material information was not disclosed. The court stated that it failed to see what material information was lacking given that the LLC had been negotiating the sale with the purchaser for approximately three years, thus affording the members plenty of time to investigate, and the members received a copy of Delgadillo’s offer and were familiar with him based on his management of the LLC. Finally, the court held that the members effectively ratified the sale of the LLC’s property even if White and Cole owed Delgadillo a fiduciary duty and breached it. Delgadillo argued that the ratification failed because the members were not fully informed. The court held that there was no evidence that the members were deprived of material information, but the court also stated that Delgadillo, as a manager, was equally to blame if there was a failure to adequately inform the members. The court reversed the trial court’s award of attorney’s fees to White and Cole because the court concluded that the member-to-member duty would have existed notwithstanding the operating agreement and the claim thus did not arise out of a contract.

**Regions Bank v. Regional Property Development Corporation**, No. 07 CVS 12469, 2008 WL 1836657 (N.C. Super. April 21, 2008). An LLC member asserted claims against the LLC’s lender for breach of contract, breach of fiduciary duty, and aiding and abetting breach of fiduciary duty in connection with the lender’s sale of the LLC’s note to the three other members of the LLC. The lender argued that there is no cause of action under North Carolina law for aiding and abetting breach of fiduciary duty and that the complaining member did not have standing to assert the claims.
because they did not involve a direct injury or special duty and could only be brought by the LLC. The court concluded that there was no binding precedent directly addressing whether there exists a cause of action for aiding and abetting breach of fiduciary duty, but there was some persuasive authority suggesting that such a claim exists. Therefore, the court declined to dismiss the case on that ground. The court concluded, however, that the member did not have standing to bring the claim. The court stated that the rules regarding shareholder derivative actions apply to members of an LLC and that the member could not bring an individual cause of action for wrongs or injuries to the LLC. The LLC was composed of four members, and the member who asserted the claim did not allege that it held a minority interest; thus, the court said it could not be said that the other members owed a special duty arising solely from their control of the LLC. The complaining member alleged that the other members, with the assistance of the lender, leveraged their control over the loan to force the complaining member to agree to allow the LLC to make distributions to the other members that were not otherwise due, but a claim that distributions were unlawfully made is just another way of saying that assets were wrongfully diverted, which is a claim that would belong to the LLC and not a member.

_Poppert v. Dicke_, 747 N.W.2d 629 (Neb. 2008). A minority shareholder of a dissolved corporation sued the majority shareholder and an LLC owned by the majority shareholder for breach of the duties of loyalty, care, and good faith and fair dealing. The trial court dismissed the breach of duty causes of action on the basis that no such duties existed. The trial court reasoned that there was no express fiduciary duty relating to the conduct of LLC members and managers under the Nebraska LLC statute. (It is not clear whether the court was referring to duties owed to the LLC and other members or to duties owed to a third party.) The trial court certified its dismissal, and the plaintiff appealed. The plaintiff argued that the trial court erred in finding that there was no fiduciary duty imposed upon members and managers of an LLC. The supreme court concluded that it lacked jurisdiction over the appeal because the trial court did not have authority to certify the judgment as final. The order disposed of three theories of recovery for a particular cause of action but did not dispose of other theories of recovery for the same cause of action. The supreme court thus dismissed the appeal.

_In re House of Lloyd Sales LLC (Stanton v. SGC Partners I, LLC)_ , Bankruptcy No. 02-40208, Adversary Nos. 05-4014, 06-4283, 2008 WL 957663 (Bankr. W.D. Mo. April 8, 2008). In this bankruptcy of the House of Lloyd companies, which were organized as LLCs, the trustee sued individuals and entities connected with an investor who purchased the ailing House of Lloyd business from the founding Lloyd family. The trustee alleged that the defendants breached their fiduciary duties to the LLCs by either choosing to go into the third party e-fulfillment business, not waiting until the existing direct sales business had been turned around to do so, or not spending enough to make the new business successful. The complaint alleged “willful and wanton and/or grossly negligent conduct” in failing to conduct a reasonable investigation of the new commerce venture and in diverting millions of dollars to the venture at a time when such funds were needed in the LLC responsible for running the direct sales side of the House of Lloyd business. The underlying theme of the trustee’s case was that the defendants acted with reckless indifference to the fate of the direct sales business, that they intended to use its warehouse, equipment, and personnel to build an e-commerce business, and that they let the sales business die because of their real interest in the new ventures. The court undertook a lengthy review of the summary judgment evidence and concluded the defendants complied with their fiduciary duties. The court relied upon the Delaware business judgment rule, which it found protected the defendants, and the court thus found it unnecessary to reach other defenses raised by the defendants. The other defenses included the Delaware statutory protection of managers and members who rely in good faith on professionals or experts, an exculpatory clause in the LLC operating agreements, and an absence of fiduciary duties to unsecured creditors prior to insolvency. The court discussed the duty of care under Delaware law and concluded that the defendants’ decision to pursue the e-fulfillment business, which was the culmination of months of due diligence, resulted from a rational, good faith process. The court also rejected the trustee’s argument that the defendants were not protected by the business judgment rule because they breached their duty of loyalty by having conflicting interests, acting in bad faith, and collecting management fees. With respect to the conflict of interest claim, the court found no evidence that the defendants used their control to act in the best interests of someone other than the House of Lloyd companies. The court found no conflict between the interests of the direct sales business of House of Lloyd and the new e-fulfillment business, and the court noted that it was illogical to assume that the defendants deliberately ignored the interests of the direct sales business, the success of which was crucial to the defendants’ investment in House of Lloyd. The court likewise rejected the trustee’s argument that the defendants acted in bad faith in authorizing or terminating the e-fulfillment business. With respect to the management fees, which were not specifically approved by the Board, but were paid in the regular course by the finance arm of the
House of Lloyd companies, the court found that payment of the fees did not rise to bad faith or breach of fiduciary duty given that the defendants did not authorize or even realize that improper payments were being made and immediately caused them to stop once learning about them. Assuming the fees should not have been paid, the court found that there was insufficient evidence of an “utter failure” to implement controls or monitor for an oversight claim, and insufficient evidence of bad faith in failing to seek recovery of fees. The court also found that, even assuming the decision to launch the e-fulfillment business was a breach of fiduciary duty, the trustee failed to show it was the cause of the demise of the House of Lloyd business. In sum, the court stated that “Delaware law encourages entrepreneurs to start new companies, and to try to save existing ones, by limiting the liability of those in control of such companies,” and the mere fact that a strategy turns out poorly does not itself create an inference that fiduciary duties were breached. The trustee failed to show that the process employed by the investors was not rational or employed in a good faith effort to advance corporate interests and failed to show that the challenged action caused the demise of the House of Lloyd business; therefore, the court granted the defendants motion for summary judgment.

**Cascade Falls, L.L.C. v. Henning.** 143 Wash.App. 1056, 2008 WL 934074 (Wash. App. April 8, 2008). Two brothers, Scott and Greg Henning, formed a Washington LLC. A few years later, they discussed going their separate ways, and Greg withdrew. After operating the LLC as its sole member for several years, Scott learned of irregular business and accounting activities by Greg. Unbeknownst to Scott, Greg had continued to operate using the LLC’s name and one of its bank accounts. Scott filed this lawsuit, alleging breach of fiduciary duties, fraud, and conversion of the LLC’s money by Greg. The court concluded that the trial court did not err in applying a discovery rule to the statute of limitations regarding the breach of fiduciary duty, fraud, and conversion claims. Greg also complained that the trial court erred in allowing evidence of damages in support of Scott’s fraud and conversion claims because Scott did not file a derivative action; however, the court found the contentions did not merit review because Greg did not properly preserve and develop his argument. Greg argued that the trial court erred in admitting evidence supporting Scott’s request for an accounting from Greg of the LLC’s assets when Scott’s complaint did not state a claim for an accounting. The court stated that the requisites for a cause of action for an accounting are (1) a fiduciary relation between the parties or the account is so complicated that it cannot be conveniently taken in an action at law, and (2) the plaintiff has demanded an accounting and the defendant has refused to render it. Scott’s complaint stated claims against Greg for breach of fiduciary duty, fraud, and conversion; there was no claim for a general accounting. Greg cited no authority that a suit for an accounting is a prerequisite for collection of damages for an LLC member’s conversion of funds based upon claims of fiduciary duty or fraud. Scott did include in his request for judgment and relief that Greg be directed to account for the LLC’s finances for a period of time; thus, there was accounting evidence admitted at trial to prove the claims of Scott and the LLC. Greg failed to object to the admission of any particular accounting evidence, and the court refused to further review his contentions in this regard.

**In re Kilroy (Guerriero v. Kilroy).** Bankruptcy No. 05-90083-H4-7, Adversary No. 06-3320, 2008 WL 780692 (Bankr. S.D. Tex. March 24, 2008). The court concluded that the debtor did not owe the plaintiff a fiduciary duty for purposes of the exception to discharge for a debt based on fraud or defalcation in a fiduciary capacity. The debtor was the majority member and manager of an LLC that served as the general partner for a limited partnership. In a prior opinion, the bankruptcy court found that the debtor exercised sufficient control over the LLC and limited partnership to establish a fiduciary relationship with the plaintiff, who was the minority member of the LLC and limited partner of the limited partnership. However, the court stated that it did not have the partnership agreement before it at the time of the prior decision, and the court found that the terms of the partnership agreement eliminated any fiduciary relationship. The partnership agreement provided: “[T]he General Partner [i.e., the LLC controlled by the debtor] shall conduct the affairs of the Partnership in good faith toward the best interest of the Partnership. The General Partner, however, is liable for errors and omissions in performing its duties with respect to the Partnership only in the case of bad faith, gross negligence, or breach of the provisions of this Agreement, but not otherwise.” Both the LLC and limited partnership were Delaware entities, and the Delaware Revised Uniform Limited Partnership Act permits partners to contract out of common law fiduciary duties in the partnership agreement. Under the Delaware limited partnership statute, the partners may eliminate fiduciary duties but may not eliminate the implied contractual covenant of good faith and fair dealing. The court concluded that the partnership agreement in this case reduced the general partner’s duties from a fiduciary duty to merely a duty of good faith. The plaintiff argued that a fiduciary duty existed because the debtor controlled the LLC which was the general partner, and the debtor was thus essentially acting as the general partner. However, the court
stated that, if the partnership agreement limited the LLC general partner’s duties to that of merely good faith, a higher standard could not be imposed on the debtor as the controlling member of the LLC.

**Madelone v. Whitten**, 18 Misc. 3d 1131, No. 9929-07, 2008 WL 399175 (N.Y. Sup. 2008). Madelone and Whitten, along with two other individuals, were members of an LLC, and Whitten was the manager. Madelone claimed that Whitten refused to acknowledge the applicability of involuntary transfer provisions in the operating agreement that were triggered when Whitten filed for divorce and that Whitten continued to hold himself out as manager of the LLC after being removed. Madelone also alleged that Whitten had engaged in conduct threatening the LLC’s credit and financial viability, that Whitten had taken steps to drive down the value of the business in connection with his pending divorce action, and that Madelone had been “frozen out” of the LLC’s day-to-day business. Thus, the petition also raised claims of breach of fiduciary duty and waste. The other members resisted Madelone’s efforts to enforce the involuntary transfer provisions, arguing that the conduct of the parties and the terms of the agreement itself demonstrated that the provision was not intended to be self-executing. The court concluded that Madelone had established a likelihood of success on his claim to enforce the involuntary transfer provisions and that he had shown the prospect of irreparable injury since the other members had indicated their intent to terminate Madelone as a member and employee absent injunctive relief and Madelone would be entitled to almost 43% of the LLC’s voting rights if the court ultimately agreed that the involuntary transfer provisions were enforceable. The court concluded that this shift in governance and control constituted irreparable harm. Madelone also contended that he had demonstrated a likelihood of success with respect to causes of action asserted derivatively on behalf of the LLC for breach of fiduciary duty and waste as well as a claim the other members breached a fiduciary duty owed to Madelone directly by freezing him out of LLC meetings and affairs. The court concluded that there was not a sufficient likelihood of success to warrant injunctive relief on the derivative claims. The court noted that a significant number of the allegations involved the business judgment of the LLC’s management, which are issues that are not generally amenable to judicial review so long as they are within the scope of management’s delegated authority and there is no showing of bad faith, self-dealing, fraud or other misconduct.

**Bank Hapoalim (Switzerland) Ltd. v. XG Technology, Inc.**, No. 8:07-cv-170-T-23MSS, 2008 WL 126583 (M.D. Fla. 2008). The plaintiff’s breach of fiduciary duty suit against individuals who were managers of a Delaware LLC that converted into a corporation failed because the plaintiff, an assignee of securities in the LLC, did not establish that it was admitted as a member of the LLC. The plaintiff also failed to establish that it became a shareholder in the corporation as a result of the conversion and failed to overcome the presumption that the individual defendants were protected by the business judgment rule as directors and officers of the corporation; therefore, the breach of fiduciary duty claims against the individuals as officers and directors failed as well. The plaintiff was a bank that was assigned units in the LLC by a member of the LLC prior to the conversion. At the request of the member, the LLC issued a certificate stating that the bank was the owner of four million units. A few months later, the LLC informed the bank that a pledge existed against the certificate and that the securities were null and void due to the member’s default under the pledge agreement. After the conversion, the corporation went public. The documents relating to the conversion did not account for the bank’s securities or list the bank as a shareholder of the corporation. The bank asserted that the managers of the LLC owed it a duty of loyalty and care as “legal title holders of the securities” and that the managers breached their duties by failing to safeguard the membership interest of the bank, failing to notify the bank of the conversion, failing to account for the securities in the public offering, and refusing to convert the securities of the LLC. The court stated that the manager of a Delaware LLC owes a fiduciary duty of loyalty and care only to the company and its members. Thus, absent an allegation that the bank was a member or a party to or otherwise bound by the LLC’s agreement, the court concluded the breach of fiduciary duty claim based on the defendants’ status as managers could not stand. Because the complaint did not even mention the LLC agreement, the court stated that the key issue was whether the complaint sufficiently alleged that the bank, an assignee of a member of the LLC, assumed member status. The court pointed out that the Delaware LLC statute provides that an assignee may become a member with the approval of all the members other than the assigning member or in compliance with the LLC agreement. The court also quoted the provision of the Delaware LLC statute that provides that an assignee becomes a member when the person’s permitted admission is reflected in the records of the LLC. Since the complaint did not allege approval by the members, compliance with the agreement, or reflection of the bank’s admission as a member in the LLC records, the complaint failed to allege that the defendants owed the bank a fiduciary duty.
In the Water Park LLC operating agreement and that the individuals' LLCs were acting as members of Reality LLC when their common ownership and management. The court pointed out that the individuals and their LLCs were not parties members (who were also the members of Reality LLC), caused Realty LLC to sell the property intended for the water park, and that the actions of Management LLC were imputed to the 51% member of Water Park LLC by and through their common ownership and management. The court pointed out that the individuals and their LLCs were not parties to the Water Park LLC operating agreement and that the individuals' LLCs were acting as members of Realty LLC when
the property was sold to another party. The court stated that Realty had no fiduciary duty to the plaintiffs, and the court found no basis to hold the defendants liable for breach of the operating agreement or breach of fiduciary duties.

*Weiner v. Weiner*, No. 1:06-CV-642, 2008 WL 746960 (W.D. Mich. March 18, 2008). The minority owner of numerous single purpose real estate entities adequately alleged a direct action for minority oppression against her brother, the majority owner of the entities. The entities included a corporation and numerous limited partnerships and LLCs. The court relied upon provisions of the Michigan LLC and corporate statutes expressly providing for minority oppression claims and noted that limited partners are free to pursue their own direct claims although the limited partnership statute does not address minority oppression claims. That the majority owner managed the jointly owned entities in accordance with the terms of the agreements governing the joint entities did not end the court’s inquiry as to oppressive conduct. The majority owner’s conduct was governed by his role as a fiduciary as well as the entity agreements. Evidence of interest-free loans by the jointly owned entities to entities owned by the majority member along with evidence of increases in management fees and lack of documentation to support the accrued management and leasing fees was sufficient to create a fact issue regarding self-dealing and resulting damages. The court stated that the evidence of interest-free loans to the majority member’s entities gave rise to a fact issue as to whether the minority member suffered an injury separate from the majority member’s injury. The court rejected the defendant’s argument that the minority member’s receipt of ownership interests in the entities as gifts, many from the defendant himself, affected her rights or altered his fiduciary obligations. The court denied the plaintiff’s request for an accounting without prejudice pending further discovery. The court urged the parties to find a resolution in order to avoid costly proceedings with a special master. The court commented that the business could no longer continue to be managed as it had been in the past and encouraged the parties to be creative in finding a solution to eliminate the conflicts of interest inherent in the current structure.

*3 Point Holdings, L.L.C. v. Gulf South Solutions, L.L.C.*, Civil Action No. 06-10902, 2008 WL 695379 (E.D. La. March 13, 2008) (granting unopposed motion for summary judgment by creditors of LLC who asserted claims against LLC’s members and managers based on “expanded fiduciary duty” owed to creditors once LLC was within “zone of insolvency”).

*Internal Medicine Alliance, LLC v. Budell*, 659 S.E.2d 668 (Ga. App. 2008). Two doctors, Verbitsky and Budell, formed a manager-managed LLC and agreed that each was a 50% member, that they would share equally in profits and losses, and that they would jointly manage the LLC. After a falling out, Budell agreed to leave and form his own practice. The members agreed that Budell was entitled to a redemption of his interest but were unable to agree on a buy out price for Budell’s interest. In litigation that ensued, the trial court awarded Budell the fair value of his interest and found that Verbitsky breached her fiduciary duty to the LLC and Budell after Budell’s departure. The trial court found that Verbitsky’s failure to repay Budell his capital contribution did not support a conversion claim. Both parties appealed. With respect to the breach of fiduciary duty claim against Verbitsky, the court stated that LLC managers have a fiduciary duty to act with the utmost good faith and loyalty. Verbitsky argued that she did not exercise management over the LLC and that, to the extent she did, it was agreed that Verbitsky and Budell would handle his or her own accounts receivable. Verbitsky argued that another individual who was not a member was the manager of the LLC, but the court concluded he was not a manager because the Georgia statute requires a non-member manager to be designated, appointed, or elected by more than one half of the members, and there was no evidence that the individual was ever chosen as a manager with the approval of both Verbitsky and Budell. The court concluded that after Budell’s departure he became a passive member and Verbitsky became the sole manager with a fiduciary duty to manage the LLC’s affairs in the manner she believed in good faith to be in the best interests of the LLC. At the time Budell left he had generated over $40,000 in receivables owed the LLC, but only a small amount was collected from insurance carriers after his departure. The evidence showed Verbitsky did nothing to collect these amounts and failed to provide the billing clerk guidance when asked what to do about Budell’s outstanding bills. In contrast, Verbitsky hired an additional billing clerk to assist in collecting her bills. Thus, the court of appeals concluded that the trial court was justified in finding Verbitsky failed to act in the best interest of the LLC by failing to take any steps to have Budell’s bills processed and collected after his departure, and given the level of hostility and bad blood, that Verbitsky’s decision was made in bad faith to negatively impact Budell’s ownership interest. The court of appeals found there was insufficient evidence to support the trial court’s finding that Verbitsky was liable for conversion based on her failure to reimburse Budell for his capital contribution while reimbursing herself for hers. The court stated that conversion is not a viable claim when there is nothing more than
plaintiff's claims were based on the alleged improper use by the defendant members of the LLC's name and the payment of a member of a Nevada LLC asserted direct and derivative claims against the other two members of the LLC. The court stated that none of the facts or conclusions alleged by the LLC or intentional misconduct. The court found that the LLC's allegations of failure to monitor and inform the LLC did not amount to allegations of gross negligence. The court stated that all claims must be dismissed based on the general exculpatory provision in the operating agreement. Under that provision, a manager could only be held liable for conduct amounting to criminal wrongdoing, fraud, gross negligence, or intentional misconduct. The court found that the LLC's allegations of failure to monitor and inform the LLC did not amount to allegations of gross negligence. The court stated that none of the facts or conclusions alleged by the LLC came close to an allegation of "gross negligence" as defined under Delaware law, i.e., that the defendants were recklessly un法学d or acted outside the bounds of reason.

All Metals Industries, Inc. v. TD Banknorth, No. CV075002464S, 2008 WL 731954 (Conn. Super. Feb. 27, 2008) (striking creditor's breach of fiduciary duty claim against LLC members because creditor of insolvent corporation cannot assert direct claim against corporation's directors, LLC members and corporate shareholders are not liable for entity's obligations, and there is no statutory or case law imposing on members, shareholders, officers or directors of corporation or LLC any fiduciary duty to creditors).

Peregrine Emerging CTA Fund, LLC v. Tradersource, Inc., No. 07 C 5528, 2008 WL 474369 (N.D. Ill. Feb. 19, 2008). An LLC that operated a commodities fund sued its manager, which was a corporation, and the manager's president for breach of contract, negligence, and breach of fiduciary duty in connection with the manager's alleged failure to monitor and inform the LLC of increased risk parameters caused by actions taken by one of the trading advisors the manager was obligated to monitor. The relationship between the manager and the LLC was governed by an operating agreement containing an exculpatory clause applicable to managers and manager associates. The operating agreement provided that it was to be governed by and construed in accordance with the law of Delaware without regard to Delaware conflict of law provisions, but the LLC argued that Illinois substantive law should be applied to each cause of action and should resolve issues such as the definition of "gross negligence" and whether the LLC had a cause of action for breach of fiduciary duty. The LLC acknowledged that it was formed under Delaware law but stated that it was a resident of Illinois and that all of the alleged conduct and losses occurred in Illinois. The court applied Illinois choice of law rules and concluded that Delaware law governed all of the issues in the case. The LLC did not show that applying Delaware law to interpretation of the operating agreement's exculpatory clause would violate a fundamental Illinois policy or that Illinois had a materially greater interest in the litigation than Delaware. The court rejected the LLC's argument that a choice of forum clause selecting Illinois constituted an agreement that Illinois substantive law should apply to the contract. The court concluded that the negligence claims were governed by Delaware law as well because they were specifically related to the contractual relationship and, in such cases, Illinois courts place great weight on the location where the contractual relationship is centered. In this case, the parties centered their relationship in Delaware, and Delaware law applied to the negligence claims arising out of the contractual relationship since Delaware had the greatest interest in the contractual relationship. With respect to the fiduciary duty claims, the court stated that Delaware law applied since such claims are governed by the law of the "state of incorporation," and the LLC was "incorporated" under Delaware law. The court dismissed the LLC's negligence and breach of fiduciary duty claims against the manager's president based on a provision in the operating agreement shielding a "manager associate" (a defined term encompassing the manager's president) from personal liability for any act or omission in the performance of the manager's duties to the LLC. The LLC alleged that the defendants failed to monitor and inform the LLC of increased risk parameters caused by actions of a trading advisor, and there was nothing to suggest the manager's president engaged in any activity outside the scope of the manager's obligations under the contract. The court rejected the LLC's arguments that limitations on the scope of indemnifiable conduct evinced an intent to hold manager associates liable under some circumstances. The court stated that the manager associate exculpatory provision trumped the indemnification clause and was intended to exculpate manager associates for all acts within the manager's duty to the LLC because the exculpatory clause was applicable "notwithstanding any other provision" of the operating agreement. Further, the court held that the negligence and breach of fiduciary duty claims should be dismissed because the allegations of wrongdoing were all related to the operating agreement and were subsumed by the breach of contract claim under Delaware law. Finally, the court held that all claims must be dismissed based on the general exculpatory provision in the operating agreement. Under that provision, a manager could only be held liable for conduct amounting to criminal wrongdoing, fraud, gross negligence, or intentional misconduct. The court found that the LLC's allegations of failure to monitor and inform the LLC did not amount to allegations of gross negligence. The court stated that none of the facts or conclusions alleged by the LLC came close to an allegation of "gross negligence" as defined under Delaware law, i.e., that the defendants were recklessly uninformed or acted outside the bounds of reason.

Kira Inc. v. All Star Maintenance Inc., 267 Fed.Appx. 352, 2008 WL 510508 (5th Cir. 2008). A minority member of a Nevada LLC asserted direct and derivative claims against the other two members of the LLC. The plaintiff's claims were based on the alleged improper use by the defendant members of the LLC's name and the payment
of management fees to affiliates of the defendants. The court of appeals agreed with the district court that there was insufficient evidence to create a jury question on the service mark claim. The evidence showed the operating agreement expressly permitted all three members to compete with each other and with the LLC, even to the exclusion of the LLC from business the LLC was capable of performing. The operating agreement did not reserve the name to the LLC or otherwise prohibit its use. The evidence also showed that the chairman of one of the defendant members had been using some form of the name for many years prior to the formation of the LLC. Thus, the district court correctly determined that the plaintiff had failed to meet its threshold burden of showing the LLC had a protectible interest in the service mark. The court of appeals also rejected the plaintiff’s argument that the district court should have entered judgment in its favor in connection with payment of management fees. The plaintiff argued that the district court should have entered judgment rescinding the contracts and requiring disgorgement of the fees to the LLC based on the jury’s finding that the defendant members breached the operating agreement and their duties of good faith and fair dealing. The court of appeals rejected this argument because the jury found that the plaintiff suffered no harm. The jury also found the defendants did not breach any fiduciary duties. Under the controlling Nevada law, rescission is an equitable remedy that seeks to place the parties in the same position they occupied before the contract. A judgment returning the fees would have effectively ignored the jury’s determination that the plaintiff suffered no harm. The court stated that the jury’s verdict was understandable given the evidence that necessary services were performed at a rate that was substantially below market rate. Thus, the plaintiff’s argument that it was entitled to equitable relief was without merit.


T. Inspection and Access to Information

Maitland v. Int'l Registries, LLC, Civil Action No. 3669-CC, 2008 WL 2440521 (Del. Ch. June 6, 2008). The court denied the motion of the plaintiff, a member of an LLC, for commission requesting documents and deposition testimony from the outside auditor of the LLC. The court stated that the action at its core was an action for inspection of LLC books and records and that granting the motion for commission would effectively give the plaintiff member the relief he sought. The court stated that the plaintiff could not use the discovery process in a books and records case to gain access to the books and records ultimately at issue.

TravelCenters of America, LLC v. Brog, Civil Action No. 3516-CC, 2008 WL 868107 (Del. Ch. March 31, 2008) (dismissing claim or access to any and all books and records of Delaware LLC for failure to allege proper purpose (relying on corporate case law regarding burden to establish proper purpose for inspection) and concluding that, even assuming proper purpose had been pleaded, books and records inspection counterclaim should not be consolidated with expedited declaratory judgment action regarding validity of defendants’ notice of intent to present business and nominate directors in view of bylaws advance notice provision).

U. Interpretation of Operating Agreement

Olson v. Halvorson, C.A. No. 1884-VCL, 2008 WL 4661831 (Del. Ch. Oct. 22, 2008). The dispute in the case arose among the founders of a hedge fund LLC when one of the founders was removed from the LLC. An unsigned LLC agreement provided that a founder was entitled to a multi-year earnout, in this case purportedly worth more than $100 million, when the founder left the LLC. The court held that the one-year provision of the Delaware statute of frauds applies to LLC operating agreements, and the multi-year payment structure set forth in the unsigned operating agreement was thus unenforceable. The court noted that the Delaware LLC statute expressly allows oral operating agreements, but does not address whether the statute of frauds applies to such agreements. Commentators disagree as to whether the statute of frauds applies to Delaware LLC agreements, and the court stated that there appeared to be no case law in Delaware or elsewhere on the subject. The court noted that few oral LLC agreements are likely to contain any term or provision that cannot possibly be performed within one year, and the statute of frauds would not limit the enforcement of an oral agreement if it contained no such provisions. If, however, an oral LLC agreement contains a provision or provisions that cannot possibly be performed within one year, the court held that such provision or provisions are unenforceable based on the policy underlying the statute of frauds. The court analyzed the payment provisions in the
unsigned LLC agreement and concluded that the payout obligation fell within the one-year statute of frauds provision because all amounts except the first payment could not possibly be calculated until after one year following the alleged agreement, and there were additional substantive obligations and restrictions on the remaining members extending for multiple years. The court analyzed exceptions to the statute of frauds involving multiple writings and part performance and concluded that these did not apply in this case. Other writings relied upon by the removed member did not clearly and specifically reference the unsigned operating agreement or the payout provision. The court followed the rule followed in the majority of jurisdictions and a Delaware Superior Court decision that an agreement not performable within one year (in contrast to a contract involving the sale of land) is not validated by part performance; therefore, the part performance exception was not available to the removed member.

_M.C. Multi-Family Development, L.L.C. v. Crestdale Associates, Ltd._, 193 P.3d 536 (Nev. 2008). The operating agreement of a residential real estate development LLC contained the following provision permitting members to engage in competition:

This Operating Agreement shall not preclude or limit in any respect the right of any Member or Administrative Committee Member to engage in or invest in any business activity of any nature or description, including those which may be the same or similar to the Company's business and in direct competition therewith. Any such activity may be engaged in independently or with other Members or Administrative Committee Members. No Member shall have the right, by virtue of the Articles of Organization, this Operating Agreement or the relationship created hereby, to any interest in such other ventures or activities, or to the income or proceeds derived therefrom. The pursuit of such ventures, even if competitive with the business of the Company, shall not be deemed wrongful or improper and any Member or Administrative Committee Member shall have the right to participate in or to recommend to others any investment opportunity.

Although the minority member had the right to develop other projects, the LLC and its majority member sued the minority member and the minority member’s company alleging, _inter alia_, that the minority member and his company converted the LLC’s contractor’s license for their own purposes when they used the LLC’s license rather than obtain a separate contractor’s license to develop competing properties. The trial court entered a directed verdict in favor of the minority member on the conversion claim, and the supreme court reversed the trial court’s judgment and remanded for a trial on that issue. The court first determined that intangible property, such as a license, can be converted under Nevada law. The court then determined that the plaintiffs had offered sufficient evidence on the issue of whether the minority member’s use of the license constituted “wrongful dominion” over the license to overcome the motion for directed verdict. There was testimony that the majority member and manager did not grant the minority member permission to use the LLC’s license and that the operating agreement did not authorize the use of the LLC’s license on the other projects even though it permitted members to engage in other projects. Although there was testimony that other members of the LLC used the license on individual projects, the court stated that the evidence was not so overwhelming that a verdict against the minority member would be contrary to law, and the probative value of any prior course of conduct concerning the license was undermined by the fact that the use of the license by other members occurred prior to the current majority member’s acquisition of its interest in the LLC. The court noted that the fact that the jury found in favor of the minority member on the other claims of wrongful conduct (which included breach of fiduciary duty claims) did not mean there could be no “wrongful dominion” with respect to the conversion claim. The court viewed the element of “wrongful dominion” as distinct from the “wrongfulness” element of other torts, and it was for the jury to determine whether the specific elements of conversion existed.

The court rejected the majority member’s argument that the trial court erred in admitting parol evidence on the meaning of the operating agreement in connection with the majority member’s breach of contract claim against the minority member for breach of the general covenant of good faith and fair dealing. The majority member argued that the operating agreement (which included a provision that the articles of organization and operating agreement contained the entire understanding of the parties and superseded prior understandings and agreements) was clear and unambiguous in that, while it unambiguously allowed members to pursue other projects, it did not provide them authority to use the LLC’s contractor’s license in pursuit of those projects. The court found that the admission of parol evidence did not violate the parol evidence rule because the agreement was silent on the ability of members to use the license on other
projects, and parol evidence was admissible on this point to prove a subsequent oral modification or to resolve a latent ambiguity in the agreement.

*Andrews v. Ford*, 990 So.2d 820 (Miss. App. 2008). After one of the members of an LLC died, the deceased member’s administrator brought suit against the remaining member for breach of contract and specific performance of a buy-sell agreement. The court construed the LLC operating agreement and buy-sell agreement between the members as part of the same transaction because the agreements were executed on the same date and the buy-sell agreement was referred to in the operating agreement. The court concluded, however, that the dispute between the deceased member’s estate and remaining member was not within the scope of the arbitration clause in the operating agreement because the deceased member’s estate was not a “member” under the operating agreement and the arbitration clause only encompassed disputes among members.

*In re Seneca Investments, LLC*, Civil Action No. 3624-CC, 2008 WL 4329230 (Del. Ch. Sept. 23, 2008). An LLC member sought judicial dissolution of the LLC. The court analyzed the claim under the judicial dissolution provisions of the Delaware LLC statute and the Delaware corporation statute because the members contractually agreed that the LLC would be governed as a corporation and that the Delaware General Corporation Law would apply. The LLC had two organizational documents: an operating agreement and a charter. The purpose clause in the charter stated that the purpose of the LLC was “to engage in any lawful act or activity for which corporations may be organized under the Delaware General Corporation Law.” The petition for dissolution alleged that the LLC had abandoned its business and should thus be dissolved. Specifically, the petition alleged that the LLC had not for several years had a business plan, sought or received capital, had shareholder or director meetings, or sought to hire anyone who could conduct business on its behalf. The LLC’s only assets were approximately $2.2 million in cash, shares of stock of a publicly held company, and a minority interest in a private internet marketing company. The LLC sought judgment on the pleadings, and the court concluded that the petitioner alleged no facts that would compel the court to grant the petition for dissolution. In the absence of extensive LLC case law interpreting the LLC judicial dissolution statute, and given the similarity of the LLC and limited partnership judicial dissolution statutes (authorizing the court to decree dissolution whenever it is not reasonably practicable to carry on the business in conformity with the LLC/limited partnership agreement), the court considered limited partnership case law in this context as well as LLC case law. In the absence of an allegation of deadlock, the court focused on whether it was impracticable for the LLC to fulfill its business purpose. Because the LLC’s charter stated that its purpose was to engage in any lawful act or activity for which corporations may be organized, and a corporation may function as a passive instrumentality to hold title to assets, the court concluded the allegations were insufficient to support a claim that it was not reasonably practicable to carry on in conformity with the operating agreement. The court stated that allegations that the LLC had failed to comply with certain provisions of the operating agreement (such as making distributions, providing reports, and continuing to allow the petitioner to serve as director) were not grounds for dissolution, and the court would not attempt to police violations of operating agreements by dissolving LLCs. The court rejected the petitioner’s argument that the operating agreement prohibited any business activity by the LLC other than liquidating assets and distributing cash. Turning to the provision of the Delaware General Corporation Law that allows the court of chancery to appoint a custodian or receiver when the corporation has abandoned its business and has failed within a reasonable time to take steps to dissolve, liquidate or distribute its assets, the court analyzed whether the LLC had abandoned its business by looking to the LLC’s purpose clause. In view of the broad purpose clause, and because a corporation can lawfully function as a passive holding company, the court concluded that the facts alleged in the petition showed that the LLC was performing a valid corporate function by passively investing in other businesses. Furthermore, the court pointed out that the LLC was pursuing counterclaims, and pursuing legal claims is an acceptable and common corporate function. The court stated that it was aware of the possibility that a company facing a petition for dissolution would file non-meritorious counterclaims to avoid dissolution, but the court did not see any indication of abuse in the instant case.


corporation (“NIBC”), seeking a declaration that VG 109 was NIBC’s alter ego, specific performance of provisions of the LLC agreement regarding the reimbursement of tax withholding payments made on VG 109’s behalf, and a declaration that VG 109’s attempted transfer of its economic interest was invalid. The LLC asserted several bases for the court’s exercise of personal jurisdiction over NIBC, one of which was premised on the terms of the LLC agreement. Personal jurisdiction over VG 109, which consented to jurisdiction in the LLC agreement, was not challenged; however, the court rejected the argument that the consent to jurisdiction provision in the LLC agreement applied to NIBC. Though the term “party” in the consent to jurisdiction provision was not defined, the court found nothing to suggest that the term would include NIBC, which was neither a signatory nor a member as to the original or amended LLC agreement. Though NIBC was an affiliate covered by the indemnification provisions of the LLC agreement, the court stated that the LLC failed to explain how the application of the indemnification provisions to NIBC supported its contention that NIBC consented to jurisdiction. In fact, the court found that the parties manifested an intent not to include affiliates in the consent to jurisdiction provision by expressly including affiliates in the indemnification provisions while referring only to parties in the consent to jurisdiction provision.

Kinnard v. Stone, No. CIV-07-250-R, 2008 WL 4000445 (W.D. Okla. Aug. 25, 2008). Stone assigned his interest in various LLCs and partnerships pursuant to written assignments. Pursuant to an unwritten agreement, Stone had the right to buy back the interests within six months. In this litigation, the parties disputed whether Stone owned any interest in the entities, and one of the arguments made by Stone was that certain assignments were prohibited by the terms of the partnership agreements or operating agreements of the particular entities. One of the LLC agreements required written consent of each member for any assignment of a member’s interest. Because Stone’s interest in the LLC was assigned, restored, and assigned again without regard to the provision, the court held that Stone waived the consent requirement. Alternatively, the court found that the required consent was satisfied by email messages among the members. The court stated that Stone could not rely on the no-waiver provision contained in the LLC operating agreement when his actions were taken in violation of the transfer restriction provisions in the agreement. The court also noted that because the transferee of Stone’s interest was already a member, there was no issue regarding substitution of a member. The court held that the members waived a consent requirement in another LLC operating agreement relating to loans to a member or affiliate and that Stone received consideration for his interests in the form of cash and assumption of certain liabilities. Finally, the court held that the assignments were sales with the right to redeem within a specified period of time rather than loans collateralized by the interests for an unlimited time.

Samsara Investment III, LLC v. Wallace, No. 07-cv-9385 (JFK), 2008 WL 3884362 (S.D.N.Y. Aug. 21, 2008). The plaintiff invested in an LLC in exchange for a specified preferred return under an operating agreement executed by the plaintiff, the defendant, and the LLC. The operating agreement was governed by Mississippi law and provided that the plaintiff would become the managing member if the preferred return was not paid by a certain date. The agreement also contained provisions prohibiting waivers and requiring that modifications be in writing. In a suit by the plaintiff against the defendant on the defendant’s guaranty of the LLC’s payment obligations, the defendant asserted counterclaims asserting that the plaintiff breached the operating agreement and fiduciary duties that a manager owes an LLC under Mississippi law. The basis of the counterclaims was the plaintiff’s failure to take over as manager when the LLC defaulted on the preferred return. The court held that, although the operating agreement prohibited waivers and required modifications to be in writing, these provisions were themselves waived by the parties’ consistent course of conduct in allowing the defendant to continue as managing member.

Tunney v. Hilliard, C.A. No. 1317-VCN, 2008 WL 3875620 (Del. Ch. Aug. 20, 2008). Tunney and Hilliard owned and operated a corporation (which was the operating entity) and an LLC (a real estate holding entity) in connection with their restaurant business. After they sold the business, Tunney argued that he was entitled to a “commission” out of the sales proceeds based on an oral agreement reached with Hilliard when Tunney assumed additional management responsibilities in Hilliard’s absence. Hilliard denied making this agreement with Tunney and claimed that any additional efforts by Tunney were de minimis or within the scope of their original 50-50 agreement. The court reviewed the evidence and agreed with Hilliard. The court found that Hilliard’s decreased presence resulted in few changes in the business. The stock certificates of the corporation evidenced equal ownership, and the written LLC agreement provided for equal distribution of the profits. The court acknowledged that Delaware law permits oral modifications of written agreements, but stated that they were not favored for “a host of policy and pragmatic reasons.” Thus, a party seeking to prove an oral modification must prove the intended change with sufficient specifici
directness as to leave no doubt of the intended change to the formal document. The court concluded Tunney fell well short of that mark. The court also rejected Tunney’s promissory estoppel claim because he failed to prove that Hilliard promised him additional compensation. Finally, the court rejected various equitable claims by both parties for compensation for “additional” efforts expended in operating the business. The court found that each contributed more or less equally to the success of the business and that they were left to abide by their original 50-50 agreement.

**R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC**, Civil Action No. 3803-CC, 2008 WL 3846318 (Del. Ch. Aug. 19, 2008). The petitioners sought judicial dissolution of nine Delaware LLCs. With respect to two of the LLCs, the court held that the petitioners did not have standing under the Delaware LLC statute to seek dissolution and winding up because only managers or members have standing to do so under the statute. The court stated that there was no authority for the proposition that a member of an LLC that is itself a member of another LLC can seek dissolution or the winding up of the latter LLC. The court held that the claim for receivership survived because the statute permits a “creditor, member or manager... or any other person who shows good cause” to present an application for receivership. With respect to the other seven LLCs, the court dismissed the action because the members waived the right to seek dissolution or the appointment of a liquidator in the LLC agreements. Although the LLC agreement specified events of dissolution that included entry of a decree of judicial dissolution, the court did not find that this provision conflicted with the waiver of dissolution rights contained elsewhere in the LLC agreement because the Delaware statute permits a court to enter a decree of judicial dissolution upon an application by or for a member or manager, and the members or managers cannot waive the rights of others to make such applications for them. The court proceeded to address freedom of contract in the LLC context to waive rights to seek judicial dissolution and the appointment of a liquidator. The court concluded that the Delaware LLC statute does not preclude waiver of these rights. The court rejected the argument that statutory provisions that do not include the qualification “unless otherwise provided in a limited liability company agreement” (or some variation thereof) are mandatory and may not be waived. The court noted that the statute did not expressly prohibit waiver of such rights, and the judicial dissolution and receivership provisions are phrased in permissive terms (i.e., the court of chancery “may” decree dissolution or appoint a trustee or receiver under such provisions). The most important factor in the analysis according to the court was the fact that the rights waived in the LLC agreement were not designed to protect third parties. The court pointed out that it had previously recognized that third parties have no interest in a judicial dissolution proceeding under the Delaware Limited Liability Company Act, and the LLC agreement did not affect the statutory right of creditors to petition for appointment of a receiver. The court also rejected the argument that the waiver of rights to seek dissolution and receivership violated the public policy of Delaware. Stressing the policy of contractual freedom and the enforceability of voluntary agreements of sophisticated parties, the court concluded that the policy of Delaware mandated that it respect the parties’ agreement. According to the court, there is no threat to equity in enforcing a waiver of the right to seek dissolution because the unwaviable implied covenant of good faith and fair dealing ensures that members will not be trapped in an LLC at the mercy of others acting unfairly and in bad faith.


**Pravak v. Meyer Eye Group, PLC**, No. 07-2433-JPM-dkv, 2008 WL 2951101 (W.D. Tenn. July 25, 2008). Three ophthalmologists agreed to form an ophthalmology practice, and Dr. Pravak signed a letter of intent in which he agreed to become a member in a newly formed LLC. The three doctors signed the LLC’s lease agreement, a membership consent form, and a loan agreement, and Dr. Pravak was paid a “draw” by the LLC until the other two doctors began characterizing themselves as the only partners and ceased to characterize Dr. Pravak’s compensation as a “draw.” The LLC’s accountant indicated that she wished to recode all Dr. Pravak’s checks as contract labor, and the other two doctors asserted that the LLC did not have formal members without an operating agreement. Dr. Pravak filed suit alleging various causes of action, including breach of contract, tortious interference with contract, breach of fiduciary duty, civil RICO violations, and injunctive and declaratory relief. The court held that the letter of intent was a binding agreement between the parties and was not subject to a condition precedent. The essential terms and the parties’ subsequent conduct were sufficient to create a binding agreement. Thus, Pravak’s breach of contract claims were claims upon which relief could be granted, and the court declined to dismiss them. Dr. Pravak’s claim that the other two doctors interfered with the LLC’s obligations under the letter of intent failed because the other two doctors were also parties to the letter of intent.
The plaintiff asserted that its removal from three LLCs was ineffective because the operating agreements authorized redemption of a member’s interest but not removal of a member. The operating agreement of the LLCs provided that each member granted the LLC the right to redeem the member’s interest, that exercise of the LLC’s right to redeem required delivery of notice to the redeeming member, and that redemption required approval of the holders of 65% of the distribution percentages of all members. The plaintiff was notified by the LLCs that he was being removed, and the plaintiff argued that its removal was ineffective because the letter did not indicate a redemption of the plaintiff’s interest. The court pointed out that the Missouri LLC statute provides that a member ceases to be a member when the member is expelled in accordance with the operating agreement. Though the terms “removal” or “expelled” were not used in the operating agreement, the court held that it was clear that the redemption clause in the operating agreements provided a mechanism to remove or expel a member. The court stated that the power to redeem a member’s interest under the operating agreement was not conditioned on use of the word “redemption.” The LLCs gave the member notice, and the removal was authorized by members owning the requisite percentage of distribution percentages; therefore, the court concluded that the plaintiff’s removal was effective. The failure of the LLCs to pay the redemption price within ten days after the notice as required by the operating agreements was a breach of contract but did not render the removal ineffective according to the court. The court rejected the plaintiff’s argument that the other members breached their duties of care and loyalty when they removed the plaintiff. The court stated that, because the members relied in good faith on the operating agreements, the district court did not err in concluding that there was no evidence of breach of fiduciary duty. Finally, the court affirmed the district court’s finding that the fair market value of the services performed by the plaintiff in exchange for its interest was $10,000. The operating agreement provided that the redemption price was the “actual tax basis of the redeeming member.” The plaintiff claimed the redemption price was $167,667 while the LLCs claimed it was zero. The court stated that tax basis in a partnership can be obtained by exchanging services for a partnership interest as well as contributing property or money or assuming liabilities. The court stated that the value of services is determined by the fair market value of the interest received. The court then concluded that the district court’s finding that the value of the services provided by the plaintiff in exchange for its partnership interest was not clearly erroneous because there was substantial evidence in the record demonstrating that the plaintiff had contributed services with a fair market value of $10,000.

ULQ, LLC v. Meder, 666 S.E.2d 713 (Ga. App. 2008). Four individuals formed an LLC, and the operating agreement designated the majority member as the sole manager. The operating agreement provided that an officer could be removed by the manager with or without cause whenever in the manager’s judgment the best interest of the LLC would be served. Removal was a dissociating event requiring the member to sell his interest to the other members or the LLC at a designated value. The manager appointed Meder, a 10% member, as vice president and later terminated him, claiming that he had abused other employees and that his termination was thus in the best interests of the LLC. The LLC exercised its right to purchase Meder’s interest. The value in effect under the operating agreement at that time was the value of a member’s capital account, and Meder’s capital account was zero due to LLC losses. Meder sued the LLC, alleging that his termination and buy out breached the operating agreement, breached fiduciary duties owed to him by the LLC, and wrongfully converted the value of his capital investment and interest. The LLC counterclaimed alleging various causes of action based on Meder’s contacting LLC clients, after his termination as an officer and before the purchase of his membership interest, to persuade them to withhold their business from the LLC. The LLC sought summary judgment on Meder’s breach of contract claim on the basis that the operating agreement permitted his termination with or without cause, but the court of appeals held that the trial court did not err in denying summary judgment because there was a fact issue with respect to the duty of good faith and fair dealing implied in all contracts. The court stated that the exercise of discretion by a party to a contract is subject to the implied duty of good faith unless the contract states that the discretion is “absolute” or within the “sole” judgment of the party. Because the operating agreement did not vest the manager with absolute discretion in terminating an officer, but rather required the manager to conclude that termination was in the best interest of the LLC, the manager was required to exercise good faith in terminating Meder. Meder presented evidence that he was not abusing other employees and that the true motive for terminating him was to allow the LLC to purchase his interest for nothing at a time when the LLC was about to take off financially, thereby raising an issue regarding the exercise of good faith by the manager. The court held that Meder breached the operating agreement by convincing a customer to withhold its business from the LLC by falsely informing the customer that the LLC was experiencing severe financial difficulties that had resulted in Meder’s termination. So long as Meder was a member or owner of the LLC, he was obligated under a provision of the operating agreement not
to interfere with customer relationships of the LLC. Finally, relying on the Georgia LLC statute, the court rejected the LLC’s argument that Meder breached a fiduciary duty to the LLC when he convinced the LLC’s customer to withhold business from the LLC. The LLC statute requires a member or manager, when managing the affairs of the LLC, to act in a manner the member or manager believes in good faith to be in the best interest of the LLC, but the statute also specifies that a non-manager member of a manager-managed LLC has no duties to the LLC or the other members solely by reason of acting as a member unless otherwise provided by the articles of organization or a written operating agreement. Based on this statutory provision, the court held that a non-managing member in a manager-managed LLC owes no duties to the LLC or other members absent provisions imposing duties in the operating agreement or articles of organization.

*Blair v. McDonagh*, 894 N.E.2d 377 (Ohio App. 2008). Blair and McDonagh formed an LLC to operate Irish pub restaurants. Disputes developed, and the members asserted against each other various claims, including claims for breach of contract and breach of fiduciary duty. The jury returned a verdict in favor of McDonagh on all claims. The court rejected Blair’s argument that the evidence established that McDonagh breached his duty of good faith and fair dealing by refusing to consent to a line of credit that Blair had negotiated for the LLC and that was necessary for the good of the LLC. The court stated that an LLC, like a partnership, involves a fiduciary relationship that imposes on the members a duty to exercise the utmost good faith and honesty in all dealings and transactions with the LLC. Similarly, the court said that the parties to a contract owe each other a duty of good faith and fair dealing. The court found that McDonagh presented substantial evidence that he had acted in good faith and that he had withheld his consent for legitimate reasons, the most important of which was that Blair had refused to provide necessary financial information to evaluate the business and the necessity for the loan. Additionally, McDonagh’s loans to the LLC would have been subordinated to the line of credit loan. The court stated that McDonagh was not acting in bad faith when he failed to consent to the line of credit loan under these circumstances. Finally, the court held that the trial court did not err in ruling that $20 million in advances by McDonagh to the LLC were loans rather than capital contributions. The operating agreement provided that the members contemplated that additional requirements of the LLC would be met by a bank loan and/or capital contribution of McDonagh and that the LLC was authorized to accept additional capital contributions from McDonagh in such amount as the members deemed appropriate or necessary. Blair argued that these provisions showed the parties contemplated that McDonagh’s advances would be treated as capital contributions rather than loans. However, the operating agreement also provided that no member was required to make any further capital contribution or loan to the LLC. Thus, under the plain language of the agreement, McDonagh was permitted, but not required, to provide loans or capital, and the operating agreement did not show that McDonagh’s advances were necessarily capital contributions. The court concluded that there was evidence to support the trial court’s decision that McDonagh’s advances were intended by the parties to be loans based on evidence of how Blair treated the advances on the LLC’s tax returns, language on the memo line of the checks, and testimony of one of Blair’s accountants.

*Impriris Investors LLC v. United States*, 83 Fed.CI. 46 (Ct. Cl. 2008). An LLC and its tax matters partner filed suit seeking readjustment of certain partnership items, and another LLC member filed a notice of election to participate and an amendment to the complaint. The primary dispute concerned whether the allocation of partnership tax items of “ordinary income” included short term capital gains for the tax year 2000. The court examined and interpreted the LLC agreement to determine whether it provided a special allocation of items of short term capital gain. The court concluded that a provision for special allocation of “ordinary income” in the LLC agreement did not provide for a special allocation of capital gains.

*IH Riverdale, LLC v. McChesney Capital Partners, LLC*, 666 S.E.2d 8 (Ga. App. 2008). The court held that amendment of an LLC operating agreement to eliminate a minority member’s 5% “guaranty profit distribution” was valid because the agreement permitted amendment by members holding at least a majority interest, defined as 80% of the aggregate ownership interest, and the amendment was approved by members owning 94.68% of the LLC’s ownership interest. The court concluded that the operating agreement was clear and unambiguous, that the guaranty distribution provision was not included in “major decisions” requiring unanimous consent, and that parol evidence could not be used to construe the contract.

*Wood v. Baum*, 953 A.2d 136 (Del. 2008). The plaintiff brought a derivative suit against the members of the board of a Delaware LLC alleging breach of fiduciary duty claims based on alleged improper valuation of certain non-
proceeding that he was defendant or disposing of by bringing his suit. The court stated that a “cause” removal was mere surplusage if it were not interpreted as requiring an action to be defensive or responsive. The court concluded the corporation to liability for indemnification and advancement in proceedings initiated by directors that were not likely included to avoid the result in a corporate case in which the absence of such language from the bylaws exposed the corporation to liability for indemnification and advancement in proceedings initiated by directors that were not responsive to an existing or threatened proceeding. The court stated that the “cause” language would be mere surplusage if it were not interpreted as requiring an action to be defensive or responsive. The court concluded that Donohue was not entitled to advancement under the LLC agreement because he did not identify a threatened proceeding that he was defending or disposing of by bringing his suit. The court stated that a “for cause” removal was

**Donohue v. Corning**, 949 A.2d 574 (Del. Ch. 2008). Donohue brought an action challenging his removal as managing member of an LLC and sought advancement of his expenses under the indemnification and advancement provision of the LLC agreement. The LLC agreement required indemnification and advancement in connection with the “defense or disposition” of a proceeding in which a covered person is involved or with which a covered person is threatened. The court cited corporate case law regarding the policy of Delaware legislation on indemnification, but the court stated that it could not award advancement merely because Donohue had a plausible argument that he brought suit, at least in part, to advance the interests of the LLC and that advancement in such a situation would comport with public policy behind allowing indemnification in corporate disputes. In view of the broad contractual discretion granted LLCs with respect to advancement, the court stated that Donohue must establish his entitlement to advancement under the terms of the LLC agreement itself. The court found Donohue’s argument telling insofar as Donohue argued that he was responding to a threatened proceeding rather than arguing that the provision contemplated coverage for directors initiating suit to fulfill their fiduciary duties by challenging a wrongful removal. The court agreed with Donohue’s implicit acknowledgment that conduct must be responsive or defensive in nature to give rise to an advancement right under the LLC agreement. The court commented that the “in connection with the defense or disposition” language was likely included to avoid the result in a corporate case in which the absence of such language from the bylaws exposed the corporation to liability for indemnification and advancement in proceedings initiated by directors that were not responsive to an existing or threatened proceeding. The court stated that the “defense or disposition” language would be mere surplusage if it were not interpreted as requiring an action to be defensive or responsive. The court concluded that Donohue was not entitled to advancement under the LLC agreement because he did not identify a threatened proceeding that he was defending or disposing of by bringing his suit. The court stated that a “for cause” removal was
not a proceeding as contemplated by the advancement provision. Donohue tried to characterize his removal for cause based on alleged breaches of fiduciary duty as a threatened proceeding, but the defendants repeatedly told Donohue that they were not threatening him with a proceeding, and the court noted that the defendants would thus be estopped to initiate proceedings against Donohue for the actions that allegedly supported his removal for cause. The court found nothing invidious about interpreting the advancement provision as permitting the LLC discretion in instituting or threatening a proceeding that would trigger advancement. The court also noted that the agreement contained an incentive for members or former members to bring meritorious disputes over the LLC agreement by requiring the losing party to pay the fees of the prevailing party.

**Berman v. Sugo LLC**, 580 F.Supp.2d 191 (S.D.N.Y. 2008). In a dispute between two members of an LLC, the court found the allegations insufficient to show that an oral operating agreement existed between the two members. A written letter of understanding specifically contemplated a “more formal” operating agreement, and a draft operating agreement stated that it would be effective when signed by all the members. Also, one of the members expressed an intent not to be bound by the operating agreement until he signed it. The court stated that the only conclusion to be drawn from these facts was that the parties intended not to be bound by the operating agreement until it was signed; thus, various claims based on alleged breaches of the operating agreement failed. Claims for tortious interference with the operating agreement failed for the same reason. The court refused to dismiss breach of fiduciary duty claims asserted against a member based on alleged misappropriation of business opportunities and unfair competition, relying on cases in which courts have recognized that LLC members, like partners in a partnership, owe a fiduciary duty of loyalty to fellow members. The court said that an argument that the letter of understanding permitted competition involved interpretation of the letter and would not be undertaken at the motion to dismiss stage. The court denied a motion for reconsideration of its opinion and explained that it applied the law of New York, the forum state, in the context of this dispute regarding a Connecticut LLC because there was no material conflict between the laws of New York and Connecticut with respect to formation of an oral agreement where a party has expressed intent not to be bound until the agreement is in writing.

**Monier v. Boral Lifetile, Inc.,** C.A. No. 3117-VCN, 2008 WL 2168334 (May 13, 2008). Monier, Inc. (Monier) and Boral Lifetile, Inc. (Boral) each owned 50% interests in a Delaware LLC that was managed by a management committee consisting of three representatives of each member. Monier sought a declaratory judgment determining the percentage of net income that must be distributed under the LLC operating agreement, and Boral sought dismissal of Monier’s claim. The operating agreement specified that 50% of the net income would be distributed each year unless the management committee approved a greater or lesser distribution without any dissenting vote. In 2000, the management committee adjusted the distribution rate to 100% of the audited net profits, and the parties disputed whether this was a change that was intended to be in effect on an ongoing basis for the indefinite future. Monier argued that making the change on an ongoing basis was a valid exercise of the management committee’s authority under the operating agreement or, alternatively, constituted an amendment of the operating agreement. Boral argued that the operating agreement gave authority to vary the 50% default distribution rate under the operating agreement from time to time, but not in perpetuity, and that the 2000 action was a limited policy change that was reaffirmed annually by action of the management committee until 2005, when the policy was questioned. Boral also argued that Monier’s construction demonstrated a violation of the management committee’s fiduciary obligations as an impermissible abdication of the committee’s duty to manage. Finally, Boral argued that the requirements for amending the operating agreement were not met. Boral interpreted the operating agreement to impose the following requirements for amendments: (1) approval by the management committee without dissent; (2) approval by all members; and (3) a signed writing of both members. The court found that Monier stated a claim for its interpretation of the operating agreement (i.e., that the agreement authorized the management committee to change the distribution rate for an indefinite period of time). Though Monier’s interpretation might not ultimately prevail, it was not unreasonable and survived the motion to dismiss. The court also concluded that Boral could not demonstrate that the mere setting of the distribution rate at 100% until the management committee unanimously determined otherwise constituted an abdication and breach of fiduciary duty.

**Tuckerbrook Alternative Investments, LP v. Banerjee,** Civil Action No. 08-10636-PBS, 2008 WL 2356349 (D. Mass. June 4, 2008). An investment advisor (Tuckerbrook) hired an individual (Banerjee) to act as portfolio manager of three funds, and the two parties entered into LLC agreements for three Delaware LLCs that served as general partners of the three funds. Tuckerbrook and Banerjee were each 50% managing members of the LLCs. After acrimony
developed and Tuckerbrook learned that Banerjee had approached competitors, Tuckerbrook terminated Banerjee’s employment “for cause” and, without Banerjee’s permission, entered into investment management agreements for each of the funds under which Tuckerbrook was to make the day-to-day decisions for the funds. Although Banerjee’s employment was terminated, he remained a co-managing member of the general partners of the Tuckerbrook funds, and the parties disputed whether Banerjee’s noncompetition agreement precluded him from continued involvement with the three funds he had been managing when he was employed. Banerjee argued that both the LLC and limited partnership agreements provided that the general partner would manage the investments and that the LLC agreement required the “managing members” (emphasizing the plural term was used) to approve any contract. Thus, Banerjee asserted that both managing members had to agree to the investment contract that was authorized by Tuckerbrook and that the agreement was not enforceable without Banerjee’s consent. The court stated that, since the LLC agreement provided that there was no manager, the management was vested in the members in proportion to the current percentage or other interest of members in the profits of the LLC as provided by the Delaware LLC statute, and neither member controlled the LLC since each owned 50%. The court stated that any victory by Banerjee that the investment management agreements were ultra vires would be a pyrrhic victory because the limited partnership agreement expressly contemplated hiring Tuckerbrook to manage the funds, and Tuckerbrook had been doing so without a written agreement since Banerjee was hired. The court stated that this course of performance supported the existence of an implied contract. The court also found that the contracts read as a whole showed a likelihood that Tuckerbrook would succeed on its argument that Banerjee was precluded from managing any distressed fund, including the Tuckerbrook funds, for a post-employment period of three months.


A member of an embattled LLC asserted claims for declaratory and injunctive relief related to his efforts to be recognized as a member of the LLC. Previous litigation had resulted in a settlement represented by an agreement in principle, but the parties ended up in a dispute regarding the meaning of the agreement in principle and the membership rights of the parties in the LLC. The defendants claimed that the plaintiff’s claims were barred by the equitable doctrine of laches. The defendants claimed that the analogous statute of limitations for the plaintiff’s equitable claims would be the three-year statute of limitations applicable to contract actions, and the plaintiff claimed that there was no analogous limitations period for his claims for declaratory and injunctive relief. The court concluded that the plaintiff’s claims were based on the agreement in principle and that the statute of limitations applicable to contract claims was the analogous statute of limitations for purposes of a laches analysis. The court determined that the agreement in principle was not a contract under seal to which the common law twenty-year limitations period would apply even though the word “seal” was pre-printed next to each signature. The court concluded that there was a genuine issue of material fact as to when the defendants breached the agreement in principle by not giving the plaintiff his due share of the LLC. Furthermore, assuming the breach occurred more than three years prior to the plaintiff’s filing of the action, the court considered it desirable to inquire further regarding the possibility that tolling occurred based on the doctrine of unknowable injuries or fraudulent concealment. The court also found there were genuine issues of material fact as to whether the plaintiff was dilatory in bringing the action based on possible inquiry notice of the defendants’ breach. Finally, the court concluded that there were genuine issues of material fact regarding the defendants’ claim that the doctrine of laches should bar the plaintiff’s claims even if the plaintiff brought them within a period less than the analogous three-year limitations period. Application of laches in this manner would require a finding that the defendants were prejudiced, and the court found that there were fact issues in that regard.


Disagreements between the members of two classes of membership interest in a Delaware LLC led to a deadlock, and one of the Class B members filed a petition for dissolution. Segal, a Class A member who was the LLC’s founding member, president, and sole officer, filed counterclaims and third-party claims against the Class B members. Johnson, a Class B member, filed a motion to dismiss Segal’s claims against him for lack of personal jurisdiction, and the other Class B members filed a motion to dismiss Segal’s counterclaims and third-party claims for failure to state a claim. The court granted Johnson’s motion to dismiss for lack of personal jurisdiction as well as the motion of the other Class B members to dismiss Segal’s claims for failure to state a claim. The court dismissed Segal’s breach of contract claim because it was based on breaches of duties not found in the LLC agreement. The court stated that the LLC agreement in no way obligated one class of members to acquiesce to the wishes of the other simply because the other believed its approach to be superior or in the best interests of the LLC. The LLC agreement contained provisions limiting the duties
of members except as expressly set forth in the agreement and waiving liability absent gross negligence, fraud, or
intentional misconduct. Segal argued that this provision established a duty to act without gross negligence, fraud, or
intentional misconduct, but the court stated that the provision did not create a code of conduct resulting in liability for
any damage caused by gross negligence, willful misconduct, or a knowing violation of law. The court stated that Segal’s
arguments regarding other provisions of the agreement were “similarly tortured” and the court “decline[d] to follow
Segal’s invitation to turn an expressly exculpatory provision into an all encompassing and seemingly boundless standard
of conduct.” Further, even if the agreement did somehow create a code of conduct, the court stated that Segal failed to
allege facts sufficient to support an inference that the members acted with gross negligence, willful misconduct, bad faith,
or in knowing violation of law. The court also dismissed Segal’s claim that the Class B members breached the implied
covenant of good faith and fair dealing by blocking financing opportunities presented by Segal. The agreement expressly
provided for the vote required to approve financing, and the court stated that mere exercise of one’s contractual rights,
without more, cannot constitute a breach of the implied covenant of good faith and fair dealing. The court dismissed
Segal’s breach of fiduciary duty claims as well. Segal relied upon the same provisions in the LLC agreement for his
breach of fiduciary duty claims that he relied upon with respect to his breach of contract claims. The court stated that
the agreement greatly restricted and even eliminated fiduciary duties as permitted by the Delaware LLC statute, but, even
assuming the validity of Segal’s argument that there remained a duty not to act in bad faith or with gross negligence, he
failed to allege facts to support such a breach of duty. Finally, the court dismissed Segal’s claim for tortious interference
with his employment contract since the employment contract allowed the LLC to replace Segal as CEO by a vote of 50%
of the board at any time after the second anniversary of the agreement.

Delaware LLC for developing a motorplex. The parties entered an operating agreement containing provisions regarding
additional capital contributions and failure to make capital contributions which were the subject of the dispute in this
case. After the initial capital contributions made by the parties, which consisted of a cash contribution by Abuy and a
credit for work performed by Yuba on the project, additional cash capital contributions were made. Abuy loaned Yuba
the amounts needed for it to make the additional contributions. Yuba defaulted in the payment of the promissory notes
to Abuy, and Abuy sought to adjust the capital accounts under the operating agreement. The adjustment essentially gave
Abuy 100% membership in the LLC. Abuy argued it had the right to adjust the capital accounts under a provision of
the operating agreement that addressed the failure of a “Defaulting Member” to make additional capital contributions.
The court determined that the term “Defaulting Member” was ambiguous and considered extrinsic evidence, including
testimony by the lawyers who represented the parties in the drafting and negotiation of the operating agreement. Both
lawyers testified that it was their understanding that the provisions of the operating agreement permitted a member to
loan funds to another member who was not willing to make an additional capital contribution and that the remedy for
a member who made such a loan and was not timely repaid was an adjustment to the capital accounts. Thus, Abuy, as
the “Non-Defaulting Member” under the agreement had the right to adjust the capital accounts due to the failure of Yuba,
the “Defaulting Member” under the agreement, to repay the loans. The evidence also showed that Yuba knew or should
have known that this provision was a legal “squeeze down provision” by which a defaulting member could lose its
ownership interest. The court commented in the course of its discussion rejecting counterclaims asserted by Yuba, that
Abuy, having properly adjusted the capital accounts in such a manner that Yuba no longer owned an interest, had no
obligation to advise or notify a non-member (Yuba) of any purported discussions or offers of alternative uses for the
subject real property.

**Hampton Island Founders v. Liberty Capital,** 658 S.E.2d 619 (Ga. 2008). An LLC that owned land (Hampton
Island Founders LLC or “Founders”) and an LLC that was to secure financing (Liberty Capital LLC or “Capital”) formed
an LLC (Hampton Island LLC or “Joint Venture LLC”) for developing the land into a residential retreat. Founders
contributed the land to Joint Venture LLC in exchange for a 40% interest, and Capital committed to secure a certain
amount of financing in exchange for a 60% interest. Hampton Island Management Inc. (“HIMI”) was the manager of
Joint Venture LLC. If Capital did not obtain the specified level of funding, its interest was to be reduced to 10%, and
Founders interest would increase to 90%. When Capital’s deadline for securing financing passed without its securing
the specified level of funding, Shealy, the individual who formed and originally controlled Founders and Founders’ four
members, declared Capital in default and took steps to terminate Joint Venture LLC’s relationship with HIMI and name
himself as sole manager of Joint Venture LLC. Founders then brought suit against Capital and others seeking a
declaration that Capital did not meet its obligation and an injunction prohibiting Capital from exercising any control of Joint Venture LLC. The defendants filed a motion for injunctive relief to maintain the status quo, and the court issued a temporary injunction decreeing that HIMI was the sole manager of Joint Venture LLC and that neither Shealy nor Founders were to manage Joint Venture LLC or claim that any other entity was the manager. Subsequently, the court permitted two of Founders’ member entities, as well as investors in Founders’ member entities, to intervene, and the intervenors/investors sought a mandatory injunction to allow meetings of Founders’ member entities so that a vote could be taken to determine who would manage the member entities. The intervenors/investors informed the court that, if permitted to vote, they would remove Shealy as manager of Founders’ member entities, remove him as manager of Founders, and appoint a manager of Founders who would be favorable to the defendants and cause Founders to dismiss its suit. The court granted the relief sought by the intervenors/investors. Founders appealed, and the supreme court determined that the first injunction maintaining the status quo by enabling HIMI to continue to manage Joint Venture LLC pending resolution of the lawsuit was appropriate. However, the court concluded that the second injunction permitting the vote to change management of Founders and its member entities did not balance the relative equities and was error. The court stated that denial of the injunctive relief sought by the intervenors/investors would only inconvenience them by forcing them to await the outcome of the litigation, but issuance of the injunction would result in dismissal of the plaintiff’s lawsuit without an opportunity for the plaintiff to be heard. The court also concluded that permitting intervention by Founders’ members and investors in those members was error because it was not clear how the intervenors’ ability to protect their interest (assuming they had a sufficient interest) in the transaction or subject matter of the lawsuit was impeded by the lawsuit, how it was not adequately protected by Capital and the other defendants, or why they could not pursue an independent remedy against Founders and Shealy.

**In re Kilroy (Guerriero v. Kilroy),** Bankruptcy No. 05-90083-H4-7, Adversary No. 06-3320, 2008 WL 780692 (Bankr. S.D. Tex. March 24, 2008). The court concluded that the debtor did not owe the plaintiff a fiduciary duty for purposes of the exception to discharge for a debt based on fraud or defalcation in a fiduciary capacity. The debtor was the majority member and manager of an LLC that served as the general partner for a limited partnership. In a prior opinion, the bankruptcy court found that the debtor exercised sufficient control over the LLC and limited partnership to establish a fiduciary relationship with the plaintiff, who was the minority member of the LLC and limited partner of the limited partnership. However, the court stated that it did not have the partnership agreement before it at the time of the prior decision, and the court found that the terms of the partnership agreement eliminated any fiduciary relationship. The partnership agreement provided: “[T]he General Partner [i.e., the LLC controlled by the debtor] shall conduct the affairs of the Partnership in good faith toward the best interest of the Partnership. The General Partner, however, is liable for errors and omissions in performing its duties with respect to the Partnership only in the case of bad faith, gross negligence, or breach of the provisions of this Agreement, but not otherwise.” Both the LLC and limited partnership were Delaware entities, and the Delaware Revised Uniform Limited Partnership Act permits partners to contract out of common law fiduciary duties in the partnership agreement. Under the Delaware limited partnership statute, the partners may eliminate fiduciary duties but may not eliminate the implied contractual covenant of good faith and fair dealing. The court concluded that the partnership agreement in this case reduced the general partner’s duties from a fiduciary duty to merely a duty of good faith. The plaintiff argued that a fiduciary duty existed because the debtor controlled the LLC which was the general partner, and the debtor was thus essentially acting as the general partner. However, the court stated that, if the partnership agreement limited the LLC general partner’s duties to that of merely good faith, a higher standard could not be imposed on the debtor as the controlling member of the LLC.

**Madelone v. Whitten,** 18 Misc.3d 1131, No. 9929-07, 2008 WL 399175 (N.Y. Sup. 2008). Three individuals, Madelone, Harrington, and Whitten, formed an LLC in which they each held a 1/3 interest and Whitten was the manager. The three original members later transferred a portion of their interest to a fourth individual who was admitted as a member and held a 10% interest. When Whitten began experiencing marital difficulties, the operating agreement was amended to include an involuntary transfer provision that would require the purchase and sale of a member’s interest in the event the member or member’s spouse filed for a legal separation or divorce. Whitten filed for a legal separation from his wife and relinquished his role as manager, but he was reinstated, and actions to effectuate the involuntary transfer provision were rescinded, when he reconciled with his wife. After Whitten re-filed for divorce, the other members removed Whitten as manager and designated Harrington as manager. Madelone and Harrington also retained a law firm that advised that the involuntary transfer provision had been triggered by Whitten’s divorce action. After a meeting of the members in which the buy out issue was not addressed, Madelone filed an action against the other
members seeking to enforce the involuntary transfer provisions or, in the alternative, a decree that it was no longer reasonably practicable to continue to operate the LLC in accordance with the articles of organization and operating agreement. Madelone claimed that Whitten refused to acknowledge the applicability of the involuntary transfer provisions and continued to hold himself out as manager of the LLC. The other members resisted Madelone’s efforts to enforce the involuntary transfer provisions, arguing that the conduct of the parties and the terms of the agreement itself demonstrated that the provision was not intended to be self-executing. After reviewing both the terms of the agreement and the action of the members, the court found these arguments were without merit. The court found the terms of the agreement were clear and rejected the argument that action taken at meetings of the members foreclosed application of the involuntary transfer provisions. The agreement contained a provision precluding claims of waiver, estoppel, and de facto amendment of the operating agreement absent a writing executed by all members specifically referring to the provision being waived or amended. Based on this provision, the court refused to give effect to resolutions purporting to define Whitten’s role and to estop the LLC and its members from asserting that Whitten was no longer a member because Madelone voted against the resolutions and Whitten abstained. The court further noted that it was unclear how the affirmative vote of just 40% in interest of the members would comply with the general voting provisions of the operating agreement that required the vote or written consent of members holding at least a majority in interest to take action. The court thus concluded that Madelone had established a likelihood of success on his claim to enforce the involuntary transfer provisions. The court also concluded that Madelone had shown the prospect of irreparable injury since the other members had indicated their intent to terminate Madelone as a member and employee absent injunctive relief and Madelone would be entitled to almost 43% of the LLC’s voting rights if the court ultimately agreed that the involuntary transfer provisions were enforceable. The court concluded that this shift in governance and control constituted irreparable harm.

**Old National Villages, LLC v. Lenox Pines, LLC**, 659 S.E.2d 891(Ga. App. 2008) (interpreting authority of general manager under operating agreement and concluding manager had authority to enter consent judgment even though sole member had no notice of complaint or consent judgment; noting that holding otherwise would undermine separate entity status of LLC and its member).

**Georgia Rehabilitation Center, Inc. v. Newnan Hospital**, 658 S.E.2d 737 (Ga. 2008). The court held that a member’s request for judicial dissolution was not subject to arbitration because the arbitration clause in the operating agreement required arbitration of any claim arising out of, in connection with, or relating to the agreement. Though the agreement provided for certain causes of dissolution, the court concluded a request for judicial dissolution was an independent legal mechanism and did not arise out of or relate to the terms of the operating agreement.

**Zebrasky v. Valdes**, No. 07 MA 34, 2008 WL 927780 (Ohio App. March 17, 2008). The court analyzed language in an LLC operating agreement that provided for compensation of members in specified amounts and stated that “no other compensation” was payable to members without a vote of the members. The court concluded that the provision was ambiguous because it could reasonably be interpreted to permit the member vested with day-to-day management authority to reduce compensation or could reasonably be interpreted to prohibit any change in compensation without action by the members. The trial court thus erred in refusing to hold a trial to determine the meaning of the provision before referring the dispute to arbitration under an arbitration clause that excluded from its scope disputes arising out of the managing member’s management authority.

**In re Kingsville Motors, Inc.,** No. 04-33755-DK, 2008 WL 686724 (Bankr. D. Md. March 12, 2008) (concluding that broad management powers conferred on LLC president under operating agreement did not give president unfettered power to transfer LLC assets to corporation where stated purpose communicated to investors was to acquire real property from corporation, not provide operating funds to corporation).

**Segal v. Geisha NYC, LLC**, 517 F.3d 501 (7th Cir. Ill.) 2008) (stating operating agreements of Delaware LLCs that owned and operated original restaurant were relevant to determination of whether new LLCs formed by certain participants in original restaurant were authorized to use original restaurant’s name and design when establishing additional restaurants, and concluding operating agreements authorized use of original restaurant’s intellectual property).
plaintiff's claims were based on the alleged improper use by the defendant members of the LLC's name and the payment member of a Nevada LLC asserted direct and derivative claims against the other two members of the LLC. The dispute regarding Red Sox shares held by second LLC). The court dismissed the LLC’s negligence and breach of fiduciary duty claims against the manager’s president based on a provision in the operating agreement shielding a “manager associate” (a defined term encompassing the manager’s president) from personal liability for any act or omission in the performance of the manager’s duties to the LLC. The court concluded that the negligence claims were governed by Delaware law as well because they were specifically related to the contractual relationship and, in such cases, Illinois courts place great weight on the location where the contractual relationship is centered. In this case, the parties centered their relationship in Delaware, and Delaware law applied to the negligence claims arising out of the contractual relationship since Delaware had the greatest interest in the contractual relationship. With respect to the fiduciary duty claims, the court stated that Delaware law applied since such claims are governed by the law of the “state of incorporation,” and the LLC was “incorporated” under Delaware law. The court dismissed the LLC’s negligence and breach of fiduciary duty claims against the manager’s president based on a provision in the operating agreement shielding a “manager associate” (a defined term encompassing the manager’s president) from personal liability for any act or omission in the performance of the manager’s duties to the LLC. The LLC alleged that the defendants failed to monitor and inform the LLC of increased risk parameters caused by actions of a trading advisor, and there was nothing to suggest the manager’s president engaged in any activity outside the scope of the manager’s obligations under the contract. The court rejected the LLC’s arguments that limitations on the scope of indemnifiable conduct evinced an intent to hold manager associates liable under some circumstances. The court stated that the manager associate exculpatory provision trumps the indemnification clause and was intended to exculpate manager associates for all acts within the manager’s duty to the LLC because the exculpatory clause was applicable “notwithstanding any other provision” of the operating agreement. Further, the court held that the negligence and breach of fiduciary duty claims should be dismissed because the allegations of wrongdoing were all related to the operating agreement and were subsumed by the breach of contract claim under Delaware law. Finally, the court held that all claims must be dismissed based on the general exculpatory provision in the operating agreement. Under that provision, a manager could only be held liable for conduct amounting to criminal wrongdoing, fraud, gross negligence, or intentional misconduct. The court found that the LLC’s allegations of failure to monitor and inform the LLC did not amount to allegations of gross negligence. The court stated that none of the facts or conclusions alleged by the LLC came close to an allegation of “gross negligence” as defined under Delaware law, i.e., that the defendants were recklessly uninformed or acted outside the bounds of reason.

_Braunstein v. Dann Ocean Towing, Inc._, 383 B.R. 362 (D. Mass. 2008) (analyzing “ordinary course of business” for purposes of powers of LLC debtor in possession that owned and managed houseboat and concluding creditor’s reasonable expectations regarding ordinary course of business would have encompassed costs of salvage and repair of damaged houseboat given provision in LLC’s operating agreement empowering LLC to enter into contracts related to accomplishment of LLC’s purposes).

_Tamposi v. Tamposi LLC_, No. 200704283, 2008 WL 497306 (Mass. Super. Jan. 7, 2008) (concluding that arbitration provision contained in operating agreement of LLC that served as manager of second LLC did not apply to dispute regarding Red Sox shares held by second LLC).

_Kira Inc. v. All Star Maintenance Inc._, 267 Fed.Appx. 352, 2008 WL 510508 (5th Cir. 2008). A minority member of a Nevada LLC asserted direct and derivative claims against the other two members of the LLC. The plaintiff’s claims were based on the alleged improper use by the defendant members of the LLC’s name and the payment
of management fees to affiliates of the defendants. The court of appeals agreed with the district court that there was insufficient evidence to create a jury question on the service mark claim. The evidence showed the operating agreement expressly permitted all three members to compete with each other and with the LLC, even to the exclusion of the LLC from business the LLC was capable of performing. The operating agreement did not reserve the name to the LLC or otherwise prohibit its use. The evidence also showed that the chairman of one of the defendant members had been using some form of the name for many years prior to the formation of the LLC. Thus, the district court correctly determined that the plaintiff had failed to meet its threshold burden of showing the LLC had a protectible interest in the service mark. The court of appeals also rejected the plaintiff's argument that the district court should have entered judgment in its favor in connection with payment of management fees. The plaintiff argued that the district court should have entered judgment rescinding the contracts and requiring disgorgement of the fees to the LLC based on the jury’s finding that the defendant members breached the operating agreement and their duties of good faith and fair dealing. The court of appeals rejected this argument because the jury found that the plaintiff suffered no harm. The court also found the defendants did not breach any fiduciary duties. Under the controlling Nevada law, rescission is an equitable remedy that seeks to place the parties in the same position they occupied before the contract. A judgment returning the fees would have effectively ignored the jury’s determination that the plaintiff suffered no harm. The court stated that the jury’s verdict was understandable given the evidence that necessary services were performed at a rate that was substantially below market rate. Thus, the plaintiff’s argument that it was entitled to equitable relief was without merit.

**Sunflower Bank, N.A. v. Airport Red Coach Inn of Wichita, L.L.C.**, No. 95,320, 2008 WL 360641 (Kan. App. Feb. 8, 2008). An LLC operating agreement provided that the members could appoint a member as general manager of the LLC and that such person would have authority to execute instruments on behalf of the LLC. The operating agreement also required consent of all members for LLC borrowing. The members appointed a manager who signed certain promissory notes on behalf of the LLC, and the bank argued that the members must have intended for the manager to have some discretionary authority. The court held that the managing member was not authorized to execute the promissory notes because the members did not approve the loans. The court found that the term “execute” meant the power to sign loan documents on behalf of the LLC, but only once the authority to borrow had been granted by all members. The manager did not have implied authority because the LLC members had no idea he was borrowing the money. The bank could not rely on statutory provisions regarding the manager’s apparent authority because the bank had a copy of the operating agreement and thus had written notice of the limits on the manager’s authority.

V. Transfer of Interest/Buy-Out of Member

**In re Dubin**, 864 N.Y.S.2d 526 (N.Y. Sup. 2008) (holding order to turn over proceeds of buy-out of deceased member’s LLC interest held in joint checking account to estate was proper, but portion of summary judgment directing that decedent’s capital account be turned over was erroneous where record suggested capital account may have been included in purchase price of interest).

**Duneland Sand, Inc. v. Misch**, No. 45A03-0801-CV-15, 2008 WL 4456340 (Ind. App. Oct. 6, 2008) (affirming trial court’s dismissal of suit filed by individual on behalf of corporation and LLC on basis individual no longer owned any interest in entities because defendant had exercised option to purchase stock and units of such entities and transfer was intended to be complete upon creation of successor entity to hold assets excluded from sale of such entities).

**Kinnard v. Stone**, No. CIV-07-250-R, 2008 WL 4000445 (W.D. Okla. Aug. 25, 2008). Stone assigned his interest in various LLCs and partnerships pursuant to written assignments. Pursuant to an unwritten agreement, Stone had the right to buy back the interests within six months. In this litigation, the parties disputed whether Stone owned any interest in the entities, and one of the arguments made by Stone was that certain assignments were prohibited by the terms of the partnership agreements or operating agreements of the particular entities. One of the LLC agreements required written consent of each member for any assignment of a member’s interest. Because Stone’s interest in the LLC was assigned, restored, and assigned again without regard to the provision, the court held that Stone waived the consent requirement. Alternatively, the court found that the required consent was satisfied by email messages among the members. The court stated that Stone could not rely on the no-waiver provision contained in the LLC operating agreement when his actions were taken in violation of the transfer restriction provisions in the agreement. The court also
noted that because the transferee of Stone’s interest was already a member, there was no issue regarding substitution of a member. The court held that the members waived a consent requirement in another LLC operating agreement relating to loans to a member or affiliate and that Stone received consideration for his interests in the form of cash and assumption of certain liabilities. Finally, the court held that the assignments were sales with the right to redeem within a specified period of time rather than loans collateralized by the interests for an unlimited time.

**Urban Hotel Development Company v. President Development Group, L.C.**, 535 F.3d 874 (8th Cir. 2008). The plaintiff asserted that its removal from three LLCs was ineffective because the operating agreements authorized redemption of a member’s interest but not removal of a member. The operating agreement of the LLCs provided that each member granted the LLC the right to redeem the member’s interest, that exercise of the LLC’s right to redeem required delivery of notice to the redeeming member, and that redemption required approval of the holders of 65% of the distribution percentages of all members. The plaintiff was notified by the LLCs that he was being removed, and the plaintiff argued that its removal was ineffective because the letter did not indicate a redemption of the plaintiff’s interest. The court pointed out that the Missouri LLC statute provides that a member ceases to be a member when the member is expelled in accordance with the operating agreement. Though the terms “removal” or “expelled” were not used in the operating agreement, the court held that it was clear that the redemption clause in the operating agreements provided a mechanism to remove or expel a member. The court stated that the power to redeem a member’s interest under the operating agreement was not conditioned on use of the word “redemption.” The LLCs gave the member notice, and the removal was authorized by members owning the requisite percentage of distribution percentages; therefore, the court concluded that the plaintiff’s removal was effective. The failure of the LLCs to pay the redemption price within ten days after the notice as required by the operating agreements was a breach of contract but did not render the removal ineffective according to the court. The court rejected the plaintiff’s argument that the other members breached their duties of care and loyalty when they removed the plaintiff. The court stated that, because the members relied in good faith on the operating agreements, the district court did not err in concluding that there was no evidence of breach of fiduciary duty. Finally, the court affirmed the district court’s finding that the fair market value of the services performed by the plaintiff in exchange for its interest was $10,000. The operating agreement provided that the redemption price was the “actual tax basis of the redeeming member.” The plaintiff claimed the redemption price was $167,667 while the LLCs claimed it was zero. The court stated that tax basis in a partnership can be obtained by exchanging services for a partnership interest as well as contributing property or money or assuming liabilities. The court stated that the value of services is determined by the fair market value of the interest received. The court then concluded that the district court’s finding that the value of the services provided by the plaintiff in exchange for its partnership interest was not clearly erroneous because there was substantial evidence in the record demonstrating that the plaintiff had contributed services with a fair market value of $10,000.

**ULQ, LLC v. Meder**, 666 S.E.2d 713 (Ga. App. 2008). Four individuals formed an LLC, and the operating agreement designated the majority member as the sole manager. The operating agreement provided that an officer could be removed by the manager with or without cause whenever in the manager’s judgment the best interest of the LLC would be served. Removal was a dissipating event requiring the member to sell his interest to the other members or the LLC at a designated value. The manager appointed Meder, a 10% member, as vice president and later terminated him, claiming that he had abused other employees and that his termination was thus in the best interests of the LLC. The LLC exercised its right to purchase Meder’s interest. The value in effect under the operating agreement at that time was the value of a member’s capital account, and Meder’s capital account was zero due to LLC losses. Meder sued the LLC, alleging that his termination and buy out breached the operating agreement, breached fiduciary duties owed to him by the LLC, and wrongfully converted the value of his capital investment and interest. The LLC counterclaimed alleging various causes of action based on Meder’s contacting LLC clients, after his termination as an officer and before the purchase of his membership interest, to persuade them to withhold their business from the LLC. The LLC sought summary judgment on Meder’s breach of contract claim on the basis that the operating agreement permitted his termination with or without cause, but the court of appeals held that the trial court did not err in denying summary judgment because there was a fact issue with respect to the duty of good faith and fair dealing implied in all contracts. Because the operating agreement did not vest the manager with absolute discretion in terminating an officer, but rather required the manager to conclude that termination was in the best interest of the LLC, the manager was required to exercise good faith in terminating Meder. Meder presented evidence that he was not abusing other employees and that the true motive for terminating him was to allow the LLC to purchase his interest for nothing at a time when the LLC
was about to take off financially, thereby raising an issue regarding the exercise of good faith by the manager. The LLC prevailed on its argument that it did not owe Meder a fiduciary duty. The court acknowledged that the majority owner as the sole manager owed a fiduciary duty to the LLC and its members, but concluded that it would make no sense to hold the LLC responsible for a manager’s breach of a fiduciary duty to the LLC and its members.

_Dickson v. Rehmke_, 164 Cal.App.4th 469, 78 Cal.Rptr.3d 874 (Cal. App. 3 Dist. 2008). The plaintiff filed this action for judicial dissolution of the LLC he co-owned with another individual. The defendant member moved to avoid the dissolution by invoking the California statutory procedure for purchase of the plaintiff’s interest at fair market value. The court appointed appraisers and issued an alternative decree determining the value of the membership interest and giving the defendant member 90 days to buy the plaintiff’s interest or allow the process of winding up and dissolution to begin. The defendant tendered a check, and the court entered a judgment in accordance with its alternative decree. The plaintiff filed his appeal within 60 days after service of the judgment but later than 60 days from the decree. The issue was the timeliness of the appeal, which depended upon whether the trial court’s decree was appealable under the language of the statute. The court stated that neither the briefing nor the court’s own research had revealed any cases involving the statutory procedures in the LLC context, but noted that parallel provisions exist for avoiding dissolution in the corporate context. The court also noted as a prefatory matter that the trial court was not bound by the findings of the appraisers and that the absence of a unanimous or majority appraisers’ award did not render the statute inapplicable. The statute provides for numerous juristic activities, i.e., appointment of appraisers, order of reference for purpose of ascertaining the dissenting share and setting procedures for necessary evidence, confirmation of unanimous or majority appraisal award or de novo determination of value, alternative decree that directs winding up and dissolution unless the purchasing parties tender timely payment, and a judgment on their bond for costs if they fail to act. The concluding provision for appellate review, however, states that “[a]ny member aggrieved by the action of the court may appeal therefrom.” The court concluded that the issuance of the decree is the action to which the provision for appeal refers, finding support for such conclusion in the text of the next provision in the statute and in the cases dealing with the purchase option in the corporate context. Because the court’s decree was appealable, the appeal was not timely and was dismissed.

_Regency Centers, L.P. v. Civic Partners Vista Village I, LLC_, No. G038095, 2008 WL 2358860 (Cal. App. 4 Dist. June 11, 2008). Two entities formed a Delaware LLC to own and develop a shopping center. The member who invested the capital (RCLP) notified the developer member (Civic) that it was exercising its option under the operating agreement to buy out Civic’s interest. Civic concluded that RCLP had miscalculated the buy out price but did not notify RCLP. The court concluded that the trial court did not err in finding Civic waived its right to challenge RCLP’s calculated purchase price by engaging in deliberate foot-dragging in hopes that RCLP would make an error in properly exercising the option. The court reversed the trial court’s judgment for punitive damages based on promissory fraud because the trial court made no finding that Civic and its member had no intention of honoring the operating agreement at the time it was entered. The court also concluded that the trial court did not err in finding that the sole member of Civic was liable for Civic’s obligations as Civic’s alter ego.

_Succession of Wascom_, No. 2007 CA 1932, 2008 WL 2065062 (La. App. 2008). A member who purported to transfer her 5% interest in an LLC argued that the transfer, as either a donation or a contract, was null and void on several grounds. The court held that there was no evidence that the transfer involved any terms other than those recited in the document, which represented that the transfer was in exchange for the assumption by the other member (the transferor’s grandfather) of any and all of the member’s existing obligations and liabilities related to the LLC.

_Bruno v. Bruno_, No. FA054004906S, 2008 WL 907512 (Conn. Super. March 17, 2008) (finding that shares in LLC previously held by terminated employee became treasury shares, acknowledging that Delaware LLC statute does not provide for creation of “treasury shares” as such, but noting that statute permits LLC to purchase, redeem, or otherwise acquire LLC interests and that such interests are deemed cancelled unless otherwise provided in LLC agreement, and concluding that, under settlement agreement which provided for forfeiture of terminated employee’s interest in LLC, terminated employee no longer owned his interest in LLC and it had been cancelled by virtue of Delaware LLC statute).
**Internal Medicine Alliance, LLC v. Budell**, 659 S.E.2d 668 (Ga. App. 2008). Two doctors, Verbitsky and Budell, formed a manager-managed LLC and agreed that each was a 50% member, that they would share equally in profits and losses, and that they would jointly manage the LLC. After a falling out, Budell agreed to leave and form his own practice. The members agreed that Budell was entitled to a redemption of his interest but were unable to agree on a buyout price for Budell’s interest. In litigation that ensued, the trial court awarded Budell the fair value of his interest, and found that Verbitsky breached her fiduciary duty to the LLC and Budell after Budell’s departure. The trial court found that Verbitsky’s failure to repay Budell his capital contribution did not support a conversion claim. Both parties appealed. With respect to the valuation of Budell’s interest, the court of appeals concluded that the trial court did not err in determining the fair value of the interest without taking into account the future lease obligation of the LLC. Verbitsky testified that she and Budell agreed at the time he left that his interest would be valued based on a portion of the “fixed assets, minus depreciation,” plus what he “brought” to the practice, minus “overhead.” She also testified that she never asked him to assume any obligation for the remaining payments on the lease. This was sufficient evidence to support valuation of Budell’s interest without including the lease obligation in overhead. With respect to the breach of fiduciary duty claim against Verbitsky, the court of appeals concluded that the trial court was justified in finding Verbitsky failed to act in the best interest of the LLC by failing to take any steps to have Budell’s bills processed and collected after his departure, and given the level of hostility and bad blood, that Verbitsky’s decision was made in bad faith to negatively impact Budell’s ownership interest. The court of appeals found there was insufficient evidence to support the trial court’s finding that Verbitsky was liable for conversion based on her failure to reimburse Budell for his capital contribution while reimbursing herself for hers. The court stated that conversion is not a viable claim when there is nothing more than a failure by a defendant to pay money owed the plaintiff. Budell did not allege that his capital contribution was entrusted to Verbitsky for a specific purpose and then misused by her; therefore, Budell’s claim was nothing more than a claim for money allegedly owed to him and could not serve as the basis for a claim of conversion.

**W. Capital Contributions and Contribution Obligations**

**Blair v. McDonagh**, 894 N.E.2d 377 (Ohio App. 2008). Blair and McDonagh formed an LLC to operate Irish pub restaurants. Disputes developed, and the members asserted various claims against each other. The court held that the trial court did not err in ruling that $20 million in advances by McDonagh to the LLC were loans rather than capital contributions. The operating agreement provided that the members contemplated that additional requirements of the LLC would be met by a bank loan and/or capital contribution of McDonagh and that the LLC was authorized to accept additional capital contributions from McDonagh in such amount as the members deemed appropriate or necessary. Blair argued that these provisions showed the parties contemplated that McDonagh’s advances would be treated as capital contributions rather than loans. However, the operating agreement also provided that no member was required to make any further capital contribution or loan to the LLC. Thus, under the plain language of the agreement, McDonagh was permitted, but not required, to provide loans or capital, and the operating agreement did not show that McDonagh’s advances were necessarily capital contributions. The court concluded that there was evidence to support the trial court’s decision that McDonagh’s advances were intended by the parties to be loans based on evidence of how Blair treated the advances on the LLC’s tax returns, language on the memo line of the checks, and testimony of one of Blair’s accountants.

**Abuy Development, L.L.C. v. Yuba Motorsports, Inc.**, No. 4:06CV799SNL, 2008 WL 1777412 (E.D. Mo. April 16, 2008). Two entities, Abuy Development, LLC (“Abuy”) and Yuba Motorsports, Inc. (“Yuba”), formed a Delaware LLC for developing a motorplex. The parties entered an operating agreement containing provisions regarding additional capital contributions and failure to make capital contributions which were the subject of the dispute in this case. After the initial capital contributions made by the parties, which consisted of a cash contribution by Abuy and a credit for work performed by Yuba on the project, additional cash capital contributions were made. Abuy loaned Yuba the amounts needed for it to make the additional contributions. Yuba defaulted in the payment of the promissory notes to Abuy, and Abuy sought to adjust the capital accounts under the operating agreement. The adjustment essentially gave Abuy 100% membership in the LLC. Abuy argued it had the right to adjust the capital accounts under a provision of the operating agreement that addressed the failure of a “Defaulting Member” to make additional capital contributions. The court determined that the term “Defaulting Member” was ambiguous and considered extrinsic evidence, including testimony by the lawyers who represented the parties in the drafting and negotiation of the operating agreement. Both lawyers testified that it was their understanding that the provisions of the operating agreement permitted a member to loan funds to another member who was not willing to make an additional capital contribution and that the remedy for
a member who made such a loan and was not timely repaid was an adjustment to the capital accounts. Thus, Abuy, as the “Non-Defaulting Member” under the agreement had the right to adjust the capital accounts due to the failure of Yuba, the “Defaulting Member” under the agreement, to repay the loans. The evidence also showed that Yuba knew or should have known that this provision was a legal “squeeze down provision” by which a defaulting member could lose its ownership interest. The court commented in the course of its discussion rejecting counterclaims asserted by Yuba, that Abuy, having properly adjusted the capital accounts in such a manner that Yuba no longer owned an interest, had no obligation to advise or notify a non-member (Yuba) of any purported discussions or offers of alternative uses for the subject real property.

**Glasnak v. Garmo**, No. 275555, 2008 WL 466886 (Mich. App. 2008) (stating that arbitrator’s decision that member was admitted to existing LLC without being obligated to make future capital contributions as provided in LLC’s operating agreement was not error of law because Michigan LLC statute provides that member may be admitted without incurring any obligation to make capital contribution and arbitrator found there was no evidence member ever agreed to be bound by operating agreement provision regarding additional capital contributions).

**X. Compensation of Member**

**Tunney v. Hilliard**, C.A. No. 1317-VCN, 2008 WL 3875620 (Del. Ch. Aug. 20, 2008). Tunney and Hilliard owned and operated a corporation (which was the operating entity) and an LLC (a real estate holding entity) in connection with their restaurant business. After they sold the business, Tunney argued that he was entitled to a “commission” out of the sales proceeds based on an oral agreement reached with Hilliard when Tunney assumed additional management responsibilities in Hilliard’s absence. Hilliard denied making this agreement with Tunney and claimed that any additional efforts by Tunney were de minimis or within the scope of their original 50-50 agreement.

The court reviewed the evidence and agreed with Hilliard. The court found that Hilliard’s decreased presence resulted in few changes in the business. The stock certificates of the corporation evidenced equal ownership, and the written LLC agreement provided for equal distribution of the profits. The court acknowledged that Delaware law permits oral modifications of written agreements, but stated that they were not favored for “a host of policy and pragmatic reasons.” Thus, a party seeking to prove an oral modification must prove the intended change with sufficient specificity and directness as to leave no doubt of the intended change to the formal document. The court concluded Tunney fell well short of that mark. The court also rejected Tunney’s promissory estoppel claim because he failed to prove that Hilliard promised him additional compensation. Finally, the court rejected various equitable claims by both parties for compensation for “additional” efforts expended in operating the business. The court found that each contributed more or less equally to the success of the business and that they were left to abide by their original 50-50 agreement.

**Mission Primary Care Clinic, PLLC v. Director, Internal Revenue Service**, Civil Action No. 5:07cv162-DCB-JMR, 2008 WL 2789504, 102 A.F.T.R.2d 2008-5256 (S.D. Miss. July 17, 2008). Stanley, a licensed physician, was a member of a professional LLC and the president and sole shareholder of an S corporation that performed services on behalf of the LLC through Stanley. The question in this case was whether payments made by the LLC to Stanley and/or his corporation were “wages or salary payable to or received by” Stanley for purposes of the continuous levy provision of Section 6331(e) of the Internal Revenue Code. The LLC argued that it was not indebted to Stanley for any undistributed profits on the date on which the LLC received the notice of levy and that Stanley was a member who received profits based upon the amount of fees he produced and not an employee to whom it paid a wage or salary. The IRS asserted that Stanley and/or his corporation should be treated as an employee or independent contractor inasmuch as they were compensated based on the amount of money collected by Mission for medical services which Stanley rendered rather than based on the membership interest of Stanley and/or his corporation in the LLC. The IRS argued that the fact that the LLC labeled Stanley and/or his corporation as its member did not change the factual nature of the relationship as that of an employee or an independent contractor. The LLC contended that the services were performed by Stanley in his own behalf as a member of the LLC and that there was no evidence that Stanley was contractually bound to provide services for the LLC. According to the LLC, it merely acted as a collection conduit (after deduction of its operating expenses) for the payments which Stanley's patients made to his corporation for medical services that Stanley had rendered and for which the corporation had billed. The LLC argued that the case law upon which the IRS relied did not support the position that profits paid to member physicians of a professional LLC constitute “wages and salary” subject to a continuing levy under the relevant federal statutes. The court cited case law construing “salary or
wages” broadly for purposes of the continuing levy provision, and the court concluded that the term includes fees paid to an independent contractor as compensation for services rendered. The court concluded that there was a fact question as to whether Stanley provided services to the LLC as an independent contractor.

**Bookhamer v. I. Karten-Bermaha Textiles Co., L.L.C.,** 859 N.Y.S.2d 172 (N.Y. A.D. 1 Dept. 2008) (holding that there were triable issues of fact as to whether controlling member was entitled to collect excess distributions as compensation for carrying out daily operations of LLC’s business and whether such compensation was fair and reasonable).

**Y. Improper Distributions**

*Bookhamer v. I. Karten-Bermaha Textiles Co., L.L.C.,* 859 N.Y.S.2d 172 (N.Y. A.D. 1 Dept. 2008) (holding that there were triable issues of fact as to whether controlling member was entitled to collect excess distributions as compensation for carrying out daily operations of LLC’s business and whether such compensation was fair and reasonable).

**Capco Properties, LLC v. Monterey Gardens of Pinecrest Condominium,** 982 So.2d 1211 (Fla. App. 2008).

The plaintiff sought discovery of financial records of an LLC in an action involving various claims against the LLC and its members, including a fraudulent transfer claim premised on the belief that the LLC had made cash distributions to its members rendering the LLC insolvent. The court concluded that the information was not discoverable because it was not relevant and would not lead to discovery of relevant information. A dissenting opinion argued that the majority’s conclusion ignored the relevance of the requested information to plaintiff’s claim regarding improper distributions.

**In re 37-02 Plaza LLC,** 387 B.R. 413 (Bankr. E.D. N.Y. 2008). Chan, a former member of a New York LLC, sought to collect on promissory notes executed by the LLC as payment for the buy-out of Chan’s interest by Tomasino, the managing member of the LLC. The note was signed by Tomasino individually and in his capacity as managing member. The LLC argued that the notes were legally unenforceable for lack of consideration and that payment of the notes would violate the statutory restriction on distributions under the New York LLC statute. The court stated that the LLC bargained for a benefit to a third party, Tomasino, in exchange for its obligation on the notes and that this benefit to a third party was consideration for the LLC’s obligation on the notes. In addition, the court held that the notes were supported by consideration because the LLC bargained for a benefit to Chan in the form of Chan’s surrender of his interest in the LLC. The court also rejected the LLC’s argument that payments on the notes amounted to distributions to Tomasino and Chan in violation of the New York LLC statute, which prohibits distributions to members of an LLC when the LLC is insolvent or the distribution would render it insolvent. The court concluded that payments on the note did not constitute “distributions” as defined by the statute because they were not payments to a person in his or her capacity as a member. Chan was no longer a member, and, while the payments resulted in a benefit to Tomasino, they were payments made pursuant to the LLC’s contractual obligation on the note rather than payments to Tomasino in his capacity as a member. Thus, payments under the note were not impermissible distributions under the New York LLC statute.

**In re Young (Rands v. Young),** 384 B.R. 94 (Bankr. D. N.J. 2008). The court held that the three-year statute of limitations governing member liability for distributions under the New Jersey LLC statute did not apply to funds misappropriated by members and did not bar embezzlement nondischargeability claims. The court noted that neither Black’s Law Dictionary nor the LLC statute provides a definition of “distribution,” but the court stated that the typical nature of a distribution is a distribution of profits or a return of capital. The transfers in issue differed from a typical distribution in that the transfers involved alleged misappropriation of funds by a member for personal use. The court found support for its conclusion in similar provisions of the New Jersey Partnership Act, which defines a “distribution” as a transfer of money or property from a partnership to a partner in the partner’s capacity as partner or to the partner’s transferee. Since the alleged transfers were for the member’s unauthorized personal use, the court did not view the member as acting in his capacity as a member. The member argued that a distribution is any money taken out of the LLC by or for a member, relying on *In re Die Fliedermaus, LLC,* a New York bankruptcy case. In that case, the trustee sought to avoid distributions as fraudulent conveyances, and the court held that the three-year statute of limitations applicable to distributions under the New York LLC statute barred the avoidance action. The court stated that the types of payments
in *Die Fliedermaus* were distinguishable because the distributions in *Die Fliedermaus* were challenged on the basis that they were made while the LLC was insolvent; there was no allegation of embezzlement. In addition, the court noted that the New York bankruptcy court had addressed the trustee’s breach of fiduciary duty claim separately, indicating the court recognized that taking money in breach of fiduciary duties was not a distribution subject to the three-year statute of limitations. The court next stated that, even if the court were to find the three-year statute of limitations applied in this case, disputed facts existed that could lead to tolling because the member allegedly concealed the misappropriations. The court found it unnecessary to resolve whether the member was acting in a fiduciary capacity for purposes of the nondischargeability provision because the allegations were consistent with embezzlement.

*Matz v. Meredith*, No. 2 CA-CV 2006-0151, 2007 WL 5290465 (Ariz. App. July 25, 2007). After a falling out among the members of an LLC that operated an emergency veterinary clinic, two of the members formed a new entity to operate a new emergency clinic at the same location. The original LLC was ordered judicially dissolved in litigation between the members, and the dissolution proceeding was eventually consolidated with another action brought by one of the members (Matz) against the two members who formed the new clinic. Matz claimed that the two members who formed the new clinic “appropriated and distributed to themselves” all of the intangible assets of the LLC, including its goodwill, and that these actions violated the LLC’s operating agreement because the assets were not distributed equally to the members. The trial court concluded that the two members who appropriated the goodwill were liable under the Arizona wrongful distribution statute and that the value of Matz’s interest in the distribution was $188,000. The two members who formed the new clinic argued that a dissolved business can have no goodwill as a matter of law, but the court rejected that argument. The court of appeals concluded that the trial court did not err in finding that the dissolved LLC had goodwill and that the two former members who conducted business at the same location as the old LLC were liable for appropriating it. The court also found that the trial court’s determination of the value of the LLC’s goodwill was not clearly erroneous. The court of appeals questioned whether appropriation of an LLC’s assets by members is a “distribution” as contemplated by the distribution statute, but assumed, without deciding, that it was proper for the trial court to grant relief under the distribution statute since the members did not address the issue on appeal.

Z. Withdrawal, Expulsion, or Termination of Member

*Implants International, Ltd. v. Implants International North America, LLC*, No. 08-12137, 2008 WL 4104477 (E.D. Mich. Sept. 4, 2008). The plaintiff argued that Mohan Emmanuel, a citizen of the United Kingdom, had severed his relationship with the defendant LLC and was not a member of the LLC when the complaint was filed and that Emmanuel’s citizenship thus should not be considered in determining the citizenship of the LLC for purposes of diversity jurisdiction. The court, however, determined that Emmanuel had not withdrawn as a member. His written correspondence only reflected his resignation as Executive Chairman. The operating agreement stated that a member may withdraw only as provided in the agreement, which required consent of the managers unless the member had assigned and transferred all his units to another member or an assignee admitted as a substitute member. The court stated that there was no evidence Emmanuel assigned or transferred all his units to another member or substitute member or that he withdrew from the LLC with the consent of the managers. He thus remained a member of the LLC whose citizenship destroyed diversity jurisdiction.

*In re Lull (Kotoshirodo v. Dorland and Associates, Inc.)*, Bankruptcy No. 06-00898, Adversary No. 08-90001, 2008 WL 3895561 (Bankr. D. Hawaii Aug. 22, 2008). Three individuals, Lull, Tipaldi, and Jasper, formed a Hawaii LLC in 2005. The articles of organization identified the three individuals as the members and managers of the LLC. The first annual report was submitted in August 2006 dated as of July 1, 2006, but was returned to Tipaldi for reasons not apparent in the record. A resubmitted annual report was received by the Department of Commerce on October 17, 2006. The report had a handwritten line through Lull’s name on the member-managers list along with a handwritten notation to remove Lull. Thereafter, Lull had no interest in the LLC. Lull filed bankruptcy on December 8, 2006, and Tipaldi filed a proof of claim based on a promissory note. The questions presented in this adversary proceeding were whether the removal of Lull from the LLC was a preferential transfer to Tipaldi and what preference period applied. The court concluded that Lull’s removal as a member and manager of the LLC fell within the broad definition of “transfer” in Section 547(b) of the Bankruptcy Code because the membership interest would have constituted property of the bankruptcy estate had he not been removed. The transfer also benefited Tipaldi, who was both a creditor of Lull and one of the two remaining members of the LLC. The element of preference was uncontested because Tipaldi filed a proof
of claim and obtained a default judgment in an adversary proceeding determining that Lull owed him over $3,000,000. Lull testified at his Section 341 creditors’ meeting that he “signed off his interest” in the LLC because he owed Tipaldi money. Lull’s insolvency during the year preceding his bankruptcy was also established. The court determined that the transfer occurred within 90 days of the bankruptcy, finding that Lull’s removal was not effective until the re-submitted annual report was accepted for filing on October 17, 2006. Even if the effective date of Lull’s removal was August 21, 2006, however, the court concluded that the one-year preference period applicable to insiders applied to Tipaldi. The court reviewed the concepts of statutory and non-statutory insiders and concluded that Tipaldi was a non-statutory insider of Lull because of their business relationship. Finally, the court determined that the transfer effected by Lull’s removal enabled Tipaldi to receive more than he would have received in a straight liquidation; however, the court concluded the sum to be recovered by the trustee from Tipaldi could not be determined on the record because there was no proof of the value of Lull’s LLC interest at the time of the transfer. The record also failed to demonstrate if or how to apportion the preferential transfer between Tipaldi and Jasper, the other remaining member of the LLC.

_Urban Hotel Development Company v. President Development Group, L.C._, 535 F.3d 874 (8th Cir. 2008).

The plaintiff asserted that its removal from three LLCs was ineffective because the operating agreements authorized redemption of a member’s interest but not removal of a member. The operating agreement of the LLCs provided that each member granted the LLC the right to redeem the member’s interest, that exercise of the LLC’s right to redeem required delivery of notice to the redeeming member, and that redemption required approval of the holders of 65% of the distribution percentages of all members. The plaintiff was notified by the LLCs that he was being removed, and the plaintiff argued that its removal was ineffective because the letter did not indicate a redemption of the plaintiff’s interest. The court pointed out that the Missouri LLC statute provides that a member ceases to be a member when the member is expelled in accordance with the operating agreement. Though the terms “removal” or “expelled” were not used in the operating agreement, the court held that it was clear that the redemption clause in the operating agreements provided a mechanism to remove or expel a member. The court stated that the power to redeem a member’s interest under the operating agreement was not conditioned on use of the word “redemption.” The LLCs gave the member notice, and the removal was authorized by members owning the requisite percentage of distribution percentages; therefore, the court concluded that the plaintiff’s removal was effective. The failure of the LLCs to pay the redemption price within ten days after the notice as required by the operating agreements was a breach of contract but did not render the removal ineffective according to the court. The court rejected the plaintiff’s argument that the other members breached their duties of care and loyalty when they removed the plaintiff. The court stated that, because the members relied in good faith on the operating agreements, the district court did not err in concluding that there was no evidence of breach of fiduciary duty. Finally, the court affirmed the district court’s finding that the fair market value of the services performed by the plaintiff in exchange for its interest was $10,000. The operating agreement provided that the redemption price was the “actual tax basis of the redeeming member.” The plaintiff claimed the redemption price was $167,667 while the LLCs claimed it was zero. The court stated that tax basis in a partnership can be obtained by exchanging services for a partnership interest as well as contributing property or money or assuming liabilities. The court stated that the value of services is determined by the fair market value of the interest received. The court then concluded that the district court’s finding that the value of the services provided by the plaintiff in exchange for its partnership interest was not clearly erroneous because there was substantial evidence in the record demonstrating that the plaintiff had contributed services with a fair market value of $10,000.

_ULQ, LLC v. Meder_, 666 S.E.2d 713 (Ga. App. 2008). Four individuals formed an LLC, and the operating agreement designated the majority member as the sole manager. The operating agreement provided that an officer could be removed by the manager with or without cause whenever in the manager’s judgment the best interest of the LLC would be served. Removal was a dissociating event requiring the member to sell his interest to the other members or the LLC at a designated value. The manager appointed Meder, a 10% member, as vice president and later terminated him, claiming that he had abused other employees and that his termination was thus in the best interests of the LLC. The LLC exercised its right to purchase Meder’s interest. The value in effect under the operating agreement at that time was the value of a member’s capital account, and Meder’s capital account was zero due to LLC losses. Meder sued the LLC, alleging that his termination and buy out breached the operating agreement, breached fiduciary duties owed to him by the LLC, and wrongfully converted the value of his capital investment and interest. The LLC counterclaimed alleging various causes of action based on Meder’s contacting LLC clients, after his termination as an officer and before the purchase of his membership interest, to persuade them to withhold their business from the LLC. The LLC sought
summary judgment on Meder’s breach of contract claim on the basis that the operating agreement permitted his termination with or without cause, but the court of appeals held that the trial court did not err in denying summary judgment because there was a fact issue with respect to the duty of good faith and fair dealing implied in all contracts. The court stated that the exercise of discretion by a party to a contract is subject to the implied duty of good faith unless the contract states that the discretion is “absolute” or within the “sole” judgment of the party. Because the operating agreement did not vest the manager with absolute discretion in terminating an officer, but rather required the manager to conclude that termination was in the best interest of the LLC, the manager was required to exercise good faith in terminating Meder. Meder presented evidence that he was not abusing other employees and that the true motive for terminating him was to allow the LLC to purchase his interest for nothing at a time when the LLC was about to take off financially, thereby raising an issue regarding the exercise of good faith by the manager. The LLC prevailed on its argument that it did not owe Meder a fiduciary duty. The court acknowledged that the majority owner as the sole manager owed a fiduciary duty to the LLC and its members, but concluded that it would make no sense to hold the LLC responsible for a manager’s breach of a fiduciary duty to the LLC and its members.

Pharmalytica Services, LLC v. Agno Pharmaceuticals, LLC, C.A. No. 3343-VCN, 2008 WL 2721742 (Del. Ch. July 9, 2008). An LLC sought a preliminary injunction prohibiting a member from taking action on behalf of the LLC or holding himself out as an authorized representative of the LLC. In 2006, after discovering that a member had formed another business that was competing with the LLC, the board of the LLC removed the member from the management team and from the positions of president and CEO by majority vote. The member objected but made no formal challenge at the time. In 2007, the LLC sued the member asserting various claims sounding in breach of fiduciary duty, equitable and legal fraud, and breach of the LLC’s operating agreement. In 2008, the LLC learned that the member was in China asserting the LLC’s rights to appoint designees to the board of a joint venture between the LLC and a Chinese entity, prompting the LLC’s motion for a preliminary injunction. The member argued that his removal required the unanimous vote of the board of directors of the LLC because the operating agreement required a unanimous vote of the board for major decisions. The LLC relied upon provisions of the operating agreement giving the board authority to remove a member of the management team with or without cause based on a majority vote and providing that senior officers and other managers could be dismissed by the board for illicitly seeking personal gain or other delinquent behavior. The court characterized the preliminary injunction sought as in the nature of a status quo order under Section 18-110 of the Delaware LLC, which is comparable to Section 225 of the Delaware General Corporation Law. That provision allows for continued operation of the business, with a goal of minimal disruption, while the identities of those properly holding corporate power can be established. The court pointed out that the member did not act in a constructive or direct fashion for the benefit of the LLC for 18 months following the 2006 meeting at which he was removed from his management positions, and his appearance in China and assertion of authority on behalf of the LLC was inconsistent with his course of action since the 2006 meeting and with the expectations of a majority of the members. The court stated that the rational, ongoing governance of the LLC required certainty as to who was running the LLC and that preserving the status quo as traditionally done in the corporate setting was the proper course. The court concluded that the management that had been in control since 2006 should remain in control in the interim and that the member should be precluded from purporting to represent the interests of the LLC. The court noted that the traditional analysis for a status quo order under the corporate and LLC statutes eschews the formalistic application of the preliminary injunction framework; however, because the LLC presented its claim as a request for a preliminary injunction, the court adhered to those standards and found that the LLC had demonstrated a reasonable probability of success on the merits that the member should not be acting on its behalf, that the member’s conduct in China without ongoing authority was likely to cause significant and irreparable harm, and that a balancing of harms weighed in favor of the LLC.

Ross v. Nelson, 861 N.Y.S.2d 670 (N.Y. A.D. 1st Dept. 2008). The court held that the plaintiff was properly removed as a member-manager although the operating agreement lacked a specific provision for removal because the operating agreement referred to “expulsion” as an event causing dissolution and reorganization. The court stated that the New York LLC statute permitted removal of a manager by majority vote of the members given the lack of a provision in the operating agreement. Two dissenting judges argued that a provision in the operating agreement requiring all members to vote for the plaintiff in any election of managers precluded removal of the plaintiff because the statutory removal provision applies “except as provided in the operating agreement.”
Joyner v. JEM Enterprises, LLC, No. CV54014991S, 2008 WL 2745885 (Conn. Super. June 16, 2008) (granting summary judgment against plaintiff on unjust enrichment claim based on LLC’s retention of plaintiff’s capital contribution following plaintiff’s withdrawal as member because plaintiff had assigned her LLC interest to individual who was not party to litigation and there was no evidence plaintiff suffered detriment).

Schell v. Kent, Civil No. 06-cv-425-JM, 2008 WL2019431 (D. N.H. May 9, 2008). Two individuals, Kent and Schell, formed a Nevada LLC. The individuals parted ways, with Schell agreeing to cease his participation in the LLC and Kent agreeing to repay Schell certain amounts for expenses Schell had incurred in connection with the LLC or on the LLC’s behalf. Kent continued to operate the LLC but failed to pay Schell the amounts he agreed to pay. Schell continued to hold a membership interest in the LLC. Eventually the Nevada Secretary of State revoked the LLC’s authority to do business, but the LLC was not wound up. Schell brought breach of contract and unjust enrichment claims based on the amounts owed him, but the court held that the claims were barred by New Hampshire’s three-year statute of limitations on contracts. The court stated that, to the extent Schell sought damages for his economic interest, that claim arose when the LLC’s authority to do business was revoked by the Nevada Secretary of State and Schell’s failure to enforce the statutory provisions and compel a winding up during the three years following the revocation of the LLC’s charter barred his unjust enrichment claim according to the court.

In re Klingerman (Klingerman v. ExecuCorp, LLC), 388 B.R.677 (Bankr. E.D. N.C. 2008). The bankruptcy debtor in possession, Klingerman, sought judicial dissolution and winding up of an LLC of which Klingerman was a founding member. The other member, Parker, alleged that Klingerman ceased to be a member when he filed bankruptcy and thus lacked standing to seek an accounting or judicial dissolution. Parker relied upon the operating agreement and the North Carolina LLC statutes. The operating agreement provided that a member shall not voluntarily withdraw or take any voluntary action that would cause a “Withdrawal Event.” The operating agreement did not define the term “Withdrawal Event,” but the North Carolina Limited Liability Company Act provides that a person ceases to be a member upon specified events of withdrawal including the filing of a voluntary bankruptcy petition. Parker argued that Klingerman ceased to be a member when he filed his bankruptcy petition because the operating agreement did not negate the statutory provisions for withdrawal. Klingerman’s loss of membership status was significant because the North Carolina LLC statute provides for judicial dissolution only where a proceeding is brought by the Attorney General, a member, or the LLC itself. The court stated that Klingerman would not have standing to pursue dissolution if the analysis stopped with the operating agreement and the North Carolina LLC statute, but the court proceeded to consider Bankruptcy Code Section 541(c). Section 541(c)(1) provides that all of the debtor’s interest in property becomes property of the estate notwithstanding any provision in applicable nonbankruptcy law that is conditioned on the commencement of a bankruptcy and that effects a forfeiture, modification, or termination of the debtor’s interest in property. Agreeing with In re Ehmann, the court concluded that all of the debtor’s rights and interest, economic and non-economic, passed to the estate under Section 541(c). The court viewed the converting of a debtor’s membership interest to that of an assignee by operation of a state statute as a modification or termination of the interest that is rendered ineffective by Section 541(c). In so concluding, the court disagreed with In re Garrison-Ashburn, L.C., in which a bankruptcy court concluded that the debtor/member’s bankruptcy estate only had the rights of an assignee. As a member of the LLC, Klingerman’s estate had standing to seek dissolution. The court left for another day the question of whether the request for judicial dissolution should be granted.

Cascade Falls, L.L.C. v. Henning, 143 Wash.App. 1056, 2008 WL 934074 (Wash. App. April 8, 2008). Two brothers, Scott and Greg Henning, formed a Washington LLC. A few years later, they discussed going their separate ways, and Greg withdrew. After operating the LLC as its sole member for several years, Scott learned of irregular business and accounting activities by Greg. Unbeknownst to Scott, Greg had continued to operate using the LLC’s name and one of its bank accounts. Scott filed this lawsuit, alleging breach of fiduciary duties, fraud, and conversion of the LLC’s money by Greg. Scott alleged that he was the sole member of the LLC, but Greg filed a counterclaim for declaratory judgment that he was still a member of the LLC because Scott had not formally consented in writing to his withdrawal pursuant to the Washington LLC statute. Scott contended that Greg should be estopped to claim membership in the LLC because he had submitted an affidavit stating that he withdrew from the LLC in another lawsuit involving the LLC and third parties. The trial court ruled that Greg was judicially estopped from claiming membership in the LLC. On appeal, Greg argued that the trial court erred because the Washington LLC statute states a bright-line rule for membership withdrawal that strictly requires written consent by all members for a member’s withdrawal if the LLC
agreement does not specify the time or events upon which a member may withdraw. Greg argued that this rule precludes application of equitable principles. The court of appeals disagreed. The pleadings and evidence factually established that Greg withdrew with Scott’s consent, and Scott effectively restated his consent in his affidavit in the other lawsuit when he characterized himself as the only member of the LLC and agreed with Greg’s statement that he had withdrawn. Further, the parties, including Scott, acted like Greg had withdrawn because the LLC’s tax return and annual report listed Scott as the only member. Under these circumstances, the court saw nothing in the statute that would preclude a finding that Scott consented.

Limousine Livery, Ltd. v. A Airport Limousine Service, L.L.C., 980 So.2d 780 (La. App. 2008) (denying member’s request for injunctive relief in connection with member’s suspension of membership because member failed to establish irreparable injury would be suffered if injunction did not issue, injunction was sought not to prevent future acts but to undo past act, and injunction was in effect mandatory injunction to reinstate member which could not be granted without hearing).

Crouse v. Mineo, 658 S.E.2d 33 (N.C. App. 2008). The court held that the plaintiff did not cease to be a member by filing a petition seeking dissolution of LLC. The statutory provision relied upon by the defendant states that a member who seeks for himself dissolution ceases to be a member; the provision does not cause dissociation of a member who files a petition for dissolution of the LLC of which he is a member.


AA. Dissolution and Winding Up

Stanziale v. Skiba. No. CV040412495, 2008 WL 4150302 (Conn. Super. Aug. 20, 2008). The court held that the proper plaintiff in an action to prosecute a claim against the defendant for payment on a construction contract with an LLC was the LLC. The LLC had been dissolved prior to the filing of the suit, and the two individuals who brought the suit alleged that they were authorized to wind up the business and affairs of the LLC. The court held that the LLC was clearly the proper plaintiff under the LLC statute. Authority to wind up the business and affairs of the LLC did not carry with it authority to bring suit in their own names or individual capacities. The court found that the mistake in naming the individual principals of the dissolved LLC rather than the LLC itself was an honest mistake and granted the motion to substitute the LLC as plaintiff.

Echelon Homes, L.L.C. v. Carter Lumber Company, No. 277471, 2008 WL 3540210 (Mich. App. Aug. 14, 2008). The court held that the trial court did not abuse its discretion in ordering the plaintiff LLC to post a bond as security where the trial court determined that the LLC was unlikely to prevail at trial and lacked the resources to pay an award of case evaluation sanctions. The court held that the trial court erred, however, to the extent it held that the dissolved LLC’s members could be held liable for sanctions against the LLC. The court noted that the members continue to be protected from personal liability for the LLC’s debts during the winding up, but that the LLC has been dissolved and is impecunious, while its members are immune from liability, is even more reason to require the LLC to post a bond to ensure a potential award of case evaluation sanctions will be paid. The court denied the defendant’s motion to dismiss the LLC’s case. The defendant sought dismissal based on the LLC’s allegedly improper dissolution without notice to creditors, and the defendant also argued that the LLC had been mismanaged and that its creditors, and perhaps its members, were the proper plaintiffs. The court noted that the LLC had filed its back reports and been reinstated before the time of dissolution, that the LLC was not required to give notice to creditors except to cut off existing claims, that there was no evidence any assets were not distributed to creditors, and that the statute only allowed members of a dissolved LLC to petition a court to wind up its affairs. The court also pointed out that the LLC statute provides that a dissolved LLC may sue and be sued in its name and that an action brought by or against an LLC before its dissolution does not abate because of the dissolution. The provisions relied upon by the defendant (which imposed duties in the management and winding up of the LLC) did not provide a basis for dismissing a pending action; rather, they impose duties that are enforceable by members, not the defendant, and the court held the trial court erred by not granting the LLC’s request for sanctions in connection with the motion to dismiss.
The dissolution of the defendant LLC did not destroy its standing to defend this action under North Carolina law. Though North Carolina’s LLC dissolution statutes are non-specific as to which activities an LLC in dissolution may continue, the court stated that the similarity in language to the corporation statute suggests that an LLC in dissolution may continue its participation in a lawsuit as part of the winding up process. Based on a careful reading of the LLC statute, corporate case law, and the corporate statute, the court concluded that defending a lawsuit is one of the limited activities permitted for an LLC in dissolution to continue the winding up process.

Wallace v. Hayes, 191 P.3d 365 (Mont. 2008). The district court did not err in concluding that an LLC member would not be allowed to share in a liquidating distribution of a judgment issued against him. The member relied upon the operating agreement and the Wyoming statute, which provided for distributions as follows: (1) payment of liabilities to creditors other than members, (2) payment of debts owing to members other than for capital and profits, (3) debts to members with respect to capital, and (4) debts to members with respect to profits. The member also argued that the statute and operating agreement entitled him to share in distributions in proportion to his share of the LLC. The court found that the judgment made clear that the member would be entitled to be paid for any obligations of the LLC to the member but would not be entitled to receive any portion of the amounts remaining from the judgment when it came to the distribution of profits. The member failed to timely appeal the judgment, and the court of appeals affirmed the order carrying out the judgment. With respect to the district court’s order that the LLC be dissolved while certain patent infringement claims against it were outstanding, the court of appeals concluded that the member had failed to present any evidence of any pending litigation and had thus failed to mount a credible challenge to the court’s decision to dissolve the LLC.

Hartford Insurance Company v. Ohio Casualty Insurance Company, 189 P.3d 195 (Wash. App. 2008). In a prior case, an LLC condominium developer which had been administratively dissolved was sued by the condominium association. The LLC did not take steps to reinstate or wind up its affairs during the two-year statutory grace period, and the secretary of state cancelled the LLC’s certificate of formation at the end of the two-year period. The LLC had filed third party claims against the construction manager and several subcontractors during the two-year period, and the LLC and the construction manager settled the condominium association’s claims six months after the cancellation of the LLC’s certificate. The construction manager had also filed third party claims (which were derivative of the LLC’s claims) against the subcontractors. The LLC and construction manager settled the condominium association’s claims, and the insurers of the LLC and the construction manager paid the settlement. The LLC’s insurer was assigned the claims of the construction manager and its insurer against the subcontractors. When the subcontractors discovered that the LLC had been cancelled, they obtained dismissal of the LLC’s third party and indemnity claims on the basis that the LLC ceased to exist and did not have standing to prosecute the claims. The claims of the construction manager were dismissed on the basis that they were entirely derivative of the LLC’s invalid claims. In the appeal of that case, the court of appeals affirmed the dismissals. In the present case, the LLC’s insurer sought equitable contribution from insurers of the subcontractors whom it alleged had improperly declined to indemnify and defend the LLC as an additional insured on the subcontractor policies. The trial court dismissed the insurer’s claims, and the insurer conceded on appeal that it had no right to recover as the assignee of the insurer of the construction manager because the construction manager’s insurer acted as a volunteer in paying on the settlement. The LLC’s insurer also conceded that it could not recover as an assignee of the LLC because the assignment occurred after the LLC’s cancellation and was thus invalid. Nevertheless, the LLC’s insurer argued that it was equitably entitled to recover from the other insurers through subrogation. The other insurers argued that the LLC’s insurer acted as a volunteer in settling the case after the LLC ceased to exist. The court disagreed with the defendants’ argument that the duty of the LLC’s insurer to defend ended when the LLC was cancelled. The court relied upon the recently enacted, and retroactively effective, three-year survival of claims statute. Under that statute, six months still remained during which suits against the LLC could be initiated because the effective date of dissolution was the date of administrative dissolution, and the settlement occurred two and one-half years after dissolution. The court stated that the legislature’s purpose in enacting the survival provision was to provide remedies for parties injured by acts of an LLC and to encourage LLCs to act in good faith. By statute, a dissolved LLC is required to pay or make reasonable provision for claims, and the court stated that it would thwart the statutory purpose of requiring a dissolving entity to leave behind such assets as will reasonably provide for unsatisfied claims if an insurance policy cannot be reached by the LLC’s creditors after the winding up process is complete. The court also rejected the argument that the LLC’s insurer could have refused to indemnify the LLC in the settlement on the basis that the cancelled

Miceli v. KBRG of Statesville, LLC, No. 5:05CV265-V, 2008 WL 2945451 (W.D.N.C. July 24, 2008).
LLC could not have asserted indemnity or bad faith claims against its insurer. The court found this argument to be inconsistent with the insurer’s obligation to act in good faith and as overly confident that it no longer faced any threat of civil litigation. The court noted that, while cancellation marks the end of an LLC as a separate legal entity, claims against the LLC or managers and members do not necessarily abate. In this evolving landscape of liability, the court did not view the fact that the LLC lacked standing to enforce the policy as dispositive of the insurer’s obligation. Where the insurer has been paid to provide indemnity, the court concluded the insurer acts prudently and in protection of its interests by making coverage available even though its insured is defunct, particularly where there is a claim survival statute. Thus, the court held that the LLC’s insurer was not acting as a volunteer when paying on behalf of the insured LLC and was not barred from pursuing reimbursement through a subrogation action.

**Downey v. Ambassador Development, LLC**, 568 F.Supp.2d 28, Civil Action No. 08-982 (JDB) (D.D.C. 2008). The court remanded this case to state court because an LLC defendant did not join in removal. The other defendants argued that the LLC could not consent to removal because it was dissolved and no longer existed. The court stated that the D.C. LLC statute and case law interpreting the concept of winding up suggest that a dissolved LLC may be subject to suit. The evidence showed that, after its dissolution, the LLC had retained counsel to represent it in an arbitration, and the court thus concluded that the record, construed in the light most favorable to the plaintiff, indicated that the dissolved LLC had the capacity to retain legal counsel and engage in matters that are part of the winding up process. Because there remained the possibility that the claims against the dissolved LLC would survive summary judgment, the court remanded the case.

**A.B. Medical Services PLLC v. Travelers Indemnity Company**, 858 N.Y.S.2d 574 (N.Y. Dist. Ct. 2008). A professional LLC sought to recover no-fault benefits as assignee of a patient who received medical treatment from the LLC. Because the license of the physician who was the LLC’s sole member and manager had been suspended, the physician was not permitted to continue as a member, and the court considered maintenance of the suit without a qualified member a nullity. However, the suspension of the member’s license did not render the existence of the LLC fraudulent. The court stated that recovery by the LLC on its claim would be permitted as part of its winding up, and the physician would be entitled to receive, as a creditor of the LLC, payments earned. The court stayed the proceeding to allow for filing of articles of dissolution and appointment of a representative to wind up the LLC’s affairs.

**Penrose v. Trojan Manufacturing Co., Inc.**, No. 07-CV-603S(F), 2008 WL 1766618 (W.D. N.Y. April 14, 2008) (stating that Tennessee LLC listed as inactive on Secretary of State’s records could be sued on claim accruing before dissolution because Tennessee LLC statute provides that dissolution of LLC does not bar assertion of claim against LLC provided liability was incurred prior to dissolution).

**Crouse v. Mineo**, 658 S.E.2d 33 (N.C. App. 2008). The court held that the statutory provision regarding judicial winding up or appointment of a person to wind up the affairs of the LLC gave the trial court discretion to do so by virtue of use of the term “may” in the statute, and the trial court did not abuse its discretion in denying plaintiff’s motion to appoint the plaintiff to wind up the affairs of the LLC.

**Sky Cast, Inc. v. Global Direct Distribution, LLC**, Civil Action No. 07-161-JBT, 2008 WL 754734 (E.D. Ky. March 18, 2008) (granting summary judgment in favor of managing members on fraudulent misrepresentation claims by dissolved LLC’s creditor where alleged misrepresentations that all debts, obligations, and liabilities of LLC had been paid or discharged were made to Florida officials to induce officials to approve dissolution and there was no evidence that creditor relied to its detriment on dissolution filing or suffered any damage based on statements contained in dissolution filing).

**Serrano on California Condominium Homeowners Association v. First Pacific Development, Ltd.**, 178 P.3d 1059 (Wash. App. 2008). The plaintiff’s claim against a dissolved LLC was barred because the court determined that the “effective date of dissolution” for purposes of the statute requiring that suits against dissolved LLCs commence within three years of the “effective date of dissolution” was the date of the LLC’s administrative dissolution rather than the date two years later when the LLC was dissolved and wound up upon cancellation of its certificate of formation. The court stated that any language in the Chadwick Farms case suggesting the three year statutory period ran from cancellation of the certificate was not necessary and was dicta. The claim was timely in Chadwick Farms regardless of whether the
“effective date of dissolution” was the date of administrative dissolution or the date of cancellation of the certificate, the court in that case did not directly address the meaning of “effective date of dissolution.”

Kwon v. Yun, No. 05 Civ. 1142(GEL)(DFE), 2008 WL 190058 (S.D.N.Y. Jan. 22, 2008) (holding prima facie credible defense to dissolved Delaware LLC’s counterclaim was stated by allegation that LLC had filed certificate of cancellation because Delaware LLC is artificial entity with power to sue or be sued, and such power continues after dissolution “until the filing of a certificate of cancellation”).

Matz v. Meredith, No. 2 CA-CV 2006-0151, 2007 WL 5290465 (Ariz. App. July 25, 2007). After a falling out among the members of an LLC that operated an emergency veterinary clinic, two of the members formed a new entity to operate a new emergency clinic at the same location. The original LLC was ordered judicially dissolved in litigation between the members, and the dissolution proceeding was eventually consolidated with another action brought by one of the members (Matz) against the two members who formed the new clinic. Matz claimed that the two members who formed the new clinic “appropriated and distributed to themselves” all of the intangible assets of the LLC, including its goodwill, and that these actions violated the LLC’s operating agreement because the assets were not distributed equally to the members. The trial court concluded that the two members who appropriated the goodwill were liable under the Arizona wrongful distribution statute and that the value of Matz’s interest in the distribution was $188,000. The two members who formed the new clinic argued that a dissolved business can have no goodwill as a matter of law, but the court rejected that argument. The court of appeals concluded that the trial court did not err in finding that the dissolved LLC had goodwill and that the two former members who conducted business at the same location as the old LLC were liable for appropriating it. The court also found that the trial court’s determination of the value of the LLC’s goodwill was not clearly erroneous. The court of appeals questioned whether appropriation of an LLC’s assets by members is a “distribution” as contemplated by the distribution statute, but assumed, without deciding, that it was proper for the trial court to grant relief under the distribution statute since the members did not address the issue on appeal.

BB. Judicial or Administrative Dissolution

In re Seneca Investments, LLC, Civil Action No. 3624-CC, 2008 WL 4329230 (Del. Ch. Sept. 23, 2008). An LLC member sought judicial dissolution of the LLC. The court analyzed the claim under the judicial dissolution provisions of the Delaware LLC statute and the Delaware corporation statute because the members contractually agreed that the LLC would be governed as a corporation and that the Delaware General Corporation Law would apply. The LLC had two organizational documents: an operating agreement and a charter. The purpose clause in the charter stated that the purpose of the LLC was “to engage in any lawful act or activity for which corporations may be organized under the Delaware General Corporation Law.” The petition for dissolution alleged that the LLC had abandoned its business and should thus be dissolved. Specifically, the petition alleged that the LLC had not for several years had a business plan, sought or received capital, had shareholder or director meetings, or sought to hire anyone who could conduct business on its behalf. The LLC’s only assets were approximately $2.2 million in cash, shares of stock of a publicly held company, and a minority interest in a private internet marketing company. The LLC sought judgment on the pleadings, and the court concluded that the petitioner alleged no facts that would compel the court to grant the petition for dissolution. In the absence of extensive LLC case law interpreting the LLC judicial dissolution statute, and given the similarity of the LLC and limited partnership judicial dissolution statutes (authorizing the court to decree dissolution whenever it is not reasonably practicable to carry on the business in conformity with the LLC/limited partnership agreement), the court considered limited partnership case law in this context as well as LLC case law. In the absence of an allegation of deadlock, the court focused on whether it was impracticable for the LLC to fulfill its business purpose. Because the LLC’s charter stated that its purpose was to engage in any lawful act or activity for which corporations may be organized, and a corporation may function as a passive instrumentality to hold title to assets, the court concluded the allegations were insufficient to support a claim that it was not reasonably practicable to carry on in conformity with the operating agreement. The court stated that allegations that the LLC had failed to comply with certain provisions of the operating agreement (such as making distributions, providing reports, and continuing to allow the petitioner to serve as director) were not grounds for dissolution, and the court would not attempt to police violations of operating agreements by dissolving LLCs. The court rejected the petitioner’s argument that the operating agreement prohibited any business activity by the LLC other than liquidating assets and distributing cash. Turning to the provision of the Delaware General Corporation Law that allows the court of chancery to appoint a custodian or receiver when the corporation has abandoned...
its business and has failed within a reasonable time to take steps to dissolve, liquidate or distribute its assets, the court analyzed whether the LLC had abandoned its business by looking to the LLC’s purpose clause. In view of the broad purpose clause, and because a corporation can lawfully function as a passive holding company, the court concluded that the facts alleged in the petition showed that the LLC was performing a valid corporate function by passively investing in other businesses. Furthermore, the court pointed out that the LLC was pursuing counterclaims, and pursuing legal claims is an acceptable and common corporate function. The court stated that it was aware of the possibility that a company facing a petition for dissolution would file non-meritorious counterclaims to avoid dissolution, but the court did not see any indication of abuse in the instant case.

**Durina v. Filtroil**, No. 07 CO 24, 2008 WL 4307892 (Ohio App. Sept. 18, 2008). A member of a Nevada LLC filed an action seeking judicial dissolution and asserting various other causes of action. The trial court determined that it lacked jurisdiction to dissolve the Nevada LLC, and the court stayed the action on the remaining claims because the LLC’s regulations required arbitration of disputes between members. The court of appeals agreed with the trial court in both respects. With respect to the judicial dissolution claim, the court cited case law in other jurisdictions holding that one state cannot dissolve a corporation from another state, and the court pointed out that the Ohio judicial dissolution statutes on which the plaintiff relied do not allow for dissolution of a non-Ohio LLC. The court stated that the Nevada and Ohio statutes are similar in that they both restrict application of their judicial dissolution statutes to LLCs formed pursuant to the laws of their respective states. The court concluded that there was no question that a Nevada LLC can only be dissolved in Nevada. The court reviewed the arbitration clause in the LLC regulations and concluded that it encompassed the claims asserted in the case. The court found no indication that there was a delay in asserting the right to arbitration.

**Ladd v. Ladd Construction, LLC**, No. TTDCV074007051S, 2008 WL 4416048 (Conn. Super. Sept. 15, 2008). The plaintiff brought suit against his parents asserting various claims against them and seeking dissolution of the family business, a construction company organized as an LLC and owned 50% by the father and 50% by the son. The son sought to add his mother as a defendant on the basis of allegations that she committed civil theft by writing checks on the LLC account for personal expenses. The court stated that the son made a sufficient showing that his mother was part of the controversy. The defendants sought dismissal of the lawsuit based on an arbitration provision in the operating agreement. The arbitration provision named the mother as arbitrator in the event of a deadlock. The court declined to send the matter to arbitration before the mother because the court had allowed the mother to be sued and she thus had a direct interest in the outcome of the matter. The court also refused to dismiss the plaintiff’s claim for judicial dissolution. Under the Connecticut LLC statute, a court may order judicial dissolution when it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement. The son alleged that he was wrongfully excluded from the business and that the assets of the LLC had been used to pay personal expenses of the father and others. The defendants argued that the disputes did not affect the functioning of the company or its ability to carry on its business because the father was the sole manager. The court found the allegations sufficient to support the claim for judicial dissolution, saying that the complaint described a once shared business that was no longer being shared. That the business may still be running did not detract from the claim that it was not running as expected according to the court. Due to unresolved fact issues as to whether the plaintiff had previously been provided complete information, the court also declined the defendants’ request to dismiss a request by the plaintiff for judicial accounting.

**R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC**, Civil Action No. 3803-CC, 2008 WL 3846318 (Del. Ch. Aug. 19, 2008). The petitioners sought judicial dissolution of nine Delaware LLCs. With respect to two of the LLCs, the court held that the petitioners did not have standing under the Delaware LLC statute to seek dissolution and winding up because only managers or members have standing to do so under the statute. The court stated that there was no authority for the proposition that a member of an LLC that is itself a member of another LLC can seek dissolution or the winding up of the latter LLC. The court held that the claim for receivership survived because the statute permits a “creditor, member or manager... or any other person who shows good cause” to present an application for receivership. With respect to the other seven LLCs, the court dismissed the action because the members waived the right to seek dissolution or the appointment of a liquidator in the LLC agreements. Although the LLC agreement specified events of dissolution that included entry of a decree of judicial dissolution, the court did not find that this provision conflicted with the waiver of dissolution rights contained elsewhere in the LLC agreement because the Delaware statute permits a court
members, and the parties were deadlocked. Kirksey and Ruby filed a suit for judicial dissolution on the basis that the motions to terminate the lease and dissolve the LLC. Major actions taken by the LLC required a majority vote of the estate indicating that it was worth over $3.2 million. At a meeting of the LLC members, Grohmann and Randell opposed motions to terminate the lease and dissolve the LLC. Major actions taken by the LLC required a majority vote of the members, and the parties were deadlocked. Kirksey and Ruby filed a suit for judicial dissolution on the basis that the LLC’s economic purpose was unreasonably frustrated and that it was not reasonably practicable to carry on the LLC’s
business in conformity with the articles of organization or operating agreement. Kirksey argued that the strained relations made any major decision making impossible. Kirksey further claimed that Grohmann and Randell had a personal financial interest in continuing the lease and preventing dissolution to the detriment of Kirksey and Ruby. The court examined the judicial dissolution provisions in the South Dakota LLC statute and discussed partnership and LLC case law in other jurisdictions addressing circumstances under which judicial dissolution was sought. The court examined the language of the operating agreement regarding the purpose of the LLC and stated that it was clear that the intended business was a livestock and farming operation. While there was no dispute that the ranching and livestock operation could continue despite the sisters’ dissension, the court stated that the question was whether it was reasonably practicable for the LLC to continue in accordance with the operating agreement. Kirksey and Ruby argued that the livestock lease was no longer beneficial to the LLC because the rental rate was set when the land was worth considerably less. Grohmann and Randell argued that Kirksey and Ruby were aware of the nominal profit margin when the LLC was formed and that nothing had changed to make it impracticable for the LLC to continue. The court stated that the sisters formed the LLC with the understanding that they would have relatively equal say in the management and operation, but the court concluded that equality in decision making no longer existed because Grohmann and Randell had all the power with no reason to change the terms of a lease extremely favorable to them. Leaving half the owners with all the power in the operation of the LLC was not a reasonable and practicable operation of the business according to the court. The court said the deadlock impeded the continued function of the business in conformity with the operating agreement because there was no procedure to break a tie and protect the LLC in the event of changed conditions. As long as the LLC was under the control of and favorable only to half its members, the court found it could not be said to be reasonably practicable for it to continue in accordance with its operating agreement. The court also concluded that the economic purpose of the LLC was likely to be unreasonably frustrated, recognizing that there is little case law addressing this standard. The court acknowledged that forced dissolution is a drastic remedy but found that the deadlocked condition of the LLC and the inability of the sisters to communicate other than through their lawyers was unreasonably frustrating the economic purpose of the LLC. The court thus remanded for an order of judicial dissolution and winding up of the LLC.

Go Fast Sports & Beverage Company v. Buckner, Civil Action No. 08-cv-01527-MSK-M JW, 2008 WL 2852626 (D. Colo. July 23, 2008). The defendants argued that the citizenship of an LLC defendant could be disregarded for purposes of diversity jurisdiction because it was administratively dissolved and could no longer be sued. The court stated that administrative dissolution of a perpetual LLC does not destroy its citizenship for diversity purposes if the LLC continues to exist under state law. The articles of organization submitted with the notice of removal stated that the LLC was a perpetual LLC that had been administratively dissolved in March 2005. At that time, Colorado law provided that an administratively dissolved LLC continues its existence but shall not carry on any business except as appropriate to wind up and liquidate its affairs. Thus, the administrative dissolution did not terminate the LLC’s existence, and the court considered its citizenship in assessing diversity jurisdiction. Because one of the LLC’s members was a Colorado citizen as well as the plaintiff, the parties were not diverse and the court lacked jurisdiction.

Hartford Insurance Company v. Ohio Casualty Insurance Company, 189 P.3d 195 (Wash. App. 2008). The court disagreed with the defendants’ argument that the duty of the LLC’s insurer to defend ended when the LLC was administratively cancelled. The court relied upon the recently enacted, and retroactively effective, three-year survival of claims statute. Under that statute, six months still remained during which suits against the LLC could be initiated because the effective date of dissolution was the date of administrative dissolution, and the settlement occurred two and one-half years after dissolution. The court stated that the legislature’s purpose in enacting the survival provision was to provide remedies for parties injured by acts of an LLC and to encourage LLCs to act in good faith. By statute, a dissolved LLC is required to pay or make reasonable provision for claims, and the court stated that it would thwart the statutory purpose of requiring a dissolving entity to leave behind such assets as will reasonably provide for unsatisfied claims if an insurance policy cannot be reached by the LLC’s creditors after the winding up process is complete.

In the Matter of the Dissolution of Beverwyck Abstract, LLC, 861 N.Y.S.2d 854 (N.Y. A.D. 3rd Dept. 2008) (holding that trial court correctly determined that date of dissolution was date on which court ordered LLC dissolved after trial of judicial dissolution action brought by members where operating agreement and LLC statute provided for nonjudicial dissolution upon vote or written consent of majority of members but no such vote or written consent occurred).
Dickson v. Rehmke, 164 Cal.App.4th 469, 78 Cal.Rptr.3d 874 (Cal. App. 3 Dist. 2008). The plaintiff filed this action for judicial dissolution of the LLC he co-owned with another individual. The defendant member moved to avoid the dissolution by invoking the California statutory procedure for purchase of the plaintiff’s interest at fair market value. The court appointed appraisers and issued an alternative decree determining the value of the membership interest and giving the defendant member 90 days to buy the plaintiff’s interest or allow the process of winding up and dissolution to begin. The defendant tendered a check, and the court entered a judgment in accordance with its alternative decree. The plaintiff filed his appeal within 60 days after service of the judgment but later than 60 days from the decree. The issue was the timeliness of the appeal, which depended upon whether the trial court’s decree was appealable under the language of the statute. The court stated that neither the briefing nor the court’s own research had revealed any cases involving the statutory procedures in the LLC context, but noted that parallel provisions exist for avoiding dissolution in the corporate context. The court also noted as a prefatory matter that the trial court was not bound by the findings of the appraisers and that the absence of a unanimous or majority appraisers’ award did not render the statute inapplicable. The statute provides for numerous juristic activities, i.e., appointment of appraisers, order of reference for purpose of ascertaining the dissenting share and setting procedures for necessary evidence, confirmation of unanimous or majority appraisal award or de novo determination of value, alternative decree that directs winding up and dissolution unless the purchasing parties tender timely payment, and a judgment on their bond for costs if they fail to act. The concluding provision for appellate review, however, states that “[a]ny member aggrieved by the action of the court may appeal therefrom.” The court concluded that the issuance of the decree is the action to which the provision for appeal refers, finding support for such conclusion in the text of the next provision in the statute and in the cases dealing with the purchase option in the corporate context. Because the court’s decree was appealable, the appeal was not timely and was dismissed.

Nichiryo America, Inc. v. Oxford Worldwide, LLC, No. 03:07-CV-00335-LRH-VPC, 2008 WL 2457935 (D. Nev. June 16, 2008) (finding it unnecessary to answer question of whether individual can be liable for LLC debt incurred prior to forfeiture of LLC’s right to do business where LLC was reinstated “as if such right had at all times remained in full force and effect”).

Tal v. Superior Vending, LLC, No. 11709/07, 2008 WL 2447365 (N.Y. Sup. June 6, 2008). After antagonism developed between two LLC members, one of them was excluded from the business. The excluded member commenced a judicial dissolution proceeding in 2003 but failed to pursue it, and it was dismissed. The member who continued the business formed another corporation and commingled the assets and business of the two entities and continued the business in the corporation using the same name. In this second dissolution proceeding, the court found that the doctrine of laches precluded the excluded member from seeking interim distributions and an equal share of the combined value of the business assets as presently constituted. The court determined that the most equitable approach to judicial dissolution was to view the parties as having parted ways when the excluded member’s involvement in the business ceased and to treat his membership interest as terminated at that time. The court ordered the member who continued the business to purchase the excluded member’s interest for the amount of the excluded member’s investment plus interest from the date of his exclusion from the business. The court further ordered that, in the event the member continuing the business failed to purchase the other member’s interest as provided in the court’s order, a receiver would be appointed to liquidate the business.

OLP, LLC v. Burningham, 185 P.3d 1138 (Utah App. 2008). Wilson and Burningham, the members of a Utah LLC, had a falling out, and Wilson filed suit alleging various causes of action, including a claim for repudiation. Burningham asserted various affirmative defenses and brought counterclaims including a request for dissolution of the LLC under the Utah LLC statute. Throughout the litigation, Burningham sought judicial dissolution and winding up of the LLC under the Utah LLC statute, and the district court eventually agreed that the LLC had been effectively dissolved by the parties’ inability to cooperate in the management and control of the LLC. Instead of proceeding with dissolution proceedings under the statute, however, the court determined that there was an initial fact question as to whether Burningham owed Wilson damages for repudiating the parties’ agreement. The jury found in favor of Wilson and awarded damages. Burningham argued that the Utah LLC statute is a comprehensive act governing all aspects of an LLC’s formation, existence, and dissolution and that it abrogates any preexisting common law action for repudiation, but the court of appeals held that a cause of action for money damages for repudiation of an LLC exists independently of the LLC act. The court relied upon partnership law recognizing a cause of action for repudiation and concluded that
permitting an LLC member to sue for damages when the other members wrongfully repudiate the LLC agreement and convert the assets to their own use does not conflict with the provisions of the LLC statute. Burningham argued that there can be no wrongful dissolution of an LLC when the LLC is rightfully dissolved under the LLC statute, and Burningham argued that the court’s order (entered at the time of trial in 2004) determining that the LLC was dissolved no later than August 31, 2001, was a rightful dissolution. The court of appeals was not convinced that the district court’s order was intended to be a formal order of dissolution as opposed to a cut-off date for Wilson’s claim to lost profits if the jury found that Burningham breached the parties’ agreement in a manner that did not constitute a repudiation. In any event, the court distinguished a claim for repudiation from one seeking dissolution and concluded that Wilson could recover damages for repudiation based on events occurring prior to dissolution. Burningham pointed out that the Utah general partnership statutes contain wrongful dissolution provisions whereas no such provisions are contained in the Utah LLC statute, and the court agreed with Burningham that the legislature apparently did not intend to allow LLC members to unilaterally dissolve an LLC in contravention of the parties’ agreement, but the court did not think permitting a wrongfully excluded member to recover money damages was inconsistent with the legislature’s intent to make an LLC more difficult to dissolve. Since the jury determined that Wilson had been wrongfully excluded prior to any dissolution by the district court, it was proper to award Wilson damages without regard to any subsequent dissolution.

The court also rejected Burningham’s argument that the district court should have conducted a judicial winding up. The court stated that the LLC statute gives courts considerable discretion in handling dissolved LLCs, and the court found nothing in the statute that precluded the court from allowing the members themselves to conduct the winding up. The court found it was appropriate for the district court to simply allow Burningham to wind up the LLC, since he was the member who was most ably situated to do so after his exclusion of Wilson and conversion of the assets and since he was the member who had requested the winding up. The court noted that it would exceed the scope of the case to decide the effect of a repudiation claim on the membership and ownership status of an LLC’s various members, and stated that it agreed with the district court that Wilson had disclaimed any continuing interest or membership in the LLC by rejecting equitable proceedings and obtaining a money judgment against Burningham.

The court rejected Burningham’s argument that he was deprived of equitable claims and defenses and stated that it was not improper for the jury to consider the repudiation claim first although it turned on the same operative facts as Burningham’s alleged equitable defenses.

The court also rejected Burningham’s argument that a repudiation claim should be limited to situations in which the repudiating party denies the parties’ business organization, be it a partnership or LLC, ever existed. The court stated that the definition of a repudiation used by the district court – that a party repudiates a contract when that party does or says anything indicating that he does not intend to perform the contract, and that repudiation is not the mere breach of the contract or some of its terms – appeared to be consistent with prior case law. The court refused to adopt a narrower rule that requires a member or partner of a company such as an LLC to deny the existence of the LLC.

Finally, the court rejected Burningham’s argument that the district court erred in allowing the jury to consider the LLC as a going concern. The court reiterated its view that the district court may or may not have dissolved the LLC by its order, and the court stated that operation of the LLC after August 31, 2001, the date on which the court determined the LLC had effectively dissolved, could not violate the court’s order because the order was not entered until the time of trial in 2004. Even if operation of the LLC did conflict with the statute, the court stated that its operation did in fact occur. Since it was Burningham who had wrongfully ousted Wilson and continued operating the LLC, the court stated that any violation would seem to be attributable to Burningham rather than Wilson or the district court. The court also stated that a claim for repudiation is not incompatible with a claim for judicial dissolution and that Wilson was not required to choose to pursue only one remedy since Utah law permits a party to seek remedies in the alternative. In any event, the court concluded that Burningham had failed to show how he was prejudiced when the district court allowed the jury to consider the LLC as a going concern.

Saunders v. Firtel, Nos. CV054007690S, CV054007691S, CV054012805S, 2008 WL 2314070 (Conn. Super. May 14, 2008) (ordering judicial dissolution of LLC on grounds it was not reasonably practicable to carry on LLC’s business in conformity with articles of organization or operating agreement).

Schell v. Kent, Civil No. 06-cv-425-JM, 2008 WL2019431 (D. N.H. May 9, 2008). Two individuals, Kent and Schell, formed a Nevada LLC. The individuals parted ways, with Schell agreeing to cease his participation in the LLC and Kent agreeing to repay Schell certain amounts for expenses Schell had incurred in connection with the LLC or on the LLC’s behalf. Kent continued to operate the LLC but failed to pay Schell the amounts he agreed to pay. Schell
continued to hold a membership interest in the LLC. Eventually the Nevada Secretary of State revoked the LLC’s authority to do business, but the LLC was not wound up. Schell brought breach of contract and unjust enrichment claims based on the amounts owed him, but the court held that the claims were barred by New Hampshire’s three-year statute of limitations on contracts. The court stated that, to the extent Schell sought damages for his economic interest, that claim arose when the LLC’s authority to do business was revoked by the Nevada Secretary of State and Schell’s failure to enforce statutory provisions and compel a winding up during the three years following the revocation of the LLC’s authority to do business was barred by this three-year statute of limitations.

**Tri-County Metropolitan Transportation District of Oregon v. Butler Block, LLC**, Civil No. 08-259-AA, 2008 WL 2037306 (D. Or. May 7, 2008). The plaintiff, an Oregon corporation, filed suit against a Delaware LLC, and the Delaware LLC sought dismissal on the basis that the court lacked diversity jurisdiction. The court held that administrative dissolution of an Oregon LLC that was a member of the Delaware LLC did not terminate the membership of the Oregon LLC in the Delaware LLC under Delaware law. The court pointed out that neither the Delaware LLC statute nor the Delaware LLC’s operating agreement permitted the Oregon LLC to withdraw. Further, the court stated that the Delaware statute does not recognize “administrative” dissolution, and the Oregon statute provides that administrative dissolution does not prevent commencement of a proceeding by or against the LLC. Thus, the court concluded that, although the Oregon LLC was administratively dissolved at the time the complaint was filed against the Delaware LLC, the Oregon LLC’s membership had not ceased and its existence as a citizen of Oregon (its sole member was an Oregon resident) continued so that complete diversity of citizenship was lacking and the court did not have subject matter jurisdiction.

**Hiner v. Boldon**, No. A07-0254, 2008 WL 1799772 (Minn. App. April 22, 2008). Two individuals, Hiner and Boldon, formed an LLC without a member control agreement, operating agreement, or buy-sell agreement. After the LLC began experiencing financial difficulties and conflicts developed between the members, Hiner sued Boldon seeking equitable relief and attorney’s fees and a judicial intervention under the Minnesota LLC statute. Boldon counterclaimed for a judicial intervention and sale of Hiner’s interest to Boldon. The trial court had difficulty sorting through the situation because of the informality with which the parties operated, but the trial court concluded that the members were deadlock the and that each member had violated his duty to act in an honest, fair, and reasonable manner to some degree. The trial court found that it would be inequitable under the circumstances to order winding up through liquidation and that it would be inequitable to order a complete equalization of contributions (the court found that Hiner and an entity owned by Hiner had contributed over $89,000 while Boldon had contributed about $33,000). Thus, the trial court ordered Hiner to form a successor entity and continue the business of the LLC and ordered that Boldon not be involved or have an interest in the successor entity. The court also granted Hiner $8,670 to equalize the contributions and $40,000 in attorney’s fees. An incomplete record was furnished to the court of appeals, and the court stated that it could not conclude that the trial court erred based on the incomplete record furnished. In the absence of any formal agreements, documents, resolutions, or minutes establishing the parties actual membership interests, the trial court did not clearly err in its accounting of the members’ contributions, and Boldon’s argument that the trial court failed to address Hiner’s breaches of fiduciary duty and abused its discretion by awarding attorney’s fees were not supported by the record before the court.

**Ervin v. Turner**, 662 S.E.2d 721 (Ga. App. 2008) (holding that trial court properly dissolved LLC under statutory provision for judicial dissolution when it is not reasonably practicable to carry on LLC’s business in conformity with written operating agreement or articles of organization because start-up bank venture of LLC failed and plaintiffs and defendants agreed to dissolve LLC).

**Georgia Rehabilitation Center, Inc. v. Newnan Hospital**, 658 S.E.2d 737 (Ga. 2008). The court held that a member’s request for judicial dissolution was not subject to arbitration because the arbitration clause in the operating agreement required arbitration of any claim arising out of, in connection with, or relating to the agreement. Though the agreement provided for certain causes of dissolution, the court concluded a request for judicial dissolution was an independent legal mechanism and did not arise out of or relate to the terms of the operating agreement.

**Serrano on California Condominium Homeowners Association v. First Pacific Development, Ltd.**, 178 P.3d 1059 (Wash. App. 2008). The plaintiff’s claim against a dissolved LLC was barred because the court determined that
the “effective date of dissolution” for purposes of the statute requiring that suits against dissolved LLCs commence within three years of the “effective date of dissolution” was the date of the LLC’s administrative dissolution rather than the date two years later when the LLC was dissolved and wound up upon cancellation of its certificate of formation. The court stated that any language in the Chadwick Farms case suggesting the three year statutory period ran from cancellation of the certificate was not necessary and was dicta. The claim was timely in Chadwick Farms regardless of whether the “effective date of dissolution” was the date of administrative dissolution or the date of cancellation of the certificate, the court in that case did not directly address the meaning of “effective date of dissolution.”

Crouse v. Mineo, 658 S.E.2d 33 (N.C. App. 2008). The court held that the plaintiff did not cease to be a member by filing a petition seeking dissolution of LLC. The statutory provision relied upon by the defendant states that a member who seeks for himself dissolution ceases to be a member; the provision does not cause dissociation of a member who files a petition for dissolution of the LLC of which he is a member. The court held that the statutory provision regarding judicial winding up or appointment of a person to wind up the affairs of the LLC gave the trial court discretion to do so by virtue of use of the term “may” in the statute, and the trial court did not abuse its discretion in denying plaintiff’s motion to appoint the plaintiff to wind up the affairs of the LLC.

Caplash v. Rochester Oral & Maxillofacial Surgery Associates, LLC, 851 N.Y.S.2d 769 (N.Y. A.D. 4 Dept. 2008) (concluding trial court erred in granting summary judgment for dissolution of LLC because, while plaintiff established that it was not reasonably practicable to carry on business of LLC in conformity with articles of organization or operating agreement, evidence of plaintiff’s termination of employment with LLC and consequent termination of membership under operating agreement gave rise to fact issue with respect to plaintiff’s standing to seek dissolution).

CC. Accounting

Ladd v. Ladd Construction, LLC, No. TTDCV074007051S, 2008 WL 4416048 (Conn. Super. Sept. 15, 2008) (declining defendants’ request to dismiss request by member for judicial accounting due to unresolved fact issues as to whether complete information had been previously furnished).

Cascade Falls, L.L.C. v. Henning, 143 Wash.App. 1056, 2008 WL 934074 (Wash. App. April 8, 2008). Two brothers, Scott and Greg Henning, formed a Washington LLC. A few years later, they discussed going their separate ways, and Greg withdrew. After operating the LLC as its sole member for several years, Scott learned of irregular business and accounting activities by Greg. Greg argued that the trial court erred in admitting evidence supporting Scott’s request for an account from Greg of the LLC’s assets when Scott’s complaint did not state a claim for an accounting. The court stated that the requisites for a cause of action for an accounting are (1) a fiduciary relation between the parties or the account is so complicated that it cannot be conveniently taken in an action at law, and (2) the plaintiff has demanded an accounting and the defendant has refused to render it. Scott’s complaint stated claims against Greg for breach of fiduciary duty, fraud, and conversion; there was no claim for a general accounting. Greg cited no authority that a suit for an accounting is a prerequisite for collection of damages for an LLC member’s conversion of funds based upon claims of fiduciary duty or fraud. Scott did include in his request for judgment and relief that Greg be directed to account for the LLC’s finances for a period of time; thus, there was accounting evidence admitted at trial to prove the claims of Scott and the LLC. Greg failed to object to the admission of any particular accounting evidence, and the court refused to further review his contentions in this regard.

East Quogue Jet, LLC v. East Quogue Members, LLC, 857 N.Y.S.2d 627 (N.Y. A.D. 2 Dept. 2008) (stating that individual had standing to bring accounting since defendants admitted in their answer that individual was member).

DD. Professional LLCs

In re Lufkin (Hendon v. Lufkin), 393 B.R. 585 (Bankr. E.D. Tenn. 2008) (stating that member of professional LLC may be personally liable by reason of such person’s own acts or conduct and debtor-attorney could not escape liability by hiding behind legal fiction that PLLC was separate entity or blaming court-appointed receiver or former financial officer).
Mission Primary Care Clinic, PLLC v. Director, Internal Revenue Service, Civil Action No. 5:07cv162-DCB-JMR, 2008 WL 2789504, 102 A.F.T.R.2d 2008-5256 (S.D. Miss. July 17, 2008). Stanley, a licensed physician, was a member of a professional LLC and the president and sole shareholder of an S corporation that performed services on behalf of the LLC through Stanley. The question in this case was whether payments made by the LLC to Stanley and/or his corporation were “wages or salary payable to or received by” Stanley for purposes of the continuous levy provision of Section 6331(e) of the Internal Revenue Code. The LLC argued that it was not indebted to Stanley for any undistributed profits and that Stanley was a member who received profits based on the amount of fees he produced and not an employee to whom it paid a wage or salary. The IRS asserted that Stanley and/or his corporation should be treated as an employee or independent contractor inasmuch as they were compensated based on the amount of money collected by Mission for medical services which Stanley rendered rather than based on the membership interest of Stanley and/or his corporation in the LLC. The IRS argued that the fact that the LLC labeled Stanley and/or his corporation as its member did not change the factual nature of the relationship as that of an employee or an independent contractor. The LLC contended that the services were performed by Stanley in his own behalf as a member of the LLC and that there was no evidence that Stanley was contractually bound to provide services for the LLC. According to the LLC, it merely acted as a collection conduit (after deduction of its operating expenses) for the payments which Stanley's patients made to his corporation for medical services that Stanley had rendered and for which the corporation had billed. The LLC argued that the case law upon which the IRS relied did not support the position that profits paid to member physicians of a professional LLC constitute “wages and salary” subject to a continuing levy under the relevant federal statutes. The court cited case law construing “salary or wages” broadly for purposes of the continuing levy provision, and the court concluded that the term includes fees paid to an independent contractor as compensation for services rendered. The court concluded that there was a fact question as to whether Stanley provided services to the LLC as an independent contractor.

A.B. Medical Services PLLC v. Travelers Indemnity Company, 858 N.Y.S.2d 574 (N.Y. Dist. Ct. 2008). A professional LLC sought to recover no-fault benefits as assignee of a patient who received medical treatment from the LLC. Because the license of the physician who was the LLC’s sole member and manager had been suspended, the physician was not permitted to continue as a member, and the court considered maintenance of the suit without a qualified member a nullity. The suspension of the member’s license did not render the existence of the LLC fraudulent, however. The court stated that recovery by the LLC on its claim would be permitted as part of its winding up, and the physician would be entitled to receive, as a creditor of the LLC, payments earned. The court stayed the proceeding to allow for filing of articles of dissolution and appointment of a representative to wind up the LLC’s affairs.

Murrin v. Fischer, No. 07-CV-1295 (PJS/RLE), 2008 WL 540857 (D. Minn. Feb. 25, 2008) (stating that limited liability of law firm LLC is provided by LLC statute rather than professional firm statute and neither failure to pay fee required by Professional Responsibility Board nor initial absence of required language in articles of organization specifying type of professional services rendered by firm was basis for holding individual members personally liable for firm wrongdoing).


EE. Foreign LLC - Failure to Qualify to Do Business


Sta-Rite Industries, LLC v. Preferred Pump & Equipment, No. 5:08 CV 1072, 2008 WL 3874676 (N.D. Ohio Aug. 14, 2008) (analyzing case law in corporate context and concluding that failure of foreign LLC to register prior to filing suit could not be cured by subsequent registration and thus required dismissal).
**Hugo Douglas & Associates v. Virgin Islands Conference**, Civil No. 2007-28, 2008 WL 2954752 (D. Virgin Islands July 30, 2008) (discussing qualification requirements for foreign LLCs under Virgin Islands law and denying defendant’s motion to dismiss in which defendant argued that plaintiff foreign LLC was precluded from commencing suit where defendant’s affidavit referred to wrong LLC in stating that foreign LLC was not registered as foreign or domestic LLC).

**Rice v. Palisades Acquisition XVI, LLC**, No. 07 C 4759, 2008 WL 538921 (N.D. Ill. Feb. 25, 2008) (holding that filing suit to collect debt was isolated transaction and did not constitute “transacting business” by foreign LLC).

**FF. Foreign LLCs - Constitutionality of Fee or Tax**

**Ventas Finance I, LLC v. California Franchise Tax Board**, 165 Cal.App.4th 1207, 81 Cal.Rptr.3d 823 (Cal. App. 1st Dist. 2008). The California Franchise Tax Board (FTB) appealed a judgment ordering a refund of the entire tax paid by a Delaware LLC for the years 2001-2003 along with an award of attorney’s fees in favor of the LLC. The court of appeals upheld the trial court’s determination that the franchise tax in effect during the years in issue violated the Commerce Clause because it was not fairly apportioned. However, the court of appeals concluded that neither federal due process nor any principle of California law required the FTB to refund the entire amount paid by the LLC. The court held that the refund should be limited to the amount paid by the LLC that exceeded the amount it would have been assessed under a fair method of apportionment, and the court remanded with directions to redetermine the amount of the refund. The court did not reach the question of whether the newly enacted franchise tax, which specifies a method for calculating the amount of refunds in the event the former provision is adjudged to violate the Commerce Clause, may be applied to this case or whether any principle of due process would preclude its retroactivity. The court also addressed the grounds on which attorney’s fees in a tax refund suit may be awarded and remanded to permit the trial court to redetermine eligibility and amount in light of the court’s determination regarding the amount of the refund.

**GG. Foreign LLC – Governing Law**

**Tenable Protective Services, Inc. v. Bit E-Technologies, L.L.C.**, No. 89958, 2008 WL 3870666 (Ohio App. Aug. 21, 2008). The plaintiff sought to hold two individuals who were members and senior managers of a Georgia LLC personally liable on a contract with the plaintiff. The court applied Ohio law to the issue of the individual defendants’ liability based on a choice-of-law provision in the contract specifying that Ohio law would govern any disputes. Relying on the Ohio LLC statute, the court held that the individual defendants were not personally liable for the obligations of the LLC.

**Berman v. Sugo, LLC**, 580 F.Supp.2d 191 (S.D.N.Y. 2008). The court denied a motion for reconsideration of its opinion and explained that it applied the law of New York, the forum state, in the context of this dispute regarding a Connecticut LLC because there was no material conflict between the laws of New York and Connecticut with respect to formation of an oral agreement where a party has expressed intent not to be bound until the agreement is in writing.

**Rual Trade Ltd. v. Viva Trade LLC**, 549 F.Supp.2d 1067 (E.D. Wis. 2008) (stating that veil piercing of LLC is generally governed by law of state of organization and that factors justifying deviation from such rule were not present).

**Construction, LLC v. Gravelroad Entertainment, LLC**, Civil Action No. 6: 07-155-DCR, 2008 WL 2038878 (E.D. Ky. May 12, 2008). The plaintiff sought to pierce the veil of a Tennessee LLC to hold the three members liable for breach of contract and fraud. The court stated that Kentucky had the most significant relationship to the transaction despite the fact that the LLC was organized under Tennessee law, and the court relied upon a Kentucky Supreme Court case for the proposition that Kentucky law will apply to a contract issue if there are sufficient contacts and not overwhelming interests to the contrary. The court analyzed the evidence and found that it was insufficient to pierce the veil.

**Westmeyer v. Flynn**, 889 N.E.2d 671 (Ill. App. 2008) (stating that Delaware law applied to LLC veil piercing claim based on rule that efforts to pierce corporate veil are governed by law of state of incorporation, and concluding
that there was authority for application of corporate veil piercing doctrine to Delaware LLC though plaintiffs did not rely on any reported Delaware decisions directly dealing with veil piercing).


_Taurus IP, LLC v. DaimlerChrysler Corp._, 534 F.Supp.2d 849 (W.D. Wisc. 2008) (stating law of “state of incorporation”of veiled entity governs whether and when its corporate form should be disregarded).

III. Charging Order

_Federal Trade Commission v. Olmstead_, 528 F.3d 1310 (11th Cir. 2008). The FTC obtained a judgment against two individuals, and the district court granted an order compelling the individuals to surrender to a receiver their membership interests in several non-party, single-member LLCs organized under Florida law. A subsequent order authorized the receiver to liquidate the assets in the individuals’ LLCs and to pay the proceeds to the FTC. The individuals challenged the district court’s order requiring them to surrender the assets of their non-party, single-member LLCs. The individuals argued that the district court’s order was contrary to the Florida Limited Liability Company Act, which provides that a judgment creditor may obtain a charging order and that the judgment creditor has only the rights of an assignee. Because the charging order provision does not distinguish between single-member and multi-member LLCs, the individuals contended that the charging order is the only remedy available to a member’s judgment creditor even if the member is the sole member of the LLC. The FTC argued that the overall statutory context leads to the conclusion that a charging order is a senseless (and non-exclusive) remedy for a judgment creditor against the membership interest in a single-member LLC. The FTC pointed to the origins of the common law charging order remedy and its purpose of protecting non-debtor partners from being forced into partnership with a partner’s creditor. That rationale is lost in a single-member LLC where no non-debtor members need protection, and the FTC argued that other provisions of the LLC statute demonstrate that application of the charging order remedy would produce absurd results. For example, the FTC argued that the provision of the LLC statute specifying that an assignee can become a member with the consent of members other than the judgment debtor would lead to absurd results if single-member LLCs were treated the same as multi-member LLCs because an assignee would not be able to become a member in a single-member LLC. The FTC also argued that application of the charging order provision in the single-member LLC context would conflict with provisions of the Florida LLC statute providing that an LLC member ceases to be a member upon assignment of the member’s interest and that an LLC is dissolved when there are no members. According to the FTC, if the charging order is the only remedy of a judgment creditor of a member of a single-member LLC, the LLC would be left without a member to manage and wind up the LLC. The FTC argued that the assignment of a member’s interest to a judgment creditor of a member of a single-member LLC should necessarily enable the creditor to step in and liquidate the LLC’s assets in order to harmonize the statutory provisions. The court of appeals determined that Florida law was not sufficiently well-established for it to determine with confidence whether the district court’s order was permissible, and the court thus certified to the Florida Supreme Court the question of whether, under the charging order provision, a court may order a judgment debtor to surrender all right, title, and interest in the debtor’s single-member LLC to satisfy an outstanding judgment. The court stated that it did not intend to limit the issues to be considered by the Florida Supreme Court and asked for guidance.

_United States Fidelity and Guaranty Company v. The Scott Companies_, No. C-03-5376 SBA (EMC), Docket No. 350, 2008 WL 728874 (N.D. Cal. March 17, 2008). The court granted a charging order with respect to partnership and membership interests owned by two judgment debtors. The court concluded that the plaintiffs failed to establish that a receivership was necessary, noting that previous fraudulent transfers by the judgment debtors involved constructive rather than actual fraud, that the plaintiffs had not shown any further fraudulent conduct since the judgments were entered, and that the value of the partnership and membership interests exceeded the amount of the judgments. Acknowledging the plaintiffs’ concern that there would be no incentive to make distributions because of the outstanding judgments against the judgment debtors, the court ordered the defendants to produce for the plaintiffs the K-1’s for the interests in issue and ordered the parties to meet and work out an auditing system for the period of time until the judgments are satisfied.
II. Divorce of Member

*Reza v. Reza*, No. 2-07-371-CV, 2008 WL 4445619 (Tex. App. Oct. 2, 2008) (noting that membership interest in LLC is personal property and that member has no interest in specific LLC property and holding that trial court in divorce action abused its discretion when it awarded to husband all interest in entity variously referred to as corporation and LLC where mediated settlement agreement did not divide or mention entity and alter ego was neither pled nor tried).

*Signore v. Signore*, 110 Conn.App. 126, 954 A.2d 245 (Conn. App. 2008) (discussing calculation of income and benefits from sole member LLC in divorce case and concluding trial court’s determination regarding husband’s gross income was supported by evidence).

*Carroll v. Elzey*, No. 59891-1-I, 2008 WL 3906353 (Wash. App. Aug. 25, 2008) (analyzing evolution of business that was conducted in several forms over time and concluding that trial court in partition action correctly determined marital community of parties had interest in LLC that was not distributed at time of marital dissolution decree and that parties thus remained tenants in common after dissolution of marriage and interest was subject to partition).

*Ulliman v. Ulliman*, No. 22560, 2008 WL 2942213 (Ohio App. Aug. 1, 2008). Susan Ulliman appealed the trial court’s refusal to consider as income for support purposes one-half of the retained earnings of an LLC of which her ex-husband, Matthew Ulliman, was a one-half owner. The members of the LLC had elected to treat the LLC as an S corporation, and the trial court found that Matthew’s entire half-interest in the LLC was marital property. The trial court valued the interest at $4,780,500, awarded the interest to Matthew, and ordered Matthew to pay Susan her half of its value. Susan asked the court to consider half of the LLC’s retained earnings, in addition to Matthew’s salary, as Matthew’s income for support purposes. The trial court refused, saying that considering the retained earnings as income would constitute “double dipping” because the value of the marital interest was based on the LLC’s historic earned income, the unspent sum of which makes up retained earnings. The court of appeals stated that the statutory definitions of “income” are broad enough to encompass retained earnings, but its mere presence is insufficient to require its inclusion. The court stated that the two critical issues to be examined were: first, whether the owning party exercises sufficient control over the decision to distribute or withdraw the retained earnings, and, second, whether the owning party is using the corporation to shelter income so as to avoid paying support. The court found the evidence that Matthew had sufficient control over the retained earnings to give him unilateral access for personal reasons to be weak. The court stated that Matthew and the other member made most decisions jointly, and, even if he had sufficient control, the law imposes on Matthew a fiduciary obligation that would preclude him from unilaterally dipping into retained earnings for personal reasons. The court characterized the tax status of the LLC as an S corporation as largely irrelevant to the question of Matthew’s control. The court pointed out that the “flow through” of income is metaphorical and that the income is merely a number on his tax return rather than cash in his pocket. The court thus concluded that there was little evidence to support the notion that Matthew had the right or ability to treat any portion of the LLC’s retained earnings as his personal piggy bank. The court also concluded that Susan failed to point to any evidence suggesting that Matthew intended to shelter his income in the retained earnings to avoid paying support. Finally, the court stated that it was important to consider the business judgment of the owners of a closely held business with respect to retained earnings in order to see if business related reasons have prompted the retention of earnings. The court found the record replete with evidence of the critical role that retained earnings played in the LLC’s operations. Thus, the court found ample support for the trial court’s decision to exclude retained earnings from Matthew’s income.

*Hernandez v. Hernandez*, 249 S.W.3d 885 (Mo. App. 2008) (affirming trial court’s finding that apartment buildings acquired by husband prior to marriage were transmuted into marital property by his contribution of buildings to LLC of which husband and wife were equal members and joint managers).

*Springer v. Damrich*, 993 So.2d 481 (Ala. Civ. App. 2008) (holding that, for purposes of child support, “gross income” of father included income from father’s single member LLC after deduction and expenses and not LLC’s gross receipts even if father reported LLC’s gross receipts on his Schedule C).

Stoneho cker v. Stoneho cker, 176 P.3d 476 (Utah App. 2008) (holding that LLC used car dealership did not have goodwill apart from husband).

Young v. Young, 881 N.E.2d 1 (Ind. App. 2007). Relying on case law holding that a shareholder of a wholly owned S corporation could be treated as self-employed for purposes of calculating the shareholder’s child support obligation, the court of appeals held that the divorce court properly credited the husband with the cost of his children’s health care insurance premium incurred by the husband’s wholly owned LLC. Inasmuch as income of the wholly owned LLC was properly factored into the determination of the member’s child support obligation, it followed that the LLC’s costs and expenses were also properly taken into consideration. The trial court erred, however, in neglecting to include cost of healthcare premium in husband’s income before crediting him with the amount.

JJ. Receivership

Zampa v. Sandora, No. CV000435965, 2008 WL 4210773 (Conn. Super. Aug. 26, 2008) (accepting LLC receiver’s final accounting where receiver was satisfied that he had received sufficient information to submit final accounting, members’ lack of cooperation had turned receivership into eight-year process of winding up LLC, and neither member was able to identify further information that would affect final accounting).

R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, Civil Action No. 3803-CC, 2008 WL 3846318 (Del. Ch. Aug. 19, 2008). The petitioners sought judicial dissolution of nine Delaware LLCs. With respect to two of the LLCs, the court held that the petitioners did not have standing under the Delaware LLC statute to seek dissolution and winding up because only managers or members have standing to do so under the statute. The court stated that there was no authority for the proposition that a member of an LLC that is itself a member of another LLC can seek dissolution or the winding of the latter LLC. The court held that the claim for receivership survived because the statute permits a “creditor, member or manager... or any other person who shows good cause” to present an application for receivership. With respect to the other seven LLCs, the court dismissed the action because the members waived the right to seek dissolution or the appointment of a liquidator in the LLC agreements.

Georgia Rehabilitation Center, Inc. v. Newnan Hospital, 663 S.E.2d 204 (Ga. 2008) (holding trial court did not err in expanding powers of receiver appointed to manage affairs of LLC during dissolution given receiver’s need to track down, control, and protect LLC’s assets).

Johnson v. Booth, 184 P.3d 289 (Mont. 2008) (holding that co-owner of corporation and LLC did not have standing to appeal appointment of receiver for corporation and LLC because claim belonged to corporation and LLC).

Asal v. Adams, No. CV-04-0072635S, 2008 WL 1735175 (Conn. Super. March 25, 2008). An LLC member sued his co-member for dissolution, breach of the operating agreement, mismanagement, and an accounting. The judge entered a TRO restricting the defendant from entering the business and appointing the plaintiff receiver of the LLC. The plaintiff failed to post the required bond and did not provide any reports concerning his activities as receiver. The defendant had been ordered to provide an accounting for the period during which the defendant ran the business, and the defendant had likewise failed to provide an accounting. The court noted that the case was peculiar in that one of the principals had been appointed receiver but had never posted the bond and never accounted to the court or the defendant regarding his actions as receiver. Faced with “this peculiar mix of a receiver who is not really a receiver,” the court looked at the operating agreement to determine the relationship of the plaintiff and defendant. Based on the capital contributions made by the parties and the terms of the operating agreement, the court determined that the defendant, as a non-contributing member under the operating agreement, should transfer all of his interest to the plaintiff, a contributing member, who was entitled to an offset under the agreement in an amount greater than the value of the non-contributing member’s interest.

KK. Bankruptcy

In the Matter of Yorkshire, LLC (Knight v. Luedtke), 540 F.3d 328 (5th Cir. 2008). The court of appeals upheld an award of sanctions against an individual, Knight, and the attorney hired by Knight as bankruptcy counsel for
a limited partnership and its general partner LLC. Knight was president and a manager of the LLC. Knight and the attorney prepared for the bankruptcy in secret and did not consult with or inform any other owner, officer, employee, or creditor. The attorney signed each petition as attorney for the debtor, and the individual signed each petition as “President, Manager.” The petitions were filed after Knight received notice from the other members of the LLC that a meeting of the entities was going to be held to consider removal of Knight from his position of authority in the LLC. The evidence showed the attorney conducted little due diligence on the financial status of the entities and no diligence on their ownership and management so as to reach an informed decision as to whether a bankruptcy filing was warranted and, if so, who had authority to file it. After the bankruptcy filings, Knight was removed from his position of authority, and new counsel was substituted for the bankrupt entities. A pending state court action brought by Knight against the entities and the other owners was removed to the bankruptcy court, and the attorney Knight hired to file bankruptcy for the entities represented Knight in the adversary action against his former clients (the debtors). Eventually all parties stipulated that the limited partnership and LLC were solvent and in no way in default, and the bankruptcies were dismissed. The bankruptcy court found that the bankruptcy filing was made in bad faith, i.e., that it was made to inflict injury on Knight’s co-members with a bad motive and with no meaningful thought being given to the actual purposes of Chapter 11 bankruptcy. Based on the finding of a bad faith filing, the bankruptcy court awarded sanctions against Knight and the attorney. The district court affirmed, and the court of appeals likewise held that the bankruptcy court did not abuse its discretion.

**In re Lull (Kotoshiro do v. Dorland and Associates, Inc.),** Bankruptcy No. 06-00898, Adversary No. 08-90001, 2008 WL 3895561 (Bankr. D. Hawaii Aug. 22, 2008). Three individuals, Lull, Tipaldi, and Jasper, formed a Hawaii LLC in 2005. The articles of organization identified the three individuals as the members and managers of the LLC. The first annual report was submitted in August 2006 dated as of July 1, 2006, but was returned to Tipaldi for reasons not apparent in the record. A resubmitted annual report was received by the Department of Commerce on October 17, 2006. The report had a handwritten line through Lull’s name on the member-managers list along with a handwritten notation to remove Lull. Thereafter, Lull had no interest in the LLC. Lull filed bankruptcy on December 8, 2006, and Tipaldi filed a proof of claim based on a promissory note. The questions presented in this adversary proceeding were whether the removal of Lull from the LLC was a preferential transfer to Tipaldi and what preference period applied. The court concluded that Lull’s removal as a member and manager of the LLC fell within the broad definition of “transfer” in Section 547(b) of the Bankruptcy Code because the membership interest would have constituted property of the bankruptcy estate had he not been removed. The transfer also benefitted Tipaldi, who was both a creditor of Lull and one of the two remaining members of the LLC. The element of preference was uncontested because Tipaldi filed a proof of claim and obtained a default judgment in an adversary proceeding determining that Lull owed him over $3,000,000. Lull testified at his Section 341 creditors’ meeting that he “signed off his interest” in the LLC because he owed Tipaldi money. Lull’s insolvency during the year preceding his bankruptcy was also established. The court determined that the transfer occurred within 90 days of the bankruptcy, finding that Lull’s removal was not effective until the re-submitted annual report was accepted for filing on October 17, 2006. Even if the effective date of Lull’s removal was August 21, 2006, however, the court concluded that the one-year preference period applicable to insiders applied to Tipaldi. The court reviewed the concepts of statutory and non-statutory insiders and concluded that Tipaldi was a non-statutory insider of Lull because of their business relationship. Finally, the court determined that the transfer effected by Lull’s removal enabled Tipaldi to receive more than he would have received in a straight liquidation; however, the court concluded the sum to be recovered by the trustee from Tipaldi could not be determined on the record because there was no proof of the value of Lull’s LLC interest at the time of the transfer. The record also failed to demonstrate if or how to apportion the preferential transfer between Tipaldi and Jasper, the other remaining member of the LLC.

**In re Klingerman,** No. 07-02455-5-ATS, 2008 WL 3287199 (Bankr. E.D.N.C. Aug. 2, 2008). In this order regarding confirmation of the debtor’s plan, the court addressed the debtor’s request for judicial dissolution of an LLC in which he and another individual (Parker) were each 50% members. The viability of the plan depended upon whether the debtor could force dissolution of the LLC. The debtor argued that the LLC should be dissolved under the North Carolina LLC statute because he and Parker were irreconcilably deadlocked, and the debtor had filed an adversary proceeding to dissolve the LLC. Parker filed a motion for summary judgment in the adversary proceeding on the grounds that the debtor ceased to be a member when he filed bankruptcy and did not have standing to force dissolution. The bankruptcy court denied that motion. In this opinion, the court discussed the members’ disagreements and disputes regarding the ownership of the LLC and matters related to the LLC’s primary asset, a building, and concluded that there
was a deadlock that was detrimental to the business. The court noted, however, that the decision to dissolve was still a discretionary decision of the trial court. The court deferred its decision on confirmation of the plan for 30 days to give the parties time to reach an agreement. In the absence of an agreement within 30 days, the court stated it would rule on the plan and, in so doing, would consider whether in the adversary proceeding it would be likely to dissolve the LLC pursuant to the LLC statute, to exercise its broad authority under the LLC statute to modify the terms of the operating agreement, or to leave things as they were.

_In re Stamat (Neary v. Stamat), 395 B.R. 59_ (Bankr. N.D. Ill. 2008) (acknowledging that characterization of single member LLCs as separate legal entities was correct but finding argument irrelevant to debtors’ failure to properly disclose gross income of single member LLCs on bankruptcy schedules and concluding debtors’ reckless disregard for truth or falsity of disclosures constituted intent to hinder, delay or defraud creditor and concealment of property supporting denial of discharge).


_In re Healy (Carwin v. Healy), Bankruptcy No. 07-31197-B-7, Adversary No. 08-02159-B, 2008 WL 2852871_ (Bankr. E.D. Cal. July 21, 2008). The plaintiff was induced to invest and become a member in an LLC based on misrepresentations made by the LLC through Healy and another individual. The plaintiff obtained a state court judgment based on the misrepresentations, and the plaintiff sought to have the judgment against Healy declared nondischargeable in Healy’s bankruptcy proceeding. The court held that the judgment did not fall within the discharge exception for fraud or defalcation while acting in a fiduciary capacity. The court acknowledged that an LLC manager owes to the LLC and its members the same fiduciary duty owed by partners in a partnership under California law, but the court said the fraud pre-dated the fiduciary relationship and Healy was not acting in a fiduciary capacity when he made the misrepresentations to the plaintiff.

_In re Klingerman (Klingerman v. ExecuCorp, LLC), 388 B.R.677_ (Bankr. E.D. N.C. 2008). The bankruptcy debtor in possession, Klingerman, sought judicial dissolution and winding up of an LLC of which Klingerman was a founding member. The other member, Parker, alleged that Klingerman ceased to be a member when he filed bankruptcy and thus lacked standing to seek an accounting or judicial dissolution. Parker relied upon the operating agreement and the North Carolina LLC statutes. The operating agreement provided that a member shall not voluntarily withdraw or take any voluntary action that would cause a “Withdrawal Event.” The operating agreement did not define the term “Withdrawal Event,” but the North Carolina Limited Liability Company Act provides that a person ceases to be a member upon specified events of withdrawal including the filing of a voluntary bankruptcy petition. Parker argued that Klingerman ceased to be a member when he filed his bankruptcy petition because the operating agreement did not negate the statutory provisions for withdrawal. Klingerman’s loss of membership status was significant because the North Carolina LLC statute provides for judicial dissolution only where a proceeding is brought by the Attorney General, a member, or the LLC itself. The court stated that Klingerman would not have standing to pursue dissolution if the analysis stopped with the operating agreement and the North Carolina LLC statute, but the court proceeded to consider Bankruptcy Code Section 541(c). Section 541(c)(1) provides that all of the debtor’s interest in property becomes property of the estate notwithstanding any provision in applicable nonbankruptcy law that is conditioned on the commencement of a bankruptcy and that effects a forfeiture, modification, or termination of the debtor’s interest in property. Agreeing with _In re Ehmann_, the court concluded that all of the debtor’s rights and interest, economic and non-economic, passed to the estate under Section 541(c). The court viewed the converting of a debtor’s membership interest to that of an assignee by operation of a state statute as a modification or termination of the interest that is rendered ineffective by Section 541(c). In so concluding, the court disagreed with _In re Garrison-Ashburn, L.C._, in which a bankruptcy court concluded that the debtor/member’s bankruptcy estate only had the rights of an assignee. As a member of the LLC, Klingerman’s estate had standing to seek dissolution. The court left for another day the question of whether the request for judicial dissolution should be granted.

_In re Lobell (Brooke Credit Corporation v. Lobell), 390 B.R. 206_ (M.D. La. 2008). The court noted that the Fifth Circuit Court of Appeals has not decided if LLC members are “fiduciaries” for purposes of the exception to discharge for fraud or defalcation in a fiduciary capacity, and stated that no controlling authority supports a creditor’s
right to enforce the duty even assuming there is such a duty. The court stated that the debtor member and her LLC were 
insiders of each other and held that the member’s transfer of the LLC’s property with intent to hinder and defraud a 
creditor within one year of filing bankruptcy barred the debtor’s discharge.

**In re J.S. II, L.L.C.**, 389 B.R. 570 (Bankr. N.D. Ill. 2008). The LLC debtors asserted claims of breach of 
fiduciary duty against a 50% member/former manager (Snitzer). Snitzer blamed the problems on mismanagement by 
the other two members and filed a counterclaim seeking to equitably subordinate the interests of the other two members. 
The other two members argued that the claims asserted by Snitzer were derivative and could only be brought by them 
as debtors in possession. The court stated that creditors have direct standing to pursue an equitable subordination claim. 
Snitzer alleged inequitable conduct on the part of the other two members consisting of disregard of corporate formalities 
with regard to the LLCs, undercapitalization of the LLCs by failing to capitalize the project as required by the operating 
agreements, and gross mismanagement. The court concluded that the allegations satisfied the requirement for equitable 
misconduct and injury, and Snitzer had standing to bring the claim for equitable subordination.

**In re Global Ship Systems, LLC**, 391 B.R. 193 (Bankr. S.D. Ga. 2007). An LLC’s lender, who was also a Class 
B interest holder whose consent was required for the LLC to file bankruptcy, challenged the involuntary bankruptcy of 
the LLC filed by three individuals who claimed to be creditors and who were solicited or encouraged by one of the 
members to file the involuntary case. The court concluded that the case fell within the parameters which classically 
define a bad faith filing, stating that the involuntary case was a pure subterfuge for a voluntary petition, filed by creditors 
at the instigation of the LLC or its managers/members. The court stated that Georgia law is clear in permitting, to the 
maximum extent possible, parties to exercise freedom of contract in structuring an LLC. The court acknowledged that 
an absolute waiver of the right to file bankruptcy violates public policy if asserted by a lender, but the operating 
agreement clearly gave the lender, in its role as a member, the right to prevent a voluntary bankruptcy by withholding 
consent. In view of the Georgia legislature’s determination that LLCs should be granted broad discretion in the 
organization and management of their affairs, the court concluded that the lender retained a separate right, as an equity 
holder, to refuse to consent to a voluntary bankruptcy. The court emphasized that the filing of an involuntary case at the 
suggestion of a debtor to circumvent limits on the filing under the debtor’s governing documents is only suggestive of, 
not conclusive evidence of, bad faith. The court distinguished **In re Kingston Square Assoc.**, in which an orchestrated 
filinig was permitted because a bankruptcy in that case could preserve equity for unsecured creditors and limited partners. 
In contrast, the debt held by the lender in this case far exceeded the value of the collateral, and there was no basis to 
believe that unsecured creditors and equity holders would be any worse off after foreclosure. The court found that there 
were other causes for dismissal in addition to its finding of bad faith, and the court also granted the lender’s motion for 
relief from the stay to permit foreclosure in the alternative. The court discussed in a footnote the relationships of the 
petitioning creditors with the LLC and stated that its finding of bad faith depended upon that of the LLC and its 
management and not that of the petitioning creditors.

**In re Young (Rands v. Young)**, 384 B.R. 94 (Bankr. D. N.J. 2008). The court held that the three-year statute of 
limitations governing member liability for distributions under the New Jersey LLC statute did not apply to funds 
misappropriated by members and did not bar embezzlement nondischargeability claims. The transfers in issue differed 
from a typical distribution in that the transfers involved alleged misappropriation of funds by a member for personal use. 
The member argued that a distribution is any money taken out of the LLC by or for a member, relying on **In re Die 
Fliedermaus, LLC**, a New York bankruptcy case. In that case, the trustee sought to avoid distributions as fraudulent 
conveyances, and the court held that the three-year statute of limitations applicable to distributions under the New York 
LLC statute barred the avoidance action. The court stated that the types of payments in **Die Fliedermaus** were 
distinguishable because the distributions in **Die Fliedermaus** were challenged on the basis that they were made while the 
LLC was insolvent; there was no allegation of embezzlement. In addition, the court noted that the New York bankruptcy 
court had addressed the trustee’s breach of fiduciary duty claim separately, indicating the court recognized that taking 
money in breach of fiduciary duties was not a distribution subject to the three-year statute of limitations. The court next 
noted that, even if the court were to find the three-year statute of limitations applied in this case, disputed facts existed 
that could lead to tolling because the member allegedly concealed the misappropriations. The court found it unnecessary 
to resolve whether the member was acting in a fiduciary capacity for purposes of the nondischargeability provision 
because the allegations were consistent with embezzlement.
The court granted the members’ motion to dismiss fraudulant transfer claims based on actual corporation, but the court stated that South Carolina law recognizes that agents may be liable for conspiring with another. The court also rejected the members’ argument that the trustee’s claim for civil conspiracy was barred by the doctrine of in pari delicto and the business judgment rule. Finally, the court rejected the members’ argument that the trustee’s claim for civil conspiracy was barred by the doctrine of intracorporate conspiracy. Under this doctrine, the agents of a corporation cannot be liable for conspiring with the corporation, but the court stated that South Carolina law recognizes that agents may be liable for conspiracy if they conspire with one another. The court granted the members’ motion to dismiss fraudulent transfer claims based on actual.
fraud due to the trustee’s failure to plead these claims with sufficient specificity, but granted the trustee leave to amend. The court found that the trustee had met its pleading burden with respect to fraudulent transfer claims based on constructive fraud. The court also found that the factual allegations of conduct constituting fraud, bad faith, and abuse of confidence or breach of fiduciary duty supported a claim for constructive trust. The members sought dismissal of a claim based on deepening insolvency, arguing that such a claim is not recognized under South Carolina law and was duplicative of other claims. The court said it had not identified a case in its district recognizing a deepening insolvency cause of action, but concluded that the fact that there had not been a reported case in that district was not grounds alone to dismiss the claim since it is a recognized cause of action in some jurisdictions and is receiving growing acceptance in the federal judiciary and especially “considering the heightened fiduciary duty placed upon shareholders of a corporation once the corporation is insolvent.” The court did not view the claim as duplicative of other claims because the deepening insolvency claim related to damages sustained by the LLC as a result of the members’ alleged wrongful prolonging of the corporate life of the LLC and incurrence of additional liabilities by the LLC, whereas the breach of fiduciary duty claim appeared primarily aimed at recovering distributions to the members that caused insolvency. The court addressed several other claims including claims for equitable subordination and equitable consolidation. The court found that the trustee had adequately alleged both claims.

**In re Derivium Capital, LLC (Campbell v. Cathcart),** 380 B.R. 429 (Bankr. D. S.C. 2006) (addressing corporate defendant’s motion to dismiss various claims filed by trustee of LLC against entity defendants owned by individual members of LLC and finding allegations supported alter ego veil piercing and substantive consolidation claims pursuant to which trustee sought to reach assets of corporate defendant to satisfy liabilities of LLC).

**LL. Fraudulent Transfer**

**In re Lobell (Brooke Credit Corporation v. Lobell),** 390 B.R. 206 (M.D. La. 2008) (stating that debtor member and her LLC were insiders of each other and holding member’s transfer of LLC’s property with intent to hinder and defraud creditor within one year of filing bankruptcy barred debtor’s discharge).

**In re Dealers Agency Services, Inc. (Menchise v. Clark),** 380 B.R. 608 (Bankr. M.D. Fla. 2007) (holding that debtor’s transfer of substantially all his assets to newly formed LLC owned and controlled by insiders of debtor when lawsuit was pending against debtor was made with actual intent to hinder, delay or defraud creditor; plaintiff did not establish that individual defendants received property of debtor in excess of earned compensation; plaintiff did not establish that transfer was constructively fraudulent because record did not establish value of assets transferred by debtor or value received by LLC; plaintiff did not satisfy burden of showing transfer to LLC was voidable preference).

**MM. Creditor’s Rights**

**Mission Primary Care Clinic, PLLC v. Director, Internal Revenue Service,** Civil Action No. 5:07cv162-DCB-JMR, 2008 WL 2789504, 102 A.F.T.R.2d 2008-5256 (S.D. Miss. July 17, 2008). Stanley, a licensed physician, was a member of a professional LLC and the president and sole shareholder of an S corporation that performed services on behalf of the LLC through Stanley. The question in this case was whether payments made by the LLC to Stanley and/or his corporation were “wages or salary payable to or received by” Stanley for purposes of the continuous levy provision of Section 6331(c) of the Internal Revenue Code. The LLC argued that it was not indebted to Stanley for any undistributed profits on the date on which the LLC received the notice of levy and that Stanley was a member who received profits based upon the amount of fees he produced and not an employee to whom it paid a wage or salary. The IRS asserted that Stanley and/or his corporation should be treated as an employee or independent contractor inasmuch as they were compensated based on the amount of money collected by Mission for medical services which Stanley rendered rather than based on the membership interest of Stanley and/or his corporation in the LLC. The IRS argued that the fact that the LLC labeled Stanley and/or his corporation as its member did not change the factual nature of the relationship as that of an employee or an independent contractor. The LLC contended that the services were performed by Stanley in his own behalf as a member of the LLC and that there was no evidence that Stanley was contractually bound to provide services for the LLC. According to the LLC, it merely acted as a collection conduit (after deduction of its operating expenses) for the payments which Stanley's patients made to his corporation for medical services that Stanley had rendered and for which the corporation had billed. The LLC argued that the case law upon which the IRS
relied did not support the position that profits paid to member physicians of a professional LLC constitute “wages and salary” subject to a continuing levy under the relevant federal statutes. The court cited case law construing “salary or wages” broadly for purposes of the continuing levy provision, and the court concluded that the term includes fees paid to an independent contractor as compensation for services rendered. The court concluded that there was a fact question as to whether Stanley provided services to the LLC as an independent contractor.

_Fritz v. Coffey_, No. 1:07-CV-115-TS, 2008 WL 2444552 (N.D. Ind. June 16, 2008) (holding that Indiana lien statute providing for priority lien in favor of employees of “corporation doing business in Indiana” on property and earnings of corporation for all work and labor performed for corporation did not encompass LLCs, pointing out other Indiana lien statutes that refer to LLCs and stating that court is not empowered to extend statutory coverage beyond wording of statute).

_Preferred Real Estate Investments, LLC v. Lucent Technologies, Inc.,_ Civil Action No. 2:07-CV-05374 (DMC), 2008 WL 2414968 (D. N.J. June 11, 2008). The plaintiff sought a writ of attachment under a statute which permitted a writ of attachment if the defendant is a corporation created by the laws of another state and that state authorizes attachments against New Jersey corporations authorized to do business in that state. The property involved was owned by a Delaware LLC, and the court noted that a strict reading of the statute would allow business entities to shield themselves from attachment by simply transferring assets to an unincorporated entity. Thus, the court concluded that a more liberal reading of the statute encompassing LLCs was appropriate. Since Delaware has a reciprocal statute allowing for attachment against a corporation not created or existing under Delaware law, the court concluded the statutory grounds for attachment were present.

NN. Secured Transactions

_In re Silver Dollar, LLC (First Community Bank of East Tennessee v. Jones)_ 388 B.R. 317 (Bankr. E.D. Tenn. 2008). In order to determine whether a financing statement adequately named the LLC debtor when it identified the LLC by its assumed name, the court analyzed UCC Section 9-503(a)(1), which provides that, in the case of a registered organization, the financing statement sufficiently names the debtor only if it sets forth “the name of the debtor indicated on the public record of the debtor's jurisdiction of organization...which shows the debtor to have been organized.” The court determined that the financing statement, which identified the LLC debtor by its assumed name, “Silver Dollar Stores, LLC,” rather than its name as set forth in the LLC’s articles of organization, “Silver Dollar, LLC,” did not comply with Tennessee UCC Section 9-503(a)(1) because an assumed name does not meet the requirements of the statute. The fact that the debtor had registered its assumed name did not cause it to fall within the phrase “name indicated on the public record” as used in Section 9-503(a)(1) according to the court. A fact issue remained as to whether the error in identifying the debtor rendered the financing statement “seriously misleading,” and thus ineffective, within the meaning of Section 9-506, because it was unclear whether a search of the records of the filing office under the debtor’s correct legal name, using the filing office’s standard search logic, would disclose the financing statements filed by the secured party under the assumed name.

_In re McGrath (Gray v. Assali)_ Bankruptcy No. 05-90165-A-7, Adversary No. 07-9002, 2008 WL 859152 (Bankr. E.D. Cal. March 31, 2008) (finding that two couples took their interests in LLC individually rather than through another LLC, that creditor did not have attached or perfected security interest in LLC interest, and enforcement of claim against debtor’s LLC interest after filing of bankruptcy petition was willful violation of automatic stay even if claimants consulted attorney and were under mistaken impression that debtor did not own LLC interest because they knew of debtor’s bankruptcy).

OO. Securities Laws

_Securities and Exchange Commission v. Wolfson,_ 539 F.3d 1249 (10th Cir. 2008) (stating that court would consider all claims in securities fraud civil enforcement action against Colorado LLC and its managing member jointly in absence of any allegation that LLC had corporate identity separate from managing member).
**U.S. v. Leonard, 529 F.3d 83 (2d Cir. 2008).** The defendants were convicted of securities fraud, and the court found the evidence was sufficient to support the jury’s finding that interests in two LLCs, each of which was formed to produce a particular movie, were securities. The parties agreed that the only category of security that potentially applied in the case was that of an “investment contract,” and the court applied Howey as interpreted in the Second Circuit. The court noted that a review of the organizational documents of the LLCs in issue indicated that the members were expected to play an active role in the management of the LLCs and would lead to the conclusion that the LLC interests were not securities if the court confined itself to an analysis of the documents. In actuality, however, the evidence showed that the members played an extremely passive role in the operation and management of the business. Although the documents called for members to vote on all important decisions, members testified that they voted, at most, only a couple of times. The documents also called for a number of committees, but only two committees were formed for each LLC, and only a few of the several hundred investors served on those committees. “Interim managers” initially controlled the LLCs and made almost every major production decision regarding the movies prior to the completion of fundraising by the LLCs. The members’ management rights did not accrue until the LLCs were “fully organized.” The court also found it relevant that the members were presented with take-it-or-leave-it subscription agreements and did not appear to have negotiated any of the terms of the LLC agreements. That the members did not play any role in shaping the organizational documents raised doubts as to whether they were expected to have significant control over the enterprise. Finally, the court noted that the members had no particular experience in film or entertainment and thus would have had difficulty exercising their formal right to take over management of the LLCs after they were fully organized.

**Securities and Exchange Commission v. Northshore Asset Management, No. 05 Civ. 2192(WHP), 2008 WL1968299 (S.D. N.Y. May 5, 2008) (holding that LLC interests in investment fund were “investment contracts” and thus “securities” for Exchange Act purposes and that failure to disclose certain information occurred in connection with purchases of interests for purposes of securities fraud under the Exchange Act).**

**Swartz v. Deutsche Bank, No. C03-1252MJP, 2008 WL 1968948 (W.D. Wash. May 2, 2008).** The court concluded that an investor in an LLC sufficiently alleged a securities fraud claim under Section 10(b) of the Exchange Act where the confidential memorandum and LLC agreement indicated the parties were to pool their resources, the defendant would act as managing member empowered to make all investment decisions, and the program was intended to produce a profit. The plaintiff failed, however, to allege facts sufficient to support his claim against an individual associated with the managing member as a control person. The Washington courts mirror the federal approach to defining a “security,” and the plaintiff’s investment in an LLC was a security under Washington securities law. The plaintiff’s allegations against the LLC’s managing member were sufficient to qualify the managing member as a “seller,” but the plaintiff’s allegations against an individual associated with the LLC’s managing member failed to establish the individual as someone who occupied a position similar to a seller or materially aided in the transaction.

**Consolidated Management Group, LLC v. Department of Corporations, 175 Cal.App.4th 598, 75 Cal.Rptr.3d 795 (Cal. App. 1 Dist. 2008) (stating, in course of analyzing joint venture interests under California securities law, that pivotal criterion for characterizing partnership or joint venture interests, as well as limited liability company interests, as securities usually will be profits “‘solely [or substantially] from the efforts of others’” element of Howey test).**

**Ward v. Bullis, 748 N.W.2d 397 (N.D. 2008).** Investors in several LLCs formed for the purpose of purchasing and holding stock in a technology company sued the attorney involved in setting up the LLCs alleging common law fraud and violations of the North Dakota securities statute. The trial court granted the attorney’s motion for summary judgment on the basis that the plaintiffs did not raise any genuine issue of material fact with respect to their fraud claims, that the attorney did not personally violate the securities statute by offering for sale or selling securities, and that the attorney was not liable as an agent under the securities statute. The plaintiffs appealed. The plaintiffs argued that the attorney was liable under the securities statute as an agent of the seller who participated or aided in the sale. The supreme court held that the statutory definition of an agent under the securities statute controlled and that the statute did not include common law agents. The statute defines an “agent” as “an individual, other than a broker-dealer, who represents a broker-dealer or an issuer or is self-employed in effecting or attempting to effect purchases or sales of securities.” The court reviewed case law in other jurisdictions regarding an attorney’s liability as an agent under securities laws and concluded that an attorney must do more than act as legal counsel to be liable as an agent under the North Dakota securities statute. The attorney must actively assist in offering securities for sale, solicit offers to buy, or actually perform the sale. The court
concluded that there was a genuine issue of material fact in this case as to whether the attorney’s conduct constituted an attempt to effect the purchase or sale of securities. The evidence, if believed, established that his role in the investment scheme was more than that of an attorney who merely provided legal services and drafted documents. The plaintiffs provided evidence that the attorney planned or assisted in planning the investment scheme, hired the stockbroker involved in the transaction, traveled to Australia and Arizona to assist in purchasing the stock, acted as “secretary” of at least one of the LLCs, drafted investment documents and was responsible for making sure they were filled out and returned, accepted the investment documents without the client’s signature, received the investment funds into his firm’s trust account and disbursed funds, received a 5% commission in addition to his flat or hourly fee, issued the investors’ shares or units, and advised one of the investors that he was an “accredited investor” when the investor stated that he was not. While the supreme court determined that the trial court improperly granted summary judgment on the plaintiffs’ fraud claims under the securities statute (because the attorney could be liable as an agent who participated in or aided a sale in violation of the statute), the trial court did not err in granting summary judgment on the common law fraud claim because there was no evidence that the attorney either made fraudulent statements or was “acting in concert,” which would require that there was a common plan, the participants knew of the plan and its purpose, and the participants took substantial steps to encourage the achievement of the result. There was no evidence presented of a common plan to commit fraud or that the attorney knew that the stockbroker made fraudulent statements or omitted material information in soliciting investors.

*Venezia Amos, LLC v. Favret*, No. 3:07cv146/MCR, 2008 WL 410163 (N.D. Fla. Feb. 12, 2008). The plaintiff sued an LLC and its managing member for federal securities fraud in connection with the plaintiff’s purchase of a 40% interest in the LLC. The defendants argued that the court lacked personal jurisdiction over them, that the membership interest purchased by the plaintiff was not a security, and that the plaintiff’s allegations failed to meet the heightened pleading requirements of the Private Securities Litigation Reform Act. The court first determined that F & F Developers, LLC (F & F), a Louisiana LLC, and its managing member (Favret), a Mississippi resident, were subject to the court’s specific and general jurisdiction. The court next determined that the 40% membership interest in F & F purchased by the plaintiff was a security under the *Howey* definition of an investment contract, rejecting the defendants’ argument that the interest lacked the passivity required to show the expectation of profit was based on the entrepreneurial efforts of a third party. The plaintiff argued that it was a passive member of F & F, having bought its interest for the purpose of investing in Venezia Resort. Further, the plaintiff argued that F & F could not be described as “member-managed” given the numerous provisions of the operating agreement effectively providing for centralized management by the managing member, Favret. The court agreed with the plaintiff. The court pointed out that the day to day management and control of F & F rested in Favret, the operating agreement stated that only Favret had authority to bind, act, or assume any obligation or responsibility for F & F, and the operating agreement gave Favret authority with regard to bank accounts and distribution of capital assets. The court was persuaded that any expectation of profit by F & F members was based strictly on the efforts of Favret, the managing member, even assuming the plaintiff had voting rights and the right to inspect the LLC’s records as argued by the defendants. The court concluded, however, that the plaintiff’s allegations of securities fraud and control liability were not sufficiently particularized to meet the heightened pleading standards of the Private Securities Litigation Reform Act.

**PP. Worker’s Compensation**

*Allen v. Reynolds*, 186 P.3d 663 (Idaho 2008) (holding that worker’s compensation insurance policy issued to individual did not cover employee of individual’s LLC).

**QQ. State and Local Taxes**

*Virginia Cellular LLC v. Virginia Department of Taxation*, 666 S.E.2d 374 (Va. 2008). A telecommunications company structured as an LLC argued that it was exempt from the minimum tax imposed on a telecommunications company under the Virginia Tax Code. The Tax Code provides that “[a] telecommunications company shall be subject to a minimum tax, instead of the corporate tax imposed by § 58.1-400...” Section 58.1-400 imposes a six percent income tax on “every corporation organized under the laws of the Commonwealth and every foreign corporation having income from Virginia sources.” The Department of Taxation promulgated a regulation stating that “every telecommunications company certified as such by the SCC is subject to the minimum tax even though it may
be exempt from, or not subject to, the corporate income tax under § 58.1-400.” The court held that the plain language of the statutes, read together, indicates that the minimum tax only applies to corporations because the minimum tax is to be paid instead of the corporate tax. The court held that the Department of Taxation’s regulation interpreting the statutory minimum tax was invalid to the extent it imposed the minimum tax on pass-through entities because the regulation was inconsistent with the statute.

*Wildwood Medical Center, L.L.C. v. Montgomery County*, 954 A.2d 457 (Md. App. 2008) (holding transfer of property from partnership to LLC whose members were same as partners of transferring partnership was exempt from recordation and transfer taxes under exemption involving transfer from and dissolution of “predecessor entity” notwithstanding property was not titled in partnership since Maryland law does not require partnership property to be held in partnership name).


*Riverboat Development, Inc. v. Indiana Department of State Revenue*, 881 N.E.2d 107 (Ind. Tax Ct. 2008). The court held that income of a Kentucky S corporation from a minority interest in an LLC that operated a gambling riverboat in Indiana was not “adjusted gross income derived from sources within Indiana” for purposes of withholding requirements on income passed through to non-resident shareholders. The LLC interest is intangible personal property, and income from intangible personal property is from an Indiana source under the Indiana tax laws if the receipt from the intangible is attributable to Indiana. Receipts in the form of dividends from investments are attributable to Indiana if the taxpayer’s commercial domicile is Indiana, and the S corporation was not domiciled in Indiana. Thus, the income the S corporation received as a result of its membership in the LLC was not “adjusted gross income derived from sources within Indiana” and was not subject to the withholding obligations applicable to such income.

*Kaplan v. Director, Division of Taxation*, 23 N.J. Tax 594, 2008 WL 269022 (N.J. Tax. Jan. 8, 2008) (holding that partnership tax treatment under New Jersey Gross Income Tax Act was not available with respect to ownership of real estate in tenancies in common made up of disregarded single member LLCs where conscious decision was made to acquire real estate in such manner in order to effect tax free exchanges under Internal Revenue Code).

RR. Medicaid Eligibility and LLC Property

*Timm v. Montana Dept. of Public Health and Human Services*, 184 P.3d 994 (Mont. 2008) (noting potentially different treatment of property of LLCs and corporations for purposes of Medicaid eligibility and concluding that rationale for “no corporation, no trust” rule could not withstand scrutiny and violated equal protection as applied to petitioner in this case).

SS. Unfair Business Practices Statutes

*Reid Pointe, LLC v. Stevens*, No. 08 CVS 4304, 2008 WL 3846174 (N.C. Super. Aug. 18, 2008). The court held that removal of a member as manager of an LLC and demands for capital calls related to matters of internal corporate governance rather than day-to-day business activities and were not sufficiently “in or affecting commerce” to sustain an Unfair and Deceptive Trade Practices Act (UDTPA) claim. Other UDTPA claims asserted by a member failed because they implicated only the rights and interests of the LLCs and thus belonged to the LLCs.

*Johnson v. Wells Fargo Home Mortgage, Inc.*, 558 F.Supp.2d 1114 (D. Nev. 2008) (holding that damages suffered by LLC borrower in connection with commercial loan were not recoverable under Fair Credit Reporting Act because that Act only protects individual consumers).
Insurance

Chapman v. Georgine Realty, No. CV055001346, 2008 WL 4307618 (Conn. Super. Aug. 29, 2008) (recognizing separate existence of LLC and its sole member and rejecting argument that allegation LLC’s sole member has insurance policy with insurer is essentially allegation that LLC has policy with insurer).

Hartford Insurance Company v. Ohio Casualty Insurance Company, 189 P.3d 195 (Wash. App. 2008). In a prior case, an LLC condominium developer which had been administratively dissolved was sued by the condominium association. The LLC did not take steps to reinstate or wind up its affairs during the two-year statutory grace period, and the secretary of state cancelled the LLC’s certificate of formation at the end of the two-year period. The LLC had filed third party claims against the construction manager and several subcontractors during the two-year period, and the LLC and the construction manager settled the condominium association’s claims six months after the cancellation of the LLC’s certificate. The construction manager had also filed third party claims (which were derivative of the LLC’s claims) against the subcontractors. The LLC and construction manager settled the condominium association’s claims, and the insurers of the LLC and the construction manager paid the settlement. The LLC’s insurer was assigned the claims of the construction manager and its insurer against the subcontractors. When the subcontractors discovered that the LLC had been cancelled, they obtained dismissal of the LLC’s third party and indemnity claims on the basis that the LLC ceased to exist and did not have standing to prosecute the claims. The claims of the construction manager were dismissed on the basis that they were entirely derivative of the LLC’s invalid claims. In the appeal of that case, the court of appeals affirmed the dismissals. In the present case, the LLC’s insurer sought equitable contribution from insurers of the subcontractors whom it alleged had improperly declined to indemnify and defend the LLC as an additional insured on the subcontractor policies. The trial court dismissed the insurer’s claims, and the insurer conceded on appeal that it had no right to recover as the assignee of the insurer of the construction manager because the construction manager’s insurer acted as a volunteer in paying on the settlement. The LLC’s insurer also conceded that it could not recover as an assignee of the LLC because the assignment occurred after the LLC’s cancellation and was thus invalid. Nevertheless, the LLC’s insurer argued that it was equitably entitled to recover from the other insurers through subrogation. The other insurers argued that the LLC’s insurer acted as a volunteer in settling the case after the LLC ceased to exist. The court disagreed with the defendants’ argument that the duty of the LLC’s insurer to defend ended when the LLC was cancelled. The court relied upon the recently enacted, and retroactively effective, three-year survival of claims statute. Under that statute, six months still remained during which suits against the LLC could be initiated because the effective date of dissolution was the date of administrative dissolution, and the settlement occurred two and one-half years after dissolution. The court stated that the legislature’s purpose in enacting the survival provision was to provide remedies for parties injured by acts of an LLC and to encourage LLCs to act in good faith. By statute, a dissolved LLC is required to pay or make reasonable provision for claims, and the court stated that it would thwart the statutory purpose of requiring a dissolving entity to leave behind such assets as will reasonably provide for unsatisfied claims if an insurance policy cannot be reached by the LLC’s creditors after the winding up process is complete. The court also rejected the argument that the LLC’s insurer could have refused to indemnify the LLC in the settlement on the basis that the cancelled LLC could not have asserted indemnity or bad faith claims against its insurer. The court found this argument to be inconsistent with the insurer’s obligation to act in good faith and as overly confident that it no longer faced any threat of civil litigation. The court noted that, while cancellation marks the end of an LLC as a separate legal entity, claims against the LLC or managers and members do not necessarily abate. In this evolving landscape of liability, the court did not view the fact that the LLC lacked standing to enforce the policy as dispositive of the insurer’s obligation. Where the insurer has been provided to provide indemnity, the court concluded the insurer acts prudently and in protection of its interests by making coverage available even though its insured is defunct, particularly where there is a claim survival statute. Thus, the court held that the LLC’s insurer was not acting as a volunteer when paying on behalf of the insured LLC and was not barred from pursuing reimbursement through a subrogation action.

Meche v. Volkov, Civil Action No. 07-1491, 2008 WL 2704531 (E.D. La. July 3, 2008) (notice of cancellation of insurance sent to LLC’s registered agent at address specified in policy application as mailing address of LLC was effective).

Focal Point LLC v. CNA Insurance Company, Inc., No. C 07-05764 MHP, 2008 WL 2397422 (N.D. Cal. June 10, 2008). An expelled LLC member asserted that the other members breached their fiduciary duties and their duty
of good faith and fair dealing and that he was not paid his fair share of the value of the LLC when he was expelled. The members tendered the claims to their D&O insurer and the insurer denied coverage. The members claimed that they were covered as individual insureds and sought recovery from the insurer of their defense costs incurred while defending against the expelled member as well as indemnification for the settlement amount they paid to the expelled member. The court concluded that neither the D&O part nor the entity coverage part of the policy covered the claims in this case. The D&O part did not cover the claims because the policy excluded suits brought by an insured person under the policy, and the expelled member was an insured person. The court concluded that the entity coverage part did not cover the claims because the expelled member did not assert a claim against the LLC; the expelled member claimed that his fellow members breached their fiduciary duties to him, and the court noted that the LLC did not owe fiduciary duties to its expelled member and could not be sued for such a breach. The individual insureds claimed that the expelled member deliberately asserted his claims in such a manner that the other members would be individually liable for their defense costs, but the court said that it was not the province of the court to fill the gap in insurance even if this was the case. The court analyzed whether the policy covered the individual insured’s claims against the LLC and concluded that the policy did not provide coverage. The indemnification by the LLC was pursuant to agreement and was not contested by the LLC, and there thus was no “claim” for indemnification. Additionally, the court concluded that the exclusion for breach of contract claims would preclude coverage of any indemnification claim even if the LLC had failed to indemnify the members because the claim would be for breach of the operating agreement. The court added that public policy also supported its conclusion, stating that the “insured v. insured” exception in the D&O part of the policy would be eviscerated if individual members who were sued by co-members for breach of fiduciary duty could turn around and seek indemnification from the LLC and trigger coverage under the policy. The court also said that it was sound public policy to uphold the exclusion limiting the insurer’s coverage for an entity’s contractual obligations. Finally, the court rejected the argument that the alleged wrongful expulsion was a covered event under the policy because it was taken on behalf of the LLC. Assuming the members were acting on behalf of the LLC, the court stated that the LLC’s contractual obligation to indemnify the members still was not covered under the policy. Further, the court stated that it would be bad public policy to hold the LLC liable for its members’ defense of breach of fiduciary duty claims under the guise of acting on behalf of the LLC.

Great American Insurance Company of New York v. North American Specialty Insurance Company, 542 F.Supp.2d 1203 (D. Nev. 2008). The court held that a liability insurance policy insuring members of an LLC in connection with the conduct of the LLC’s business covered the members in connection with a claim against them in connection with the construction of a home by the LLC under a contract executed by a predecessor partnership and assumed by the LLC in the LLC’s purchase of the partnership’s assets. The LLC actually built the home, and the fact that the members were named in the homeowners’ suit as general partners of the LLC’s predecessor and that the policy excluded coverage for any past partnership was immaterial since it was the LLC’s conduct that was in issue.

UU. Statute of Frauds

Olson v. Halvorsen, C.A. No. 1884-VCL, 2008 WL 4661831 (Del. Ch. Oct. 22, 2008). The dispute in the case arose among the founders of a hedge fund LLC when one of the founders was removed from the LLC. An unsigned LLC agreement provided that a founder was entitled to a multi-year earnout, in this case purportedly worth more than $100 million, when the founder left the LLC. The court held that the one-year provision of the Delaware statute of frauds applies to LLC operating agreements, and the multi-year payment structure set forth in the unsigned operating agreement was thus unenforceable. The court noted that the Delaware LLC statute expressly allows oral operating agreements, but does not address whether the statute of frauds applies to such agreements. Commentators disagree as to whether the statute of frauds applies to Delaware LLC agreements, and the court stated that there appeared to be no case law in Delaware or elsewhere on the subject. The court noted that few oral LLC agreements are likely to contain any term or provision that cannot possibly be performed within one year, and the statute of frauds would not limit the enforcement of an oral agreement if it contained no such provisions. If, however, an oral LLC agreement contains a provision or provisions that cannot possibly be performed within one year, the court held that such provision or provisions are unenforceable based on the policy underlying the statute of frauds. The court analyzed the payment provisions in the unsigned LLC agreement and concluded that the payout obligation fell within the one-year statute of frauds provision because all amounts except the first payment could not possibly be calculated until after one year following the alleged agreement, and there were additional substantive obligations and restrictions on the remaining members extending for
multiple years. The court analyzed exceptions to the statute of frauds involving multiple writings and part performance and concluded that these did not apply in this case. Other writings relied upon by the removed member did not clearly and specifically reference the unsigned operating agreement or the payout provision. The court followed the rule followed in the majority of jurisdictions and a Delaware Superior Court decision that an agreement not performable within one year (in contrast to a contract involving the sale of land) is not validated by part performance; therefore, the part performance exception was not available to the removed member.

VV. Equitable Contribution

*Amphibious Partners, LLC v. Redman*, 534 F.3d 1357 (10th Cir. 2008). The plaintiff sued its co-members in an LLC for contribution after the plaintiff paid the full amount of an LLC loan guaranteed by the defendants and by five of the six individual members of the plaintiff. The plaintiff sought 50% of the debt based on the defendants’ 50% interest in the LLC, and the defendants argued that their liability should be limited to 2/7 based on the number of guarantors. The trial court found that the defendants improperly excluded the plaintiff from the business and retained the funds earned from the business, thus destroying the plaintiff’s ability to benefit from the loan. Because the defendants received the entire benefit from the loan, the trial court concluded that the defendants were liable in contribution to the plaintiff for the entire amount of the debt. The court of appeals found no abuse of discretion in the trial court’s application of equitable principles. The court stated that contribution is an equitable doctrine and that the portion of the contribution co-obligors must bear is determined by the benefit each has received.

WW. Tortious Interference

*Out of the Box Promotions, LLC v. Koschitski*, 866 N.Y.S.2d 677 (N.Y. Sup. 2008). The plaintiff alleged that he and the defendant were each 50% members of an LLC, and the plaintiff brought a derivative suit alleging various acts of misconduct on the part of the defendant. The court found that the plaintiff stated a cause of action for wrongful interference with prospective contractual relations because the defendant, as an LLC manager, owed a fiduciary duty to the plaintiff and the LLC and the alleged means employed by the defendant violated the duty of fidelity and thus constituted “wrongful means.”

*Ladd v. Ladd Construction, LLC*, No. TTDCV074007051S, 2008 WL 4416048 (Conn. Super. Sept. 15, 2008). In a dispute involving a father and son owned LLC, the son asserted a claim for tortious interference against the father, alleging that the father exerted influence to prevent the son from performing work in the construction industry and prevented the son from performing excavation or sewer work by refusing to provide the son with his share of the LLC’s profits (which prevented the son from acquiring the equipment necessary to perform the work). The court dismissed the tortious interference claim because the allegations failed to state a claim of intentional interference with any particular, existing business relationship, failed to indicate whether the father knew of the business relationship, and failed to provide a factual basis for permitting proof of malice.

*Pravak v. Meyer Eye Group, PLC*, No. 07-2433-JPM-dkv, 2008 WL 2951101 (W.D. Tenn. July 25, 2008) (doctor’s claim that two other doctors interfered with LLC’s obligations under letter of intent regarding formation of LLC ophthalmology practice failed because other two doctors were also parties to letter of intent).

*ULQ, LLC v. Meder*, 666 S.E.2d 713 (Ga. App. 2008) (holding member breached operating agreement by convincing customer to withhold its business from LLC because member was obligated under operating agreement not to interfere with customer relationships but same conduct could not form basis of tortious interference claim because member was owner of LLC rather than a stranger to contract or business relationship).

*Fishkin v. Susquehanna Partners, G.P.*, 563 F.Supp.2d 547 (E.D. Pa. 2008) (stating that LLC can only act through employees and managers and that claim that LLC induced its member/managers to breach contracts is problematic, but finding it unnecessary to decide issue because facts failed to establish that LLC induced member/managers to breach their contracts).
**Fisk Ventures, LLC v. Segal**, Civil Action No. 3017-CC, 2008 WL 1961156 (Del. Ch. May 7, 2008) (dismissing member’s claim against other members for tortious interference with his employment contract since employment contract allowed LLC to replace member as CEO by vote of 50% of board at any time after second anniversary of agreement).

**XX. Intracorporate Conspiracy**

**In re Derivium Capital, LLC (Campbell v. Cathcart)**, 380 B.R. 407 (Bankr. D. S.C. 2006) (rejecting LLC members’ argument that trustee’s claim for civil conspiracy was barred by doctrine of intracorporate conspiracy, under which corporate agents cannot be liable for conspiring with corporation, because South Carolina law recognizes that agents may be liable for conspiracy where they conspire with one another).

**YY. Successor Liability**

**Milliken & Company v. Duro Textiles, LLC**, 887 N.E.2d 244 (Mass. 2008) (applying de facto merger and mere continuation theories of successor liability and concluding that continued existence of predecessor corporation did not preclude imposition of successor liability on LLC purchaser of corporation’s assets).

**Simpson v. Ithaca Gun Company LLC**, 856 N.Y.S.2d 397 (N.Y. A.D. 4 Dept. 2008). The court found that the elements of a de facto merger were not present in connection with a creditor’s acceptance of an LLC’s assets under security agreements. Orders were filled and repairs were completed by the LLC’s employees for several weeks after the assets were surrendered; however, within six months, the creditor surrendered the assets to another secured creditor with priority, and the second creditor sold the remaining assets and operations at the LLC’s facility ceased.

**ZZ. Conversion, Merger, Reorganization**

**Lach v. Man O’War, LLC**, 256 S.W.3d 563, No. 2005-SC-001014-DG (Ky. 2008). A limited partnership serving as the sole general partner of another limited partnership was reorganized as an LLC, and a limited partner challenged the reorganization on the basis that it was in effect a conversion for which her consent had not been obtained as required by Kentucky law. The reorganization was accomplished by a series of steps involving the formation of the LLC, transfer to the LLC of the partnership’s interest as general partner in the second limited partnership, and dissolution of the limited partnership resulting in distribution of the LLC ownership to the partners in proportion to their interests in the partnership. The plaintiff argued that the transaction amounted to a conversion under Kentucky law and thus required approval of all the partners. The supreme court reached the same conclusion as the court of appeals, finding that there was no conversion because a conversion involves only one entity changing its legal form. The court noted that the general partners referred to the transaction on a couple of occasions as a conversion, but stated that the transaction must be analyzed for what it was, not what someone said it was. The court also commented that it had not been asked, and had not considered, whether the restructuring constituted a merger under the Kentucky limited partnership statute. The supreme court disagreed with the court of appeals on the issue of whether the restructuring of the limited partnership was a breach of fiduciary duty by the general partners. The court concluded as a matter of law that the restructuring of the limited partnership into an LLC without the limited partner’s approval was a breach of fiduciary duty to her, as was the transfer of the partnership’s assets to the LLC. The court held that the transfer of the limited partnership’s assets to the LLC violated the Kentucky limited partnership statute because the statute deprives a general partner of the authority to do any act which makes it impossible to carry on the ordinary business of the partnership without the written consent of all limited partners. The court also held that the attorney-client privilege could not be used to prevent discovery of information related to the breach of a partner’s fiduciary duty.

**In re Dimmings**, 386 B.R. 199 (Bankr. N.D. Ohio 2008) (holding that LLC’s motion for relief from stay did not show it held security interest in collateral where it attached several corporate certificates, including certificate of conversion, but did not show that assets in issue were transferred, assigned, or otherwise legally became property of movant LLC).
a limited partnership’s rights as the designated beneficiary of a key man life insurance policy vested in an LLC pursuant into which the LLC is being converted. The court of claims concluded that a deemed liquidation occurred and deprived the corporation of standing to sue for a tax refund when the corporation converted to an LLC; however, the appeals court held that the court of claims erred in relying on a provision of the check-the-box regulations regarding the effect of a conversion of an eligible entity classified as an association to a disregarded entity. Since the converting corporation was not an eligible entity covered by the rule and there was no other authority supporting the contention that the corporation ceased to exist for purposes of filing for tax refunds for years prior to the conversion, the conversion did not deprive the corporation of standing to sue for the tax refund.

Bank Hapoalim (Switzerland) Ltd. v. XG Technology, Inc., No. 8:07-cv-170-T-23MSS, 2008 WL 126583 (M.D. Fla. 2008). The plaintiff’s breach of fiduciary duty suit against individuals who were managers of a Delaware LLC that converted into a corporation failed because the plaintiff, an assignee of securities in the LLC, did not establish that it was admitted as a member of the LLC. The plaintiff also failed to establish that it became a shareholder in the corporation as a result of the conversion and failed to overcome the presumption that the individual defendants were protected by the business judgment rule as directors and officers of the corporation; therefore, the breach of fiduciary duty claims against the individuals as officers and directors failed as well. The plaintiff was a bank that was assigned units in the LLC by a member of the LLC prior to the conversion. At the request of the member, the LLC issued a certificate stating that the bank was the owner of four million units. A few months later, the LLC informed the bank that a pledge existed against the certificate and that the securities were null and void due to the member’s default under the pledge agreement. After the conversion, the corporation went public. The documents relating to the conversion did not account for the bank’s securities or list the bank as a shareholder of the corporation. The bank asserted that the managers of the LLC owed it a duty of loyalty and care as “legal title holders of the securities” and that the managers breached their duties by failing to safeguard the membership interest of the bank, failing to notify the bank of the conversion, failing to account for the securities in the public offering, and refusing to convert the securities of the LLC. The court stated that the manager of a Delaware LLC owes a fiduciary duty of loyalty and care only to the company and its members. Thus, absent an allegation that the bank was a member or a party to or otherwise bound by the LLC’s agreement, the court concluded the breach of fiduciary duty claim based on the defendants’ status as managers could not stand. Because the complaint did not even mention the LLC agreement, the court stated that the key issue was whether the complaint sufficiently alleged that the bank, an assignee of a member of the LLC, assumed member status. The court pointed out that the Delaware LLC statute provides that an assignee may become a member with the approval of all the members other than the assigning member or in compliance with the LLC agreement. The court also quoted the provision of the Delaware LLC statute that provides that an assignee becomes a member when the person’s permitted admission is reflected in the records of the LLC. Since the complaint did not allege approval by the members, compliance with the agreement, or reflection of the bank’s admission as a member in the LLC records, the complaint failed to allege that the defendants owed the bank a fiduciary duty. Having failed to allege its status as a member of the LLC, the bank also failed to allege its status as a shareholder of the corporation resulting from the conversion. The bank relied upon the statutory conversion provision that states that the rights, securities, or interests in the converting LLC may be exchanged or converted into securities or interests of the converted entity, but the court stated that this provision permits, but does not require, conversion of the LLC interests, and that the statutory provision also authorizes cancellation of interests. Because the complaint failed to allege the bank’s status as a shareholder, and based on the presumption of propriety of director and officer actions under the business judgment rule, the court held that the breach of fiduciary duty claim against the defendants as corporate officers and directors failed. The court also dismissed claims seeking an order compelling conversion of the LLC securities into shares of the corporation and issuance of the converted shares as well as a claim for damages resulting from the refusal to convert the securities because the statutory conversion provision relied upon by the bank does not require conversion of the interests of the converting LLC into securities of the entity into which the LLC is being converted.

Allen v. United of Omaha Life Insurance Company, 236 S.W.3d 315 (Tex. App. 2007). The court held that a limited partnership’s rights as the designated beneficiary of a key man life insurance policy vested in an LLC pursuant
against successive sole owners of a single member LLC. The check-the-box regulations was correct as applied to the levy of employment taxes and the filing of related tax liens. The court thus ruled that the IRS interpretation of determined that the check-the-box regulations are actually in harmony with the employment tax statute as they resolve an ambiguity in how to treat an LLC for employment tax purposes. The court thus determined that the IRS interpretation of the check-the-box regulations was correct as applied to the levy of employment taxes and the filing of related tax liens against successive sole owners of a single member LLC.

AAA. Single Member’s Employment Tax Liability / Validity of Check-the-Box Regulations

Kandi v. United States, 295 Fed.Appx. 873, 2008 WL 4429296 (9th Cir. 2008). The court rejected the taxpayer’s challenge to the check-the-box regulations and held that the regulations represented a reasonable interpretation by the Treasury Department of the Internal Revenue Code. The court stated that the recent decision by the IRS to adopt new regulations regarding the treatment of employment taxes on wages paid after January 1, 2009 by a sole member LLC did not change the result. The decision to adopt an alternative approach did not make the prior approach unreasonable or strip the agency of Chevron deference.

Seymour v. United States, No. 4:06-CV-116, 2008 WL 2509831 (W.D. Ky. June 19, 2008). The court concluded that the sole member of an LLC was personally liable for employment taxes owed by the LLC. The LLC leased the restaurant and obtained a liquor license, but the member argued that she did not authorize anyone to operate a restaurant under the auspices of her LLC and that she had a “gentlemen’s agreement” with another individual who was to operate the restaurant. The court stated that whether the operation of the restaurant under the legal identity of the LLC was within the understanding of the “gentlemen’s agreement” was a matter between the member and the other individual and did not affect the member’s liability for the employment taxes. The court also found that the bookkeeper for the restaurant was personally liable although he was not the owner of the LLC and was not provided funds to pay the taxes. The bookkeeper had authority to sign checks for the LLC and was responsible for calculating payroll taxes and filing payroll tax returns; therefore, he was a “responsible person” under Section 6672(a). The court determined his conduct was “willful” because he knew about the delinquent taxes and chose to pay other creditors before paying the government.

L & L Holding Company, L.L.C. v. United States, 101 A.F.T.R.2d 2008-2081, 2008-1 USTC ¶ 50,324, 2008 WL 1908840 (W.D. La. April 30, 2008). The IRS filed tax liens against two entities, each of which was the sole member of a disregarded LLC for a period of time, to collect unpaid employment and unemployment tax owed by the LLC. Each member filed suit challenging the IRS determination that the liens were valid, and the suits were consolidated. The court rejected the plaintiffs’ argument that the employment tax statute and check-the-box regulations are in conflict. The court determined that the check-the-box regulations are actually in harmony with the employment tax statute as they resolve an ambiguity in how to treat an LLC for employment tax purposes. The court thus ruled that the IRS interpretation of the check-the-box regulations was correct as applied to the levy of employment taxes and the filing of related tax liens against successive sole owners of a single member LLC.
BBB. **LLC Payments as Wages or Salary Subject to IRS Levy**

*Mission Primary Care Clinic, PLLC v. Director, Internal Revenue Service*, Civil Action No. 5:07cv162-DCB-JMR, 2008 WL 2789504, 102 A.F.T.R.2d 2008-5256 (S.D. Miss. July 17, 2008). Stanley, a licensed physician, was a member of a professional LLC and the president and sole shareholder of an S corporation that performed services on behalf of the LLC through Stanley. The question in this case was whether payments made by the LLC to Stanley and/or his corporation were “wages or salary payable to or received by” Stanley for purposes of the continuous levy provision of Section 6331(e) of the Internal Revenue Code. The LLC argued that it was not indebted to Stanley for any undistributed profits on the date on which the LLC received the notice of levy and that Stanley was a member who received profits based upon the amount of fees he produced and not an employee to whom it paid a wage or salary. The IRS asserted that Stanley and/or his corporation should be treated as an employee or independent contractor inasmuch as they were compensated based on the amount of money collected by Mission for medical services which Stanley rendered rather than based on the membership interest of Stanley and/or his corporation in the LLC. The IRS argued that the fact that the LLC labeled Stanley and/or his corporation as its member did not change the factual nature of the relationship as that of an employee or an independent contractor. The LLC contended that the services were performed by Stanley in his own behalf as a member of the LLC and that there was no evidence that Stanley was contractually bound to provide services for the LLC. According to the LLC, it merely acted as a collection conduit (after deduction of its operating expenses) for the payments which Stanley's patients made to his corporation for medical services that Stanley had rendered and for which the corporation had billed. The LLC argued that the case law upon which the IRS relied did not support the position that profits paid to member physicians of a professional LLC constitute “wages and salary” subject to a continuing levy under the relevant federal statutes. The court cited case law construing “salary or wages” broadly for purposes of the continuing levy provision, and the court concluded that the term includes fees paid to an independent contractor as compensation for services rendered. The court concluded that there was a fact question as to whether Stanley provided services to the LLC as an independent contractor.

CCC. **Attorney Liability, Disqualification**

*Event Firm, LLC v. Augustin*, 985 So.2d 1174 (Fla. App. 2008) (holding trial court erred in disqualifying LLC’s attorneys without conducting evidentiary hearing on issue of whether attorneys previously represented defendant member or LLC only).

*In the Matter of Yorkshire, LLC (Knight v. Luedtke)*, 540 F.3d 328 (5th Cir. 2008). The court of appeals upheld an award of sanctions against an individual, Knight, and the attorney hired by Knight as bankruptcy counsel for a limited partnership and its general partner LLC. Knight was president and a manager of the LLC. Knight and the attorney prepared for the bankruptcy in secret and did not consult with or inform any other owner, officer, employee, or creditor. The attorney signed each petition as attorney for the debtor, and the individual signed each petition as “President, Manager.” The petitions were filed after Knight received notice from the other members of the LLC that a meeting of the entities was going to be held to consider removal of Knight from his position of authority in the LLC. The evidence showed the attorney conducted little due diligence on the financial status of the entities and no diligence on their ownership and management so as to reach an informed decision as to whether a bankruptcy filing was warranted and, if so, who had authority to file it. After the bankruptcy filings, Knight was removed from his position of authority, and new counsel was substituted for the bankrupt entities. A pending state court action brought by Knight against the entities and the other owners was removed to the bankruptcy court, and the attorney Knight hired to file bankruptcy for the entities represented Knight in the adversary action against his former clients (the debtors). Eventually all parties stipulated that the limited partnership and LLC were solvent and in no way in default, and the bankruptcies were dismissed. The bankruptcy court found that the bankruptcy filing was made in bad faith, i.e., that it was made to inflict injury on Knight’s co-members with a bad motive and with no meaningful thought being given to the actual purposes of Chapter 11 bankruptcy. Based on the finding of a bad faith filing, the bankruptcy court awarded sanctions against Knight and the attorney. The district court affirmed, and the court of appeals likewise held that the bankruptcy court did not abuse its discretion.

*Ward v. Bullis*, 748 N.W.2d 397 (N.D. 2008). Investors in several LLCs formed for the purpose of purchasing and holding stock in a technology company sued the attorney involved in setting up the LLCs alleging common law fraud
and violations of the North Dakota securities statute. The trial court granted the attorney’s motion for summary judgment on the basis that the plaintiffs did not raise any genuine issue of material fact with respect to their fraud claims, that the attorney did not personally violate the securities statute by offering for sale or selling securities, and that the attorney was not liable as an agent under the securities statute. The plaintiffs appealed. The plaintiffs argued that the attorney was liable under the securities statute as an agent of the seller who participated or aided in the sale. The supreme court held that the statutory definition of an agent under the securities statute controlled and that the statute did not include common law agents. The statute defines an “agent” as “an individual, other than a broker-dealer, who represents a broker-dealer or an issuer or is self-employed in effecting or attempting to effect purchases or sales of securities.” The court reviewed case law in other jurisdictions regarding an attorney’s liability as an agent under securities laws and concluded that an attorney must do more than act as legal counsel to be liable as an agent under the North Dakota securities statute. The attorney must actively assist in offering securities for sale, solicit offers to buy, or actually perform the sale. The court concluded that there was a genuine issue of material fact in this case as to whether the attorney’s conduct constituted an attempt to effect the purchase or sale of securities. The evidence, if believed, established that his role in the investment scheme was more than that of an attorney who merely provided legal services and drafted documents. The plaintiffs provided evidence that the attorney planned or assisted in planning the investment scheme, hired the stockbroker involved in the transaction, traveled to Australia and Arizona to assist in purchasing the stock, acted as “secretary” of at least one of the LLCs, drafted investment documents and was responsible for making sure they were filled out and returned, accepted the investment documents without the client’s signature, received the investment funds into his firm’s trust account and disbursed funds, received a 5% commission in addition to his flat or hourly fee, issued the investors’ shares or units, and advised one of the investors that he was an “accredited investor” when the investor stated that he was not. While the supreme court determined that the trial court improperly granted summary judgment on the plaintiffs’ fraud claims under the securities statute (because the attorney could be liable as an agent who participated in or aided a sale in violation of the statute), the trial court did not err in granting summary judgment on the common law fraud claim because there was no evidence that the attorney either made fraudulent statements or was “acting in concert,” which would require that there was a common plan, the participants knew of the plan and its purpose, and the participants took substantial steps to encourage the achievement of the result. There was no evidence presented of a common plan to commit fraud or that the attorney knew that the stockbroker made fraudulent statements or omitted material information in soliciting investors.

*Jean v. Angle*, No. CV064016486, 2008 WL 2168873 (Conn. Super. May 1, 2008) (granting motion to disqualify attorney from representation of defendant in dispute concerning purchase of limousine business where plaintiffs claimed that LLC of which they were members purchased limousine business and defendant claimed he purchased it, attorney was only party present at closing on behalf of purchaser of business, and parties disputed whether attorney represented LLC or individual).

*Madelone v. Whitten*, 18 Misc.3d 1131, No. 9929-07, 2008 WL 399175 (N.Y. Sup. 2008) (denying motion for disqualification of counsel for plaintiff member of LLC in action seeking enforcement of operating agreement involuntary transfer provisions and asserting derivative claims, notwithstanding fact that counsel had previously represented LLC and another member, because court found interests of plaintiff and LLC were not materially adverse and sufficient factual basis for disqualification was not established with respect to prior representation of other member where details regarding such representation were not presented).

*Kira Inc. v. All Star Maintenance Inc.*, 267 Fed.Appx. 352, 2008 WL 510508 (5th Cir. 2008). A minority member of a Nevada LLC brought a derivative suit against the other two members of the LLC. The plaintiff asserted various claims based on the alleged improper use by the defendant members of the LLC’s name and the payment of management fees to affiliates of the defendants. The plaintiff argued that the district court erred in denying its motion to disqualify defense counsel due to conflicts in representing the LLC and the defendant members accused of harming the LLC’s interests. The court stated that any conflicts asserted by the plaintiff were more theoretical than real. All members were parties to the action, and the plaintiff was the only party who stood to benefit from a plaintiff’s verdict. The court could not imagine any remedy that could have been obtained by the LLC that would have been different from a remedy in favor of the plaintiff and saw no purpose that would have been served by independent counsel for the LLC in this case. Thus, the court held that the district court did not abuse its discretion in denying the motion to disqualify.
In litigation between an LLC and Montgomery, a member and former manager, the LLC resisted certain discovery requests on the grounds of attorney-client privilege. Montgomery claimed that, as a member and former manager of the LLC, he was a “joint client” and that the attorney-client privilege could not be asserted against him with respect to privileged communications during the time he was a manager. The LLC argued that it was the sole client and that the ability to assert the privilege belonged to current management. The issue of first impression for the court was whether an LLC should be treated as a partnership or corporation for purposes of the attorney-client privilege. The court discussed the “hybrid” nature of an LLC and cited LLC cases addressing derivative litigation, the business judgment rule, and veil piercing in which courts have applied corporate law to LLCs. The court stated that Montgomery cited no case law applying the law of partnerships to LLCs and that Montgomery relied only upon the general proposition that members of an LLC owe one another fiduciary duties and a general comparison of the structure of the LLC to that of a partnership. The court agreed with the LLC that, even if the court found the LLC operated like a partnership, partnerships and limited partnerships are treated as corporations for purposes of the attorney-client privilege under federal law. Based on a review of the LLC’s operating agreement, the court concluded that the LLC’s management structure more resembled a corporation than a partnership. Taking into account the case law applying corporate law to LLCs in other areas, Montgomery’s failure to cite case law applying partnership law to LLCs, and the fact that federal courts have treated partnerships as corporations for purposes of the attorney-client privilege, the court concluded that the LLC should be treated as a corporation pursuant to federal common law. The court then discussed the divergent views reflected in the case law regarding who the client is for purposes of the attorney-client privilege. Some courts have held that the corporate entity is the sole client, while others have embraced a “joint client” exception, i.e., have taken the view that the corporate entity and present and former directors are joint clients for purposes of asserting the privilege. The court found the “sole client” line of cases more persuasive and was influenced by the fact that Montgomery was suing to benefit himself individually rather than on behalf of the LLC or in his capacity as a former manager or officer. The court thus held that the LLC was the client for purposes of the attorney-client privilege and that only current management of the LLC was entitled to assert or waive the privilege.
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Plaintiff, a member of a Delaware LLC (the “Company”), brought an action to inspect the Company’s books and records pursuant to Section 18-305 of the LLC Act. The Company was a joint venture formed by the plaintiff and defendant THQ, Inc. (“THQ”) to develop and sell wrestling-based video games pursuant to a license from World Wrestling Entertainment (“WWE”). The WWE license would expire on December 31, 2009; however, the Company had an option to extend the term of the license agreement for a five-year period if the Company were not in default under the license agreement. Pursuant to the Company’s LLC agreement, THQ operated the Company on a day-to-day basis and plaintiff was entitled to a guaranteed preferred return based on an income stream related to the license agreement contributed by plaintiff to the Company. The preferred return was based upon historical sales data such that it would approximate 49% of the profits of the Company during the distribution period. Initially, the percentage agreed upon was 10% for the period from October 1999 to June 30, 2006. The current distribution period began July 1, 2006 and ended December 31, 2009. The parties had been unable to establish a preferred return rate for the current distribution period and therefore the issue was presented to an arbitrator as required under the Company’s LLC Agreement.

Although extensive discovery was taken in connection with the arbitration, in March, 2008, plaintiff made a demand for financial documents, which the Company complied with. Subsequently, plaintiff made a second demand for a broad range of documents relating to the Company and THQ. THQ responded that plaintiff’s request was overly broad but that THQ was willing to make a limited production, subject to plaintiff’s agreement to certain conditions. Plaintiff refused the offer and commenced this action to enforce its rights under Section 18-305 of the LLC Act.

Plaintiff offered three purposes for which it needed the demanded documents: (1) to aid it in negotiating the preferred return for the next distribution period, (2) to value its interest in the Company, and (3) to investigate alleged mismanagement and wrongdoing by THQ in managing the affairs of the Company. The court ruled in favor of the Company, stating that plaintiff had failed to demonstrate a proper purpose for its demand. The court stated that, under Section 18-305 of the LLC Act, a member must first establish, by a preponderance of the evidence, the existence of a proper purpose for the inspection sought. Additionally, the court stated that “such a purpose cannot be proper in the abstract, but must be reasonably related to the specific interests of the member making the demand.”

The court went on to analyze separately each purpose offered by plaintiff. With respect to the first purpose offered by plaintiff, that it needed the documents to aid it in negotiating the preferred return for the next distribution period, the court reasoned that due to the current relationship between plaintiff and WWE and the ongoing litigation between WWE and the Company, there was no certainty that the Company would be able to renew its license with WWE, thus any future distribution period was “highly speculative.” The court reasoned that if the Company were later able to extend the
license, a books and records demand might then be appropriate. Thus the court concluded “a demand in order to satisfy a purpose so disconnected from the likely course of events is not ‘reasonably related’ to [plaintiff’s] interest in the LLC.”

The second purpose offered by plaintiff was that it needed the documents to value its interest in the Company. According to the court, normally this would be a proper purpose for a demand, but here it was largely meaningless. The court reasoned that plaintiff only had an interest in the preferred return and had no residual equity interest. The value of plaintiff’s interest in the Company was simply the present value of the preferred return for the current distribution period. Thus, once the arbitrator determined the preferred return rate, the calculation of the value of plaintiff’s interest would be a matter of simple arithmetic, and there would be no need for further documents to determine what the value of that interest was. The court, therefore, concluded that the production of further documents could not reasonably serve the purpose of valuing plaintiff’s interest in the Company.

The last purpose offered by plaintiff was that it needed the documents to investigate mismanagement by THQ. The court stated that to support an allegation of mismanagement under a Section 18-305 action, a member is required to offer a credible basis to suspect mismanagement or wrongdoing, and, in this case, the court found that plaintiff failed to do so. The court was not convinced by the two witnesses offered by plaintiff that there was a credible basis to infer that THQ breached any of its duties under the LLC Agreement. Thus, the court denied plaintiff’s action to inspect the books and records of the Company under Section 18-305 of the LLC Act.

2. *In re NextMedia Investors, LLC*, C.A. No. 4067-VCS (Del. Ch. May 6, 2009)

The potential adoption of an amendment to an LLC agreement was the crux of this motion for summary judgment on the petition of certain members of NextMedia Investors, LLC (the “Company”) for (i) the judicial dissolution of the Company and (ii) the appointment of a liquidating trustee. The proposed amendment would have extended the date of dissolution of the Company by four years. Pursuant to the LLC agreement, the dissolution section, among others, could not be amended “to adversely affect any Member” without the consent of each member to be adversely affected. Petitioners argued that the proposed amendment, by extending the term of the Company, and therefore the members’ investment period, created an adverse effect and required the consent of all members for adoption. Since petitioners had not given their consent, they argued that the amendment was ineffective and the Company had dissolved. The Company countered that (i) petitioners’ interpretation of the amendment provisions of the LLC agreement was not reasonable or, in the alternative, another reasonable interpretation existed rendering the agreement ambiguous and (ii) whether petitioners were adversely affected was a relevant factual issue.

The court noted that summary judgment in the context of interpreting a contract requires that the contract be unambiguous. Assessing the amendment provision of the LLC agreement, the court found that the plain language of the agreement supported one reasonable meaning and therefore could not be considered ambiguous. The court agreed
with petitioners that the dissolution provision could not be amended without the consent of all members because all members would be adversely affected by the extension of the term of the Company, which would deny them the ability to withdraw from the Company on the investment horizon that was originally contemplated by the LLC agreement. The court rejected the Company’s argument that the approval of the amendment by a majority of the members proved that the amendment did not have an objectively adverse effect. Such a reading, the court stated, would have converted the amendment provision into a class voting provision, but its plain language granted each individual member a consent right. After finding petitioners’ interpretation to be reasonable, the court addressed the Company’s alternative reading of the amendment provision, which would require consent only if the board of managers subjectively intended that a proposed amendment adversely affect the members. The Company’s proposed reading was based on a technical reading of the words “to affect” to require intention or purpose. The court rejected this interpretation as inconsistent with the plain meaning of the section, stating that the Company’s interpretation required “the type of awkward linguistic leap that this court will not make in giving a practical reading to a contract.”

Significantly, the court also rejected the Company’s final argument, namely, that petitioners were not entitled to summary judgment because they had not provided the court with the factual basis to conclude that they were adversely affected by the proposed amendment. The Company’s position was that petitioners must prove to the court, as an issue of fact, that they were adversely affected by the proposed amendment in order to demonstrate that their consent was required. The Company bolstered its position by offering affidavits from its officers indicating that a liquidation of its assets upon the original dissolution date would have resulted in no distributions to the Company’s equity holders because of the depressed market prices of those assets. The court, however, rejected the Company’s argument. It held that whether petitioners were to be adversely affected for purposes of the amendment section was necessarily a “before the fact question” and stated that a company cannot determine “who is entitled to vote on an action by first carrying out the action and then seeing who is adversely affected.” The court added that petitioners should not be required to show they were entitled to vote on the proposed amendment through factual evidence. Rather, the court held, the question of who was entitled to vote was best judged “by who can be reasonably expected to be adversely affected.” The court continued that whether an amendment triggers an individual approval right “depends not on an empirical, factual assessment of whether a member is correct about the effect of a change in the contract, but on whether the proposed contractual amendment would alter an economically meaningful term. If it does, the individual approval right [of the amendment provision] is implicated” and the court found that a change to the lifespan of the entity like the one proposed was clearly a triggering amendment. Thus the court held that petitioners were entitled to dissolution.

While the court granted the dissolution of the Company, it declined to appoint a liquidating trustee. Under the terms of the LLC agreement, the board of managers was authorized to liquidate the Company and if the board of managers did not, the Class A members were entitled to appoint a liquidator. Under the LLC agreement, this right was specifically subject to the right of any member or creditor to apply to a court in respect of the dissolution of the Company and the court interpreted this language together with
Section 18-803 of the LLC Act to require petitioners at the very least to show cause as to why the Class A members should be denied their right to appoint the liquidating trustee. As petitioners had not done so, their motion to appoint a liquidating trustee was denied.

3. *In re Arrow Inv. Advisors, LLC, C.A. No. 4091-VCS (Del. Ch. Apr. 23, 2009)*

In this case, the petitioner sought the judicial dissolution of Arrow Investment Advisors, LLC (the “Company”), which was founded by the petitioner and two other individuals. The petitioner held a 30% stake in the Company and also had served as the Company’s CEO. The Company was formed for the purpose of acting as an investment advisor to certain investment funds and for such other lawful business as the management committee chose to pursue. In 2008, the Company encountered difficulties. A financial report sent to the members of the Company showed that the Company was operating at an almost $275,000 loss for the first seven months of 2008. Consequently, the Company sought capital contributions from each of the members to support the Company’s entry into additional investment-related ventures.

Shortly after the request by the Company for additional capital contributions, petitioner sought judicial dissolution of the Company under Section 18-802 of the LLC Act. In response, the Company sought dismissal of petitioner’s action under Rule 12(b)(6). The court stated that for petitioner to be successful, petitioner must allege specific facts supporting a rational inference that the standard set forth in Section 18-802 for judicial dissolution has been met. Thus, petitioner must demonstrate that “it is not reasonably practicable to carry on the business in conformity with [the] limited liability company agreement.” The court further stated that the ultimate determination of whether to grant judicial dissolution was left to the discretion of the court. The court went on to state that due to the extreme nature of the remedy of judicial dissolution, the remedy was granted sparingly. Thus the court reasoned that the remedy would be granted only in situations “in which the LLC’s management has become so dysfunctional or its business purpose so thwarted that it is no longer practicable to operate the business, such as in the case of a voting deadlock or where the defined purpose of the entity has become impossible to fulfill.”

Petitioner argued that the Company should be dissolved because it failed to meet projections contained in its initial business plan and sought to pursue strategies that were not set forth in its initial business plan. In rejecting this argument, the court noted that this argument did not suggest the Company was unable to operate in accordance with its governing document, which is the test required by Section 18-802 of the LLC Act. Petitioner also argued that although the LLC Agreement contained a broad purpose clause that allowed the Company to enter into any business that the management committee chose to pursue, the Company’s purpose, nevertheless, should be read narrowly because a broad reading would render the court’s power under Section 18-802 of the LLC Act meaningless and render Section 18-802 of the LLC Act superfluous. The court rejected this argument as unpersuasive and reasoned that there could be a confluence of specific circumstances that “make it nihilistic for the [Company] to continue.” For example, dissolution might be appropriate where a petitioner is able to show that in spite of a manager’s intentions to pursue a business line allowed by the
LLC’s governing instrument, it would be obviously futile and would not result in a business success. Further, the court reasoned that it could not conclude that a specifically negotiated provision of the LLC Agreement that allowed for a broad purpose should be used by petitioner prematurely to end the Company’s existence because petitioner was unhappy with how the Company’s management had chosen to exercise discretion granted to it in the LLC Agreement.

Petitioner also alleged breaches of fiduciary duty by the managers in support of his action to dissolve the Company. The court stated that the cursory nature of the allegations made in the complaint were inadequate and suffered from a number of deficiencies, including a failure to allege any specific facts to support allegations that the managers breached their fiduciary duties. Additionally, the court noted that termination of an LLC due to fiduciary breaches would be rare. Further, even if the allegations were sufficient, petitioner failed to pursue the action in the correct manner for at least two policy-based reasons. First, many breach of fiduciary duty claims belong to the entity itself, not its equityholders, and therefore the law has developed rules for bringing a derivative action. The LLC Act requires that a complaint set forth with particularity the effort of plaintiff to secure the initiation of the action by a manager or member or the reasons for not making the effort. Further, the demand rule exists, in part, to give an LLC the right to control litigation to address any alleged wrongs and Section 18-802 judicial dissolution actions should not be used to by-pass this right of the LLC. Second, petitioner’s action to allege breaches of fiduciary duty also sought to by-pass certain procedural mechanisms set forth in the LLC Agreement, principally the requirement that “any questions, issues or disputes arising out of or relating to the” LLC Agreement be handled through negotiation then mandatory mediation and then, finally, binding arbitration prior to any lawsuit being brought. Because Delaware policy favors alternative dispute resolution mechanisms, the court held that petitioner could not use a Section 18-802 action as an end-run around the dispute resolution mechanisms contained in the LLC Agreement. Thus, the court granted the Company’s motion to dismiss the petition with prejudice except that the court held dissolution could be sought at the end of the arbitration process if breaches of fiduciary duty were proven and a good faith argument could be made that the remedies granted by the arbitrator supported an order of dissolution.


This action arose out of a failed development project between plaintiff Bay Center Apartments Owner, LLC (“Bay Center”) and defendant Emery Bay PKI, LLC (“PKI”). PKI was owned and operated by defendant Alfred E. Nevis (“Nevis”). To effectuate the development project, Bay Center and PKI formed defendant Emery Bay Member, LLC, a Delaware LLC (“Emery Bay”), and designated PKI as its managing member. Emery Bay’s LLC Agreement provided for PKI to manage the project, but the details of its management duties were defined in a separate Development Management Agreement, which was an exhibit to the LLC Agreement. Under the LLC Agreement, PKI was required to cause one of its subsidiaries to enter into the Development Management Agreement with the Development Manager, which was defined as PKI or one of its affiliates. PKI designated another Nevis-owned affiliate, defendant Emery Bay ETI, LLC
(“ETI”), as the Development Manager. Thus, the entity with primary responsibility for the success of the development project, the Development Manager, was not a contractual partner of Bay Center. Under the LLC Agreement, however, PKI had the power and authority to ensure that the Development Manager performed its obligations under the Development Management Agreement.

Soon after the project began, Emery Bay defaulted on a construction loan that Nevis had guaranteed. Bay Center alleged that defendants secretly renegotiated the loan on several occasions, which both diverted cash flow from the development project and allowed Nevis to avoid triggering his personal guarantee. After a series of other problems allegedly resulting from mismanagement by PKI’s affiliates, the development project failed and was put into receivership. In this case, Bay Center pursued a breach of contract claim against PKI, the only defendant that was party to the LLC Agreement, and sought to expand its remedial options by filing suit for breach of the contractually implied covenant of good faith and fair dealing, breach of fiduciary duty, common law fraud, and aiding and abetting a breach of fiduciary duty. This decision addressed defendants’ motion to dismiss all of Bay Center’s claims except for those based on breach of contract.

In its breach of contract claim, Bay Center argued that, under the terms of the LLC Agreement, PKI was required to cause ETI to perform its obligations under the Development Management Agreement and cause Emery Bay to perform its obligations under the loan documents. PKI, on the other hand, argued that it was simply empowered, not required, to cause these entities to perform such obligations. The court found the LLC Agreement to be ambiguous on this point and, for purposes of the motion to dismiss, construed the ambiguity against Bay Center. The court then examined the question of whether that obligation could be implied in the LLC Agreement. The court stated that Delaware courts have only sparingly applied the implied covenant of good faith and fair dealing, especially in detailed, complex agreements, but they have “recognized the occasional necessity of implying contractual terms to ensure the parties’ reasonable expectations are fulfilled.” In this case, the court found that PKI was required to act in good faith in managing Emery Bay and exercising its discretion to cause the supporting agreements to be performed. Thus, PKI could not “engage in ‘arbitrary or unreasonable conduct’ that had the effect of preventing Bay Center from ‘receiving the fruits of the bargain,’” which bargain in this case was that, in exchange for Bay Center’s contribution of real estate, Bay Center would enjoy the benefit of PKI’s project management skills and efforts. Because Bay Center pled facts from which it could be reasonably inferred that PKI’s actions were not in good faith, the court found that Bay Center had sufficiently pled that PKI had an implied duty of good faith to cause performance of the supporting agreements and that PKI had breached this duty.

With respect to Bay Center’s fiduciary duty breach claims, the court first looked to the provisions of the LLC Agreement regarding the fiduciary obligations of the members. One section of the LLC Agreement provided that members owed each other the default fiduciary duties that exist between members of an LLC except where the LLC Agreement provided otherwise but the very next section of the LLC Agreement provided that no member owed the other member any duty of any kind that was not imposed by the LLC Agreement itself. The court found these seemingly contradictory provisions to create an
ambiguity and, for purposes of the motion to dismiss, resolved the ambiguity in favor of an interpretation that the LLC Agreement required members to act in accordance with traditional fiduciary duties. The court thus denied defendants’ motion to dismiss Bay Center’s fiduciary duty claims against PKI.

Bay Center also alleged that Nevis, despite being neither a member nor an officer of Emery Bay, breached his fiduciary duty to Bay Center. The court stated that Nevis would be beyond the normal scope of those who owe fiduciary duties in the corporate context, but could be subject to fiduciary duties under the line of cases in the alternative entity context starting with In re USA Cafes, L.P. Litig., 600 A.2d 43 (Del. Ch. 1991). The court held that to apply the USA Cafes doctrine to hold an affiliate liable for breach of fiduciary duty to an entity, the affiliate must exert control over the assets of that entity and, if such control is established, the affiliate only has “the duty not to use control over the partnership’s property to advantage the corporate director at the expense of the partnership.” The court, in attempting to resolve uncertainty regarding the scope of the duties under the USA Cafes doctrine, stated that limiting the application of USA Cafes to this duty provides a rational and disciplined way of protecting investors in alternative entities with managing members who are themselves entities, while not subjecting all the individuals who work for managing members to wide-ranging causes of action. The court found that Bay Center sufficiently pled that Nevis (a) exerted direct control over Emery Bay’s property and (b) used such control to stave off personal liability. As such, the motion to dismiss this fiduciary duty claim against Nevis was denied.

The court next turned to Bay Center’s aiding and abetting claims and stated that to allege a claim for aiding and abetting a breach of fiduciary duty, a plaintiff must plead: “(1) the existence of a fiduciary relationship; (2) the fiduciary breached its duty; (3) a defendant, who is not a fiduciary, knowingly participated in a breach; and (4) damages to the plaintiff resulted from the concerted action of the fiduciary and the nonfiduciary.” The court found that Bay Center had pled sufficient facts in this regard and thus denied defendants’ motion to dismiss the aiding and abetting claims.

With respect to Bay Center’s common law fraud allegations, the court stated that there are three ways to demonstrate common law fraud: (1) overt misrepresentation; (2) silence in the face of a duty to speak; or (3) deliberate concealment of material facts. In its claim, Bay Center argued that PKI and Nevis had a duty to speak and failed to do so. The court stated that to commit common law fraud through silence, a defendant must have a duty to speak that arises by operation of law, not purely by contract. For purposes of this motion, the court considered PKI subject to traditional fiduciary duties and held that fiduciaries of an LLC have a duty to disclose fully and fairly all material information within their control when they seek members’ consent. Because the LLC Agreement required Bay Center’s consent for any refinancing or restructuring of loans and the facts alleged showed that PKI failed to notify Bay Center of six of seven loan modifications, the court held that Bay Center successfully pled its fraud claim against PKI. The court stated that under Delaware law, “[a] corporate officer can be held personally liable for the torts he commits and cannot shield himself behind a corporation when he is a participant,” which includes situations where a corporate agent participates in corporate
fraud. On this basis, the court found that Bay Center had a proper claim against Nevis for his individual participation in PKI’s fraud.


Plaintiff was a member of defendant SPJS Holdings, L.L.C., a Delaware limited liability company (“SPJS”). Because of disagreements with his fellow members, plaintiff decided to withdraw from SPJS. Plaintiff and defendants entered into negotiations regarding his withdrawal, but the parties were unable to reach an agreement on the amount plaintiff was owed under the parties’ agreements or resolve a controversy surrounding an allegedly inaccurate Schedule K-1. Plaintiff also alleged that the defendants attempted to undermine his reputation and undermine his economic opportunities in order to save their personal reputations, and plaintiff brought an action against SPJS and his fellow members for: (a) breach of contract, (b) tortious interference with contract, (c) tortious interference with prospective economic advantage, (d) breach of the implied covenant of good faith and fair dealing, (e) conversion, (f) unjust enrichment, and (g) civil conspiracy.

In their motion to dismiss, defendants Liberty Square Asset Management, L.L.C. (“Liberty Square”) and WGL Capital Corp. (“Capital”), the managing members of SPJS, argued that the breach of contract claims against them should be dismissed because they were not liable for SPJS’s purported breaches of the LLC agreement and pointed to language in the LLC agreement that tracked Section 18-303(a) of the LLC Act. While the court acknowledged that the provision of the LLC agreement did limit the liability of members of SPJS, the court held that it did not necessarily limit the liability of the managing members for the kinds of breaches alleged in plaintiff’s complaint. Accordingly, their motion to dismiss was denied.

Plaintiff also alleged that SPJS, Liberty Square and Capital breached provisions of the LLC agreement when they issued a Schedule K-1 that improperly assigned him taxable income. To state a claim for breach of contract, the court stated that a plaintiff “must demonstrate: first, the existence of a contract, whether express or implied; second, the breach of an obligation imposed by that contract; and third, the resultant damage to the plaintiff.” The court dismissed plaintiff’s claim because (a) plaintiff, a Japanese citizen, failed to establish that he paid or even owed taxes in the U.S. or that he paid higher taxes or suffered any adverse consequence as a result of the schedule, and (b) plaintiff failed to make the contention that a tax audit was a logical and reasonably foreseeable consequence in his complaint, and, even if he had, such a speculative harm was not sufficient to state a claim for breach of contract.

Next, plaintiff argued that the principals of SPJS, Capital and Liberty Square tortiously interfered with plaintiff’s contractual interests under the LLC agreement because they caused SPJS, Capital and Liberty Square to breach the contract. Because a party to a contract cannot be held liable for both breaching the contract and for tortiously interfering with that contract, plaintiff must show that these defendants were each “a stranger to both the contract and the business relationship giving rise to and underpinning the contract.” As such, insofar as these defendants acted within the scope of their respective roles in the entities, they could not be held liable for tortious interference with
contract. No factual allegation in the complaint sufficiently demonstrated that any defendant exceeded the scope of his authority. Accordingly, the claim was dismissed.

With regard to plaintiff’s claim for tortuous interference with perspective economic advantage, the court stated that such a claim will survive a motion to dismiss where a plaintiff alleges: “(a) the reasonable probability of a business opportunity, (b) the intentional interference by defendant with that opportunity, (c) proximate causation, and (d) damages.” Further, under Delaware law, direct claims relating to an LLC are only available where the member of the LLC has suffered damage that is independent of any damage suffered by the LLC. Because all of the harm allegedly suffered by plaintiff affected him through his interest in the LLC through which he did business, the court held that any claim for damages must be asserted by that LLC. Plaintiff failed properly to assert a derivative claim on behalf of that LLC. As such, the claim was dismissed.

In support of his claim for breach of the implied covenant of good faith and fair dealing, plaintiff alleged “arbitrary, unreasonable, and/or deceitful conduct” on the part of defendants. In its analysis, the court held that the implied covenant of good faith and fair dealing “requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits’ of the bargain.” However, it cannot be used to override the express terms of the contract. The court stated that to state a claim for breach of the implied covenant, a plaintiff must allege (a) a specific implied contractual obligation and (b) how the violation of that obligation denied the plaintiff the fruits of the contract. Because of its narrow purpose, the court added the implied covenant of good faith and fair dealing is only rarely invoked successfully. The court held that plaintiff failed to state a proper claim because his claim regarding defendants’ failure to pay money due under the contract was governed by the express terms of the contract. Further, to the extent that plaintiff’s claim was based upon allegations concerning defendants’ attempts to undermine his reputation, plaintiff failed to allege any contractual benefit that he was denied as a result of such conduct. Accordingly, the claim was dismissed.

Conversion, the court stated, is any distinct act of dominion wrongfully exerted over the property of another in denial of the plaintiff’s right or inconsistent with it. A plaintiff who wishes to assert a tort claim in addition to a contract claim must allege that the defendant violated a legal duty separate from its contractual duties. The court dismissed plaintiff’s complaint because he failed to identify an interference with his right to the money that arose independently of the rights granted to him under the contract. Additionally, plaintiff’s claim failed to fall within a narrow exception to the general rule prohibiting claims for the conversion of money—recognized in other jurisdictions, but not in Delaware—that permits a claim “only when it can be described or identified as a specific chattel, but not where an indebtedness may be discharged by the payment of money generally.”

As to plaintiff’s claims of unjust enrichment, the court defined such a claim as “the unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience.” The court continued that the claim was not available where there was a contract that
governed the relationship between the parties. Because plaintiff’s complaint alleged that defendants were unjustly enriched by services that he provided pursuant to their consulting agreement, it was clear that the parties’ relationship was governed by an express contract. While the plaintiff argued that his claims against certain defendants should not be dismissed because they were not parties to the relevant contracts, the court held that unjust enrichment could not be used “to circumvent basic contract principles recognizing that a person not a party to a contract cannot be held liable to it.”

Finally, plaintiff brought a claim against defendants for civil conspiracy, alleging that they “knowingly entered into a confederation or combination to pursue unlawful ends vis-à-vis [plaintiff], including violations of implied covenants of good faith and fair dealing and tortious interference with [plaintiff’s] contractual interests and economic expectations.” The court held, however, that civil conspiracy was not an independent claim. To be actionable, a civil action must embody an underlying wrong that would be actionable in the absence of the conspiracy. Because plaintiff failed to allege such a wrong, the court dismissed the claim.


This case involved a Delaware LLC formed by two brothers, each of whom owned a 50% membership interest. Following the death of one of the brothers, his wife became vested in his 50% share of the LLC. The wife had a very contentious relationship with the other brother and filed a petition seeking judicial dissolution of the LLC, claiming that she and the other brother were hopelessly deadlocked. This decision addressed the parties’ cross-motions for summary judgment.

The court denied the motions, stating that in this case the determination of “whether it is ‘reasonably practicable’ to carry on the business and operations of the LLC” is a mixed question of law and fact that must be determined by a trial. The court stated, however, that based on the precedent set in *Haley v. Talcott*, 864 A.2d 86 (Del. Ch. 2004), in which the court ordered the dissolution of a two 50% member LLC where the members were deadlocked over business strategy, it was “exceedingly likely” that the court would order the dissolution of the LLC. The court urged the parties to reach an amicable compromise to unwind their relationship to avoid a difficult and expensive trial and cautioned that the result of such a trial likely will be a court-ordered sale of the business, the costs of which may well result in nothing being left to divide among the members.


In this case involving cross-motions for summary judgment, the court addressed the issue of what evidence would be admissible to prove standing for purposes of a books and records demand under Section 18-305 of the LLC Act. Defendant LFF, L.L.C. (“LFF”) argued that plaintiff was not entitled to inspect LFF’s records because, according to LFF’s documents, she was neither a member nor a manager of LFF. While plaintiff conceded that she was not listed as a member in either the operating agreement or its
amendments, she argued that contemporaneous documents signed by the initial two members of LFF, Richard Mickman (her ex-husband) and Howard Gleit, supported a reasonable inference that she was a member. One document, a 2001 tax return for LFF, which included a Schedule K-1 for each member, listed the members as Howard Gleit and Richard and Elaine Mickman. In a second document, signed prior to the couple’s divorce, Richard Mickman signed under penalty of perjury an Offer in Compromise to the IRS in which he stated that his “only assets [were] his house . . . and stock in a number of closely held companies owned jointly by Taxpayer and his wife.”

Section 18-305 of the LLC Act states that “[e]ach member of a limited liability company has the right . . . to obtain from the limited liability company from time to time upon reasonable demand for any purpose reasonably related to the member’s interest as a member of the [LLC] . . . [various records of the LLC].” Relying on Shaw v. Agri-Mark, Inc., 663 A.2d 464 (Del. 1995), LFF argued that the court should apply the same evidentiary standard for an LLC as it does for a corporation in considering a demand for books and records. For purposes of a request for books and records under Section 220 of the Delaware General Corporation Law, only those stockholders listed in the stock ledger are recognized as holders of record of stock. A party that supplies equity to a stock corporation, but is not a stockholder of record, has no right to inspect the corporation’s books and records. As such, LFF argued that only those members listed in its operating agreement should be recognized as having a right to inspect its books and records. The court disagreed, however, stating that, due to the flexible and less formal nature of LLCs, it is reasonable for the court “to consider any evidence beyond the four corners of the operating agreement, where, as here, the plaintiff has presented admissible evidence that, notwithstanding the language of the operating agreement, suggests the parties to that agreement intended to make, and believed they had made, the plaintiff a member of the LLC.”

Despite LFF’s contentions that the representations in the aforementioned documents were simply mistakes, the court held that LFF’s argument raised factual issues that could not be determined on a motion for summary judgment. Therefore, LFF’s motion for summary judgment was denied.


Two Delaware limited liabilities companies (the “LLCs”) were formed by four siblings to hold and manage certain real property. To take significant action with respect to the respective real property, each LLC operating agreement required the unanimous consent of the members, who were the four siblings. The members could not agree on whether to keep the properties or sell them. Because of this deadlock, three of the members sought judicial dissolution under Section 18-802 of the LLC Act. The other member-sibling opposed judicial dissolution and filed a counterclaim (among others) in which she alleged that her right to vote under the operating agreements had been interfered with or coerced by her siblings’ refusal to accede to her position regarding the sale of the properties. She specifically requested that the court enjoin her siblings from proceeding with the litigation in order to vindicate her “right to vote” under the operating agreements. The
The court was presented with a motion to dismiss this claim brought by the other members. The court did not reach the merits of this issue as it determined the issue was premature, but the court noted that it seemed “highly dubious” that the court would conclude that the member’s right to vote had somehow been infringed upon or coerced in the context of the family feud. In this regard, the court observed that the member asserting this counterclaim attested in her own pleadings to her full exercise of her voting authority by withholding her consent to the sale of the properties or the dissolution of the LLCs.


Plaintiff BASF Corporation (“BASF”), a limited partner of a Delaware limited partnership, brought this action against the partnership and the general partner for a declaration that its right to withdraw from the partnership and to have its partnership interest bought out by the general partner had been triggered. The purpose of the partnership as articulated in its partnership agreement was to own a petrochemical facility (the “Plant”). When the partnership was formed, in addition to the partnership agreement, the general partner entered into a supplementary agreement with each limited partner setting forth such limited partner’s capital contribution obligations and other matters. BASF’s supplementary agreement provided that if the general partner were to become aware “that the Plant no longer is to be operated by [Lyondell Chemical Company (“Lyondell”)] or its Affiliates (as defined in the Partnership Agreement), it shall so notify [BASF], such notification to be given at any time up to thirty days after the date of such change in operation. Upon receipt of such notice, [BASF], shall have ninety days to notify [POSM II Properties] that it wishes to withdraw from the partnership.” The supplementary agreement then provided a mechanism for purchase of BASF’s partnership interest upon such a withdrawal. Following a “going private” transaction in which all of Lyondell’s stock was acquired by a privately held chemical group, BASF attempted to invoke this right to withdraw. BASF argued that the change in control of Lyondell was a change in the operator of the Plant or, alternatively, that Lyondell’s new corporate parent, rather than Lyondell, was actually operating the Plant. This opinion addressed defendants’ motion to dismiss.

In considering the first of BASF’s arguments, the court found that the plain language of the supplementary agreement contemplated a situation in which Lyondell or one of its affiliates was no longer operating the Plant rather than a change in control of Lyondell. BASF argued that the change in control of Lyondell resulted in Lyondell having a sole stockholder that controlled Lyondell and was in a position to influence Lyondell and therefore indirectly operate the Plant. The court stated that this did not, in and of itself, mean that Lyondell was no longer operating the Plant, nor did the change in the ownership of Lyondell’s equity render it a different company. The court stated that if the supplementary agreement were construed as BASF suggested, it would mean that there was a change in the operator of the Plant and that a withdrawal right existed whenever Lyondell’s stockholder base changed in some significant way or its stockholders or any third party influenced the operation of the Plant. The court further stated that had the parties intended to give BASF withdrawal rights upon a change in control of Lyondell, they could have included an express provision in the supplementary agreement granting
BASF this right upon an acquisition of Lyondell by another company, changes to the board or management of Lyondell or modification of the capital structure of Lyondell. The court stated that BASF’s withdrawal right under the supplementary agreement is only triggered if Lyondell no longer operates the Plant, which Lyondell may continue to do even if it experiences a change in control of its equity. The court thus refused to adopt BASF’s argument for an expansive interpretation of the withdrawal provision in the supplementary agreement. The court also rejected BASF’s alternative argument that Lyondell’s corporate parent was in fact operating the Plant. The court noted that BASF did not plead any facts suggesting that Lyondell’s officers and employees were no longer directly managing and operating the Plant or that operations of the Plant were changed in any way after the acquisition of Lyondell by a single owner.


Plaintiff and defendant each owned a 50% interest in a Delaware LLC formed for the purpose of constructing an office building in which the parties leased space for their joint medical practice. After a falling out between the two parties, plaintiff left to practice on his own and plaintiff and defendant were unable to agree on how to unwind their relationships. Plaintiff ultimately sought a decree of judicial dissolution of the LLC pursuant to Section 18-802 of the LLC Act or, alternatively, an order pursuant to Section 18-803 of the LLC Act appointing a liquidating trustee to effectuate the winding up of the LLC because the LLC had allegedly already dissolved by express will of its members pursuant to Section 5.1 of the LLC agreement. Section 5.1 of the LLC agreement provided, in relevant part, that the LLC “shall be dissolved and its affairs wound up as soon as possible after the construction of the building had been completed, the condominium documents have been finalized and a certificate of occupancy has been issued with respect to each condominium unit . . . .”

Both parties conceded that each of the preconditions to dissolution set forth in Section 5.1 of the LLC agreement had been satisfied. Defendant argued, however, that the dissolution and winding up of the LLC was improper because Section 5.1 of the LLC agreement did not accurately reflect the original intentions of the parties regarding dissolution. Defendant asserted that neither party knew that Section 5.1 was part of the LLC agreement and, thus, that it did not embody their true intentions and should not be enforced. In support of this position, defendant argued that the failure of either party to take steps to implement the dissolution and winding up of the LLC as called for in the LLC agreement was evidence of the parties’ “true intent” to continue the LLC indefinitely.

Applying general contract principles to the construction of the LLC Agreement, the court concluded that Section 5.1 of the LLC Agreement was unambiguous and should be enforced in accordance with its terms. The court held that because Section 5.1 of the LLC agreement was found to be unambiguous on its face, the parol evidence rule precluded the introduction of outside evidence to dispute its terms. Consequently, the court held that the LLC had been dissolved by express will of its members pursuant to Section 5.1 of the LLC agreement and that the winding up of its affairs was necessary.
With respect to plaintiff’s request for the appointment of a liquidating trustee pursuant to
Section 18-803 of the LLC Act, the court held that because the parties were deadlocked
on how to proceed with the winding up of the LLC, the only rational and equitable result
was for the court to appoint such a person. The court stated that because the LLC had
been dissolved by the express will of its members and the parties were unable or
unwilling to implement the winding up process that naturally follows dissolution in the
life cycle of an LLC, “cause” within the meaning of Section 18-803(a) of the LLC Act
existed for the court to appoint a liquidating trustee to wind up the LLC’s affairs. Thus,
plaintiff’s motion for summary judgment on its petition for appointment of a liquidating
trustee was granted.

In connection with plaintiff’s petition for appointment of a liquidating trustee, defendant
asserted a counterclaim, derivatively on behalf of the LLC, alleging that plaintiff had
breached his fiduciary duties to the LLC by refusing to participate in the refinancing of
the building’s mortgage. Plaintiff moved to dismiss defendant’s counterclaim for failure
properly to plead demand futility with the particularity required by Court of Chancery
Rule 23.1. Defendant argued that demand futility has been sufficiently demonstrated
because plaintiff, by virtue of his 50% interest in the LLC, may effectively veto any
proposed action and it would be futile to request that plaintiff grant permission to the
LLC to sue himself for the alleged conduct. The court held that to show demand futility,
defendant must (i) show a “substantial likelihood” of plaintiff’s personal liability and
(ii) plead “with particularity” the facts supporting his claim that there is a “substantial
likelihood” of personal liability of plaintiff. The court held that the “mere threat” of
personal liability is insufficient to show a substantial likelihood of personal liability. In
this case, the court held that defendant had pleaded only the naked assertion of a breach
of fiduciary duty by plaintiff and, thus, the counterclaim showed no more than a mere
threat of personal liability, which was insufficient to satisfy the defendant’s pleading
requirements. Plaintiff’s motion to dismiss the counterclaim was therefore granted.

11.  

Petitioner, Fisk Ventures, LLC, sought judicial dissolution of Ginitrix, LLC (the
“Company”) pursuant to Section 18-802 of the LLC Act. Petitioner was a Class B
member of the Company and the respondent, Andrew Segal (“Segal”), was the sole
holder of Class A membership interests in the Company. Under the Company’s LLC
Agreement, the Company’s board could only act pursuant to approval of 75% of the
members of the board. Thus, the Company could not act without the agreement of the
Class A representatives and the Class B representatives. The Company had been
involved in a long-lived corporate dispute that resulted in a deadlocked board. The issue
before the court was whether it was “reasonably practicable” under Section 18-802 of the
LLC Act for the Company to continue to operate its business in conformity with its LLC
Agreement. Petitioner made a motion for judgment on the pleadings which the court
granted.

In reviewing petitioner’s motion, the court stated that the test for judicial dissolution is
whether it is reasonably practicable for the Company to carry on its business, not whether
it is impossible. The court stated that several factual circumstances have frequently been
cited in the case law: (1) whether the members’ vote is deadlocked at the board level; (2) whether the operating agreement gives no means of navigating around the deadlock; and (3) whether due to the financial condition of the company, there is effectively no business to operate. The court noted that the foregoing circumstances were not individual dispositive, nor did they all have to exist for the standard to be met. In the present case, however, the court found more than sufficient undisputed evidence that all three factors were present and, therefore, it was not reasonably practicable to carry on the business of the Company in conformity with its LLC agreement. Segal had argued that the LLC Agreement granted petitioner a “put right” which would permit petitioner to exit the Company at fair market value for any reason or for no reason, and this put right was a provision that could resolve the board’s deadlock. The court, however, rejected this argument, reasoning that the put right was a right of petitioner’s and not a right of the Company. Thus, it would be inequitable for the court to force petitioner to use its put right to exit its investment if it did not deem it to be in its best interest. The court went on to state that it would not second guess a party’s business decision in choosing whether to exercise its previously negotiated option rights.

Segal also argued that a dissolution would destroy any value the Company had preserved in valuable patent rights. The court rejected this argument reasoning that a potential purchaser could structure the transaction to reap the benefits of the Company’s patent rights. Further the court found that the parties would never be able to reach agreement on how to dispose of the patent rights regardless of their potential value. Finally, Segal argued that petitioner could not seek judicial dissolution because it came to the court with unclean hands. Segal argued that petitioner had unclean hands because it had used its contractually negotiated rights under the LLC Agreement to benefit itself, but the court held that petitioner had the right to maximize its position in accordance with the terms of the LLC Agreement. Finally, the court rejected Segal’s argument that petitioner sought dissolution simply to buy the Company’s assets at fire sale prices, finding that he presented no support for such contention. The court concluded that because the Company’s financial progress was impeded by a deadlock in the boardroom and the deadlock could not be remedied through a legal mechanism set forth within the four corners of the operating agreement, dissolution was the only remedy available as a matter of law. The court stated that it would not re-draft the LLC Agreement for the sophisticated and well-represented parties. Thus, the court granted petitioner’s motion seeking judgment on the pleadings on its petition for dissolution of the Company.


Plaintiff initiated the present litigation by filing a derivative complaint alleging that defendants, who were directors of Travel Centers of America, LLC (the “Company”), breached their fiduciary duties to the Company. The individual directors filed a motion to dismiss plaintiff’s action under Rules 12(b)(6) and 23.1. This opinion addresses defendants’ motion. In 2007, the Company along with Hospitality Trust (“HPT”), a company controlled by defendant director Barry Portnoy (“Portnoy”), acquired Petro Stopping Holdings, L.P. and Petro Stopping Centers, L.P. In connection with this transaction, HPT leased the real estate it acquired in the transaction to the Company (the “Petro Lease Agreement”). Plaintiff alleged that the terms of the Petro Lease Agreement
were more favorable to HPT than to the Company and required the Company to pay HPT above-market rent. Plaintiff also alleged that the directors breached their fiduciary duties by approving the transaction to benefit, at the expense of the Company, HPT, Portnoy and Reit Management & Research (“RMR”), a company controlled by Portnoy, which provided management and administrative services to the Company. According to plaintiff, pursuant to the RMR management agreement, the Petro Lease Agreement benefited HPT because it was able to collect above-market rents and it benefited RMR (and therefore Portnoy) because RMR collects a fee percentage of the gross rent collected by HPT.

The court began its analysis by looking at the terms of the LLC Agreement to determine what fiduciary duties the directors owed the Company and whether the directors could be personally liable if they breached those duties. The LLC Agreement provided that the authority, powers, functions and duties (including fiduciary duties) of the board would be identical to those of a board of directors of a Delaware corporation under the DGCL, unless otherwise specifically provided for in the LLC agreement. Defendants argued that Section 7.5(a) of the LLC Agreement modified the board of directors’ duties and altered the pleading standard required under Rule 12(b)(6) by creating a presumption that the board of directors acted in accordance with its duties, notwithstanding that the board’s decision might have been interested. Further, plaintiff could only overcome that presumption by clear and convincing evidence. The court, however, found that defendants’ interpretation of Section 7.5(a) was not the only reasonable interpretation of that provision. Specifically, defendants interpreted Section 7.5(a) as applying to a conflict between directors and the Company, but the court found that Section 7.5(a) could also reasonably be interpreted as applying only to conflicts between (i) a shareholder and the board or (ii) a shareholder and the Company. Here, the conflict was between Portnoy who was a director, and the Company; thus under one of the two reasonable interpretations of Section 7.5(a), that section would not apply to the conflict at issue. On a Rule 12(b)(6) motion, the court held that it was required to adopt the reasonable interpretation that favored the nonmoving party. Furthermore, the court noted that even assuming that Section 7.5(a) applied, it would not necessarily alter the pleading standard as the court would not apply a standard of proof at the motion to dismiss stage and, therefore, plaintiff would not need to meet the heightened evidentiary standard set forth in the applicable provision at the pleading stage.

Next, the court discussed what fiduciary duties the directors owed to the Company. The LLC Agreement provided that the directors had the same powers and duties (including fiduciary duties) as a board of directors of a Delaware corporation, meaning they would owe the dual duties of due care and loyalty. Although the LLC Agreement modified the directors’ duties for certain transactions, under one of the two reasonable interpretations of Section 7.5(a), that modification would not apply to conflicts between directors and the Company. Therefore, for purposes of the motion to dismiss, the court assumed that the directors’ duties were defined by the duties owed by directors of a Delaware corporation.

Next the court discussed whether the director defendants could be personally liable for violating their duties. The LLC Agreement contained two different, and arguably
conflicting exculpation provisions. Although both provisions provided the directors with exculpation for their acts under various circumstances, neither provision provided exculpation for personal liability where the director acted in bad faith. Given the allegations, the court concluded that based on the limited record and the requisite assumptions made in plaintiff’s favor at this stage, plaintiff made a sufficient showing to rebut the presumption that the directors acted in good faith. The court stated that Portnoy’s loyalties were divided with respect to the Petro Lease Agreement because in approving the transaction he was acting as a director for both HPT and the Company, which at least raised a reasonable doubt as to whether he was acting in the best interest of the Company. Further Portnoy would benefit personally due to his interest in RMR if the Company were bound to pay above market rents. With respect to the other directors, the court concluded that the complaint contained sufficient allegations to support the claim that each director was beholden to Portnoy and approved the Petro Lease Agreement to benefit Portnoy. Thus because the court concluded that it was possible for plaintiff to show that the directors acted in bad faith, plaintiff had met the notice pleading burden of Rule 12(b)(6).

To maintain a derivative suit on behalf of an LLC, a member must either (i) make demand on the managers to bring the suit or (ii) show that “an effort to cause the managers or members to bring the action is not likely to succeed.” Thus, because plaintiff did not claim that demand was made on the board, the analysis turns on whether plaintiff properly alleged demand futility. Under the familiar Aronson test, applicable to derivative suits, the allegations in the complaint must allege particularized facts that establish a reasonable doubt that “(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.” Defendants argued that the first prong of the Aronson test was unavailable to plaintiff because Section 7.5(a) modified the requirement for demand futility by creating a presumption that the decision of whether to pursue a lawsuit was disinterested, notwithstanding that the board may be interested. First, the court reiterated that the LLC Agreement could be interpreted as not applying in a conflict between a director and the Company and therefore Section 7.5(a) did not alter the application of the Aronson test. Further, even assuming Section 7.5(a) applied, because plaintiff was not required to meet any standard of proof, the court was not convinced Section 7.5(a) would change the Aronson test. Therefore, the court went on to apply the Aronson test to determine if a demand on the board would have been futile and under the first prong stated that the plaintiff must create a reasonable doubt as to the disinterestedness or independence of at least three of the five directors of the Company. The court concluded that plaintiff’s complaint created a reasonable doubt as to the disinterestedness or independence of a majority of the Company’s board.

With respect to Portnoy and defendant Thomas M. O’Brien (“O’Brien”), the court concluded that they were both interested under the first prong of Aronson. Portnoy was interested in the Petro Lease Agreement because he was a director for both the Company and HPT and owed fiduciary duties to both companies. Additionally, Portnoy was owner of RMR, which would receive fees from HPT which were allegedly increased by above-market rent payments from the Company. O’Brien was a director of the Company, a senior officer of RMR and held positions with a number of other Portnoy-related entities.
The court concluded that because of the payments RMR would receive from HPT and his position as Senior Vice President of RMR, there was a reasonable doubt as to whether O’Brien stood on both sides of the transaction. Further, the court noted that due to the “extensive relationships” between O’Brien and several Portnoy-related entities, there was also a reasonable doubt as to whether he was so beholden to Portnoy that he would be unable to exercise independent business judgment regarding the derivative action.

With respect to the other defendant directors Arthur G. Koumantzelis (“Koumantzelis”), Barbara D. Gilmore (“Gilmore”) and Patrick F. Donelan (“Donelan”), the court concluded that plaintiff’s complaint was sufficient to create a reasonable doubt as to their independence. The court noted that ordinarily, reasonable director compensation, without more, is not enough to establish that a director was not independent. However, in this case the facts alleged in the complaint suggested that Koumantzelis, Gilmore and Donelan had relationships with numerous other Portnoy-related entities and received compensation for serving as directors or officers for such entities. Thus, due to the relationships of Koumantzelis, Gilmore and Donelan with Portnoy-related entities and the compensation received by them for their service to Portnoy-related entities, the court concluded that the complaint created a reasonable doubt as to their independence. Further, the court stated “there is not a single director on the [Company] board who could serve as an independent voice, free of the potential influence of serving in a paid position of another Portnoy-related entity.” The court also noted that when the relationships of each of the Company directors to other Portnoy-related entities are considered together with the allegations of a conflicted transaction with Portnoy-related entities, it was clear that there was a reasonable doubt that the Company board would be able to exercise disinterested and independent business judgment in deciding whether to pursue the derivative action. Thus the court found that demand was futile and ultimately denied defendants’ motion to dismiss.


Plaintiff, Travelcenters of America LLC (the “Company”), sought indemnification from defendants, who were shareholders of the Company, for costs incurred by the Company related to a proposal by defendants to nominate two persons to the board of directors of the Company which the court had previously held, in a declaratory judgment action brought by the Company, failed to comply with the detailed notice procedures required by the Company’s LLC Agreement for a shareholder to nominate a member to the board of directors. The Company argued that it was entitled to indemnification pursuant to Section 10.3 of the Company’s LLC Agreement, which provided that “each shareholder . . . will indemnify [the Company] from and against all costs and expenses, including reasonable attorneys’ and other professional fees, arising from such shareholder’s breach of any provision of the LLC Agreement.” Defendants moved for judgment on the pleadings. This opinion addresses defendants’ motion for judgment on the pleadings.

The court held that for the Company to recover under Section 10.3 of the Company’s LLC Agreement, the Company would need to show that defendants breached the Company’s LLC Agreement. The Company argued that defendants breached the
Company’s LLC Agreement by failing to comply with Section 9.7 of the Company’s LLC Agreement, but the court rejected this argument. The court reasoned that there is a distinction between promises and conditions, and that while the non-performance of a promise can result in a breach of a contract, the non-occurrence of a condition is not considered a breach unless the party promised that the condition would occur. Accordingly, unless a party is under a duty that a condition occur, the non-performance of a condition is not a breach of that agreement. In this case the court concluded that the requirements of the notice provision were conditions to the Company’s performance and not promises by the shareholders. Although the Company acknowledged that the notice provision was a condition, it argued that it was also a promise by shareholders not to submit non-compliant notices. In support of this contention, the Company relied on the “mandatory” language in the notice provision of the Company’s LLC Agreement. In rejecting this argument, the court explained that the presence of mandatory words such as “must” and “shall” did not compel a finding that the notice requirements were promises not to submit non-compliant notices. The notice requirements were conditions to the nomination of a person for election as a director. Therefore, defendants’ failure to comply with the notice provisions was not a breach of the Company’s LLC Agreement entitling the Company to indemnification but rather was merely the non-occurrence of a condition. Thus, the court concluded that defendants were entitled to judgment as a matter of law and granted their motion for judgment on the pleadings.


In its fourth opinion in the Cencom case, the court considered the general partner’s motion for summary judgment on the three claims that remained after the prior proceedings and the limited partner’s cross-motion for partial summary judgment on the claim with respect to the termination of distributions. As to the claim with respect to the scope and potential breach of the general partner’s voluntarily-assumed duty in confirming the fairness of the sale, the general partner argued that the limited partner’s rights to enforce such a duty were based in promissory estoppel, making lack of reliance by the limited partner fatal to its claim. The court rejected the general partner’s promissory estoppel argument, with its basis in contractual principles, given that the duty voluntarily assumed by the general partner was a common law fiduciary duty and therefore denied the motion for summary judgment. The general partner also advanced a new argument with respect to the claim arising from its termination of distributions prior to the closing of the sale, namely, that the cash held by the partnership between the effective date of the sale and the closing date of the sale was for the benefit of the purchasers and not available for distribution. Because title to the partnership’s assets was not transferred until the closing date, the court rejected this argument and denied summary judgment to the general partner. The court noted, however, that in a trial it could be determined that the interest paid on the purchase price between the effective date and the closing date compensated the limited partner for the loss of the distribution, rendering it unable to prove damages. (The court also rejected the limited partner’s cross-motion for summary judgment on this claim, deeming it the equivalent of a motion to reconsider.) On the third claim relating to the appraisal of the partnership’s assets, the court as it had in the two prior proceedings found the record inadequate to support
summary judgment on the question of the valuation of the assets individually or in the aggregate. In addition, the court denied summary judgment on the general partner’s newly advanced argument that because the purchase price exceeded the value of the assets regardless of the method of calculation, the limited partner was without damages, stating it to be a question of fact not law. Finally, the disclosure issue with respect to the appraisal claim was split into the sub-issues of whether the general partner’s presentation of the appraisals conformed to standard techniques and whether such presentation adequately disclosed all material facts, with the court granting summary judgment to the general partner on the first, but not the second.


Plaintiff, a limited partner of a Delaware master limited partnership, brought this proceeding as a class action on behalf of unitholders and derivatively on behalf of the partnership against the general partner and other related entities of the partnership and certain directors of the partnership and the general partner alleging breach of the directors’ fiduciary duties and failure to disclose material information in connection with the solicitation of limited partners’ votes on the general partner’s proposals to exchange certain of its distribution rights for limited partnership units and to amend the partnership agreement. Defendants moved to dismiss the fiduciary duty claims against some of the directors for failure to sufficiently plead facts as to their involvement in allegedly unfair transactions and to dismiss all of the disclosure claims.

While the immediate issue involved the general partner’s acquisition of additional limited partnership units and amendments to the partnership agreement, among them an amendment to reduce the vote required for approval of conflict transactions from 66 2/3% of outstanding units to a majority, plaintiff’s claims cited certain affiliate transactions (including a joint venture and a sale) that had been consummated in the months prior to the solicitation of the limited partner vote. In the original complaint, plaintiff alleged that fiduciary duties were breached by the partnership’s entry into grossly unfair transactions and that the disclosures in the proxy materials in connection with the limited partner vote on the amendments to the partnership agreement were insufficient and misleading. Subsequent to the filing of the original complaint, the partnership made supplemental disclosures in public filings. For its part, the general partner filed a letter from its president and CEO, Jerry Thompson, to the unitholders of the partnership, outlining the benefits of the proposals and encouraging their approval and directing the unitholders to the previous proxy materials, together with a letter from Dan Duncan to Mr. Thompson, which Mr. Thompson described in his letter as representing Mr. Duncan’s view of the proposals, as additional proxy materials. Mr. Duncan, in addition to being a director of the partnership and of the general partner, was a director of the general partner of a company with which the partnership had entered into a joint venture arrangement and to which the partnership sold its interest in a processing plant, as well as being the chairman of the company that provided management, administrative and operating services for the partnership and the general partner and for the company involved in the joint venture and sale transactions. Mr. Duncan also owned limited partnership units of the partnership, indirectly acquired the controlling interest in
the general partner and owned limited partnership units of the company involved in the joint venture and sale transactions. At a meeting following the supplemental disclosures, the owners of at least 66 2/3% of the outstanding units of the partnership approved the proposals. Plaintiff then amended the complaint to modify the disclosure claims given the additional filings, resting such claims on the information provided about the joint venture and sale transactions and on Mr. Duncan’s letter as a one-sided portrayal of the general partner’s proposals, and defendants moved to dismiss as described above.

The court denied the motion to dismiss the fiduciary duty claims, finding that the allegations in the complaint referring collectively to the directors of the general partner as responsible for approving certain affiliate transactions were adequate pleadings that put the directors on notice of the claims against them. The motion to dismiss the disclosure claims, however, was granted as to all defendants. As to such claims, the court noted that the violation must be material and that under Delaware law this standard requires that there exists a “substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable stockholder as having significantly altered the ‘total mix’ of information made available.” (quoting Loudon v. Archer-Daniels-Midland Co., 700 A.2d 135, 143 (Del. 1997)). Plaintiff had not claimed that materially false statements were made but rather alleged that there were actionable omissions and misleading partial disclosures. Plaintiff had attempted to connect the joint venture and sale transactions to the proposals based on the fact that an effect of the passage of the proposals would be that similar affiliate transactions would be easier to approve. The court determined that the proxy materials neither contained inadequate detail nor did they present a misleadingly good view of these prior transactions. Further, as to the information disclosed with respect to the proposals, the court declined to view Mr. Duncan’s letter in isolation, as plaintiff had urged, and found that the material facts cited by plaintiff as being absent from the letter were part of the “total mix” of information available to unitholders before their vote, either in the original proxy statement or the supplemental materials. In reaching this decision, the court considered the content of the letters from Messrs. Duncan and Thompson, including the specific direction to review the proxy materials in the latter, and concluded that a reasonable unitholder would not have relied on the Duncan letter alone. As to the remaining allegation that the letter should have disclosed an intention to transfer the partnership’s assets to affiliates, the court stated that the record did not support such an intention and that the disclosures sought by plaintiff would have been tantamount to Mr. Duncan implicating himself in future breaches of fiduciary duty.


This case involved breach of fiduciary duty claims against the managing owner (the “Managing Owner”) of a Delaware statutory trust (the “Trust”) and against Cargill Investor Services, Inc. (“CIS”), which was the parent of the Managing Owner, and Cargill, Inc. (“Cargill” and, together with CIS, the “Cargill Plaintiffs”), which was the parent of CIS. The claims arose from Cargill’s sale of, among other things, control of the Managing Owner to Refco Group Ltd., LLC, a wholly owned subsidiary of Refco, Inc. (collectively, “Refco”). As a result of the Refco transaction, certain accounts of the Trust
were transferred to Refco and its affiliates. Soon after the Refco transaction, Refco became embroiled in a financial scandal that resulted in the bankruptcy of Refco and certain of its affiliates and consequently the loss of approximately $35 million of the Trust’s assets.

The Cargill Plaintiffs filed a declaratory judgment action in the Court of Chancery seeking, among other things, a declaration that the Cargill Plaintiffs did not owe any fiduciary duties to the Trust and a declaration that the Cargill Plaintiffs did not breach any fiduciary obligation to the Trust. JWH Special Circumstance LLC (“JWH”) acted on behalf of the Trust in answering the complaint and asserting counterclaims against the Cargill Plaintiffs alleging, among other things, breaches of fiduciary duties owed to the Trust and aiding and abetting breaches of fiduciary duties by the Managing Owner. This opinion addressed the Cargill Plaintiffs’ motion for judgment on the pleadings and motion to dismiss JWH’s counterclaims.

JWH argued that the Cargill Plaintiffs breached fiduciary duties to the Trust and aided and abetted the Managing Owner’s breach when they sold control of the Managing Owner to Refco without obtaining the consent of the unitholders of the Trust. Although the Trust Agreement contained an anti-assignment provision that applied to the Managing Owner, it did not contain a change of control provision that was broad enough to be triggered upon the sale of the equity of the Managing Owner. JWH alleged that the sale of the equity of the Managing Owner, in lieu of an assignment by the Managing Owner of its rights under the Trust Agreement to Refco, circumvented the requirement for unitholder approval under the Trust Agreement and that this circumvention constituted a breach of fiduciary duty. The court found that the sale of control of the Managing Owner did not breach the provisions of the Trust Agreement and that, in any event, neither of the Cargill Plaintiffs were a party to the Trust Agreement and therefore could not have breached the Trust Agreement. The court thus found no basis for JWH’s fiduciary duty claims and dismissed JWH’s “circumvention” allegation for failure to state a claim.

The court next addressed JWH’s claims that the Cargill Plaintiffs breached their fiduciary duties as the parent and grandparent of the Trust, citing to the line of cases in the partnership context beginning with In re USACafes, L.P., Litigation. Under this line of cases, if a corporate parent of a fiduciary exercises dominion and control over the fiduciary in connection with a transaction that benefits the corporate parent at the expense of the underlying entity, the corporate parent may owe fiduciary duties directly to the underlying entity in connection with the transaction. JWH argued that under this line of cases, the Cargill Plaintiffs at least owed a duty of loyalty to the Trust because they caused the Managing Owner to consent to take actions in furtherance of Refco transaction for the benefit of the Cargill Plaintiffs at the expense of the Trust. The Cargill Plaintiffs argued that the USACafes line of cases is not applicable in the statutory trust context because, according to the Cargill Plaintiffs, the DTA preempts the application of common law fiduciary duties to statutory trusts and thus unless a trust agreement explicitly provides a corporate parent with fiduciary duties, it does not owe any fiduciary duties to the statutory trust. The court rejected this argument, holding that common law fiduciary duties apply to statutory trusts except (i) to the extent a trust’s governing instrument provides otherwise and (ii) to the extent provided in the DTA.
The court then addressed whether the Trust Agreement or the DTA modified the common law fiduciary duties that would otherwise be owed by Cargill Plaintiffs to the Trust. The court stated that, like a corporate fiduciary, a fiduciary of a trust does owe a duty of care and a duty of loyalty under the common law. However, by virtue of Section 3809 of the DTA, which provides that, except to the extent otherwise provided in the governing instrument of a statutory trust or in the DTA, Delaware law pertaining to common law trusts applies to statutory trusts, the court stated that fiduciaries of statutory trusts are subject to the more rigorous standards associated with the common law duty of care and the duty of loyalty under trust law. After reviewing the provisions of the Trust Agreement, the court concluded that the Trust Agreement did not eliminate the common law fiduciary duties that the Cargill Plaintiffs may have owed to the Trust.

The court also examined whether the DTA itself preempts any common law fiduciary duties the Cargill Plaintiffs would otherwise have owed to the Trust. In support of their contention that they owed no fiduciary duties to the Trust, the Cargill Plaintiffs pointed to Section 3806(a) of the DTA for the proposition that an entity’s exercise of power over the trust’s manager does not cause such person to become subject to the fiduciary duties of a trustee. The third sentence of Section 3806(a) states, “Except to the extent otherwise provided in the governing instrument of a statutory trust, neither the power to give direction to a trustee or other persons nor the exercise thereof by any person (including a beneficial owner) shall cause such person to be a trustee.” The court acknowledged that an entity’s exercise of power over a trust’s managing owner, in and of itself, does not subject that entity to the fiduciary duties of a trustee but held that this does not mean that Section 3806 of the DTA precludes a claim against a parent entity under the USACafes line of cases. The court rejected the Cargill Plaintiffs’ interpretation of Section 3806(a) and found that the applicable language contained in the fourth sentence of Section 3806(a), which provides that “[t]o the extent provided in the governing instrument of a statutory trust, neither the power to give direction to a trustee or other persons nor the exercise thereof by any person (including a beneficial owner) shall cause such person to have duties (including fiduciary duties) or liabilities relating thereto to the statutory trust or to a beneficial owner thereof,” requires that a provision be included in a trust instrument to override any fiduciary duties that those who have control over the managing owner might otherwise have under the trust law.

Having concluded that neither the Trust Agreement nor the DTA preempted the common law fiduciary duties owed by the Cargill Plaintiffs to the Trust, the court then considered whether the Cargill Plaintiffs in fact owed a duty to the Trust under the USACafes line of cases. The court noted that the USACafes line of cases arise from the law of trusts and found that the reasoning in these cases is applicable in the statutory trust context. Applying the law from these cases, the court stated that for JWH to defeat the pending motions it must have alleged specific facts that lead to a reasonable inference that the Cargill Plaintiffs exercised control over the Trust or its assets in connection with the Refco transaction to benefit themselves at the expense of the Trust. The court found that the facts alleged by JWH were sufficient to support such an inference and therefore denied the Cargill Plaintiffs’ motions to dismiss the breach of fiduciary duty claims.
The court then turned to JWH’s claims for aiding and abetting the Managing Owner’s breach of fiduciary duty. To successfully prove an aiding and abetting claim, the court stated that JWH would have to have shown (i) the existence of a fiduciary relationship; (ii) the fiduciary breached its duty; (iii) a defendant, who is not a fiduciary, knowingly participated in a breach; and (iv) damages to the plaintiff resulted from the concerted action of the fiduciary and the nonfiduciary. The court found that the Managing Owner was a fiduciary of the Trust and that JWH’s allegations were sufficient to allege breaches of the Managing Owner’s fiduciary duties of care and loyalty based on the Managing Owner’s conduct in connection with Refco transaction. The court also found that JWH sufficiently alleged that the Cargill Plaintiffs knowingly participated in the breach and that damages resulted from the actions of the Cargill Plaintiffs and the Managing Owner. The motion to dismiss the aiding and abetting claims were thus denied.


Plaintiff was one of three founding partners of an investment management firm and hedge fund known as Viking Global (“Viking”). Viking was initially comprised of three Delaware entities, each of which was governed by a written operating agreement. At plaintiff’s insistence, a fourth Delaware entity was formed a few months later called Viking Global Founders LLC (“Founders”). No short-form LLC agreement was ever drafted for Founders. A long-form LLC agreement was drafted but never signed. This unsigned LLC agreement was drafted primarily by plaintiff and included a multi-year earnout provision not found in any of the other operating agreements. According to its terms, any of the three founders who voluntarily or involuntarily retired from Viking would be entitled to a percentage of Founder’s income over the six years following his retirement. This provision diverged significantly from the withdrawal provisions in each of the other operating agreements, which provided that a departing member was entitled only to the balance of his capital account and accrued compensation upon leaving the firm.

Plaintiff was subsequently removed from his position at Viking and paid over $100 million, which amount represented his capital account balance and accrued compensation as called for under the terms of each of the written operating agreements. Plaintiff brought suit seeking, among other things, enforcement of the earnout provision in the unsigned Founders LLC agreement. Defendants disputed plaintiff’s claim, arguing that they had never reached an agreement on the terms of the unsigned Founders LLC agreement. Both parties moved for summary judgment.

The primary issue before the court, and a matter of first impression in Delaware, was whether the statute of frauds applied to LLC operating agreements under Delaware law. In considering the issue, the court acknowledged that the Delaware LLC Act expressly allowed oral LLC agreements but noted that it did specify whether the statute of frauds applied to such agreements. The court noted that there was a disagreement among commentators as to whether the statute of frauds applied to the operating agreements of Delaware LLCs. Some commentators reasoned that without an express, specific indication of intent to overrule a statutorily enacted principle of contract law, the
principle should apply. Others argued that the stated policy of the LLC Act to give
maximum effect to the enforceability of LLC agreements, along with the express
authorization of oral operating agreements, created an inference that the legislature
intended to override the statute of frauds. The court ultimately concluded that the policy
for the enactment of the statute of frauds—to protect defendants against unfounded or
fraudulent claims that would require performance over an extended period of time—
called for the application of the statute of frauds to LLC agreements if an LLC agreement
contains a provision or multiple provisions that could not possibly be performed within
one year, with the result that such provision or provisions would be unenforceable.
However, the court went on to state that in keeping with the legislature’s expressed intent
to give maximum effect to the enforceability of limited liability companies, provisions of
an oral LLC operating agreement that could possibly be performed within one year would
not fall within the statute of frauds and would remain enforceable. The court also
asserted that few oral LLC agreements were likely to contain any term or provision that
could not possibly be performed within one year and, to that extent, the statute of frauds
would not limit the enforcement of such agreements.

Having determined that the statute of frauds applied to LLC agreements, the court went
on to conclude that the earnout provisions at issue in the unsigned Founders LLC were
subject to the statute of frauds because none of them could possibly be performed within
one year. In reaching this conclusion, the court rejected plaintiff’s argument that the
statute of frauds did not apply because the only thing that remained to be done after one
year was the payment of money. The court held that it was undisputed that, in addition to
the payment of money, the unsigned Founders LLC agreement imposed substantive
obligations and restrictions on the remaining members that would affect how they chose
to run the business over a multi-year period. The court also held that the “multiple
writings” and “part performance” exceptions argued by plaintiff did not apply to the facts
of the case to remove the unsigned Founders LLC agreement from the statute of frauds.
Thus, the court granted summary judgment as to plaintiff’s breach of contract claim.

In a subsequent decision in this case, plaintiff sought fair value for his interests in various
Delaware entities. Based on Section 17-604 of DRULPA and Section 18-604 of the LLC
Act, the court held that where a valid and enforceable agreement of the parties conflicts
with the applicable fair value statute, the agreement of the parties will govern. Thus,
plaintiff was not entitled to fair value for his interests in the Viking entities because the
parties had previously reached an oral agreement that conflicted with the fair value
statutes by providing that a member would only take his accrued compensation and
capital account balance upon leaving Viking. While this agreement was refined by
subsequent written agreements for three of the four Viking entities, all of which were
consistent with this limitation, the court found that it continued to apply to Founders as
the original agreement governing its operation and constituted an enforceable oral limited
liability company agreement because it was possible that it could be completed in the
span of one year. Additionally, the court held that plaintiff failed to prove the existence
of any superseding agreement that conflicted with the parties’ oral agreement and,
therefore, the plaintiff was entitled to the balance of his capital account and accrued
compensation but nothing further.
As an alternative to his fair value claim, plaintiff sought damages based on theories of promissory estoppel, civil conspiracy, unjust enrichment and breach of fiduciary duty. However, the court held that plaintiff failed to prove any of the required elements of his estoppel claims and entered judgment in favor of defendants. With respect to plaintiff’s other claims, the court held that they similarly failed because plaintiff failed to show deprivation of value to which he was entitled. According to the court, the operating agreements of the Viking entities uniformly provided that a departing member or partner would receive only his accrued compensation and capital account upon departure and, therefore, plaintiff, having already received such amounts, was entitled to no more.


Petitioner, a member and the former CEO of a Delaware LLC filed a petition seeking judicial dissolution of the LLC, alleging that since his removal as CEO the LLC had not had a business plan and had not made any investments, sought or received any additional capital, held any director or member meeting or sought to hire anyone to conduct the business of the LLC. The LLC’s operating agreement provided that, subject to certain exceptions, the “[LLC] will be governed in all respects as if it were a corporation organized under and governed by the Delaware General Corporation Law . . . and the rights of its Stockholders will be governed by the DGCL.” Petitioner thus sought judicial dissolution of the LLC under both Section 18-802 of the LLC Act and Section 226(a)(3) of the Delaware General Corporation Law (the “DGCL”). In this opinion, the Court of Chancery addressed the LLC’s motion for judgment on the pleadings.

Under Section 18-802 of the LLC Act, the Court of Chancery may decree dissolution “whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement.” Based on the lack of extensive case law interpreting Section 18-802 of the LLC Act, the court looked to case law involving judicial dissolution of limited partnerships and observed that judicial dissolution has been ordered where there was a “deadlock” that prevented a company from operating and where the defined purpose of the company was fulfilled or impossible to carry out. The court stated that since there is no allegation of a deadlock, the inquiry must focus on whether it is impracticable for the LLC to fulfill its business purpose. To determine whether it was reasonably practicable to carry on the business of the LLC, the court looked to the purpose clause set forth in the governing document of the LLC, which provided that the LLC could “engage in any lawful act or activity for which corporations may be organized under the [DGCL].” Because petitioner alleged that the LLC was functioning as a passive instrumentality, which is a function that is both lawful and common for an LLC, the court found that petitioner had not alleged sufficient facts to support a claim that it is not reasonably practicable for the LLC to carry on business in conformity with its operating agreement. The court stated that it will not attempt to divine some other business purpose by interpreting provisions of the LLC’s governing documents other than the purpose clause. In addition, the court rejected petitioner’s further argument that the court should order judicial dissolution of the LLC because the LLC had allegedly failed to comply with the certain provisions of its operating agreement, including, for example, failing to make required cash distributions. The court stated that violations of an operating agreement are not necessarily grounds to order
dissolution. The court also noted that the LLC had filed several counterclaims, including claims for conversion and unjust enrichment, against petitioner, and under Delaware case law, a non-deadlocked LLC pursuing claims is a legitimate business activity that can defeat a petition for dissolution.

Because the LLC had elected to be governed by the DGCL, the court also analyzed whether dissolution could be warranted under Section 226(a)(3) of the DGCL. Under Section 226(a)(3) of the DGCL, the Court of Chancery has the power to appoint a custodian or receiver for a corporation when the “corporation has abandoned its business and has failed within a reasonable time to take steps to dissolve, liquidate or distribute assets.” The court again looked to the LLC’s purpose clause and observed that a corporation can lawfully function as a passive holding company. Citing prior case law, the court stated that “waiting to see if an opportunity presents itself to realize a return on its investment” is “a rational, lawful use of the corporate form.”

Finally, the court addressed petitioner’s claim that the LLC cannot take any action other than liquidation because a provision of its operating agreement provides that “[d]istributions of available cash for any Fiscal Year shall be made to the Stockholders in accordance with the number of Common Shares held by each.” The court acknowledged that a court should not decide between reasonable interpretations of a contract provision on a motion for judgment on the pleadings; however, the court found petitioner’s interpretation of the foregoing provision was not reasonable and thus dismissed the petition for judicial dissolution.


Plaintiff, a Delaware LLC, sued Vredezich’s Gravenhage 109 B.V. (“VG 109”), a Dutch private limited liability company, and its parent, NIBC Bank N.V. (“NIBC”), also a Dutch entity, for breach of VG 109’s obligation under the LLC Agreement to reimburse the LLC for payments relating to withholding tax the LLC made on VG 109’s behalf. In this decision, the Chancery Court addressed NIBC’s motion to dismiss for lack of personal jurisdiction over NIBC.

The LLC was formed in a restructuring transaction in which a lending group, which included NIBC, swapped its debt in an entity for equity in the LLC. NIBC designated VG 109 as the entity to acquire its portion of the equity in the LLC. VG 109 was a wholly owned subsidiary of NIBC, with the same business address as NIBC, with no employees or officers of its own, and without letterhead or envelopes of its own. NIBC was the managing director of VG 109 and NIBC’s employees signed documents on behalf of VG 109. VG 109 signed the original LLC Agreement of the LLC as a member. The LLC Agreement identified NIBC as a “Designating Lender” affiliated with VG 109 but NIBC did not sign the LLC Agreement and was not a member of the LLC.

The LLC first argued that NIBC was subject to the Chancery Court’s jurisdiction directly, via Delaware’s long arm statute, arguing that by participating in the formation of the LLC, it had thereby transacted business or performed work within Delaware. Plaintiff
cited to case law providing that the incorporation and operation of a Delaware subsidiary constitutes the transaction of business in Delaware. The court rejected this argument as too attenuated, especially because the LLC had failed to demonstrate that it was a subsidiary of either defendant. In fact, VG 109 held only a minority interest in the LLC and did not control the LLC. In addition, the court found the act of formation of the LLC was not fundamental to the underlying dispute.

The LLC also argued that NIBC had consented to jurisdiction in Delaware pursuant to a clause in the LLC Agreement under which the parties to the LLC Agreement consented to the personal jurisdiction of the Delaware courts. While agreeing that parties may consent to personal jurisdiction via contract, the court rejected this argument because NIBC was not a signatory to the agreements.

Finally, the LLC claimed that the court had personal jurisdiction over NIBC indirectly through VG 109, which had consented to personal jurisdiction in Delaware, under the agency theory and the alter ego theory. The court refused to impute the contractual consent to jurisdiction by VG 109 to NIBC, stating that because the LLC Agreement was negotiated by sophisticated parties and included a consent to jurisdiction by the parties, but not their affiliates, the court would not accept the LLC’s attempt to circumvent the parties’ intention under the guise of an agency argument. The court also stated that a minority, passive investor in a Delaware LLC who allegedly breaches the LLC agreement in a manner that affects only the LLC and its members is not subject to Delaware’s long-arm statute for the alleged breach without a showing that the investor in the LLC took additional action from which the asserted cause of action arose to consciously take advantage of the laws of Delaware. On this basis, the court held that, even if all of the actions of VG 109 in this case were imputed to NIBC, those actions still would not provide a sufficient basis for subjecting NIBC to personal jurisdiction in Delaware. The court thus granted NIBC’s motion to dismiss for lack of personal jurisdiction.

In reaching its decision in this case the court commented that “VG 109’s execution of the Amended LLC Agreement, as a fundamental governance document, conceivably could supply a basis for personal jurisdiction in this Court.” The court stated that the execution and alleged breach of an LLC agreement presents interesting jurisdiction questions, since the LLC agreement itself is a “jurisdictional hybrid.” It is similar to a certificate of incorporation, in that it is a foundational document controlling the entity’s governance, thereby relating to the very nature of the entity, so that manipulation of the governance provisions could be a basis for jurisdiction. On the other hand, the LLC Act and the Delaware courts have emphasized that when dealing with LLC agreements, freedom of contract is paramount, which draws the conclusion that such agreements “also may contain provisions that do not implicate the fundamental attributes and workings of a Delaware entity.” However, because the provision in the LLC Agreement on which this cause of action was based was a collateral provision that did not significantly affect plaintiff’s operation under Delaware law, the court did not find it necessary to delve further into this issue.
Plaintiffs sought judicial dissolution under Section 18-802 of the LLC Act or in the alternative the winding up under Section 18-803 of the LLC Act or the appointment of a receiver under Section 18-805 of the LLC Act of nine Delaware LLCs. The Delaware LLCs were managed by an individual manager who was not made a party to the lawsuit. The respondent LLCs moved to dismiss the petition and made two arguments in support of their motion. First, in support of their motion to dismiss with respect to two of the nine LLCs (the “Pandora Entities”), respondents argued that petitioners lacked standing to seek the dissolution or winding up of the LLCs under Sections 18-802 or 18-803 of the LLC Act because both sections by their terms only permit members and managers to act and petitioners were neither members nor managers of the Pandora Entities and therefore lacked standing. The court agreed and dismissed petitioners’ claims under Section 18-802 and 18-803 of the LLC Act. Petitioners also sought the appointment of a receiver for the Pandora Entities under Section 18-805 of the LLC Act, which provides that any “creditor, member or manager of the limited liability company, or any other person who shows good cause” may seek the appointment of a receiver. The court found that respondents did not challenge petitioners’ ability to seek relief under Section 18-805 of the LLC Act and therefore denied the motion with respect to Section 18-805 of the LLC Act.

Petitioners were members of the other seven Delaware LLCs (the “Waiver Entities”) and therefore there was no question that they had standing to seek relief under Sections 18-802, 18-803 and 18-805 of the LLC Act. Respondents argued that pursuant to the applicable LLC agreement of each of the Waiver Entities (the “LLC Agreements”), petitioners waived their right to seek dissolution or appointment of a liquidator. Petitioners conceded that the contractual language in the applicable LLC agreements purported to effect a waiver of such rights but nevertheless argued that the waiver was invalid as a matter of law. The court, however, rejected this argument and granted respondents’ motion with respect to the Waiver Entities. The court began its analysis by observing that the policy behind the LLC Act is to provide the parties involved with the maximum amount of freedom of contract, private ordering and flexibility. The court noted that petitioners obviously availed themselves of this flexibility to tailor the respective LLC Agreements in such a way as to meet each LLC’s needs including by providing for a waiver of members’ rights to seek dissolution or the appointment of a liquidator. In support of their argument that the waiver provisions contained in each of the LLC Agreements were unenforceable as a matter of law, petitioners first argued that Section 18-109(d) of the LLC Act stood for the proposition that “non-managing members may not waive their rights to maintain legal actions in Delaware courts absent an agreement to arbitrate.” Thus, because petitioners were non-managing members and had not agreed to arbitrate, the waiver provision violated the statute and was therefore void. The court rejected this argument, finding that Section 18-109(d) was essentially a venue provision. The court went on to state that if the statute were interpreted in the manner asserted by petitioners, the LLC Act would conflict with itself and the rules of statutory construction would caution against such a conclusion.
Petitioners’ second argument was that certain provisions of the LLC Act, including those governing judicial dissolution or the appointment of a receiver were mandatory and non-waivable. In support of this proposition, petitioners argued that any “statutory provisions that did not contain the qualification ‘unless otherwise provided in a limited liability company agreement (or a variation thereof)’ are mandatory and may not be waived.” In rejecting this broad rule offered by petitioners, the court noted that in general the mandatory provisions of the LLC Act are those that are intended to protect third parties, not the contracting members. Additionally, the use of the word “may” indicates the “voluntary, not mandatory or exclusive, set of options.” Thus, the court found that sections 18-802, 18-803 and 18-805 of the LLC Act were not mandatory for three reasons. First, the LLC Act does not expressly say that these provisions cannot be modified by agreement. Second, the provisions employ permissive rather than mandatory language in that each provision uses the auxiliary verb “may” to indicate the options of the court under the subject provisions. Third, and the court stated most importantly, none of the rights conferred by the applicable statutory provisions were designed to protect third parties.

Petitioners also argued that the waiver of a member’s right to seek dissolution or the appointment of a receiver violated the public policy of Delaware and offended notions of equity. The court also rejected this argument for three reasons. First, the court reasoned that the LLC Act was based on the policy of freedom of contract and allowing the members of an LLC to order their affairs contractually as they deemed appropriate. Further, Delaware as a freedom of contract state has a policy of enforcing the voluntary agreement of sophisticated parties, such as those party to the LLC Agreements. Thus, because the LLC Agreements were among sophisticated parties, the court concluded that the state’s policy “mandates that [the] Court respect and enforce the parties’ agreement.” Second, the court reasoned that there are legitimate business reasons why members of an LLC would want to include a provision whereby members prospectively waive their right to seek dissolution or the appointment of a receiver in its LLC agreement. For example, a lender under a loan agreement may require an LLC prospectively to agree to waive their rights to judicial dissolution to protect the LLC, otherwise a disgruntled member could push the LLC into default on all of its outstanding loans simply by filing a petition with the court. Third, the court found petitioners’ plea to the court’s sense of equity misplaced, finding that the LLC Act did not leave petitioners without any recourse. The court emphasized that the LLC Act prohibits parties from waiving the implied covenant of good faith and fair dealing and it is the protection of the “implied covenant that allows the vast majority of the remainder of the LLC Act to be so flexible.”


Plaintiff, a Delaware LLC, filed suit against defendants for breach of fiduciary duty, equitable and legal fraud, and breach of plaintiff’s LLC agreement. The lawsuit was based upon actions by defendant James Chen (“Chen”), who was ousted from the management team and his positions as CEO and president of plaintiff when the other members discovered that he had formed a competitive entity that was pursuing business opportunities that otherwise would have been available to plaintiff. Although Chen
objected to the calling of the meeting and did not attend, a quorum was present and a unanimous vote taken in favor of a resolution removing Chen from these positions. In connection with the lawsuit, plaintiff allegedly discovered that Chen had made modifications to its draft operating agreement after circulating the draft to the other members, which went unnoticed when the members later signed the agreement into effect, as modified. These changes, in part, gave Chen as CEO the power unilaterally to appoint and approve personnel to plaintiff’s or any joint venture’s board of directors or management team.

This opinion arose out of a motion filed by plaintiff for a preliminary injunction against Chen when it was discovered that he was asserting plaintiff’s rights in China to appoint designees to the board of a joint venture established between plaintiff and another company. Chen was apparently using a “Certificate of Appointment,” which identified him as the legal representative and CEO of plaintiff, to authorize these actions. Plaintiff’s asserted justifications for a preliminary injunction to halt these activities were that Chen had no authority to represent the plaintiff, his conduct was antithetical to the plaintiff’s interests, and he was duly and properly removed from any office within the plaintiff thereby making unauthorized his current efforts, which justifications were supported by the allegedly fraudulently inserted terms in the operating agreement. Defendants responded that the efforts to remove Chen from office failed primarily because the operating agreement required a unanimous vote of the board of directors for any “major decisions,” which was rendered impossible by Chen’s absence from the meeting.

Although plaintiffs sought a preliminary injunction, the court found that the relief sought more closely resembled that recoverable under Section 18-110 of the LLC Act, the companion section to Section 225 of the DGCL. Under that section, a venture may continue to operate according to the “status quo,” with minimal disruption, while the identity of those individuals who are appropriate holders of corporate power are established. The court noted that the traditional analysis under those sections does not typically apply the formalistic test for a preliminary injunction; however, because plaintiff had presented its claim under this framework, the court in this case adhered to the preliminary injunction standards.

First, the court found that plaintiff had demonstrated a reasonable probability of success on the merits of its claim that Chen should not be acting on plaintiff’s behalf because his recent actions in China were inconsistent with the reasonable expectations of the other members of plaintiff. Next, the court found the record to show that Chen’s conduct without plaintiff’s authority was likely to cause significant and irreparable harm to plaintiff. Finally, the court agreed with plaintiff that when the harms were balanced, the risks to plaintiff were obvious and material, whereas the potential harm to Chen was minimal. For these reasons, the court granted a status quo order to plaintiff prohibiting Chen and the other defendants, pending final resolution of the merits, from taking any action on behalf of the plaintiff and from holding themselves out, individually or collectively, as representatives of plaintiff with any power to act on its behalf.
Plaintiff appealed the Court of Chancery’s decision to dismiss her derivative action on behalf of Municipal Mortgage & Equity, LLC (the “LLC”). The LLC was managed by a ten-member Board of Directors (the “Board”), of which eight were independent and two were inside directors. Plaintiff claimed the members of the Board, and one former member, breached their fiduciary duties by (a) improperly valuing certain assets which allegedly resulted in false financial statements, (b) making improper charitable contributions to conceal the deterioration of the LLC’s bond portfolio, (c) engaging in related-party transactions to inflate the LLC’s financial performance and (d) “fail[ing] properly to institute, administer and maintain adequate accounting and reporting controls, practices and procedures . . . .” The Court of Chancery had dismissed the complaint for failure to allege particularized facts sufficient to establish that demand on the Board would have been futile in accordance with Court of Chancery Rule 23.1.

Applying Delaware corporate law principles, by analogy, the Delaware Supreme Court highlighted that a stockholder may not pursue a derivative suit against a corporation unless the stockholder: (a) has first demanded that the directors pursue the corporate claim and the directors have wrongfully refused to do so; or (b) establishes that pre-suit demand is excused because the directors are deemed incapable of making an impartial decision regarding the pursuit of the litigation. In this instance, plaintiff sought to establish demand futility. Accordingly, to satisfy demand futility under Court of Chancery Rule 23.1, plaintiff had to satisfy either the Aronson test for those claims contesting a transaction that allegedly arose out of a conscious business decision in breach of the directors’ fiduciary duties, or the Rales test for those claims that the Board violated its oversight duties. Under Aronson, a plaintiff must allege particularized facts creating a reason to doubt that (1) the directors were disinterested or independent or that (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. Under Rales, a plaintiff must allege particularized facts establishing a reason to doubt that “the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand.”

The gravamen of plaintiff’s complaint alleged that the Board could not exercise valid business judgment because of a substantial risk of personal liability. The court noted that the operating agreement of the LLC included a provision that exempted directors from liability “except in the case of fraudulent or illegal conduct . . . .” The court also cited Section 18-1101(e) of the LLC Act which permits an LLC to “provide for the limitation or elimination of any and all liabilities . . . for breach of duties (including fiduciary duties) of a [director],” except that an LLC “may not eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.” The court stated that where directors are contractually or otherwise exculpated from liability, and a plaintiff alleges demand futility based on risk of personal liability to the directors, then a plaintiff must plead a non-exculpated claim based on particularized facts. Because the members of the Board were exculpated except for “fraudulent,” “illegal” or “bad faith” conduct, the court also required plaintiff to plead that the members had “knowingly” engaged in “fraudulent” or “illegal” conduct or a “bad faith” breach of the covenant of good faith and fair dealing. The court observed that
plaintiff failed to plead sufficiently that the Board had knowledge and plaintiff’s allegations that the Board made affirmative misrepresentations in the financial statements of the LLC were also not sufficient. The Board’s execution of financial reports, without more, was insufficient to create an inference of actual or constructive notice of any illegality. The court also rejected plaintiff’s assertion that Board approval of a transaction or membership on a company’s audit committee was sufficient to infer culpable knowledge or bad faith. Accordingly, the court affirmed the Court of Chancery’s decision that the Board’s approval of the financial reports, without more, was insufficient to create an inference either that (i) each member of the Board knew that the alleged transactions were improper or that (ii) the Board consciously and in bad faith failed to discharge fiduciary contractual responsibilities with respect to those transactions.

Plaintiff also claimed the Board knowingly ignored “red flags.” Under Delaware law, the court stated, red flags “are only useful when they are either waved in one’s face or displayed so that they are visible to the careful observers.” In this case, there were no cognizable “red flags” to infer that the Board knew certain accounting requirements were being improperly applied.

Finally, the court also held that the complaint did not purport to allege a “bad faith violation of the implied contractual covenant of good faith and fair dealing.” In this regard, the court stated that such covenant applies to protect stockholders’ expectations that the company and its board will properly perform contractual obligations under the organizational documents, including the operating agreement. Here, the complaint did not allege any contractual claims let alone a bad faith breach of the implied covenant.


Plaintiffs, who were investors in a Delaware limited liability company operating as a private hedge fund (the “Company”), filed a class action against the Company and its management claiming breaches of fiduciary duty for failing to adequately disclose material information necessary for investors to adequately assess their options under a tender offer by the Company to repurchase interests in the Company. The tender offer followed a significant infusion of capital into the Company by an affiliated entity, which became necessary due to a severe decrease in the value of the Company’s assets. The tender offer offered the investors monetary and other financial consideration for their interests but required the tendering investors to release defendants from all legal claims directly or indirectly arising from the operation, management, supervision and investment of the Company’s assets. This decision addressed plaintiffs’ motion to expedite the proceedings based on allegations that the exchange memorandum delivered in connection with the tender offer contained material omissions.

Plaintiffs claimed that the exchange memorandum failed, among other things, to disclose the manner in which the equity in the Company received by the affiliated entity in consideration for its capital infusion was valued or to provide information on the nature
of claims investors were being asked to release. Defendants responded with several arguments, none of which the court found convincing. Among defendants’ arguments was an argument that plaintiffs could not demonstrate a colorable claim because the information they sought was not material. The court stated that in order to state a claim for breach by omission of the duty to disclose, a plaintiff must plead facts identifying material, reasonably available information that was omitted from the proxy materials and further stated that omitted information is material if a reasonable stockholder would consider it important in deciding whether to tender his shares or would find that the information has altered the total mix of information available. In this case, the court held that plaintiffs had articulated a colorable claim for breach of the duty of disclosure, finding that how the Company’s assets were valued and the nature of the claims being released, including a description of an SEC investigation, would alter the “total mix of information” and that a reasonable shareholder would consider this information important in deciding whether to accept the tender offer. The court thus granted plaintiffs motion to expedite the proceedings.

Following the grant of the motion to expedite proceedings, the court conducted a preliminary injunction in which it held that the disclosures in the exchange memorandum were insufficient and that the tender offer would be enjoined if not supplemented. Three months later, the parties entered into a memorandum of understanding that included terms of a settlement. As part of the settlement, the Company issued a revised exchange memorandum and tender offer that included significantly more disclosure, increased the monetary consideration for investors and expanded the options offered to investors. In a subsequent opinion, the court, among other things, analyzed the adequacy of the settlement and held it to be fair and reasonable.


Plaintiff, following his removal for cause as a managing partner, chairman of the board and a managing member of a Delaware LLC (the “Company”) sought advancement of legal fees and expenses incurred in a legal proceeding that he initiated to challenge his removal, alleging that there was no “cause.” In ruling on a motion by plaintiff for summary judgment, the Chancery Court addressed the issue of whether the Company’s LLC Agreement provided plaintiff with a right to advancement for an action he brought to contest his removal. The court denied plaintiff’s motion, finding that the relevant provision of the Company’s LLC Agreement provided advancement only for the defense or other defensive disposition of an actual or threatened proceeding and that, because defendants did not threaten or initiate a proceeding against plaintiff, he is not entitled to advancement.

The relevant provision of the Company’s LLC Agreement that plaintiff looked to in support of his claim for advancement provided in part that: “the Company shall indemnify and hold harmless . . . the Covered Persons from and against all liabilities and expenses . . . incurred in connection with the defense or disposition of any claim, action, suit, or proceeding . . . with which the Covered Person may be threatened . . . .” The court determined that the best reading of the advancement provision is that it was meant to apply only in situations in which a suit has been brought against or threatened against a
person entitled to indemnification under the Company’s LLC Agreement. Plaintiff argued that his removal for cause, which was based on an alleged breach of his fiduciary duties to the Company, constituted a threat of a proceeding against him. The court found, however, that defendants, who were clearly aware of the contours of the advancement provision, never actually threatened to bring an action for breach of fiduciary duty against plaintiff or otherwise took actions that could reasonably be interpreted as a threat of a proceeding and that the removal of plaintiff was the only consequence defendants intended to attach to the actions they alleged constituted “cause.” The court thus held that plaintiff was not entitled to advancement because he could not identify a threatened “claim, action, suit or proceeding” and therefore denied his motion for summary judgment. In rendering its decision, the court noted that the LLC Agreement provided an adequate incentive for members and former members to bring meritorious suits to enforce their contractual rights under the LLC Agreement by requiring the losing party in such a suit to pay the fees and costs of the prevailing party.


Plaintiffs, who had withdrawn as limited partners of a hedge fund formed as a Delaware limited partnership, claimed that the non-pro rata in-kind distribution they received from the hedge fund in respect of their withdrawal violated the partnership agreement and Section 17-605 of the LP Act. This decision addressed a motion to dismiss by defendants.

As a preliminary matter, defendants argued that because the hedge fund is not a party to its own partnership agreement and is not alleged to have caused a breach of the partnership agreement, the hedge fund cannot be liable for breach of the partnership agreement. The court held that, because Section 17-606(a) of the LP Act makes it clear that it is the partnership that owes the distribution to the limited partners, the hedge fund is a proper defendant. [Note: The court presumably could have also cited to the definition of “partnership agreement” in Section 17-101(12) of the LP Act, which provides that a limited partnership is bound by its partnership agreement whether or not the limited partnership executes the partnership agreement.]

Section 17-605 of the LP Act provides in relevant part that, except as provided in a partnership agreement, a partner may not be compelled to accept a distribution in kind to the extent that that the percentage of the asset distributed exceeds a percentage of that asset which is equal to the percentage in which the partner shares in distributions from the partnership. The hedge fund’s partnership agreement provided that distributions to withdrawing partners “shall be made in cash or, in the sole discretion of the General Partner, in securities selected by the General Partner or partly in cash and partly in securities selected by the General Partner.” Plaintiffs acknowledged that Section 17-605 can be overridden by a partnership agreement but alleged that the language in the hedge fund’s partnership agreement was not sufficient to do so. Although the partnership agreement did not explicitly permit non-pro rata in-kind distributions, the court held that the broad discretion given to the general partner to determine which, if any, securities to distribute in kind and whether to make a distribution entirely in kind, even if the fund also has cash assets, was sufficient to override the default rule of Section 17-605.
court therefore held that the hedge fund was permitted to make non-pro rata in-kind distributions and dismissed this claim.

The court also addressed the parties’ dispute as to whether the withdrawing partners were entitled to a distribution of the securities specified by the general partner for distribution to the withdrawing partners at the time of withdrawal, even if those securities had declined in value between the time of withdrawal and the time when the securities were actually distributed, or, alternatively, to assets whose aggregated value at the time of distribution equaled the withdrawing partners’ share of the hedge fund as of the time of withdrawal. Under the partnership agreement, the hedge fund was required to make distributions to a withdrawing partner within thirty days of its withdrawal in an amount equal in value to not less than 90% of the estimated amount of the withdrawing partner’s capital account balance as of the withdrawal date. Plaintiffs argued that they are entitled to a distribution in an amount equal to the value of their capital account balance as of the withdrawal date, which becomes a fixed amount as of the withdrawal date. The court held that plaintiffs had at least a colorable claim that the plain language of the partnership agreement supported their argument and, accordingly, denied defendants’ motion to dismiss this claim.

Plaintiffs also claimed the general partner breached its fiduciary duties to the withdrawing partners by taking the actions set forth above. On the basis of the court’s holding that plaintiffs might succeed in proving that defendants’ interpretation of the partnership agreement was incorrect with respect to determining the value of the distribution to which plaintiffs’ were entitled, the court denied defendants’ motion to dismiss this claim. Defendants also argued that the fiduciary duties claims should be dismissed because they were duplicative of the breach of contract claims. The court disagreed, holding that although each of the claims shared a common nucleus of operative facts, the fiduciary duty claims depended on additional facts, were broader in scope, and involved different considerations in terms of a potential remedy.

Finally, plaintiffs demanded an accounting. The court set forth several factors that are typically examined when considering a demand for an accounting, which include whether: (i) the partner was wrongfully excluded from the partnership; (ii) there is a breach of fiduciary duty; and (iii) other circumstances render an accounting just and reasonable. Based on the complexity of the allegations regarding improper distributions and the nature of the wrongs alleged, the court denied defendants’ motion to dismiss plaintiffs’ demand for an accounting.


In an action under Section 18-305 of the Delaware LLC Act for inspection of the books and records of two different limited liability companies, plaintiff filed two motions. Plaintiff’s first motion sought to strike an answer filed by one of the defendant companies (“Vienna”) and disqualify Vienna’s counsel. The second motion was for a commission requesting documents and deposition testimony from the outside auditing firm of the second defendant company.
Plaintiff was one of two members and a fifty percent interest holder of Vienna and, as such, claimed that Vienna was not authorized to file an answer and hire counsel without plaintiff’s consent. Section 7 of Vienna’s LLC agreement provided that the decision of the members holding a majority interest shall be controlling. Section 7 went on to state that the members were “granted all rights, powers, authorities, and authorizations necessary, appropriate, and advisable and/or convenient to manage [Vienna] and to determine and carry out its affairs.” The court held, however, that while this provision may allow for one member to act unilaterally where the other is silent, where the members disagree, the quoted language does not trump the language providing that decisions of the majority are controlling. Recognizing that the dispute between plaintiff and Vienna was essentially a dispute between plaintiff and the other member, the court went on to state that, although plaintiff’s motion to strike the answer and disqualify counsel would be granted, the second member was expressly permitted to intervene as a party defendant with authority to defend on behalf of Vienna.

The court denied plaintiff’s second motion for a commission, citing Chancery Court Rule 26, which restricts discovery to matters relevant to the subject matter involved. The court stated that to grant such a sweeping request would effectively grant plaintiff its final relief—the books and records ultimately at issue. Thus, because there was no showing that the requested commission was for materials relevant to the narrow issue at hand, the motion was denied.


Plaintiffs were Venhill Limited Partnership (“Venhill”), a Delaware limited partnership created to serve as an investment vehicle for the benefit of the families of Howard Hillman (“Howard”) and Tatnall Hillman (“Tatnall”), and two trusts (the “Trusts”) that were limited partners in Venhill. Howard, the principal defendant, served as general partner of Venhill, and Howard, Tatnall and Joe Hill (“Joe”), a cousin, were the three trustees for the Trusts. The litigation related to the substantial investments Howard had caused the Trusts, through Venhill, to make in Auto-trol (“Auto-trol”), a portfolio company owned by Venhill. Howard was effectively on both sides of the Auto-trol transactions because he was CEO and controlled Auto-tel when, as general partner of Venhill, he caused Venhill to make investments in Auto-trol. Although Auto-trol experienced some success following Venhill’s acquisition in 1973, the company only survived due to substantial investments by Venhill. By July of 2005, Howard had caused Venhill to make 186 loans to, and invest $85.4 million in, Auto-trol. As early as 1990, Auto-trol began to exhibit strong signs of failure. Consequently, Howard began to cause Venhill to make loans to Auto-trol at rates and upon terms that would not have been available to Auto-trol in the marketplace. Tatnall and Joe were aware that Howard, in his capacity as general partner of Venhill, was causing Venhill to invest substantial sums of money in Auto-trol and expressed their reservations as early as 1994. In spite of their reservations, Tatnall and Joe continued to allow Howard to invest Venhill funds in Auto-trol. Although Tatnall and Joe, under Venhill’s partnership agreement, had the power to remove Howard, they did not do so and instead limited Howard’s ability unilaterally to cause the Trusts to loan money to Venhill to fund Auto-trol. Nevertheless, although Howard could no longer cause the Trusts to invest in Auto-trol through Venhill, Howard
used his discretion as general partner of Venhill to fund Auto-trol’s operations using Venhill’s remaining capital. Additionally, Howard, acting as CEO for Auto-trol on the one hand and general partner of Venhill on the other, caused Venhill to convert much of the Auto-trol debt held by Venhill into equity. In January 2005, Howard, sensing that he would soon be removed as general partner of Venhill, took a number of actions designed to protect Auto-trol from Venhill’s control and to benefit himself. Howard transferred the shares of Auto-trol owned by Venhill to a newly created LLC of which Venhill was the sole member but that Howard controlled as manager. Additionally, Howard caused Venhill to (i) loan Auto-trol $2 million, (ii) pay his personal lawyers, and (iii) reimburse him for the out-of-pocket costs he incurred related to litigation involving the Trusts. Following his removal, Howard continued to support Auto-trol by attempting to force Venhill to subscribe to a stock offering to prevent severe dilution of its equity interest in Auto-trol.

Plaintiffs brought actions against Howard alleging he breached his fiduciary duties of loyalty and care. Plaintiffs sought, inter alia, damages for all of the losses suffered by Venhill (including the loss of profits that would have been made if funds were invested consistent with Venhill’s other investments), rescission of a promissory note that consolidated all of the debt owed to Venhill into a single note that would not come due until 2020, the cancellation of any security interest in Auto-trol’s real property and attorneys fees incurred by plaintiffs in connection with their action.

The court first discussed the standard of review relating to Howard’s liability for damages to Venhill and the Trusts. Although the court found that the parties agreed the entire fairness standard should apply to the investments in Auto-trol because of their interested character, they disagreed on how that standard should apply. Howard argued that plaintiffs could not challenge the Auto-trol investments because Joe and Tatnall were aware that he was causing Venhill to invest in Auto-trol and they failed to exercise their rights as limited partners in Venhill to remove him as a general partner. In essence Howard argued that plaintiffs acquiesced and ratified his actions. The court was not persuaded and concluded that an equity holder does not have an affirmative duty to exercise its powers of removal if it disagrees with a fiduciary’s actions, and the court concluded that the parties did not acquiesce or ratify any of Howard’s actions. To the contrary, the court found that “nothing [plaintiffs] did gave Howard any reason to believe that they approved his desire to continue funding Auto-trol.” Similarly, the court rejected defendant’s ratification argument because neither Joe nor Tatnall consented to any of the relevant investments.

Additionally, Howard argued that the exculpation provision contained in the Venhill partnership agreement modified the entire fairness standard. Based on the exculpation provision, Howard argued that he would only be liable for damages if it could be shown that he (i) engaged in bad faith acts, (ii) made grossly negligent decisions, or (iii) committed acts of willful and wanton misconduct. On this issue, the court reasoned that the entire fairness standard was at its core an inquiry to determine whether a transaction should be set aside. The court went on to state “[the standard] has only a crude and potentially misleading relationship to the liability any particular fiduciary has for involvement in a self dealing transaction.” In this instance, “the exculpation
provision prevents [plaintiffs] from recovering from Howard unless he acted in bad faith, with gross negligence, or engaged in willful and wanton misconduct.” Thus, an interested transaction could be enjoined if it failed the entire fairness test, but if the transaction were consummated, plaintiffs could only recover damages if Howard acted in the proscribed manner. Interestingly, the court noted that under the applicable standard—a common one in alternative entities—an interested transaction could be substantially unfair and yet not give rise to personal liability. Still, to determine whether Howard would be personally liable, the court found it helpful to analyze the Venhill investments in Auto-trol under the entire fairness standard. The first prong of the entire fairness test required that the court consider the process used to implement the transactions. Finding it impossible “to detail all the ways in which the process fell short of fair” the court highlighted the following points: (i) Howard never conducted a market check; (ii) Howard never engaged or sought the advice of competent professionals; and (iii) Howard did not engage in any analytical process. Thus, the court found the process used by Howard to make investments for Venhill in Auto-trol “grossly deficient.” The second prong of the entire fairness test requires a court to review the substantive fairness of a transaction. In this regard, the court found the transaction substantively unfair for the following reasons: (i) the terms and conditions of the investments were not fair to Venhill and Venhill could have obtained better terms and conditions from other borrowers, (ii) Auto-trol did not have a plan to return the company to solvency, (iii) Howard’s implicit admission that he believed Auto-trol equity was worth only $1 and his unwillingness to pay off any of the substantial debt owed by Auto-trol “demonstrates that [the] transactions were unfair,” and (iv) the imbalance of the Venhill investment portfolio which had over 50% of its assets invested in Auto-trol. Howard argued that the exculpation provision contained in the Venhill partnership agreement protected him from liability because he acted in good faith and subjectively believed that Auto-trol would be a financial success. The court disagreed, however, finding that Howard did not subjectively believe that Auto-trol would be a success as evidenced by his unwillingness to acquire Auto-trol. The court found the case to present a “clear case of fiduciary disloyalty, although Howard’s motives were not financial enrichment they were personal.” In sum, the court found that Howard acted in bad faith and, additionally, that he engaged in willful misconduct and acted in a grossly negligent manner. Thus the court awarded damages to Venhill. In addition, with respect to the debt that was consolidated into a single note in 2003, the court ordered rescission of that note to allow Venhill to collect on debts based on the obligations owed to it by Auto-trol prior to the consolidation. Finally, the court set aside the security interest granted Howard.

With respect to their attorneys fees claim, plaintiffs argued that Howard’s actions were of such an egregious nature that the bad faith exception to the American Rule should apply and Howard should pay their fees. The court reasoned that the bad faith exception to the American Rule could not apply to every case of intentional fiduciary wrongdoing; otherwise the rule would be eviscerated. Instead the bad faith exception to the American Rule should be reserved for “unusually deplorable behavior.” In this case, the court found that the following actions would fall within the bad faith exception: (i) the actions taken by Howard in transferring the equity of Auto-trol to the newly formed LLC, (ii) the coercive stock subscription offering that would have severely diluted Venhill’s equity
holdings in Auto-trol, and (iii) causing Venhill to make payments to his attorneys. As to these actions the court required that Howard pay plaintiffs’ related attorneys’ fees.


Genitrix, LLC (the “Company”) was formed to develop and market biomedical technology. The equity in the Company was divided into three classes, a Class A membership interest primarily owned by Dr. Andrew Segal (“Segal”), a Class B membership interest primarily owned by Dr. H. Fisk Johnson (“Johnson”), Fisk Ventures, LLC (“Fisk”) and affiliates of Fisk and Class C membership interests owned by passive investors. The Company’s LLC Agreement required the cooperation of the Class A and Class B members for the effective operation of the Company. However, the Class A and Class B members consistently disagreed on matters related to research and financing. The failure of the Class A and Class B members to agree left the Company virtually frozen and at the time of litigation the Company had only one employee, no office, no capital funds, no grant funds and it generated no revenue. The Class B members initiated a suit to dissolve the Company under Sections 18-801 and 18-802 of the LLC Act. In response, Segal counterclaimed against Fisk, Johnson and Stephen Rose and William Freund (who were representatives of Fisk on the board of representatives of the Company) alleging that the counterclaim/third party defendants breached the Company’s LLC Agreement, breached the implied covenant of good faith and fair dealing implicit in the LLC Agreement, breached their fiduciary duties to the Company and tortiously interfered with Segal’s employment agreement with the Company. Johnson moved to dismiss under Rule 12(b)(2) for lack of personal jurisdiction and the other counterclaim/third party defendants moved to dismiss the claims under Rule 12(b)(6) for failure to state a claim upon which relief could be granted. The court’s opinion addressed the motions to dismiss made by the counterclaim/third party defendants.

The court first analyzed Johnson’s motion for dismissal under Rule 12(b)(2) and his contention that the court did not have personal jurisdiction over him. The court agreed with Johnson that service of process was not appropriate under 10 Del. C. § 3104 and Section 18-109 of the LLC Act. Under Section 3104, Delaware's long arm statute, the court concluded that although Johnson did have limited contacts with Delaware, the claims asserted by Segal did not arise from and had no nexus with those limited contacts and therefore service of process under Section 3104 was improper.

Under Section 18-109 of the LLC Act, service of process is appropriate only as to named managers of an LLC or those who participate materially in the management of an LLC. The statute makes clear that the power to appoint a manager does not constitute participation in the management of the LLC. Segal argued that Johnson participated materially in the management of the Company because (i) he “controlled” the actions of the persons he appointed to the board and (ii) the LLC Agreement provided him with broad management rights. The court rejected the assertion that Johnson controlled his appointees as conclusory and held that the mere fact that Johnson had the right to affect the activities of the Company through his representative did not mean that he participated materially in the management of the Company. Thus, the court granted Johnson’s motion to dismiss.
The court granted all the other counterclaim defendants’ motion to dismiss under Rule 12(b)(6). As to Segal’s first claim for breach of contract with respect to the Company’s LLC Agreement, the court noted that before it could begin its analysis as to whether a breach had occurred, it had to determine that there was a duty. In this respect it found that Segal failed to identify any breaches of duties found in the Company’s LLC Agreement. Segal argued that the Company’s LLC Agreement established a code of conduct to which the members of the Company were bound, namely, a duty to act without gross negligence, fraud or intentional misconduct. The court, however, found that the provisions cited by Segal did not establish a code of conduct, but rather limited or waived liability, and the court declined to turn an exculpation clause into an all encompassing and seemingly boundless standard of conduct. Further, the court reasoned that even assuming such a code of conduct had been created, Segal failed to show that the counterclaim defendants acted with gross negligence, willful misconduct or bad faith or knowingly violated the law. The fact that the Class B members did not take actions suggested by Segal to assist the Company in obtaining financing did not indicate that they acted in bad faith. Additionally, Segal argued that the Class B members breached the Company’s LLC Agreement by removing him as CEO with a vote of less than 75% of the board. The court found, however, that under the Company’s LLC Agreement and Segal’s employment agreement, the board was entitled to remove Segal with a vote of less than 75% of the board, thus Segal’s removal by less than 75% of the board was not a breach of duty but rather an exercise of a contractual right.

Segal also alleged that the counterclaim defendants breached the implied covenant of good faith and fair dealing contained in the Company’s LLC Agreement by frustrating or blocking the financing opportunities proposed by Segal. The court, in discussing the implied covenant, found that it is invoked to protect the spirit of what was actually bargained and negotiated for in the contract and further, because it is implied, it cannot be invoked where the contract itself expressly covers the subject at issue. Here, the court found that the Company’s LLC Agreement did not provide Segal with a unilateral right to determine what fundraising or financing opportunities the Company would pursue. In fact, the Company’s LLC Agreement specifically addressed financing and provided that financings required the approval of 75% of the board. The court found that implicit in this provision was the right of Class B board representatives to disapprove of and block Segal’s proposals.

Segal also argued that the counterclaim defendants violated their fiduciary duties to Segal. In support of his breach of fiduciary duty claim, he pointed to the same provisions of the Company’s LLC Agreement that he cited for his breach of contract claims. The court found that these claims should be dismissed for two reasons. First, the Company’s LLC Agreement, as permitted by the LLC Act, had restricted or even eliminated fiduciary duties. Second, even assuming that there remained a fiduciary duty to not act in bad faith or with gross negligence, Segal failed to allege facts sufficient to support a claim that such duty had been breached. The court also dismissed Segal’s claim that Rose and Freund tortiously interfered with his employment contract because the court concluded that Segal failed to plead facts indicating that there was ever a breach of his employment contract.
Following the court’s decision, Segal filed a motion for reargument pursuant to Rule 59(f). In his motion, Segal sought reargument on two issues: (i) the sufficiency of his claim that Rose and Freund breached their fiduciary duties; and (ii) the claim of tortious interference with Segal’s employment contract by Rose and Freund. With respect to Segal’s claims that Rose and Freund breached their fiduciary duties, Segal argued that the court’s dismissal was based on a misunderstanding of the fiduciary duties owed by Rose and Freund as representatives of the Company. Segal argued that the court based its dismissal on its conclusion that members of the Company owed no duties to each other but Segal argued that the representatives owed duties different than those owed by members of the Company. The court stated that it did not misunderstand the Company’s LLC Agreement and in fact, it specifically concluded that “because the agreement does not expressly articulate fiduciary obligations, they are eliminated.” Further, the court noted that its previous opinion addressed the potential liability for breaches of fiduciary duties by the representatives throughout the opinion. The court stated, “even if Segal were correct that in the LLC Agreement there remained a fiduciary duty not to act in bad faith or with gross negligence, Segal has manifestly failed to allege facts sufficient to support a claim that anyone had breached such a hypothetical duty.” Thus, because the court concluded that Segal had failed to demonstrate that the court’s decision was predicated upon a misunderstanding of a material fact or a misapplication of law, his motion for reargument on the fiduciary duty claim was denied. Similarly, the court denied Segal’s motion for reargument on the claim of tortious interference finding that, first, its initial holding did not misapply the law and, second, that even if it did, the outcome of the decision would not be affected because the doctrine of tortious interference requires that the defendants be strangers to the contract in question and the defendants were not and further that Segal failed to plead facts showing that the defendants had exceeded the scope of their authority which would be necessary to support his contention that the stranger doctrine did not apply.


Plaintiff limited partner, who was in the business of making initial investments in partnerships and then conducting tender offers for additional interests in such partnerships, made a small investment in a Delaware limited partnership and then made several books and records demands on the partnership for detailed information concerning the partnership’s principal assets. When the general partner failed to respond, plaintiff brought this action alleging that the general partner, in refusing to make available the requested information, breached plaintiff’s rights under Section 17-305 of DRULPA and the partnership agreement.

With respect to plaintiff’s statutory claim, the court first analyzed whether plaintiff had a proper purpose for inspecting the information it sought under Section 17-305 of DRULPA. The plaintiff stated two purposes for its demand: (1) to value its existing investment in the partnership; and (2) to value the partnership as a whole in anticipation of making a tender offer. The court stated that a limited partner bears the burden of proving a proper purpose and where a limited partner has more than one purpose, the primary purpose must be proper and any secondary purpose, whether proper or not, is
irrelevant. Thus, in determining whether plaintiff had stated a proper purpose, the court held that a critical issue was whether plaintiff’s primary purpose was to value its existing investment in the partnership or to value the partnership as a whole in anticipation of making a tender offer. Based on the evidence, which included an admission by plaintiff that valuing the partnership as a whole in anticipation of making a tender had always been the chief purpose for its inspection demand, the court concluded that plaintiff’s primary purpose for inspecting the requested information was to determine whether or not to make a tender offer and if so on what terms. The court stated that plaintiff’s status in valuing a tender offer is that of a bidder, not of a limited partner valuing its interest in the partnership. The court concluded that plaintiff’s primary purpose for inspecting the requested books and records was not reasonably related to its interest as a limited partner and, therefore, was not a proper purpose under Section 17-305 of DRULPA.

The court also noted that Section 17-305(b) of DRULPA provided the general partner with an alternative and independent basis for denying plaintiff’s statutory demand to inspect the requested information because (1) the general partner had demonstrated that it was required by law and certain third party confidentiality agreements to keep certain of the requested information confidential and (2) the general partner had established its reasonable belief that the requested information was in the nature of trade secrets. Accordingly, the court concluded that plaintiff did not have a statutory right to inspect the requested information pursuant to Section 17-305 of DRULPA and consequently that the general partner had not breached DRULPA.

The court next addressed plaintiff’s claim for breach of contract. Section 10(a) of the partnership agreement required the partnership to make available for examination by the partners its “books of account.” The main contention between the parties was whether the various books and records sought by plaintiff constituted “books of account” under Section 10(a) of the partnership agreement. The court determined that the term “books of account” as used in the partnership agreement had a fairly narrow definition and was less expansive than the term “books and records.” Central to the court’s determination was a provision in the partnership agreement that provided that the partnership’s “books of account” shall be closed as of the end of each fiscal year. The court construed the term “books of account” as used in the partnership agreement to refer to a limited range of financial documents of the partnership, such as its general ledger and the financial statements derived from the general ledger. Accordingly, the court held that the books and records sought by plaintiff fell outside the scope of the books of account referred to in Section 10(a) and, thus, plaintiff was not entitled to inspect the requested information pursuant to the provisions of the partnership agreement. Having concluded that plaintiff was not entitled to the requested information under the partnership agreement, the court held that it was unnecessary to rule on the general partner’s “improper purpose defense” to plaintiff’s breach of contract claim.


Plaintiff and defendant were the only members of a Delaware LLC, each owning a fifty percent membership interest. Following a dispute among the members as to the distribution policy of the LLC, plaintiff filed an action for declaratory judgment in the
The court determined that it could not at this stage of the proceedings conclude that plaintiff’s interpretation of the distribution provisions of the LLC Agreement was unreasonable. The court found the LLC Agreement to be unclear as to whether the Management Committee’s authority to adjust the distribution rate was intended to endure until the Management Committee acted unanimously to change the rate. Defendant argued that such an interpretation of the LLC Agreement would be tantamount to permitting the Management Committee to amend the LLC Agreement contrary to other provisions of the LLC Agreement that provided for an amendment procedure involving all members. The court stated that while defendant’s interpretation of the distribution provisions of the LLC Agreement may be the better reading, it could not find at this stage
that it was the only reasonable reading of such provisions and thus could not grant defendant’s motion to dismiss.

The court addressed in a footnote plaintiff’s argument that the Management Committee action in 2000 had effected an amendment to the LLC Agreement. The court stated that nothing in the Management Committee’s action suggested an intent of the Management Committee or the members to amend the LLC Agreement and that the only reasonable inference to be drawn from such action is that the Management Committee was doing nothing more than exercising its authority to set the distribution rate.

Defendant also claimed that if the Management Committee’s action in 2000 had changed the distribution rate in perpetuity until the Management Committee unanimously decreed otherwise, it would constitute an abdication of the Management Committee’s fiduciary obligations to the LLC and its members. The court rejected this argument, holding that if the members of the LLC intended to confer broad authority on the Management Committee to establish the distribution rate, and the Management Committee validly exercised that authority, there is no basis to claim that the Management Committee breached its fiduciary duty simply by adopting a change to the baseline distribution rate.

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LLCs – IMPORTANT CASE LAW DEVELOPMENTS 2009

CURRENT STATUS OF BANKRUPTCY ISSUES

August 2009

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I. Applying Bankruptcy Law to LLCs.

A. Eligibility of an LLC to File a Bankruptcy Petition.

Title 11 of the United States Code (the “Bankruptcy Code”) permits “persons” to file bankruptcy petitions, and the statutory definition of “person” includes “individual, partnership, and corporation.” Bankruptcy Code § 101(41). Although an LLC is not a “partnership” in a state law sense, the Bankruptcy Code defines “corporation” to include:

(ii) partnership association organized under a law that makes only the capital subscribed responsible for the debts of such association; [or]

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(iv) unincorporated company or association;

Bankruptcy Code § 101(9)(A). For the purposes of determining an LLC’s eligibility to file a bankruptcy petition, an LLC should be able to fit within either of the subsections cited above. It might be possible to argue with the characterization of an LLC as a corporation because § 101(9)(B) specifically excludes limited partnerships from the definition of corporations, but this distinction is unlikely to matter in any event. The definition of “person” lists individuals, partnerships and corporations as entities “included” within the definition, but is not so exclusive as to prevent another type of entity not listed in the statute from also being characterized by a court as a “person.”

It is also worth observing that the classification of an LLC as a partnership or as a corporation for purposes of determining the applicability of the Bankruptcy Code should have little other effect on the disposition of a bankruptcy proceeding. Most of the provisions of the Bankruptcy Code that apply specifically to partnerships relate to issues, such as the liabilities of general partners, that are not likely to apply in an LLC context.

The distinction between a “partnership” and a “partnership association” that fits within the Bankruptcy Code definition of “corporation” arose in In re Rambo Imaging, L.L.P., 2008 Bankr. LEXIS 2311 (Bankr. W.D. Tex. July 15, 2008). In that case, the bankrupt entity was a Texas general partnership that had elected limited liability partnership status. Although the partnership agreement described numerous actions that could be taken only with the approval of two-thirds of the holders of partnership units, and delegated other actions to the “Managing Partners,” the agreement did not specifically address the power to put the partnership into bankruptcy. The partnership was clearly a general partnership, but the court engaged in an analysis of the limited liability of the partners, and relied on a treatise reference in Collier’s, to
conclude that an LLP should be treated as a “partnership association,” and therefore a “corporation” for Bankruptcy Code definitional purposes. On that basis, the court held that a dissident general partner did not have the power to commence an involuntary bankruptcy proceeding on behalf of the partnership.

The court in In re Midpoint Development, L.L.C, 313 B.R. 486 (Bankr. W.D. Okla. 2004) noted the omission of LLCs from the Bankruptcy Code, and analogized to corporations and partnerships. In that case, the court held that even a limited liability company in dissolution is entitled to make a bankruptcy filing, because a dissolved LLC is still in the process of winding up, and the winding up process may be conducted through bankruptcy. However, this case was ultimately reversed by the Tenth Circuit because the bankrupt LLC had not only dissolved, but had actually filed articles of dissolution that became effective prior to the bankruptcy filing. On the effective date of the articles of dissolution, the Oklahoma LLC ceased to exist, and so could not later file for bankruptcy. See In re Midpoint Development, L.L.C., 466 F.3d 1201 (10th Cir. 2006).

B. Authority to File a Bankruptcy Petition.

As a general proposition, state law determines who has the legal right to file a bankruptcy petition. With respect to general partnerships, the federal bankruptcy rules provide that a bankruptcy petition may be filed by any general partner, provided that all general partners consent, see Fed. Bankr. R. § 1004(a), but in corporate and other contexts, the power to file a petition will depend on the actual authority of those wishing to do so. The decision will usually rest with a corporation’s board of directors, but in an LLC setting, the authority of managers is not as clear. State LLC statutes generally do not prescribe whether members or managers have the power to file federal bankruptcy petitions, and this determination will require an analysis of the terms of the LLC’s governing documents. If the articles of organization and the operating agreement do not describe the authority of members or managers to file for bankruptcy, the answer to this question will depend on whether the LLC is member-managed or manager-managed, and the extent to which the articles and operating agreement otherwise delegate actions to managers and reserve actions to members. For example, if an LLC’s managers are given relatively broad authority to take significant business actions on behalf of the LLC, it might be appropriate for a bankruptcy court to conclude that the managers also have authority to file a bankruptcy petition. By contrast, if an LLC operating agreement reserves almost all significant business decisions to the members collectively (by whatever voting rule), the members will probably be deemed to have the authority to make the bankruptcy filing decision. The risk that a bankruptcy court will be vested with the power to determine which managers or members have the power to file a bankruptcy petition should provide sufficient justification for careful drafting of an operating agreement provision.

Most of the cases addressing the power to file a bankruptcy petition are divided into two categories: those that deal with the statutory power to initiate bankruptcy, and others that address whether a bankruptcy has been appropriately commenced given the terms of an LLC’s governing documents or other agreements.
1. Statutory Power to File.

In In re A-Z Electronics LLC, 350 B.R. 886 (Bankr. D. Idaho 2006), a bankruptcy proceeding on behalf of an LLC had been commenced by the LLC’s sole member, but the member was himself the subject of a Chapter 7 bankruptcy proceeding. On that basis, the court concluded that the member’s bankruptcy trustee had the statutory status of the member, and therefore was the only person entitled to commence the bankruptcy proceeding on behalf of the LLC. In In re Delta Starr Broadcasting, L.L.C., 2006 WL 285974 (E.D. La. Feb. 6, 2006), the court analyzed the Louisiana LLC statute and concluded that a bankruptcy petition should be likened to other major actions requiring majority approval of an LLC’s members under that statute. Although the LLC had not undertaken formal procedures (including resolutions or a meeting) before initiating the LLC’s bankruptcy, the court concluded that a majority of the members had unambiguously approved the filing, and that Louisiana law did not require “corporate” formalities in order for an LLC to take valid member action.

2. Contractual Power to File.

The value of a contractual provision limiting the authority of managers or member to file made bankruptcy petition was a clear in In re Avalon Hotel Partners, LLC, 302 B.R. 377 (Bankr. D. Or. 2003). In this case, the operating agreement required 75% member approval for certain “Major Decisions.” Although bankruptcy was not specifically listed as an event triggering the “Major Decision” clause, the court reached the conclusion that a bankruptcy filing was analogous to a conversion into another type of entity, and imposed the 75% requirement. However, it is preferable to anticipate bankruptcy more explicitly.

Courts have generally enforced explicit contractual provisions governing the right to file a bankruptcy proceeding, including provisions that have been drafted to protect creditors. In In re Orchard at Hansen Park, LLC, 347 B.R. 822 (Bankr. N.D. Tex. 2006), the operating agreement required unanimous member consent for the filing of a voluntary bankruptcy proceeding, and the court allowed a creditor to intervene and contest the authority of one of the members to file the petition. The court concluded that a creditor had standing to make that challenge, reviewed an operating agreement provision that required unanimous member vote, and concluded that without evidence of that vote, the filing member was without authority to file the bankruptcy petition on behalf of the LLC. Compare In re Telluride Income Growth Limited Partnership, 311 B.R. 585 (Bankr. D. Colo. 2004) (dissolved LLC serving as general partner of limited partnership not eligible to initiate bankruptcy on behalf of limited partnership because limited partnership agreement provided for the termination of the LLC’s status as general partner upon dissolution).

In two other cases, courts have enforced provisions that give lenders an explicit voice in the filing of a bankruptcy petition. In In re Global Ship Systems, LLC, 391 B.R. 193 (Bankr. S.D. Ga. 2007), the operating agreement established the creditor as a “Class B shareholder,” and the filing of a voluntary bankruptcy by the LLC required the consent of the Class B shareholder. This case actually involved the ruse of the LLC soliciting the filing of an involuntary case that it then failed to contest, but the court concluded that that end-run around the creditor’s contractual rights as a member was inappropriate, and granted the creditor relief from the stay because the bankruptcy had been filed without its consent. In In re Green Power
Kenansville, LLC, 2004 WL 5413067 (Bankr. E.D.N.C. Nov. 18, 2004), an LLC’s sole member had assigned its interest in the LLC to a third party, which then commenced a bankruptcy petition on behalf of the LLC. The assignment violated a loan agreement, the voting of the interest by the assignee was contrary to a pledge agreement provision that allowed the creditor to vote all of the original member’s interests upon a loan default, and the assertion of authority by the assignee apparently attempted to override an independent manager provision that effectively required lender consent to a bankruptcy filing by the LLC. The court enforced the independent manager provision, despite the fact that the assignee may not have had knowledge of the provision, on the basis that the assignee member was governed by the written operating agreement irrespective of knowledge. Because the assignee lacked power to file the petition, the court dismissed the bankruptcy proceeding.

C. Effects of an LLC Bankruptcy Filing.

1. LLC Bankruptcy Filing as a Dissolution Event.

The LLC statutes do not define a bankruptcy filing by an LLC as an event of dissolution or dissociation, and so it is unnecessary to determine whether the winding-up process will be triggered by such a bankruptcy.

2. Composition of the Bankruptcy Estate.

The “estate” of a bankrupt partnership will include “all legal or equitable interests” of the LLC as of the time of filing. Bankruptcy Code § 541(a). In addition to the LLC’s property, these interests will include all rights of the LLC under an operating agreement to additional member contributions or required member loans.

In In re KRSM Properties, LLC, 318 B.R. 712 (Bankr. App. 9th Cir. 2004), the court was confronted by a claim by the member-owners of a bankrupt LLC that they were entitled to challenge a creditor’s attempt to recover tax payments made by the LLC on behalf of the individual owners. The members took the position that they were synonymous with the LLC, that their tax obligations were those of the LLC, and that the prior tax payments were properly made. The court correctly concluded that the status of the LLC as a pass-through entity did not vitiate the separateness of the LLC from its members, and concluded that the LLC’s bankruptcy estate could properly include the prior tax payments.

In In re Ealy, 307 B.R. 653 (Bankr. E.D. Ark. 2004), the court observed the general rule that the assets of an LLC are not equitably owned by its members, so that the bankruptcy estate of a member does not include the LLC’s assets. However, in that case, the court found other equitable circumstances for treating the individual member as having an equitable interest in real estate nominally owned by the LLC.

3. Preferences.

Under Bankruptcy Code § 547(b)(4), the “insiders” of a debtor are subject to a one year preference period. Managers of an LLC are likely to be considered insiders of the LLC, and members in a member-managed LLC will probably have the same status. It is possible that
investor members of an LLC that do not otherwise participate in the LLC’s business might fall outside the “insider” preference period.

Although Section 101(31) of the Bankruptcy Code does not explicitly define managers and others in positions of management responsibility of an LLC as “insiders,” the court in In re CEP Holdings, LLC, 2006 WL 3422665 (Bankr. N.D. Ohio Nov. 28, 2006) concluded that the statutory definition of officers of a corporation as corporate insiders should be “transferred” to determine insider status for an LLC. The court concluded that the title bestowed upon a potential insider would not be determinative, but that the appropriate test was the actual position and responsibility of the insider. Because managers and members with significant responsibilities may have the kind of relationship with an bankrupt LLC that would make their dealings with the LLC subject to scrutiny because of the possibility of non-arms-length transactions, it is likely that such persons will be presumed to have insider status for the purposes of evaluating potential preferences.

4. **Member or Creditor?**

The court in In re Cybersight, LLC, 2004 WL 2713098 (D. Del. Nov. 17, 2004) addressed the status of a former member’s claim to payment in respect of a membership interest. The former member had arbitrated the amount of his claim for the former interest, and reduced the arbitration award to judgment. The court concluded that notwithstanding the fact that the award related back to a prior equity interest in the LLC, the interest was properly viewed as a debt obligation of the debtor LLC, so that the former member was entitled to be treated as a general unsecured creditor.

5. **Applicability of Stay to Members.**

In contrast to the partnership context, where a stay that extends to the property of individual partners may be appropriate in order to protect creditor access to the assets of the partners, it would not be appropriate for a stay to be made applicable to the members of an LLC. As a general proposition, the members and managers of an LLC are not liable, by reason of their status as such, for the obligations of the entity.

Courts have generally recognized the distinction between an LLC’s assets and the assets of members, and have held that when one or the other files bankruptcy, the bankruptcy stay does not include the assets of the other. In In re Calhoun, 312 B.R. 380 (Bankr. N.D. Iowa 2004), the court noted that in a case involving an individual member bankruptcy, LLCs in which the debtor had an interest would not be subject to or protected by the provisions of the automatic stay.

6. **Agreement to Issue LLC Interest as an Executory Contract.**

In In re Sandman Associates, L.L.C., 251 B.R. 473 (W.D. Va. 2000), a prospective member of an LLC entered into a letter agreement with the LLC to make a capital contribution in exchange for an interest. The letter contemplated that the new member would sign the operating agreement, but even though the contribution was made, the operating agreement was never signed. After the parties engaged in series of disputes, the LLC filed for
bankruptcy in an effort to shed itself of the dissident contributor. The court concluded that the failure to sign the operating agreement was a technical matter that did not alter the fact that the performance obligations of the contributor under the letter agreement (i.e. the making of the contribution) had been satisfied. Because the performance had already occurred and the letter agreement did not contemplate any unperformed future acts, the letter was not an executory contract capable of being rejected by the bankrupt LLC.

7. **Substantive Consolidation.**

Two courts addressed the equitable doctrine of substantive consolidation in 2005. Substantive consolidation is often sought by bankrupt debtors that wish to include the assets of legally separate but related entities in the bankruptcy estate, or by creditors wishing to gain access to the assets of non-bankrupt but affiliated entities.

In **In Re Brentwood Golf Club, LLC**, 329 B.R. 802 (Bankr. E.D. Mich. 2005), the LLC operator of a golf course was the bankrupt, and its lender sought to be able to reach the assets of a separate LLC that operated the restaurant at the golf course. The court found that the bank could reach the assets of the restaurant LLC on both a piercing the corporate veil basis and under the doctrine of substantive consolidation. The court considered evidence that ownership of the restaurant assets had never been transferred from the golf course LLC to the restaurant LLC, that the two LLCs did not maintain separate bank accounts until after the bankruptcy petition was filed, that the lease to the restaurant LLC was at a substantially below-market rate (less than approximately fifty cents per square foot), that the restaurant LLC had failed to make rent payments or other payments required under the lease, that the financial records of the entities were “inextricably” intertwined, and that the reality of operations of the golf course made the restaurant and the course interdependent. The court found that the two entities met the requirements of Michigan’s common law alter ego test. Although it was unnecessary to its decision, the court then proceeded to evaluate the substantive consolidation issue, and separately went through the substantive consolidation analysis under the second circuit’s Augie/Restivo and the D.C. Circuit’s Auto-Train tests. The court noted that substantive consolidation did not necessarily require it to find facts as plain as those that enabled it to apply the state law alter ego test, and concluded that substantive consolidation was appropriate under both standards.

In **In Re Owens Corning**, 419 F.3d 195 (3d Cir. 2005) involved an attempt by bankrupt Owens Corning to force the substantive consolidation of its non-bankruptcy subsidiaries. One of the principal lenders had extended financing that was based on separate guaranties received from, among others, certain of Owens Corning’s non-consolidated subsidiaries. The Third Circuit reversed the district court’s holding that the entities should be substantively consolidated. The non-consolidated subsidiaries (both LLCs and corporations) had been maintained separately before the filing of the bankruptcy petition, and the evidence of commingling and lack of separateness was minimal. The court concluded that consolidation would be appropriate only if separateness of the entities had been disregarded prior to the filing of the bankruptcy petition, such that Owens Corning’s creditors knew the separation of the entities had broken down, or if the assets of the entities were so commingled that separating them after the filing of the petition would be prohibitive. The Third Circuit found that neither
factor was present and also seemed troubled by the fact that substantive consolidation was being used “offensively” by the debtor in order to prefer certain creditors over others.

II. Bankruptcy of a Member.

A. Nature of a Bankrupt Member’s Bankruptcy Estate.

As observed above, the bankruptcy estate of a debtor includes all of the debtor’s legal or equitable interests as of the filing of the bankruptcy petition. In the many cases that have addressed the bankruptcy of a partnership’s general partner, it has been observed that the partner’s interest in the partnership consists of the partner’s economic rights, the partner’s management rights, and the partner’s rights as a co-owner of partnership property. In re Cardinal Industries, Inc., 116 B.R. 964, 970-71 (Bankr. S.D. Ohio 1990). The concept of co-ownership of partnership property flows from sections 24 and 25 of the Uniform Partnership Act, which specify that a partner holds partnership property as a tenant in partnership with the other partners.

Because the members of an LLC do not have any interest in an LLC’s property, a member’s bankruptcy estate will consist of the member’s economic rights in the LLC (referred to in some statutes as the member’s “distributional interest”), and the member’s management rights in the LLC. See In re Garrison-Ashburn, L.C., 253 B.R. 700, 707-708 (E.D. Va. 2000) (bankruptcy estate includes both economic and non-economic rights in the LLC). A more extensive discussion of the distinction between economic and non-economic rights, and the extent to which they are affected by provisions of state law and operating agreements, is contained in subsections C and D below.

B. Scope of Estate.

The contents of a bankrupt member’s bankruptcy estate are also affected by pre-bankruptcy agreements and by the distinction between a member’s rights in the member’s membership interest from a possible interest in the underlying assets of the LLC.

1. Pre-Bankruptcy Restrictive Contracts.

In In re Weiss, 376 B.R. 867 (N.D. Ill. 2007), the debtor member was subject to operating agreements that prohibited a pledge or assignment of the member’s interests without the consent of the LLCs’ managers. Notwithstanding this restriction, the debtor had pledged his interests in the LLCs to his creditors, and the creditors sought relief from the bankruptcy stay in the member’s case on the basis that they were secured creditors. The court concluded that the interests were not subject to the security interests because the member had no legal right to make the pledges, and concluded that the security interests in the LLC interests were therefore unperfected because they could not attach to collateral that the debtor had no right to transfer.

2. Debtor’s Interest in the LLC.

The separateness of an individual debtor from a related LLC, even where an LLC is a single-member LLC, was emphasized by the court in In re McCormick, 381 B.R. 594
In that case, the debtor filed for individual relief under Chapter 13 of the Bankruptcy Code, and attempted to draw the single-member LLC of which he was the sole member into his individual bankruptcy proceeding. The court concluded that the automatic stay that applied to the individual debtor would not apply to the LLC, and concluded that because an entity was not an eligible debtor under Chapter 13, the LLC could not be a co- or joint debtor with the bankrupt member under Chapter 13. A similar result occurred in In re Knefel, 2007 WL 2416535 (Bankr. E.D. Va. Aug. 17, 2007), in which the court concluded that a single-member LLC owned by the member debtor was not subject to the automatic stay that applied to the individual debtor.

C. Provisions of State Law and Operating Agreements that Apply in Bankruptcy.

Most LLC acts provide, as a default rule, that unless otherwise agreed by an LLC’s members, the bankruptcy of a member will be an event of dissociation. Most operating agreements will address the extent to which a bankruptcy filing by a member will trigger dissociation or dissolution, but this contractual language will often be co-extensive with the statutory default rules.

To the extent that the remaining members of an LLC elect to continue the business of an LLC following an event of dissociation or dissolution, both statutory law and operating agreements will generally provide that the bankrupt member loses its status as a member and thereby ceases to have any management rights in the LLC. At that point, the member’s rights in the LLC will typically be limited to economic or “distributional” rights. The bankrupt member will have the status of a transferee or assignee of an LLC interest, and cannot again take on the status of a member unless admitted to membership by the requisite vote of the remaining members. The effect of these general statutory and contractual rules in the bankruptcy context is addressed in subsection D below. Some more general issues are also addressed by the following cases:

1. Forfeiture of an Interest May Be Treated as a Preference in Favor of Non-Debtor Members.

In In re Lull, 2008 WL 3895561 (Bankr. D. Hawaii Aug. 22, 2008), the bankrupt member had been removed from his status as a member of the LLC. There was a dispute as to whether the removal (which the court denoted as a “transfer”) took place before or after the filing of the petition, but in any event, the court analyzed the automatic dissociation of the bankrupt member under the Hawaii LLC statute, and concluded that whether the forfeiture took place under the terms of that statute or the operating agreement, the consequent benefit to the other members might be treated as a preference. The court concluded that the non-bankrupt member was a statutory insider (and therefore subject to the one-year preference), found that the non-bankrupt member received more because of the bankrupt member’s removal/forfeiture than he would have as an unsecured creditor, and reserved for later judgment a determination of the actual amount of the preference. This kind of preference analysis, if applied more widely by the courts, could have a significant impact on the ability of LLCs and non-bankrupt members to effectively enforce contractual and statutory restrictions that might otherwise be enforceable, because a court could potentially treat every forfeiture or reduction of a bankrupt member’s economic interest as a preference directly recoverable from the LLC’s other members (even
where the non-bankrupt members may not have liquidity in the LLC sufficient to pay the preferred amount into the bankruptcy estate).

2. **Exercise of Rights as Member or Manager.**

   In one recent case, without substantive discussion of the issue, a North Carolina bankruptcy court held that a bankrupt member had standing to seek judicial dissolution of a non-bankrupt LLC notwithstanding the fact that the North Carolina LLC Act and the operating agreement caused the bankrupt member to cease to be a member upon the filing of his bankruptcy petition. Under the dissolution provisions of the North Carolina statute, absence of status as a member should have defeated the bankrupt member’s subsequent attempt to pursue judicial dissolution, but the court treated the prohibition as an invalid ipso facto clause (see the further discussion below), and without further analysis, proceeded to analyze the requested dissolution on its substantive merits in later proceedings. See *In re Klingerman*, 388 B.R. 677 (Bankr. E.D.N.C. 2008). The continuing rights of a bankrupt member (or that bankrupt member’s personal representative) to exercise management rights can also arise in a context where the bankrupt member may object to the assertion of management rights, because those rights will be exercised by the debtor’s bankruptcy trustee. In *In re Modanlo*, 2007 WL 2609470 (Bankr. D. Md. May 19, 2006), the bankrupt member objected to actions proposed to be taken by his bankruptcy trustee. The trustee had designated himself as the manager of a single-member LLC controlled by the bankrupt, and the court analyzed Delaware law and concluded that the personal representative had the statutory power to continue a single-member LLC following a dissolution caused by the bankruptcy of its sole member. Having continued the LLC in its status as personal representative of the sole member, the trustee therefore had the power to designate itself as the manager.

D. **Enforceability of Statutory and Operating Agreement Provisions in the Bankruptcy Context.**

1. **Operating Agreement as an Executory Contract.**

   It is generally established that partnership agreements, to the extent they delineate material unperformed obligations of the partners, are executory contracts within the meaning of the Bankruptcy Code. Almost all of the cases that have thus far addressed bankruptcy issues in the LLC context have likewise held that operating agreements are executory contracts. See *In re Daugherty Construction, Inc.*, 118 B.R. 607 (Bankr. D. Neb. 1995), (“Daugherty”); *In re DeLuca*, 194 B.R. 65 (Bankr. E. D. Va. 1996) (“DeLuca I”); *In re DeLuca*, 194 B.R. 79 (Bankr. E. D. Va. 1996) (“DeLuca II”). Operating agreements will contain numerous provisions relating to ongoing agreements and covenants of the parties, and for this reason, it is often appropriate that they also be classified as executory contracts for purposes of the Bankruptcy Code. For example, in *Allentown Ambassadors, Inc.*, 361 B.R. 422 (Bankr. E.D. Pa. 2007), the court concluded that an operating agreement relating to the operation of an independent professional baseball league was an executory contract because the members had continuing duties, including duties to manage the LLC (*i.e.*, the baseball league), and the duty to make additional cash contributions as needed for the operation of the LLC.
Notwithstanding the trend of cases holding that partnership agreements and operating agreements are executory contracts, several courts have determined that operating agreements did not contain sufficient unperformed obligations to be treated as executory contracts. The court in In re Garrison-Ashburn, L.C., 253 B.R. 700 (E.D. Va. 2000) found that the operating agreement did not contemplate future performance by the members, but merely served to establish the framework under which the LLC would be managed. Because the court concluded that the operating agreement was not an executory contract, the court gave effect to the current Virginia LLC act provision that makes the bankruptcy of a member an event of dissociation, and concluded that the prohibitions on *ipso facto* clauses that apply to executory contracts did not apply to this LLC. The court’s reasoning appeared to be affected both by a Virginia statutory change since the date of the cases cited above, which changed the bankruptcy of a member from an event causing the dissolution of the LLC itself to one that causes the dissociation of the member, and by the fact that the LLC’s operating agreement did not include the kinds of provisions that would have created the possibility of future performance obligations (such as provisions related to future capital contributions or loans, requiring active participation in management or imposing negative restrictions on the ability of members to compete or otherwise take actions contrary to the interests of the LLC).

Another court held that because an operating agreement did not contain any current obligations or continuing management role for an LLC’s member, the operating agreement was not an executory contract capable of being assumed, assigned or rejected. See In re Capital Acquisitions & Management Corp., 341 B.R. 632 (Bankr. N.D. Ill. 2006). Likewise, in In re Tsiaoushis, 2007 WL 2156132 (E.D. Va. July 19, 2007), both the district court and the bankruptcy court in a previous decision found that the operating agreement was not an executory contract because there were no material, continuing obligations of the members. The bankrupt debtor had no managerial duties in a manager capacity, and had no unperformed duties as a member. Because the agreement imposed no additional duties or responsibilities, the court found that the agreement was not an executory contract, that it was therefore not subject to the Bankruptcy Code Section 365 analysis discussed further below, and that the trustee would be entitled to enforce the provisions of the operating agreement requiring the dissolution and winding up of the LLC as a result of the debtor member’s bankruptcy filing.

A similar result was reached in In re Ehmann, 319 B.R. 200 (Bankr. D. Ariz. 2005). In Ehmann, the LLC had been formed by an individual debtor’s parents, apparently for estate planning purposes. Ehmann’s bankruptcy trustee pursued various claims against the LLC, asserting that it had the right to make those claims because it was stepping into the shoes of Ehmann as a member. In its defense, the LLC attempted to rely on some of the bankruptcy provisions discussed in the following sections of this outline, and claimed that the trustee did not have the power to assume the debtor member’s rights under the operating agreement, which it alleged to be an executory contract. The court concluded, however, that the operating agreement of the LLC contained no unperformed obligations of the type that would cause it to be deemed an executory contract, and that in fact, the debtor member had no “obligations” to be performed that would trigger the bankruptcy law provisions sought to be applied by the LLC. Those substantive bankruptcy law issues were not reached because the court concluded that no executory contract was involved.
A second decision was issued in Ehmann in late 2005. 334 B.R. 437 (Bankr. D. Ariz. 2005). In this decision, a bankruptcy court permitted the bankruptcy trustee to exercise a member’s rights to seek remedies for breaches of the operating agreement by the non-bankrupt manager, who was apparently authorizing loans and other insider transactions in a manner that was contrary to the operating agreement. The transactions appeared to be designed to avoid distributing to the bankrupt Ehmann his share of the proceeds of a prior transaction which resulted in significant cash being available to the LLC. The court concluded that an injunctive remedy would not be effective against this misbehavior, and ordered the appointment of a receiver. Note, however, that this opinion was withdrawn by the bankruptcy court in late January 2006.

2. **Applicable Bankruptcy Law Provisions.**

Section 365(a) of the Bankruptcy Code provides that the bankruptcy trustee, subject to court approval, may assume or reject any of the debtor’s executory contracts. Section 365(f) further provides that except as provided in Section 365(c), the trustee may assign an executory contract notwithstanding any contrary provision in any contract or under applicable law. Note that for the purposes of Chapter 11 of the Bankruptcy Code, references to the “trustee” should be considered to refer also to a debtor in possession. Bankruptcy Code § 1107.

The general rule is that the trustee or debtor in possession is permitted to assume an executory contract even if nonbankruptcy law or the contract itself would forbid such an assumption. Section 541(c) of the Bankruptcy Code overrides any restriction on the transferability of an asset in the bankruptcy estate that may be imposed by an agreement or nonbankruptcy law, and Section 365(e)(1) permits the avoidance of so-called “ipso facto” clauses that would otherwise provide for the termination or modification of a contract or contract right that might be triggered by the debtor’s commencement of the bankruptcy case or insolvency or financial condition prior to the termination of the bankruptcy case. Two other sections of the Bankruptcy Code, however, hold out the possibility that it might still be possible to enforce statutory and agreement provisions that are triggered by a partner’s or member’s bankruptcy.

Section 365(c) of the Bankruptcy Code provides that the trustee or debtor in possession may not assume or assign an executory contract if:

(1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment;

Bankruptcy Code § 365(c). This section is consistent with similar language in § 365(e)(2), which exempts the same categories of executory contracts from the provisions cited above that would otherwise override *ipso facto* clauses.
Paragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if (A)(i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and (ii) such party does not consent to such assumption or assignment.

Based on a strict construction of the statutory language, therefore, it would seem that a trustee (including even the debtor in possession) will not be permitted to assume an operating agreement if it can be determined that the agreement is of a type as to which state law excuses a nonbankrupt member from accepting performance from or rendering performance to any party other than the debtor or the debtor in possession.

3. The Right Of A Debtor Member To Assume An Operating Agreement

Two courts have addressed in detail whether a debtor in possession or trustee may assume an operating agreement, notwithstanding state law provisions that would provide for bankruptcy as a disassociation or dissolution event. In the absence of bankruptcy law provisions that override state law, the bankruptcy of a member would, at least in member-managed LLCs, trigger an opportunity for the remaining members to vote whether to continue the LLC. In any event, the bankruptcy would cause the bankrupt member’s status as a member to cease.

a. Daugherty.

In Daugherty, which was decided in October 1995, the bankruptcy court concluded that the provisions of the Nebraska Limited Liability Company Act were overridden by the Bankruptcy Code, and that the bankruptcy of a member did not trigger a dissolution of the LLC. The court held that even under an operating agreement, Section 365(c)(1) does not permit a party to avoid accepting from or rendering performance to a debtor in possession. 188 B.R. at 614. This analysis is consistent with the majority rule in partnership cases, and the leading case in partnership area is In re Cardinal Industries, Inc., 116 B.R. 964 (Bankr. S.D. Ohio 1990). The Daugherty court specifically rejected a separate line of cases which have held that a partnership dissolves, and a partner’s status as such ceases, upon a partner’s bankruptcy filing.

b. The DeLuca Cases.

Both of the DeLuca cases arose from the bankruptcy filings of a husband and wife who are involved in numerous entities, including several LLCs. In DeLuca I, the principal question was whether the remaining members of the LLC could remove the DeLucas as managers of the LLC and insert a new manager, when the underlying operating agreement required unanimous member consent for the appointment of a new manager. The court concluded that the pre-petition removal of the DeLucas as managers was valid because the operating agreement was silent on removal but state law permitted removal upon a majority vote.
of the members. The court also found that a new manager could be appointed by the remaining members after the bankruptcy petition because the bankruptcy petition of the DeLucas had the effect of terminating the DeLucas’ status as members.

In DeLuca II, the DeLucas were members of an LLC that was itself one of two members of a second LLC. The other member of the second LLC sought the court’s determination that the DeLucas’ bankruptcy caused a dissolution of the first LLC (because there were no non-bankrupt members of that LLC who could vote to continue), and that the dissolution of the first LLC therefore triggered the dissolution of the second LLC. Again, the court gave effect to state law provisions and agreed that the second LLC had dissolved as a result of the DeLucas’ Chapter 11 filing. However, without reaching the question whether the DeLucas had unlawfully dissolved the second LLC, the court concluded that it would not disturb the prior appointment of a bankruptcy trustee in favor of allowing the remaining member of the second LLC to wind up the LLC’s business. The applicable Virginia statute would have permitted all members (presumably including the first LLC) that had not “wrongfully dissolved” the LLC to participate in the winding up.

In both of the DeLuca cases, the court relied primarily on Breeden v. Catron, 158 B.R. 624 (Bankr. E. D. Va. 1992), aff’d, 158 B.R. 629 (E. D. Va. 1993), aff’d, 25 F.3d 1038 (4th Cir. 1994), a general partnership case in which the lower courts and in the Fourth Circuit concluded that the language of Section 365(c) should be read literally to prevent the debtor in possession’s assumption of a partnership agreement because applicable state law would not require the remaining partners to perform their obligations under the partnership agreement or to accept the performance of the bankrupt partner’s obligations from any party other than the bankrupt partner. In such circumstances, the Catron court concluded, neither the trustee nor the debtor in possession could assume the contract. In the DeLuca cases, the court likened the partnership agreement at issue in Catron to the operating agreements involved in the DeLuca cases, and concluded that the state law provisions governing dissolution and the status of a bankrupt member should be given effect notwithstanding the Bankruptcy Code’s general preference toward permitting the assumption of executory contracts.


4. Other Cases Addressing Assumption and Ipso Facto Issues

Several other cases have addressed the relationship of the bankruptcy law provisions to single-member LLCs. In In re Desmond, 316 B.R. 593 (Bankr. D.N.H. 2004), an individual debtor sought to prevent a creditor of a wholly-owned LLC from taking action against the LLC by asserting that obligations entered into by the LLC were invalid because the authorization of the obligations by the debtor in his manager capacity was invalid because the management rights were an asset of his individual bankruptcy estate. The court found that because the LLC was not in bankruptcy, nothing about the debtor’s individual bankruptcy deprived him of the right to take action on behalf of the LLC. The court distinguished In re Albright, 291 B.R. 538 (Bankr. D. Colo. 2003). In Albright, the court concluded that it could
disregard statutory provisions requiring approval for the admission of an assignee as a member because the LLC at issue was a single-member LLC, and there were no other members whose approval was required before the chapter 7 trustee could be substituted as a member for the bankrupt debtor-member.

Two Delaware cases have also addressed the ipso facto clause issue and the status of and distinction between economic and management rights in an LLC. In Milford Power Company, LLC v. PDC Milford Power, LLC, 866 A. 2d 738 (Del. Ch. 2004), the court analyzed the appropriate bankruptcy law sections and concluded that bankruptcy law preempted any provisions of the LLC operating agreement that would deprive a debtor of making its economic rights available to assignee, but would allow the enforcement of the agreement to the extent it restricted the assignment of the debtor’s management rights. A similar result was reached by another Delaware court in In Re IT Group, Inc., 302 B.R. 483 (D. Del. 2003).

The court in the Allentown case also conducted an extensive analysis of the Section 365 and ipso facto clause issues. Having concluded that the operating agreement relating to the operation of a professional baseball league constituted an executory contract, the court concluded that the debtor member’s interest in the LLC was not terminated as a result of the member’s bankruptcy. The court synthesized the partnership and LLC cases addressing the tension between the various Section 365 subsections, and concluded that the North Carolina statutory provisions that restrict assignments of membership interests are sufficiently ambiguous that they do not constitute applicable non-bankruptcy law prohibiting assignment. The court also concluded on the facts that the operation of the LLC did not demonstrate that a member’s duties were the kinds of non-delegable duties that should render the membership interest non-assignable.

E. LLC as Insider of Member Debtor.

In In re Barman, 237 B.R. 342 (Bankr. E.D. Mich. 1999), the court held that for the purposes of defining the “insiders” of an individual Chapter 7 debtor, an LLC is sufficiently close to a corporation to apply the bankruptcy principles that apply to corporations. Under the Bankruptcy Code, a corporation of which the debtor is a director, officer or control person, or an affiliate or insider of an affiliate, constitutes an insider. A corporation is an affiliate if the debtor controls 20% or more of its “voting securities.” In this case, which involved a South Carolina LLC, the court found that the LLC was an insider of the member debtor because the debtor was one of three of the LLC’s members and owned or controlled one-third of the voting rights in the LLC.
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Sample Publications
- Louis G. Hering, David A. Harris, 2008 Cumulative Survey of Delaware Case Law Relating to Alternative Entities (February 1, 2008). Presented at 2008 ABA Spring Meeting, Section of Business Law
- Louis G. Hering, Walter C. Tuthill, David A. Harris, Amendments Adopted to Delaware’s Alternative Entity Statutes (BNA’s Corporate Counsel Weekly, August 9, 2006, Vol. 21, No. 31)
• Louis G. Hering, David A. Harris, 2006 Cumulative Survey of Delaware Case Law Relating to Alternative Entities (June 16, 2006). Presented at 2006 ABA Annual Meeting, Section of Business Law
• Louis G. Hering, Stanford L. Stevenson, III, David A. Harris, Limited Liability Companies: Legal Aspects of Organization, Operation and Dissolution (The Bureau of National Affairs, Inc. 2006)

Professional and Community Activities
Membership on the Delaware State Bar Association Alternative Entity Committee and Delaware State Bar Association Statutory Trust Committee which are responsible for reviewing and updating Delaware’s limited liability company, partnership and statutory trust statutes. Membership on the American Bar Association Business Law Section Committee on LLCs, Partnerships and Unincorporated Business Associations, chair of the Limited Partnership Subcommittee and of the Task Force on drafting single member limited liability company operating agreements. Membership on the American Bar Association Business Law Section Committee on Legal Opinions. Member of the Steering Committee of the Working Group on Legal Opinions affiliated with the American Bar Association Business Law Section. Listed in the 2008 Best Lawyers in America and in the 2008 Chambers USA America’s Leading Lawyers for Business, as a leader in Delaware M&A: Alternative Entities. Membership on the Board of Directors of New Castle County Head Start, Inc., Delaware.
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The objectives of the LLCs, Partnerships and Unincorporated Entities Committee are: (1) to provide leadership in the area of legislative revisions and proposals to laws regulating unincorporated business organizations (including partnerships, limited partnerships, limited liability partnerships, limited liability companies, and business trusts) and, to that end, to work closely with the National Conference of Commissioners on Uniform State Laws (NCCUSL), (2) to guide and assist practitioners dealing with unincorporated business entities in delivering the most sophisticated services possible by publishing resources such as state-of-the-art prototype agreements, commentary, and other practice tools, and (3) to provide updates on current legal developments for committee members through committee reports and publications.

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