March, 2019

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FROM THE CHAIR

Garth Jacobson
CT Corporation
Seattle, Washington

Greetings from the Chair,

From the onset of my serving as chair and the general attitude of our committee, past and present, has been is to provide the greatest benefit for the least cost to our committee members. That is in line with the attitude that every law firm and company expects much more return for dollars spent. We have to justify why we attend the meetings and programs in order to gain time off or use law firm or company funds or our own money. That message resonates now at all levels of the ABA. They are now making every effort to reduce costs and increase benefits. The roll out of new dues pricing reflects the desire to enable the newer attorneys to participate in the ABA while trying to amp up the available services to the existing and long terms members as a way to justify staying a member. As a committee we have instilled that message long the big ABA. To that end we have provided some of the best programs and publications in the section. In my opinion our LLC Institute provides the best bang for the buck of any CLE program anywhere. We constantly drive to provide an outlet for discussing and informing everyone on the latest committee related topics. In brief we are a good value. However past performance can’t carry us and we must constantly renew that pledge and strive to justify our existence. We have been blessed with past chairs and very active members who have given so much so that we can achieve those goals. That spirit must be renewed with new members and existing members who appreciate the value of these efforts. I encourage you to let me know if you are interested in doing any CLE or publication project or have ideas for one.

In the spirit of great value we continue to develop the LLC Institute to provide the best programs for the least cost. Generally we try to price it at a break even amount with it going a little over or under each year. However with the ABA belt tightening we must make sure it at least breaks even for it to continue. That should
not be a problem but it does reinforce the need for your attendance. This year we are moving it to Tampa. Perhaps because the long cold winter created our desire to go to a warm place. But the real reason is that the Business Law Section Midyear meeting is in DC and going to the same place in two months seemed redundant. Likewise the cost of DC may be too much for us to sustain low cost tuition. Lou Conti convinced us that Tampa would be nice and the costs would be low. So this your invitation to enjoy the last bit of summer weather while enjoying another great institute. The Institute will be in Tampa Nov. 7 and 8. Perhaps you might even want to bring your spouse or favorite person with you and stay the weekend.

Speaking of the Institute, we always have the Luboroff dinner on that Thursday night. Please send me your nomination for who you would like to have as a recipient of it. If you are not familiar with the criterion just consider past winners as examples of the quality people who receive it. I know it is a bit early but given how fast time seems to go, I thought it would be better to start early rather than wait until it is almost too late.

Finally there is an opportunity to develop your leadership skills through the newly developed Business Law Section Leadership Academy. The Academy will offer an advancing curriculum of CLE programs aimed to develop leadership skills of lawyers. The programs will be held over the course of a two-year period at four in-person meetings at section conferences and two ancillary webinar presentations. After attending all programs in the curriculum, participants will receive a certificate of completion from the Business Law Section. To apply click on the link. Applications for the Leadership Academy are due June 1, 2019.

I look forward to seeing you at the spring meeting in Vancouver, BC at the end of the month or the midyear meeting in DC September 12-14 or and most importantly at the LLC Institute Nov. 7 and 8 in Tampa.

Thanks,

Garth
Vancouver

As you know, the Section of Business Law will be holding its spring meeting in Vancouver, Canada over March 28-31, 2019. The Committee on LLCs, Partnerships and Unincorporated Entities (a/k/a The Best Damn Committee In the ABA) will be sponsoring a number of programs and holding a number of meetings and other events. The calendar for those programs and events is:

Thursday, March 28, 2019

Program: LLC Boot Camp: What Every Associate (And Every Partner) Needs To Know  
10:30 AM - 12:30 PM  
West Level 2, Room 208 & 209

Program: Lessons from the Trenches for Transactional Lawyers  
2:30 PM - 4:30 PM  
West Level 2, Room 205 & 206

International Use of U.S. Business Entities Subcommittee Meeting  
4:30 PM - 5:30 PM  
West Level 1, Room 113

Friday, March 29, 2019

Program: LLC Case Law Update  
8:00 AM - 10:00 AM  
West Level 2, Room 217 & 218

LLCs, Partnerships and Unincorporated Entities Committee Meeting  
10:00 AM - 12:00 PM  
West Level 1, Room 122

Security Interests in LLC and Other Unincorporated Entity Interests Joint Task Force Meeting  
11:30 AM - 12:30 PM  
East Meeting Level, Room 1 - 3

In addition, on Thursday, March 28, starting at 7:30, we will be holding our committee dinner at:

Coal Harbour Cactus Club  
1085 Canada Place  
Vancouver BC

Registration for the dinner is done through the registration page for the spring meeting.
What's Happening

Maryland

Ed Wender reports that a Maryland committee has been organized and is tasked with considering whether to permit series LLCs in Maryland. As the Maryland LLC Act is a non-uniform, integrating the Uniform Protected Series Act would at minimum be difficult. This has led to questions as to whether it is time to revise the LLC Act generally. No recommendation has yet been made.

Ohio

Russell Rosler reports that Michael Moeddel, Chair of the Corporation Law Committee of the Ohio State Bar Association, is leading a committee rewriting Ohio’s LLC Act to be based upon, at least in part, the Revised Prototype Limited Liability Company Act. Michael Moeddel reports as well that there has been proposed in the Ohio legislature a bill to mandate the collection of real property transfer taxes and to impose reporting requirements for “the transfer of any ownership interest in a pass-through entity that, directly or indirectly, owns real property. Sam Beavers characterizes the situation in Ohio as “Ohio is completely restating its LLC Act.”

Wisconsin

Joseph Masterson reports that the state is still working through possible revisions across all of its business entity laws, including, subject to a number of modifications, adoption of the Revised Uniform Limited Liability Company Act (2013).

Massachusetts

Ed Smith reports that there has been filed in the Massachusetts legislature a bill to update the Massachusetts UCC to conform to the most recent revisions of sections 9-406 and 9-408. This will be part of a general UCC update bill.

Florida

Lloyd Granet reports that Florida is doing a major rewrite of its Business Corporation Act, Chapter 607. This committee is chaired by Phil Schwartz and Gary Teblum. Gary Teblum supplemented these notes to the effect that the anticipated redraft of the Florida Business Corporation Act will also include harmonizing changes to the LLC in partnership backs. The Florida legislature goes into session the first week of March. The proposed legislation covers some 400 pages.

Virginia

Allan Donn and Jim Wheaton report that the Uniform Protected Series Act has cleared both houses of the Virginia legislature. The effective date will not be until 2020, the delay being necessitated by the need to reprogram some of the Secretary of State’s computer systems.
**South Carolina**

Scott Barnes reports that there has been introduced legislation to adopt the Revised Uniform Partnership Act and a new LLC Act. There is apparently dispute between the lawyers and the Bankers Association with respect to the exclusivity of the charging worker remedy. Another point that remains in contention is whether a member is deemed to consent to the terms of the operating agreement where they become a member. Scott Barnes identifies the problem as being “how do you consent to the allocation of profits and losses existing at the operating agreement at the time you join.” Rather (and these are my suggested words), the new member should be deemed to have consented to “the operating as modified/supplemented by the new member’s capital contribution and sharing ratios as to allocations, distributions and voting rights.”

**Arizona**

Jim Reynolds reminds us that the Arizona legislature adopted a version of RULLCA in 2018 that will be effective for newly formed LLCs on September 1, 2019 and will apply retroactively to all LLCs effective September 1, 2020.

**California**

Gerald Niesar reminds everybody that the Franchise Tax Board feels that the *Swart* decision is only “a narrow exception (that) may apply in limited circumstances.” In an October ruling, the Franchise Tax Board said that a 15% non-managing member of an LLC doing business in California is itself doing business in California.

**New York**

Michael Bamberger reports a statement from Governor Cuomo: “Ban Corporate Contributions and Fully Close the LLC Loophole: Ever since the Citizens United decision in 2010, corporate money has overtaken our elections system. It is time for New York State to finally say enough is enough. Governor Cuomo will fix this problem once and for all by banning all corporate and LLC contributions. It is time to restore the power to the people, and take it out of the hands of dark money and special interest donors.”

**New Mexico**

Jay Rosenblum reports that there is a bill pending in the New Mexico legislature that will require that the articles of organization disclose the name and address of every member of the limited liability company. Likewise, the articles will need to be amended to reflect any change in membership, including the name of it and address of each newly added member. The bill is S.B. 169.

Thanks everybody for sharing the status information. Of course, bills could have died, and new bills could have been introduced, since this information was provided.
Interest Dilution and Damages as Contribution-Default Remedies in Failing LLCs and Partnerships

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• Contribution-default remedies appear in most operating agreements and partnership agreements.
• Recent cases illustrate the legal repercussions of drafting contribution-default remedies for LLC or limited partnership ventures that fail.
• Such repercussions may differ from those in ventures that have positive, increasing value, and exploration of the nuances of interest-dilution provisions is necessary.

Failure is not an option—at least not until it happens. Starting a venture with the attitude that failure is not an option may reflect the American spirit, but the reality is that attitude alone does not control the fate of the venture—even if it did, events can change attitude, precipitating the decline of a once-promising idea. Market or other forces often affect whether a venture fails or succeeds, and failure is a definite possibility for most ventures. Advisors working with venturers in their euphoric, optimistic days of formation must maintain a realistic perspective and help them draft provisions of their entity documents that effectively address the possibility of failure. For instance, the preference for particular contribution-default remedies can change as a venture’s promise and condition change. Consider how the members’ preference for interest dilution and damages can change as the fortunes of a venture change. Recognizing such preferences should affect the venturers’ decisions as their advisors help them draft the entity documents. A recent case from the Delaware Superior Court and earlier cases from the Kansas Court of Appeals help illustrate the legal repercussions of drafting contribution-

default remedies for LLC or limited partnership ventures that fail. The cases all considered contribution-default remedies in LLC operating agreements, but the principles should apply to limited partnership agreements as well.

The operating agreement in Canyon Creek Development, LLC v. Fox, 46 Kan. App. 2d 370, 263 P.3d 799 (2011), allowed a majority in interest of the members (i.e., those holding more than 50 percent of the ownership interests (percentage interests) in the LLC) to issue a capital call. The majority in interest (following a contribution to service the LLC’s debt, which was excepted from the Majority-in-Interest capital call rule) did issue such a call, and Fox, one of the members, defaulted on his obligation to contribute additional capital. The LLC’s operating agreement provided that if a member defaulted on a contribution obligation, the other members had the right, but not the obligation, to cover the defaulted amount. The agreement further provided that in the event that a member covered a defaulting member’s default amount, the percentage interests of the members would be adjusted to reflect each member’s contribution as a percentage of total contributions.

The contributing members, having obtained a majority interest in the LLC through additional contributions, appointed themselves managers and caused the LLC to sue Fox for, among other things, breach of the operating agreement, claiming that the LLC was entitled to damages for his failure to satisfy his additional contribution obligation. Fox argued that the dilution in his interest in the LLC that he suffered consequent to his default was the contractually agreed-upon remedy. He further claimed there could not be in substitution or addition a suit for damages (in effect specific performance). The court recognized that Kansas state law provides:

• an operating agreement may specify the penalties or consequences to members who fail to comply with the terms and conditions of the operating agreement (KSA § 17-7691);
• that a member who fails to make a required
contribution is obligated, at the option of the LLC, to contribute cash equal to the value of the agreed obligation (KSA § 17-76-100(a));

- that reduction in membership interest was an acceptable penalty for defaulting on a contribution obligation (KSA § 17-76-100(c)); and

- a catch-all providing that the rules of law and equity apply, if not otherwise provided in the act (KSA § 17-76-135).

The court was satisfied that the interest-dilution provision was clearly stated and that the operating agreement did not provide for any additional remedies. It noted that a remedy such as damages is so fundamental that failure to mention it in an operating agreement is an expression of clear intent that damages cannot be assessed against a member who defaults on a contribution obligation absent such a stated remedy.

By contrast, although the operating agreement under consideration in Skyscapes of Castle Pines, LLC v. Fischer, 337 P.3d 72 (Kan. App. 2014) (slip opinion), provided an interest-dilution remedy for contribution-defaults, the court found that was not the exclusive contribution-default remedy in the agreement. This case involved a real estate venture that collapsed along with the real estate market generally in the late 2000s. When one member refused to make contributions required by a managers-initiated capital call, see Brief of Appellee, 2014 WL 2113037 (Kan. App. Apr. 7, 2014), the LLC sued the defaulting member. The court found that the Skyscapes operating agreement did not make interest-dilution the sole remedy for contribution-defaults. In fact, the court stated that interest dilution does not extinguish the defaulting member’s personal liability. This operating agreement specifically provided that the rights and remedies of the parties under the agreement are not mutually exclusive and preserved equitable remedies. The court noted that money damages (a remedy at law) might be inadequate in some instances and that nothing in the operating agreement was intended to limit any rights at law or by statute or otherwise for breach of a provision.

The Skyscapes court recognized that the situation under which default occurs could affect parties’ preferences for different remedies. In the situation Skyscape faced, the court observed that in the circumstance of a failing venture, the participants would have strong economic incentive to avoid complying with a capital call, and interest-dilution as a remedy would be singularly ineffective. The contributing members would not “be too happy about making up the delinquency and, thereby, garnering a greater interest in what had turned into a losing proposition.” The preferable remedy for the other members and the entity would be suing to collect from the defaulting member the assessed but delinquent contribution. Based upon that reasoning, the court concluded that it “seems unlikely the operating agreement would have been written to limit the participants’ remedies that way.”

The Skyscapes court distinguished the Skyscapes operating agreement from the Canyon Creek operating agreement in holding that the defaulting member was personally liable to make the additional capital contribution. Although both agreements included interest-dilution remedies, the Skyscapes agreement did not make that the exclusive remedy. The Skyscapes preservation of remedies and other provisions provided other remedies that the entity could seek against a member who failed to satisfy contribution obligations.

The operating agreement in Vinton v. Grayson, 189 A.3d 695, 2018 WL 2993550 (Super. Ct. Del. June 13, 2018), granted Vinton, the manager, sole authority to make capital calls in good faith. Any member who failed to make an additional contribution within 45 days after the notice of the capital call automatically transferred 50 percent of the member’s units to the contributing members. A noncontributing member forfeited the remaining 50 percent of the member’s units by failing to make the contribution within 180 days after the first notice of the capital call. The operating agreement also provided: “The rights and remedies provided by this Agreement are given in addition to any other rights and remedies a Member may have by law,
The lesson to be drawn from these three cases is that an LLC operating agreement or limited partnership agreement (entity agreement) may provide that interest-dilution (or readjustment-of-interests including forfeiture) is the exclusive remedy if a member defaults on a contribution obligation. What is less clear is whether an entity agreement must expressly provide that interest-dilution is the exclusive remedy, or whether failure to provide for any other remedy is sufficient to create exclusivity. The court in Canyon Creek found that the absence of a provision for other remedies made interest-dilution the sole remedy. The court in Vinton suggested that the absence of a statement that interest-dilution is the exclusive remedy, combined with other language preserving other options, indicated that the LLC could pursue a damages remedy. The court in Vinton also relied upon a preservation-of-remedies clause in the operating agreement to hold that the LLC had a cause of action for damages against the defaulting member. Absent such a preservation-of-remedies provision, perhaps the Vinton court, like the Canyon Creek court, would have found that interest-dilution was the exclusive remedy.

The combination of these cases provides a road map for either making interest-dilution the exclusive contribution-default remedy, or preserving damages as a remedy. To make interest-dilution the exclusive remedy, the entity agreement should provide for that remedy, should state that it is the exclusive remedy for failure to meet a contribution obligation, and either not include a preservation-of-remedies clause or, if one is included for other purposes, exclude from its scope contribution default. To provide for interest-dilution or damages as a remedy, an entity agreement should state that interest-dilution is not the exclusive remedy. The entity agreement may accomplish that with a preservation-of-remedies provision, but an express statement avoids ambiguity.

Drafting an entity agreement to establish interest-dilution as the exclusive contribution-default remedy or as one of multiple contribution-default remedies is only part of the challenge attorneys face in advising clients with respect to this issue. Clients may also seek advice about whether interest-dilution should be the exclusive remedy. The court in Skyscapes recognized that nondefaulting members will be disappointed if the LLC is unable to recover damages from a defaulting member of a failing LLC, and that interest-dilution would be singularly ineffective in such circumstances. The defaulting member would, of course, be relieved to know that the agreement did not require throwing good money after bad. If every member defaults, all might avoid the good-money-after-bad situation. Parties have the freedom to contract and determine which contribution-default remedies to include in their entity agreements. The difficulty they face is making that choice upon formation of the entity or as part of an amendment to an existing entity agreement.

At the time of formation, parties should be optimistic about a venture’s prospects. In that state of mind, the members may think about how they will deal with a weak member—one who is unable to meet a capital-call obligation. The optimism bias that infects all the members will blind them from seeing the possibility that one of them might be the member facing financial hardship and the inability to meet a capital-call obligation in the future. Thus, the members will be open to a contribution-default remedy that will be painful to the defaulting member. Under the influence of their optimism bias, they may believe that at the time of the future capital call, the entity will be increasing in value, and interest-dilution will be a painful and suitable remedy against the defaulting member. Thus, they will prefer interest-dilution with an eye toward upside potential.

Attorneys should remind the venturers that it is possible for the entity to lose money. If the venture is in a loss situation with doubtful future prospects, then perhaps no member will want to be liable to make any additional capital contributions. Attorneys should help members consider whether they want to be liable to make
additional capital contributions to a failing entity. At the start of a venture, the members would not foresee the venture failing, but they should be able to appreciate that they would not want to throw good money after bad and would want a mechanism in place that would limit their liability for making additional contributions to a failing entity. Thus, contrary to the Skyscapes court’s view that the members will not be too happy if interest-dilution is the exclusive contribution-default remedy, one could understand why, at the time of formation, the members would agree to interest-dilution as the exclusive remedy. The Skyscapes court may have been presumptuous in focusing solely on the state of mind of the members when the entity was failing. Their preference most likely would have been quite different at the time of formation.

One must also question the contributing members’ motive in bringing a claim for damages instead of opting for interest-dilution. Making interest-dilution the sole remedy could be a form of Ulysses pact. The members in both Skyscapes and Vinton opted to bring damages claims against the defaulting members instead of applying interest-dilution. Those members may be kicking themselves now. The value of real estate in many markets across the country has increased in value significantly since the financial crisis. Members who contributed to a losing venture during the crisis and awaited the market upswing should have profited significantly from an interest-dilution remedy. As the market rebounded, the contributors owned property that they acquired at a low price. In the midst of a crisis, they may not realize that interest-dilution will be their best alternative. If they recognize this possibility at formation, they can include interest-dilution as the sole contribution-default remedy to ensure that they benefit from the cheap membership interests instead of seeking damages from defaulting members.

Members may have additional interests to address in choosing default remedies. If only certain members are personally guaranteeing the bank debt, they are especially incentivized to have the entity collect contributions and apply them to pay down the bank debt. Even if all of the members have guaranteed an entity liability, as appeared to be the case in Skyscapes, the contributing members would most likely prefer that the defaulting member be obligated to make the additional contribution to avoid legal action from the lender. The preference could be practical or perceptional. As a practical matter, the contributing members may have deeper pockets, and if the guarantors are jointly and severally liable on the guarantee, the lender could collect the entire balance from them. From a perception standpoint, the contributing members may prefer not to be named in legal action by the lender. Their concern may be multidimensional. As members of the entity, their identities may not be publicly known. Legal action by the lender to collect on the guarantee would publicize their identities. A public legal battle about an unpaid debt could also harm the reputations of the members and make them less attractive as investors in other deals. Consequently, the existence of guarantees on an entity’s liability may incentivize contributing members to have the entity proceed against the defaulting member under a breach-of-agreement theory.

A challenge members will face with interest-dilution remedies in failing LLCs or partnerships is computing the interest adjustments when at least one member defaults and at least one other member acts on a capital call. The dilution denominator will affect the adjustments and in some situations could make the computations of adjustments challenging. Examples of contribution-denominated adjustments and value-denominated adjustments illustrate the challenge of adjusting interests in loss LLCs or partnerships that have negative value. The agreements in Canyon Creek and Skyscapes, see Brief of Appellee, 2014 WL 2113037 (Kan. App. Apr. 7, 2014), provided for contribution-denominated adjustments, computing a member’s percentage interests by dividing the member’s total contributions by the total contributions to the entity. Thus, if a member has contributed $250,000 to an LLC, and the total contributions to the LLC equal $1,250,000, the member will have a 20-percent interest in the LLC ($250,000 ÷ $1,250,000). If that same member contributes another $500,000 to the LLC and no other member makes a contribution, the member’s percentage interest will become about 43 percent ($750,000 total member contributions ÷ $1,750,000 total contributions to entity). The value of the entity does not affect a member’s interest if percentage interests are contribution-denominated. Although contribution-denominated interest adjustments raise interesting and challenging tax and financial
questions (e.g., is there a taxable capital shift if value differs from contributions, and does the contributor pay a premium or receive a discount on the additional interests acquired?), they are easy to compute.

Value-denominated interest adjustments, on the other hand, use the members’ share of the value of the entity’s assets to determine their percentage interest. For instance, if a member has a 20-percent interest in an LLC that has assets valued at $1,500,000, the member’s share of that value would be $300,000. If the member makes a $500,000 contribution, and no other member makes a contribution, the value of the LLC’s assets will increase to $2,000,000. The value of the member’s share in those assets will be the member’s $300,000 precontribution value plus the member’s $500,000 contribution, or $800,000. Thus, the member’s post-contribution interest will be 40 percent ($800,000 member’s precontribution value + additional member contribution ÷ $2,000,000 entity precontribution value + additional member contribution). Determining the value of an entity’s assets could be difficult, but once the members know that value, they can easily determine their interests in the entity using value-denominated adjustments.

Computing value-denominated adjustments becomes more challenging if an entity has negative value. To illustrate, an LLC might burn through all member capital contributions and borrow $1,000,000 to fund operations. After that money is spent, the entity would owe $1,000,000 and have no assets, so its value would be negative $1,000,000. Assume a member makes a capital contribution of $500,000, no other member makes a contribution, and the operating agreement provides for interest-dilution as a remedy in such situations. If the LLC provides for contribution-denominated adjustments, then computing the adjustment will be straightforward, even though the entity has negative value.

The contributing member may, however, be disappointed to find that the contribution, which provides the entity its only capital, might have nominal effect on the interest adjustment. If the operating agreement provides for value-denominated adjustments, then computing the adjustments will be a challenge. If, prior to the contribution the contributing member’s percentage interest was 20 percent, then the value of that interest would be negative $200,000. Following the contribution, the LLC’s value would be negative $500,000. The member’s share of that value depends upon the member’s percentage interest, and the member’s percentage interest depends upon the effect that the member’s contribution has on the value of the LLC and the value of the member’s interest. The contribution would appear to change the value of the member’s interest from negative $200,000 to positive $300,000, and change the value of the entity from negative $1,000,000 to negative $500,000. Imagining how a member’s interest in an entity could be positive while the entity’s value is negative is a challenge. Computing the members’ interest in the entity following the contribution to a negative-value entity is also a challenge. Given that math does not appear to provide an obvious answer, members should consider how they will address interest adjustments in entities that have negative value if they do not provide for damages as a remedy.

Last, consideration must be given to the capacity to enforce whatever rights remedy may be provided for in a particular entity agreement. In both Canyon Creek and Skyscapes, the manager-managed LLC was the plaintiff against the defaulting member. In contrast, Vinton was brought by the members who had satisfied their respective contribution obligations against the member who had not; the LLC itself does not appear to have been a party to the action. This raises the question of standing. The operating agreement is a contract to which each of the members and the LLC are parties. See, e.g., Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 287 (Del. 1999). There is no dispute that the obligation to contribute capital is for the LLC’s benefit; members do not contribute capital to other members. For example, section 18-502 of the Delaware LLC Act refers to how a member “is obligated to a [LLC]” and the “right of specific performance that the [LLC] may have against such [defaulting] member.” The defendant, Grayson, argued in the Vinton case that only the LLC, and not the other members, could bring an action to enforce his capital contribution obligation. Applying the “Rights and Remedies Cumulative” provision of the operating agreement at issue in the Vinton case, namely:

\[ \text{[the rights and remedies provided by this Agreement}} \]
are given in addition to any other rights and remedies any Member may have by law, statute, ordinance or otherwise. All such rights and remedies are intended to be cumulative and the use of any one right or remedy by any Member shall not preclude or waive such Member's right to sue any or all other rights or remedies.

the court held, "Here, as signatories to the Route 9 Agreement, each of the Member Plaintiffs has standing to sue Grayson for his breach."

Reasonable minds may differ as to whether the Vinton court properly characterized the claims as direct. Regardless, the decision is the decision. Going forward, drafters must consider and address who does (and does not) have standing to enforce (and collect upon) defaulted capital-contribution obligations.

An LLC’s management structure may also affect whether the entity makes a capital call and whether it brings a cause of action against the defaulting members. In Canyon Creek, the contributing members obtained control of the entity following their contributions and the resulting interest adjustment. If they had successfully caused the LLC to obtain an award for damages, presumably Fox’s contribution would have realigned the members’ interests to the predefault percentages. At those percentages, the contributing members would not have a controlling interest. If the interest adjustment is retroactive, the members would not have had authority to issue the capital call. That dynamic creates interesting management considerations. Can members use contribution-default remedies to obtain temporary control, only to use that authority to obtain a contribution that effectively causes the contributing members to cede control? Such dynamics may affect whether contributing members bring a direct action against the defaulting member or cause the entity to bring the action.

Contribution-default remedies appear in most entity agreements and partnership agreements. The three cases discussed in this article consider the enforceability of contribution-default remedies in ventures that were losing money and appear to have had negative value. The issues raised in such situations may differ from issues that arise in ventures that have positive, increasing value. This article scratches the surface of legal, financial, and tax issues that contribution-default remedies raise. The questions raised but unanswered in this article are some of many that warrant detailed consideration. Advisors must begin to carefully account for these and other questions, and commentators should continue to research and explore the nuances of these provisions.

**ANOTHER LLC LOOPHOLE**

According to a recent public report, the collective winners of a major lottery drawing in New York were able to avoid identifying their individual identities through use of an LLC. According to those news reports, the winners of the lottery must be disclosed. In this instance, a group of workers who had won the lottery in a pool organized an LLC and assigned the lottery proceeds to it. The name of the LLC was disclosed, the members therein were not.
LLC and Partnership Transfer Restrictions Excluded From UCC Article 9 Overrides

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The organizational law of limited liability companies (LLCs) and partnerships has always fundamentally embraced an idea known as the “pick-your-partner principle,” under which transfers of a member’s or partner’s ownership interest are restricted by statute, and those restrictions may be tightened or loosened by agreement. In recent years the pick-your-partner principle has interacted in complex and not always practical ways with Article 9 of the Uniform Commercial Code (UCC). Since 2001, UCC §§ 9-406 and 9-408 have overridden a broad range of statutory and agreement-based anti-assignment provisions, subject to complex exceptions that have tended to protect the pick-your-partner principle in many significant respects, while also proving analytically very difficult to handle. Recently, however, in an important step forward, however, Article 9’s overrides of anti-assignment provisions have recently been amended to make them simply inapplicable to LLC and partnership interests.

One hopes that these amendments to Article 9’s overrides (hereinafter the “2018 amendments” because they were approved last year) will soon be enacted by the states, but in the meantime, the current overrides will remain on the books in various jurisdictions with all of their existing complexities. Accordingly, this article focuses not only on the 2018 amendments, but also on an analysis of the overrides as they now stand, as applied to LLC and partnership interests. The amendments themselves are quite simple, but the article discusses them only after analyzing the overrides because the amendments are more easily understood against that background.

I. Background on Unincorporated Organization Law and UCC Article 9

Any co-owner of a privately held business organization may have a substantial stake in determining who the other co-owners are. If a second co-owner has the power to transfer its interest to a stranger, then the second co-owner can, in effect, force the first co-owner into a venture with the stranger/transferee without the first co-owner’s consent. The policy and effect of the pick-your-partner principle under LLC and partnership law is to prevent such an outcome.

UCC Article 9, by contrast, has the very different policy orientation of facilitating voluntary transfers of personal property. Article 9’s most familiar application is to transfers of property as security for the repayment of loans, but Article 9 also applies to outright sales of certain types of personal property. Some of these transfers and outright sales are precisely those that the pick-your-partner principle seeks to prevent, and as a result, for personal property consisting of LLC or partnership interests, the interaction of the pick-your-partner principle with Article 9 has been complex and thorny. Some have even called it recondite.

Ownership interests in a business organization, particularly one that is unincorporated, can be formally or informally bifurcated into governance rights and economic (or financial) rights. Governance rights consist of the owner’s right to vote on, consent to, or otherwise make decisions about the organization’s activities, and the right to receive information about the organization. Economic rights consist of the owner’s entitlement to receive monetary distributions from the organization, whether from its profits or from an eventual dissolution and winding up. A complete ownership interest typically comprises both governance rights and economic rights. A good example of purely economic rights is a transferable interest in an LLC or limited partnership. See, e.g., Uniform Limited Liability Company Act (ULLCA) § 102(24) (2013).

Article 9 broadly covers ordinary security interests in both of the above aspects of ownership rights as well as in virtually all other personal property, plus the outright sales of some types of personal property, to be explained below. In light of this vast coverage, and in order to provide appropriately tailored rules for particular patterns of
transaction, Article 9 subdivides personal property into an array of statutorily defined “types” or classifications. The most important classification for purposes of this article is general intangibles, which is Article 9’s residual or catch-all classification, meaning that it includes any personal property that does not fall within the other Article 9 classifications. Hence, an asset is a general intangible only if it is not, for example, inventory or other goods, accounts, instruments, chattel paper, or securities or other investment property. See UCC § 9-102(a)(42). Examples of general intangibles range from trademarks to taxicab medallions, and centrally for purposes of this article, the category includes most LLC and partnership interests. (LLC or partnership interests may alternatively be classified as securities, using an opt-in process discussed in Part II.C.)

The other key type of property for purposes of this article is payment intangibles, which is a subset of general intangibles. The distinction between a general intangible that is also a payment intangible on one hand, and a general intangible that is not a payment intangible on the other, is that the former includes only general intangibles under which the “principal obligation” of the “account debtor” is “a monetary obligation.” § 9-102(a)(62). In this article, the important term “account debtor” may be understood simply as the entity that is obligated on a payment intangible or other general intangible, i.e., the LLC or partnership itself as opposed to its members or partners. To determine whether the “principal obligation” is “monetary,” one must weigh the relative importance of a member’s or partner’s governance and economic rights: if the LLC’s or partnership’s principal obligation in respect of the ownership interest is economic and thus “monetary,” then the ownership interest is a general intangible that is also a payment intangible (or simply “payment intangible” for short). Otherwise, the ownership interest is a general intangible that is not a payment intangible. In general, if a member or partner has governance rights that the LLC or partnership is obligated to respect, the ownership interest is likely a general intangible that is not a payment intangible.

This distinction between payment intangibles and other general intangibles affects Article 9’s scope, which is crucial to understanding the overrides because of course the overrides apply only within that scope. Article 9’s scope includes two principal types of transactions relevant to this article: interests in either payment intangibles or other general intangibles that secure a loan or another obligation (referred to in this article as ordinary security interests), and outright sales of payment intangibles. In fact, outright sales of payment intangibles are statutorily defined in Article 9 as “security interests,” purely as a matter of terminological convenience, because many (though not all) of Article 9’s rules for ordinary security interests also apply directly to sales of payment intangibles. By contrast, Article 9’s scope does not include outright sales of general intangibles that are not payment intangibles, because most of such sales have little enough in common with ordinary security interests that inclusion would not be sensible. (The boundary between an outright sale of property and an ordinary security interest in the property is not always self-evident, but that topic is beyond the scope of this article. See, e.g., § 9-109 cmt. 4.) One final note on Article 9’s scope is that transfers by gift or, generally, transfers by operation of law are not covered.

Bringing these strands together, Article 9 typically does not apply to all to the most common kind of transfer in this area—namely, outright sales of a member’s or partner’s complete ownership interest—because such a transaction is typically the sale of a general intangible that is not a payment intangible. By the same token, Article 9 does not apply to outright sales of a member’s or partner’s governance rights alone. But Article 9 does apply, and hence its overrides discussed below might apply, to ordinary security interests in complete ownership interests; to ordinary security interests in economic rights alone; and to outright sales of economic rights alone.

The fact that Article 9 applies to a particular transaction, though, does not necessarily mean that there is a practical conflict between an Article 9 override and the pick-your-partner principle. Whether a practical conflict exists depends on three elements. First, do the applicable statutes governing the organization directly restrict transfers? Such restrictions are universal or nearly so in the case of governance rights and complete ownership interests (e.g., ULLCA § 407(b)(2) (2013)), but they are nonexistent or nearly so in the case of economic rights (e.g., id. § 502(a)). Second, do the LLC’s or partnership’s own organic documents alter (or perhaps track) the statutory law just mentioned, for example by restricting transfers of economic rights? Organizations may indeed adopt restrictions on the transfer of economic rights, in order to ensure that all owners retain their economic stake in the organization and, as a result, have reasonably well-aligned governance incentives. And finally, if a restriction on transfer is imposed by either of the foregoing sources, does
one of the Article 9 overrides invalidate or limit the restriction?

II. Navigating Unamended §§ 9-406 and 9-408

Part of what makes Article 9’s overrides of anti-assignment provisions difficult is that they appear in two separate sections that are phrased quite similarly, but have subtle distinctions, and do not overlap. The first override, in § 9-406, is relatively strong and simple in its effects, but it applies to only a narrow set of transactions. The second override, in § 9-408, applies more broadly and is more complex in its provisions that apply to LLC and partnership interests, but it has only relatively weak effects on the transactions to which it applies. Taking into account the narrowness of the first and the weakness of the second, plus the availability of the opt-in process discussed in Part II.C, the overrides have generally not posed substantial problems for those who seek the protection of the pick-your-partner principle. On the other hand, general conclusions only take one so far in particular transactions.

A. Section 9-406

Article 9’s first override, beginning at § 9-406(d), invalidates any “term in an agreement between an account debtor and an assignor” to the extent that that term “prohibits, restricts, or requires the consent of . . . the account debtor” to “the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in . . . the payment intangible.” The simplicity of this provision is evident from its shortness, and the strength of this provision is that it overrides restrictions on all aspects of security interests, including “enforcement,” as further discussed below.

The § 9-406 override is narrow, however, in three important ways. First, it applies only to payment intangibles (leaving aside its application to other types of property not relevant to this article), and only to ordinary security interests in them. See § 9-406(e). In other words, the override does not apply to transfers of governance rights, in either an outright sale or an ordinary security interest; and it does not apply to transfers of a complete ownership interest in either an outright sale or an ordinary security interest, assuming that the complete ownership interest is a general intangible that is not a payment intangible. Nor does the override apply to an outright sale of a payment intangible (other than a foreclosure sale or a secured party’s acceptance of the payment intangible in satisfaction of the obligation it secures). See the discussion of § 9-408 in Part II.B. The narrowness of the § 9-406 override is important as a practical matter because when an LLC’s or partnership’s organic documents impose restrictions on transfer, the restrictions sometimes apply by their own terms only to governance rights or complete ownership interests, not to purely economic rights (classified as payment intangibles) in the first place.

Second, the § 9-406 override has no effect on an anti-assignment clause in an agreement among the organization’s members or partners inter se, as opposed to terms in an agreement with the organization itself. This is because the override applies only to terms in an agreement with “an account debtor” and the assignor/transferor, and as noted in Part I, the LLC or partnership itself, rather than the other members or partners, is the account debtor in this context. Moreover, there may be substantial grounds to question whether the override applies even to an anti-assignment clause that is set forth directly in the organization’s operating agreement, partnership agreement or other organic documents, because as a formal matter, an LLC or partnership is usually not a party to these agreements. On the other hand, substance-over-form arguments should be borne in mind on this point.

Third and relatedly, if the term of the agreement imposes a consent requirement, the override applies only if the consent required is that of the LLC or partnership itself, as opposed to one or more members or partners. For example, if an LLC is member-managed, the agreement will almost certainly require the consent of the members, and accordingly, the override will not apply to that requirement.

B. Section 9-408

Article 9’s other override, beginning at § 9-408(a), invalidates any term in “an agreement between an account debtor and a debtor which relates to . . . a general intangible” that “prohibits, restricts, or requires the consent of . . . the account debtor” to “the assignment or transfer of, or creation, attachment, or perfection of a security interest in . . . the . . . general intangible.” It also invalidates any provision of a statute or other rule of law that similarly “prohibits, restricts, or requires the consent of . . . [an] account debtor” to “the assignment or transfer of, or creation of a security interest in, a . . . general intangible.” Thus § 9-408 is more complex than § 9-406 as applied to LLC and partnership interests, because it overrides not only terms of agreements, but also statutes or other rules of law. (Although § 9-406 also overrides some
Section 9-408 is also broader than § 9-406 in two additional ways. First, it applies to a broader range of transactions, namely outright sales of payment intangibles (statutorily included in Article 9's term "security interest," as noted in Part I) and ordinary security interests in general intangibles that are not payment intangibles. Outright sales of economic rights, covered here, perhaps are more common than ordinary security interests in them, covered in §9-406; and certainly general intangibles that are not payment intangibles is the most common classification of an LLC or partnership interest.

Second, the statutes that § 9-408 overrides are of broad applicability because they are restrictions on the transfer of general intangibles that are not payment intangibles, i.e., virtually all complete ownership interests, plus all governance rights taken alone. As a practical matter, such statutory restrictions are nearly universal in this area, though a particular organization's organic documents may sometimes alter the statutory default rules.

On the other hand, just as for § 9-406 above, § 9-408 does not apply to an anti-assignment clause in an agreement among the organization's members or partners inter se, as opposed to an agreement with the organization itself. Similarly, and again just as for § 9-406, if the term of the agreement imposes a consent requirement, § 9-408 applies only if the consent required is that of the organization itself, as opposed to one or more members or partners. This override of consent requirements, in § 9-408 unlike § 9-406, extends to statutes as well as terms in an agreement, but nonetheless only if the consent required is that of the organization itself as opposed to one or more members or partners—but this is not how the LLC and partnership statutes work. Instead, the statutes place the power to give or withhold consent in the hands of the members or partners themselves.

The feature of this override that makes its effects relatively weak, and thereby substantially accommodates parties seeking the protection of the pick-your-partner principle, is that § 9-408 invalidates restrictions only on the "creation, attachment, or perfection" of security interests. It does not, unlike § 9-406, invalidate restrictions on "enforcement" of security interests. Subsection 9-408(d) amplifies on this point by specifying among other things that, even giving effect to the § 9-408 override, a security interest that is subject to an otherwise enforceable restriction is "not enforceable" against the "account debtor" (i.e., the LLC or partnership itself), and "does not entitle the secured party to enforce the security interest." In other words, under § 9-408, a security interest (including an outright sale of a payment intangible) may go forward as between the transferor and transferee, but not as between the transferee and the LLC or partnership. The secured party acquires property rights (an ordinary security interest or an ownership interest) to the transferring member's or partner's ownership interest, and the value of these rights would be respected, for example in a bankruptcy of the transferor, or as applied to proceeds from a transfer not affected by a restriction. See UCC § 9-408 cmt. 7. But the secured party is nonetheless without power of its own to step into the transferor's shoes and exercise the transferor's governance or economic rights.

Summarizing the substance of the two overrides, it is useful to think in terms of four permutations, based on the two classifications of collateral and the two forms of transaction. First, an outright sale of a general intangible that is not a payment intangible is not within the scope of Article 9, so neither override applies. Second, with an ordinary security interest in a general intangible that is not a payment intangible, the relatively weak override in § 9-408 applies, so that the secured party cannot enforce the transferred governance or economic rights against the organization. Third, with an outright sale of a payment intangible, again the relatively weak override in § 9-408 applies, so that the secured party cannot enforce the transferred rights against the organization. And fourth, with an ordinary security interest in a payment intangible, the relatively strong override in § 9-406 applies, so that the secured party can enforce the transferred rights against the organization. The Permanent Editorial Board for the Uniform Commercial Code (P.E.B.) is considering issuing a report that would further detail the application of both overrides to LLC and partnership interests.

C. Opting into Article 8

Neither of the Article 9 overrides applies to property that is a security as defined in UCC Article 8. This is because securities are classified by Article 9 as "investment property" rather than as general intangibles or, a fortiori, payment intangibles.

The term "security" generally does not include ownership interests in LLCs and
partnerships, but it does include them if the “terms” of the ownership interest “expressly provide that it is a security” governed by Article 8. See §§ 8-102(a)(15), 8-103(c). Hence, one established way for transactional lawyers to avoid the overrides altogether is to have the organization “opt in” to Article 8 by adopting appropriate provisions in its organic documents. Related measures include providing for the security to be certificated or uncertificated, and preventing the organization from opting back out of Article 8 without the consent of the parties concerned.

III. The 2018 Amendments, Non-Uniform Amendments, and Choice of Law

Compared to the complex analysis in Part II, enactment of the 2018 amendments will markedly simplify the law in this area, eliminating the possible conflicts with the pick-your-partner principle that can remain despite the exceptions in §§ 9-406 and 9-408, and without the need for an Article 8 opt-in.

The 2018 amendments statutorily provide that Article 9’s overrides do not apply to “a security interest in an ownership interest in a general partnership, limited partnership, or limited liability company.” (In § 9-406, this language appears in a new subsection (k), which explicitly applies to subsections (d), (f), and (j). In § 9-408, the same language appears in a new subsection (f), which explicitly applies to the entire section.) A new comment to § 9-408 reads:

This section does not apply to an ownership interest in a limited liability company, limited partnership, or general partnership, regardless of the name of the interest and whether the interest: (i) pertains to economic rights, governance rights, or both; (ii) arises under: (a) an operating agreement, the applicable limited liability company act, or both; or (b) a partnership agreement, the applicable partnership act, or both; or (iii) is owned by: (a) a member of a company or transferee or assignee of a member; or (b) a partner or a transferee or assignee of a partner; or (iv) comprises contractual, property, other rights, or some combination thereof.

A new comment to § 9-406 provides that the § 9-408 comment applies to § 9-406 as well.

By excluding from the overrides “a security interest” in an ownership interest, the 2018 amendments permit outright sales of payment intangibles to go forward, as well as ordinary security interests in payment intangibles, and ordinary security interests in general intangibles that are not payment intangibles. The overrides remain in effect for general intangibles that are not LLC or partnership interests and for other classifications of personal property that are not relevant to this article.

The 2018 amendments were initially recommended by the P.E.B. in conjunction with representatives from the Joint Editorial Board on Uniform Unincorporated Organization Acts. They were then approved in accordance with the respective procedures of the UCC’s two sponsoring organizations, the American Law Institute and the Uniform Law Commission. As a result, they are now a part of the UCC’s official text.

At the time of this writing, it is too early for the 2018 amendments to have been enacted in any jurisdiction. On the other hand, in recent years a number of states, led by Delaware, have enacted non-uniform provisions having the same thrust. Some of the non-uniform provisions appear in the enacting states’ UCC; others appear in their LLC and partnership organizational statutes; and others appear in both spots, as belt and suspenders and to ensure they will be found.

An important conflict-of-laws question can arise if a transaction involves elements from more than one jurisdiction, one of which has the unamended Article 9 overrides, and another of which has an eventual enactment of the 2018 amendments (or an existing, comparable non-uniform provision). Article 9’s conflicts rule for perfection and priority of security interests in general intangibles does not apply to the treatment of transfer restrictions, because this issue is neither “perfection,” “the effect of perfection or nonperfection,” nor “priority.” See § 9-301(1). Article 1’s main catch-all conflicts rule, which leaves some conflicts questions to the agreement of the parties, would also generally be inappropriate here because transfer restrictions inherently present a three-party question that is not amenable to treatment by two-party agreement. See § 1-301(a). Accordingly, a choice-of-law clause in the security agreement or other agreement between transferor and transferee does not control, as Comment 3 to § 9-401 makes clear. Instead, one would hope that a court would apply the version of the overrides enacted by the jurisdiction in which the entity is organized, as the same Comment assumes. (The “internal affairs” doctrine in business entity law would also be consistent with such an outcome, although of course, restrictions on transfers to nonmembers or nonpartners are not strictly internal affairs issues.) In any case, the bottom line is that real certainty in this area will most promisingly have to come from
broad enactment of the 2018 amendments. The members of each state’s Uniform Law Commission delegation can often be of direct help in those enactment efforts.

* * *

The 2018 amendments will protect the pick-your-partner principle while also greatly simplifying and clarifying its interactions with Article 9. By the same token, as is often true of simple rules, the 2018 amendments may also sometimes reach more broadly than really needed, for example by preventing simple attachment and perfection, without enforcement, of a security interest in a complete ownership interest. However, those transactions can continue to go forward despite the 2018 amendments by means of, for example, the Article 8 opt-in, or other amendment or waiver of the organization’s organic documents. On balance, the gains in this area from simplicity and clarity should clearly outweigh the losses from the occasional extra burden to an Article 9 transaction.

Joan Heminway Recognized for Her Work on Behalf of the Bench & Bar

Recently the University of Tennessee College of Law presented the Tom & Elizabeth Fox Faculty Award for Service to the Bench & Bar to Joan Heminway. Following is the text of the speech that was given by Dean Wilson at the awards banquet announcing Joan as the winner of the award.

This award honors the memory of the late Tom Fox, a 1948 graduate of the College of Law, and his late wife Elizabeth Fox, who graciously endowed a fund to benefit the greatest needs of the College. This year, the award recognizes a member of our law faculty for his or her outstanding service to the Bench and Bar.

This year’s recipient of the Fox Award serves the bench and bar in numerous ways. She has been active in the Hamilton Burnett Chapter of the American Inns of Court since 2002. For over fifteen years, she has played a key role in numerous Tennessee Bar Association committees focused on business law in Tennessee. She participated in the TBA’s Revised Uniform Limited Partnership Act Revision Committee and its LLC Act Revision Committee. She is currently a member of the TBA’s Business Entity Study Committee and Business Law Section Executive Council. When Tennessee adopted the Uniform Bar Exam and began developing a Tennessee Law Course, she took the lead in preparing course materials on Tennessee Business Organizations. I am pleased to announce that the recipient of the Fox Award for Outstanding Service to the Bench & Bar is Professor Joan Heminway.
Quick Take on Polsky’s Explaining Choice-of-Entity Decisions by Silicon Valley Start-Ups

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Perhaps the most fundamental role of a business lawyer is to recommend the optimal entity choice for nascent business enterprises. Nevertheless, even in 2018, the choice-of-entity analysis remains highly muddled. Most business lawyers across the United States consistently recommend flow-through entities, such as limited liability companies and S corporations, to their clients. In contrast, a discrete group of highly sophisticated business lawyers, those who advise start-ups in Silicon Valley and other hotbeds of start-up activity, prefer C corporations.

Prior commentary has described and tried to explain this paradox without finding an adequate explanation. These commentators have noted a host of superficially plausible explanations, all of which they ultimately conclude are not wholly persuasive. The puzzle therefore remains.

This Article attempts to finally solve the puzzle by examining two factors that have been either vastly underappreciated or completely ignored in the existing literature. First, while previous commentators have briefly noted that flow-through structures are more complex and administratively burdensome, they did not fully appreciate the source, nature, and extent of these problems. In the unique start-up context, the complications of flow-through structures are exponentially more problematic, to the point where widespread adoption of flow-through entities is completely impractical. Second, the literature has not appreciated the effect of perplexing, yet pervasive, tax asset valuation problems in the public company context. The conventional wisdom is that tax assets are ignored or severely undervalued in public company stock valuations. In theory, the most significant benefit of flow-through status for start-ups is that it can result in the creation of valuable tax assets upon exit. However, the conventional wisdom makes this moot when the exit is through an initial public offering or sale to a public company, which are the desired types of exits for start-ups. The result is that the most significant benefit of using a flow-through is eliminated because of the tax asset pricing problem. Accordingly, while the costs of flow-through structures are far higher than have been appreciated, the benefits of these structures are much smaller than they appear.

Before commenting, let me be clear: I am not an expert in tax or in start-up entities, so my take on this falls much more from the perspective of what Polsky calls "main street businesses." I am merely an interested reader, and this is my first take on his interesting paper.

To start, Polsky distinguishes "tax partnerships" from "C Corporations." I know this is the conventional wisdom, but I still dislike the entity dissonance this creates. Polsky explains:

Tax partnerships generally include all state law entities other than corporations. Thus, general and limited partnerships, LLCs, LLPs, and LLLPs are all partnerships for tax purposes. C corporations include state law corporations and other business entities that affirmatively elect corporate status. Typically, a new business will often need to choose between being a state-law LLC taxed as a partnership or a state-law corporation taxed as a C corporation. The state law consequences of each are nearly identical, but the tax distinctions are vast.

As I have written previously, I'd much rather see the state-level entity decoupled from the tax code, such that we would have (1) entity taxation, called C Tax, where an entity chooses to pay tax at the entity level, which would be typical C Corp taxation; (2) pass-through taxation, called K Tax, which is what we usually think of as partnership tax; and (3) we get rid of S corps, which can now be LLCs, anyway, which would allow an entity to choose S Tax.

As Dinky Bosetti once said, "It's good to want things."

Anyway, as one who focuses on entity choice from (mostly) the non-tax side, I dispute the idea that "[t]he state law consequences of each [entity] are nearly identical, but the tax distinctions are vast." From governance to fiduciary duties to creditor relationships to basic operations, I think there are significant differences (and potential consequences) to entity choice beyond tax implications.

I will also quibble with Polsky's statement that "public companies are taxed as C corporations." He is right, of course, that the default rule is that "a publicly traded partnership shall be treated as a corporation." I.R.C. § 7704(a). But, in addition to Business Organizations, I teach Energy Law, where we encounter Master Limited Partnerships (MLPs),
which are publicly traded pass-through entities. *See id. § 7704(c)-(d).*

Polsky notes that "while an initial choice of entity decision can in theory be changed, it is generally too costly from a tax perspective to convert from a corporation to a partnership after a start-up begins to show promise." This is why those of us not advising VC start-ups generally would choose the LLC, if it's a close call. If the entity needs to be taxed a C corp, we can convert. If it is better served as an LLC, and the entity has appreciated in value, converting from a C corp to an LLC is costly. Nonetheless, Polsky explains for companies planning to go public or be sold to a public entity, the LLC will convert before sale so that the LLC and C Corp end up in roughly the same place:

The differences are (1) the LLC’s pre-IPO losses flowed through to its owners while the corporation’s losses were trapped, but as discussed above this benefit is much smaller than it appears due to the presence of tax-indifferent ownership and the passive activity rules, (2) the LLC resulted in additional administrative, transactional, and compliance complexity (including the utilization of a blocker corporation in the ownership structure), and (3) the LLC required a restructuring on the eve of the IPO. All things considered, it is not surprising that corporate classification was the preferred approach for start-ups.

This is an interesting insight. My understanding is that the ability pass-through pre-IPO losses were significant to at least a notable portion of investors. Polsky’s paper suggests this is not as significant as it seems, as many of the benefits are eroded for a variety of reasons in these start-ups. In addition, he notes a variety of LLC complexities for the start-up world that are not as prevalent for main street businesses. As a general matter, for traditional businesses, the corporate form comes with more mandatory obligations and rules that make the LLC the less-intensive choice. Not so, it appears, for VC start-ups.

I need to spend some more time with it, and maybe I’ll have some more thoughts after I do. If you’re interested in this sort of thing, I recommend taking a look.

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**2019 Status of the Uniform Protected Series Act**

Based upon information provided by the Uniform Law Commission on March 1, the Uniform Protected Series Act is pending in the following jurisdictions:

- Arkansas (HB 1611)
- Connecticut (HB 7127)
- Iowa (HS B209)
- Iowa (SB 1199)
- Tennessee (HB 1296)
- Tennessee (SB 995)
- Virginia (HB 2272)
Each day of your life you do something you have never done before

Each day of your life you do something you will never do again

Like many of the clients we advise who enter into unincorporated business relationships, those of us who work and play in the unincorporated business organization vineyard have unique and nuanced relationships with each other. One of the benefits of flexibility is that a well-structured relationship changes as the lives of its members change. In this regard three recent events have reminded me how fortunate we are to have the friends and colleagues we do, and how important it is to appreciate the transitions in the lives of those with whom we share these experiences.

Since the beginning of the current year, three people, each a close friend of mine and important part of the story of the development of unincorporated law have undergone significant changes: George Coleman has retired from the practice of law. Tony van Westrum died while taking photographs in the snow, and Allen Sparkman has been diagnosed with ALS. These events, some tragic, some liberating, some sobering are not the only significant events that members of our community have experienced – many other changes in the personal lives of our colleagues and friends are occurring all the time and this is not meant to minimize the significance of those event but rather to remind each of to pay attention to our colleagues and the changes occurring to them. Nonetheless, these events happening as they have since the beginning of this year barely three months old, provide a jarring reminder that we should take the time to think of, appreciate, and thank the people with whom we share life’s burdens and excitement.

Early in 2019, I received an E-mail from George Coleman which stated, “Great news, I have officially retired from active law practice and given up my office at the firm. I will remain as “of counsel” to the firm (without being employee of the firm). So please change my email address and telephone number to: gwcoleman@sbcglobal.net and 214.668.5690. I plan to continue my speaking and teaching for at least next couple of years.” Shortly thereafter, I received the news that Tony van Westrum had died, and then that Allen Sparkman had been diagnosed with ALS. Each of George, Tony, Allen has always put the development of the law and solving problems ahead of the seemlier aspects of the practice such as pecuniary gain and personal aggrandizement.

Anthony van Westrum, who was admitted to the practice of law in October 3, 1969, has participated in statutory drafting projects at the state and national level since the late 1980’s. Tony combined an engineer’s fine judgment (B.S. Mechanical engineering from Purdue) with a Michigan Law Review quality legal mind. His tenacity and good judgment earned him the respect of his friends and colleagues in Colorado as he shepherded and cat-herded the revision to the corporation code through the Colorado legislature in the late 1980s and early 1990s, even before most of us had any idea what an LLC was.1 Tony died suddenly on January 20th,2 his passing shocked his Colorado friends.3

His engineering precision and rigorous thought process made him the amanuensis for each Colorado committee with which he served. When in 2004 the Colorado drafting committee brought forth a revision of business organization law so large it had to be presented to legislators in electronic form, it was only though Tony’s leadership (and Allen’s help) that it was possible to get the legislation drafted and passed. Tony was given special recognition in the introductory comments to the Uniform Partnership Act of 1997.4 He was a member of the Colorado Bar Association Ethics Committee,5 the American

1 Bill Callison called Tony upon the enactment of the Colorado Corporation Code in 1993 and made a comment to the effect the adoption – in which Tony was a key player and took a couple of trips to legislature – was a wonderful achievement, but then Bill asked, “what is a corporation?”


3 See the personal comments from some of Tony’s friends including lawyers, judges, and a justice of the Colorado Supreme Court at https://www.dignitymemorial.com/obituaries/wheat-ridge-co/anthony-van-westrum-8135609.


5 One Ethics Committee member referred to Tony as “the conscience of the bar.”
Law Institute, the Colorado Bar Association Executive Council, the Colorado Supreme Court Standing Committee on the Rules of Professional Conduct. He received the Award of Merit from the Colorado (2010) and Denver (2006) Associations (in each case, the highest award granted by association), and the Colorado Bar Association Sue Burch Award for legislative activities.

In each of his endeavors – statutory drafting; bar work on alternative dispute resolution, diversity, and ethics; gratuitous mentoring of younger lawyers, and professional practice – Tony worked selflessly to bring lawyers together and to make the practice of law the noble calling we all imagined it to be when we went to law school.

Tony was fond of the metaphor of treating each day of your life as a gold coin, of which we are each granted only a certain number. Tony endeavored to spend each of those days in making the world a better place for lawyers and their clients. Since Tony’s death, I have discovered that virtually every person who came into contact with Tony has a story about a book received from Tony or an act of generosity or wise comment made by Tony that solved a problem.

George Coleman, a Lubaroff laureate in 2007, was admitted to the practice of law on September 17, 1963. Like Tony, George’s undergraduate degree is in engineering (in George’s case, petroleum engineering from the University of Oklahoma, 1961). From 1963 to 2006 George practiced with Jenkins and Gilchrist, where he was a protege and friend of Allan Bromberg, another Lubaroff Award recipient and a direct link with Judson Crane and the birth of partnership legislation in the United States. George, with Beth Miller, Daryl Robertson and other Texas lawyers moved the law of unincorporated organizations forward in Texas and developed the University of Texas Partnership (now LLC, LPs, and Partnerships) program which has been conducted annual for over a quarter century. As stated by Tom Rutledge, “George is one of those all too few persons whose life and career embodies ‘service to the community.’”

In 1995, long before Texas and Colorado adopted cross-entity or junction box statutes, George (sub nom Azel Society) developed the UNIversal [Contractual] ORgaNization Act or UNICORN, the earliest precursor of the Texas Business Organizations Code and the Model Entity Transactions Act. George has been recognized by his colleague through the receipt of the Dallas Bar Association Justinian Award (April 2007) and the Texas Bar Foundation Dan Rugeley Price Memorial Award (June 2009) (reflecting George’s recognition as “an outstanding lawyer who exemplifies the qualities of an accomplished legal writer and researcher, a talented and dedicated practicing lawyer, a servant to the profession as a volunteer and advocate on its behalf, unreserved in his commitment to his clients, his practice of our profession, his dedication to the Bar and his service to the public.”)

Allen Sparkman, who began practicing law in 1973, has been diagnosed with amyotrophic lateral sclerosis (ALS), also known as Lou Gehrig’s disease, one of the most challenging disorders facing those affected and their families. He reports that he has a great group of doctors at the ALS Center at Houston Methodist Hospital (https://www.houstonmethodist.org/neurology/locations/texas-medical-center/clinical-programs/als-clinic/). He reports that, although he will not be able to travel, he is still staying involved in the legal issues to which he has contributed over the years and continues to think about the issues we all spend our time on. As stated on the Houston Methodist website, “[f]or patients suffering from ALS, every day is a battle that demands inner strength and tremendous courage. For their families, it is a test of caring and patience.” Allen is maintaining his traditional strength and humor indicating that he has a great medical team and there are new drugs that slow the disease down.

Allen has been actively involved in statutory revision in Colorado (including a working weekend in 2004 in which Allen and Tony completely revised Colorado statutes dealing with business organizations), Texas and nationally, and has been a prolific author and speaker on alternative entities in Colorado, Texas and, through the ABA, nationally. Allen was the person who introduced me to LLCs in the late 1980s. Professionally, he has served as a consulting or testifying expert in Colorado, Texas, and California. Allen has also been actively involved in legal ethics for the Colorado

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6 Rutledge, George W. Coleman to Receive Martin I. Lubaroff Award, Pubogram (November 2007) at page 3.
Allen was an officer in the United States Army from January 1969 through April 1971 and earned a Certificate in Theology and Ministry from Princeton Theological Seminary in 2015. He and Adrienne Bond share a love of photography and Allen is very proud of his children, both of whom are professionals, like Allen, working to make the world a better place: Julian Overstreet, a human relations executive, David Sparkman, Ph. D. Civil Engineering, and Miriam Grace Sparkman Reece, MD.

When asked for the elevator speech describing the practice of the law of unincorporated or alternative entities, I describe it as the practice of the law of nonmatrimonial relationships. Each of Tony, George and Allen personify the best of this practice. It is not a coincidence that each of them exhibits expertise in ethics and professional responsibility. In some respects, the disciplines are similar — ethics may be thought of as agency with an attitude. Legal and client relationships are hard, but they are important. In each case the wisdom and kindness each has shared with many of us has made our work and lives immeasurably better.

Tony will continue in the consciousness of those whose life he touched and in the statutes to which he contributed, as will all the contributions and relationships we have had with Allen and George, although we can look forward to future contributions from and relationships with George and Allen. While there are many superb lawyers in the LPUE Committee, few personify the selflessness and wisdom reflected by Tony, Allen, and George. Each reminds of what we could be as relationship lawyers.

Each of us has been fortunate to have known Tony, George, and Allen, and, in the case of George and Allen, hope to have the opportunity to continue our friendships for a long time to come. We should all remember each of the colleagues with whom we practice, do volunteer work and, in Tony’s words “spend a majority of the gold coins of life.” In the words of a person who understood these relationships better than any of us, we should “do as adversaries do in law, strive mightily, but eat and drink as friends.”

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7 I sometimes think of partnership breakups as just like divorces except without the fond recollections of intimacy.

8 The Taming of the Shrew, Act 1, scene 2, 274-275.
WORTH READING


PLANNING AHEAD

The Committee on LLCs, Partnerships and Unincorporated Entities will meet three times in 2019: at the Spring Meeting of the Section on Business Law, at the Annual Meeting of the Section of Business Law, and at the 2019 LLC Institute. Looking forward:

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<td>2019 ABA BLS Annual Meeting</td>
<td>September 12-14, 2019</td>
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<td>2019 LLC Institute</td>
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The detailed schedules for Committee meetings and programs at these meetings will be announced in future issues of the LLC & Partnership Reporter.
Case Law Reviews

This issue of the LLC & Partnership Reporter contains two current case law reviews. In addition, because they were not available when the last LLC & Partnership Reporter went to press, included as well are the trio of case law reviews presented at The 2018 LLC Institute.
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Miscellaneous Recent (Non-Delaware) Partnership and LLC Cases

Elizabeth S. Miller

Veil Piercing

_Sky Cable, LLC v. DIRECTV, Inc._, 886 F.3d 375 (4th Cir. 2018).

After a judgment against an LLC and its sole member went unsatisfied, the district court entered an amended judgment that reverse pierced the veil of three other LLCs owned by the individual and made them co-judgment debtors with the individual. On issues of first impression, the court of appeals affirmed the district court’s decision and held that Delaware law permits the remedy of reverse veil piercing when the LLC is the alter ego of its member.

In 2000, Randy Coley, through his subsequently-defunct East Coast Cablevision, LLC (“ECC”), contracted with DIRECTV, Incorporated (“DIRECTV”) to provide its programming to 168 rooms at a Virginia resort. In 2011, an investigation by DIRECTV revealed a fraudulent scheme pursuant to which ECC and Coley received payment for cable services provided by DIRECTV to over 2,500 units at the resort while continuing to pay DIRECTV only for those services provided to the 168 units. DIRECTV eventually obtained a judgment for $2.4 million against Coley and ECC for violations of federal communications law based on the unauthorized receipt and distribution of DIRECTV’s programming.

Coley dissolved ECC after the district court entered its judgment, and DIRECTV was unable to collect any payment from Coley, who had few personal assets. Discovery in the post-judgment phase of the case revealed that several LLCs owned and managed by Coley held title to or managed Coley’s assets. DIRECTV filed a motion in the district court to reverse pierce three LLCs owned and managed by Coley in order to obtain access to the assets of these LLCs. These three companies were not parties to the case and had not been served with process. In 2016, the district court entered an amended judgment rendering the three LLCs co-judgment debtors with Coley and held that: (1) under Delaware law, the three LLCs were alter egos of Coley; (2) Delaware would recognize reverse veil piercing under such circumstances; and (3) DIRECTV’s failure to serve process on the three LLCs did not prevent the court from exercising jurisdiction over them. Coley and one of the three LLCs appealed, arguing that Delaware law does not permit reverse piercing of a corporate veil even when the corporation is the alter ego of the judgment debtor, and that Delaware’s LLC charging order statute provides the exclusive remedy for a judgment creditor seeking access to the financial interest of an LLC’s member.

The court of appeals reviewed de novo whether Delaware law would permit reverse piercing of an LLC. The court first discussed corporate and LLC veil piercing in general and distinguished the various types of veil piercing. The court explained that traditional veil piercing permits a court to hold an owner liable for a judgment against the entity, whereas reverse veil piercing imposes liability on the entity for a judgment against an owner. The court further explained that an additional classification of reverse piercing concerns the origin of a request to the court to disregard the entity’s form: “insider” reverse piercing applies when the entity’s controlling owner makes such a request, whereas “outsider” reverse piercing (relevant here) applies when an outsider/third party (often a creditor) makes the request.

Because the law of the state in which an entity is “incorporated” generally governs the question of whether a court may pierce an entity’s veil, and the parties did not dispute that Delaware law applied to the reverse piercing claim, the court relied on Delaware case law to analyze whether Delaware permits
reverse veil piercing. The court discussed Delaware’s recognition of traditional veil piercing as an equitable remedy in exceptional circumstances and noted that the purpose of reverse piercing is to hold a company liable for a member’s actions to prevent fraud or injustice. The court stated that reverse piercing is particularly appropriate when an LLC has a single member because there are no other members whose interests are affected. According to the court, “because Delaware courts apply the alter ego theory only in exceptional circumstances, recognition of reverse veil piercing for the limited purpose of preventing fraudulent conduct would not threaten the general viability of the corporate form in Delaware.” The court noted Delaware’s “powerful interest . . . in preventing entities that it charters from being used as vehicles for fraud,” and the court discerned that Delaware courts have “signaled some willingness to apply a theory of reverse veil piercing.” Thus, the court concluded that “Delaware would recognize outsider reverse veil piercing of an LLC’s veil when the LLC is the alter ego of its sole member.”

The court next analyzed Coley’s contention that Delaware’s LLC charging order statute precluded reverse piercing of his LLC based on the following “exclusivity” provision of the statute:

The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or a member’s assignee may satisfy a judgment out of the judgment debtor’s limited liability company interest and attachment, garnishment, foreclosure or other legal or equitable remedies are not available to the judgment creditor, whether the limited liability company has 1 member or more than 1 member.

6 Del. Code § 18-703(d).

Although Delaware courts have not interpreted this provision, the court found it to be clear that piercing the veil of an alter ego was not the type of remedy the statute was intended to prohibit. The court applied the statutory construction rule of “ejusdem generis” and concluded that the general reference to “other legal or equitable remedies” applied only to types of remedies that are similar to those specifically listed, i.e., “attachment, garnishment, [and] foreclosure.” Reverse veil piercing of an LLC when the LLC is the alter ego of its sole member permits the court to treat the LLC as “identical” to its member and effectively eliminates the legal status of the LLC in narrow circumstances involving fraud or injustice. Therefore, the court considered reverse piercing to be unlike the common-law seizure remedies listed in the exclusivity provision of the charging statute. Additionally, the court determined that Coley’s interpretation of the charging order statute would impermissibly limit Delaware’s ability to prevent the entities that it charters from being used as vehicles for fraud.

The court then analyzed Coley’s contention that the district court erred in reverse piercing the veil of Coley’s LLC because the district court failed to make a finding of fraudulent purpose. The appellate court stated that in order to prevail under an alter ego theory, a plaintiff is not required to show “actual fraud but must show a mingling of the operations of the entity and its owner plus an ‘overall element of injustice or unfairness.’” The court stated that an inference may be drawn that entities are one and the same if they fail to follow corporate formalities when doing business with one another. In a footnote, the court noted that “LLCs must observe fewer internal formalities than corporations, but the principle that they should follow ordinary formalities and norms when doing business with other entities is the same.” The court described
evidence of commingling of funds, lack of proper accounting records, unexplained transfers of funds, and payments by one LLC of another LLC’s or Coley’s expenses or obligations. The court also concluded that an “overall element of injustice or unfairness” was present because DIRECTV had not yet received any payment on its judgment obtained more than four years ago. Based on this evidence, the appellate court concluded that the district court’s finding of alter ego was not clearly erroneous.

Next the court rejected Coley’s contention that the district court erred in holding that Coley’s participation in the post-judgment proceedings permitted the district court to exercise jurisdiction over his LLC despite the fact that the LLC was not served with process. The appellate court reasoned that when reverse veil piercing a single-member LLC, the individual is already before the district court, and there is no concern that the alter-ego LLC must receive independent notice of a legal action. Thus, the court held that an LLC that is the alter ego of its sole member is properly before the court when the court has jurisdiction over the member.

Finally, the court rejected Coley’s argument that the district court erred in applying the doctrine of equitable estoppel in the post-judgment proceedings with respect to the contention that Mrs. Coley was also a member of his LLC. During the pre-judgment proceedings, Mrs. Coley represented that she was not an owner of any of Coley’s business entities and was not a member of the LLC. Coley also testified that he was the sole member of the LLC and produced an operating agreement that indicated he was the sole member. DIRECTV relied on these representations in dismissing Mrs. Coley. After the judgment was entered, the Coleys sought to establish that Mrs. Coley was a member (in order to oppose reverse piercing the LLC on the basis that it would prejudice Mrs. Coley as an innocent owner), and the court concluded that “[t]he Coleys’ shifting positions reflected an attempt to assert whatever position would advance their quest to avoid liability and place their personal assets beyond the reach of DIRECTV.” Thus, the court held that the district court did not abuse its discretion in estopping the assertion of Mrs. Coley’s interest in the LLC in the post-judgment proceedings.

**Personal Liability of Member for LLC Debts Under Operating Agreement**


The court of appeals held that the operating agreement of a Kentucky LLC unambiguously required a member to pay an amount equal to one-third of the LLC’s liabilities based on a provision of the operating agreement that divided the “profits and liabilities” of the LLC equally between the three members.

In 2004, Troy VanWinkle, Lyle Walker, and Carl David Crawford formed TLC Developers, LLC (“TLC”), and executed an operating agreement. TLC’s business purpose was to develop and build residential structures in Madison County, Kentucky. Several years later, TLC experienced severe cash-flow problems and was unable to pay its business expenses. Because Walker and Crawford believed that the operating agreement required the members to pay equally for these expenses if TLC could not, they contributed personal funds to the company’s account. VanWinkle claimed that he was not required to pay expenses of TLC, although he did pay one-third of TLC’s property taxes on multiple occasions.

In 2013, Walker and Crawford filed a complaint seeking a declaration of rights as to the members’ dispute over the
agreement to equally pay TLC’s liabilities. After a bench trial, the circuit court determined that the operating agreement unambiguously stated that the three members agreed to split company liabilities in thirds and ordered VanWinkle to pay $87,000 as his one-third share of TLC’s liabilities.

On appeal, VanWinkle argued that the circuit court erred because: (1) the operating agreement contained an express provision protecting the members from personal liability; and (2) holding the members personally liable for TLC’s liabilities would be inconsistent with the intent of the Kentucky Limited Liability Company Act (the “Kentucky LLC Act”).

The court’s analysis of VanWinkle’s first argument focused on two separate provisions in the TLC operating agreement. One of these provisions, titled “Immunity from Personal Liability” (the “Immunity provision”), stated:

As provided in [Kentucky LLC Act] 275.150, no member, employee or agent of the Company will be personally liable by reason of such status under a judgment, decree, or order of a court or agency, or tribunal of any type, or in any other manner, in this or any other state, or on any other basis, for a debt, obligation, or liability of the Company, whether arising in contract, tort, or otherwise. The status of a person as a Member, employee or agent of the Company shall not subject the person to personal liability for the acts or omissions, including any negligence, wrongful act, or actionable misconduct, of any other Member employee of agent of the company.

The other provision, titled “Division of Profits and Liabilities” (the “Division provision”), stated:

The profits and liabilities of the Company shall be divided as follows: Carl David Crawford = thirty-three and one-third (33 1/3%), Lyle A. Walker = thirty-three and one-third (33 1/3%) percent and Troy Van Winkle [sic] thirty-three and one-third (33 1/3%).

VanWinkle contended that the Immunity provision acted “as a shield against any personal liability arising from” TLC’s liabilities, despite the existence of the Division provision. The court disagreed, first noting that the Immunity provision was “almost identical” to Section 275.150(1) of the Kentucky LLC Act, which does, in general, limit personal liability of members of an LLC. Because of this direct reference to a specific statute, the court concluded that the members “clearly” intended to mimic Section 275.150. Second, the court noted that VanWinkle appeared to ignore Section 275.150(2), which states that the members may alter the general rule of nonliability by agreeing to be personally obligated for the liabilities of the LLC in a written operating agreement. The court concluded that Section 275.150(2) was articulated in the TLC operating agreement under the Division provision. Third, the court referenced case law for the requirement that “[a]ny such assumption of personal liability ... must be stated clearly in unequivocal language which leaves no room for doubt about the parties’ intent[.]” citing Racing Inv. Fund 2000 v. Clay Ward Agency, 320 S.W.3d 654, 659
The court concluded that the language of the second provision met this “unequivocal language” standard because the Division provision unambiguously mandated that TLC’s liabilities be divided evenly between the three members, and the provision appeared on the same page of the agreement that VanWinkle signed. The court also pointed out that, because VanWinkle previously paid his share of the company’s property taxes on at least two occasions, it appeared that “he understood this provision at one point in time.” As a result, the court rejected VanWinkle’s first argument.

The court then turned to VanWinkle’s argument that he could not be personally liable for TLC’s liabilities because “the hallmark of an LLC—and [the Kentucky LLC Act, by extension]—is to limit the liability of LLC members.” The court agreed that members are not, as a general rule, liable for the liabilities of the LLC under the Kentucky LLC Act. However, the court pointed out that Section 275.003 of the Kentucky LLC Act provides that it is the policy of the statute “to give maximum effect to the principles of freedom of contract and the enforceability of operating agreements” to allow business partners the freedom to contract and structure an LLC to fit the needs of its members. The court noted that holding the members personally liable for TLC’s liabilities may seem contrary to the point of establishing an LLC, but this result adhered to the legislative intent of allowing members the freedom to contract and establish an LLC that fits their needs. Here, the three members each agreed to the equal division of TLC’s liabilities, and the circuit court thus did not err in ordering VanWinkle to pay his agreed-upon share of the company’s liabilities.

The court affirmed the trial court’s dismissal of a nondiverse partnership in a suit brought by two partners alleging claims against the other two partners for fraud, breach of fiduciary duty, breach of partnership agreement, conversion, and money had and received. The court concluded that the partnership was dispensable because all partners were party to the suit and the partnership’s interests in the suit were adequately represented by the partners. Further, any risk of duplicative litigation brought by the partnership itself could be prevented by injunctive relief. The court applied the same reasoning to an LLC formed by one of the plaintiffs and one of the defendants.

The plaintiffs, separately, formed partnerships with defendant Marko Princip, whereby each plaintiff received 30% ownership in the partnership. The plaintiffs filed suit against Princip and another partner, Martin, alleging that the parties had created a partnership and that the defendants were liable for common-law fraud, breach of fiduciary duty, breach of the partnership agreement, conversion, and money had and received. The defendants removed the case to federal court from a Texas state court on the basis of diversity jurisdiction. A jury determined that a partnership existed among the parties, and the defendants moved to dismiss the claim for lack of subject-matter jurisdiction just before the entry of final judgment. The defendants argued that there was incomplete diversity due to the presence of the partnership. The plaintiffs moved to dismiss the partnership as a dispensable nondiverse party. The trial court granted the plaintiffs’ motion, restoring complete diversity, and the defendants appealed.
The court of appeals first recognized that for purposes of diversity jurisdiction, a partnership is a citizen of every state in which one of its partners is a citizen. Ordinarily, diversity jurisdiction must exist at the time of removal. However, courts may dismiss nondiverse parties under Rule 21, “even after judgment has been rendered.” Under Rule 19, a court can dismiss a required party who would destroy diversity, if the court determines the party is dispensable. When making this determination regarding “whether, in equity and good conscience, the action should proceed among the existing parties,” the court will consider four factors. These four factors include: (1) the extent to which a judgment rendered in the person’s absence might prejudice that person or the existing parties; (2) the extent to which any prejudice could be lessened or avoided by protective provisions in the judgment, shaping the relief, or other measures; (3) whether a judgment rendered in the person’s absence would be adequate; and (4) whether the plaintiff would have an adequate remedy if the action were dismissed for nonjoinder. As the court noted, this analysis requires a case-by-case approach.

The court noted two previous decisions of the Fifth Circuit Court of Appeals in which the court found the partnership indispensable when the claims were derivative of the partnership’s interests. However, recognizing Rule 19 as a flexible and pragmatic approach, the court distinguished the two prior decisions on the basis that they involved “threatened prejudice to the partnership if the case proceeded in its absence.” Further, in neither of the two cases were all constituent partners of the partnership parties to the suit. The court looked instead to decisions by sister courts in which the courts found a partnership’s interest was adequately represented when all partners, or all general partners, were parties to the suit. While the court suggested the trial court could consider the tactical advantage of the partnership’s presence, no such advantages were present in this case, where the partnership’s role was purely passive throughout the litigation. The court acknowledged that a partnership is legally treated as a separate entity, but the court stated that “[a] partnership’s interests as an entity consist of an aggregation of those interests of each of the individual partners that are relevant to the purpose of the partnership.”

The court next addressed the defendants’ assertion that the partnership was required to be joined as a “real party in interest” under Rule 17(a). The court pointed out that the Texas partnership statute provides for liability of a partner to a partnership or its partners for breach of the partnership agreement or violation of duties. The court commented in a footnote that some Texas courts have construed the statute to restrict partners’ ability to sue for actions that have diminished the value of the partnership, but the court pointed out that these cases only address limited partnerships, and the court cited other cases indicating that the logic of these limited partnership cases is not universally accepted. The court stated that it could not conclude that the partnership was required to be joined as a plaintiff here because any interest of the partnership was fully represented and vindicated and there was no need to preserve partnership assets for all partners’ benefit. The court reiterated that the partnership was a proper party but was not indispensable since its interest was fully represented by the presence of all partners. The court further explained that “the fact that an absent person could bring the action as a real party in interest does not of itself make that person a necessary or indispensable party.” Although Rule 17 insures that a judgment will generally have proper effect as res judicata and protect a defendant from the risk of subsequent litigation, the court stated
that any risk of duplicative litigation could be alleviated through properly tailored protective provisions in the judgment (such as injunctive relief prohibiting the plaintiffs from suing the defendants on behalf of the partnership on claims the partnership could have raised in the suit and ordering the plaintiffs to cause the partnership to release the claims as a condition of judgment).

The defendants also raised essentially the same challenges based on the presence of an LLC formed by one of the plaintiffs and one of the defendants. The court stated that the defendants did not argue that the LLC should be treated differently from the partnership, and the court stated that its analysis extended to the LLC, which was also dismissed by the district court.

In sum, the court concluded that the partnership and LLC were not indispensable parties, and the court remanded the case in order for the district court to consider appropriate injunctive relief to guard against any risk of duplicative litigation.

**Reynolds v. Lyman**, 903 F.3d 693 (7th Cir. 2018).

The court of appeals held that the managing member of several LLCs could not bring a legal malpractice suit on his own behalf because there was no attorney-client relationship between the managing member and the law firm or lawyer. The court also held that the law firm and lawyer did not owe a third-party duty of care to the managing member based on the representation of the LLCs, and the managing member was not an intended third-party beneficiary of the law firm’s retainer agreement with the LLCs.

Brian Reynolds co-owned and managed several LLCs, which were represented by a law firm and one of its lawyers (collectively, “the firm”). In his capacity as managing member, Reynolds communicated with and was advised by the firm. Reynolds brought a legal malpractice suit against the firm, alleging that the firm gave negligent advice to these LLCs and this advice led him to violate federal disclosure laws when he drafted the companies’ financial statements. The district court granted summary judgment to the firm, explaining that Reynolds could not bring a legal malpractice suit on his own behalf because he did not have a personal attorney-client relationship with the firm. Reynolds appealed.

The court of appeals began its analysis by listing the elements under Illinois law of a legal malpractice claim, the first element of which is an attorney-client relationship. The court further noted that the Illinois Supreme Court has described the attorney-client relationship as “a voluntary, contractual relationship that requires the consent of both the attorney and client.” Reynolds admitted that he never asked the firm to represent him individually and that the firm never said anything to suggest it was representing Reynolds, but Reynolds argued that the firm owed him a third-party duty of care from its legal representation of the LLCs because his personal interests and those of the companies were “so closely bound ... as to be functionally indistinguishable.” The court characterized his theory as facially plausible but “foreclosed by decades of Illinois law.”

The court pointed to Illinois cases consistently holding that neither shared interests nor shared liability give rise to liability to a third party. Instead, the claimant must have been a direct and intended beneficiary of the legal representation in order for an Illinois attorney to be liable to the claimant as a third party. The mere fact that Reynolds was at risk of personal liability did not transform the incidental benefits of the firm’s
representation of the LLCs into direct and intended benefits for Reynolds. Under Illinois law, the lawyer for a business entity generally owes a duty of care to the entity itself and not to the individual owners, officers, or directors. The court acknowledged that an Illinois attorney does owe a duty of care to a third party when “hired for the primary purpose of benefitting that third party.” The court noted, however, that Illinois courts have emphasized that the “primary purpose of a retainer agreement between a business entity and a lawyer is to benefit the business entity, not to benefit that entity’s owners or officers, however closely aligned their interests might be.”

Even if the court had the power to change Illinois law or carve out exceptions, the court stated that the current rule “makes good sense.” According to the court, adopting the approach advocated by Reynolds would undermine the integrity of the attorney-client relationship by forcing attorneys to assume competing duties of care to non-clients. Likewise, Reynolds’ approach would “chip away” at the legal distinction between business entities and individuals and introduce a “bizarre” double standard whereby business owners or officers could hide behind the limited-liability business structure to defend a lawsuit, yet cast that structure aside as plaintiffs when seeking to recover for injuries sustained by the business. Thus, the court concluded that the firm did not owe Reynolds a third-party duty of care arising out of its representation of the LLCs and was not liable to Reynolds as a third party for legal malpractice.

In the alternative, Reynolds argued that he had a valid breach-of-contract claim against the firm because he was an intended third-party beneficiary of the firm’s retainer agreement with the LLCs. The court characterized this claim as duplicative of Reynolds’ legal malpractice claim and thus applied similar reasoning. The record did not suggest that the firm undertook its representation of the LLCs for the “direct and manifest purpose” of benefitting Reynolds, as is required for third-party beneficiary status in Illinois. The court held that Reynolds was not a third-party beneficiary of the firm’s retainer agreement with the LLCs and, as a result, he did not have a breach-of-contract claim against the law firm.

Finally, Reynolds attempted to avoid summary judgment by arguing that the district judge lacked the power to grant summary judgment because the Erie doctrine allocates duties between a judge and jury and federal procedural law required a jury—not a judge—to determine whether a duty was owed. The court was not persuaded for two reasons. First, the court noted that the issue of whether a duty exists is a question of law to be decided by a judge. The court further noted, “at the risk of stating the obvious,” that whether Illinois law imposes a duty of care on someone is a question about the scope of Illinois law, and federal procedure generally requires judges to answer such “scope” questions. Second, the court reasoned that even if the existence of a duty was a jury question under federal law, Illinois substantive law would govern and that law is clear that an attorney for a business entity generally owes a duty of care to the entity itself. The court concluded that no reasonable jury could have found in Reynolds’ favor based on the facts he alleged and summary judgment against him thus was proper.

**Capital Contributions**


In a dispute regarding a member’s breach of an LLC operating agreement and alleged withdrawal from the company, the court of appeals concluded that the trial
court did not err in finding that the member breached the operating agreement by failing to make his required initial capital contribution, but the breach did not equate to his withdrawal under the operating agreement or the Missouri Limited Liability Company Act.

Peter Nicolazzi and Laura Bone formed Young in Spirit Adult Day Care, LLC (the “LLC”), an adult daycare business, in 2005. Immediately following its formation, Nicolazzi and Bone were the LLC’s only workers and, under the operating agreement they signed in 2005, the only members. Nicolazzi was responsible for performing service-related tasks for the LLC’s customers and Bone primarily performed managerial and nursing duties. When business expanded, Bone’s duties grew while Nicolazzi’s tasks were handled by employees that the company hired. As time went on, the parties’ business relationship deteriorated. In 2011, Nicolazzi did not seek Bone’s permission before he approached a competitor about buying his interest in the LLC. On April 30, 2011, Nicolazzi effectively stopped participating in the operation of the LLC, while Bone continued to operate the LLC. In June of 2011, Bone filed articles of incorporation for “Young in Spring Adult Day Center, Inc.” and, on the next day, notified Nicolazzi that the business would continue in this new entity and that she would be dissolving the LLC.

On June 30, 2011, Nicolazzi filed his petition against Bone and requested: (1) a declaratory judgment determining whether Bone was still a member and whether she had misappropriated LLC funds, and ordering Bone to reimburse Nicolazzi for distributions received in excess of her fifty percent share; (2) a complete accounting from Bone of the LLC and the new business entity; and (3) judgment for the losses, expenses, and damages that Bone owed to Nicolazzi for his interest in the LLC. Among her counterclaims, Bone asked the trial court to find that Nicolazzi was no longer a member of the LLC because he breached the operating agreement by failing to make his required capital contribution and by soliciting purchase of his membership interest by a third party without her consent. After a bench trial, the trial court entered judgment in favor of Bone and against Nicolazzi, finding that Nicolazzi breached the LLC’s operating agreement by failing to make the required capital contribution and by soliciting purchase of his membership interest without Bone’s consent, and that his actions constituted “events of withdrawal” under the Missouri Limited Liability Company Act (the “Missouri LLC Act”). The trial court concluded that Nicolazzi was no longer a member of the LLC, that Bone was the sole member and owner of the LLC, and that Nicolazzi had been paid all salary and distributions the LLC owed to him. After Nicolazzi’s motion for a new trial and amendment of the judgment was denied, he appealed.

Because Nicolazzi’s arguments on appeal depended upon the application of the LLC’s operating agreement and the Missouri LLC Act, the court cited a number of Missouri law propositions, including: (1) “[w]hile limited liability companies are creatures of statute, [the court] ‘interpret[s] an L.L.C.’s operating agreement according to the ordinary rules of contract law’”; (2) “[t]he primary rule of contract interpretation is to determine the intent of the parties and to give effect to that intent”; (3) “[i]n interpreting an operating agreement, [the court] applie[s] the plain and ordinary meaning of the words in the agreement and consider[s] the document as a whole”; and (4)”[w]here a contract’s terms are clear and unambiguous, [the court will] enforce the agreement as written and will not supply additional terms.” The court also cited the Missouri LLC Act for the requirement that member(s) adopt an operating agreement and the statutory definition of “member” as “any person that
signs in person ... or otherwise is a party to the operating agreement at the time the [LLC] is formed and is identified as a member in that operating agreement....” The court reasoned that because Nicolazzi was named in the LLC’s operating agreement, he signed the operating agreement when the LLC was formed, and the operating agreement did not establish any further condition or prerequisites to membership, then he was a member from that point forward. The court of appeals further concluded that Nicolazzi and Bone were the only members of the LLC throughout the company’s existence.

The standard of review in this case required the court of appeals to affirm the trial court’s judgment unless there was no substantial evidence to support it, it was against the weight of the evidence, or it erroneously declared or applied the law. The court organized its discussion around two primary issues: first, whether Nicolazzi breached the LLC’s operating agreement; and second, whether Nicolazzi’s actions constituted withdrawal from the LLC, leaving Bone as the sole member.

The first issue that the court of appeals addressed was whether the trial court erred in finding that Nicolazzi breached the LLC’s operating agreement. Nicolazzi argued that the trial court’s conclusion that he breached the operating agreement by failing to make his initial capital contribution was against the weight of the evidence. The LLC’s operating agreement contained a provision requiring Nicolazzi and Bone to contribute capital in equal amounts, including “initial contributions” of $50,000 each. However, no deadline was stated in the operating agreement and neither party testified that a due date had been agreed to otherwise. At trial, the parties presented “staggeringly” different amounts when providing evidence of Nicolazzi’s cash and non-cash capital contributions during the five years between the LLC’s formation and when he filed his petition: Bone and the LLC’s CPA testified that he had contributed $31,065, while Nicolazzi and his retained expert witness (who was also a CPA) testified that he had contributed $79,271. In its judgment, the trial court justified its determination that the testimony on Bone’s side was more credible and reliable by recognizing “inconsistencies and shortcomings” in Nicolazzi’s purported contributions and that his expert’s opinion was based on those facts. The trial court even noted that “[i]t was difficult at best, impossible at worst, to sort out [Nicolazzi’s] personal finances from company business.” Because the court’s deference to the trial court’s findings of facts in this case extended to credibility determinations of witnesses, the court of appeals held that the trial court’s conclusion that Nicolazzi breached the LLC’s operating agreement by failing to make his required initial capital contribution requirement was not against the weight of the evidence. The court of appeals noted that it was not necessary to analyze the meaning of the word “initial” in relation to the required capital contributions, despite the absence of a deadline in the operating agreement, because it was established at trial that both parties intended and understood the $50,000 would be paid within six months of the execution of the LLC’s operating agreement. The court further noted that under any definition of “initial,” Nicolazzi’s failure to make the required initial capital contribution within a five-year time span undoubtedly constituted a breach of the operating agreement. Therefore, the court of appeals affirmed the trial court’s judgment in this regard.

After concluding that Nicolazzi’s mere attempt to sell his interest in the LLC without Bone’s consent did not breach the restriction on transfer contained in the operating agreement, the court of appeals addressed whether the trial court erred in finding that
Nicolazzi’s actions constituted an “event of withdrawal” under the Missouri LLC Act, leaving Bone as the LLC’s sole member. The court of appeals observed that the trial court relied on two provisions of the Missouri LLC Act when it concluded that Nicolazzi’s actions of failing to make his required initial capital contributions, attempting to sell his membership interest, and leaving the LLC in April of 2011 constituted “events of withdrawal.” The Missouri LLC Act permits a member to withdraw from a LLC as specified in writing in the operating agreement, at any time upon giving ninety-days’ prior written notice to the other members, or under certain conditions (e.g., assignment of a member’s entire interest in the LLC or expulsion as a member in accordance with the operating agreement). Because the LLC’s operating agreement was silent on what would constitute an event of withdrawal, Nicolazzi did not give any written notice to Bone, and the other statutory conditions were not present before Nicolazzi filed his petition, the court of appeals concluded that the trial court erroneously applied the two provisions of the Missouri LLC Act in finding that Nicolazzi’s actions constituted “events of withdrawal” from the LLC. The court pointed out that while it did affirm the trial court’s finding that Nicolazzi breached the operating agreement by failing to make his initial capital contribution, that breach did not equate to his withdrawal under the operating agreement or the Missouri LLC Act. As a result, the court of appeals reversed the trial court’s judgment in that regard.

The court of appeals went on to suggest that Nicolazzi’s actual filing of his petition may itself have constituted an “event of withdrawal” under the Missouri LLC Act, but this issue was not before the trial court, so the court of appeals remanded the case to the trial court to determine if Nicolazzi withdrew pursuant to the Missouri LLC Act, and if he did, to determine the “fair value” of his interest in the LLC at the time of withdrawal.


The court of appeals held that the trial court erred in entering a judgment that a member of three LLCs was entitled to one-third of the profits of each of the LLCs because the Texas Business Organizations Code provides that profits and losses are allocated to the members based on the agreed value of the members’ contributions as stated in the company’s records, and none of the LLCs had a record of the member’s alleged contribution. Although the member testified that he contributed cash to the LLCs, and the jury found that the member was entitled to a one-third profit distribution from each LLC, the court of appeals stated that allowing the member’s oral testimony to establish his entitlement to one-third of the profits of the LLCs in the absence of any written records of his contributions would be contrary to the plain language of the LLC statute.

Nizar Sunesara and Anis Virani started selling smoking accessories and devices in flea markets on the weekends in 2002, and the next year they established a brick-and-mortar retail shop called “Zig Zag Smoke Shop.” Sunesara created MNA Corporation to operate Zig Zag, and Virani and Sunesara offered Manisch Sohani (a supplier of Zig Zag) an ownership interest in the business. The three men each owned one third of MNA Corporation, and profits of Zig Zag were distributed in cash each month. Sunesara and Virani both took positions with Sohani’s company, and Sunesara transitioned out of the day-to-day business of Zig Zag while Virani continued to manage Zig Zag’s day-to-day operations as well as working for Sohani’s company. Zig Zag did well, and in 2012, Virani and Sunesara started a second retail location, which they called “Burn
Smoke Shop” (“Burn I”). Sunesara testified that he contributed $10,000 cash to the start up of Burn I. He stated that he gave the money to Virani and did not request any receipt or documentation of his contribution. SSV Corporation, which was incorporated by Sunesara in 2007, owned the assets of both Zig Zag and Burn I. Sunesara and Virani each owned 50% of SSV Corporation, but records showed that Sohani shared equally with Sunesara and Virani in profit distributions, and Sunesara testified that Sohani was considered a partner even though he was not a formal owner.

Toward the end of 2012, Sunesara, Virani, and Sohani agreed to buy an existing retail smoke shop, whose name they changed to “Burn Smoke Shop Two” (“Burn II”). Sunesara testified that he contributed $10,000 cash to the start up of Burn II, again giving the money to Virani without obtaining any receipt or documentation of his contribution. Before the purchase of Burn II was finalized, Sohani and Virani asked Sunesara to file paperwork with the Texas Secretary of State to form three LLCs to run the three smoke shops. Each certificate of formation, which was signed by Sunesara but not the other two men, listed Sohani, Virani, and Sunesara as governing persons. Signature cards and depository resolutions for the bank accounts for the three LLCs listed all three men as members and were signed by all three men. Virani and Sohani claimed that Sunesara handled the paperwork for forming the LLCs and opening the bank accounts, and Virani and Sohani claimed that they should have been listed as the only two members of the LLCs. The franchise tax public information report for 2013 listed all three men as members of the LLCs, but the franchise tax report for 2014 as well as federal income tax returns for 2013 and 2014 only listed Virani and Sohani as members or owners of the LLCs.

Sohani and Virani testified that Sunesara did not contribute anything to the three shops. They also testified that they never received any profit distributions from the LLCs because the profits went to Sohani’s company to pay back inventory Sohani contributed and to pay other vendors and creditors of the LLCs.

After federal law enforcement officers began targeting sellers of synthetic marijuana and raiding retailers, wholesalers, and distributors in the smoke shop industry, Sunesara became concerned because Sohani’s company and the three retail shops sold synthetic marijuana. Sunesara wanted Sohani’s company and the shops to stop selling the product. Sohani’s company was raided in 2013, and Sunesara took a leave of absence from the company and did not return. After the raid, Sohani and Virani realized that they lacked important documentation for the LLCs, such as operating agreements, and (after conducting internet research) the two men drafted and signed form operating agreements listing them as members and stating that they each made 50% of contributions and owned 50% of profits and assets. Sunesara’s name did not appear in any of the three agreements, and he was not involved in the drafting of the agreements. Sunesara testified that he received monthly profit distributions for the first five months of 2013 and inquired regularly “what the situation was with profit distributions” after the raid but was given excuses why there were no distributions until October of 2013, when the parties ceased communicating. The parties disagreed over whether Sunesara had a share of the business, and Sohani and Virani were unable to open new bank accounts or obtain loans for the LLCs without Sunesara’s authorization and signature. In 2015, Virani and Sohani sued Sunesara asserting various causes of action, including a claim for a declaratory judgment that Sunesara was not a member of the LLCs. Sunesara
counterclaimed for a declaration that he was a member of the LLCs, was entitled to one-
third of the profits of the LLCs, and was entitled to examine the LLCs’ books and records.

The jury answered “yes” to three questions inquiring whether Sunesara was a member entitled to a one-third profit distribution of each of the LLCs at the time they were formed. No definitions or instructions accompanied these questions. The jury also found that Sohani and Virani were estopped to deny Sunesara was a member of the LLCs and that Sunesara did not commit fraud against Virani and Sohani. After the verdict, Virani and Sohani moved to dismiss the action for lack of subject-matter jurisdiction based on documentation that they argued demonstrated the combined total of one-third profit distributions from the three LLCs exceeded $200,000, the upper limit of the county court’s jurisdictional limits. Sohani and Virani also argued that Sunesara presented only his self-serving testimony that he was a member and had made contributions to the LLCs but presented no evidence of an oral or written operating agreement entitling him to membership and one-third of the profits of the LLCs. Virani and Sohani relied on Tex. Bus. Orgs. Code § 101.201, which provides that profits and losses of an LLC shall be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company’s records. The court reviewed the definitions of a “member,” “membership interest,” “governing documents,” “company agreement,” and “contribution,” and pointed out that the Business Organizations Code does not require a person to make a contribution in order to be admitted as a member or acquire a membership interest. The court also pointed out that the statutory provisions addressing allocation of profits and losses and the sharing of distributions provide that such matters are based on the agreed value of each member’s contributions as stated in the company’s records required to be kept under the statute. Tex. Bus. Orgs. Code §§ 101.201, 101.203. Section 3.151 of the Business Organizations Code contains general recordkeeping requirements for filing entities, and Section 101.501 has specific requirements for LLCs that include maintaining a record of “the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member.” Tex. Bus. Orgs. Code § 101.501(a)(7).

The court’s analysis of Sohani’s and Virani’s contention focused on the “plain meaning” of Sections 101.201 and 101.501 of the Business Organizations Code. At trial, Sunesara testified that he made contributions to the LLCs in the form of $10,000 cash contributions and “deferred profits” to the startup of Burn I and the acquisition of Burn II. Sunesara did not, however, offer any documentary evidence reflecting those contributions. The record contained no writing setting out the specific contributions made by any of the three members or stating
that Sunesara was entitled to one-third of the profits from the LLCs. The company agreements for each of the LLCs were admitted into evidence, but they listed only Sohani and Virani as members and stated, under each of their names, “Made 50% of contributions, Owns 50% of profits and assets.” The court construed Section 101.501 of the Business Organizations Code to require an LLC to include a statement of the amount of cash contributions made by each member and a statement of the agreed value of any other contribution made by each member in the written records of the company and construed Section 101.201 to provide that these records establish the allocation of a member’s share of the profits and losses of the company. Because Sunesara did not introduce any records of the LLCs reflecting the contributions that he made to the LLCs, the court concluded that he presented no evidence that he is entitled to one-third of the profits of the LLCs under Section 101.201.

Sunesara argued that his testimony that he made contributions to the LLCs sufficed to demonstrate his entitlement to one-third of the profits of the LLCs, but the court stated that the plain language of Section 101.201 requires profits and losses to be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company’s records required under Section 101.501, and the plain language of Section 101.501 requires an LLC to maintain a written record of the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member.

Sunesara pointed to the 2008 tax return of MNA Corporation (which stated that Sunesara, Virani, and Sohani were each allocated one-third of the profits for that corporation) and the records of SSV Corporation (which stated that Sunesara and Virani each owned fifty percent of that corporation) and argued that, when the LLCs were created and took over operation of the smoke shops, these records became a part of the records for the LLCs and satisfied the writing requirement of Section 101.201. But the court stated that the corporations and LLCs were all separate and distinct entities, and Sunesara cited no law supporting the proposition that the records from the earlier-formed entities became records of the new LLCs when they began operating the smoke shops. The court stated that the documentary evidence reflecting that Sunesara had a one-third ownership interest in MNA Corporation and a one-half interest in SSV Corporation established only that he was entitled to distributions from MNA Corporation and SSV Corporation, not that he made contributions to the LLCs or that he was entitled to one-third of the profits from the LLCs. Thus, the court held that the trial court erred to the extent that it ruled that Sunesara was entitled to one-third of the profits from each of the LLCs. “Because Sunesara was not assigned a share of profits in the company agreements and presented no evidence that he was entitled to a one-third share of profits in the LLCs, he was not entitled to a share in profits as a matter of law.”

**Fiduciary Duties**


An Illinois LLC sued a former officer for breach of fiduciary duties in connection with the acquisition and subsequent transfer of certain leasehold interests in a commercial development. The appellate court held that a non-member vice president did not owe any fiduciary duties to the manager-managed LLC. The court rejected the LLC’s argument that the officer owed fiduciary duties, either by virtue of his title as vice president or by
allegedly exercising managerial control over the LLC. In the alternative, the court went on to conclude that there was no evidence to demonstrate a breach even if the officer did owe fiduciary duties to the LLC.

The operating agreement of a two-member, manager-managed LLC contained a provision stating that its purpose was to obtain a leasehold interest in the commercial space and parking garage (the “Assets”) of a complex consisting of five components: commercial space, a parking garage, an apartment complex, a surface parking lot, and a marina. The operating agreement named Nicholas Gouletas (“Gouletas”) as the LLC’s managing member and permitted him, as manager, to appoint officers to assist in the LLC’s operations.

Gouletas and the other member of the LLC jointly issued a certificate of managing member authority (the “Certificate”) on behalf of the LLC. The Certificate appointed John Cadden (“Cadden”) as the LLC’s vice president and authorized the LLC to acquire the leasehold interest in the Assets. The lease initially included rights to the marina, but it had been amended to remove the marina, and the Certificate ordered and directed Cadden to approve the amendment and proceed with the lease on behalf of the LLC. At closing, the LLC received a leasehold interest in only the Assets, which were encumbered by first and second mortgages. A few years later, the LLC was in default on both mortgages.

WRT-Marc RC, LLC (“WRT”) sought to acquire the Assets by purchasing the first mortgage and then initiating a foreclosure. At this time, a separate Gouletas-owned entity known as River City Commercial (“RCC”), was the fee simple owner and lessor of the Assets. In order to obtain a fee simple interest in the Assets, WRT sought consent of the LLC and RCC to a foreclosure. Cadden was still vice president of the LLC and had also become vice president of RCC. During negotiations with WRT, an agreement arose that neither the LLC nor RCC would contest the foreclosure of the Assets, provided that WRT granted an option to acquire the parking garage from WRT at WRT’s cost. WRT prepared a document evidencing the option agreement (“Option #1”), but it went unsigned and undated by either the LLC or WRT. Eventually, WRT and Cadden (in his capacity as RCC’s vice president) executed a written and signed option agreement (“Option #2”) granting RCC the option to acquire the parking garage. WRT obtained a foreclosure judgment and purchased the Assets at a foreclosure sale. Subsequent to the foreclosure, the holder of the second mortgage took control of the LLC’s voting rights, removed Gouletas as the LLC’s manager, and ended Cadden’s role as the LLC’s vice president. The LLC filed a complaint against Cadden, alleging breach of fiduciary duties he owed to the LLC as its vice president. The LLC contended that Cadden owed it fiduciary duties for two reasons: by virtue of Cadden’s title as vice president and because Cadden exercised managerial control over the LLC. The trial court entered summary judgment in favor of Cadden on the basis that he owed no fiduciary duties to the LLC or alternatively that the evidence did not establish a breach of any fiduciary duty.

The first issue addressed by the court of appeals was whether the trial court erred in concluding that Cadden did not owe the LLC any fiduciary duties. The LLC contended that Cadden owed it fiduciary duties for two reasons: by virtue of Cadden’s title as vice president and because Cadden exercised managerial control over the LLC. With respect to the first reason, the LLC argued that neither the Illinois LLC Act nor any relevant agreement was intended to supplant the common-law doctrine that an officer of a corporation owes fiduciary duties to the
corporation. The court’s analysis of this first argument focused primarily on relevant provisions of the Illinois LLC Act, the operating agreement, and the Certificate. Because the Illinois LLC Act directly addresses who does and does not owe fiduciary duties in the context of a manager-managed limited liability company, the court concluded that the common-law considerations and analogies to corporations cited by the LLC were not relevant. The court reviewed the statutory provisions addressing fiduciary duties owed to a manager-managed limited liability company and pointed out that the statute provides that such duties reside in the manager alone and not in a non-manager member solely by reason of being a member. 805 ILCS 180/15-1(c), 180/15-3(g)(1).

Furthermore, the court pointed out that Section 15–5 of the Illinois LLC Act allows a limited liability company to enter into an operating agreement to regulate the affairs and business of the company and the relations among the members, managers, and company. 805 ILCS 180/15-5(a). In this case, the LLC’s operating agreement, which was adopted in accordance with the Illinois LLC Act, specified that Gouletas was the sole manager and empowered him to appoint officers. Section 5.9 of the LLC’s operating agreement detailed the responsibilities of these officers and provided:

The Managing Member shall elect officers (“Officers”) to carry out the policies and objectives of the Managing Member. Subject to the policies and objectives prescribed by the Managing Member, the Officers shall establish operating procedures for, and administer and direct, the day to day operations of the Company. The powers of the Officers may be broadened or limited from time to time in the discretion of the Managing Member and each Officer shall, at a minimum, be empowered to carry out (and shall carry out) any activity expressly authorized in a written resolution of the Managing Member. ... Each Officer shall serve until removed by the Managing Member. The Managing Member may remove any Officer at any time for any reason. ... No Officer shall receive any compensation for such Officer’s services to the Company.

Although the operating agreement stated that Cadden, as an officer, was charged with the “day to day operations” of the LLC, the court stated that Cadden had “no free rein” in any respect to control the LLC and was authorized to do only what the manager ordered. The Certificate appointed Cadden as vice president “in accordance with the provisions of Section 5.9 of the Operating Agreement” and ordered him to take specific action with respect to the leasehold interest. Because all power and duties resided in the manager, the court characterized the title of vice president in this context as irrelevant. Based on the Illinois LLC Act, the LLC’s operating agreement, and the Certificate, the court concluded that Cadden owed no fiduciary duties to the LLC.

Next, the court addressed the LLC’s argument that Cadden owed it fiduciary duties because he exercised managerial control over the company. The appellate court’s analysis continued despite noting that the LLC was procedurally prohibited from making this argument on appeal because it was not pled in the company’s complaint. In support of this second argument, the LLC relied on Section 15–3(g)(3) of the Illinois LLC Act, which states that, in a manager-managed limited liability company, fiduciary
duties may be imposed on a person other than a manager, but only if that person “is a member who exercises some or all of the authority of a manager. . . .” 805 ILCS 180/153(g)(3). According to the LLC, Cadden “ran most of [Gouletas’s] companies” and therefore exercised sufficient managerial control to impose fiduciary duties under subsection (g)(3). The court acknowledged that Section 15–3(g)(3) is an exception to the general rule that only a manager owes fiduciary duties to a manager-managed limited liability company. Subsection (g)(3) contains a two-prong requirement in order to impose fiduciary duties on a person other than a manager of a manager-managed LLC: (1) the person is a member, and (2) that member exercises the same control and authority as the manager. 805 ILCS 180/15-3(g)(3). Because the record made clear that Cadden was not a member of the LLC, the court concluded that subsection (g)(3) was inapplicable. Still, assuming “for whatever unfathomable notion” that Cadden was a member, the court set forth additional support for its conclusion that Cadden did not exercise the requisite managerial control and authority under the statute: (1) Cadden was an officer without control of any facet of the LLC; (2) pursuant to the Illinois LLC Act, the LLC’s operating agreement, and the Certificate, Cadden had no power to act without the direction of the manager; and (3) the LLC was not dependent on Cadden to run the company because this duty fell solely to the manager, who governed the business, as well as the contents and duration of Cadden’s employment as officer. The court thus concluded that Cadden did not exercise managerial control over the LLC sufficient to impose fiduciary duties on him.

The second issue that the court of appeals addressed was whether the trial court erred in concluding that Cadden, assuming he did owe fiduciary duties to the LLC, did not breach those duties. The LLC contended that Cadden breached his fiduciary duties in two respects: by purposely diverting the parking garage option away from the LLC to a separate entity and “underhandedly” trading out the marina from the lease for no compensation. The court reviewed relevant Illinois case law and pointed out that a fiduciary is obligated to first disclose potential opportunities to the company and is prohibited from taking advantage of business opportunities that belong to the company. The court also pointed out that Illinois case law defines such opportunities as those in which the company has the capacity to engage and are reasonably incident to the company’s present or future business prospects. The court’s analysis of this contention focused on applying the definition of “business opportunities” to the parking garage option and marina (separately and independently). With respect to the parking garage option, the court noted that the LLC’s operating agreement stated that it “shall engage in no other business [other than a leasehold interest in the Assets]” until both the first and second mortgages were fully repaid. The LLC’s involvement with WRT and the consent foreclosure concerned only the first mortgage. Following the consent foreclosure, however, the LLC remained liable to and in default on the second mortgage. The court determined that, at that point in time and according to its own operating agreement, the LLC could not engage in any business, including obtaining the parking garage option. As a result, the court then determined that the parking garage option was not incident to the LLC’s business prospects because Option #1 was never a firm agreement. The court concluded that the parking garage option was not an opportunity in which the LLC could engage, and the parking garage option was not an opportunity reasonably incident to the LLC’s business prospects. Thus, the parking garage option was not a business opportunity that belonged to the LLC, and Cadden could not have
breached a fiduciary duty with respect to the parking garage option.

The court applied similar reasoning to the LLC’s claim that Cadden breached his fiduciary duties to the company by underhandedly trading out the marina from the deal for no compensation. The court noted that according to the LLC’s operating agreement, the company was specifically formed to acquire a leasehold interest in the Assets (the commercial space and parking garage). Therefore, the court concluded that the LLC was never intended to obtain an interest in the complex’s three remaining components: the marina, the apartment complex, or the surface parking lot. As a result, the court found that the marina was not a business opportunity for the LLC. Furthermore, the record indicated that the initial lease included rights to the marina, the lease was then amended by the LLC’s manager and members to remove the marina from the deal, and then (via the Certificate) Cadden was specifically ordered and directed to proceed with the amended lease for the Assets only and not the marina. The court stated that it failed to see how Cadden could breach a fiduciary duty with respect to a marina the LLC was never intended to possess.

The court further noted that, even if the parking garage option or the marina were business opportunities for the LLC, there was no evidence in the record to show that Cadden failed to disclose them to the company or derived personal gain from his alleged diversion from the LLC. In fact, the court noted that the evidence supported disclosure (the LLC’s manager and all members attested that they knew Cadden was negotiating on behalf of it and RCC) and the absence of personal gain (Cadden testified that he never obtained any personal benefit).

**Indemnification**


A former employee sued a restaurant-chain LLC and its parent corporation seeking indemnification for expenses incurred in defending against federal charges. The district court held that the former employee was not entitled to indemnification under the governing documents of either entity and the business judgment rule protected the LLC’s decision to deny indemnification on the grounds that the former employee engaged in fraud and willful misconduct.

Autumn Lee Tangas began working for International House of Pancakes, LLC (“IHOP”) in 1991 and became a “franchise bureau consultant” (FBC) in 2003. As an FBC, Tangas acted as a liaison to franchisees who operated restaurants in her multi-state territory, helped franchisees boost sales, and ensured that they adhered to IHOP operating standards. In September 2011, the FBI raided the home of a franchisee whose operations Tangas oversaw. After the raid, IHOP opened its own investigation to determine if the company itself might be a target of the FBI investigation or a potential victim of wrongdoing. In 2012, DineEquity’s in-house counsel communicated to Tangas’s lawyer that Tangas was obligated to cooperate with the internal investigation under the IHOP code of conduct and a refusal to do so would result in termination. After Tangas’s lawyer responded that Tangas would not answer any questions, IHOP fired Tangas for violating the IHOP code of conduct and refusing to participate in the interview. A federal grand jury subsequently indicted Elkafrawi, Tangas, and others. The indictment, which charged Tangas with money laundering, conspiring to harbor illegal aliens, and mail fraud, essentially alleged that Tangas used her position as an FBC to hide Elkafrawi’s criminal activities from IHOP. The criminal
case against Tangas proceeded for more than two years until the U.S. Attorney’s Office dismissed the charges without prejudice in 2014. At that time, Tangas had incurred more than $130,000 in legal fees. In 2015, Tangas demanded that IHOP pay these legal fees. After the FBI provided part of its investigative file to IHOP, the LLC denied her request in light of “the allegations in the indictment and supported by the evidence in the government interviews.”

The first issue that the district court addressed was whether Tangas had a right to indemnification under DineEquity’s corporate bylaws, which provided that the corporation must indemnify a person who is or may be a party to any suit “by reason of the fact that [s]he is or was a director or officer of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise[.]” Therefore, in order to qualify for indemnification, Tangas was required to show that she was a director of DineEquity, that she was an officer of DineEquity, or that she served at the request of DineEquity as an employee of another corporation (i.e., that DineEquity requested Tangas to serve as an FBC for IHOP). The court held that Tangas did not have a right to indemnification under the DineEquity bylaws because she was neither a director nor an officer of the parent corporation, she did not serve IHOP at the request of DineEquity, and she was employed by the subsidiary LLC and not its parent corporation.

Tangas next argued that Delaware corporate law required DineEquity to indemnify her because she was successful in defending the criminal case. The court noted that, at one time, Delaware did require corporations to indemnify any director, officer, employee, or agent who was successful on the merits or otherwise in defense of any action. Under current law, however, the mandatory obligation to indemnify applies only to officers and directors. 8 Del. C. § 145(c). The court held that this mandatory indemnification provision did not apply to Tangas because she “was not an officer of any company, let alone DineEquity...”

Next the district court addressed whether Tangas had a right to indemnification under IHOP’s LLC agreement. Both sides relied on the language of IHOP’s LLC agreement, which provided that:

the Company shall indemnify and hold harmless each Covered Person from and against any and all losses, claims, demands, liabilities, expenses, judgments, fines, settlements and other amounts arising from any and all claims, demands, actions, suits or proceedings, civil criminal administrative or investigative (“Claims”), in which the Covered Person may be involved, or threatened to be involved as a party or otherwise, by reason of its management of the affairs of the Company or which relates to or arises out of the Company or its property, business or affairs. A Covered Person shall not be entitled to indemnification under this Section 8.2 with respect to (i) any Claim with respect to which such Covered Person has engaged in fraud, willful misconduct, bad faith or gross negligence[.]
The LLC agreement defined “Covered Persons” to include “the Member [i.e., DineEquity], any officers, directors, stockholders, partners, employees, affiliates, representatives, or agents of any of the Member,” or “any officer, employee, representative, or agent of the Company [i.e., IHOP].” Because the parties agreed that Tangas was a “Covered Person” until she was fired in 2012, the court focused on determining if Tangas was entitled to indemnification of expenses incurred post-termination.

DineEquity and IHOP argued that Tangas’s indemnification rights did not continue post-termination because the Delaware LLC statute, unlike the corporate statute, does not provide a default rule that requires continuation of indemnification rights after a person ceases to be an employee, and such rights were not provided in IHOP’s LLC agreement. Tangas argued that IHOP impliedly agreed to cover expenses of former employees by failing to specify that the indemnification clause does not exclude former employees, but the court was not persuaded by Tangas’s interpretation of the indemnification clause because the interpretation was logically flawed (all categories of persons not defined as “Covered Persons” could claim indemnification) and unsupported by case law (absent explicit language inclusive of former employees, Delaware courts interpret “employee” as referring to current employees only). The court noted that the operating agreement had a provision limiting IHOP’s ability to amend the agreement to strip Covered Persons of their existing indemnification rights, but the language forbidding IHOP from retroactively stripping a Covered Person of existing indemnification rights did not prohibit IHOP from discontinuing indemnification once a person ceased to be a Covered Person. Tangas also argued that she had a vested right to indemnification that continued after her firing, but the court distinguished Delaware cases in which the courts determined that an indemnification right became vested and could not be terminated. The only right that could have vested in this case was Tangas’s right to be indemnified while she was a Covered Person involved or threatened to be involved in a proceeding. Because Delaware law did not prohibit IHOP from limiting its indemnification obligations in this manner and nothing in the LLC agreement required IHOP to indemnify a former employee whom it had fired, Tangas was not entitled to indemnification under the IHOP LLC agreement as a matter of law.

Finally, assuming arguendo that IHOP’s LLC agreement required it to indemnify Tangas, the district court addressed whether IHOP reasonably declined to indemnify Tangas on the basis that her conduct amounted to fraud or willful misconduct. IHOP and DineEquity argued that Delaware’s business judgment rule protected their decision not to indemnify Tangas, but Tangas argued that the business judgment rule was inapplicable because the LLC agreement entitled her to indemnification. The court concluded that the business judgment rule was applicable to the issue of whether Tangas engaged in fraud or willful misconduct. Because IHOP had the power to deny indemnification in those circumstances, the court stated that Tangas was asking the court to second guess the propriety of an action that IHOP had the authority to take and that Tangas must thus show IHOP’s decision to deny indemnification was not the product of reasoned, well-informed decision making. The court concluded that the undisputed evidence established that IHOP made a reasonable decision to deny indemnification after investigating the situation and concluding that Tangas engaged in fraud “with respect to” the criminal case against
Tangas. Additionally, the court concluded that IHOP and DineEquity made a reasoned business judgment not to indemnify Tangas on the ground that her refusal to participate in the interview as required by IHOP’s code of conduct was willful misconduct “with respect to” the criminal case.


The court of appeals affirmed the judgment of the trial court that a Delaware LLC owed indemnity to its officer and that a settlement agreement precluded further collection of the judgment against the officer.

Jim Sandt, a former officer and member of Energy Maintenance (a Delaware LLC), sued Energy Maintenance, Timothy Nesler (the company’s CEO), and other officers claiming that the defendants had committed fraud and breach of fiduciary duty by wrongfully diluting his ownership interest. While Sandt’s suit was pending, the Energy Maintenance board agreed in a company resolution to indemnify Nesler for any liability arising out of or related to the Sandt litigation. The board resolution stated that the board agreed to indemnify Nesler after reviewing the Sandt litigation and discussing it with the company’s officers and attorneys. The resolution also stated that the board had determined that Nesler acted in good faith and in a manner that he reasonably believed was in the company’s best interest.

A jury found in favor of Sandt and against Energy Maintenance and Nesler. While an appeal was pending, the company’s primary creditor took control and terminated Nesler from his position as CEO. The new board of directors then voted to revoke the prior indemnification as of the date it was purportedly granted. The rationale for the revocation was, in part, that Nesler had misrepresented to the board the facts related to the Sandt matter. After the company refused to provide indemnification, it filed suit against Nesler seeking a declaration that it did not owe him indemnity and claiming that the jury’s findings of fraud and breach of fiduciary duty against him alleviated the company’s indemnification obligation. Nesler counterclaimed for breach of contract.

The trial court ruled that Nesler was entitled to indemnification and that the company’s failure to provide it was a breach of contract. Because a settlement agreement between the company and Sandt stated that Sandt could not recover any further, directly or indirectly, from the company, the trial court further declared that Sandt could not pursue Nesler for any amounts that the company had to indemnify. Both the company and Sandt appealed.

On appeal, the court noted that Energy Maintenance was a Delaware LLC; thus, Delaware law controlled the interpretation of the company’s formation agreement. The court cited a number of Delaware law propositions, including (1) “[u]nder Delaware law, a limited liability company may indemnify any member, manager, or another ‘against any and all claims and demands whatsoever,’ subject to whatever standards or restrictions are included in its company agreement”; (2) “[f]or limited liability companies, Delaware law ‘defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification’”; (3) “[w]hen interpreting the provisions of a limited liability company agreement, ordinary contract interpretation rules apply; the court’s role is to effect the parties’ intent based on the plain meaning of the agreement’s terms”; and (4) “[a] court cannot rewrite or add omitted provisions in the guise of interpreting a contract.”
The court noted that Article VIII of the Energy Maintenance company agreement contained provisions for indemnification and advancement of expenses. Although the provisions obligated Energy Maintenance to indemnify persons who acted in good faith, it vested the board with the authority to decide if they did act in good faith. The agreement expressly specified that an adverse judgment did not create a presumption of bad faith, and it stated a company policy of indemnifying corporate officers to the fullest extent legally possible. According to the court, “Energy Maintenance’s company agreement does not, in express and affirmative terms, make members and directors ineligible for indemnification previously granted simply because a jury finds that they did not act in good faith, and we cannot rewrite its company agreement to say something it does not.” In addition, the court concluded that unless Energy Maintenance had a contractual right to reconsider its decision to indemnify Nesler, it could not rescind its earlier determination. Because “[n]either its company agreement nor the board’s 2007 indemnity resolution reserved a right to revisit Nesler’s right to indemnity,” the court concluded that the company “could not rescind its agreement to indemnify him.”

Despite the company agreement provisions that vested the board with the authority to determine whether the conditions for authorizing indemnification had been met, Energy Maintenance contended that the jury’s unfavorable verdict and the judgment against Nesler for fraud disproved his good faith and thereby provided a basis for the board to revoke its earlier grant of indemnity. The company relied on Delaware decisions construing that state’s corporate indemnification statute, 8 Del. Code § 145, for the proposition that a jury’s finding of fraud negates good faith as a matter of public policy. The court disagreed, noting that the statutes governing Delaware corporations and Delaware limited liability companies were different. Unlike Section 145, which applied to corporations, the statute governing limited liability companies allowed indemnity “against any and all claims and demands whatsoever,” subject only to the express terms of the company agreement. This statute did not purport to adopt or incorporate Delaware’s public policy regarding indemnity in the corporate context, and it deferred instead to the contracting parties to place limits on indemnification.

Although the court decided that the company was obligated to indemnify Nesler from liability in the Sandt litigation, it also concluded that Sandt, in a settlement agreement, agreed to forego any collection of the judgment against Nesler for which the company would be liable. The settlement agreement provided that Sandt “will not seek to execute and will not accept recovery, in each case whether directly or indirectly, against” Energy Maintenance for any remaining liability arising from the suit. The trial court reasoned that Energy Maintenance owed indemnity to Nesler, and thus an attempt to collect the remaining money that Nesler owed under the Sandt judgment would violate the settlement agreement’s clause barring Sandt from recovering any additional sum from Energy Maintenance “directly or indirectly.” In light of this clause and others, the court of appeals concluded that the trial court correctly interpreted the settlement agreement: “In sum, the settlement agreement bars Sandt from recovering from Nesler because it would result in an indirect recovery from Energy Maintenance, which is obligated to indemnify Nesler for the Sandt judgment.”

**Information Rights**

*Succession of McCalmont*, 2018 WL 6521176, __ So. 3d __ (La. App. 3d Cir. 2018).
The court of appeals held that the executor of the estate of the deceased wife of a member of several LLCs was not entitled to the production of LLC business, financial, and tax records because neither the agreements nor the Louisiana LLC statute gave an assignee a right of access to the LLC’s books and records.

Colleen McCalmont filed for divorce from her husband James McCalmont (“James”) in August of 2016, but she passed away before the divorce was finalized or community property partitioned. One of the McCalmonts’ children, Jay McCalmont (“Jay”) was appointed executor of her estate. As part of the executor’s duties in preparing a detailed description of property in the succession, Jay sought information from James regarding property believed to be community property. After James refused to provide this information, Jay sought to compel discovery.

The trial court granted Jay’s motion to compel and ordered James to produce business, financial, and tax records of certain LLCs in which the McCalmonts had held an interest. The trial court also ordered James to comply with certain other discovery requests not involving the LLC. James appealed.

On appeal, James argued that the trial court erred in ordering the discovery of LLC documents because the operating agreement of one LLC specifically restricted assignees from inspecting records and the Louisiana Limited Liability Company statute did not entitle assignees to inspect the records of the other involved LLCs. The court cited several Louisiana law propositions, including: (1) “[a]n operating agreement, whether written or oral, governs the operations of an LLC; (2) “[i]n the absence of [an operating agreement], the default provisions of the Louisiana LLC statute govern”; (3) “[a]n operating agreement is contractual in nature; thus, it binds the members of the LLC as written and is interpreted pursuant to contract law”; (4) as to contractual interpretation, “[t]he interpretive purpose is to determine the common intent of the parties”; (5) the ordinary contract interpretation rules apply, including the interpretation of “each contractual provision in light of the other provisions in order to arrive at the meaning of the contract as a whole”; and (6) “[t]he determination of whether the words of a contract are clear and explicit or ambiguous is a question of law [and thus] an appellate court’s determination on review is whether the trial court interpreted a contract correctly or incorrectly.” Applying an abuse-of-discretion standard, the court of appeals examined the evidence in the record. As to the discovery ordered against the LLCs, the court organized its analysis around whether the operating agreements dealt with maintenance of business records and the rights of an assignee. If the operating agreements addressed these issues, the court applied the pertinent provisions of the operating agreement; if not, the court applied the Louisiana LLC statute.

First, James argued, and the court agreed, that the operating agreement of one of the LLCs at issue specifically restricted assignees of a member from inspecting company records. Section 6.1 of the the operating agreement, titled “Books and Records,” required certain records (including those at the center of this dispute) “to be maintained and to be available to ‘any Member or an assignee of an Interest.’” On the other hand, Section 8.5 provided for the rights of unadmitted assignees as follows:

A person who acquires all or any portion of an Interest but who is not admitted as a Substituted Member ... shall be entitled only to allocations and distributions with respect
to such interest ... but shall have no right to any information or accounting of the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.

Interpreting the language from Section 6.1 and Section 8.5 in the manner that best conformed to the objectives of the operating agreement, the court determined that the specific provision of Section 8.5 controlled over the more generally worded Section 6.1. The court reasoned that to conclude otherwise would simply eliminate the effects of Section 8.5 entirely and lead to an “absurd” reading of the operating agreement as a whole. As a result, the court concluded that Jay, as an assignee, had “no right to any information or accounting of the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.” Furthermore, the court concluded that it was clear the operating agreement prohibited Jay from receiving the business, financial, and tax records that were the subject of the trial court’s discovery order. Thus, the court of appeals held that it was an abuse of discretion for the trial court to order the LLC governed by this operating agreement to produce those records and reversed the order compelling discovery.

Next, the court analyzed James’ argument that the Louisiana LLC statute, which governed the remaining LLCs whose operating agreements were silent as to the rights of assignees of membership interests, expressly restricts assignees to statutorily limited rights that do not include the right to inspect the records of the LLC. The court began its analysis by pointing out that the Louisiana LLC statute recognizes only one form of transfer of a membership interest—

an assignment—whether voluntary or involuntary. In the case of an involuntary assignment, as in the case of a member’s death, the deceased member is the assignor and the recipient of the transferred interest, such as the executor or other legal representative, is treated strictly as the assignee. The court explained that an assignment results in a bifurcation of membership rights: the financial rights vest with the assignee, while the management rights remain vested with the assignor, even if deceased, until the assignee is admitted as a member. Thus, the statute confers on the assignee only the limited right to receive those distributions and allocations of profits, losses, and tax items that the assignor would otherwise have been entitled to receive. The court of appeals then relied on its decision in a 2004 case for the proposition that an assignee “is not entitled to inspect [the LLC’s] records, since this action is reserved for the members of the LLC.” The court acknowledged that “the law as written allows for the creation of situations whereby an assignee of a deceased member’s rights, while due distributions, may never be able to see company records to ensure he is actually receiving those distributions in full, because remaining members can simply withhold records that would show what, if anything, may be owed.” However, the court concluded that Louisiana LLC law clearly limited Jay’s rights as an assignee and compelled the court to hold that it was an abuse of discretion for the trial court to order the LLCs to produce the requested records. Thus, the court reversed the trial court’s order compelling discovery.

Interpretation of Operating Agreement or Partnership Agreement

Succession of McCalmont, 2018 WL 6521176, __ So. 3d __ (La. App. 3d Cir. 2018).

The court of appeals held that the executor of the estate of the deceased wife of a member of several LLCs was not
entitled to the production of LLC business, financial, and tax records because neither the agreements nor the Louisiana LLC statute gave an assignee a right of access to the LLC’s books and records.

Colleen McCalmont filed for divorce from her husband James McCalmont (“James”) in August of 2016, but she passed away before the divorce was finalized or community property partitioned. One of the McCalmonts’ children, Jay McCalmont (“Jay”) was appointed executor of her estate. As part of the executor’s duties in preparing a detailed description of property in the succession, Jay sought information from James regarding property believed to be community property. After James refused to provide this information, Jay sought to compel discovery.

The trial court granted Jay’s motion to compel and ordered James to produce business, financial, and tax records of certain LLCs in which the McCalmonts had held an interest. The trial court also ordered James to comply with certain other discovery requests not involving the LLC. James appealed.

On appeal, James argued that the trial court erred in ordering the discovery of LLC documents because the operating agreement of one of the LLCs at issue specifically restricted assignees from inspecting records and the Louisiana Limited Liability Company statute did not entitle assignees to inspect the records of the other involved LLCs. The court cited several Louisiana law propositions, including: (1) “[a]n operating agreement, whether written or oral, governs the operations of an LLC; (2) “[i]n the absence of [an operating agreement], the default provisions of the Louisiana LLC statute govern”; (3) “[a]n operating agreement is contractual in nature; thus, it binds the members of the LLC as written and is interpreted pursuant to contract law”; (4) as to contractual interpretation, “[t]he interpretive purpose is to determine the common intent of the parties”; (5) the ordinary contract interpretation rules apply, including the interpretation of “each contractual provision in light of the other provisions in order to arrive at the meaning of the contract as a whole”; and (6) “[t]he determination of whether the words of a contract are clear and explicit or ambiguous is a question of law [and thus] an appellate court’s determination on review is whether the trial court interpreted a contract correctly or incorrectly.” Applying an abuse-of-discretion standard, the court of appeals examined the evidence in the record. As to the discovery ordered against the LLCs, the court organized its analysis around whether the operating agreements dealt with maintenance of business records and the rights of an assignee. If the operating agreements addressed these issues, the court applied the pertinent provisions of the operating agreement; if not, the court applied the Louisiana LLC statute.

First, James argued, and the court agreed, that the operating agreement of one of the LLCs at issue specifically restricted assignees of a member from inspecting company records. Section 6.1 of the the operating agreement, titled “Books and Records,” required certain records (including those at the center of this dispute) “to be maintained and to be available to ‘any Member or an assignee of an Interest.’” On the other hand, Section 8.5 provided for the rights of unadmitted assignees as follows:

A person who acquires all or any portion of an Interest but who is not admitted as a Substituted Member ... shall be entitled only to allocations and distributions with respect to such interest ... but shall have no right to any information or accounting of
the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.

Interpreting the language from Section 6.1 and Section 8.5 in the manner that best conformed to the objectives of the operating agreement, the court determined that the specific provision of Section 8.5 controlled over the more generally worded Section 6.1. The court reasoned that to conclude otherwise would simply eliminate the effects of Section 8.5 entirely and lead to an “absurd” reading of the operating agreement as a whole. As a result, the court concluded that Jay, as an assignee, had “no right to any information or accounting of the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.” Furthermore, the court concluded that it was clear the operating agreement prohibited Jay from receiving the business, financial, and tax records that were the subject of the trial court’s discovery order. Thus, the court of appeals held that it was an abuse of discretion for the trial court to order the LLC governed by this operating agreement to produce those records and reversed the order compelling discovery.

Next, the court analyzed James’ argument that the Louisiana LLC statute, which governed the remaining LLCs whose operating agreements were silent as to the rights of assignees of membership interests, expressly restricts assignees to statutorily limited rights that do not include the right to inspect the records of the LLC. The court concluded that Louisiana LLC law clearly limited Jay’s rights as an assignee and compelled the court to hold that it was an abuse of discretion for the trial court to order the LLCs to produce the requested records. Thus, the court reversed the trial court’s order compelling discovery.


In a dispute regarding a member’s breach of an LLC operating agreement and alleged withdrawal from the company, the court of appeals concluded that: (1) the trial court did not err in finding that the member breached the operating agreement by failing to make his required initial capital contribution; (2) the trial court erroneously applied the law in finding that the member breached the operating agreement by discussing the sale of his interest with a third party without the consent of the other member; (3) the trial court erroneously applied the law in finding that the member’s actions prior to filing his petition constituted withdrawal from the LLC; (4) the trial court erred in determining that the other member was the sole member of the LLC; and (5) the member’s filing of his petition may have constituted an “event of withdrawal” as a matter of law.

Peter Nicolazzi and Laura Bone formed Young in Spirit Adult Day Care, LLC (the “LLC”), an adult daycare business, in 2005. Immediately following its formation, Nicolazzi and Bone were the LLC’s only workers and, under the operating agreement they signed in 2005, the only members. Nicolazzi was responsible for performing service-related tasks for the LLC’s customers and Bone primarily performed managerial and nursing duties. When business expanded, Bone’s duties grew while Nicolazzi’s tasks were handled by employees that the company hired. As time went on, the parties’ business relationship deteriorated. In 2011, Nicolazzi did not seek Bone’s permission before he approached a competitor about buying his interest in the LLC. On April 30, 2011, Nicolazzi effectively stopped participating in the
operation of the LLC, while Bone continued to operate the LLC. In June of 2011, Bone filed articles of incorporation for “Young in Spring Adult Day Center, Inc.” and, on the next day, notified Nicolazzi that the business would continue in this new entity and that she would be dissolving the LLC.

On June 30, 2011, Nicolazzi filed his petition against Bone and requested: (1) a declaratory judgment determining whether Bone was still a member and whether she had misappropriated LLC funds, and ordering Bone to reimburse Nicolazzi for distributions received in excess of her fifty percent share; (2) a complete accounting from Bone of the LLC and the new business entity; and (3) judgment for the losses, expenses, and damages that Bone owed to Nicolazzi for his interest in the LLC. Among her counterclaims, Bone asked the trial court to find that Nicolazzi was no longer a member of the LLC because he breached the operating agreement by failing to make the required capital contribution and by soliciting purchase of his membership interest by a third party without her consent. After a bench trial, the trial court entered judgment in favor of Bone and against Nicolazzi, finding that Nicolazzi breached the LLC’s operating agreement by failing to make the required capital contribution and by soliciting purchase of his membership interest by a third party without Bone’s consent, and that his actions constituted “events of withdrawal” under the Missouri Limited Liability Company Act (the “Missouri LLC Act”). The trial court concluded that Nicolazzi was no longer a member of the LLC, that Bone was the sole member and owner of the LLC, and that Nicolazzi had been paid all salary and distributions the LLC owed to him. After Nicolazzi’s motion for a new trial and amendment of the judgment was denied, he appealed.

Because Nicolazzi’s arguments on appeal depended upon the application of the LLC’s operating agreement and the Missouri LLC Act, the court cited a number of Missouri law propositions, including: (1) “[w]hile limited liability companies are creatures of statute, [the court] ‘interpret[s] an L.L.C.’s operating agreement according to the ordinary rules of contract law’”; (2) “[t]he primary rule of contract interpretation is to determine the intent of the parties and to give effect to that intent”; (3) “[i]n interpreting an operating agreement, [the court] applie[s] the plain and ordinary meaning of the words in the agreement and consider[s] the document as a whole”; and (4)”[w]here a contract’s terms are clear and unambiguous, [the court will] enforce the agreement as written and will not supply additional terms.” The court also cited the Missouri LLC Act for the requirement that member(s) adopt an operating agreement and the statutory definition of “member” as “any person that signs in person ... or otherwise is a party to the operating agreement at the time the [LLC] is formed and is identified as a member in that operating agreement....” The court reasoned that because Nicolazzi was named in the LLC’s operating agreement, he signed the operating agreement when the LLC was formed, and the operating agreement did not establish any further condition or prerequisites to membership, then he was a member from that point forward. The court of appeals further concluded that Nicolazzi and Bone were the only members of the LLC throughout the company’s existence.

The standard of review in this case required the court of appeals to affirm the trial court’s judgment unless there was no substantial evidence to support it, it was against the weight of the evidence, or it erroneously declared or applied the law. The court organized its discussion around two primary issues: first, whether Nicolazzi breached the LLC’s operating agreement; and second, whether Nicolazzi’s actions
constituted withdrawal from the LLC, leaving Bone as the sole member.

The first issue that the court of appeals addressed was whether the trial court erred in finding that Nicolazzi breached the LLC’s operating agreement. Nicolazzi argued that the trial court’s conclusion that he breached the operating agreement by failing to make his initial capital contribution was against the weight of the evidence. The LLC’s operating agreement contained a provision requiring Nicolazzi and Bone to contribute capital in equal amounts, including “initial contributions” of $50,000 each. However, no deadline was stated in the operating agreement and neither party testified that a due date had been agreed to otherwise. At trial, the parties presented “staggeringly” different amounts when providing evidence of Nicolazzi’s cash and non-cash capital contributions during the five years between the LLC’s formation and when he filed his petition: Bone and the LLC’s CPA testified that he had contributed $31,065, while Nicolazzi and his retained expert witness (who was also a CPA) testified that he had contributed $79,271. In its judgment, the trial court justified its determination that the testimony on Bone’s side was more credible and reliable by recognizing “inconsistencies and shortcomings” in Nicolazzi’s purported contributions and that his expert’s opinion was based on those facts. The trial court even noted that “[i]t was difficult at best, impossible at worst, to sort out [Nicolazzi’s] personal finances from company business.” Because the court’s deference to the trial court’s findings of facts in this case extended to credibility determinations of witnesses, the court of appeals held that the trial court’s conclusion that Nicolazzi breached the LLC’s operating agreement by failing to make his required initial capital contribution requirement was not against the weight of the evidence. The court of appeals noted that it was not necessary to analyze the meaning of the word “initial” in relation to the required capital contributions, despite the absence of a deadline in the operating agreement, because it was established at trial that both parties intended and understood the $50,000 would be paid within six months of the execution of the LLC’s operating agreement. The court further noted that under any definition of “initial,” Nicolazzi’s failure to make the required initial capital contribution within a five-year time span undoubtedly constituted a breach of the operating agreement. Therefore, the court of appeals affirmed the trial court’s judgment in this regard.

Nicolazzi next argued that the trial court’s conclusion that his attempt “to sell his interest in the business to a third party without [Bone’s] written consent” constituted a breach of the operating agreement was a misapplication of law. Paragraph 7 of the LLC’s operating agreement stated that “[n]either of the Members shall, without the written consent of the other Member, sell, assign, pledge, mortgage, or otherwise transfer [his] [her] interest in the LLC.” However, the court observed that neither the operating agreement nor the Missouri LLC Act defined these prohibited actions. At trial, it was established that Nicolazzi did discuss a sale of his interest in the LLC with a third party without seeking Bone’s permission, though Nicolazzi testified the discussion was to gauge how interested this buyer was in the potential sale. The court found that a plain reading of Paragraph 7 would prohibit the parties from the listed actions without the other member’s written consent. However, the court distinguished between a conveyance and a solicitation and noted that the language of Paragraph 7 indicated that the parties intended to prohibit one another from conveying their membership interest without the other member’s permission. On the other hand, neither Paragraph 7 nor any other provision of the operating agreement prohibited (or even addressed) a member’s attempt to sell or to
discuss a sale of his or her interest. The court observed that it was undisputed that Nicolazzi did not ever actually perform any of the actions listed in Paragraph 7, and Bone argued before the trial court that Nicolazzi breached the operating agreement by soliciting the purchase of his membership interest. The court concluded that the operating agreement did not necessitate that a member receive the other member's consent before soliciting purchase of the member's interest by a prospective buyer. Because the operating agreement lacked such language, the court of appeals found that the trial court's conclusion that Nicolazzi breached the operating agreement by attempting to sell his membership interest to a third party without Bone's written consent was an erroneous application of the law. Therefore, the court reversed the trial court's judgment on this issue.

The second issue that the court of appeals addressed was whether the trial court erred in finding that Nicolazzi's actions constituted an “event of withdrawal” under the Missouri LLC Act and finding that Bone was the LLC's sole member. Nicolazzi argued that the trial court's conclusion that he withdrew was a misapplication of the Missouri LLC Act. The court of appeals observed that the trial court relied on two provisions of the Missouri LLC Act when it concluded that Nicolazzi’s actions of failing to make his required initial capital contributions, attempting to sell his membership interest, and leaving the LLC in April of 2011 constituted “events of withdrawal.” The Missouri LLC Act permits a member to withdraw from a LLC as specified in writing in the operating agreement, at any time upon giving ninety-days’ prior written notice to the other members, or under certain conditions (e.g., assignment of a member's entire interest in the LLC or expulsion as a member in accordance with the operating agreement). Because the LLC’s operating agreement was silent on what would constitute an event of withdrawal, Nicolazzi did not give any written notice to Bone, and the other statutory conditions were not present before Nicolazzi filed his petition, the court of appeals concluded that the trial court erroneously applied the two provisions of the Missouri LLC Act in finding that Nicolazzi’s actions constituted “events of withdrawal” from the LLC. The court pointed out that while it did affirm the trial court’s finding that Nicolazzi breached the operating agreement by failing to make his initial capital contribution, that breach did not equate to his withdrawal under the operating agreement or the Missouri LLC Act. As a result, the court of appeals reversed the trial court’s judgment in that regard.

The court further concluded that Nicolazzi was still a member of the LLC at the time he filed his petition because he was a member when the LLC was formed and did not withdraw before filing. Therefore, the court of appeals reversed the trial court’s determination that Bone was the sole member of the LLC. However, the court also found that, as a matter of law, Nicolazzi may have withdrawn from the LLC by actually filing his petition. Under the Missouri LLC Act, an “event of withdrawal” includes a member filing a petition “[s]eeking for himself any reorganization, arrangement, composition, readjustment, liquidation, or similar relief under any statute, law, or regulation ....” Because this issue was not before the trial court, the court of appeals remanded the case to that court with instructions to determine whether Nicolazzi’s filing of his petition constituted an event of withdrawal. The court of appeals also found that the LLC’s operating agreement did not state the amount or method for determining the distribution to be paid to a withdrawing member. Thus, if the trial court determined that Nicolazzi’s filing of his petition constituted such an “event of withdrawal,” then the court of appeals
instructed the trial court to determine the “fair value” of Nicolazzi’s interest in the LLC as of the date of withdrawal (the date that he filed his petition).

In sum, the court of appeals held that the trial court’s conclusion that Nicolazzi breached the LLC’s operating agreement by failing to make his required initial capital contribution was not against the weight of the evidence and affirmed the trial court’s judgment in that regard. The court of appeals also held that the trial court erroneously applied the law in finding that Nicolazzi breached the LLC’s operating agreement by discussing the sale of his interest with a third party without Bone’s consent and in finding that Nicolazzi withdrew from the LLC prior to the filing of his petition, reversing the trial court’s judgment on these issues. Because the court of appeals found that Nicolazzi did not withdraw from the LLC prior to the filing of his petition, the court also found that the trial court erred in determining that Bone was the sole member of the LLC and reversed the trial court’s judgment in that regard. Finally, as a matter of law, the court of appeals found that Nicolazzi’s actual filing of his petition may itself have constituted an “event of withdrawal.” Because this issue was not before the trial court, the court of appeals remanded the case to the trial court to determine if Nicolazzi withdrew pursuant to the Missouri LLC Act, and if he did, to determine the “fair value” of his interest in the LLC at the time of withdrawal.


The court of appeals held that the operating agreement of a Kentucky LLC unambiguously required a member to pay an amount equal to one-third of the LLC’s liabilities based on a provision of the operating agreement that divided the “profits and liabilities” of the LLC equally between the three members.

In 2004, Troy VanWinkle, Lyle Walker, and Carl David Crawford formed TLC Developers, LLC (“TLC”), and executed an operating agreement. TLC’s business purpose was to develop and build residential structures in Madison County, Kentucky. Several years later, TLC experienced severe cash-flow problems and was unable to pay its business expenses. Because Walker and Crawford believed that the operating agreement required the members to pay equally for these expenses if TLC could not, they contributed personal funds to the company’s account. VanWinkle claimed that he was not required to pay expenses of TLC, although he did pay one-third of TLC’s property taxes on multiple occasions.

In 2013, Walker and Crawford filed a complaint seeking a declaration of rights as to the members’ dispute over the agreement to equally pay TLC’s liabilities. After a bench trial, the circuit court determined that the operating agreement unambiguously stated that the three members agreed to split company liabilities in thirds and ordered VanWinkle to pay $87,000 as his one-third share of TLC’s liabilities.

On appeal, VanWinkle argued that the circuit court erred because: (1) the operating agreement contained an express provision protecting the members from personal liability; and (2) holding the members personally liable for TLC’s liabilities would be inconsistent with the intent of the Kentucky Limited Liability Company Act (the “Kentucky LLC Act”).

The court’s analysis of VanWinkle’s first argument focused on two separate provisions in the TLC operating agreement.
One of these provisions, titled “Immunity from Personal Liability” (the “Immunity provision”), stated:

As provided in [Kentucky LLC Act] 275.150, no member, employee or agent of the Company will be personally liable by reason of such status under a judgment, decree, or order of a court or agency, or tribunal of any type, or in any other manner, in this or any other state, or on any other basis, for a debt, obligation, or liability of the Company, whether arising in contract, tort, or otherwise. The status of a person as a Member, employee, or agent of the Company shall not subject the person to personal liability for the acts or omissions, including any negligence, wrongful act, or actionable misconduct, of any other Member employee or agent of the company.

The other provision, titled “Division of Profits and Liabilities” (the “Division provision”), stated:

The profits and liabilities of the Company shall be divided as follows: Carl David Crawford = thirty-three and one-third (33 1/3%), Lyle A. Walker = thirty-three and one-third (33 1/3%) percent and Troy Van Winkle [sic] thirty-three and one-third (33 1/3%).

VanWinkle contended that the Immunity provision acted “as a shield against any personal liability arising from” TLC’s liabilities, despite the existence of the Division provision. The court disagreed, first noting that the Immunity provision was “almost identical” to Section 275.150(1) of the Kentucky LLC Act, which does, in general, limit personal liability of members of an LLC. Because of this direct reference to a specific statute, the court concluded that the members “clearly” intended to mimic Section 275.150. Second, the court noted that VanWinkle appeared to ignore Section 275.150(2), which states that the members may alter the general rule of nonliability by agreeing to be personally obligated for the liabilities of the LLC in a written operating agreement. The court concluded that Section 275.150(2) was articulated in the TLC operating agreement under the Division provision. Third, the court referenced case law for the requirement that “[a]ny such assumption of personal liability ... must be stated clearly in unequivocal language which leaves no room for doubt about the parties’ intent[.]” citing Racing Inv. Fund 2000 v. Clay Ward Agency, 320 S.W.3d 654, 659 (Ky. 2010) (emphasis added). The court concluded that the language of the second provision met this “unequivocal language” standard because the Division provision unambiguously mandated that TLC’s liabilities be divided evenly between the three members, and the provision appeared on the same page of the agreement that VanWinkle signed. The court also pointed out that, because VanWinkle previously paid his share of the company’s property taxes on at least two occasions, it appeared that “he understood this provision at one point in time.” As a result, the court rejected VanWinkle’s first argument.

The court then turned to VanWinkle’s argument that he could not be personally liable for TLC’s liabilities because “the hallmark of an LLC—and [the Kentucky LLC Act, by extension]—is to limit the liability of LLC members.” The court agreed that
members are not, as a general rule, liable for the liabilities of the LLC under the Kentucky LLC Act. However, the court pointed out that Section 275.003 of the Kentucky LLC Act provides that it is the policy of the statute “to give maximum effect to the principles of freedom of contract and the enforceability of operating agreements” to allow business partners the freedom to contract and structure an LLC to fit the needs of its members. The court noted that holding the members personally liable for TLC’s liabilities may seem contrary to the point of establishing an LLC, but this result adhered to the legislative intent of allowing members the freedom to contract and establish an LLC that fits their needs. Here, the three members each agreed to the equal division of TLC’s liabilities, and the circuit court thus did not err in ordering VanWinkle to pay his agreed-upon share of the company’s liabilities.


The court of appeals held that the removal of an individual as co-manager of an LLC was effective where half of the members signed a written consent voting to remove the individual as manager, and the remaining members (one of whom was the individual who was being removed) did not object after receiving written notice of the written consent. The court also held that the subsequent expulsion of the individual as a member from a related LLC was valid under the terms of the company agreement of that LLC.

Pak was the majority member of Villas on Raiford Carrollton Senior Housing, LLC (“Villas CSH”) and Villas on Raiford, LLC (“Villas Manager”), the ownership and management entities of a low-income senior housing project. Pak and AD Villarai, LLC, an entity controlled by Anderson, were co-managers of Villas Manager. After various acts of mismanagement by Pak came to light, the Villas entities sued Pak. Certain members of Villas Manager took action to remove Pak as a manager and member of that entity, and members of Villas CSH subsequently took action to expel Pak as a member from that entity. The issues were tried in a bench trial, and the trial court concluded that Pak was validly removed as co-manager of Villas Manager and that Pak breached his fiduciary duties to Villas CSH and Villas Manager and materially breached the company agreements of each entity. However, the trial court found that the member consent expelling Pak as a member of Villas CSH did not comply with the company agreement and was not effective. Both sides appealed.

On appeal, Pak argued that his removal as co-manager of Villas Manager was not effective because he did not vote as a member in favor of his removal as a manager. The company agreement provided for the removal of a manager with the vote of a majority of the members and defined a majority as more than 50% of the number of members. At the time, Villas Manager had four members, and two of them signed a written consent removing Pak as a manager and member and appointing AD Villarai, LLC as sole manager of Villas Manager. The company agreement of Villas Manager contained a provision authorizing action by the members without a meeting as follows:

*Any action required by the BOC* [Business Organizations Code] *to be taken at a meeting of the Members, or any action which may be taken at a meeting of the Members, may be taken without a meeting, without prior notice, and without a vote if a written consent or consents in writing, setting forth the*
action so taken, shall have been signed by the Members entitled to vote with respect to the action which is the subject matter of the consent, and such consent shall have the same force and effect as a unanimous vote of the Members.

This provision additionally required that a written consent be signed, dated, and delivered as required by the BOC. Finally, the provision stated that “prompt notice” of any action taken by members without a meeting by less than unanimous consent must be given to those members who did not consent in writing to the action. In such cases, the agreement required that “prompt notice” be given to those who did not consent, but the agreement did not address the effect of giving such notice. The court then discussed Section 101.359 of the Texas Business Organizations Code, which governs an LLC unless the LLC’s company agreement provides otherwise. Section 101.359 provides that members and managers may take action without a meeting in various ways, and Section 101.359(2)(A) provides that an action is effective if it is taken with the consent of each member, “which may be established by: (A) the member’s failure to object to the action in a timely manner, if the member has full knowledge of the action.” Because nothing in the company agreement of Villas Manager provided that consent could not be established by failure to object as provided by the statute, and the plain wording of the company agreement did not conflict with applying the statute to the member actions in this case, the court concluded that a member’s failure to object after being given written notice of the written consent was deemed consent to the action taken by the written consent such that the action became effective. The evidence showed that Pak and the other member who did not sign the written consent were given written notice three days after the action removing Pak as co-manager, and neither of them objected. Pak argued that the written consent was signed while the two sides were in litigation, and the trial court could not have reasonably concluded that Pak would have consented to his removal, but the court of appeals stated that the statute did not require the trial court to guess at Pak’s reasons for failing to object. Thus, the court of appeals concluded that Pak was validly removed as co-manager of Villas Manager.

The court of appeals also addressed the trial court’s conclusion that Pak’s expulsion as a member of Villas CSH failed to comply with the terms of the company agreement, and the court of appeals held that the evidence conclusively established that Pak was properly expelled. The company agreement of Villas CSH contained the following expulsion provision:

If a Member willfully violated any term of provision of this Agreement and fails or cannot cure such violation within ten (10) business days after having been given notice of the violation by the Company, then the Managers shall have the right, but not the obligation, to expel such Member as a Member of Company, provided, however, that the remaining Members unanimously vote to expel such Member.

The undisputed evidence showed that Pak was given notice of specified violations of the company agreement and that sixteen days later, after Pak failed to cure all the violations, a written consent expelling Pak as a member of Villas CSH was signed by AD
Villarai, LLC — the remaining manager of Villas Manager (the manager of Villas CSH) — and the three other members of Villas CSH. The court of appeals explained that the trial court had erroneously concluded that Pak’s vote as well as that of AD Villarai, LLC was required for Villas Manager to act. Although Pak and AD Villarai, LLC had been co-managers of Villas Manager, Pak was validly removed as co-manager of Villas Manager several months before the execution of the written consent expelling Pak as a member from Villas CSH. Thus, at the time of Pak’s expulsion, AD Villarai, LLC was the sole manager with authority to act for Villas Manager. Once AD Villarai, LLC, as sole manager of Villas Manager, voted to expel Pak, the company agreement required the “remaining” members to vote unanimously to expel Pak. The court stated that it was clear in this context that “remaining” members meant members other than Pak. The consent was signed by the three members other than Pak as well as Villas Manager as the manager of Villas CSH. Thus, the court held that the written consent properly expelled Pak as a member.


In a dispute regarding the ownership of a limited partnership and its general partner, the court of appeals concluded that: (1) the trial court erred in submitting a jury question inquiring whether the parties to written assignments of interests in the limited partnership and its LLC general partner agreed to an alleged oral condition because the alleged condition contradicted the unambiguous terms of the assignments and was thus precluded by the parol evidence rule; (2) the language of certain assignments did not transfer any interest in the LLC general partner of the limited partnership; (3) certain purported transfers of interest in the LLC general partner were null and void ab initio because they were prohibited under the company agreement, and subsequent consent or ratification could not operate to give life to an attempted transfer that was null and void; (4) certain purported transfers of interests in the limited partnership were valid even if the transfers were prohibited by the partnership agreement because the partnership agreement allowed the general partner to recognize a transfer that would otherwise be null and void under the terms of the agreement.

Osama Abdullatif (“Latif”) and Ali Mokaram entered into a real estate investment venture by forming Mokaram Latif West Loop, L.P. (“ML Partnership”) in which Mokaram and Latif were each 49.5% limited partners and Mokaram-Latif General, LLC (“ML General”) was the 1% general partner. Mokaram and Latif were the managers and equal members of ML General. Mokaram and Ali Choudhri became friends and engaged in business transactions together, including transactions in 2008 and 2010 involving ML Partnership and ML General.

The 2008 transaction included an agreement in which Mokaram purported to transfer to Choudhri a limited partnership interest in ML Partnership, and the 2010 transaction included purported assignments by Mokaram to Choudhri of interests in ML Partnership and ML General. Disputes regarding these transactions arose, and eventually Latif purchased all of Mokaram’s interests in ML Partnership and ML General along with all of Mokaram’s claims against Choudhri relating to interests in the entities. Mokaram agreed to continue to pursue his claims against Choudhri in this lawsuit in which Mokaram, Latif, Choudhri, and ML Partnership were parties. The trial court entered a declaratory judgment regarding the ownership of the entities, and Mokaram and Latif appealed.
The first issue the court of appeals addressed was whether the trial court erred in submitting a jury question inquiring whether Mokaram and Choudhri agreed that the 2010 assignment was not effective and that Mokaram would return the money paid by Choudhri to Mokaram. Because the unambiguous language of the assignment provided that it was effective immediately and did not indicate that it was contingent on any condition, the court of appeals concluded that the testimony regarding an alleged oral condition was precluded by the parol-evidence rule from contradicting the unambiguous language of the assignment. Thus, the trial court should not have submitted any question inquiring into the enforceability of the oral condition. The court stated that the parol-evidence rule would not have precluded the trial court from submitting a question about an alleged subsequent agreement to rescind, but the jury question that was submitted did not ask about a subsequent agreement to rescind. The court also stated that the evidence did not raise a genuine fact issue as to whether Mokaram and Choudhri agreed to rescind the assignment after they executed it.

The court next addressed the argument that the trial court lacked jurisdiction over the declaratory judgment claims regarding Choudhri’s ownership and management rights in ML General because ML General was not a party. The court of appeals held that the trial court did not lack jurisdiction over the claims. Although the declaratory judgment did not bind ML General, it was binding on the parties in this action.

Next the court of appeals discussed whether the trial court erred in declaring that Choudhri had owned an interest in ML General since the date of the 2008 assignment. Based on the language of the documents executed in 2008, which purported to transfer to Choudhri an interest in ML Partnership and certain real property, the court concluded that Mokaram did not purport to transfer any interest in ML General. The documents indicated that Mokaram and Choudhri thought that ML Partnership owned the real property referred to in the assignments and that they intended to transfer an indirect interest in the real property by transferring an interest in ML Partnership. However, assuming that ML Partnership owned the real property referred to in the assignments, that would not mean that ML General had any ownership in the property, and the court concluded that the evidence did not show that Mokaram transferred any interest in ML General to Choudhri by virtue of the 2008 assignments.

The 2010 assignments purported to transfer from Mokaram to Choudhri interests in both ML General and ML Partnership. Both the company agreement of ML General and the partnership agreement of ML Partnership contained restrictions on transfer, and the court discussed the effect of the purported transfers by Mokaram.

The ML General company agreement prohibited a member from transferring any of its membership interest except in limited circumstances, such as with the approval of members having more than 66.67% of the interests of all members. The company agreement stated that a transfer in violation of its provisions was “null and void ab initio.” Assuming Mokaram’s execution of the assignments represented his approval of the transfers, there was no evidence that Latif, the other 50% member at the time, approved the assignments before Mokaram purported to assign his interest, and there was no evidence that any of the other circumstances under which a transfer was permitted were present. Choudhri relied on a 2011 consent signed by Latif as manager and member of ML General in which Latif consented to any prior transfers.
by Mokaram to Choudhri of a membership interest in ML General. The court concluded that the purported assignments were null and void from the outset under the unambiguous language of the company agreement, and as such the purported transfers could not be ratified or validated after the fact. Thus, the trial court erred in declaring that Choudhri had owned 50% of ML General and had been a manager of ML General from and after the 2010 assignments.

The ML Partnership agreement also contained prohibitions on transfer, and the court next addressed the effect of purported assignments in 2010 by Mokaram to Choudhri of a limited partnership interest in ML Partnership. Section 10.1 of the partnership agreement prohibited a limited partner from transferring all or any portion of the limited partner’s interest without the prior written consent of the general partner. Section 10.2 of the partnership agreement contained a right-of-first-refusal provision in favor of the other partners in the event a limited partner received a bona fide offer to purchase all or any portion of the limited partner’s interest. Section 10.3 provided for certain “Permitted Transfers” (to a trust for the benefit of the limited partner, the guardian or estate of a limited partner, or a person approved by all the partners) notwithstanding the consent otherwise required by Section 10.1. Section 10.6 provided that a transfer that was not permitted under the partnership agreement “shall be null and void and of no effect whatever; provided that if the Partnership is required to recognize a Transfer that is not permitted (or if the Partnership, in its sole discretion, elects to recognize a Transfer that is not permitted),” the transferred interest was limited to the transferor’s rights to allocations and distributions. Finally, Section 10.10 provided that the partnership was not required to recognize the interest of any transferee who obtained a purported transferred interest pursuant to a transfer that was not authorized by the partnership agreement, and such a transfer was “null and void for all purposes.”

The court stated that the plain meaning of “null and void and of no effect whatever” would preclude a transfer that was not permitted by the partnership agreement from being subject to ratification, confirmation, or waiver, but the court concluded that the phrase “null and void and of no effect whatever” was not used in its ordinary sense given that the agreement unambiguously provided that the partnership could elect to recognize a transfer that was not permitted and thus was or would have been “null and void and of no effect whatever.” The court noted the difference between the ML General company agreement (which the court had held did not permit ratification of a null and void transfer) and the ML Partnership agreement and concluded that the two agreements were separate and independent agreements that should not be construed together as one. Further, assuming the agreements should be construed as a single contract, the provisions unambiguously allowed the recognition of an otherwise void transfer of a partnership interest but did not allow the recognition of a void transfer of a membership interest.

Because Mokaram signed the assignment of his interests to Choudhri not only as assignor, but in his capacity as manager of ML General, the general partner of ML Partnership, under a legend stating that the transfer was consented to by the general partner, the court concluded that ML Partnership recognized the transfer of the interests. Relying on the language of the ML General company agreement (which provided that the managers shall have the sole and exclusive control of the management of ML General and shall make all decisions not otherwise provided for in the company agreement) and Section 101.254 of the Business Organizations Code (which provides...
that each governing person is an agent of the LLC for the purpose of its business), the court stated that Mokaram’s signature as manager was binding on ML General, and ML Partnership thus recognized the transfer as valid and effective as provided by Section 10.6 of the partnership agreement. The court concluded that an earlier purported transfer in 2008 by Mokaram to Choudhri of a limited partnership interest was not effective because there was no evidence that the transfer was permitted under any of the provisions of the partnership agreement nor was there any evidence that the partnership was required to recognize the transfer or exercised its discretion to recognize the transfer.

Finally, the court concluded that the trial court did not err in refusing to clarify what rights Choudhri had as a result of his ownership of an interest in ML Partnership. The trial court declared that Choudhri owned 49.5% of ML Partnership from and after the 2010 assignments and that he had “all beneficial rights and interests” that flowed from his ownership of an interest in ML Partnership. The court stated that the interests transferred to Choudhri were limited to rights to allocations and distributions under the unambiguous language of Section 10.6 of the partnership agreement, and neither Section 10.2 nor 10.6 gave Choudhri the right to become a limited partner under the assignments. The trial court did not declare that Choudhri was a limited partner, and although the “beneficial rights and interests” were significantly limited by the agreement, the trial court did not inaccurately characterize them. Thus, the court of appeals concluded that the trial court did not err in making the declaration and in refusing to clarify it.


The court of appeals held that the trial court erred in entering a judgment that a member of three LLCs was entitled to one-third of the profits of each of the LLCs because the Texas Business Organizations Code provides that profits and losses are allocated to the members based on the agreed value of the members’ contributions as stated in the company’s records, and none of the LLCs had a record of the member’s alleged contribution. Although the member testified that he contributed cash to the LLCs, and the jury found that the member was entitled to a one-third profit distribution from each LLC, the court of appeals stated that allowing the member’s oral testimony to establish his entitlement to one-third of the profits of the LLCs in the absence of any written records of his contributions would be contrary to the plain language of the LLC statute.

Nizar Sunesara and Anis Virani started selling smoking accessories and devices in flea markets on the weekends in 2002, and the next year they established a brick-and-mortar retail shop called “Zig Zag Smoke Shop.” Sunesara created MNA Corporation to operate Zig Zag, and Virani and Sunesara offered Manisch Sohani (a supplier of Zig Zag) an ownership interest in the business. The three men each owned one third of MNA Corporation, and profits of Zig Zag were distributed in cash each month. Sunesara and Virani both took positions with Sohani’s company, and Sunesara transitioned out of the day-to-day business of Zig Zag while Virani continued to manage Zig Zag’s day-to-day operations as well as working for Sohani’s company. Zig Zag did well, and in 2012, Virani and Sunesara started a second retail location, which they called “Burn Smoke Shop” (“Burn I”). Sunesara testified that he contributed $10,000 cash to the start up of Burn I. He stated that he gave the money to Virani and did not request any
receipt or documentation of his contribution. SSV Corporation, which was incorporated by Sunesara in 2007, owned the assets of both Zig Zag and Burn I. Sunesara and Virani each owned 50% of SSV Corporation, but records showed that Sohani shared equally with Sunesara and Virani in profit distributions, and Sunesara testified that Sohani was considered a partner even though he was not a formal owner.

Toward the end of 2012, Sunesara, Virani, and Sohani agreed to buy an existing retail smoke shop, whose name they changed to “Burn Smoke Shop Two” (“Burn II”). Sunesara testified that he contributed $10,000 cash to the start up of Burn II, again giving the money to Virani without obtaining any receipt or documentation of his contribution. Before the purchase of Burn II was finalized, Sohani and Virani asked Sunesara to file paperwork with the Texas Secretary of State to form three LLCs to run the three smoke shops. Each certificate of formation, which was signed by Sunesara but not the other two men, listed Sohani, Virani, and Sunesara as governing persons. Signature cards and depository resolutions for the bank accounts for the three LLCs listed all three men as members and were signed by all three men. Virani and Sohani claimed that Sunesara handled the paperwork for forming the LLCs and opening the bank accounts, and Virani and Sohani claimed that they should have been listed as the only two members of the LLCs. The franchise tax public information report for 2013 listed all three men as members of the LLCs, but the franchise tax report for 2014 as well as federal income tax returns for 2013 and 2014 only listed Virani and Sohani as members or owners of the LLCs.

Sohani and Virani testified that Sunesara did not contribute anything to the three shops. They also testified that they never received any profit distributions from the LLCs because the profits went to Sohani’s company to pay back inventory Sohani contributed and to pay other vendors and creditors of the LLCs.

After federal law enforcement officers began targeting sellers of synthetic marijuana and raiding retailers, wholesalers, and distributors in the smoke shop industry, Sunesara became concerned because Sohani’s company and the three retail shops sold synthetic marijuana. Sunesara wanted Sohani’s company and the shops to stop selling the product. Sohani’s company was raided in 2013, and Sunesara took a leave of absence from the company and did not return. After the raid, Sohani and Virani realized that they lacked important documentation for the LLCs, such as operating agreements, and (after conducting internet research) the two men drafted and signed form operating agreements listing them as members and stating that they each made 50% of contributions and owned 50% of profits and assets. Sunesara’s name did not appear in any of the three agreements, and he was not involved in the drafting of the agreements. Sunesara testified that he received monthly profit distributions for the first five months of 2013 and inquired regularly “what the situation was with profit distributions” after the raid but was given excuses why there were no distributions until October of 2013, when the parties ceased communicating. The parties disagreed over whether Sunesara had a share of the business, and Sohani and Virani were unable to open new bank accounts or obtain loans for the LLCs without Sunesara’s authorization and signature. In 2015, Virani and Sohani sued Sunesara asserting various causes of action, including a claim for a declaratory judgment that Sunesara was not a member of the LLCs. Sunesara counterclaimed for a declaration that he was a member of the LLCs, was entitled to one-third of the profits of the LLCs, and was entitled to examine the LLCs’ books and records.
The jury answered “yes” to three questions inquiring whether Sunesara was a member entitled to a one-third profit distribution of each of the LLCs at the time they were formed. No definitions or instructions accompanied these questions. The jury also found that Sohani and Virani were estopped to deny Sunesara was a member of the LLCs and that Sunesara did not commit fraud against Virani and Sohani. After the verdict, Virani and Sohani moved to dismiss the action for lack of subject-matter jurisdiction based on documentation that they argued demonstrated the combined total of one-third profit distributions from the three LLCs exceeded $200,000, the upper limit of the county court’s jurisdictional limits. Sohani and Virani also argued that Sunesara presented only his self-serving testimony that he was a member and had made contributions to the LLCs but presented no evidence of an oral or written operating agreement entitling him to membership and one-third of the profits of the LLCs. Virani and Sohani relied on Tex. Bus. Orgs. Code § 101.201, which provides that profits and losses of an LLC shall be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company’s records. The trial court entered judgment in favor of Sunesara declaring that he was a member of the LLCs and entitled to one-third of the profits from the LLCs.

The court of appeals analyzed the contention of Sohani’s and Virani’s that the trial court’s judgment, which declared that Sunesara was a member of each of the LLCs and was entitled to one-third of the profits from each of the LLCs, conflicted with Section 101.201 of the Business Organizations Code, which states that an LLC’s allocation of profits and losses are to be made “on the basis of the agreed value of the contributions made by each member, as stated in the company’s records.” Sohani and Virani argued that there was no written record reflecting Sunesara’s contributions to the LLCs or demonstrating that he was entitled to one-third of the profits. The court reviewed the definitions of a “member,” “membership interest,” “governing documents,” “company agreement,” and “contribution,” and pointed out that the Business Organizations Code does not require a person to make a contribution in order to be admitted as a member or acquire a membership interest. The court also pointed out that the statutory provisions addressing allocation of profits and losses and the sharing of distributions provide that such matters are based on the agreed value of each member’s contributions as stated in the company’s records required to be kept under the statute. Tex. Bus. Orgs. Code §§ 101.201, 101.203. Section 3.151 of the Business Organizations Code contains general recordkeeping requirements for filing entities, and Section 101.501 has specific requirements for LLCs that include maintaining a record of “the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member.” Tex. Bus. Orgs. Code § 101.501(a)(7).

The court’s analysis of Sohani’s and Virani’s contention focused on the “plain meaning” of Sections 101.201 and 101.501 of the Business Organizations Code. At trial, Sunesara testified that he made contributions to the LLCs in the form of $10,000 cash contributions and “deferred profits” to the startup of Burn I and the acquisition of Burn II. Sunesara did not, however, offer any documentary evidence reflecting those contributions. The record contained no writing setting out the specific contributions made by any of the three members or stating that Sunesara was entitled to one-third of the profits from the LLCs. The company agreements for each of the LLCs were admitted into evidence, but they listed only Sohani and Virani as members and stated, under each of their names, “Made 50% of
contributions, Owns 50% of profits and assets.” The court construed Section 101.501 of the Business Organizations Code to require an LLC to include a statement of the amount of cash contributions made by each member and a statement of the agreed value of any other contribution made by each member in the written records of the company and construed Section 101.201 to provide that these records establish the allocation of a member’s share of the profits and losses of the company. Because Sunesara did not introduce any records of the LLCs reflecting the contributions that he made to the LLCs, the court concluded that he presented no evidence that he is entitled to one-third of the profits of the LLCs under Section 101.201.

Sunesara argued that his testimony that he made contributions to the LLCs sufficed to demonstrate his entitlement to one-third of the profits of the LLCs, but the court stated that the plain language of Section 101.201 requires profits and losses to be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company’s records required under Section 101.501, and the plain language of Section 101.501 requires an LLC to maintain a written record of the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member.

Sunesara pointed to the 2008 tax return of MNA Corporation (which stated that Sunesara, Virani, and Sohani were each allocated one-third of the profits for that corporation) and the records of SSV Corporation (which stated that Sunesara and Virani each owned fifty percent of that corporation) and argued that, when the LLCs were created and took over operation of the smoke shops, these records became a part of the records for the LLCs and satisfied the writing requirement of Section 101.201. But the court stated that the corporations and LLCs were all separate and distinct entities, and Sunesara cited no law supporting the proposition that the records from the earlier-formed entities became records of the new LLCs when they began operating the smoke shops. The court stated that the documentary evidence reflecting that Sunesara had a one-third ownership interest in MNA Corporation and a one-half interest in SSV Corporation established only that he was entitled to distributions from MNA Corporation and SSV Corporation, not that he made contributions to the LLCs or that he was entitled to one-third of the profits from the LLCs. Thus, the court held that the trial court erred to the extent that it ruled that Sunesara was entitled to one-third of the profits from each of the LLCs. “Because Sunesara was not assigned a share of profits in the company agreements and presented no evidence that he was entitled to a one-third share of profits in the LLCs, he was not entitled to a share in profits as a matter of law.”


A former employee sued a restaurant-chain LLC and its parent corporation seeking indemnification for expenses incurred in defending against federal charges. The district court held that the former employee was not entitled to indemnification under the governing documents of either entity and the business judgment rule protected the LLC’s decision to deny indemnification on the grounds that the former employee engaged in fraud and willful misconduct.

Autumn Lee Tangas began working for International House of Pancakes, LLC (“IHOP”) in 1991 and became a “franchise bureau consultant” (FBC) in 2003. As an FBC, Tangas acted as a liaison to franchisees who operated restaurants in her multi-state
territory, helped franchisees boost sales, and ensured that they adhered to IHOP operating standards. In September 2011, the FBI raided the home of a franchisee whose operations Tangas oversaw. After the raid, IHOP opened its own investigation to determine if the company itself might be a target of the FBI investigation or a potential victim of wrongdoing. In 2012, DineEquity’s in-house counsel communicated to Tangas’s lawyer that Tangas was obligated to cooperate with the internal investigation under the IHOP code of conduct and a refusal to do so would result in termination. After Tangas’s lawyer responded that Tangas would not answer any questions, IHOP fired Tangas for violating the IHOP code of conduct and refusing to participate in the interview. A federal grand jury subsequently indicted Elkafrawi, Tangas, and others. The indictment, which charged Tangas with money laundering, conspiring to harbor illegal aliens, and mail fraud, essentially alleged that Tangas used her position as an FBC to hide Elkafrawi’s criminal activities from IHOP. The criminal case against Tangas proceeded for more than two years until the U.S. Attorney’s Office dismissed the charges without prejudice in 2014. At that time, Tangas had incurred more than $130,000 in legal fees. In 2015, Tangas demanded that IHOP pay these legal fees. After the FBI provided part of its investigative file to IHOP, the LLC denied her request in light of “the allegations in the indictment and supported by the evidence in the government interviews.”

After rejecting Tangas’s argument that she was entitled to indemnification under DineEquity’s bylaws or the Delaware corporate statute, the district court addressed whether Tangas had a right to indemnification under IHOP’s LLC agreement. Both sides relied on the language of IHOP’s LLC agreement, which provided that:

the Company shall indemnify and hold harmless each Covered Person from and against any and all losses, claims, demands, liabilities, expenses, judgments, fines, settlements and other amounts arising from any and all claims, demands, actions, suits or proceedings, civil criminal administrative or investigative (“Claims”), in which the Covered Person may be involved, or threatened to be involved as a party or otherwise, by reason of its management of the affairs of the Company or which relates to or arises out of the Company or its property, business or affairs. A Covered Person shall not be entitled to indemnification under this Section 8.2 with respect to (i) any Claim with respect to which such Covered Person has engaged in fraud, willful misconduct, bad faith or gross negligence[.]

The LLC agreement defined “Covered Persons” to include “the Member [i.e., DineEquity], any officers, directors, stockholders, partners, employees, affiliates, representatives, or agents of any of the Member,” or “any officer, employee, representative, or agent of the Company [i.e., IHOP].” Because the parties agreed that Tangas was a “Covered Person” until she was fired in 2012, the court focused on determining if Tangas was entitled to indemnification of expenses incurred post-termination.

DineEquity and IHOP argued that Tangas’s indemnification rights did not
continue post-termination because the Delaware LLC statute, unlike the corporate statute, does not provide a default rule that requires continuation of indemnification rights after a person ceases to be an employee, and such rights were not provided in IHOP’s LLC agreement. Tangas argued that IHOP impliedly agreed to cover expenses of former employees by failing to specify that the indemnification clause does not exclude former employees, but the court was not persuaded by Tangas’s interpretation of the indemnification clause because the interpretation was logically flawed (all categories of persons not defined as “Covered Persons” could claim indemnification) and unsupported by case law (absent explicit language inclusive of former employees, Delaware courts interpret “employee” as referring to current employees only). The court noted that the operating agreement had a provision limiting IHOP’s ability to amend the agreement to strip Covered Persons of their existing indemnification rights, but the language forbidding IHOP from retroactively stripping a Covered Person of existing indemnification rights did not prohibit IHOP from discontinuing indemnification once a person ceased to be a Covered Person. Tangas also argued that she had a vested right to indemnification that continued after her firing, but the court distinguished Delaware cases in which the courts determined that an indemnification right became vested and could not be terminated. The only right that could have vested in this case was Tangas’s right to be indemnified while she was a Covered Person involved or threatened to be involved in a proceeding. Because Delaware law did not prohibit IHOP from limiting its indemnification obligations in this manner and nothing in the LLC agreement required IHOP to indemnify a former employee whom it had fired, Tangas was not entitled to indemnification under the IHOP LLC agreement as a matter of law.

Finally, assuming arguendo that IHOP’s LLC agreement required it to indemnify Tangas, the district court addressed whether IHOP reasonably declined to indemnify Tangas on the basis that her conduct amounted to fraud or willful misconduct. IHOP and DineEquity argued that Delaware’s business judgment rule protected their decision not to indemnify Tangas, but Tangas argued that the business judgment rule was inapplicable because the LLC agreement entitled her to indemnification. The court concluded that the business judgment rule was applicable to the issue of whether Tangas engaged in fraud or willful misconduct. Because IHOP had the power to deny indemnification in those circumstances, the court stated that Tangas was asking the court to second guess the propriety of an action that IHOP had the authority to take and that Tangas must thus show IHOP’s decision to deny indemnification was not the product of reasoned, well-informed decision making. The court concluded that the undisputed evidence established that IHOP made a reasonable decision to deny indemnification after investigating the situation and concluding that Tangas engaged in fraud “with respect to” the criminal case against Tangas. Additionally, the court concluded that IHOP and DineEquity made a reasoned business judgment not to indemnify Tangas on the ground that her refusal to participate in the interview as required by IHOP’s code of conduct was willful misconduct “with respect to” the criminal case.


The court of appeals affirmed the judgment of the trial court that a Delaware LLC owed indemnity to its officer and that a settlement agreement precluded further collection of the judgment against the officer.
Jim Sandt, a former officer and member of Energy Maintenance (a Delaware LLC), sued Energy Maintenance, Timothy Nesler (the company’s CEO), and other officers claiming that the defendants had committed fraud and breach of fiduciary duty by wrongfully diluting his ownership interest. While Sandt’s suit was pending, the Energy Maintenance board agreed in a company resolution to indemnify Nesler for any liability arising out of or related to the Sandt litigation. The board resolution stated that the board agreed to indemnify Nesler after reviewing the Sandt litigation and discussing it with the company’s officers and attorneys. The resolution also stated that the board had determined that Nesler acted in good faith and in a manner that he reasonably believed was in the company’s best interest.

A jury found in favor of Sandt and against Energy Maintenance and Nesler. While an appeal was pending, the company’s primary creditor took control and terminated Nesler from his position as CEO. The new board of directors then voted to revoke the prior indemnification as of the date it was purportedly granted. The rationale for the revocation was, in part, that Nesler had misrepresented to the board the facts related to the Sandt matter. After the company refused to provide indemnification, it filed suit against Nesler seeking a declaration that it did not owe him indemnity and claiming that the jury’s findings of fraud and breach of fiduciary duty against him alleviated the company’s indemnification obligation. Nesler counterclaimed for breach of contract.

The trial court ruled that Nesler was entitled to indemnification and that the company’s failure to provide it was a breach of contract. Because a settlement agreement between the company and Sandt stated that Sandt could not recover any further, directly or indirectly, from the company, the trial court further declared that Sandt could not pursue Nesler for any amounts that the company had to indemnify. Both the company and Sandt appealed.

On appeal, the court noted that Energy Maintenance was a Delaware LLC; thus, Delaware law controlled the interpretation of the company’s formation agreement. The court cited a number of Delaware law propositions, including (1) “under Delaware law, a limited liability company may indemnify any member, manager, or another ‘against any and all claims and demands whatsoever,’ subject to whatever standards or restrictions are included in its company agreement”; (2) “for limited liability companies, Delaware law ‘defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification’”; (3) “[w]hen interpreting the provisions of a limited liability company agreement, ordinary contract interpretation rules apply; the court’s role is to effect the parties’ intent based on the plain meaning of the agreement’s terms”; and (4) “[a] court cannot rewrite or add omitted provisions in the guise of interpreting a contract.”

The court noted that Article VIII of the Energy Maintenance company agreement contained provisions for indemnification and advancement of expenses. Although the provisions obligated Energy Maintenance to indemnify persons who acted in good faith, it vested the board with the authority to decide if they did act in good faith. The agreement expressly specified that an adverse judgment did not create a presumption of bad faith, and it stated a company policy of indemnifying corporate officers to the fullest extent legally possible. According to the court, “Energy Maintenance’s company agreement does not, in express and affirmative terms, make members and directors ineligible for indemnification previously granted simply because a jury finds that they did not act in good faith, and we cannot rewrite its company agreement to say something it does not.”
addition, the court concluded that unless Energy Maintenance had a contractual right to reconsider its decision to indemnify Nesler, it could not rescind its earlier determination. Because “[n]either its company agreement nor the board’s 2007 indemnity resolution reserved a right to revisit Nesler’s right to indemnity,” the court concluded that the company “could not rescind its agreement to indemnify him.”

Despite the company agreement provisions that vested the board with the authority to determine whether the conditions for authorizing indemnification had been met, Energy Maintenance contended that the jury’s unfavorable verdict and the judgment against Nesler for fraud disproved his good faith and thereby provided a basis for the board to revoke its earlier grant of indemnity. The company relied on Delaware decisions construing that state’s corporate indemnification statute, 8 Del. Code § 145, for the proposition that a jury’s finding of fraud negates good faith as a matter of public policy. The court disagreed, noting that the statutes governing Delaware corporations and Delaware limited liability companies were different. Unlike Section 145, which applied to corporations, the statute governing limited liability companies allowed indemnity “against any and all claims and demands whatsoever,” subject only to the express terms of the company agreement. This statute did not purport to adopt or incorporate Delaware’s public policy regarding indemnity in the corporate context, and it deferred instead to the contracting parties to place limits on indemnification.

Although the court decided that the company was obligated to indemnify Nesler from liability in the Sandt litigation, it also concluded that Sandt, in a settlement agreement, agreed to forego any collection of the judgment against Nesler for which the company would be liable. The settlement agreement provided that Sandt “will not seek to execute and will not accept recovery, in each case whether directly or indirectly, against” Energy Maintenance for any remaining liability arising from the suit. The trial court reasoned that Energy Maintenance owed indemnity to Nesler, and thus an attempt to collect the remaining money that Nesler owed under the Sandt judgment would violate the settlement agreement’s clause barring Sandt from recovering any additional sum from Energy Maintenance “directly or indirectly.” In light of this clause and others, the court of appeals concluded that the trial court correctly interpreted the settlement agreement: “In sum, the settlement agreement bars Sandt from recovering from Nesler because it would result in an indirect recovery from Energy Maintenance, which is obligated to indemnify Nesler for the Sandt judgment.”

**Assignment of Interest; Restrictions on Transfer**

*Succession of McCalmont*, 2018 WL 6521176, __ So. 3d __ (La. App. 3d Cir. 2018).

The court of appeals held that the executor of the estate of the deceased wife of a member of several LLCs was not entitled to the production of LLC business, financial, and tax records because neither the agreements nor the Louisiana LLC statute gave an assignee a right of access to the LLC’s books and records.

Colleen McCalmont filed for divorce from her husband James McCalmont (“James”) in August of 2016, but she passed away before the divorce was finalized or community property partitioned. One of the McCalmonts’ children, Jay McCalmont (“Jay”) was appointed executor of her estate. As part of the executor’s duties in preparing a detailed description of property in the succession, Jay sought information from James regarding property believed to be community property. After James refused to
provide this information, Jay sought to compel discovery.

The trial court granted Jay’s motion to compel and ordered James to produce business, financial, and tax records of certain LLCs in which the McCalmons had held an interest. The trial court also ordered James to comply with certain other discovery requests not involving the LLC. James appealed.

On appeal, James argued that the trial court erred in ordering the discovery of LLC documents because the operating agreement of one LLC specifically restricted assignees from inspecting records and the Louisiana Limited Liability Company statute did not entitle assignees to inspect the records of the other involved LLCs. The court cited several Louisiana law propositions, including: (1) “[a]n operating agreement, whether written or oral, governs the operations of an LLC; (2) “[i]n the absence of [an operating agreement], the default provisions of the Louisiana LLC statute govern”; (3) “[a]n operating agreement is contractual in nature; thus, it binds the members of the LLC as written and is interpreted pursuant to contract law”; (4) as to contractual interpretation, “[t]he interpretive purpose is to determine the common intent of the parties”; (5) the ordinary contract interpretation rules apply, including the interpretation of “each contractual provision in light of the other provisions in order to arrive at the meaning of the contract as a whole”; and (6) “[t]he determination of whether the words of a contract are clear and explicit or ambiguous is a question of law [and thus] an appellate court’s determination on review is whether the trial court interpreted a contract correctly or incorrectly.” Applying an abuse-of-discretion standard, the court of appeals examined the evidence in the record. As to the discovery ordered against the LLCs, the court organized its analysis around whether the operating agreements dealt with maintenance of business records and the rights of an assignee. If the operating agreements addressed these issues, the court applied the pertinent provisions of the operating agreement; if not, the court applied the Louisiana LLC statute.

First, James argued, and the court agreed, that the operating agreement of one of the LLCs at issue specifically restricted assignees of a member from inspecting company records. Section 6.1 of the the operating agreement, titled “Books and Records,” required certain records (including those at the center of this dispute) “to be maintained and to be available to ‘any Member or an assignee of an Interest.’” On the other hand, Section 8.5 provided for the rights of unadmitted assignees as follows:

A person who acquires all or any portion of an Interest but who is not admitted as a Substituted Member ... shall be entitled only to allocations and distributions with respect to such interest ... but shall have no right to any information or accounting of the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.

Interpreting the language from Section 6.1 and Section 8.5 in the manner that best conformed to the objectives of the operating agreement, the court determined that the specific provision of Section 8.5 controlled over the more generally worded Section 6.1. The court reasoned that to conclude otherwise would simply eliminate the effects of Section 8.5 entirely and lead to an “absurd” reading of the operating agreement.
agreement as a whole. As a result, the court concluded that Jay, as an assignee, had “no right to any information or accounting of the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.” Furthermore, the court concluded that it was clear the operating agreement prohibited Jay from receiving the business, financial, and tax records that were the subject of the trial court’s discovery order. Thus, the court of appeals held that it was an abuse of discretion for the trial court to order the LLC governed by this operating agreement to produce those records and reversed the order compelling discovery.

Next, the court analyzed James’ argument that the Louisiana LLC statute, which governed the remaining LLCs whose operating agreements were silent as to the rights of assignees of membership interests, expressly restricts assignees to statutorily limited rights that do not include the right to inspect the records of the LLC. The court began its analysis by pointing out that the Louisiana LLC statute recognizes only one form of transfer of a membership interest—an assignment—whether voluntary or involuntary. In the case of an involuntary assignment, as in the case of a member’s death, the deceased member is the assignor and the recipient of the transferred interest, such as the executor or other legal representative, is treated strictly as the assignee. The court explained that an assignment results in a bifurcation of membership rights: the financial rights vest with the assignee, while the management rights remain vested with the assignor, even if deceased, until the assignee is admitted as a member. Thus, the statute confers on the assignee “is not entitled to inspect [the LLC’s] records, since this action is reserved for the members of the LLC.” The court acknowledged that “the law as written allows for the creation of situations whereby an assignee of a deceased member’s rights, while due distributions, may never be able to see company records to ensure he is actually receiving those distributions in full, because remaining members can simply withhold records that would show what, if anything, maybe owed.” However, the court concluded that Louisiana LLC law clearly limited Jay’s rights as an assignee and compelled the court to hold that it was an abuse of discretion for the trial court to order the LLCs to produce the requested records. Thus, the court reversed the trial court’s order compelling discovery.


In a dispute regarding a member’s breach of an LLC operating agreement and alleged withdrawal from the company, the court of appeals concluded that the trial court erroneously applied the law in finding that the member breached the operating agreement by discussing the sale of his interest with a third party without the consent of the other member.

Peter Nicolazzi and Laura Bone formed Young in Spirit Adult Day Care, LLC (the “LLC”), an adult daycare business, in 2005. Immediately following its formation, Nicolazzi and Bone were the LLC’s only workers and, under the operating agreement they signed in 2005, the only members. Nicolazzi was responsible for performing service-related tasks for the LLC’s customers and Bone primarily performed managerial and nursing duties. When business expanded, Bone’s duties grew while Nicolazzi’s tasks were handled by employees that the company hired. As time went on, the parties’ business relationship deteriorated. In 2011, Nicolazzi
did not seek Bone’s permission before he approached a competitor about buying his interest in the LLC. On April 30, 2011, Nicolazzi effectively stopped participating in the operation of the LLC, while Bone continued to operate the LLC. In June of 2011, Bone filed articles of incorporation for “Young in Spring Adult Day Center, Inc.” and, on the next day, notified Nicolazzi that the business would continue in this new entity and that she would be dissolving the LLC.

On June 30, 2011, Nicolazzi filed his petition against Bone and requested various forms of relief. Among her counterclaims, Bone asked the trial court to find that Nicolazzi was no longer a member of the LLC because he breached the operating agreement by failing to make his required capital contribution and by soliciting purchase of his membership interest by a third party without her consent. After a bench trial, the trial court entered judgment in favor of Bone and against Nicolazzi, finding that Nicolazzi breached the LLC’s operating agreement by failing to make the required capital contribution and by soliciting purchase of his membership interest by a third party without her consent. The court also cited the Missouri LLC Act for the requirement that member(s) adopt an operating agreement and the statutory definition of “member” as “any person that signs in person ... or otherwise is a party to the operating agreement at the time the [LLC] is formed and is identified as a member in that operating agreement....” The court reasoned that because Nicolazzi was named in the LLC’s operating agreement, he signed the operating agreement when the LLC was formed, and the operating agreement did not establish any further condition or prerequisites to membership, then he was a member from that point forward. The court of appeals further concluded that Nicolazzi and Bone were the only members of the LLC throughout the company’s existence.

The standard of review in this case required the court of appeals to affirm the trial court’s judgment unless there was no substantial evidence to support it, it was against the weight of the evidence, or it erroneously declared or applied the law. The court organized its discussion around two primary issues: first, whether Nicolazzi breached the LLC’s operating agreement; and second, whether Nicolazzi’s actions constituted withdrawal from the LLC, leaving Bone as the sole member.

The first issue that the court of appeals addressed was whether the trial court erred in
finding that Nicolazzi breached the LLC’s operating agreement. After concluding that the trial court did not err in finding that Nicolazzi breached the operating agreement by failing to making his required initial capital contribution, the court of appeals turned to Nicolazzi’s argument that the trial court misapplied the law in concluding that his attempt “to sell his interest in the business to a third party without [Bone’s] written consent” constituted a breach of the operating agreement. Paragraph 7 of the LLC’s operating agreement stated that “[n]either of the Members shall, without the written consent of the other Member, sell, assign, pledge, mortgage, or otherwise transfer [his] [her] interest in the LLC.” However, the court observed that neither the operating agreement nor the Missouri LLC Act defined these prohibited actions. At trial, it was established that Nicolazzi did discuss a sale of his interest in the LLC with a third party without seeking Bone’s permission, though Nicolazzi testified the discussion was to gauge how interested this buyer was in the potential sale. The court found that a plain reading of Paragraph 7 would prohibit the parties from the listed actions without the other member’s written consent. However, the court distinguished between a conveyance and a solicitation and noted that the language of Paragraph 7 indicated that the parties intended to prohibit one another from conveying their membership interest without the other member’s permission. On the other hand, neither Paragraph 7 nor any other provision of the operating agreement prohibited (or even addressed) a member’s attempt to sell or to discuss a sale of his or her interest. The court observed that it was undisputed that Nicolazzi did not ever actually perform any of the actions listed in Paragraph 7, and Bone argued before the trial court that Nicolazzi breached the operating agreement by soliciting the purchase of his membership interest. The court concluded that the operating agreement did not necessitate that a member receive the other member’s consent before soliciting purchase of the member’s interest by a prospective buyer. Because the operating agreement lacked such language, the court of appeals found that the trial court’s conclusion that Nicolazzi breached the operating agreement by attempting to sell his membership interest to a third party without Bone’s written consent was an erroneous application of the law. Therefore, the court reversed the trial court’s judgment on this issue.


In a dispute regarding the ownership of a limited partnership and its general partner, the court of appeals concluded that: (1) the trial court erred in submitting a jury question inquiring whether the parties to written assignments of interests in the limited partnership and its LLC general partner agreed to an alleged oral condition because the alleged condition contradicted the unambiguous terms of the assignments and was thus precluded by the parol evidence rule; (2) the language of certain assignments did not transfer any interest in the LLC general partner of the limited partnership; (3) certain purported transfers of interest in the LLC general partner were null and void ab initio because they were prohibited under the company agreement, and subsequent consent or ratification could not operate to give life to an attempted transfer that was null and void; (4) certain purported transfers of interests in the limited partnership were valid even if the transfers were prohibited by the partnership agreement because the partnership agreement allowed the general partner to recognize a transfer that would otherwise be null and void under the terms of the agreement.

Osama Abdullatif (“Latif”) and Ali Mokaram entered into a real estate investment venture by forming Mokaram Latif West Loop, L.P. (“ML Partnership”) in
which Mokaram and Latif were each 49.5% limited partners and Mokaram-Latif General, LLC ("ML General") was the 1% general partner. Mokaram and Latif were the managers and equal members of ML General. Mokaram and Ali Choudhri became friends and engaged in business transactions together, including transactions in 2008 and 2010 involving ML Partnership and ML General.

The 2008 transaction included an agreement in which Mokaram purported to transfer to Choudhri a limited partnership interest in ML Partnership, and the 2010 transaction included purported assignments by Mokaram to Choudhri of interests in ML Partnership and ML General. Disputes regarding these transactions arose, and eventually Latif purchased all of Mokaram’s interests in ML Partnership and ML General along with all of Mokaram’s claims against Choudhri relating to interests in the entities. Mokaram agreed to continue to pursue his claims against Choudhri in this lawsuit in which Mokaram, Latif, Choudhri, and ML Partnership were parties. The trial court entered a declaratory judgment regarding the ownership of the entities, and Mokaram and Latif appealed.

The first issue the court of appeals addressed was whether the trial court erred in submitting a jury question inquiring whether Mokaram and Choudhri agreed that the 2010 assignment was not effective and that Mokaram would return the money paid by Choudhri to Mokaram. Because the unambiguous language of the assignment provided that it was effective immediately and did not indicate that it was contingent on any condition, the court of appeals concluded that the testimony regarding an alleged oral condition was precluded by the parol-evidence rule from contradicting the unambiguous language of the assignment. Thus, the trial court should not have submitted any question inquiring into the enforceability of the oral condition. The court stated that the parol-evidence rule would not have precluded the trial court from submitting a question about an alleged subsequent agreement to rescind, but the jury question that was submitted did not ask about a subsequent agreement to rescind. The court also stated that the evidence did not raise a genuine fact issue as to whether Mokaram and Choudhri agreed to rescind the assignment after they executed it.

The court next addressed the argument that the trial court lacked jurisdiction over the declaratory judgment claims regarding Choudhri’s ownership and management rights in ML General because ML General was not a party. The court of appeals held that the trial court did not lack jurisdiction over the claims. Although the declaratory judgment did not bind ML General, it was binding on the parties in this action.

Next the court of appeals discussed whether the trial court erred in declaring that Choudhri had owned an interest in ML General since the date of the 2008 assignment. Based on the language of the documents executed in 2008, which purported to transfer to Choudhri an interest in ML Partnership and certain real property, the court concluded that Mokaram did not purport to transfer any interest in ML General. The documents indicated that Mokaram and Choudhri thought that ML Partnership owned the real property referred to in the assignments and that they intended to transfer an indirect interest in the real property by transferring an interest in ML Partnership. However, assuming that ML Partnership owned the real property referred to in the assignments, that would not mean that ML General had any ownership in the property, and the court concluded that the evidence did not show that Mokaram
transferred any interest in ML General to Choudhri by virtue of the 2008 assignments.

The 2010 assignments purported to transfer from Mokaram to Choudhri interests in both ML General and ML Partnership. Both the company agreement of ML General and the partnership agreement of ML Partnership contained restrictions on transfer, and the court discussed the effect of the purported transfers by Mokaram.

The ML General company agreement prohibited a member from transferring any of its membership interest except in limited circumstances, such as with the approval of members having more than 66.67% of the interests of all members. The company agreement stated that a transfer in violation of its provisions was “null and void ab initio.” Assuming Mokaram’s execution of the assignments represented his approval of the transfers, there was no evidence that Latif, the other 50% member at the time, approved the assignments before Mokaram purported to assign his interest, and there was no evidence that any of the other circumstances under which a transfer was permitted were present. Choudhri relied on a 2011 consent signed by Latif as manager and member of ML General in which Latif consented to any prior transfers by Mokaram to Choudhri of a membership interest in ML General. The court concluded that the purported assignments were null and void from the outset under the unambiguous language of the company agreement, and such the purported transfers could not be ratified or validated after the fact. Thus, the trial court erred in declaring that Choudhri had owned 50% of ML General and had been a manager of ML General from and after the 2010 assignments.

The ML Partnership agreement also contained prohibitions on transfer, and the court next addressed the effect of purported assignments in 2010 by Mokaram to Choudhri of a limited partnership interest in ML Partnership. Section 10.1 of the partnership agreement prohibited a limited partner from transferring all or any portion of the limited partner’s interest without the prior written consent of the general partner. Section 10.2 of the partnership agreement contained a right-of-first-refusal provision in favor of the other partners in the event a limited partner received a bona fide offer to purchase all or any portion of the limited partner’s interest. Section 10.3 provided for certain “Permitted Transfers” (to a trust for the benefit of the limited partner, the guardian or estate of a limited partner, or a person approved by all the partners) notwithstanding the consent otherwise required by Section 10.1. Section 10.6 provided that a transfer that was not permitted under the partnership agreement “shall be null and void and of no effect whatever; provided that if the Partnership is required to recognize a Transfer that is not permitted (or if the Partnership, in its sole discretion, elects to recognize a Transfer that is not permitted),” the transferred interest was limited to the transferor’s rights to allocations and distributions. Finally, Section 10.10 provided that the partnership was not required to recognize the interest of any transferee who obtained a purported transferred interest pursuant to a transfer that was not authorized by the partnership agreement, and such a transfer was “null and void for all purposes.”

The court stated that the plain meaning of “null and void and of no effect whatever” would preclude a transfer that was not permitted by the partnership agreement from being subject to ratification, confirmation, or waiver, but the court concluded that the phrase “null and void and of no effect whatever” was not used in its ordinary sense given that the agreement unambiguously provided that the partnership could elect to recognize a transfer that was
not permitted and thus was or would have been “null and void and of no effect whatever.” The court noted the difference between the ML General company agreement (which the court had held did not permit ratification of a null and void transfer) and the ML Partnership agreement and concluded that the two agreements were separate and independent agreements that should not be construed together as one. Further, assuming the agreements should be construed as a single contract, the provisions unambiguously allowed the recognition of an otherwise void transfer of a partnership interest but did not allow the recognition of a void transfer of a membership interest.

Because Mokaram signed the assignment of his interests to Choudhri not only as assignor, but in his capacity as manager of ML General, the general partner of ML Partnership, under a legend stating that the transfer was consented to by the general partner, the court concluded that ML Partnership recognized the transfer of the interests. Relying on the language of the ML General company agreement (which provided that the managers shall have the sole and exclusive control of the management of ML General and shall make all decisions not otherwise provided for in the company agreement) and Section 101.254 of the Business Organizations Code (which provides that each governing person is an agent of the LLC for the purpose of its business), the court stated that Mokaram’s signature as manager was binding on ML General, and ML Partnership thus recognized the transfer as valid and effective as provided by Section 10.6 of the partnership agreement. The court concluded that an earlier purported transfer in 2008 by Mokaram to Choudhri of a limited partnership interest was not effective because there was no evidence that the transfer was permitted under any of the provisions of the partnership agreement nor was there any evidence that the partnership was required to recognize the transfer or exercised its discretion to recognize the transfer.

Finally, the court concluded that the trial court did not err in refusing to clarify what rights Choudhri had as a result of his ownership of an interest in ML Partnership. The trial court declared that Choudhri owned 49.5% of ML Partnership from and after the 2010 assignments and that he had “all beneficial rights and interests” that flowed from his ownership of an interest in ML Partnership. The court stated that the interests transferred to Choudhri were limited to rights to allocations and distributions under the unambiguous language of Section 10.6 of the partnership agreement, and neither Section 10.2 nor 10.6 gave Choudhri the right to become a limited partner under the assignments. The trial court did not declare that Choudhri was a limited partner, and although the “beneficial rights and interests” were significantly limited by the agreement, the trial court did not inaccurately characterize them. Thus, the court of appeals concluded that the trial court did not err in making the declaration and in refusing to clarify it.

**Withdrawal of Member**


In a dispute regarding a member’s breach of an LLC operating agreement and alleged withdrawal from the company, the court of appeals concluded that: (1) the trial court did not err in finding that the member breached the operating agreement by failing to make his required initial capital contribution; (2) the trial court erroneously applied the law in finding that the member breached the operating agreement by discussing the sale of his interest with a third party without the consent of the other member; (3) the trial court erroneously
applied the law in finding that the member’s actions prior to filing his petition constituted withdrawal from the LLC; (4) the trial court erred in determining that the other member was the sole member of the LLC; and (5) the member’s filing of his petition may have constituted an “event of withdrawal” as a matter of law.

Peter Nicolazzi and Laura Bone formed Young in Spirit Adult Day Care, LLC (the “LLC”), an adult daycare business, in 2005. Immediately following its formation, Nicolazzi and Bone were the LLC’s only workers and, under the operating agreement they signed in 2005, the only members. Nicolazzi was responsible for performing service-related tasks for the LLC’s customers and Bone primarily performed managerial and nursing duties. When business expanded, Bone’s duties grew while Nicolazzi’s tasks were handled by employees that the company hired. As time went on, the parties’ business relationship deteriorated. In 2011, Nicolazzi did not seek Bone’s permission before he approached a competitor about buying his interest in the LLC. On April 30, 2011, Nicolazzi effectively stopped participating in the operation of the LLC, while Bone continued to operate the LLC. In June of 2011, Bone filed articles of incorporation for “Young in Spring Adult Day Center, Inc.” and, on the next day, notified Nicolazzi that the business would continue in this new entity and that she would be dissolving the LLC.

On June 30, 2011, Nicolazzi filed his petition against Bone and requested: (1) a declaratory judgment determining whether Bone was still a member and whether she had misappropriated LLC funds, and ordering Bone to reimburse Nicolazzi for distributions received in excess of her fifty percent share; (2) a complete accounting from Bone of the LLC and the new business entity; and (3) judgment for the losses, expenses, and damages that Bone owed to Nicolazzi for his interest in the LLC. Among her counterclaims, Bone asked the trial court to find that Nicolazzi was no longer a member of the LLC because he breached the operating agreement by failing to make his required capital contribution and by soliciting purchase of his membership interest by a third party without her consent. After a bench trial, the trial court entered judgment in favor of Bone and against Nicolazzi, finding that Nicolazzi breached the LLC’s operating agreement by failing to make the required capital contribution and by soliciting purchase of his membership interest without Bone’s consent, and that his actions constituted “events of withdrawal” under the Missouri Limited Liability Company Act (the “Missouri LLC Act”). The trial court concluded that Nicolazzi was no longer a member of the LLC, that Bone was the sole member and owner of the LLC, and that Nicolazzi had been paid all salary and distributions the LLC owed to him. After Nicolazzi’s motion for a new trial and amendment of the judgment was denied, he appealed.

Because Nicolazzi’s arguments on appeal depended upon the application of the LLC’s operating agreement and the Missouri LLC Act, the court cited a number of Missouri law propositions, including: (1) “[w]hile limited liability companies are creatures of statute, [the court] ‘interpret[s] an L.L.C.’s operating agreement according to the ordinary rules of contract law’”; (2) “[t]he primary rule of contract interpretation is to determine the intent of the parties and to give effect to that intent”; (3) “[i]n interpreting an operating agreement, [the court] applie[s] the plain and ordinary meaning of the words in the agreement and consider[s] the document as a whole”; and (4)”[w]here a contract’s terms are clear and unambiguous, [the court will] enforce the agreement as written and will not supply additional terms.” The court also cited the Missouri LLC Act for the requirement that member(s) adopt an
operating agreement and the statutory definition of “member” as “any person that signs in person ... or otherwise is a party to the operating agreement...” The court reasoned that because Nicolazzi was named in the LLC’s operating agreement, he signed the operating agreement when the LLC was formed, and the operating agreement did not establish any further condition or prerequisites to membership, then he was a member from that point forward. The court of appeals further concluded that Nicolazzi and Bone were the only members of the LLC throughout the company’s existence.

The standard of review in this case required the court of appeals to affirm the trial court’s judgment unless there was no substantial evidence to support it, it was against the weight of the evidence, or it erroneously declared or applied the law. The court organized its discussion around two primary issues: first, whether Nicolazzi breached the LLC’s operating agreement; and second, whether Nicolazzi’s actions constituted withdrawal from the LLC, leaving Bone as the sole member.

The first issue that the court of appeals addressed was whether the trial court erred in finding that Nicolazzi breached the LLC’s operating agreement. Nicolazzi argued that the trial court’s conclusion that he breached the operating agreement by failing to make his initial capital contribution was against the weight of the evidence. The court further noted that under any definition of “initial,” Nicolazzi’s failure to make the required initial capital contribution within a five-year time span undoubtedly constituted a breach of the operating agreement. Therefore, the court of appeals affirmed the trial court’s judgment in this regard.

Nicolazzi next argued that the trial court’s conclusion that his attempt “to sell his interest in the business to a third party without [Bone’s] written consent” constituted a breach of the operating agreement was a
The first issue that the court of appeals addressed was whether the trial court erred in finding that Nicolazzi’s actions constituted an “event of withdrawal” under the Missouri LLC Act and finding that Bone was the LLC’s sole member. Nicolazzi argued that the trial court’s conclusion that he withdrew was a misapplication of the Missouri LLC Act. The court of appeals observed that the trial court relied on two provisions of the Missouri LLC Act when it concluded that Nicolazzi’s actions of failing to make his required initial capital contributions, attempting to sell his membership interest, and leaving the LLC in April of 2011 constituted “events of withdrawal.” The Missouri LLC Act permits a member to withdraw from a LLC as specified in writing in the operating agreement, at any time upon giving ninety-days’ prior written notice to the other members, or under certain conditions (e.g., assignment of a member’s entire interest in the LLC or expulsion as a member in accordance with the operating agreement). Because the LLC’s operating agreement was silent on what would constitute an event of withdrawal, Nicolazzi did not give any written notice to Bone, and the other statutory conditions were not present before Nicolazzi filed his petition, the court of appeals concluded that the trial court erroneously applied the two provisions of the Missouri LLC Act in finding that Nicolazzi’s actions constituted “events of withdrawal” from the LLC. The court pointed out that while it did affirm the trial court’s finding that Nicolazzi breached the operating agreement by failing to make his initial capital contribution, that breach did not equate to his withdrawal under the operating agreement or the Missouri LLC Act. As a result, the court of appeals reversed the trial court’s judgment in that regard.
The court further concluded that Nicolazzi was still a member of the LLC at the time he filed his petition because he was a member when the LLC was formed and did not withdraw before filing. Therefore, the court of appeals reversed the trial court’s determination that Bone was the sole member of the LLC. However, the court also found that, as a matter of law, Nicolazzi may have withdrawn from the LLC by actually filing his petition. Under the Missouri LLC Act, an “event of withdrawal” includes a member filing a petition “[s]eeking for himself any reorganization, arrangement, composition, readjustment, liquidation, or similar relief under any statute, law, or regulation ....” Because this issue was not before the trial court, the court of appeals remanded the case to that court with instructions to determine whether Nicolazzi’s filing of his petition constituted an event of withdrawal. The court of appeals also found that the LLC’s operating agreement did not state the amount or method for determining the distribution to be paid to a withdrawing member. Thus, if the trial court determined that Nicolazzi’s filing of his petition constituted such an “event of withdrawal,” then the court of appeals instructed the trial court to determine the “fair value” of Nicolazzi’s interest in the LLC as of the date of withdrawal (the date that he filed his petition).

In sum, the court of appeals held that the trial court’s conclusion that Nicolazzi breached the LLC’s operating agreement by failing to make his required initial capital contribution was not against the weight of the evidence and affirmed the trial court’s judgment in that regard. The court of appeals also held that the trial court erroneously applied the law in finding that Nicolazzi breached the LLC’s operating agreement by discussing the sale of his interest with a third party without Bone’s consent and in finding that Nicolazzi withdrew from the LLC prior to the filing of his petition, reversing the trial court’s judgment on these issues. Because the court of appeals found that Nicolazzi did not withdraw from the LLC prior to the filing of his petition, the court also found that the trial court erred in determining that Bone was the sole member of the LLC and reversed the trial court’s judgment in that regard. Finally, as a matter of law, the court of appeals found that Nicolazzi’s actual filing of his petition may itself have constituted an “event of withdrawal.” Because this issue was not before the trial court, the court of appeals remanded the case to the trial court to determine if Nicolazzi withdrew pursuant to the Missouri LLC Act, and if he did, to determine the “fair value” of his interest in the LLC at the time of withdrawal.

**Derivative Suits**

*Moss v. Princip*, 913 F.3d 508 (5th Cir. 2019).

The court affirmed the trial court’s dismissal of a nondiverse partnership in a suit brought by two partners alleging claims against the other two partners for fraud, breach of fiduciary duty, breach of partnership agreement, conversion, and money had and received. The court concluded that the partnership was dispensable because all partners were party to the suit and the partnership’s interests in the suit were adequately represented by the partners. Further, any risk of duplicative litigation brought by the partnership itself could be prevented by injunctive relief. The court applied the same reasoning to an LLC formed by one of the plaintiffs and one of the defendants.

The plaintiffs, separately, formed partnerships with defendant Marko Princip, whereby each plaintiff received 30% ownership in the partnership. The plaintiffs filed suit against Princip and another partner, Martin, alleging that the parties had created a
partnership and that the defendants were liable for common-law fraud, breach of fiduciary duty, breach of the partnership agreement, conversion, and money had and received. The defendants removed the case to federal court from a Texas state court on the basis of diversity jurisdiction. A jury determined that a partnership existed among the parties, and the defendants moved to dismiss the claim for lack of subject-matter jurisdiction just before the entry of final judgment. The defendants argued that there was incomplete diversity due to the presence of the partnership. The plaintiffs moved to dismiss the partnership as a dispensable nondiverse party. The trial court granted the plaintiffs’ motion, restoring complete diversity, and the defendants appealed.

The court of appeals first recognized that for purposes of diversity jurisdiction, a partnership is a citizen of every state in which one of its partners is a citizen. Ordinarily, diversity jurisdiction must exist at the time of removal. However, courts may dismiss nondiverse parties under Rule 21, “even after judgment has been rendered.” Under Rule 19, a court can dismiss a required party who would destroy diversity, if the court determines the party is dispensable. When making this determination regarding “whether, in equity and good conscience, the action should proceed among the existing parties,” the court will consider four factors. These four factors include: (1) the extent to which a judgment rendered in the person’s absence might prejudice that person or the existing parties; (2) the extent to which any prejudice could be lessened or avoided by protective provisions in the judgment, shaping the relief, or other measures; (3) whether a judgment rendered in the person’s absence would be adequate; and (4) whether the plaintiff would have an adequate remedy if the action were dismissed for nonjoinder. As the court noted, this analysis requires a case-by-case approach.

The court noted two previous decisions of the Fifth Circuit Court of Appeals in which the court found the partnership indispensable when the claims were derivative of the partnership’s interests. However, recognizing Rule 19 as a flexible and pragmatic approach, the court distinguished the two prior decisions on the basis that they involved “threatened prejudice to the partnership if the case proceeded in its absence.” Further, in neither of the two cases were all constituent partners of the partnership parties to the suit. The court looked instead to decisions by sister courts in which the courts found a partnership’s interest was adequately represented when all partners, or all general partners, were parties to the suit. While the court suggested the trial court could consider the tactical advantage of the partnership’s presence, no such advantages were present in this case, where the partnership’s role was purely passive throughout the litigation. The court acknowledged that a partnership is legally treated as a separate entity, but the court stated that “[a] partnership’s interests as an entity consist of an aggregation of those interests of each of the individual partners that are relevant to the purpose of the partnership.”

The court next addressed the defendants’ assertion that the partnership was required to be joined as a “real party in interest” under Rule 17(a). The court pointed out that the Texas partnership statute provides for liability of a partner to a partnership or its partners for breach of the partnership agreement or violation of duties. The court commented in a footnote that some Texas courts have construed the statute to restrict partners’ ability to sue for actions that have diminished the value of the partnership, but the court pointed out that these cases only address limited partnerships, and the court cited other cases indicating that the logic of these limited partnership cases is not
The court stated that it could not conclude that the partnership was required to be joined as a plaintiff here because any interest of the partnership was fully represented and vindicated and there was no need to preserve partnership assets for all partners’ benefit. The court reiterated that the partnership was a proper party but was not indispensable since its interest was fully represented by the presence of all partners. The court further explained that “the fact that an absent person could bring the action as a real party in interest does not of itself make that person a necessary or indispensable party.” Although Rule 17 insures that a judgment will generally have proper effect as res judicata and protect a defendant from the risk of subsequent litigation, the court stated that any risk of duplicative litigation could be alleviated through properly tailored protective provisions in the judgment (such as injunctive relief prohibiting the plaintiffs from suing the defendants on behalf of the partnership on claims the partnership could have raised in the suit and ordering the plaintiffs to cause the partnership to release the claims as a condition of judgment).

The defendants also raised essentially the same challenges based on the presence of an LLC formed by one of the plaintiffs and one of the defendants. The court stated that the defendants did not argue that the LLC should be treated differently from the partnership, and the court stated that its analysis extended to the LLC, which was also dismissed by the district court.

In sum, the court concluded that the partnership and LLC were not indispensable parties, and the court remanded the case in order for the district court to consider appropriate injunctive relief to guard against any risk of duplicative litigation.

The Virginia Supreme Court held that amendments to the provisions of the Virginia LLC statute on derivative suits in 2011 did not abolish the futility exception to the demand requirement.

Before it was amended in 2011, § 13.1-1042 of the Virginia Code authorized a member to bring a derivative action on behalf of the LLC “if members or managers with authority to do so have refused the action or if an effort to cause those members or managers to bring the action is not likely to succeed.” This language effectively codified, in the LLC context, Virginia case law in the corporate context requiring demand on the board of directors subject to a futility exception. As amended, § 13.1-1042 imposes a written demand requirement and 90-day waiting period before a member may file a derivative suit on behalf of the LLC, and § 13.1-1042 makes no mention of any futility exception. However, § 13.1-1044, which sets forth pleading requirements for a member derivative suit, requires the complaint to “set forth with particularity the effort of the plaintiff to secure commencement of the action by a member or manager with the authority to do so or the reasons for not making the effort.” (Emphasis added.) The court observed that this language would be superfluous absent a futility exception. In addition, the court pointed out that § 13.1-1001(A) provides that “the principles of law and equity supplement” the LLC statute except where displaced by particular provisions of the statute. Because derivative actions, including the futility exception, “developed on the equity side of the court” and are thus “principles of equity,” the court concluded that the 2011 amendment “had the effect of replacing an express textual reference in Code § 13.11042 with an incorporation by reference of a rule drawn by case law.” In sum, the court held that the
General Assembly did not abolish the futility exception when it amended § 13.1-1042 in 2011.

**In re LoneStar Logo & Signs, LLC,** 552 S.W.3d 342 (Tex. App. 2018).

The court of appeals held that the trial court abused its discretion in holding that a former member of a closely held LLC had standing to pursue derivative claims. The court rejected the former member’s argument that the Legislature in Subchapter J of Chapter 101 of the Texas Business Organizations Code intended to eliminate any requirement of present member status with respect to a “derivative proceeding” on behalf of a closely held LLC.

Dunster Live, LLC (“Dunster”), the plaintiff in the action underlying this mandamus action, sued individually and derivatively complaining that the defendant members of LoneStar Logo & Signs, LLC (“LoneStar 1”) acted wrongfully in forming a new LLC, which did not include the plaintiff as a member, to perform a new contract that essentially continued the business in which LoneStar 1 was previously engaged. The defendants acknowledged that the majority owners of LoneStar 1 deliberately sought to exclude Dunster from their dealings relating to the new contract but maintained that they possessed the legal right and good reason to do so. The immediate focus of this mandamus proceeding was the threshold question of Dunster’s standing to pursue its derivative claims.

The defendants in the underlying proceeding sought summary judgment on the basis that Dunster’s interest in LoneStar 1 had been redeemed due to failure to pay a capital call before Dunster filed its lawsuit and that Dunster thus did not have standing to pursue its derivative claims. Dunster disputed the effectiveness of the redemption based on the terms of the company agreement and alleged breaches of fiduciary duty and lack of a valid business purpose, but the trial court ruled that Dunster’s membership interest in LoneStar 1 was validly redeemed and that Dunster ceased being a member of LoneStar 1 before the lawsuit was filed. The trial court declined to dismiss Dunster’s derivative claims, however, concluding that Dunster had standing because Dunster was a member at the time its derivative claims accrued.

The court of appeals began its analysis by noting that “the legal principles governing derivative claims brought on behalf of LLCs are, at least with respect to this case, materially identical extensions or analogues of those that have developed in regard to shareholder-derivative actions on behalf of corporations.” The court reviewed the historical roots, purposes, and requirements of a derivative action, including “the rule, recognized in Texas as elsewhere, that a corporate shareholder (and, by logical extension, an LLC member) must have and maintain that ownership status in order to have standing to prosecute derivative claims on the entity’s behalf.” The court acknowledged that “Texas courts have recognized an equitable exception to this ownership requirement where a shareholder’s interest is ‘destroyed’ involuntarily without a valid business purpose,” but the court stated that “the district court has determined that this exception is not applicable here by granting partial summary judgment recognizing that the redemption had been effective in causing Dunster to ‘cease[ ] being a member of LoneStar Logo & Signs, LLC . . .’”

The court generally reviewed the matters covered by Subchapter J of Chapter 101 of the Texas Business Organizations Code (Sections 101.451 through 101.463), which addresses derivative proceedings in the LLC context and parallels the statutes governing derivative proceedings involving
for-profit corporations in Subchapter L of Chapter 21 of the Texas Business Organizations Code. The court called attention to the standing requirements of Section 101.452, which include the so-called “contemporaneous ownership” requirement. Section 101.463, however, contains provisions specifically applicable to LoneStar 1 as a “closely held LLC” (an LLC with fewer than 35 members and no membership interests listed on a national securities exchange or regularly quoted in an over-the-counter market). Section 101.463 provides that Sections 101.452-101.459 do not apply to closely held LLCs. The court explained that the Texas Supreme Court has determined that the analogous provisions in the corporate context codified a version of the shareholder-derivative action that permits a shareholder of a closely held corporation to bring an action on behalf of the corporation free of the statutory standing, demand, and mandatory-dismissal requirements that would otherwise apply.

The court explained that “[t]he gravamen of Dunster’s standing theory is that Sections 101.463 and 101.451, as the Texas Supreme Court has construed this same language in regard to shareholder-derivative suits, codifies a version of the derivative action that also eliminates any requirement that a claimant presently possess member status in order to assert derivative claims on behalf of a closely held LLC.” Dunster argued that it satisfied the contemporaneous-ownership requirement in Section 101.452 because it still had member status when the derivative claims accrued, and the district court relied on this rationale in denying summary judgment on the standing issue. Dunster’s arguments rested upon the premise that the Legislature in Subchapter J intended to eliminate any requirement of present member status from the “derivative proceeding” it codified, but the court of appeals concluded that “[t]he statutory language does not go that far, nor has the Texas Supreme Court so held.”

In explaining its rejection of Dunster’s standing theory, the court of appeals initially observed that the implications of Dunster’s theory should give some pause in that its theory seemed to imply that a litigant need not meet standing requirements of any kind in order to bring a derivative suit on behalf of a closely held LLC. The court rejected Dunster’s argument that the import of Section 101.463’s provision allowing a court to treat a derivative action brought by a member of a closely held LLC as a direct action for the member’s own benefit is that a plaintiff’s standing to bring a derivative claim is contingent on its standing to bring a direct claim. The court pointed out that the Texas Supreme Court has held that “the proceeding still must be derivative” under the parallel language governing closely held corporations, and the court of appeals presumed that the Legislature codified its statutory versions of “derivative actions” with awareness that a fundamental feature of such an action is the claimant’s possession of an interest in the entity on whose behalf it sues such that the plaintiff has a stake in the outcome. The court said the text of Subchapter J contemplated rather than abrogated this fundamental feature as reflected by its text, including references in Section 101.463 to “‘a derivative proceeding brought by a member of a closely held limited liability company’ and ‘a recovery in a direct or derivative proceeding by a member,’” and additional prerequisites to standing that apply under Section 101.452 to one who is presently a “member.” The court pointed out that sister courts of appeals have held that the parallel corporate provisions require that shareholder status be maintained throughout the suit, and recent decisions of the Texas Supreme Court addressing derivative suits brought on behalf of closely held corporations “have uniformly presumed a plaintiff who is presently a shareholder.”
In conclusion, the court held that (1) the trial court abused its discretion in holding that Dunster had standing as a former member to pursue derivative claims on LoneStar 1’s behalf and (2) the relators lacked an adequate remedy by appeal after final judgment. Thus, mandamus relief was appropriate, and the court conditionally granted the writ and directed the trial court to vacate its previous order and dismiss Dunster’s derivative claims for want of standing.

**Charging Order**

*Sky Cable, LLC v. DIRECTV, Inc.*, 886 F.3d 375 (4th Cir. 2018).

After a judgment against an LLC and its sole member went unsatisfied, the district court entered an amended judgment that reverse pierced the veil of three other LLCs owned by the individual and made them co-judgment debtors with the individual. On issues of first impression, the court of appeals affirmed the district court’s decision and held that Delaware law permits the remedy of reverse veil piercing when the LLC is the alter ego of its member.

In 2000, Randy Coley, through his subsequently-defunct East Coast Cablevision, LLC (“ECC”), contracted with DIRECTV, Incorporated (“DIRECTV”) to provide its programming to 168 rooms at a Virginia resort. In 2011, an investigation by DIRECTV revealed a fraudulent scheme pursuant to which ECC and Coley received payment for cable services provided by DIRECTV to over 2,500 units at the resort while continuing to pay DIRECTV only for those services provided to the 168 units. DIRECTV eventually obtained a judgment for $2.4 million against Coley and ECC for violations of federal communications law based on the unauthorized receipt and distribution of DIRECTV’s programming.

Coley dissolved ECC after the district court entered its judgment, and DIRECTV was unable to collect any payment from Coley, who had few personal assets. Discovery in the post-judgment phase of the case revealed that several LLCs owned and managed by Coley held title to or managed Coley’s assets. DIRECTV filed a motion in the district court to reverse pierce three LLCs owned and managed by Coley in order to obtain access to the assets of these LLCs. These three companies were not parties to the case and had not been served with process. In 2016, the district court entered an amended judgment rendering the three LLCs co-judgment debtors with Coley and held that: (1) under Delaware law, the three LLCs were alter egos of Coley; (2) Delaware would recognize reverse veil piercing under such circumstances; and (3) DIRECTV’s failure to serve process on the three LLCs did not prevent the court from exercising jurisdiction over them. Coley and one of the three LLCs appealed, arguing that Delaware law does not permit reverse piercing of a corporate veil even when the corporation is the alter ego of the judgment debtor, and that Delaware’s LLC charging order statute provides the exclusive remedy for a judgment creditor seeking access to the financial interest of an LLC’s member.

The court of appeals reviewed de novo whether Delaware law would permit reverse piercing of an LLC. The court first discussed corporate and LLC veil piercing in general and distinguished the various types of veil piercing. The court explained that traditional veil piercing permits a court to hold an owner liable for a judgment against the entity, whereas reverse veil piercing imposes liability on the entity for a judgment against an owner. The court further explained that an additional classification of reverse piercing concerns the origin of a request to the court to disregard the entity’s form: “insider” reverse piercing applies when the entity’s controlling owner
makes such a request, whereas “outsider” reverse piercing (relevant here) applies when an outsider/third party (often a creditor) makes the request.

Because the law of the state in which an entity is “incorporated” generally governs the question of whether a court may pierce an entity’s veil, and the parties did not dispute that Delaware law applied to the reverse piercing claim, the court relied on Delaware case law to analyze whether Delaware permits reverse veil piercing. The court discussed Delaware’s recognition of traditional veil piercing as an equitable remedy in exceptional circumstances and noted that the purpose of reverse piercing is to hold a company liable for a member’s actions to prevent fraud or injustice. The court stated that reverse piercing is particularly appropriate when an LLC has a single member because there are no other members whose interests are affected. According to the court, “because Delaware courts apply the alter ego theory only in exceptional circumstances, recognition of reverse veil piercing as an equitable remedy in exceptional circumstances, recognition of reverse veil piercing for the limited purpose of preventing fraudulent conduct would not threaten the general viability of the corporate form in Delaware.” The court noted Delaware’s “‘powerful interest...in preventing entities that it charters from being used as vehicles for fraud,’” and the court discerned that Delaware courts have “signaled some willingness to apply a theory of reverse veil piercing.” Thus, the court concluded that “Delaware would recognize outsider reverse veil piercing of an LLC’s veil when the LLC is the alter ego of its sole member.”

The court next analyzed Coley’s contention that Delaware’s LLC charging order statute precluded reverse piercing of his LLC based on the following “exclusivity” provision of the statute:

6 Del. Code § 18-703(d).

Although Delaware courts have not interpreted this provision, the court found it to be clear that piercing the veil of an alter ego was not the type of remedy the statute was intended to prohibit. The court applied the statutory construction rule of “ejusdem generis” and concluded that the general reference to “other legal or equitable remedies” applied only to types of remedies that are similar to those specifically listed, i.e., “attachment, garnishment, [and] foreclosure.” Reverse veil piercing of an LLC when the LLC is the alter ego of its sole member permits the court to treat the LLC as “identical” to its member and effectively eliminates the legal status of the LLC in narrow circumstances involving fraud or injustice. Therefore, the court considered reverse piercing to be unlike the common-law seizure remedies listed in the exclusivity provision of the charging statute. Additionally, the court determined that Coley’s interpretation of the charging order statute would impermissibly limit Delaware’s ability to prevent the entities that it charters from being used as vehicles for fraud.
The court then analyzed Coley’s contention that the district court erred in reverse piercing the veil of Coley’s LLC because the district court failed to make a finding of fraudulent purpose. The appellate court stated that in order to prevail under an alter ego theory, a plaintiff is not required to show “actual fraud but must show a mingling of the operations of the entity and its owner plus an ‘overall element of injustice or unfairness.’” The court stated that an inference may be drawn that entities are one and the same if they fail to follow corporate formalities when doing business with one another. In a footnote, the court noted that “LLCs must observe fewer internal formalities than corporations, but the principle that they should follow ordinary formalities and norms when doing business with other entities is the same.” The court described evidence of commingling of funds, lack of proper accounting records, unexplained transfers of funds, and payments by one LLC of another LLC’s or Coley’s expenses or obligations. The court also concluded that an “overall element of injustice or unfairness” was present because DIRECTV had not yet received any payment on its judgment obtained more than four years ago. Based on this evidence, the appellate court concluded that the district court’s finding of alter ego was not clearly erroneous.

Next the court rejected Coley’s contention that the district court erred in holding that Coley’s participation in the post-judgment proceedings permitted the district court to exercise jurisdiction over his LLC despite the fact that the LLC was not served with process. The appellate court reasoned that when reverse veil piercing a single-member LLC, the individual is already before the district court, and there is no concern that the alter-ego LLC must receive independent notice of a legal action. Thus, the court held that an LLC that is the alter ego of its sole member is properly before the court when the court has jurisdiction over the member.

Finally, the court rejected Coley’s argument that the district court erred in applying the doctrine of equitable estoppel in the post-judgment proceedings with respect to the contention that Mrs. Coley was also a member of his LLC. During the pre-judgment proceedings, Mrs. Coley represented that she was not an owner of any of Coley’s business entities and was not a member of the LLC. Coley also testified that he was the sole member of the LLC and produced an operating agreement that indicated he was the sole member. DIRECTV relied on these representations in dismissing Mrs. Coley. After the judgment was entered, the Coleys sought to establish that Mrs. Coley was a member (in order to oppose reverse piercing the LLC on the basis that it would prejudice Mrs. Coley as an innocent owner), and the court concluded that “[t]he Coleys’ shifting positions reflected an attempt to assert whatever position would advance their quest to avoid liability and place their personal assets beyond the reach of DIRECTV.” Thus, the court held that the district court did not abuse its discretion in estopping the assertion of Mrs. Coley’s interest in the LLC in the post-judgment proceedings.


The court of appeals held that the trial court did not abuse its discretion in ordering the turnover of a judgment debtor’s interest in a limited partnership and an LLC.

In a personal injury action that Teresa Heckert brought against her ex-husband Clyde Heckert, a jury awarded Teresa $381,342.27. Teresa filed a motion
seeking the turnover of any of Clyde’s nonexempt assets, including his interest in a limited partnership (A2R, Ltd.) and a single-member LLC (Averse 2 Risk, LLC). Both entities were formed after the divorce while Teresa’s personal injury suit was pending against Clyde. The LLC was the general partner of the limited partnership, and Clyde was the sole limited partner. Clyde was also the sole member of the LLC. The limited partnership owned stock that was awarded to Clyde in the divorce.

The court determined that Clyde’s ownership interests in the entities were nonexempt. Nevertheless, Clyde argued that the interests were not susceptible to turnover because, according to Clyde, “sections 101.112 and 153.256 of the Business Organizations Code provide that the exclusive remedy by which a judgment creditor of a limited partnership or limited liability company may satisfy a judgment out of the judgment debtor’s interest in that limited partnership or limited liability company is a charging order.”

The court agreed that “[t]he plain language of sections 101.112(d) and 153.256(d) provides that a charging order is generally the exclusive remedy by which to satisfy a judgment out of the judgment debtor’s interest in a limited partnership or limited liability company.” Nevertheless, the court noted that “courts have held that there are some exceptions to this rule.” For example, the Dallas Court of Appeals held that the sections do not preclude turnover of a person’s distributions from an LLC or limited partnership. In addition, the Houston (14th) Court of Appeals held that “turnover of a member’s interest in a limited liability company was not precluded by section 101.112 ‘when the judgment creditor seeking the membership interest itself from one party to the other as part of the judgment.’” According to the Heckert court, “[t]his is because in these types of situations, the purpose of a charging order has not come into play: the charging order was developed to prevent a judgment creditor’s disruption of an entity’s business by forcing an execution sale of the partner’s or member’s entity interest to satisfy a debt of the individual partner or member.”

The Heckert court determined that “the same reasoning applies here because neither A2R, Ltd. nor Averse 2 Risk, LLC is an operating business; both entities appear to have been formed by Clyde for the sole purpose of taking ownership of nonexempt assets awarded to him in the divorce.” The court noted that “[n]o other party’s interest will be disrupted by the turnover of those interests and the stock owned by A2R, Ltd.,” and it observed that “Clyde has already assigned his interests and the [stock] to the receiver, subject to his right of appeal.” As a result of this analysis, the court held that the trial court did not abuse its discretion in ordering the turnover of Clyde’s interest in the limited partnership and the LLC.
2019 SPRING MEETING OF ABA BUSINESS LAW SECTION

2019 SUMMARY OF DELAWARE CASE LAW RELATING TO ALTERNATIVE ENTITIES

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9 Morris Nichols maintains a Cumulative Survey of Delaware case law relating to alternative entities which is updated annually, organized by subject area and includes most cases that address significant alternative entity issues. The entire Cumulative Survey and annual updates are available on the Morris Nichols website at www.mnat.com/practices/commercial under EPublications.
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26. REJV5 AWH Orlando, LLC v. AWH Orlando Member, LLC, No. CV 2017-0708-JRS (Del. Ch. Feb. 28, 2018) (V.C. Slights) ........................................................................................................................................ 139
Plains All American Pipeline, L.P., a Delaware master limited partnership ("Plains"), owned pipelines in California that leaked, causing an oil spill (the "Spill") that resulted in high clean-up costs and a conviction in California for various felonies and misdemeanors and contributed at least in part to reputational loss and declining revenues and stock price. Plaintiff, a unitholder in Plains, brought a derivative action against Plains’ general partner, the general partner’s controlling entities, and individual directors, claiming breaches of fiduciary duty, waste, entitlement to contribution, breach of contract and breach of the implied covenant. Defendants moved to dismiss for failure to make a demand or plead demand futility and for failure to state a claim.

The court first addressed the motion to dismiss for failure to make a demand or plead demand futility, noting that well-established Delaware law requires a unitholder seeking to assert claims on behalf of an entity must make pre-suit demand or show demand futility. Plaintiff did not make pre-suit demand. Thus, the court turned to the Delaware Supreme Court cases that articulate the tests for demand futility— Rales v. Blasband and Aronson v. Lewis.

The parties agreed that Rales applied and the court stated that, under Rales, a plaintiff must allege particularized facts that create a reasonable doubt that the board could have properly exercised its independent and disinterested business judgment in responding to the demand. With respect to disinterestedness, under Rales, directors who face “a substantial likelihood of personal liability” are deemed to be interested in the transaction, but a plaintiff must show a sufficient connection between the corporate action and the board such that at least half the directors faced such substantial likelihood of personal liability. Plaintiff advanced this theory, arguing that defendants were interested in the transaction because they faced a substantial likelihood of personal liability due to their breach of fiduciary duties. Defendants, however, argued that the partnership agreement eliminated fiduciary duties and, therefore, they faced no such likelihood of personal liability because no possibility of personal liability existed.

The court turned to the terms of the partnership agreement, which mirrored the language in the partnership agreement in Norton v. K-Sea Transportation Partners L.P. The Supreme Court held in Norton that the same language eliminated common law fiduciary duties and replaced them with a contractual fiduciary duty—specifically, that the general partner must reasonably believe that its actions were in the best interests of, or not inconsistent with, the best interests of the partnership. Because Norton was controlling, the same interpretation applied to Plains’ partnership agreement. Thus, the court held that plaintiff could not demonstrate director interestedness because “directors cannot face a substantial likelihood of personal liability for breaching duties that they do not owe.” Because the fiduciary duty claim failed, so did the waste claims (which derive from common law fiduciary duties) and the contribution claims (which depended on an underlying breach of fiduciary duty). The court also noted in a footnote that plaintiff failed to argue in a non-conclusory fashion that the director defendants faced personal liability for breach of contractual duties or the implied covenant.

Having found that plaintiff failed to adequately allege that defendants were interested in the transaction, the court then
addressed whether plaintiff adequately alleged that a majority of directors were not independent. The board was comprised of ten members. Plaintiff made no arguments regarding the independence of three of the members. Three other members served on the audit committee of Plains, and plaintiff argued that this service meant that they could not be independent because the audit committee was responsible for monitoring Plains’ compliance with legal and regulatory requirements, which Plains was found to have violated. The court stated, however, that, under well-settled Delaware law, membership on a committee that is responsible for the decisions that are being challenged does not call into question a director’s impartiality. Thus, plaintiff failed to adequately allege that a majority of directors were not independent.

Having failed in its attempts to demonstrate the directors’ were either interested in the transaction or lacked independence, plaintiff did not adequately plead demand futility and, as plaintiff did not make a pre-suit demand, the court dismissed plaintiff’s claims. However, the court dismissed the claims without prejudice, as plaintiff argued that it could likely establish a “tighter nexus between the [board] and what happened” due to various felony and misdemeanor verdicts against defendants that have occurred since the complaint in this case was filed.


Plaintiff, A&J Capital, Inc., a California corporation, was the manager of defendant company LA Metropolis Condo I, LLC, a Delaware limited liability company (the “Company”). Plaintiff was removed as manager of the Company by a majority of the Company’s members for cause. After its removal, plaintiff filed an action for seeking a declaratory judgment that it was improperly removed as manager and moved for summary judgment.

The Company received capital from 200 foreign investors that became Class B Members of the Company. Plaintiff was named as the Class B Manager of the Company pursuant to the operating agreement of the Company (the “Operating Agreement”) and the management agreement between, inter alia, the Company and plaintiff (the “Management Agreement”). The Operating Agreement had two provisions regarding the removal of managers, which stated “the Class B Members, by Majority Vote, shall have the sole and exclusive right to approve or disapprove the following . . . (f) Subject to 5.3, appointment, reappointment and removal, as applicable of any Manager” and “[t]he Class B Manager may be removed by Majority Vote of the Class B Members for gross negligence, intentional misconduct, fraud or deceit, all as more fully set forth in the Management Agreement.” The Management Agreement stated “[t]he Class B Manager may be removed by Majority Vote (as defined in the Operating Agreement) of the Class B Members for gross negligence, intentional misconduct, fraud or deceit; provided that in any of such events as specified in this Section 12(b), without limiting any of their respective rights and remedies, the Members shall be entitled to exercise their respective powers under the Operating Agreement to appoint a new Class B Manager and to cause the Company to issue written notice of termination to the Class B Manager hereunder.” The court explained that these three provisions “comprise the universe of contractual provisions that govern the procedure for removal of the Class B Manager.” In March of 2018, plaintiff was notified through a letter that a majority of the Class B Members had voted to remove it.
as manager and that the Law Office of Krug was appointed as the interim manager. The notice did not state a reason for plaintiff’s removal and did not give any further details regarding the members’ vote. Prior to the notice, plaintiff did not receive any notice of alleged default or the intent to hold a vote for its removal.

Plaintiff argued that the Operating Agreement and Management Agreement required the Class B Members to deliver plaintiff a notice of intent to remove it as manager and provide plaintiff an opportunity to be heard prior to removal. In addition, plaintiff argued that even if the agreements did not expressly provide it the right to notice and the opportunity to be heard, Delaware common law provides those rights and such common law should alter the Operating Agreement and Management Agreement. Defendants, on the other hand, argued that the provisions in the Operating Agreement and Management Agreement were clear and unambiguous and that the governance scheme, a product of the parties’ contracts, could not be altered by common law.

The court held that the terms of the Operating Agreement and Management Agreement regarding the removal of a manager were clear and unambiguous and did not provide the right for plaintiff to receive notice prior to its removal or the opportunity to respond. The court clarified that the only “notice” required under the agreements was after-the-fact notice of termination. The fact that the Management Agreement expressly provided for notice of termination after the Class B Members vote, but was silent regarding prior notice and an opportunity to be heard, proved that the parties did not contract for pre-removal notice. Plaintiff maintained that even if the pre-removal rights were not expressly stated, the rights were embedded in the Operating Agreement and Management Agreement because the common meaning of being removed “for gross negligence, intentional misconduct, fraud or deceit” requires notice prior to removal. The court, however, explained that operating agreements for non-corporate business entities will normally provide for pre-removal protections if the parties intend for them to apply and if those provisions do not exist, the court will not infer them.

The court also held that common law regarding pre-removal notice in corporate law decisions did not alter the terms of the Operating Agreement or Management Agreement. Plaintiff contended that because certain corporate law cases in Delaware held that a director of a Delaware corporation must receive pre-removal notice and an opportunity to respond before such director can be removed for cause, the same rights and protections should exist for managers of a Delaware limited liability company. The court, however, explained that the Delaware LLC Act grants limited liability companies broad discretion in drafting their operating agreements and ensures that those agreements, with specific exceptions, will be respected. The court further explained that, unlike a Delaware corporation, “the scope, structure and very personality of [a limited liability company] is set almost exclusively by its operating agreement”. In addition, plaintiff argued that Section 18-1104 of the LLC Act, which states “[i]n any case not provided for in this chapter, the rules of law and equity, including the rules of law and equity relating to fiduciary duties and the law merchant, shall govern,” reflects the General Assembly’s belief that a purely contractarian view must give way to common law. The court held that plaintiff’s interpretation of Section 18-1104 was incorrect, stating that “Delaware’s pro-contractarian policy in the alternative entity space is alive and well.”
The court further noted that in governance disputes among constituencies in a limited liability company, the court’s role is to interpret the contract and effectuate the parties’ intent, not to rewrite the contact. When operating agreements use corporate elements, the courts may view that as a signal that the parties intended to use a corporate structure for the alternative entity; however, the court is careful not to interpret the similarities too broadly or without close analysis because contractual flexibility is a key feature of the limited liability company structure. In this case, the court held that the facts were distinguishable from cases where the court borrowed from corporate law when construing governance rights under a limited liability company operating agreement. For the court to impose the requested additional procedures for “for cause” removal, the court would have to rewrite clearly written contracts that reflected the terms the parties bargained for. In addition, the Company was expressly “uncorporate” in its governance structure because it was managed by a single managing member and the Class B Members maintained the right to approve and disapprove several operational decisions. Because the parties did not intend to borrow from corporate law to alter or supplement the bargained for rights and obligations, the court held that common law did not rewrite the Operating Agreement and Management Agreement.

The court held that the terms of the Operating Agreement and the Management Agreement were clear and unambiguous and did not provide the manager pre-removal notice rights or the right to be heard before removal, and common law could not be used to rewrite the Operating Agreement and the Management Agreement because the governance structure of the Company was not analogous to that of a corporation. The court thus denied plaintiff’s motion for summary judgment.

Following denial of the summary judgment motion, this case went to trial and the court delivered an opinion declaring that plaintiff’s removal was improper because plaintiff had not violated the standards of conduct for removal set forth in the Operating Agreement and the Management Agreement. In reaching this conclusion, the court denied defendants’ argument that defendants were not required to show that plaintiff’s conduct harmed, or risked harm, the Company when proving that plaintiff violated the standards of conduct set forth in the Operating Agreement and Management Agreement. The court stated that the inclusion of those standards of conduct in the Operating Agreement and Management Agreement incorporated an appreciation that the proscribed conduct must be harmful, or risk harm, to the Company.

The court then moved to a discussion of whether plaintiff’s conduct constituted just cause for removal. First, defendants argued that plaintiff’s requests for prepayment fees were an “attempt to steal a substantial amount of money from the Members, under false pretenses.” The court rejected Krug’s argument, noting that plaintiff disclosed all of the reasons why plaintiff believed that it was deserving of the prepayment fee, and put the matter to a vote of the members, which did not amount to cause for removal.

The court also addressed Krug’s argument that plaintiff caused the Company to make improper payments to Henry Global Consulting Group (“Henry Global”), the company responsible for securing investments in the Company. The court noted that the Operating Agreement stated that plaintiff could “enter into any agreement which the Managers may reasonably deem appropriate for any purpose beneficial to the Company.” The record showed that the payments made to Henry Global were reasonable and plaintiff believed them to be reasonable. The court
held that the payments to Henry Global were not unauthorized, excessive or improperly hidden and therefore, plaintiff could not have engaged in “gross negligence, intentional misconduct, fraud or deceit” when plaintiff made payments to Henry Global.


On appeal to the Delaware Supreme Court, defendant below, Oxbow Carbon LLC (the “Company”), challenged the Court of Chancery’s interpretation and application of provisions of the limited liability company agreement (the “LLC Agreement”) governing the forced sale of the Company. When two minority members of the Company (the “Minority Members”) made their initial investment, they were granted a liquidity right that provided them with the option (i) to put (the “Put Right”) their limited liability company interests (the “Units”) to the Company (the “Put”) or (ii) if the Company rejected the Put, to cause all members of the Company and/or the Company to sell (the “Exit Sale Right”) all, but not less than all, of the outstanding securities of the Company and/or all assets of the Company to a non-affiliated third-party in a bona fide arms’-length transaction equal to or exceeding Fair Market Value (as defined in the LLC Agreement) (the “Exit Sale”). The Exit Sale Right was conditioned on the requirement that the other members of the Company receive 1.5 times their aggregate capital contributions, accounting for any prior distributions to such members (the “1.5X Clause”). The Court of Chancery found the Minority Members negotiated for these liquidity rights due to their minority position in the Company and the control that William Koch (“Koch”) and certain affiliated entities (collectively with Koch, the “Majority Members”) retained over the Company and the Company’s board of directors (the “Board”). On April 28, 2011, the Board, including the Minority Members’ representatives, voted unanimously to issue Units to a limited liability company benefiting certain family members of Koch (the “Family LLC”) and a limited liability company benefiting certain employees of the Company (the “Executive LLC” and together with the Family LLC, the “Small Holders”). However, the Board failed to follow the requisite formalities specified in the LLC Agreement for the admission of the Small Holders, including failing to set the terms and rights that would apply to the Small Holders. Around the same time the Small Holders were admitted, the Minority Members exercised the Put Right, which the Majority Members rejected, and the Minority Members subsequently exercised the Exit Sale Right. Koch filed the suit below, primarily seeking a declaratory judgment that its interpretation of the LLC Agreement was correct and that the Small Holders could block the Exit Sale under the terms of the LLC Agreement.

The Court of Chancery first held that laches applied to the Minority Members and that the Small Holders were members of the Company despite their admission not strictly complying with the formalities set forth in the LLC Agreement. Next, the Court of Chancery held the plain language of the LLC Agreement did not allow the Minority Members to force an Exit Sale unless the Small Holders would receive 1.5X their initial capital contributions in the transaction, taking into account any distributions received. However, the Court of Chancery found a gap existed in the LLC Agreement as to the terms on which the Small Holders became members. Relying on the implied covenant, the Court of Chancery “filled the gap” by holding the Exit Sale could proceed only if the Small Holders received additional funds to satisfy the 1.5X Clause, providing them with
additional consideration that would not be given to any other member (the “Seller Top Off”). After resolving the application of the 1.5X Clause, the Court of Chancery held the Majority Members breached their obligations to use reasonable efforts to effect the sale under the Exit Sale provision. The Company appealed on the grounds that (i) the Court of Chancery improperly applied the implied covenant, (ii) there was no contractual gap in the LLC Agreement, (iii) the Company did not breach the LLC Agreement and (iv) the rulings on remedies were erroneous.

The Supreme Court first addressed whether a gap existed in the Company’s LLC Agreement. The Supreme Court found the plain language of the LLC Agreement delegated responsibility to the Board to set the terms of admission, but did not require the Board to issue new units with different rights or classes. The record showed that the Board admitted the Small Holders without imposing a different set of rights, including a subscription letter and Board resolutions that addressed the price terms and number of units to be issued. Because the Board did not specify different rights, the Supreme Court found the unambiguous Exit Sale Right applied with equal force to the Small Holders. The Supreme Court held the Court of Chancery erred in holding a gap existed in the LLC Agreement because the parties did not give adequate attention to the effect the admission of the Small Holders would have on the Exit Sale Right provision of the LLC Agreement. Any mistakes the parties subjectively made about the implications of admitting new members to the Company should not operate to create contractual gaps. Accordingly, an Exit Sale could only be required by the Minority Members if all members, including the Small Holders, received at least 1.5X their initial capital contribution and distributions were pro rata.

Turning to the Court of Chancery’s application of the implied covenant, the Supreme Court declined to apply the implied covenant because no gap existed concerning the admission of the Small Holders and because the admission of new members and their impact on the Exit Sale process could have been anticipated. The Supreme Court stated that the implied covenant does not apply when the contract addresses the conduct at issue and, even when the contract is silent, the covenant cannot be used to re-write the agreement between the parties and courts should be cautious about implying a contractual protection when the contract could have easily been drafted to expressly provide for it. The Supreme Court held the Court of Chancery erred in finding a gap in the LLC Agreement and in using the implied covenant to imply a Seller Top Off Right. Finally, the Supreme Court agreed with the Koch parties that no Exit Sale was available under prevailing market conditions that could satisfy the LLC Agreement’s express requirements. Thus, the Koch parties could not have breached the LLC Agreement’s requirement that they use reasonable efforts to effectuate the Exit Sale and the Court of Chancery’s remedies ruling on that issue constituted error.

Accordingly, the Supreme Court (1) affirmed the portion of the Court of
Chancery’s decision that found that the plain language of the LLC Agreement did not allow the Minority Members to force an Exit Sale unless the Small Holders would receive 1.5X their initial capital contributions in the transaction, taking into account any distributions received, (2) reversed the portion of the Court of Chancery’s decision that found that a gap existed in the LLC Agreement and used the implied covenant to imply a Seller Top Off Right, and (3) vacated the Court of Chancery’s remedies ruling.


In the 1970s, two individuals formed a partnership to present Broadway-style shows in San Francisco. The families of those founders have operated that company, currently known as the Shorenstein Hays-Nederlander Theatres LLC, a Delaware limited liability company (the “Company”), for the past fifty years through their ultimate ownership of the two entities that are both fifty-percent members of the Company, CSH Theatres L.L.C. (“CSH”), which is controlled by the Shorenstein-Hays family (including Carole and Jeff Hays, referred to herein as “Carole” and “Jeff”), and NSF Associates (“NSF”), which is controlled by Robert Nederlander (“Robert”). Carole and Jeff also served as CSH-appointed managers of the Company.

The company had been leasing the Curran Theatre to show some of the Company’s Broadway-style productions. When the Curran came up for sale, the families could not agree on whether to buy it, so the Hays family purchased it with the consent of the Nederlander family. The parties, however, disputed the terms surrounding that consent. Those on the Nederlander family’s side of the dispute alleged that Carole agreed to continue to rent the Curran to the Company. Those on the Hays family’s side of the dispute disagreed. The relationship between the two families deteriorated, and the Hays family eventually cut ties with the Company and began operating the Curran itself. In this case, the parties asked the court to determine whether there was an enforceable promise by the Hays family to continue leasing the Curran to the Company, whether CSH and its controllers, Jeff and Carole, breached the LLC agreement’s provisions on competing with the Company and whether Carole and Jeff breached fiduciary duties they owed to the Company as managers.

The court found that there was not an enforceable contract or promise to lease the Curran to the Company. NSF and Robert, counterclaim plaintiffs, advanced four legal theories to support their allegations that Carole promised to continue to lease the Curran to the Company after her purchase of the Curran—that there was an enforceable contract to renew the lease, that there was an enforceable oral lease renewal, that Carole’s alleged promise to continue the Company’s lease should be enforced under the doctrine of promissory estoppel and that Carole made an enforceable promise to negotiate in good faith the Company’s renewal of the Curran lease. All four theories revolve around a discussion that Carole and Robert had when Carole was attempting to purchase the Curran. The only evidence of the substance of that discussion was oral testimony, and the court found that the evidence submitted by counterclaim plaintiffs failed to satisfy their burden to show that Carole made any promise to renew the Company’s lease of the Curran. Thus, the court found that all four claims relating to the lease renewal failed.
The court also found that CSH, Jeff and Carole did not breach the LLC agreement’s provision on competing with the Company by showing Broadway-style shows at the Curran through their venture and not through the Company. The court began its analysis by noting that CSH, Jeff and Carole (part of the “Shorenstein Entity” as defined in the LLC agreement) were bound by the LLC agreement’s provisions on competing with the Company. These provisions included not only Section 7.02(a), which required the Shorenstein Entity to devote its efforts “to maximize the economic success of the Company”, but also Section 7.06, which permitted Carole and Jeff to compete with the Company, subject to certain restrictions that prohibited staged productions that Carole and Jeff controlled within 100 miles of San Francisco unless that production already played at one of the Company’s theaters, NSF’s representatives turned down the production or the Company shared in the profits of the production (the “Control Exceptions”). Robert and NSF claimed that Carole violated these restrictions. However, while the evidence was clear that Carole staged a production she controlled within the geographic area specified in the LLC agreement, Robert and NSF provided no evidence regarding whether NSF turned down the production or whether the Company shared in the profits of the production. Further, Robert and NSF provided no evidence of damages. Thus, their breach of contract claim failed.

Finally, the court found that Jeff and Carole breached fiduciary duties they owed to the Company. Jeff and Carole, as managers of the LLC, owed common law fiduciary duties because the LLC agreement did not disclaim those duties. The court found that Carole breached her fiduciary duties by placing her interests above those of the Company. She played “hardball” with the Company during board meetings, used her fiduciary position to prevent the Company from pursuing opportunities that Carole wanted to pursue herself and instructed Company employees of the Company not to communicate with other employees and managers about Company business. The court found that Jeff breached his fiduciary duties by taking actions that were not in the best interests of the Company—notably, he shared confidential information with direct competitors of the Company and attempted to secure confidential information to hire away employees of the Company. Accordingly, the court granted Robert and NSF’s requested declaratory relief that Carole and Jeff breached their fiduciary duties to the Company while serving as managers of the Company, awarded nominal damages for the breach of fiduciary duty, and enjoined Carole and Jeff from using any confidential information gained while they were fiduciaries of the Company to compete with the Company.

In a subsequent decision, the court addressed claims that two new productions scheduled to play at the Curran would breach the limitations on competition in the LLC agreement. Nederlander sued, alleging that defendants breached the LLC agreement and their fiduciary duties by entering into contracts to stage the productions without complying with the LLC agreement’s provisions on competing with the Company. In this action, plaintiff sought to enjoin defendants from staging those productions until final resolution of plaintiff’s claims in the case. Plaintiff argued that it had a reasonable probability of success on the merits because CSH had the ability to determine where the two productions would play (at the Curran) and the terms of those engagements; thus, CSH had control of the productions under the LLC agreement and, because it did not meet any of the Control Exceptions, it violated the LLC agreement. Plaintiff also alleged that it would suffer irreparable harm if the productions proceeded, both because a contractual
provision stated that breach constituted irreparable harm and because it would suffer reputational damage.

The court first addressed defendants’ argument that the claims were barred by res judicata and held that res judicata did not apply, both because the facts surrounding the two new productions were unknown at the time of the prior litigation and the court did not rule on whether those productions by CSH constituted breaches of the LLC agreement. The court next addressed defendants’ argument that the claims were barred by collateral estoppel. Defendants stated that plaintiff was attempting merely to re-litigate the meaning of control under the LLC agreement; the court disagreed. In its prior decision, the court held that ownership equaled control. Here, plaintiff alleged that staging a production equaled control. The court noted that while staging a play at a theater one owns “may be an important stick in the bundle of property rights we call ownership, it is not the only right in the bundle.” Plaintiff raised a new argument in a dispute over new productions regarding what constituted control; thus, collateral estoppel did not apply.

The court then turned to plaintiff’s request for preliminary injunction and, particularly, whether plaintiff showed reasonable probability of success on the merits of its claim that defendants breached the LLC agreement by staging productions that they controlled without meeting any of the Control Exceptions. The parties agreed that no Control Exceptions existed. Instead, the claims turned on whether defendants staged productions that they “controlled” within the meaning of the LLC agreement (i.e., whether they had the ability to determine where the productions played and the terms and conditions of the engagement). Plaintiff argued that any time defendants staged (or presented) a show directly, defendants controlled the show, regardless of whether the show could have chosen to play at another theater or whether the terms and conditions of the show were the product of negotiations that occurred simply because the show chose to play at the Curran and Carole owned the Curran and could negotiate terms she desired. The court disagreed with plaintiff’s interpretation. The LLC agreement stated that “neither [party] will stage any Production that it controls” unless a Control Exception is met. Interpreting “staging” to mean “control” would create surplusage. Further, the drafting history showed that the language “that it controls” was added, suggesting that the parties intended to prohibit only controlled staged productions, not all staged productions. The evidence also showed the parties engaged in open competition to show both productions. Unlike in the prior decision, defendants “had no independent right or authority to cause [the productions] to play at the Curran or to set the terms for either play.” The court found that plaintiff’s interpretation was not reasonable and created surplusage and, therefore, plaintiff failed to show a likelihood of success on the merits. Thus, it denied plaintiff’s request for a preliminary injunction.


Plaintiff, Decco U.S. Post-Harvest, Inc. formed a Delaware limited liability company (the “Company”) with defendant MirTech, Inc. as a vehicle for their joint venture to commercialize products based on the gas 1-Methycyclopropene (“1-MCP”). As part of the business arrangement, defendant granted the Company a license to use its intellectual property rights in 1-MCP. Defendant represented in the Company’s operating agreement and the licensing agreement between Defendant and the Company that it was the sole owner of 1-MCP. The Company created and began
selling its product, TruPick, which delivered 1-MCP gas to fruit.

After the Company began selling TruPick, AgroFresh Inc. brought suit in the United States District Court for the District of Delaware claiming it owned the patents used to develop TruPick. Defendant previously entered into a commercial agreement and consulting agreement with AgroFresh. Those agreements granted AgroFresh sole ownership over the parties’ joint inventions. Defendant and AgroFresh entered into a settlement agreement, where defendant agreed that AgroFresh owned the intellectual property rights defendant had licensed to the Company. Plaintiff then brought this suit seeking to dissolve the Company because it was no longer reasonably practicable to carry on its business given that AgroFresh owned the intellectual property rights related to 1-MCP.

The Company’s operating agreement had a purpose clause that stated the purpose of forming the Company was to conduct and coordinate all activities related to 1-MCP products. The clause additionally stated that plaintiff and defendant intended the Company be used for the development of other technologies not related to 1-MCP. The operating agreement granted plaintiff a right of first refusal over non-1-MCP products. Plaintiff had sixty days to determine whether it wanted to pursue commercialization of non-1-MCP products. If plaintiff exercised its option, plaintiff and defendant had 120 days to negotiate an agreement. If plaintiff did not exercise its option or the parties could not reach an agreement, defendant could contract with third parties to commercialize the non-1-MCP products.

The court granted plaintiff’s motion to dissolve the Company under Section 18-802 of the Delaware LLC Act. The court looked to the Company’s operating agreement to determine the purpose for which it was formed and found the record established the Company no longer had any 1-MCP Business and would never have any non-1-MCP Business because the settlement agreement prevented the Company from continuing to sell TruPick, which was the Company’s only product. The court rejected defendant’s argument that it could rely on defendant’s “know-how” and “trade secrets” to conduct a 1-MCP business because these were both assigned to AgroFresh. The court found it was not practicable for the Company to carry out the aspect of the business related to 1-MCP products.

The court also found it was not reasonable for the Company to carry out its second purpose, which was to act as a vehicle for non-1-MCP business. In order for a non-1-MCP business to exist, plaintiff must exercise its right of first refusal and partner with defendant to develop a new product. However, plaintiff stated at trial it would no longer do business with defendant. The court was satisfied the evidence established there was no viable non-1-MCP business. Accordingly, the court granted plaintiff’s motion to dissolve the Company.


Plaintiffs were limited partners of Blue Bell Creameries, L.P., a Delaware limited partnership (“Blue Bell”). Blue Bell was managed by its general partner, Blue Bell Creameries, Inc. (“BB GP”), a wholly owned subsidiary of Blue Bell Creameries USA, Inc. (“BB USA”). Blue Bell manufactured and sold ice cream products in the southern United States, and as of 2014, Blue Bell was the third largest ice cream manufacturer in the United States. In January 2015, South Carolina state health inspectors discovered Listeria
monocytogenes bacteria (“Listeria”) in a routine sampling of Blue Bell products, and shortly thereafter, the Food & Drug Administration and other state health agencies found Listeria contamination in other Blue Bell ice cream products. Further, it was determined that Blue Bell had discovered Listeria on its own in 2013, but had failed to conduct any analysis of the source of the bacteria. The discovery of Listeria had a devastating impact on Blue Bell’s business.

Plaintiffs brought a derivative action on behalf of Blue Bell based on conduct relating to the Listeria disaster setting forth four counts: (1) against BB GP, for breach of Blue Bell’s partnership agreement; (2) against BB USA, “as controller, principal, and joint venturer” of BB GP, and against certain directors and officers of BB GP and BB USA (the “Individual Defendants”), as “controllers” of BB GP, “for causing BB GP to breach the partnership agreement;” (3) against BB USA and the Individual Defendants, for aiding and abetting BB GP’s breach of its “contractual fiduciary duties” under the partnership agreement; and (4) against BB USA and the Individual Defendants, “for breach of common law fiduciary duties” owed to Blue Bell. In response, defendants moved to dismiss the complaint for failure to state a claim and for failure to make a pre-suit demand on BB GP.

The court began its discussion with the claim that BB GP violated Section 6.01(e) of Blue Bells’ limited partnership agreement (the “LPA”). The pertinent part of Section 6.01(e) of the LPA provided that BB GP shall use its “best efforts” to conduct Blue Bell’s business “in accordance with sound business practices in the industry.” The court found that under Section 6.01(e)’s plain meaning, BB GP was required to endeavor diligently to conduct Blue Bell’s business in accordance with practices that (1) were based on thorough knowledge of and experience with the dairy industry or (2) agreed with accepted views within the dairy industry. Defendants argued that the language of Section 6.11(d) modified or negated BB GP’s obligation under Section 6.01(e). Section 6.11(d) provided that:

any standard of care and duty imposed by this agreement or under DRULPA or any applicable law, rule or regulation shall be modified, waived or limited, to the extent permitted by law, as required to permit BB GP to act under this agreement or any other agreement contemplated by this Agreement and to make any decision under the authority prescribed in this agreement, so long as the action is reasonably believed by BB GP to be in, or not inconsistent with, Blue Bell’s best interests.

The court noted that the Delaware Supreme Court has confirmed that language such as that contained in Section 6.11(d) of the LPA eliminates all common law standards of care and fiduciary duties, and replaces them with a contractual good faith standard of care. However, the court held that the contractual good faith standard did not modify the affirmative language in Section 6.01(e) because Section 6.01(e) created an express contractual obligation for BB GP to follow and the contractual good faith standard operated only in spaces of the LPA without express standards of care. Thus, the court denied defendants’ motion to dismiss the first count because the court found that the express contractual language required BB GP to conduct Blue Bell’s business in accordance with sound business practices in
the dairy industry as set forth in Section 6.01(e).

The court then held that plaintiffs’ veil piercing, agency and joint venturer liability claims against BB USA and is directors failed. The court stated that plaintiffs’ veil piercing claim failed because the complaint did not allege or suggest that BB GP existed solely as a vehicle for fraud. Further, the court held that plaintiffs’ attempt to hold BB USA liable for BB GP’s alleged breach of the LPA under an agency theory failed because Delaware law does not recognize a theory under which a principal can be vicariously liable for its agent’s non-tortious actions. Finally, the court stated that the terms of the LPA clearly stated that the arrangement was not a joint venture and there was no reasonable inference that the conduct of BB GP and BB USA amended the LPA to make the arrangement a joint venture. The court thus held that the plaintiffs’ joint venturer theory failed.

The court also dismissed plaintiffs’ aiding and abetting claims. The court stated that BB GP’s obligations under the LPA were contractual and therefore plaintiffs’ claim was for aiding and abetting a breach of contract. Because Delaware law does not recognize a claim for aiding and abetting a breach of contract, the court dismissed this count.

The court then addressed plaintiffs’ breach of fiduciary duties claim against BB USA and the Individual Defendants. Plaintiffs claimed that BB USA and the Individual Defendants breached their common law fiduciary duties that were owed to Blue Bell under the In re USACafes, L.P. Litigation, 600 A.2d 43 (Del. Ch. 1991) line of cases, which stand for the proposition that a corporate general partner’s fiduciary duties to the limited partnership may extend to the general partner’s controllers if such persons exercise control over the limited partnership’s property. The court stated that this rule had limited, if any, application in this context because the LPA eliminated all common law fiduciary duties, and therefore neither BB USA nor the Individual Defendants owed any fiduciary duties directly to Blue Bell even if they exercised control over Blue Bell’s property. Thus, the court dismissed these claims.

Finally, the court addressed whether demand on BB GP was excused for plaintiffs’ derivative claims. The court stated that demand was futile in this case because there was reasonable doubt that BB GP could have properly exercised independent and disinterested business judgment in evaluating a demand to bring this derivative action. The court noted that the exculpatory language in the LPA did not provide a basis in this case for overcoming properly pled allegations supporting demand futility.

Following the dismissal of plaintiffs’ claims against BB USA based on vicarious liability, veil-piercing and joint liability theories, plaintiffs filed a motion to reargue, stating that the Court of Chancery “misapprehended long-standing Delaware law regarding liability of a parent entity for its subsidiary’s breach of contract.” Plaintiffs sought reargument on six theories: (1) that BB USA was vicariously liable for BB GP’s breach of contract; (2) that BB USA was directly liable for BB GP’s breach of contract; (3) that the court should pierce the BB GP corporate veil because BB GP’s corporate structure caused fraud; (4) that the court should pierce the BB GP corporate veil on a theory of domination and control; (5) that BB GP and BB USA formed a joint venture; and (6) that plaintiffs were not afforded an adequate opportunity to access pertinent information before their answering brief was due.

The court noted that it will deny a motion for reargument unless it overlooked a
decision or principle of law that would have a controlling effect or misapprehended the law or the facts so that the outcome of the decision would be affected. The court found that its findings in its initial decision on these issues were consistent with Delaware law. The court therefore denied plaintiffs’ motion for reargument.


This case arose on appeal from the Court of Chancery by then-defendant Composecure, L.L.C. Plaintiff appealed on the grounds that the Court of Chancery erred in holding (i) that the Marketing Agreement was voidable, rather than void, under the LLC Agreement and (ii) that there was implicit ratification of the Marketing Agreement. Defendant argued that even if plaintiff were correct about the aforementioned errors of law in the Court of Chancery, the court should nonetheless enforce the Marketing Agreement based on a provision in the LLC Agreement that addressed reliance by third parties on certain company actions.

The court noted that the primary issue with the Court of Chancery ruling was that the lower court had failed to consider whether the Marketing Agreement was a “Restricted Activity” under the LLC Agreement, which, if so, would have rendered the Marketing Agreement void. If the Marketing Agreement was void, it would be incapable of ratification. Thus, a factual finding as to whether the Marketing Agreement was a “Restricted Activity” was determinative of the outcome of the case and the court remanded the issue to the Court of Chancery for determination. In doing so, the court dispensed with defendant’s claim that plaintiff had waived the argument that the Marketing Agreement was void and should be unable to raise it on appeal. The court noted that, although defendant had only weakly raised the issue below and failed to fully flesh out the rationale behind such claim, defendant had nonetheless repeatedly asserted that the Marketing Agreement was “void”. That distinction made by defendant that the Marketing Agreement was “void” rather than “voidable” was sufficient to preserve the argument on appeal.

The court found no other error in the Court of Chancery’s legal analysis and affirmed its ruling that (i) New Jersey law governed the issue of implicit ratification of the Marketing Agreement, (ii) implicit ratification of the Marketing Agreement occurred and (iii) the third party reliance provision of the LLC Agreement could not save the Marketing Agreement even if it were a “Restricted Activity”.


This litigation arose out of a business dispute between plaintiffs Village Green Holding, LLC (“Village Green”), CCI Historic, Inc. and VG ECU Holdings, LLC and defendants Jonathon Holtzman (“Holtzman”), Village Green Residential Properties LLC (“VGRP”) and VGM Clearing, LLC involving ownership of property management entities and a large apartment complex located in Pittsburgh (the “Property”). Through a waterfall of holding companies (the “Property Holdings Companies”), the parties owned interests in the Property. Pursuant to a redemption agreement (the “Redemption Agreement”), Holtzman indirectly held a right to purchase the interests of Village Green (and certain affiliated entities) in the Property Holding Companies. The Redemption Agreement further provided that if Holtzman failed to
exercise his purchase right within a specified time period, Village Green and its affiliates would become entitled to purchase Holtzman’s interest in the Property Holding Companies. A similar stand-alone provision establishing Holtzman’s right to purchase Village Green’s interest in the other Property Holding Companies was present in the operating agreement (the “Operating Agreement”) of Morrow Park Holding, LLC (“MP Holding”), one of the Property Holding Companies. Holtzman sought to exercise the purchase right contained in the Operating Agreement.

After a disagreement arose regarding the appraisal procedures required under the Operating Agreement for Holtzman’s exercise of the purchase right, Holtzman (through VGRP) filed suit in the Court of Chancery to resolve the appraisal issues. Because the appraisal dispute was delaying the sale, Holtzman realized that the purchase option may expire by the time the dispute was resolved. As a result, Holtzman sought an injunction to compel Village Green to close the deal. The injunction was not granted, but the Court of Chancery did issue an order preventing, among other things, the parties from transferring their rights without the consent of the other party and preserving the parties’ rights under the Operating Agreement from expiring during the pendency of the litigation.

While the Delaware litigation was ongoing, a third-party minority investor in one of the Property Holding Companies commencing an action in Pennsylvania that ultimately called for a court-ordered sale of the Property itself. The Pennsylvania sale order allowed both Village Green and Holtzman to bid on the Property, which Holtzman felt was unfair given his contractual purchase rights. Therefore, Holtzman filed a motion in Pennsylvania seeking a modification to the sale order that would give him a priority purchase right, in accordance with the priority right he had in the Operating Agreement. In response to Holtzman’s motion, Village Green sought an injunction in the Court of Chancery to prevent Holtzman from further pursuing the modification to the sale order motion and from filing any additional actions in Pennsylvania. Village Green also sought an order directing Holtzman to withdraw his request for modification of the sale order.

The Operating Agreement contained a forum selection clause requiring any actions based in statute, tort, contract or otherwise arising out of or relating to the Operating Agreement to be brought exclusively in the Delaware federal district court or the Court of Chancery.

The court first set out the standard that must be met by the moving party for the granting of a preliminary injunction: (i) a reasonable probability of success on the merits, (ii) an imminent threat of irreparable injury and (iii) a balance of the equities in favor of injunction.

As to the first prong, Holtzman argued that, under El Paso Natural Gas Co. v. TransAmerican Natural Gas Corp., 669 A.2d 36 (Del. 1995), a forum selection clause requiring litigation to be conducted in the Court of Chancery was unenforceable because a contract cannot confer exclusive jurisdiction over all disputes, including purely contractual ones, upon the Court of Chancery. The court here disagreed with Holtzman’s comparison, noting that, unlike in El Paso, the forum selection clause in the Operating Agreement did not confer exclusive jurisdiction over all claims on the Court of Chancery because the Delaware federal district court was also an option. Furthermore, the forum selection provision in El Paso was contained in a run-of-the-mill contract, rather than an LLC agreement. Relevant to this point, plaintiffs also noted that Section 18-111 of the Delaware LLC
Act grants an independent basis for subject matter jurisdiction on the Court of Chancery for all actions “to interpret, apply or enforce the provisions of a limited liability company agreement . . . .” Because the main issue of the case at hand was the purchase right contained in the Operating Agreement, the court determined that it clearly had jurisdiction pursuant to Section 18-111. Additionally, the court found that the Redemption Agreement, as an agreement among the members of Village Green, was similarly picked up as an agreement “contemplated by [the provisions] of the [Delaware LLC Act],” and was therefore within the court’s subject matter jurisdiction. As to the second prong, the threat of imminent irreparable injury, the court noted that Delaware cases have consistently held that procession of an action in an unwarranted forum poses a threat of per se irreparable harm. The court found that the final prong, balancing of the equities, also favored plaintiffs. The court noted that corporate formalities are respected in Delaware and that the Pennsylvania action and the Delaware action technically involved different entities -- the Pennsylvania action related to the sale of the Property by its owner while the Delaware action related to the sale of ownership interests in the Property Holding Companies. The court therefore granted plaintiffs’ motion for the preliminary injunction.


In this case, defendants, who were the largest holders of membership units in Trumpet Search, LLC, a Delaware limited liability company ("Trumpet"), filed a motion to dismiss an action seeking relief under the implied covenant of good faith and fair dealing. Plaintiffs claim alleged that HCP & Company, together with its affiliates (collectively, the “HCP Entities”) violated the implied covenant of good faith and fair dealing when the HCP Entities controlled board of managers of Trumpet (the “Board”) sold Trumpet without conducting an auction or open sales process designed to achieve the highest value reasonably available for all of the members of Trumpet. The operating agreement of Trumpet set out a distribution waterfall for determining members’ returns on capital investment in the event of a sale or otherwise. The HCP Entities held 78.5% of the Class E units and 87.5% of the Class D units, which were entitled to a first-position payout and second-position payout, respectively. Under this distribution waterfall scheme, if Trumpet were sold roughly 90% of the first $30 million in sales proceeds would go to the HCP Entities. After the first $30 million in sales proceeds, other classes of members would receive millions of dollars in proceeds before the HCP Entities would again share pro rata in the sales price.

Less than a year after the operating agreement was adopted, an unaffiliated third party, MTS Health Partners, L.P. ("MTS") made an initial offer of $31 million to purchase Trumpet. The HCP-affiliated managers elected not to run an open sales process and gave the non-affiliated managers little time to find alternative buyers. Nonetheless, this abbreviated sales process led MTS to increase its initial offer from $31 million to $41 million and Trumpet was eventually sold to MTS for $43 million. Plaintiffs claimed that the HCP Entities breached the implied covenant of good faith and fair dealing in approving the sale of Trumpet to MTS by refusing to pursue an open sales process designed to achieve the highest value reasonably available for all of the members of Trumpet and instead agreeing to a below-market sale
that allowed the HCP Entities to achieve a quick exit from Trumpet and a 200% return on their investment due to the waterfall payment scheme set forth in the operating agreement.

In the first step of its implied covenant analysis, the court looked to whether the operating agreement in fact contained a gap that must be filled. The court initially noted that the operating agreement explicitly waived default fiduciary duties in accordance with the Delaware LLC Act, and that the operating agreement did not, by its terms, require the Board to conduct an open market sales process designed to achieve the highest value reasonably available for all members of Trumpet. Defendants argued that the operating agreement was not “truly silent” as to how Trumpet could be marketed and sold because Section 8.06(a) explicitly addressed the issue of how Trumpet could be sold. This provision stated that “the Board shall determine in its sole discretion the manner in which [a sale of all Trumpet membership units to an independent third party] shall occur, whether as a sale of assets, merger, transfer of Membership Interests or otherwise.” Defendants argued that this provision expressly permitted the Board to sell Trumpet without an open-market sales process, so long as the sale was not to an affiliated party.

Plaintiffs argued that there remained a gap in the operating agreement as to the type of sales process the Board could conduct because Section 8.06(a) addressed only the “form” of a sale and not the methods that could be employed in marketing Trumpet. In the alternative, plaintiffs argued that even if Section 8.06(a) addressed the methods the Board may employ in marketing the sale of Trumpet, the implied covenant required that the Board exercise that discretion reasonably and in good faith.

The court held that the operating agreement did not contain a gap as to how Trumpet could be marketed and sold. The court found plaintiffs reading of Section 8.06(a) to be “unreasonable” and stated that the plain and unambiguous meaning of that provision was that the Board can market the company in whatever manner it chooses to an independent third party, and that such discretion included decisions about the form of the transaction. Turning to plaintiffs’ second argument, the court first acknowledged that when a contract confers a discretionary right on one party, the implied covenant requires that right to be exercised reasonably and in good faith. However, the court rejected this argument because the operating agreement specified the scope of the Board’s discretion by providing it with sole discretion to determine how to conduct a sales process, so long as the sale was to an unaffiliated third party. The court held that because the scope of discretion had been specified by the parties, there was no gap in the operating agreement as to the scope of discretion and therefore no reason for the court to invoke the implied covenant to determine how discretion should be exercised.

Additionally, in support of its claim for breach of the implied covenant of good faith and fair dealing, plaintiffs cited several cases for the proposition that the implied covenant applies with particular force to contractual grants of sole discretion. The court noted that some courts have applied the implied covenant to sole discretion clauses because an unqualified grant of sole discretion presents the opportunity that a party entitled to exercise that discretion may abuse it for self-interested reasons and thereby deprive the other party of the benefit of its bargain. However, the court found that those cases were not controlling because the parties to the operating agreement had explicitly addressed this concern by providing that the Board did not retain sole
discretion to sell the company to affiliates or insiders and therefore the parties had recognized and filled that gap that some courts have found in contracts that provide for an unqualified grant of sole discretion.

Finally, the court noted in dicta that even if plaintiffs were correct and the operating agreement contained a gap as to how Trumpet could be sold, the implied covenant claim would still fail because plaintiffs’ reasonable expectations were not frustrated by defendants’ conduct during the sales process. The court specifically noted that the express terms of the operating agreement, such as the requirement that the Board notify the members of a sale and the lack of an information right of members for an ongoing sales process, suggested that the parties actually contemplated that Trumpet may be sold through private negotiation rather than an open-market process. The court stated that adding an auction sales process requirement would alter rather than enforce the deal actually struck since “the members agreed to a process that would enable investors to structure and time an exit at a very substantial premium to their investment, in a way that encouraged investment at the cost of fiduciary protections for earlier equity holders.”

On appeal, the Supreme Court disagreed with the Chancery Court’s finding that the operating agreement did not contain a gap as to how Trumpet could be marketed and sold, and held that the terms of Section 8.06(a) did not displace the implied covenant entirely. However, the Supreme Court affirmed the Chancery Court’s decision because it agreed with the “essential holding that the implied covenant could not be used to imply Revlon-type sale requirements”, particularly when the operating agreement expressly eliminated fiduciary duties.


In this case, defendant George Bouri (“Bouri”) fraudulently induced Rakesh Kishan (“Kishan”), a management consultant looking for an investor or partner for his consulting firm, into forming Trascent Management Consulting, LLC (“Trascent”) and making Bouri a manager and member of Trascent. Bouri was terminated without cause from his prior employment with Time Warner after an investigation was launched due to complaints about Bouri’s management style. Some of the complaints alleged that Bouri was unreasonable, aggressive and disrespectful and that he made and engaged in inappropriate sexual comments and conduct in the workplace. After Bouri’s termination, he struggled financially. When Kishan initiated negotiations with Bouri, Bouri explained he resigned from Time Warner because he was being micromanaged. Further, Bouri represented himself as a man of “substantial financial means,” by talking in detail about his property and family wealth.

Bouri insisted he would only go into business with Kishan if the parties formed an entity that made Bouri an equity partner. In April 2013, Kishan formed UMS Advisory, LLC, which later changed its name to Trascent Management Consulting, LLC. Rather than contributing cash to Trascent, Bouri convinced Kishan to let him sign a promissory note. Trascent’s operating agreement became effective January 1, 2014, and Bouri was made a manager and unitholder of Trascent. Bouri was in charge of finances and HR for Trascent, and he dig Trascent into a financial hole. He substantially increased overhead costs, refused to contribute any cash, requested several advancements on his paychecks and forged a letter from a client
so he could submit a personal expense as a business expense. Kishan terminated Bouri’s employment for cause after Bouri fabricated an HR investigation and involved a client in the matter. Trascent then sought rescission of Bouri’s employment agreement procured by fraud, a declaration that the LLC agreement was unenforceable by Bouri and attorneys’ fees and costs. The court granted all of Trascent’s requests, but opted to award some, not all, of the attorneys’ fees and costs as a sanction for bad faith litigation conduct.

As for the fraudulent inducement claim, the court rejected Bouri’s first argument that the claim must fail because the misrepresentations predated the LLC’s existence. The court applied the two-part test outlined in *Nye Odorless Incinerator Corp. v. Felton*, 162 A. 504 (Del. Super. 1931): an entity can maintain a claim based on misstatements made before its formation when (1) the fraudulent statements were made to an innocent individual to induce him/her to form an entity and have that entity take certain actions, and (2) that individual forms the entity and causes it to take said action. The court found the *Nye* test to be satisfied because Bouri’s statements regarding his prior employment with Time Warner induced Kishan to form an entity and to make Bouri a manager and unitholder. The court found that Trascent satisfied its burden of proving the elements of fraudulent inducement. The court reasoned that Bouri made misrepresentations he knew were false with the intent to induce action by Trascent and that Trascent justifiably relied on those statements. Further, the court deemed the misrepresentations to be material because a reasonable person would have considered it important to know that a potential member and manager to a new entity was struggling financially and was previously terminated from his last job after an investigation into his management style. Finally, Trascent was damaged by the justifiable reliance because the company entered into the employment agreement and LLC agreement.

The court also rejected Bouri’s argument that legal rescission of the employment agreement would be improper because (1) Trascent would reap the benefits of his contributions while he would lose all the benefits and protections and (2) he abided by the eighteen-month post-termination non-compete provision. The court agreed Bouri contributed to Trascent’s business but also found that he cost them a significant amount of money by increasing the size of the firm from ten to eighteen employees and not producing a profit for Trascent in 2014. The court found it was possible to return the parties to status quo because the benefits bestowed by Bouri and the expenses incurred by Trascent were comparable. Accordingly, the court rescinded the employment agreement.

Next, the court granted Trascent’s motion to declare the LLC agreement unenforceable by Bouri. When there is fraud in the inducement, a contract is enforceable against at least one party and “voidable” at the option of the innocent party. The court rejected Bouri’s argument that the LLC agreement was not procured by fraud holding that once Bouri gave an explanation for his departure from Time Warner, he had to give a full and open disclosure around those circumstances. Additionally, once Bouri volunteered information that gave Kishan a false impression about his financial status, Bouri had to correct that impression. The court found it inconceivable that Kishan would have made Bouri a member of Trascent had he known the truth about Bouri’s financial status. Kishan was looking for members to invest cash in Trascent when necessary. Further, Kishan testified the only reason he accepted a promissory note in exchange for Bouri’s equity was that he believed Bouri was a wealthy man. The
court also found it hard to believe Kishan would have formed Trascent, made Bouri a member and offered him complete independence and decision-making had Bouri been truthful about why he departed from Time Warner and the particular allegations against him. Thus, the court found that Bouri could not enforce the LLC agreement.

Finally, the court addressed Trascent’s request for attorneys’ fees and costs. First, the court denied Trascent’s request for return of the attorneys’ fees and costs advanced to Bouri because he was entitled to advancement under both the employment agreement and LLC agreement. The court explained Bouri was entitled to advancement until a final, non-appealable order was entered in the action. Second, the court denied Trascent’s request for its own attorneys’ fees and costs because Trascent did not argue that an exception to the American Rule applied. However, Trascent successfully sought sanctions against Bouri for repeatedly misrepresenting in discovery and before the court the nature of his departure from Time Warner. As a result, the court awarded Trascent its reasonable attorneys’ fees and costs in bringing the Motion for Sanctions and two-fifths of its reasonable attorneys’ fees and costs incurred in the litigation.


In March 2017, the Supreme Court reversed a decision of the Court of Chancery in which it had dismissed plaintiff’s challenge to a conflicted dropdown transaction where the parent (“Enbridge”) of the general partner (the “GP”) of Enbridge Energy Partners L.P., a master limited partnership (the “MLP”), sold its interest in a pipeline joint venture, which it had acquired from the MLP six years earlier, back to the MLP at a higher price than it had originally paid the MLP (the earlier Chancery decision is referred to herein as “Brinckerhoff IV” and the Supreme Court’s decision reversing the Chancery decision is referred to herein as “Brinckerhoff V”). In doing so, the Supreme Court “provided certain definitive constructions of the [MLP’s] LPA, defined the boundaries of the contractual good faith standard imposed by that contract and remanded for further proceedings consistent with its guidance.” After Brinckerhoff V, the Court of Chancery permitted Mesirov to be substituted as lead plaintiff and an amended complaint to be filed, which included the following defendants: the MLP; the GP; Enbridge Energy Manager, L.L.C., which managed the MLP and was owned in part by the GP (“Enbridge Management”); Enbridge; the individual directors of the GP and Enbridge Management, two of whom were the members of the Special Committee of the GP; and Piper Jaffray & Co., successor by merger to Simmons & Company International, which served as financial advisor to the Special Committee (“Simmons”). Plaintiff’s amended complaint asserted breaches of the LPA and the implied covenant against the GP and Enbridge Management (plaintiff had dropped those same claims against Enbridge and the individual directors following Brinckerhoff IV), aiding and abetting and tortious interference with the GP’s performance of the LPA against Enbridge, the individual directors, Enbridge Management and Simmons and breach of residual fiduciary duty against Enbridge and the individual directors, and sought reformation or rescission of the transaction. Defendants moved to dismiss the amended complaint for failure to make demand on the GP’s board to prosecute the claims derivatively and for failure to state legally viable claims.
Plaintiff challenged the MLP’s repurchase of an interest in the Alberta Clipper pipeline (the “AC Interest”) from Enbridge for $1 billion. Plaintiff alleged that the Special Committee and Simmonds knew but ignored the fact that the MLP was overpaying for the AC Interest and provided three metrics to support its assertion. First, despite a decrease in EBIDTA in the AC Interest by almost 20% between Enbridge’s purchase in 2009 and the MLP’s repurchase in 2015 and the fact that the 2009 transaction included rights to expand the pipeline and the 2015 transaction did not, the EBITDA multiple associated with the MLP’s repurchase price was higher than the EBITDA multiple associated with Enbridge’s initial purchase price. Second, the “rate base” of the pipeline, which the court noted was a meaningful proxy for current market and fair value, implied a value of $674 to $707 million at the time of the repurchase. Third, the MLP paid an amount that was well above the GP management’s own DCF equity value for the AC Interest. Additionally, plaintiff argued that the deal was not fair to the MLP because the GP was paid the equity portion of the deal in new Class E units that had a unique tax benefit that allocated over half of the gross income associated with the transaction away from the Class E unitholder to the other unitholders and a unique liquidation preference (the “Class E Attributes”) and the Special Committee and Simmons allocated no value to those Class E Attributes.

The court next addressed plaintiff’s direct and derivative breach of contract claims. Under Tooley, to determine whether a claim is direct or derivative, one must analyze who suffered the alleged harm and who would receive the benefit of any recovery. A claim could be “dual-natured” if there was an improper transfer of both economic value and voting power from minority equity holders to majority equity holders. Here, plaintiff’s core theory was that the MLP was injured when it overpaid for the AC Interest. Further, the alleged breach was of Section 6.6(e) of the LPA, which required that GP and its affiliates to act in a manner that was “fair and reasonable to the Partnership.” Finally, plaintiff did not allege any voting harm that could lead to a dual-natured claim. Thus, the court dismissed the direct breach of contract claims. It refused to dismiss the derivative breach of contract claims against the GP, noting that the Supreme Court held in Brinckerhoff V that plaintiff’s allegations were sufficient to state a claim for breach of Section 6.6(e) and, therefore, that was the law of the case.

The court also held that in Brinckerhoff IV, it incorrectly dismissed the breach of contract claims against “Affiliates” and “Indemnitees” under the LPA on the grounds that such persons were not parties to the LPA. The Supreme Court in Brinckerhoff V had found that the transaction was expressly governed by Section 6.6(e) of the LPA, which stated that neither the GP nor its Affiliates (which term included Enbridge) could sell any property to or purchase any property from the MLP unless the transaction was fair and reasonable to the MLP. Further, under the LPA, Indemnitees (defined to include the GP, Affiliates of the GP such as Enbridge and Enbridge Management, and the individual directors) were not liable for monetary damages for actions taken in good faith. The court addressed these LPA provisions in its first and third Brinckerhoff
decisions, finding that plaintiff’s claims could survive a motion to dismiss if it well-pled facts suggesting defendants acted in bad faith, and the Supreme Court did not overturn this holding in Brinckerhoff V. Thus, the court held that plaintiff could reinstate claims for breach of Section 6.6(e) against Enbridge, Enbridge Management and the individual directors in an amended complaint.

The court next addressed the breach of implied covenant claim, noting that its prior dismissal of this claim was undisturbed by Brinckerhoff V, which noted that the transaction was “expressly governed by Section 6.6(e)”, leaving no room for the implied covenant to operate. Thus, the court granted defendants’ motion to dismiss plaintiff’s implied covenant claim.

The court then turned to the “secondary” claims, that is, if a party were not liable under a theory noted above, it would be liable as an aider and abettor, for tortious interference with a contract or for breach of residual fiduciary duties—and found that these claims failed as a matter of law. Under Delaware law, one generally cannot aid and abet a breach of contract. There is an exception for aiding and abetting breaches of “contractual fiduciary duties” that applies if the LPA does not expressly eliminate all fiduciary duties. Here, the court found that the LPA did not expressly eliminate all fiduciary duties. In so finding, it pointed to Brinckerhoff V and noted that the Supreme Court (1) interpreted the “fair and reasonable” standard in Section 6.6(e) to something akin to the entire fairness standard of review and (2) refused to “upset” the “settled interpretation” that a partnership agreement like the MLP’s that provided that standards of care and duty imposed by the partnership agreement or applicable law were modified, waived or limited to permit a general partner to act “so long as such action is reasonably believed by the General Partner to be in the best interests of the Partnership” provided a contractual fiduciary duty standard. While an aiding and abetting claim theoretically could be brought under this LPA, the aiding and abetting claims were against Enbridge, Enbridge Management and the individual directors who, under the express terms of Section 6.6(e), owed duties directly to the MLP. Thus, they could not be liable for aiding and abetting. The same defendants also could not be liable for tortious interference because they were not strangers to the LPA or the transaction. Further, Enbridge and the individual directors could not be liable for breach of residual fiduciary duties. These defendants were bound by Section 6.6(e), which expressly governed the transaction and replaced common law duties with contractual fiduciary duties similar to entire fairness. The Supreme Court did not overturn the court’s determination in its first and third Brinckerhoff decisions that claims against these persons would survive dismissal if plaintiff well-pled that such defendants acted in bad faith. Thus, Enbridge and the individual directors could not be liable for breach of residual fiduciary duties when they were bound by the terms of the Section 6.6(e), which supplanted common law fiduciary duties.

The remaining claims were against Simmons for aiding and abetting breach of contractual fiduciary duties and for tortious interference with the LPA. Neither claim had been brought previously; thus, Brinckerhoff V did not address them. The court held that the aiding and abetting claim could not be dismissed, as plaintiff adequately pled that Simmons knowingly participated in the GP’s and Enbridge Management’s breaches of the LPA’s contractual fiduciary duties. In so holding, the court pointed to, inter alia, plaintiff’s allegations that Simmons created an “informational vacuum” by ignoring and
failing to address the economic metrics outlined previously and the Class E Attributes and relied on the GP’s management’s “fully baked” EBITDA projections in providing its fairness opinion. The court then addressed the tortious interference claim, noting that Delaware follows the Restatement (Second) of Torts and that, under the Restatement, (1) Simmons’ “sole motive” must have been to interfere with the LPA, (2) Simmons was entitled to the “advisor’s privilege” (which allows an advisor to provide advise without fear that its advice will give rise to a tortious interference claim), and (3) Simmons could only face tort liability if it counseled the GP and Enbridge in bad faith to breach the LPA. As plaintiff’s complaint did not make these allegations, the court dismissed the tortious interference claim against Simmons.

Finally, the court addressed plaintiff’s claims for rescission or reformation and refused to dismiss such claims on the grounds that the Supreme Court “made clear that the LPA does not ‘limit equitable remedies’” even if the GP was found to have acted in good faith and therefore was not liable for monetary damages under the LPA.


In this case, plaintiffs, who were two members of the Board of Managers (the “Board”) of HMS Holdings 3, LLC (“Holdco 3”), acted by written consent to terminate defendant Harley Franco from his positions as President and CEO of Harley Marine Services, Inc., a Washington corporation (“HMS Inc.”). In 2008, Franco sold a significant equity stake in HMS Inc. to Macquarie Capital, a private equity firm. In connection with Macquarie’s investment in HMS Inc., the parties created a complex, multi-tiered ownership structure. At the time they took action by written consent, plaintiffs also comprised two of the four members of the board of managers of two additional Delaware limited liability companies: HMS Holdings 1, LLC (“Holdco 1”) and HMS Holdings 2, LLC (“Holdco 2”). The three Holdco entities constituted a three-tiered holding company structure for HMS Inc. Holdco 1 owned 100% of the equity of HMS Inc., Holdco 2 owned a 76.64% member interest in Holdco 1, and Holdco 3 owned an 82.22% member interest in Holdco 2. Macquarie owned a 15.44% membership interest in Holdco 3 and HMS Partners, LLC, an entity controlled by Franco (“Franco Partners”), owned an 84.56% member interest in Holdco 3.

Each Holdco was a manager-managed LLC governed by a board of managers consisting of four managers and each LLC agreement specified that two managers were to be selected by Franco Partners (each, a “Franco Manager”), one manager was to be selected by Macquarie (the “Macquarie Manager”) and one manager was to be independent of Macquarie and Franco Partners (the “Independent Manager”). Plaintiffs were the Macquarie Manager and Independent Manager. The Holdco 3 LLC agreement differed from the other Holdco LLC agreements in three key respects. First, Franco executed the Holdco 3 LLC agreement personally and became a party in his individual capacity for purposes of the “Personal Commitment Provision.” The Personal Commitment Provision required Franco to cause Franco Partners to perform all of its obligations under the Holdco 3 LLC agreement, to at all times maintain control of Franco Partners and to abide by the provisions set forth in each Holdco LLC agreement that applied to him in his personal capacity. Second, the Holdco 3 LLC agreement contained language authorizing the Board to select the officers of Holdco 3’s subsidiaries. Third, the Holdco 3 LLC agreement contained...
language obligating the parties to that agreement to conform the governing boards of all of Holdco 3’s subsidiaries to the composition of the Board.

After investigating allegations that Franco had misappropriated fund from HMS Inc., plaintiffs, in their capacities as the Independent Manager and Macquarie Manager of Holdco 3, purported to take action by written consent on behalf of the boards of managers of the Holdcos, the board of directors of HMS Inc. and the governing boards of each of HMS Inc.’s subsidiaries (the “Written Consent”). The Written Consent purported to terminate Franco’s employment with HMS Inc. for cause pursuant the employment agreement between Franco and HMS Inc., and remove Franco as President, CEO and the Chairman of the Board of each Holdco, HMS Inc. and ten subsidiaries of HMS Inc.

The court first held that terminating Franco under the employment agreement constituted an “Interested Party Decision” under Section 1.10 of the Holdco 3 LLC agreement and that, as a result, the votes of the Independent Manager and the Macquarie Manager were the only votes required to terminate Franco under his employment agreement with HMS Inc. pursuant to the terms of the Holdco 3 LLC agreement. Plaintiffs next sought a declaration that the Independent Manager and the Macquarie Manager could act by written consent to make the decision to terminate Franco. Section 4.3(d) of the Holdco 3 LLC Agreement permitted the Board to take any action that could be taken at a meeting by written consent if the consent was signed by the number of Board members required to approve such action at a meeting held by the Board at which a quorum was present. The court found that the need for a quorum to meet and discuss the proposed action before valid action could be taken at a meeting did not apply to action taken by written consent.

The court interpreted the quorum provision in Section 4.3(d) to mean that if the individuals who signed the consent could have approved the action at a hypothetical meeting of the Board at which a quorum was present, then the consent would be valid, and granted summary judgment for the plaintiffs on this issue.

Plaintiffs also sought a declaration that the Written Consent constituted valid and effective action to terminate Franco’s employment at HMS Inc. and remove him from his positions as President and CEO of that entity. The court held that under the governance structure that the parties crafted, the parties to the Holdco 3 LLC agreement made contractual commitments to implement certain decisions at Holdco 3’s various subsidiaries. The court rejected Franco’s argument that the provisions in the Holdco 3 LLC agreement purporting to let the Board address the rights of other entities were a legal nullity. Franco argued that only the governing body of an entity can make decisions regarding that entity’s rights, so therefore the Board could not address any rights other than the rights of Holdco 3. However, the court noted that the Holdco 3 LLC agreement’s provisions that required that certain decisions made by the Board of Holdco 3’s to be implemented by each of its subsidiaries were not unlike the voting agreements that a corporation makes with its stockholders in a stockholder agreement, and that such contractual agreements are generally enforceable; so too with these Holdco 3 LLC agreement provisions. The court also noted that under Franco’s argument, several provisions of the Holdco 3 LLC agreement, including the definition of an “Interested Party Decision” and the related mechanics for the Board to make Interested Party Decisions would be illusory. Additionally, the court found that the inclusion of the Personal Commitment Provision supported this structure—by binding Franco personally to the Holdco 3
LLC agreement, the parties ensured that Franco would have a contractual obligation to abide by the provisions of the Holdco 3 LLC agreement and to implement decisions made by the Board in accordance with those provisions. However, the court declined to address the question of whether a party to the Holdco 3 LLC agreement would be obligated to comply with a contractual obligation under that agreement notwithstanding competing obligations (like fiduciary duties to a subsidiary). The court noted that because HMS Inc. was a Washington corporation, Franco’s compliance with a contractual obligation under the Holdco 3 LLC agreement could raise issues under Washington law, particularly if Franco were to assert that compliance would cause him to breach his fiduciary duties to HMS Inc.

The court rejected plaintiffs’ argument that the action of the Board had a direct effect on Franco’s status at HMS Inc. and automatically resulted in his termination as President and CEO of that entity. The court held that the contractual commitments contained in the Holdco 3 LLC agreement to implement certain decisions made by the Holdco 3 Board at Holdco 3’s subsidiaries were not self-executing and required formal action at the relevant subsidiaries. The court noted that accepting plaintiffs’ position would contravene the “bedrock principle of corporate separateness.”


Defendant, Nimesh S. Shah (“Shah”), was a member of a management company, Domain Associates, LLC (the “Company”), a venture capital firm. The other members of the Company (together with the Company, plaintiffs in this case) voted to force Shah to withdraw as member of the Company and, upon his withdrawal, paid Shah the value of his capital account. Plaintiffs sued, seeking a declaratory judgment that Article VII of the Company’s Limited Liability Company Agreement (the “LLC Agreement”) specified the payment Shah was entitled to receive, and Shah counterclaimed for breach of contract, arguing that Article VII did not specify the payment he was entitled to receive and that under the Delaware Limited Liability Company Act (the “Act”), he was owed the fair value of his membership interest.

Shah initially joined the venture capital firm as an employee, but in November 2014 he was invited to become a member of the Company. When Shah was admitted as a member in January 2015, he made a capital contribution of $25,000 to become an equity partner and he signed the LLC Agreement, knowing that it was not negotiable. By December 2015, and until Shah’s withdrawal, Shah’s membership interest in the Company was 12.1%. In January 2016, Shah was asked to leave the Company because his expertise was no longer needed. Shah and the other members of the Company tried to negotiate a severance package for months following the members’ decision to ask Shah to leave, but they could not come to an agreement. As a result, in April 2016 all of the members of the Company except Shah voted to require Shah to withdraw from the Company. The members believed that Shah was entitled to a payment equal to his capital account in return for his membership interest at the time of his forced withdrawal and sent Shah a check for that amount. Shah asserted that, instead, he was entitled to 12.1% (the percentage of his membership interest) of the Company’s cash on hand at the time of his withdrawal.

Plaintiffs argued that under Article VII of the LLC Agreement Shah was entitled to receive the value of his capital account. Article VII provided, in part, as follows:
Any Member may retire from the Company upon not less than 90 days’ prior written notice to the other Members. Any Member may be required to withdraw from the Company for or without cause at any time upon written demand signed by all of the other Members except for any one other such Member, so long as such demand shall have been approved at a meeting of Members held for such purpose, to which all Members shall be given written notice in advance . . . If the remaining Members continue the business of the Company, the Company shall pay to any retiring Member, or to the legal representative of the deceased, insane or bankrupt Member, as the case may be, in exchange for his entire interest in the Company, an amount equal to (A) such Member’s capital account, to be determined as of the date of a Member’s death or retirement, or his withdrawal from the Company (such date of death or withdrawal being referred to herein as the “Withdrawal Date”), which capital account, for purposes of such determination, shall be computed on the cash and disbursements basis of accounting, shall take into account, without limitation, the aggregate amount of cash contributed to the capital of the Company by such Member, plus the aggregate amount of such Member’s share, as in effect from time to time, of the net profits of the Company through the last day of the month next preceding the Withdrawal Date, less the aggregate amount of such Member’s share, as in effect from time to time, of the net losses of the Company through the last day of the month next preceding the Withdrawal Date, less the aggregate amount of distributions to such Member through the Withdrawal Date in respect of the net profits or capital of the Company, or both; less (B) the aggregate amount, if any, of indebtedness of such Member to the Company at the Withdrawal Date.

The court held that Article VII was unambiguous and did not set forth the required payment for a member that is forced to withdraw. The court explained that while Article VII included forced withdrawal as a means by which a member’s status as such could be terminated, Article VII was silent about payment following a forced withdrawal and the payment formula in Article VII only applied to a retiring member or the legal representative of a deceased, insane or bankrupt member. The court also stated that even if Article VII was not plain and unambiguous, the court would not look to extrinsic evidence. Instead, because the LLC Agreement was drafted solely by one side and was presented on a “take-it-or-leave-it” basis, the doctrine of contra proferentem would apply and the LLC Agreement would be interpreted against the drafters. Plaintiffs argued that interpreting Article VII to say that a member that was forced to withdraw would receive a greater compensation than a member that withdrew for other reasons would lead to an
irrational result. The court, however, disagreed, explaining that members may have been worried about disputes with other members and wanted protection from being forced out by other members. To protect themselves from being forced out, the court held that it was rational for forced-withdrawal to be excluded from the scenarios that are covered under Article VII’s payout formula.

Because the LLC Agreement was silent on the payment Shah should have received when he was forced to withdraw, the default provisions of the Act controlled. Shah argued that he should be paid the fair value of his membership interest under Section 18-604 of the Act. The court held that Section 18-604 applied only to voluntary withdrawal and not to forced withdrawal. Because Section 18-604 did not apply, the court turned to the default principles of law under Section 18-1104 and held that “the rules of law and equity… shall govern.” The court stated that this was a question of first impression under the Act, but relied on Hillman v. Hillman, 910 A.2d 262, 271-78 (Del. Ch. 2006), a case in which then-Vice Chancellor Strine interpreted Section 15-701 of the Delaware Revised Uniform Partnership Act (the “Partnership Act”), which states that an expelled partner is owed an amount “equal to the fair value of such partner’s economic interest as of the date of dissociation based upon such partner’s right to share in distributions from the partnership.” The court held that the same analysis applied here and that, because the Company was member-managed, the governance structure resembled a partnership and, therefore, the application of the Partnership Act was especially appropriate. The court elaborated by giving the following guidance: (i) when a limited liability company is member-managed, then the parties should expect a court to draw on analogies to partnership law, (ii) when a limited liability company has a single managing member with other generally passive, non-managing members, then the parties should expect a court to draw on analogies to limited partnership law and (iii) when a limited liability company has a manager-managed entity, and it operating agreement created a board of directors and adopted other corporate features, then the parties should expect a court to draw on analogies to corporate law. In this case, the court applied partnership law because the Company was member-managed; therefore, the court found that Shah was owed the fair value of his membership interest. Because Shah was paid the value of his capital account instead of the fair value of his membership interest, the court held that plaintiffs breached the LLC Agreement and Shah was entitled to the difference between the fair value of his membership interest in the Company and the payment he received.

The court held that the individual members were jointly and severally liable for the damages awarded. The court explained that a party to a contract is liable when it breaches such contract and because the individual plaintiffs were members of the Company and parties to the LLC Agreement, they were liable for breaching the LLC Agreement. Plaintiffs argued that the individuals could not be held liable because Section 18-303 of the Act said “no member or manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.” The court, however, held that Section 18-303 was not applicable because (i) Section 18-303 only applies to liability to a third party and Shah was not a third party, (ii) the liability to Shah was not a liability of the Company because the LLC Agreement did not expressly create an obligation on the part of the Company to pay Shah and (iii) the members were not passive actors or so
uninvolved in management of the Company that it would have been unfair to hold them liable.

In conclusion, the court held that, because plaintiffs failed to pay Shah the fair value of his membership interest in the Company after his forced withdrawal, they breached the LLC Agreement, Shah was entitled to damages based on the fair value of his membership interest and the remaining members of the Company were jointly and severally liable for such damages.


Plaintiff Triple H Family Limited Partnership was a holding company formed for investments made indirectly by Jeffrey Hoops (“Hoops”), a businessman in the coal mining industry. Defendant Jerry Neal (“Neal”) was an insurance agent who owned an insurance company he formed. Neal and Hoops, who went to high school together, were reunited at their school’s fortieth reunion. During that night, Hoops and Neal agreed to start Omni Insurance Group, LLC (“Omni”), an insurance agency, whereby Hoops would purchase insurance for his coal mining business and Neal would operate the company and source additional commissions, the profit of which would be split amongst the two. The relationship quickly soured when Neal failed to timely secure insurance coverage for the coal mining business, resulting in a brief lapse of coverage for Hoops. The lapse subjected Hoops and his coal company to an immense amount of liability and Hoops informed Neal that Omni would not be moving forward. The relationship having soured, the parties sued each other for claims of breach of contract, breach of fiduciary duties, fraud and judicial dissolution of Omni.

Omni never had a formal written operating agreement. Thus, the court primarily used email correspondence and trial testimony to glean information regarding the terms of the limited liability company relationship that was intended between the parties. As part of this process, the court noted that it placed heavy weight on the testimony of Hoops, who had proven to be a reliable and honest source of information, over the testimony of Neal, who, in the view of the court, would “say whatever he needs to, regardless of veracity . . . .” The court further stated that because the parties repeatedly relied on extrinsic evidence to support their arguments about the terms of the oral limited liability company agreement, all extrinsic evidence therefore became fair game for the court to review in order to divine the extent of the agreement.

Having established what it considered to be the terms of the Omni operating agreement through analysis of extrinsic evidence and email correspondence, the court turned to the issue of breach of fiduciary duty. In order to determine whether a breach of fiduciary duty occurred, the court first needed to establish whether the parties owed such duties at all. Delaware case law has recognized that a person who is not named as a manager in a limited liability company’s governing documents may nonetheless be deemed a de-facto manager and fiduciary of the company. In *WaveDivision Hldgs., LLC v. Millenium Digital Media Sys., L.L.C.*, 2010 WL 3706624 (Del. Ch. Sept. 17, 2010), a person who had “unfettered access” to information and took actions relating to a limited liability company’s strategy was held to be a de-facto manager and fiduciary of the LLC. Relying on *WaveDivision*, the court held that both Neal and Hoops were de-facto managers and fiduciaries of Omni based upon the managerial roles that each took in developing Omni. Hoops disagreed, arguing that he was not a de-facto manager because
Neal was designated as “President and CEO” of Omni and thus had to be the manager. The court countered this argument, noting that an LLC may have more than one manager and that, in any event, a person other than a named officer can also be a de-facto manager under WaveDivision.

Having determined the scope of Omni’s operating agreement and the duties owed by each party, the court held that Neal breached the operating agreement and violated his duties of loyalty and care by (i) failing to obtain promised insurance coverage and misleading his only customer (Hoops) about a serious lapse of such insurance and (ii) failing to roll his own existing insurance business into Omni as previously agreed. The court further held that judicial dissolution of Omni was unnecessary because Hoops and Neal had already agreed to dissolve the company pursuant to email correspondence that amounted to a written consent to dissolve and instead ordered that Omni commence the winding up process.


Primary defendant Kentucky Retirement System (“KRS”) was the sole limited partner in four Delaware limited partnerships. KRS exercised its right to remove the general partner of each limited partnership “for Cause” and gave notice of such exercise to the general partners (who collectively comprise the plaintiffs in this action). Plaintiffs filed suit in Delaware to obtain declarations that their removal was improper (the “Delaware Litigation”). Shortly thereafter, KRS filed an action in Kentucky seeking a declaration that removal was proper (the “Kentucky Litigation”).

KRS moved to dismiss the Delaware Litigation on the grounds that the forum selection clause in the partnership agreement of each limited partnership required plaintiffs to litigate in Kentucky. The combined governing law and forum selection clause (the “Forum Clause”) stated that “except as otherwise provided by the [DRULPA], this Agreement and the rights and obligations of the parties hereunder shall be governed by and interpreted, construed and enforced in accordance with the laws of the Commonwealth of Kentucky . . . . Each of the Partners hereby consents to the jurisdiction of the courts of the Commonwealth of Kentucky and further consents that venue shall lie in the Franklin Circuit Court located in Franklin County, Kentucky.”

Plaintiffs countered that the Forum Clause was not an exclusive venue provision and that, in the alternative, even if the Forum Clause did require KRS to bring claims exclusively in Kentucky, it would be unenforceable because it violated DRULPA Section 17-109(d), which prohibits limited partners from waiving their right to litigate matters relating to the internal affairs of the limited partnership in Delaware.

The court began its analysis by noting that Delaware courts defer to forum selection clauses and grant motions to dismiss based on improper forum if the application of such a clause is relevant. However, given that each partnership agreement chose Kentucky law as the governing law, the court queried whether Kentucky courts treat forum selection clauses in the same way. Confirming that they did, the court declined to engage in a choice of law analysis given there was no conflict of laws. The court noted that all parties agreed to the application of Kentucky law to this dispute.

Having found no conflict of laws, the court turned to whether the Forum Clause was permissive or mandatory in regard to KRS’s right to bring claims. The court noted that
the Forum Clause stated that “each Partner hereby consents” to the jurisdiction of Kentucky courts. Such language did not expressly state or otherwise imply that Kentucky courts were the exclusive forum for the resolution of questions of internal affairs of the limited partnership. The court therefore denied defendants’ motion to dismiss that was premised upon the enforcement of the Forum Clause.

Although a stay of proceedings was not requested by defendants, the court nonetheless imposed a stay *sua sponte* pending resolution of the Kentucky action. The court noted that, in situations where a Delaware action is filed first or simultaneously with action in another jurisdiction, Delaware courts will consider the same factors considered in a motion to dismiss for *forum non conveniens* to determine whether a stay is appropriate. The court also noted that, although a first-filed Delaware action typically weighs in favor of moving forward with Delaware litigation, in situations where the actions are filed relatively close in time, the factual scenario surrounding the filings should be taken into account. Applied here, the court noted that it may have been the case that the Delaware Litigation was filed in order to “scuttle or confound” the Kentucky Litigation that plaintiffs suspected KRS was preparing to file. Given that the partnership agreements chose to be governed by Kentucky law (and that substantive questions about the proper or improper removal would be questions of Kentucky law interpretation) and that both the Delaware Litigation and Kentucky Litigation were focused on the same issues, the court found the stay appropriate.

The court further rejected plaintiffs’ argument that litigating the dispute outside of Delaware would violate Delaware public policy. The court stated that had the General Assembly intended for Section 17-109(d) to mandate litigation of internal affairs of limited partnerships in Delaware, it could have done so. KRS could have litigated in Delaware but chose not to and that choice was to be respected.

*Phillip M. Issac and James R. Freedman v. IFTHC, LLC et al., C.A. No. 2017-0821-TMR (Del. Ch. June 18, 2018) (V.C. Montgomery-Reeves)*

Plaintiffs filed an action seeking approximately $470,000 from defendants for accrued salaries. Plaintiffs were managers of IF Technologies, Inc. (“IF Technologies”) and its predecessor entities before IF Technologies sold substantially all of its assets in exchange for RemitDATA, Inc. ("RemitData") stock (the “Transaction”). In connection with the Transaction, IF Technologies dissolved and transferred its liabilities and the RemitDATA stock to defendant IFTHC, LLC (“IFTHC”) and the stockholders of IF Technologies became unitholders of IFTHC. The board of directors of IF Technologies (the “IFT Board”), which was composed of the same persons who constituted the board of directors of IFTHC, approved an amendment to IFTHC’s operating agreement (the “Operating Agreement”) which stated that in the event of dissolution, all of the debts, liabilities and obligations of IFTHC must be paid. After the approval of the amendment and after speaking to plaintiffs, IFTHC’s counsel added the following parenthetical to that provision: “(including without limitation, the compensation obligations owed to [plaintiffs] in the aggregate amount of $464,000 and all expenses incurred in liquidation).” The Board then distributed an information statement to the IF Technologies’ stockholders seeking their approval of the Transaction and agreement to be bound by the Operating Agreement (which included the parenthetical). The stockholders approved the Transaction, the Transaction
closed and plaintiffs requested payment for their accrued salaries. IFTHC refused to pay, and plaintiffs sued.

Plaintiffs moved for partial judgment on the pleadings as to their claim for breach of the Operating Agreement. Plaintiffs argued that the parenthetical in the amended Operating Agreement provided that plaintiffs must be paid immediately for their accrued salaries. Defendants argued that the parenthetical was unenforceable because the Board did not approve it and the stockholders did not know the Board did not approve it when they approved the amendment. As a result, defendants contended that there were “serious doubts concerning the validity and enforceability” of the parenthetical. The court explained that it would grant a motion for judgment on the pleadings when “there are no material issues of fact and movant is entitled to judgment as a matter of law.” The court held that because defendant raised a question of fact as to whether the parenthetical was operative, plaintiffs did not establish as a matter of law that there was a contractual obligation for defendants to pay plaintiffs’ accrued salaries. Plaintiffs also argued that even if the parenthetical was not operative, the Operating Agreement provided that the plaintiffs should be paid their accrued salaries. They argued that the requirement for IFTHC to pay all debts, liabilities and obligations of IFTHC included the accrued salaries. Defendants argued, on the other hand, that a 2011 purchase agreement, which stated that accrued salaries were to be paid from future profits with approval by the IFT Board, was not altered by the amendment to the Operating Agreement. Therefore, defendants argued that they did not owe plaintiffs payment for the accrued salaries because IF Technologies was not profitable. The court held that there were factual disputes as to whether plaintiffs’ accrued salaries were debts and liabilities under the Operating Agreement. Because there were factual disputes, the court denied partial judgment on the pleadings.


Obeid was a member and manager of Gemini Real Estate Advisors, LLC (the “Company”) and, following disputes arising with other managers of the Company, sought books and records of the Company relating to distributions to investors, management fees and operating subsidiary accounts (the “Information”) pursuant to the Company’s LLC Agreement and Section 18-305 of the Delaware Limited Liability Company Act (the “LLC Act”).

The court found that Obeid was entitled to the Information in his capacity as a manager of the Company under Sections 18-305(a) and (b) of the LLC Act, which provide managers with the right to examine information regarding the status of the business and financial condition of an LLC for a purpose reasonably related to the position of manager. The court noted that this language was “tantamount” to that used in Section 220 of the Delaware General Corporations Law and that the cases interpreting Section 220 were an analogue to Section 18-305 inspection rights. The court stated that it presumes that sitting directors are entitled to “unfettered access” to company books and records. Obeid was a manager of the Company, so he made a prima facie case for access to the Information. It was then up to defendants to carry the “rather substantial burden” of proving that Obeid was not motivated by a proper purpose, which could be shown by “concrete evidence” that Obeid would use the Information to harm the Company in violation of his fiduciary duties. Defendants pointed to one prior act by Obeid (he filed noticed of pendency against the Company’s properties during the course of active
litigation) and asserted that Obeid was using this books and records action to make an end-run around the discovery process in a separate litigation proceeding in a North Carolina court. The court found that neither of these reasons was sufficient to warrant denying Obeid’s access to the Company’s books and records, particularly since Obeid agreed to a confidentiality order that prohibited him from using the Information in the North Carolina litigation absent Delaware and North Carolina court approval. Thus, defendants were unsuccessful in their claims of improper purpose against Obeid. Defendants further argued that they provided Obeid with the information he needed to discharge his fiduciary duties to the Company. The court found that this was not a valid defense, noting again that directors’ and managers’ access to company information is “essentially unfettered” absent valid contractual restrictions.

The court also found that Obeid was entitled to the Information under Section 8.6.1 of the Company’s LLC Agreement as a member of the Company. Section 8.6.1 of the Company’s LLC Agreement provided that “[a]ll of the records and books of account of the Company . . . shall be open to the inspection and examination of the Members or their representatives during reasonable business hours.” Defendants tried again to argue that Obeid had an improper purpose in seeking the Information as a member. The court noted that the implied covenant of good faith and fair dealing would permit defendants to raise an improper purpose defense absent express language in the LLC Agreement to the contrary. To successfully assert this defense, defendants would have to show that Obeid was seeking the Information for a personal purpose that was also adverse to the interests of the Company. Defendants failed to satisfy this burden.

Specifically with respect to the information requested relating to operating subsidiary accounts, the court noted that the Company used its records database to maintain books and records of its operating subsidiaries. These operating subsidiaries did not have their own employees and relied on the Company to carry out their management functions and maintain responsibility over their funds and assets, and the court found that such “unity of control and management composition is sufficient to subject operating subsidiary information to a proper request by a parent Manager in accordance with Section 18-305(b)” (quoting RED Capital Inv. L.P. v. RED Parent LLC, 2016 WL 612772, at *5 (Del. Ch. Feb. 11, 2016)). Thus, the court held that Obeid was entitled to the Information.


Plaintiff, Richard Kay (“Kay”), and defendant, Stanley Campbell (“Campbell”), sought to form a business venture to market certain medical diagnosis and prescription technology that Campbell had developed. Under the principal terms of the business venture that were outlined in two letter agreements, Campbell would contribute to the venture stock in his wholly-owned subsidiaries and certain intellectual property, and Kay would contribute cash. For nearly a year, the parties negotiated the terms of a contribution agreement (the “Contribution Agreement”) and operating agreement of Eagle Force Holdings LLC (the “Operating Agreement,” and together with the Contribution Agreement, the “Transaction Documents”), each of which contained a forum selection clause pursuant to which the parties consented to personal jurisdiction in the Delaware courts. Kay and Campbell eventually signed the Transaction Documents, but the parties dispute whether
such signed documents represent binding contracts. Following the execution of the Transaction Documents, Kay and Campbell were unable to resolve the remaining open items regarding the Transaction Documents, and Campbell sought to move on from his business venture with Kay. Consequently, Kay caused Eagle Force Holdings LLC to file suit against Campbell for breach of contract and fiduciary duty and sought specific performance of Campbell’s obligations under the Transaction Documents. Campbell argued that the Court of Chancery could not assert personal jurisdiction over him because the only basis to support personal jurisdiction over him was the forum selection clause in each of the Transaction Documents. Campbell argued that the Court of Chancery could not assert personal jurisdiction over him because the only basis to support personal jurisdiction over him was the forum selection clause in each of the Transaction Documents. However, according to Campbell, the signing of those documents did not create binding contracts. A full trial was held to determine whether Campbell was bound by the Transaction Documents and therefore subject to the court’s personal jurisdiction. The court found that the Transaction Documents did not include agreement on material terms such as the intellectual property to be contributed, and contracts to be assigned to Eagle Force Holdings LLC and the equity interests in Eagle Force Holdings LLC to be issued to each party. Therefore, the court agreed with Campbell that the parties did not form binding contracts because essential terms of the Transaction Documents were missing. Consequently, the court held that it could not assert personal jurisdiction over Campbell, and plaintiff’s complaint was dismissed.

On appeal, the Supreme Court reversed and remanded the case back to the Court of Chancery, noting that the Court of Chancery must analyze whether the Transaction Documents were valid, binding contracts under the Osborn test. In Osborn ex rel. Osborn v. Kemp, 991 A.2d 1153 (Del. 2010), the court held that “a valid contract exists when (1) the parties intended that the contract would bind them, (2) the terms of the contract are sufficiently definite, and (3) the parties exchange legal consideration.” With respect to the Contribution Agreement, the Supreme Court provided guidance to the Court of Chancery on the first prong of the Osborn test, noting that a signature on a document generally indicates assent absent fraud, duress, mutual mistake or unconscionability. However, there was also evidence that suggested that the parties may not have intended to be bound by the Contribution Agreement, including blank schedules and “DRAFT” on the top of the Contribution Agreement.

With respect to the second prong of Osborn, whether the contract’s material terms are sufficiently definite, the court stated that this was a question of law. The court adopted the test from the Restatement (Second) of Contracts § 33(2), which states that terms are sufficiently definite if they “provide a basis for determining the existence of a breach and for giving an appropriate remedy.” While the Court of Chancery determined that the parties failed to agree on the precise scope of consideration of the Contribution Agreement, the Supreme Court disagreed, reasoning that the terms of the Contribution Agreement allowed the court to ascertain the consideration, the remedies if the consideration was not provided and the manner to enforce the agreement. Notably, the court stated that the Contribution Agreement recitals articulated the consideration, which was also reiterated in the body of the agreement. Additionally, the court noted that the Contribution Agreement provided that Campbell must contribute all right, title and interest in and to, any and all “Intellectual Property”, which was defined as the “Transferred IP”, and all “Targeted Companies Securities”. As these terms were defined in the Contribution Agreement and the Contribution Agreement specified that all “Intellectual Property” and “Targeted Companies Securities” must be
contributed by Campbell, the court held that the Contribution Agreement consideration was sufficiently definite. Additionally, the court noted that the negotiations between the parties did not create ambiguity as the language regarding the consideration was definitive. In addition, the court found that Kay had recourse if Campbell did not contribute the required assets through actions for breaches of the warranty or indemnification provisions. Thus, the court held that the second prong of Osborn was satisfied. With respect to the third prong of Osborn, the court noted that the parties did not dispute that legal consideration exists and therefore the third prong of Osborn was satisfied.

In regards to the Operating Agreement, similar to the Contribution Agreement analysis, the Supreme Court noted that, as in the Contribution Agreement, the parties signed the Operating Agreement, which provides evidence that the parties did intend to be bound by the Operating Agreement. Additionally, the Operating Agreement provided that each member intended to be bound by the document. On remand, the Supreme Court stated that the Court of Chancery should consider the policy of the Delaware Limited Liability Company Act to give maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements. With respect to the second and third prongs of Osborn, the court held that because the parties did not contest these prongs, the two prongs were satisfied.

In re Energy Transfer Equity L.P. Unitholder Litigation, C.A. No. 12197-VCG (May 17, 2018) (V.C. Glasscock)

This litigation arose out of the private placement issuance of convertible units to some of the unitholders, most of whom were insiders, in Energy Transfer Equity, L.P., a Delaware limited partnership (“ETE”), in return for which the unitholders gave up their rights to certain distributions for a time on their common units (the “Issuance”). Defendants asserted that the Issuance was a necessary device used to prevent a downgrade by credit rating agencies without cutting distributions on ETE’s units. Plaintiffs asserted that the issuance was a hedge designed to protect insiders from possible bad effects of ETE’s planned merger with The Williams Companies, Inc. (“Williams Co.”) and a downturn in the energy sector. In making this assertion, plaintiffs advanced two theories of liability. First, they argued that the Issuance was a “distribution” under ETE’s partnership agreement (the “LPA”), that the LPA required that distributions be made pro rata to unitholders and that the Issuance violated this provision because the securities were not issued pro rata to unitholders. Second, plaintiffs argued that the Issuance violated the provisions of the LPA applicable to conflicted transactions because defendants did not comply with the “safe harbor” provisions of the LPA and the Issuance was not “fair and reasonable” to ETE.

In two prior decisions in this matter in 2017, the court denied the parties’ cross-motions for summary judgment, finding that a more developed factual record was needed to determine whether the “special approval” safe harbor for a conflicted transaction in the LPA had been met and whether the Issuance was a “distribution” under the LPA. Trial on those and related issues commenced in February 2018, during which additional facts were revealed. The relevant facts that emerged in depositions and at trial follow.

ETE was managed by its general partner, LE GP, LLC (the “General Partner”), which was in turn managed by a board of directors (the “Board”), which appointed ETE’s executive officers. Many of the individual defendants were members of the Board or officers of ETE and current or former directors or
officers of other companies in the ETE family. Plaintiffs were an individual and an entity that held ETE common units at all relevant times. In September 2015, ETE entered into an agreement to merge with Williams Co., wherein Williams Co. would receive cash financed by ETE through new debt. Once the merger was consummated, ETE’s consolidated debt would increase by over $30 billion. After the merger was announced, the energy market took a nosedive, the credit market for energy companies experienced significant stress and energy companies’ access to credit was reduced. This was bad for ETE, which distributed all of its available cash every quarter to its unitholders and depended heavily on capital markets access to fund its growth. The credit rating agencies expected ETE’s debt-to-EBITDA ratio (“D/E”) not to exceed 4.0x. ETE’s CFO informed the rating agencies that an equity issuance would be on the table if this occurred. However, if the Williams Co. merger closed, ETE’s D/E would likely reach 4.7x. Thus, ETE was facing a credit rating downgrade that would significantly harm ETE’s competitiveness and commercial reputation and significantly increase its interest expense. ETE explored deleveraging options like issuing equity, renegotiating the Williams Co. merger to require less cash up front, selling assets and cutting distributions. Some of the options (like asset sales) were not feasible given market conditions. ETE also tried and failed to renegotiate the merger with Williams Co., and the merger agreement contained conduct-of-business restrictions that took other deleveraging options off the table. ETE’s management did not want to cut distributions, calling it a “nuclear option”. This left one option—issuing equity.

In February 2016, the Board considered a public offering of securities that guaranteed $0.11 in cash or accrual if common unit distributions were above $0.11, participating unitholders would receive $0.11 in cash and an accrual, redeemable for common units, for the amount exceeding $0.11 (the “Initial Terms”). On February 13, Williams Co.’s CFO informed ETE’s CFO that the public offering required Williams Co.’s consent, which he did not think would be provided, and that he would not permit Williams Co.’s auditors to release the financial statements needed to file the S-3, which was required for the public offering. Email correspondence from that same day shows that ETE’s general counsel and its president were aware of Williams Co.’s CFO’s position. On February 15, Latham & Watkins, ETE’s counsel, sent ETE updated documents for the public offering. Notably, these revised documents increased the quarterly accrual for units from $0.11 to $0.285 (the “Revised Terms”), a “massive hedge” for participating unitholders if ETE cut distributions that ETE’s financial adviser described as “a ‘wealth transfer’ to subscribers in case distribution [sic] were cancelled.” That same day, the Board held a telephonic meeting. The unredacted portion of the minutes did not include any discussion of the Revised Terms. The resolutions included Board approval of the public issuance on “substantially the terms set forth in the term sheet previously provided to the Board,” which were the Revised Terms that the Board was informed of on the date of the meeting. ETE’s CFO testified that he provided the Board with a report on his conversation with Williams Co.’s CFO at the Board meeting. Thus, evidence showed that the Board knew on February 15 that Williams Co. likely would not consent to the public offering. Indeed, on February 18, Williams Co.’s CFO informed ETE’s CFO that the Williams Co. board, acting unanimously, refused to consent to the public offering. ETE’s Board members testified that they were “floored” and “very disappointed” by this; the court
found that testimony not credible given that the Board already knew of Williams Co.’s position.

On February 22, the Board met and agreed to pursue a private offering of securities, which would not require Williams Co.’s consent. The terms of the private offering largely mimicked the Revised Terms for the public offering. The Board approved the private offering on February 28.

At the February 22 Board meeting, the Board established a conflicts committee consisting of three individuals (Williams, Turner and Collins). Williams was an engineer that had never served on a conflicts committee. As was later discovered, Turner and Collins were directors of affiliates of the General Partner and thus, under the terms of the LPA, were ineligible to serve on the conflicts committee. After the meeting, Turner told another Board member, who told ETE’s general counsel, that he (Turner) was ill and could not serve on the conflicts committee. On February 24, ETE’s general counsel told their investment bank that Collins and Williams were on a two-person conflicts committee, despite the fact that the Board never designated a two-person committee. Latham discovered Collins’ and Turner’s ineligibility to serve on the conflicts committee on February 26, the date of the first conflicts committee meeting. It also realized that a separate committee—audit and conflicts (“A&C”)—needed to approve the Issuance. A&C was a standing committee also consisting of Williams, Turner and Collins. Latham and Akin Gump decided to create “revised resolutions” for the February 22 meeting that purportedly would reflect the Board’s decision to appoint Williams as a one-man conflicts committee and for Williams and Collins to serve as the members of the A&C committee. However, the minutes of the February 22 meeting did not match those resolutions and there was no evidence that the Board ever adopted those “revised” resolutions. Further, the Board never met to reconstitute or approve the constitution of the conflicts committee as a one-man committee consisting of Williams.

The conflicts committee purported to meet on February 26, when Williams and an attorney from Akin Gump met telephonically. Phone records and testimony do not match regarding the length of this meeting, which could have lasted anywhere from twenty-seven seconds (per the phone records) to twenty minutes (per the testimony). On the morning of this meeting, Collins, who was ineligible to serve on the conflicts committee, signed an engagement letter with a financial adviser for the conflicts committee; apparently Collins was not informed that he was not a member of the conflicts committee until February 27, though it does not appear that Collins attended the February 26 meeting. On February 27, the conflicts and A&C committees held a joint telephonic meeting, attended by Williams, Collins, the financial adviser and Akin Gump, and met again that afternoon for a presentation on the proposed issuance by the financial adviser. The committees met a final time on February 28. The financial adviser gave one last presentation, notably devoid of any explanation of how the specific terms of the private offering were desirable as compared to any other terms. The record contains no evidence that either committee considered whether the terms were fair to ETE. Williams’ testimony made clear that he did not understand key aspects of the transaction he was approving. Both committees voted to approve the Issuance. Later that same day, the Board met to discuss the Issuance. At this meeting, an Akin Gump attorney told the Board that Williams, Turner and Collins had acted as a “special committee” of the Board. However, there was no evidence that ETE ever formed a “special committee” or that such a committee was involved in the
Issuance. The Board approved the Issuance and documents relating thereto. Notably, while the Board resolutions from the meeting contained “whereas” clauses referencing the Board’s purported prior formation of a one-man conflicts committee, no actual resolutions ratified the decision to use such a committee.

The private placement was offered to individuals—at least 70% of whom were affiliated with ETE or related to an individual with an ETE affiliation—and 3 of the 400 institutional investors that ETE had at the time. One institutional investor decided to participate. The rating agencies reacted positively to the Issuance. ETE announced that it was going to cut distributions. However, ETE terminated the merger agreement with Williams Co. on June 29, 2016 and subsequently did not cut distributions. In fact, ETE increased quarterly distributions twice during the Issuance plan period. The plan period expired on May 18, 2018, at which time the securities would convert into common units in accordance with their terms.

The court first addressed plaintiffs’ argument that the private issuance was a “distribution” under the LPA and, as such, was required to be made pro rata to all unitholders. The court noted that Section 5.8 of the LPA provided the General Partner with the discretion to issue securities on terms the General Partner found appropriate. Further, the court found that the term “distribution” was not ambiguous and the term referred “to something transferred to the unitholders, as, for instance, a payment; rather than something that is offered to the unitholders for sale, which they may accept or reject.” Such a definition comported with the LPA as a whole, especially in light of Section 5.8. Therefore, the court found that the Issuance did not constitute a distribution and thus was not prohibited under the provisions of the LPA that required distributions to be made pro rata.

The court next determined whether the Issuance was “fair and reasonable” to ETE as required under Section 7.6(f) of the LPA for transactions with affiliates, which the Issuance was. The LPA provided that the General Partner could conclusively establish that a transaction was fair and reasonable if it complied with one of the safe harbor provisions in the LPA. One safe harbor was to receive “Special Approval” (i.e., approval of a properly constituted conflicts committee). Unfortunately, as outlined in the summary of the facts above, a conflicts committee was never properly constituted. The conflicts committee that the Board established and approved included two individuals who were not, under the terms of the LPA, eligible to serve. The Board never reconstituted that committee, nor did not ratify the purported establishment of a one-man conflicts committee consisting of Williams. The court noted that the actions of then-counsel for ETE’s committees created “a record which is at best misleading . . . . Suffice it to say that these actions are not helpful to the Defendants, at all.”

The court then turned to a second safe harbor, which provided that an affiliate transaction was deemed fair and reasonable to ETE if the terms of the transaction were no less favorable to ETE than those generally being provided to unrelated third parties. Defendants argued that the private placement was offered to three institutional investors; therefore, it was conclusively fair and reasonable. The court disagreed. However, the court agreed with ETE’s position that one could satisfy the safe harbor by comparing the challenged transaction to similar arms-length transactions. However, that option was not available here, as defendants created a “unique and complex security” offered to selected parties simultaneously. There were
neither “generally” similar transactions with which to compare the terms of the Issuance nor similar securities being offered in the market. Because defendants did not satisfy any safe harbor, the court turned to analyzing whether the Issuance was fair and reasonable to ETE.

The court found that the contractual “fair and reasonable” standard invoked a review similar to that of entire fairness. Thus, the Issuance must evidence a fair process and be undertaken at a fair price. The court found that defendants failed to show that the Issuance was entirely fair to ETE. In so determining, the court found that the Initial Terms would have provided significant benefit to ETE while providing a benefit that likely would induce investors to subscribe, and that the Initial Terms were fair to ETE. However, the Initial Terms were replaced with the Revised Terms, which neither the Board nor the committees discussed in relation to the Initial Terms. The Revised Terms were introduced at a time when the Board knew that Williams Co. likely would not consent to a public offering. Further, defendants were unable to explain how the Revised Terms originated or were placed before the Board or how they determined that the Revised Terms were necessary for the success of the public offering. The court adopted a “reasonable supposition” that ETE’s CFO informed insiders that, based on the likelihood that Williams Co. would not consent to the public offering, a private offering, a private offering would be an alternative and that distribution cuts loomed, and insiders seized the opportunity to hedge against these cuts. The Revised Terms were “not fair in terms of process, and nothing in the Board’s actions indicated that it was fair as to price.” Thus, the securities, to the extent transferred to the General Partner or its affiliates, breached the LPA and defendant Directors caused the General Partner to breach the LPA by issuing those securities.

The court then turned to the remedy for that contractual breach. Plaintiffs sought only equitable relief in the form of cancellation of the securities. The court found that equitable relief was not warranted. The terms of the Issuance that the court found to be unfair—the Revised Terms—would have resulted in harm to ETE and value to the Issuance’s subscribers only if ETE reduced distributions during the plan period of the Issuance. This did not occur; ETE increased distributions during that time. Therefore, the unfair terms caused ETE no damages, and the court found that rescission of the securities would be disproportional to the “loss” (which was nothing).


Primary defendant Keith Goggin (“Goggin”) was sole manager of East Coast Miner LLC (the “Company”), an entity formed for the purpose of purchasing a senior debt note from U.S. Coal (“US Coal”). Pursuant to the note purchase, the Company obtained the right to credit bid the value of the note for the assets of Licking River, a division of US Coal, in the event US Coal entered bankruptcy. Plaintiff MHS Capital LLC held a 23.75% interest in the Company and was told repeatedly by Goggin that it would receive a majority stake in Licking River’s assets in the event the credit bid was exercised.

In May of 2014, US Coal entered bankruptcy. However, instead of having the Company exercise the credit bid, Goggin formed two additional entities and had one of those entities exercise the credit bid. As a result, the proceeds of the Licking River assets were shared between the newly formed entities and the Company, ultimately resulting in a dilution of the interest plaintiff expected to receive. The credit bid was
approved by the United States Bankruptcy Court for the Eastern District of Kentucky.

In the weeks leading up to the credit bid, efforts were made by plaintiff to ascertain information regarding its investment in the Company and the rationale behind the decision to exercise the credit bid. These efforts were either rebuffed or ignored by the Company and Goggin. A consent package was circulated less than twenty-four hours before the required Company vote on the exercise of the credit bid but did not include any financial information relevant to evaluating the bid. The consent package also requested that all members of the Company ratify all prior acts of Goggin, though it did not detail what exactly those actions were.

Plaintiff sued defendants for monetary damages and requested equitable relief based on a variety of theories including breach of contract, breach of fiduciary duty, fraud, breach of the implied covenant, tortious interference with contract and unjust enrichment. Defendants moved for dismissal, claiming among other things that Goggin, as manager of the Company, was exculpated from liability for monetary damages for breach of duties owed under the Company operating agreement.

With respect to defendants’ motion to dismiss the breach of contract claim, the Company’s operating agreement replaced traditional fiduciary duties with a contractual standard providing that: “[Goggin] shall discharge his . . . duties in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner [Goggin] reasonable believes to be in the best interests of the Company.” The operating agreement also exculpated Goggin from liability to the Company or any member for monetary damages for breach of any duty as manager, except otherwise required under the Delaware LLC Act. Given that defendants did not argue that plaintiff failed to state a claim for breach of contract, the court was permitted to assume that the complaint properly stated such claim and thus denied defendants’ motion to dismiss.

However, the court did grant defendants’ motion to dismiss for the breach of fiduciary duty claim based on the fact that the claim was duplicative of the breach of contract claim. The court noted that when a dispute arises based on obligations that are expressly addressed by a contract, a breach of fiduciary duty claim is superfluous. Here, the court held that any conduct that would conceivably give rise to a fiduciary duty claim would be covered by the duties expressly set forth in the operating agreement.

Plaintiff’s implied covenant claim was premised on the fact that Goggin usurped corporate opportunities from the Company when he shared the profits of the credit bid. Defendants argued that the operating agreement expressly required Goggin to act in good faith, which would obviously prevent the usurpation of corporate opportunities. The court agreed and dismissed the implied covenant claim, stating that the contract directly addressed the issue and left no gap to fill.

With respect to plaintiff’s books and records claim, the court dismissed this claim without prejudice on the grounds that such a claim should be litigated in Eames v. Quantlab Grp. GP, LLC, No. CV 2017-0792-JRS (Del. Ch. May 1, 2018) (V.C. Slights)

This case concerned a voting trustee’s, acting on behalf of 96% of the voting limited partnership interests of Quantlab Group, LP (the “Partnership”), purported
action to remove Quantlab Group GP, LLC ("Quantlab GP") as general partner of the Partnership and add Quantlab Group GP II, LLC ("Quantlab GP II") as general partner of the Partnership. Simultaneously with this action, Plaintiff Bruce Eames ("Eames"), in his capacity as a manager of Quantlab GP, consented to Quantlab GP II’s addition as general partner of the Partnership. Under the Partnership’s limited partnership agreement (the “Partnership Agreement”), the general partner could be removed without cause only if there was one other general partner and the new general partner’s admission was consented to by the removed general partner. Under the limited liability company agreement of Quantlab GP (the “Quantlab GP Agreement”), the managers could act unilaterally to transact business on behalf of and for the benefit of Quantlab GP. This was restricted by the requirement that managers of Quantlab GP could not take any action that would make it impossible to carry on the ordinary business of Quantlab GP or change the nature of Quantlab GP’s business, which was to act as the general partner of the Partnership. On the same day as the purported removal and admission, plaintiffs filed this complaint under 6 Del. C. § 17–110 to confirm that Quantlab GP was removed as general partner of the Partnership and Quantlab II GP was admitted as general partner of the Partnership. Plaintiffs argued that Quantlab GP II was the sole general partner of the Partnership.

Defendant Quantlab GP, in its motion for partial summary judgement, argued that these actions were invalid under the terms of the Partnership’s limited partnership agreement (the “Partnership Agreement”) and thus Quantlab GP was still the sole general partner of the Partnership. The court agreed. The court held that the clear and unambiguous terms of the Partnership Agreement did not allow for a simultaneous removal and replacement of the general partner, reasoning that the Partnership Agreement required that a second general partner must be admitted before Quantlab GP could be removed as general partner. Additionally, the court held that Eames did not have authority to unilaterally consent on behalf of Quantlab GP to Quantlab GP II being added as a general partner. Plaintiffs argued that Eames could take action to add Quantlab GP II as general partner because he was acting for the benefit of Quantlab GP and the action did not change the business of Quantlab GP. The court disagreed, reasoning that Eames did not have the unilateral authority to take this action under the Quantlab GP Agreement because he could not take any action that would make it impossible to carry on the ordinary business of Quantlab GP or change the nature of Quantlab GP’s business. The court stated that the sole purpose of Quantlab GP was to act as the general partner of the Partnership; therefore, by adding Quantlab GP II as a general partner of the Partnership, Eames changed the business from acting as the general partner of the Partnership to acting as a general partner of the Partnership. Additionally, the court held that his action was not for the benefit of the Quantlab GP, which was required for unilateral action by a manager. Therefore, the court granted defendant’s motion for partial summary judgement.

Capone v. LDH Management Holdings LLC, C.A. No. 111687-VCG (Del. Ch. Apr. 25, 2018) (V.C. Glasscock)

In this case, the court addressed the requirements of Section 18-804(b) of the Delaware Limited Liability Company Act (the “LLC Act”), which requires an LLC that has been dissolved to, among other things, pay or make reasonable provision to pay claims known to the LLC. Plaintiffs were unitholders in an LLC that held a fifteen percent profits interest in another LLC (referred to herein as “LDH”).
Plaintiffs’ employment was terminated, triggering a call right held by the LLC. The LLC agreement included several relevant provisions that applied to the exercise of the call right. First, the call right was required to be exercised at the “Fair Market Value” as of the last day of the last fiscal year preceding the fiscal year in which the call notice was given. The notice was given and the units were redeemed in early 2011; thus, the relevant “as of” date for determining Fair Market Value was December 31, 2010. Second, “Fair Market Value” was defined as the amount that would be distributed if all of the assets of LDH and its subsidiaries had been sold at their “Gross Asset Value” (adjusted immediately prior to such deemed sale by the LLC’s board in good faith in consultation with LDH’s board), the proceeds had been distributed to the members of LDH (including the LLC) and the amount of the LLC’s distribution had been distributed to its members in accordance with its LLC agreement. Third, the determination of Gross Asset Value was to be made promptly following the relevant date and based on the LLC’s financial statements for the fiscal quarter ending on the relevant date or during which the relevant date occurred, unless otherwise determined by the board.

LDH had two divisions: a midstream asset division and a merchant trading business. LDH retained bankers to explore a sale of its midstream assets in November 2010. In December 2010, LDH sent an information memorandum to potential bidders. Prior to sending out the memorandum, Energy Transfer Partners (“ETP”) expressed to LDH its interest in buying LDH’s midstream assets and asked whether LDH would entertain an exclusive deal with ETP. Plaintiffs testified that they learned in December 2010 that ETP was interested in buying the midstream assets for around $2 billion and that they shared these rumors with members of LDH’s management. In the meantime, management was valuing LDH’s business as a whole for purposes of determine the price to be paid for plaintiffs’ units in connection with the LLC’s exercise of its call right. The valuation was finalized on December 23, 2010 and the board approved it—LDH as a whole was valued at $1.744 billion and its midstream assets were valued at $1.43 billion, all as of December 31, 2010. LDH continued to pursue a sale of its midstream assets. Twenty-three bids were submitted on January 14, 2011. The median bid was $1.8 billion and all but one were higher than the $1.43 billion valuation approved by the board. About a week later, one of the plaintiffs told LDH’s CEO and certain members of management that he thought it was legal error not to take account of the bids in valuing the midstream assets for purposes of the call right valuation. On February 4, 2011, the other plaintiff wrote a letter to LDH’s CEO questioning the call right valuation and noting that if the midstream assets were significantly undervalued in that valuation, it would be “devastating” to the repurchase of his units and “something I would need to review and perhaps formally question.” On March 22, 2011, LDH sold its midstream assets for $1.925 billion. On April 12, 2011, defendants redeemed plaintiffs’ units in the LLC using the $1.744 billion valuation of LDH (including the $1.43 billion valuation of its midstream assets). The two plaintiffs continued to reach out to management to question the valuation and seek information as to how the call right valuation was determined. On December 31, 2012, LDH was acquired by third-party investors. The same day, the LLC and its managing member (another LLC) were cancelled, purportedly as part of the restructuring necessary to consummate the LDH acquisition. Defendants did not notify plaintiffs of the cancellations and did not reserve any funds in connection with plaintiffs’ claims.
On May 21, 2015, plaintiffs sued the LLC, its managing member and some members of management in New York for breach of contract, alleging, among other things, that defendants failed to determine in good faith the fair market value of LDH and plaintiffs’ units in the LLC. Plaintiffs also commenced a Delaware action asserting various claims and seeking an order nullifying the certificates of cancellation of the LLC and its managing member so that plaintiffs could pursue their breach of contract claims in New York. The parties cross-moved for summary judgment on the nullification issue, and the New York court stayed the breach of contract claim before it pending a ruling from the Delaware Court of Chancery on the nullification claim. Plaintiffs argued that the defendants violated Section 18-804(b) of the LLC Act by cancelling the LLC and its managing member without setting aside any reserve to cover plaintiffs’ breach of contract claims. Plaintiffs contended that, at the time of the cancellations, defendants knew of those claims or were aware of facts that made those claims likely to arise. Defendants argued that the dissolutions were accomplished in accordance with the LLC Act, but they did not argue that, should the court find their actions violated the LLC Act, nullification would be improper.

The court first provided an overview of the relevant provisions of the LLC Act and common law. It noted that Sections 18-804(b)(1) and (b)(3) require an LLC to “pay or make reasonable provision to pay all claims and obligations, including all contingent, conditional or unmatured contractual claims, known to the limited liability company” and “make such provision as will be reasonably likely to be sufficient to provide compensation for claims that . . . are likely to arise or to become known to the limited liability company within 10 years after the date of dissolution.” Further, the court stated that Delaware case law permits a court to nullify the certificate of cancellation of an LLC that is not wound up in accordance with the LLC Act. The court emphasized that a dissolved LLC must provide for all claims (even contingent or unmatured) irrespective of the likelihood that such claims will vest, and that the term “claims” includes contract, tort or statutory claims whether or not reduced to a judgment. The court also noted that the LLC Act provides flexibility for those making provision for such claims by prescribing a reasonableness standard. Whether the provision made was reasonable depends on several factors, including the potential amount of a claim and the likelihood of a claim actually becoming a liability for which the company must answer. The court explained that the minimal likelihood of a given claim actually arising or vesting could justify making no or minimal provision for the payment of such a claim. However, the court noted that standard must also be applied in the context of the purpose of Section 18-804 of the LLC Act, which is to provide “mandatory protection to creditors” of an LLC when the LLC dissolves and winds up.

The court reviewed plaintiffs’ claims and the evidence relating to those claims. Plaintiffs alleged that defendants breached the LLC’s operating agreement by redeeming plaintiffs’ units based on a bad-faith estimate of LDH’s value as of December 31, 2010. Plaintiffs put forward evidence that the valuation was done on December 23, 2010, prior to the valuation date of December 31, 2010, when the LLC’s operating agreement required the valuation to be performed “promptly following” the valuation date. Further, plaintiffs argued that between December 23, 2010 valuation of LDH and the April 2011 redemption of their units, “highly probative evidence” (in the form of the multiple bids for the midstream assets) emerged that showed that the midstream assets were worth almost
$500 million more than the call right valuation suggested. Further, the record contained no evidence that the midstream assets increased in value during that timeframe. Finally, evidence existed showing that plaintiffs made their concerns about the valuation known to LDH management prior to the dissolution of the LLC.

The court then applied the LLC Act and common law to plaintiffs’ claims and related evidence. The court found that plaintiffs’ breach of contract claims were “known to the limited liability company” for purposes of Section 18-804(b)(1) of the LLC Act when the LLC and its managing member were dissolved, pointing to the communications between plaintiffs and high-ranking officers of LDH and other management in which plaintiffs accused defendants of acting “in bad faith under the contract” and “with malice” in breaching the LLC’s operating agreement and asserted that it was legal error not to consider the midstream asset bids when undertaking the valuation for the call right. The court also found that defendants did not “make reasonable provision to pay” for those known claims as required under Section 18-804(b)(1) of the LLC Act because they did not set aside any funds for those claims. Such a zero-dollar reserve was not reasonable because the court found that plaintiffs’ claims were not meritless, despite defendants’ arguments to the contrary.

Because defendants violated the requirement of Section 18-804(b)(1) of the LLC Act to create a reasonable reserve to address known claims, the court granted plaintiffs the relief they sought and nullified the LLC’s and its managing member’s certificates of cancellation, enabling plaintiffs to pursue their breach of contract claims in the New York action.


In this case, defendant, Invenergy Wind LLC (“Invenergy”) exercised a right under Invenergy’s limited liability company agreement (the “LLC Agreement”) to call the membership interests of Leaf Invenergy Company (“Leaf”). Under the LLC Agreement, Invenergy could not engage in an asset sale of a specified magnitude (the “Material Partial Sale”) unless Invenergy either obtained Leaf’s consent or paid Leaf an amount sufficient for Leaf to achieve an agreed upon rate of return (the “Target Multiple”). The court referred to the requirement that Invenergy obtain Leaf’s consent as the “Series B Consent Right.” The court had previously granted Leaf’s motion for judgment on the pleadings on the question of whether Invenergy had breached the LLC Agreement by engaging in a Material Partial Sale without obtaining Leaf’s consent or paying Leaf its Target Multiple.

The court’s decision in this case concerned the proper damages award to Leaf as a result of Invenergy’s breach of the Series B Consent Right. Leaf sought to recover its Target Multiple as a remedy for Invenergy’s breach of the Series B Consent Right despite the fact that the LLC Agreement did not include a liquidated damages provision or specify a remedy for breach of the Series B Consent Right. Leaf had argued that the parties’ subjective beliefs were that Invenergy would be required to pay the Target Multiple in the event of a breach of the Series B Consent Right. Although the court found that both Leaf and Invenergy did subjectively believe that Invenergy would be required to pay the Target Multiple if it engaged in a Material Partial Sale without obtaining Leaf’s consent, the court held that these subjective beliefs were not controlling unless they were
implemented in a remedial provision in an agreement, such as a liquidated damages clause.

The court noted that Leaf must show that it suffered actual harm from the breach of the Series B Consent Right in order to recover damages. The court set forth two ways that Leaf could prove actual damages. Leaf could prove that the Material Partial Sale itself harmed their interests, or, in the alternative, Leaf could prove that if Invenergy had respected the Series B Consent Right, then Leaf could have bargained for consideration in exchange for granting its consent. In order to prove that the Material Partial Sale itself harmed Leaf’s interests, Leaf would need to show that it was worse off than it would have been had the Material Partial Sale not taken place. The court held that Leaf failed to show that it suffered actual harm as a result of the breach of the Series B Consent Right, and in fact actually benefitted from the transaction and awarded Leaf one dollar in nominal damages.

As to whether Leaf could have bargained for consideration in exchange for granting its consent, Leaf conceded that any steps taken to withhold their consent would not have been to protect Leaf from an economic downside or threatened harm, but rather to act as “leverage to ask for something in return.” The court observed that under its prior decision in *Fletcher International, Ltd. v. Ion Geophysical Corporation*, 2013 WL 6327997, at *18 (Del. Ch. Dec. 4, 2013), a consent right does not give the holder the “opportunity to coerce value” from a counterparty “in circumstances where [the holder of the consent right] believed that the transaction it was being asked to consent to was highly beneficial.” However, the court noted that Leaf could still demonstrate actual damages under *Fletcher* by showing that it could have negotiated for consideration for waiving its consent if given the opportunity. The court held that Leaf would not have been able to extract any payment in return for its consent and therefore did not suffer any actual damages as a result of Invenergy’s breach of the Series B Consent Right. Specifically, the court noted that Invenergy had various alternative options to the transaction that triggered the Series B Consent Right, was not facing any financial pressure and therefore would have had significant leverage in any negotiations with Leaf. Additionally, Leaf would have had no real ability to block the deal since Invenergy needed to obtain other investor consents in order for the transaction to close and testimony had shown that Leaf had no intention of delaying or jeopardizing the transaction.

Invenergy also sought a declaratory judgment that Leaf had breached certain put-call provisions of the LLC Agreement that required the parties to “negotiate in good faith” to determine the price at which Invenergy would purchase Leaf’s interests by making an aggressive opening demand for the exercise price. Invenergy pointed to Leaf’s opening bid of $214 million as evidence of bad faith since this figure was between three and five times as high as the figure offered by certain independent appraisal firms. However, the court found that this figure was supportable and not outside the realm of reason, and held that Leaf’s aggressive opening bid alone was not enough to establish bad faith.

Additionally, the court dismissed Invenergy’s alternative claim that Leaf breached the implied covenant of good faith and fair dealing by not conducting the appraisal “in good faith.” The court first noted that Invenergy did not engage in a methodical analysis of the implied covenant and did not expressly identify the gap it sought to fill, or the terms with which it sought to fill the alleged gap. Invenergy
claimed that Leaf breached an implied term to conduct the appraisal in good faith by instructing an independent appraisal firm to determine “Fair Market Value” as the “highest” price that anyone would pay for the company. However, the contractual definition of “Fair Market Value” in the LLC Agreement when Leaf originally invested specifically contemplated that “Fair Market Value” would be determined as the highest price that Invenergy could obtain for the company. The definition of “Fair Market Value” in the LLC Agreement subsequently dropped the “highest price” component. However, the court found that given the history of this provision, it was not unreasonable for Leaf to instruct the independent appraisal firm to determine “Fair Market Value” as the highest price that could be obtained by Invenergy.


Plaintiff brought an action against, among others, his brother, Johny, and three Delaware LLCs formed by Johny, alleging that defendants engaged in a fraudulent scheme and conspiracy to deprive plaintiff of his inheritance from his parents’ estate. The court granted defendants’ motion to dismiss based on a number of factors, including, in relevant part, due to lack of personal jurisdiction over Johny.

Plaintiff’s father built El Rosado Group (the “Group”), one of the largest commercial groups in Ecuador, and structured the Group as a web of companies owned directly and indirectly by himself, his wife, and his three children that were parties to this action. Plaintiff’s father died intestate in Ecuador in 2003 and his mother died in intestate in 2013. Plaintiff brought this action in Delaware because he alleged that Johny wrongfully transferred Group stock that should have been part of the inheritance to British Virgin Island entities and then redomesticated the British Virgin Island entities into the defendant Delaware LLCs.

The court held that it lacked personal jurisdiction over Johny. Plaintiff argued that the court had personal jurisdiction over Johny under 10 Del C. § 3104, Delaware’s long-arm statute, because Johny “formed his Delaware LLCs in Delaware in furtherance of a fraudulent scheme and the formation of Johny’s Delaware LLCs is an integral part of the actions giving rise to Danny’s claims.” The court explained that under 10 Del C. § 3104(c)(1), Johny would have to have transacted business in Delaware and that act of transacting business needed to be an integral component of the transaction to which the cause of action relates. Even though Johny formed the defendant LLCs in Delaware, plaintiff would need to prove that the formation was integral to the alleged fraudulent scheme. The court explained, however, that the formation of the Delaware LLCs was not an integral part of the scheme because the scheme was completed when the Group stock was transferred to British Virgin Island entities, before the Delaware entities were created. In addition, the LLCs had no offices or employees and did not conduct business in Delaware and therefore had not transacted business in Delaware after their formation.

The court also lacked personal jurisdiction over Johny under Delaware LLC Act Section 18-109, the implied consent statute for non-resident managers of Delaware LLCs. In order to exercise personal jurisdiction under Section 18-109, “the Court must find that: (1) the claims at issue focus on the manager’s ‘rights, duties, and obligations’; (2) the resolution of the matter is ‘inextricably bound up in Delaware law’; and (3) Delaware has a strong interest in providing a forum for the resolution of the type of dispute at issue”. The court held that in this action, none of those factors were
met. First, as stated above, the alleged fraud was committed outside of Delaware and was not based on Johny’s rights, duties or obligations as manager of the Delaware LLCs. Second, the alleged fraud commenced in Ecuador, was completed in the British Virgin Islands and the wrongful removal claims are matters of Israeli or Ecuadorian law, and therefore, was not inextricably linked to Delaware law. Finally, under principles of comity Delaware was not the proper forum when a foreign court already made a substantive ruling relating to the controversy and it is a dispute over foreign assets governed by foreign law.


In an earlier proceeding, plaintiffs Greg MacDonald and Dennis Smythe had been granted summary judgment (the “Entitlement Decision”) entitling them to indemnification from defendants Quizmark LLC and QCE Gift Card LLC arising from losses incurred defending claims filed in Colorado (the “Colorado Action”). The Entitlement Decision did not quantify the indemnification award, instead instructing plaintiffs and defendants to attempt to negotiate an agreement on the amount. The parties could not reach an agreement and an application was filed for a determination under Court of Chancery Rule 88. Consumer Capital Partners LLC (“Consumer Capital”), the entity that had paid all of plaintiffs’ legal expenses to date, was a movant in the application and asserted its right of subrogation against defendants.

The court agreed with defendants’ initial argument that plaintiffs could not recover any amounts in their own right because they themselves did not pay for any expenses out of pocket. Plaintiffs therefore lacked standing to assert any indemnification claim. To recover the legal fees, Consumer Capital, as the payor, would have to seek subrogation. A claim for subrogation requires a showing that (i) defendant is primarily obligated for the loss, (ii) that the subrogee is secondarily responsible for the loss and (iii) that by paying the loss, the subrogee satisfied defendant’s liability for the loss.

Defendants’ first argument related to prong (ii) above, that Consumer Capital was not secondarily responsible for the loss. Defendants pointed to the fact that one of the ancillary indemnity agreements entered into between Consumer Capital and Dennis Smythe (the “Smythe Agreement”) did not contain explicit language otherwise found in a sister agreement entered into between Consumer Capital and Greg MacDonald (the “MacDonald Agreement”). The MacDonald Agreement stated that the rights provided therein were “supplemental and secondary” to the rights the indemnitee had against the primary indemnitor. Defendants argued that the inclusion of the language in the MacDonald Agreement and the exclusion of the language in the Smythe Agreement had to be given meaning. This meaning, defendants asserted, was that the Smythe Agreement did not make Consumer Capital’s indemnification obligation secondary. The court disagreed, stating that despite the lack of the explicit “secondary language,” the Smythe Agreement nonetheless evidenced clear intent to establish a secondary subrogation relationship rather than a primary indemnification relationship. As the court stated, “the language in MacDonald’s agreement [was] thus a better version, but the language in Smythe’s agreement [did] the trick.”

Defendants next argued that Consumer Capital acted as a volunteer when it paid plaintiffs’ legal expenses before entering into the above-referenced agreements, making it ineligible for subrogation. Although the court hesitated to apply the
volunteer exception, it noted that to the extent the exception did apply, Consumer Capital did not act as a volunteer because Consumer Capital had an existing relationship with the indemnitees and made payment to preserve and further that relationship.

Defendants further claimed that expenses incurred by plaintiffs in connection with a bankruptcy proceeding were unrelated and not subject to indemnification. The court disagreed, noting that plaintiffs were forced to intervene in the bankruptcy action in order to protect their rights in the proceedings to which indemnification directly applied.

Defendants next argued that a fee-sharing arrangement entered into between plaintiffs and the other eight defendants in the Colorado Action (whereby plaintiffs would be responsible for 20% of the legal fees) applied in such a way that defendants’ indemnification obligation was similarly limited to 20% of the total amount of that litigation. The court agreed, noting that an allocation agreement cannot be “recut . . . so as to impose a greater burden on the third party than they would have borne themselves.”

Consumer Capital also sought to recover certain fees-on-fees in its capacity as subrogee of plaintiffs. The court noted that under Delaware law, successful enforcement of indemnification rights entitles plaintiffs to fees-on-fees and Consumer Capital’s status as subrogee was sufficient to entitle it to similar recovery. Consumer Capital sought roughly 39% of the total expenses incurred by plaintiffs when pursuing the claims as fees-on-fees. Fees-on-fees awards must be reasonably proportionate to the level of success achieved. Applying this standard, the court first halved the total expenses of plaintiffs based on the fact that one group of claims failed and the other group of claims succeeded. That halved amount was further reduced by the court to reflect the fact that roughly 20% of the total amount of expenses sought by plaintiffs in the current action was actually awarded. The court then multiplied 20% (representing the amount awarded) by 50% (representing the total expenses minus the failed claims) to reach 10%, which the court held was the proper percentage of fees-on-fees to be awarded from the total expenses and represented a reasonable amount given the degree of success achieved by plaintiffs.

Finally, the court granted pre-judgment interest only from the date at which plaintiffs asserted their rights under the relevant operating agreements. Plaintiffs claimed that such interest should accrue from the time they initially made demand for reimbursement. Defendants posited, and the court agreed, that pre-judgment interest should not be awarded from the date of a demand for reimbursement when such demand does not specify the source of promise to pay underlying the demand.

REJV5 AWH Orlando, LLC v. AWH Orlando Member, LLC, No. CV 2017-0708-JRS (Del. Ch. Feb. 28, 2018) (V.C. Slights)

Plaintiff REJV5 AWH Orlando, LLC’s predecessor-in-interest and defendant AWH Orlando Member, LLC entered into an LLC Agreement (the “LLC Agreement”) for the purpose of pursuing a hotel redevelopment project (the “Project”). Plaintiff and defendant’s dispute centered on plaintiff’s ability to unconditionally remove defendant as manager of the Project if the Project was not completed by a deadline described in the LLC Agreement. Defendant argued that plaintiff could not remove defendant as manager when it was plaintiff’s conduct that caused the failure to complete the Project on time. In an oral ruling on February 1, 2018 (the “Ruling”), the court held that plaintiff was entitled to remove defendant as
manager based on the express terms of the LLC Agreement. In response, defendant filed an application for certification of an interlocutory appeal or, alternatively, for entry of partial final judgment.

Delaware Supreme Court Rule 42(b)(i) provides that “[n]o interlocutory appeal will be certified by the trial court or accepted by [the Delaware Supreme] Court unless the order of the trial court decides a substantial issue of material importance that merits appellate review before a final judgment.” Defendant presented seven different appeal issues to the court in its application. First, defendant argued that the court improperly applied the “prevention doctrine.” The court denied the application on this issue, holding that it only applied the prevention doctrine to the facts at hand in the Ruling and did not extend or restrict the doctrine as would be required to grant the application. Plaintiff’s second argument was that the court erroneously held that defendant was required to plead a culpable mental state for purposes of pleading bad faith in the implied covenant defense context. The court denied the application on this issue because defendant mischaracterized the Ruling. The court held that the Ruling correctly acknowledged the pleading standard for the implied covenant in Delaware, which requires that facts that support a reasonable inference that a party failed to act in a manner reasonably believed to be in the best interests of the LLC. The third, fourth, fifth and sixth appeal issues were related to the court’s interpretation of the LLC Agreement. The court denied plaintiff’s application on these issues, stating that issues of contract interpretation are not worthy of interlocutory appeal. The seventh appeal issue was in regards to the court’s refusal to find that plaintiff waived arguments that were not properly argued by plaintiff in the briefs. The court held that as this was matter within the court’s discretion, it was not an issue for interlocutory appeal. Thus, the court denied defendant’s application for certification of an interlocutory appeal. The court also denied defendant’s motion for entry of partial final judgment because there were outstanding claims and issues that needed to be resolved before entering final judgement.

* * *

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Miscellaneous Recent (Non-Delaware) Partnership and LLC Cases

2018 LLC Institute
LLCs, Partnerships and Unincorporated Entities Committee
Business Law Section
American Bar Association

October 11, 2018

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Veil Piercing

Sky Cable, LLC v. DIRECTV, Inc., 886 F.3d 375 (4th Cir. 2018).

After a judgment against an LLC and its sole member went unsatisfied, the district court entered an amended judgment that reverse pierced the veil of three other LLCs owned by the individual and made them co-judgment debtors with the individual. On issues of first impression, the court of appeals affirmed the district court’s decision and held that Delaware law permits the remedy of reverse veil piercing when the LLC is the alter ego of its member.

In 2000, Randy Coley, through his subsequently-defunct East Coast Cablevision, LLC (“ECC”), contracted with DIRECTV, Incorporated (“DIRECTV”) to provide its programming to 168 rooms at a Virginia resort. In 2011, an investigation by DIRECTV revealed a fraudulent scheme pursuant to which ECC and Coley received payment for cable services provided by DIRECTV to over 2,500 units at the resort while continuing to pay DIRECTV only for those services provided to the 168 units. DIRECTV eventually obtained a judgment for $2.4 million against Coley and ECC for violations of federal communications law based on the unauthorized receipt and distribution of DIRECTV’s programming.

Coley dissolved ECC after the district court entered its judgment, and DIRECTV was unable to collect any payment from Coley, who had few personal assets. Discovery in the post-judgment phase of the case revealed that several LLCs owned and managed by Coley held title to or managed Coley’s assets. DIRECTV filed a motion in the district court to reverse pierce three LLCs owned and managed by Coley in order to obtain access to the assets of these LLCs. These three companies were not parties to the case and had not been served with process. In 2016, the district court entered an amended judgment rendering the three LLCs co-judgment debtors with Coley and held that: (1) under Delaware law, the three LLCs were alter egos of Coley; (2) Delaware would recognize reverse veil piercing under such circumstances; and (3) DIRECTV’s failure to serve process on the three LLCs did not prevent the court from exercising jurisdiction over them. Coley and one of the three LLCs appealed, arguing that Delaware law does not permit reverse piercing of a corporate veil even when the corporation is the alter ego of the judgment debtor, and that Delaware’s LLC charging order statute provides the exclusive remedy for a judgment creditor seeking access to the financial interest of an LLC’s member.

The court of appeals reviewed de novo whether Delaware law would permit reverse piercing of an LLC. The court first discussed corporate and LLC veil piercing in general and distinguished the various types of veil piercing. The court explained that traditional veil piercing permits a court to hold an owner liable for a judgment against the entity, whereas reverse veil piercing imposes liability on the entity for a judgment against an owner. The court further explained that an additional classification of reverse piercing concerns the origin of a request to the court to disregard the entity’s form: “insider” reverse piercing applies when the entity’s controlling owner makes such a request, whereas “outsider” reverse piercing (relevant here) applies when an outsider/third party (often a creditor) makes the request.

Because the law of the state in which an entity is “incorporated” generally governs the question of whether a court may pierce an entity’s veil, and the parties did not dispute that Delaware law applied to the reverse piercing claim, the court relied on Delaware case law to analyze whether Delaware permits reverse veil piercing. The court discussed Delaware’s recognition of traditional veil piercing as an equitable remedy in exceptional circumstances and noted that the purpose of reverse piercing is to hold a company liable for a member’s actions to prevent fraud or injustice. The court stated that reverse piercing is particularly appropriate when an LLC has a single member because there are no other members whose interests are affected. According to the court, “because Delaware courts apply the alter ego theory only in exceptional circumstances, recognition of reverse veil piercing for the limited purpose of preventing fraudulent conduct would not threaten the general viability of the corporate form in Delaware.” The court noted Delaware’s “powerful interest. . .in preventing entities that it charters from being used as
vehicles for fraud,” and the court discerned that Delaware courts have “signaled some willingness to apply a theory of reverse veil piercing.” Thus, the court concluded that “Delaware would recognize outsider reverse veil piercing of an LLC’s veil when the LLC is the alter ego of its sole member.”

The court next analyzed Coley’s contention that Delaware’s LLC charging order statute precluded reverse piercing of his LLC based on the following “exclusivity” provision of the statute:

The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or a member’s assignee may satisfy a judgment out of the judgment debtor’s limited liability company interest and attachment, garnishment, foreclosure or other legal or equitable remedies are not available to the judgment creditor, whether the limited liability company has 1 member or more than 1 member.

6 Del. Code § 18-703(d).

Although Delaware courts have not interpreted this provision, the court found it to be clear that piercing the veil of an alter ego was not the type of remedy the statute was intended to prohibit. The court applied the statutory construction rule of “ ejusdem generis” and concluded that the general reference to “other legal or equitable remedies” applied only to types of remedies that are similar to those specifically listed, i.e., “attachment, garnishment, [and] foreclosure.” Reverse veil piercing of an LLC when the LLC is the alter ego of its sole member permits the court to treat the LLC as “identical” to its member and effectively eliminates the legal status of the LLC in narrow circumstances involving fraud or injustice. Therefore, the court considered reverse piercing to be unlike the common-law seizure remedies listed in the exclusivity provision of the charging statute. Additionally, the court determined that Coley’s interpretation of the charging order statute would impermissibly limit Delaware’s ability to prevent the entities that it charters from being used as vehicles for fraud.

The court then analyzed Coley’s contention that the district court erred in reverse piercing the veil of Coley’s LLC because the district court failed to make a finding of fraudulent purpose. The appellate court stated that in order to prevail under an alter ego theory, a plaintiff is not required to show “actual fraud but must show a mingling of the operations of the entity and its owner plus an ‘overall element of injustice or unfairness.’” The court stated that an inference may be drawn that entities are one and the same if they fail to follow corporate formalities when doing business with one another. In a footnote, the court noted that “LLCs must observe fewer internal formalities than corporations, but the principle that they should follow ordinary formalities and norms when doing business with other entities is the same.” The court described evidence of commingling of funds, lack of proper accounting records, unexplained transfers of funds, and payments by one LLC of another LLC’s or Coley’s expenses or obligations. The court also concluded that an “overall element of injustice or unfairness” was present because DIRECTV had not yet received any payment on its judgment obtained more than four years ago. Based on this evidence, the appellate court concluded that the district court’s finding of alter ego was not clearly erroneous.

Next the court rejected Coley’s contention that the district court erred in holding that Coley’s participation in the post-judgment proceedings permitted the district court to exercise jurisdiction over his LLC despite the fact that the LLC was not served with process. The appellate court reasoned that when reverse veil piercing a single-member LLC, the individual is already before the district court, and there is no concern that the alter-ego LLC must receive independent notice of a legal action. Thus, the court held that an LLC that is the alter ego of its sole member is properly before the court when the court has jurisdiction over the member.

Finally, the court rejected Coley’s argument that the district court erred in applying the doctrine of equitable estoppel in the post-judgment proceedings with respect to the contention that Mrs. Coley was also a member of his LLC. During the pre-judgment proceedings, Mrs. Coley represented that she was not an owner of any of Coley’s business entities and was not a member of the LLC. Coley also testified that he was the sole member of the LLC and produced an operating agreement that indicated he was the sole member. DIRECTV relied on these representations in dismissing Mrs. Coley. After the judgment was entered, the Coleys sought to establish that Mrs. Coley was a member (in order to oppose reverse
piercing the LLC on the basis that it would prejudice Mrs. Coley as an innocent owner), and the court concluded that "[t]he Coleys’ shifting positions reflected an attempt to assert whatever position would advance their quest to avoid liability and place their personal assets beyond the reach of DIRECTV." Thus, the court held that the district court did not abuse its discretion in estopping the assertion of Mrs. Coley’s interest in the LLC in the post-judgment proceedings.

**Personal Liability of Member or Manager for Member's or Manager's Own Acts Under Other Law**


The State of Texas sued an individual member/manager of an LLC for violations of the Texas Water Code based on the individual’s role in the LLC’s failure to satisfy the compliance plan accompanying the LLC’s hazardous waste permit. The court of appeals relied on the liability protection provided to members and managers of LLCs under the Texas LLC statute and concluded that the State had not shown that the alleged failures to satisfy the compliance plan constituted the type of "tortious or fraudulent" acts for which corporate officers can be held personally liable when they participate in or perform such acts as agents of a corporation. The supreme court acknowledged the liability protection provided to members and managers of LLCs under the Texas LLC statute but stated that the individual was personally liable based on the language of the Texas Water Code and the individual's own actions, which subjected the individual to liability regardless of whether the individual was acting as an agent of the LLC.

Bernard Morello formed White Lion, L.L.C. ("White Lion") to purchase property out of a bankruptcy estate. When White Lion purchased the property, a hazardous-waste permit and compliance plan associated with the property were transferred to White Lion. A few years later, the State of Texas sued White Lion alleging that White Lion did not meet the requirements of the compliance plan. The State subsequently amended its petition and sued Morello individually as well as White Lion. After the trial court granted the State’s motion for summary judgment against White Lion and severed the claims against Morello, the State moved for summary judgment against Morello. The State alleged that Morello was the sole decision maker for White Lion and was personally and substantially involved in operating, managing, and making decisions concerning White Lion’s facility. The State also asserted that Morello personally removed and disposed of water-treatment systems and equipment. Morello’s actions, the State asserted, violated Water Code § 7.101, which provides that it is a violation of the Water Code for a person to cause, suffer, allow, or permit a violation of a statute within the commission’s jurisdiction or a rule adopted or an order or permit issued under such a statute. The trial court granted the State’s motion for summary judgment and ordered Morello to pay $367,250 in civil penalties.

Morello appealed the trial court’s judgment, arguing that he could not be held individually liable because the State was not attempting to pierce the veil of the LLC and did not allege the type of conduct for which an agent of an LLC may be held individually liable when acting on behalf of the company. The court of appeals recognized that the formation of an LLC is intended to shield members from the company’s liabilities and obligations, but also acknowledged the common-law principle that a corporate officer may be held individually liable when the officer knowingly participates in tortious or fraudulent acts” even though the officer performed the acts as an agent of the corporation. The court of appeals concluded that the State had not shown that the alleged failures to comply with the compliance plan constituted “tortious or fraudulent conduct of Morello individually or that those failures to comply should somehow be treated as if they were... The State appealed.

The Texas Supreme Court explained that Morello’s claim that he could not be held personally liable was premised on the liability protection provided members and managers of LLCs under the Texas Business Organizations Code, but the State relied on application of the Texas Water Code directly to Morello because of his own actions, not because of the LLC’s liability. The court examined the plain language of Section 7.01 of the Water Code, which provides that “[a] person may not cause, suffer, allow, or permit a violation of a statute within the commission’s jurisdiction or a rule adopted or an order or permit issued under such a statute.” Section 7.02 provides that [a] person who causes, suffers, allows, or permits a violation of a statute, rule, order, or permit relating to any other matter within the commission’s
jurisdiction to enforce ... shall be assessed” a civil penalty. Morello argued that he was not a “person” within the meaning of Section 7.02, but the court determined that the plain meaning of “person,” which is not defined in Chapter 7 of the Water Code, includes an individual in the absence of a definition excluding an individual.

Morello argued that he never assumed or was transferred any obligations under the permit, but the court said nothing in the language of the Water Code limits the number of persons to whom its penalties apply. The plain language of the statute permitted assessment of a penalty against Morello if he was “a” person who caused or allowed violation of the permit; he did not have to be “the” person holding the permit. Thus, the State could assess a penalty against him regardless of whether White Lion or others were also subject to penalties arising from violations and regardless of who had obligations under the permit.

The Austin Court of Appeals had agreed with Morello that he could not be individually liable because his acts as an agent of White Lion were not the type of tortious or fraudulent acts for which agents can be held personally liable when acting in their agency capacity. The court of appeals distinguished or disagreed with other cases in which employees or officers had been held personally liable for statutory violations based on acts taken in their representative capacity. According to the court of appeals, statutory violations must be in the nature of “fraudulent” or “tortious” conduct in order to hold an individual liable for actions taken in a representative capacity. The Texas Supreme Court rejected this distinction and stated that the analysis in the other cases focused on whether the individual could be liable under the language of the statute and whether the individual personally engaged in the conduct constituting the violation. For example, the supreme court pointed to a case in which it held that a corporate agent acting in the scope of his employment could be held personally liable for violations of the Texas Deceptive Trade Practices Act (DTPA). Based on the plain language of the DTPA—which permits a claim against any person—the court held that a sales agent of a homebuilder was personally liable for DTPA violations based on misrepresentations made by the agent. The court also pointed to two cases in which a Texas appellate court interpreted the Water Code as providing for liability of individual agents for their own actions, and the court stated that “federal and state courts have consistently rejected the position that where an environmental statute applies to a ‘person,’ corporate officers can avoid individual liability for violating the statute if they personally participated in the wrongful conduct.” Although the federal and state cases cited by the court did not involve the provision of the Water Code at issue in this case, the court said that the cases were consistent with the court’s view that an individual is not protected by the corporate shield when an environmental regulation applies to a “person” and the individual personally participates in conduct that violates a statute. In sum, Morello was not held liable for an obligation or liability of White Lion (which he asserted is prohibited by the Texas Business Organizations Code) but was held liable based on his individual, personal actions.

The supreme court also rejected Morello’s argument that the severance of the claims against him from the claims against White Lion resulted in two judgments based on identical theories of liability and facts and violated his constitutional rights to equal protection and due course of law by imposing excessive fines leading to a double recovery for the State. The court stated that the trial court’s severance of the cases was not improper since they were two causes of action that could have been brought separately. Further, although the cases were factually intertwined, the State’s case against Morello involved evidence of his personal actions (such as Morello’s removal and disposal of certain systems and equipment) that was not presented in the case against White Lion. Thus, the trial court did not abuse its discretion in severing the claims against White Lion from the claims against Morello. The court also explained that the severance of the claims did not result in a double recovery for the State because the civil penalties do not reimburse the State for loss or damage but are instead penalties against Morello and White Lion. The civil penalties “are not recoveries designed to make the State whole for damages it suffered and undertook to prove, much less are they two separate recoveries for the same damages the State suffered. Thus, the civil penalties assessed against Morello are constitutional.”
Capital Contributions


The court of appeals held that the trial court erred in entering a judgment that a member of three LLCs was entitled to one-third of the profits of each of the LLCs because the Texas Business Organizations Code provides that profits and losses are allocated to the members based on the agreed value of the members’ contributions as stated in the company’s records, and none of the LLCs had a record of the member’s alleged contribution. Although the member testified that he contributed cash to the LLCs, and the jury found that the member was entitled to a one-third profit distribution from each LLC, the court of appeals stated that allowing the member’s oral testimony to establish his entitlement to one-third of the profits of the LLCs in the absence of any written records of his contributions would be contrary to the plain language of the LLC statute.

Nizar Sunesara and Anis Virani started selling smoking accessories and devices in flea markets on the weekends in 2002, and the next year they established a brick-and-mortar retail shop called “Zig Zag Smoke Shop.” Sunesara created MNA Corporation to operate Zig Zag, and Virani and Sunesara offered Manisch Sohani (a supplier of Zig Zag) an ownership interest in the business. The three men each owned one third of MNA Corporation, and profits of Zig Zag were distributed in cash each month. Sunesara and Virani both took positions with Sohani’s company, and Sunesara transitioned out of the day-to-day business of Zig Zag while Virani continued to manage Zig Zag’s day-to-day operations as well as working for Sohani’s company. Zig Zag did well, and in 2012, Virani and Sunesara started a second retail location, which they called “Burn Smoke Shop” (“Burn I”). Sunesara testified that he contributed $10,000 cash to the start up of Burn I. He stated that he gave the money to Virani and did not request any receipt or documentation of his contribution. SSV Corporation, which was incorporated by Sunesara in 2007, owned the assets of both Zig Zag and Burn I. Sunesara and Virani each owned 50% of SSV Corporation, but records showed that Sohani shared equally with Sunesara and Virani in profit distributions, and Sunesara testified that Sohani was considered a partner even though he was not a formal owner.

Toward the end of 2012, Sunesara, Virani, and Sohani agreed to buy an existing retail smoke shop, whose name they changed to “Burn Smoke Shop Two” (“Burn II”). Sunesara testified that he contributed $10,000 cash to the start up of Burn II, again giving the money to Virani without obtaining any receipt or documentation of his contribution. Before the purchase of Burn II was finalized, Sohani and Virani asked Sunesara to file paperwork with the Texas Secretary of State to form three LLCs to run the three smoke shops. Each certificate of formation, which was signed by Sunesara but not the other two men, listed Sohani, Virani, and Sunesara as governing persons. Signature cards and depository resolutions for the bank accounts for the three LLCs listed all three men as members and were signed by all three men. Virani and Sohani claimed that Sunesara handled the paperwork for forming the LLCs and opening the bank accounts, and Virani and Sohani claimed that they should have been listed as the only two members of the LLCs. The franchise tax public information report for 2013 listed all three men as members of the LLCs, but the franchise tax report for 2014 as well as federal income tax returns for 2013 and 2014 only listed Virani and Sohani as members or owners of the LLCs.

Sohani and Virani testified that Sunesara did not contribute anything to the three shops. They also testified that they never received any profit distributions from the LLCs because the profits went to Sohani’s company to pay back inventory Sohani contributed and to pay other vendors and creditors of the LLCs.

After federal law enforcement officers began targeting sellers of synthetic marijuana and raiding retailers, wholesalers, and distributors in the smoke shop industry, Sunesara became concerned because Sohani’s company and the three retail shops sold synthetic marijuana. Sunesara wanted Sohani’s company and the shops to stop selling the product. Sohani’s company was raided in 2013, and Sunesara took a leave of absence from the company and did not return. After the raid, Sohani and Virani realized that they lacked important documentation for the LLCs, such as operating agreements, and (after conducting internet research) the two men drafted and signed form operating agreements listing them as
members and stating that they each made 50% of contributions and owned 50% of profits and assets. Sunesara’s name did not appear in any of the three agreements, and he was not involved in the drafting of the agreements. Sunesara testified that he received monthly profit distributions for the first five months of 2013 and inquired regularly “what the situation was with profit distributions” after the raid but was given excuses why there were no distributions until October of 2013, when the parties ceased communicating. The parties disagreed over whether Sunesara had a share of the business, and Sohani and Virani were unable to open new bank accounts or obtain loans for the LLCs without Sunesara’s authorization and signature. In 2015, Virani and Sohani sued Sunesara asserting various causes of action, including a claim for a declaratory judgment that Sunesara was not a member of the LLCs. Sunesara counterclaimed for a declaration that he was a member of the LLCs, was entitled to one-third of the profits of the LLCs, and was entitled to examine the LLCs’ books and records.

The jury answered “yes” to three questions inquiring whether Sunesara was a member entitled to a one-third profit distribution of each of the LLCs at the time they were formed. No definitions or instructions accompanied these questions. The jury also found that Sohani and Virani were estopped to deny Sunesara was a member of the LLCs and that Sunesara did not commit fraud against Virani and Sohani. After the verdict, Virani and Sohani moved to dismiss the action for lack of subject-matter jurisdiction based on documentation that they argued demonstrated the combined total of one-third profit distributions from the three LLCs exceeded $200,000, the upper limit of the county court’s jurisdictional limits. Sohani and Virani also argued that Sunesara presented only his self-serving testimony that he was a member and had made contributions to the LLCs but presented no evidence of an oral or written operating agreement entitling him to membership and one-third of the profits of the LLCs. Virani and Sohani relied on Tex. Bus. Orgs. Code § 101.201, which provides that profits and losses of an LLC shall be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company’s records. The trial court entered judgment in favor of Sunesara declaring that he was a member of the LLCs and entitled to one-third of the profits from the LLCs.

The court of appeals analyzed the contention of Sohani and Virani that the trial court’s judgment, which declared that Sunesara was a member of each of the LLCs and was entitled to one-third of the profits from each of the LLCs, conflicted with Section 101.201 of the Business Organizations Code, which states that an LLC’s allocation of profits and losses are to be made on the basis of the agreed value of the contributions made by each member, as stated in the company’s records. Sohani and Virani argued that there was no written record reflecting Sunesara’s contributions to the LLCs or demonstrating that he was entitled to one-third of the profits. The court reviewed the definitions of a “member,” “membership interest,” “governing documents,” “company agreement,” and “contribution,” and pointed out that the Business Organizations Code does not require a person to make a contribution in order to be admitted as a member or acquire a membership interest. The court also pointed out that the statutory provisions addressing allocation of profits and losses and the sharing of distributions provide that such matters are based on the agreed value of each member’s contributions as stated in the company’s records required to be kept under the statute. Tex. Bus. Orgs. Code §§ 101.201, 101.203. Section 3.151 of the Business Organizations Code contains general recordkeeping requirements for filing entities, and Section 101.501 has specific requirements for LLCs that include maintaining a record of “the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member.” Tex. Bus. Orgs. Code § 101.501(a)(7).

The court’s analysis of Sohani’s and Virani’s contention focused on the “plain meaning” of Sections 101.201 and 101.501 of the Business Organizations Code. At trial, Sunesara testified that he made contributions to the LLCs in the form of $10,000 cash contributions and deferred profits to the startup of Burn I and the acquisition of Burn II. Sunesara did not, however, offer any documentary evidence reflecting those contributions. The record contained no writing setting out the specific contributions made by any of the three members or stating that Sunesara was entitled to one-third of the profits from the LLCs. The company agreements for each of the LLCs were admitted into evidence, but they listed only Sohani and Virani as members and stated, under each of their names, “Made 50% of contributions, Owns 50% of profits and assets.” The court construed Section 101.501 of the Business Organizations Code to require an LLC to include a statement of the amount of cash contributions made by each member and a statement of the agreed value of any other contribution made by each member in
the written records of the company and construed Section 101.201 to provide that these records establish the allocation of a member’s share of the profits and losses of the company. Because Sunesara did not introduce any records of the LLCs reflecting the contributions that he made to the LLCs, the court concluded that he presented no evidence that he is entitled to one-third of the profits of the LLCs under Section 101.201.

Sunesara argued that his testimony that he made contributions to the LLCs sufficed to demonstrate his entitlement to one-third of the profits of the LLCs, but the court stated that the plain language of Section 101.201 requires profits and losses to be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company’s records required under Section 101.501, and the plain language of Section 101.501 requires an LLC to maintain a written record of the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member.

Sunesara pointed to the 2008 tax return of MNA Corporation (which stated that Sunesara, Virani, and Sohani were each allocated one-third of the profits for that corporation) and the records of SSV Corporation (which stated that Sunesara and Virani each owned fifty percent of that corporation) and argued that, when the LLCs were created and took over operation of the smoke shops, these records became a part of the records for the LLCs and satisfied the writing requirement of Section 101.201. But the court stated that the corporations and LLCs were all separate and distinct entities, and Sunesara cited no law supporting the proposition that the records from the earlier-formed entities became records of the new LLCs when they began operating the smoke shops. The court stated that the documentary evidence reflecting that Sunesara had a one-third ownership interest in MNA Corporation and a one-half interest in SSV Corporation established only that he was entitled to distributions from MNA Corporation and SSV Corporation, not that he made contributions to the LLCs or that he was entitled to one-third of the profits from the LLCs. Thus, the court held that the trial court erred to the extent that it ruled that Sunesara was entitled to one-third of the profits from each of the LLCs. “Because Sunesara was not assigned a share of profits in the company agreements and presented no evidence that he was entitled to a one-third share of profits in the LLCs, he was not entitled to a share in profits as a matter of law.”

Admission of Member


Two men orally agreed to form an LLC in which one of them would take an active role as the manager and the other would not take part in the day-to-day business. The men also agreed to recruit an employee from a competing business with a view towards later admitting her as a member. The individual who agreed to manage the LLC recruited the employee and formed the LLC. After a written operating agreement was prepared with terms satisfactory to the parties, the inactive individual refused to sign the written operating agreement. Initially, the refusal was based on his desire to keep his role in the business a secret, but later the refusal was based on financial difficulties of the LLC. The individual who formed the LLC operated it for a period of time and eventually agreed to sell all the LLC’s assets to another company after the LLC’s financial difficulties continued. The purchasing company acquired the LLC’s assets in exchange for assumption of the LLC’s debts, which greatly exceeded the LLC’s assets. The inactive individual and the employee of the LLC filed suit alleging that they were members of the LLC since its inception and that they were improperly expelled. The trial court concluded that the plaintiffs never became members of the LLC, interpreting the oral agreement between the two men to require that the plaintiffs sign the written operating agreement to become members. The Idaho Supreme Court affirmed.

Johnson and Crossett agreed to form an LLC to operate a business similar to a business Johnson’s brother-in-law (“Brother-In-Law”) had started. Under the oral agreement reached by Johnson and Crossett (the “Oral Agreement”), Crossett would be the sole agent and manager, receive a fixed salary, and own a 46% interest. Johnson would not be involved in day-to-day operations or receive compensation but would own a 44% interest. The two men also agreed that Crossett would contact Cousins, an employee of Brother-In-Law’s company, to recruit her to work for their company. Cousins
was hired in May 2013 and was to receive a 10% interest in the company at some point, but she was not a party to the Oral Agreement.

Crossett filed a certificate of organization to form the company as a single-member LLC in June 2013. By the end of July 2013, a written operating agreement ("Written Agreement") was prepared and approved by Crossett and Johnson, but the agreement was never signed. The LLC opened for business in July 2013 and was sued by Brother-In-Law’s company. Johnson refused to sign the Written Agreement because he did not want Brother-In-Law or other members of his family to know he was associated with the LLC. The LLC’s business grew quickly and ran into cash flow problems, bad publicity from Brother-In-Law’s lawsuit, and large legal fees from defending the lawsuit. Cousins resigned in October 2014 and was paid all the money she was owed.

Late in 2014, Crossett insisted that Johnson sign the Written Agreement and join him in personally guaranteeing some of the legal fees owed the LLC’s attorneys. Johnson refused and stated that these problems must be solved by Crossett. Johnson said he would not sign until the problems were resolved. Johnson and Crossett did not come to terms, and Crossett continued to operate the LLC as a single-member LLC. Johnson was eventually repaid what he invested in the LLC, but the LLC continued to have financial difficulties. Crossett outsourced the LLC’s business to a new LLC he formed with another individual, and eventually Crossett agreed to sell the LLC’s assets to the new company in exchange for the new company’s assumption of the LLC’s debts, which far exceeded the value of the LLC’s assets.

After a two-day bench trial, the trial court found that the Oral Agreement served as an operating agreement for the LLC in that it was an agreement to operate the LLC until the Written Agreement was ready to be signed. Specifically, the district court found that the Oral Agreement provided that Johnson and Cousins would only become members once they signed the Written Agreement. The trial court also concluded that Crossett did not breach any fiduciary duties (because the plaintiffs were not members and were paid what they were owed) and was not liable for money he withdrew from the LLC (because the withdrawals did not exceed what he was owed for his managerial duties).

On appeal, the plaintiffs first contended that Crossett’s admission to a particular allegation in the complaint precluded the trial court from finding that Crossett formed a single-member LLC. The court characterized the plaintiffs’ reliance on the admission as “flimsy” and rejected the contention that the admission demonstrated that the trial court’s finding was clearly erroneous. The court acknowledged that Crossett could have been more specific in clarifying his response to one part of the allegation (in which he was referred to as “a” member rather than “the” member), but the lack of specificity did not render the trial court’s finding clearly erroneous.

The court next rejected the plaintiffs’ contention that the trial court erred in interpreting or applying the Idaho Uniform Limited Liability Company Act (the "LLC Act") by allowing the unsigned Written Agreement to undercut the parties’ Oral Agreement. The plaintiffs argued that the trial court ignored the provision of the LLC Act that provided an operating agreement may be oral. The court stated that the plaintiffs took certain statements by the trial court out of context and that the trial court did not hold that an oral operating agreement may be undermined by the mere drafting of a written agreement. The court said the trial court “made clear that it was not the mere drafting of the Written Agreement, in the abstract, that undermined the Oral Agreement; rather, per the Oral Agreement, once the Written Agreement was ready to be signed, Appellants could only become members by signing.”

Finally, the court held that the trial court did not err by awarding attorney’s fees to Crossett under an Idaho statute that allows a prevailing party to recover attorney’s fees when the gravamen of the lawsuit is a commercial transaction. The court cited a case in which members of an LLC brought individual and derivative claims against the founder of the LLC, and the court affirmed an award of attorney’s fees on the individual claims pursuant to the statute regarding a commercial transaction and an award of attorney’s fees on the derivative claims pursuant to the LLC Act. The court distinguished cases in the partnership and corporate context where attorney’s fees were not recoverable because the gravamen of the actions related to enforcement of statutory provisions. Although the LLC Act was related to this action, the court
said the gravamen of the action was a dispute over a claimed breach of contract, i.e., the Oral Agreement, which was a commercial transaction.


The court held that the rights of the estate of a deceased member of a Delaware LLC were limited by the LLC agreement to the rights of an assignee notwithstanding Section 18-705 of the Delaware Limited Liability Company Act, which provides that a deceased member’s personal representative may exercise all of the rights of the member for the purpose of settling the member’s estate or administering the member’s property.

Alex Calderwood formed an LLC with Ecoplace LLC (“Ecoplace”), an LLC controlled by Stefanos Economu. Calderwood died unexpectedly. At the time of his death, Calderwood held a majority stake in the LLC, which Ecoplace offered to purchase. The estate refused the offer and sued the LLC, Ecoplace, and Economu asserting numerous causes of action. The motion court dismissed several of the estate’s claims, and the estate appealed.

First, the appellate court addressed the motion court’s dismissal of the estate’s claim for a declaration that the estate was a member of the LLC with all of Calderwood’s rights. The defendants relied on the LLC agreement, but the estate argued that the Delaware LLC statute conferred the estate with all of Calderwood’s rights notwithstanding the LLC agreement.

Section 9.7(b) of the LLC agreement provided:

Upon the death or disability of a Member ... (the Withdrawing Member), the Withdrawing Member shall cease to be a Member of the Company and the other Members and the Board shall ... have the right to treat such successor(s)-in-interest as assignee(s) of the Interest of the Withdrawing Member, with only such rights of an assignee of a limited liability company interest under the Act as are consistent with the other terms and provisions of this Agreement and with no other rights under this Agreement. Without limiting the generality of the foregoing, the successor(s)-in-interest of the Withdrawing Member shall only have the rights to Distributions provided in Sections 4 and 10.3, unless otherwise waived by the other Members in their sole discretion.

Section 18-705 of the Delaware LLC Act states:

If a member who is an individual dies ... the member’s personal representative may exercise all of the member’s rights for the purpose of settling the member’s estate or administering the member's property, including any power under a limited liability company agreement of an assignee to become a member.

The estate argued that the statutory provision permitted the estate to exercise all of Calderwood’s rights notwithstanding the limitations in the LLC agreement, but the court responded by recognizing that the parties to an LLC agreement have substantial latitude to shape their own affairs and that the primary function of the statute is to fill gaps in the LLC agreement. The estate argued that Section 18-705 controlled over the LLC agreement because Section 18-705 does not contain the proviso “unless otherwise provided in the limited liability company agreement,” but the court rejected that argument on the basis of Delaware case law finding that another provision of the LLC statute lacking such a proviso was nonetheless permissive and subject to modification. The court also found it notable that Section 18-705 contains the phrase “may exercise,” which Delaware case law has stated indicates a “voluntary, not mandatory or exclusive, set of options.” The court also rejected the estate’s argument that the policy of protecting vulnerable heirs supported the conclusion that Section 18-705 is mandatory under Delaware law. The court quoted Delaware case law stressing the primacy of contract in the LLC context and concluded: “Whether section 18-705 is mandatory or permissive, we, nonetheless, find that in this case it does not override section 9.7(b) of the LLC Agreement.”

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The court next rejected the estate’s contention that the LLC agreement did not unambiguously abrogate Section 18-705 of the Delaware LLC Act. First, the court noted that any conflict between the LLC agreement and the statute should be resolved in favor of the LLC agreement. Second, the court concluded that the LLC agreement was not susceptible to different interpretations, but clearly stated the consequences of the death of a member.

The estate also argued that a determination that the estate was not a member of the LLC would lead to an absurd result because the majority owner would have no participation or control rights while the minority owner would have full control. The court did not view such a result as absurd, pointing to Delaware case law recognizing the distinction between tolerating a new passive co-investor that one did not choose and enduring a new co-manager without consent.


An individual’s tax returns showing income from an LLC and filings made by the LLC with the Ohio Division of Liquor Control naming the individual as “owner,” “manager,” and “partner” of the LLC were not “records of the limited liability company” for purposes of determining that the individual was a member. When determining whether a person is a member of an LLC, a court must consider records that are maintained by the LLC for the purpose of its corporate governance and that name owners entitled to receive distributions and share in profits and losses of the LLC.

A judgment creditor obtained charging orders against the judgment debtor’s alleged interests in three LLCs. Although the operating agreements of the LLCs did not list the judgment debtor as a member, the tax returns of the judgment debtor showed income from the three LLCs, and documents filed by the LLCs with the Ohio Department of Commerce–Division of Liquor Control listed the judgment debtor alternately as “owner,” “manager,” and “partner.” On appeal, the judgment debtor argued that the operating agreements established that he was not a member and that the trial court erred in granting the charging orders.

The Ohio LLC statute permits a judgment creditor of a member to apply for an order charging the membership interest of the member, and the statute defines a “member” as “a person whose name appears on the records of the limited liability company as the owner of a membership interest in that company.” Ohio Rev. Code § 1705.01(G). A “membership interest” is “a member’s share of the profits and losses of a limited liability company and the right to receive distributions from that company.” Ohio Rev. Code § 1705.01(H). The judgment debtor argued that the operating agreements conclusively established that he was not a member of the LLCs, but the judgment creditor argued that the records from the Division of Liquor Control were “records of the limited liability company” because the statute does not define the phrase or limit such records to the operating agreement. The judgment creditor argued that “records of the limited liability company” should include any document that “records or documents past events” of the LLC—in essence, any document generated by the LLC in the normal course of business.

The court rejected the judgment creditor’s proposed definition of “records of the limited liability company” as unworkably broad and found it instructive to look at the statutory provision listing the records required to be kept by an LLC at its principal office. The court said that all of the listed records are required to be maintained for purposes of the LLC’s corporate governance. According to the court, limiting “records of the limited liability company” to documents involving corporate governance that establish a membership interest in an LLC is consistent with the statutory record keeping requirement, provides the most reliable information regarding the LLC’s structure and operation, and guides the trial court as to what records to examine to determine whose name appears as an owner “entitled to receive distributions and share in the profits and losses.” Thus, to determine who is a member of an LLC for purposes of issuance of a charging order, a court must consider records that are maintained by the LLC for the purpose of its corporate governance and that name those owners entitled to receive distributions and share in the profits and losses of the company.
Based on the definition of "records of the limited liability company" adopted by the court, the judgment creditor failed to produce evidence that the judgment debtor was a member of any of the three LLCs at issue. The filings with the Division of Liquor Control were documents relating to the LLC's business operation, not its corporate governance, and the judgment debtor's tax returns were not documents of any of the three LLCs. The only "records" of the three LLCs before the trial court were the operating agreements, which showed that the judgment debtor was not a member of any of the three LLCs. The trial court thus erred when it granted the motion for the charging orders.

**Fiduciary Duties**


An Illinois LLC sued a former officer for breach of fiduciary duties in connection with the acquisition and subsequent transfer of certain leasehold interests in a commercial development. The appellate court held that a non-member vice president did not owe any fiduciary duties to the manager-managed LLC. The court rejected the LLC's argument that the officer owed fiduciary duties, either by virtue of his title as vice president or by allegedly exercising managerial control over the LLC. In the alternative, the court went on to conclude that there was no evidence to demonstrate a breach even if the officer did owe fiduciary duties to the LLC.

The operating agreement of a two-member, manager-managed LLC contained a provision stating that its purpose was to obtain a leasehold interest in the commercial space and parking garage (the "Assets") of a complex consisting of five components: commercial space, a parking garage, an apartment complex, a surface parking lot, and a marina. The operating agreement named Nicholas Gouletas ("Gouletas") as the LLC's managing member and permitted him, as manager, to appoint officers to assist in the LLC's operations.

Gouletas and the other member of the LLC jointly issued a certificate of managing member authority (the "Certificate") on behalf of the LLC. The Certificate appointed John Cadden ("Cadden") as the LLC's vice president and authorized the LLC to acquire the leasehold interest in the Assets. The lease initially included rights to the marina, but it had been amended to remove the marina, and the Certificate ordered and directed Cadden to approve the amendment and proceed with the lease on behalf of the LLC. At closing, the LLC received a leasehold interest in only the Assets, which were encumbered by first and second mortgages. A few years later, the LLC was in default on both mortgages.

WRT-Marc RC, LLC ("WRT") sought to acquire the Assets by purchasing the first mortgage and then initiating a foreclosure. At this time, a separate Gouletas-owned entity known as River City Commercial ("RCC"), was the fee simple owner and lessor of the Assets. In order to obtain a fee simple interest in the Assets, WRT sought consent of the LLC and RCC to a foreclosure. Cadden was still vice president of the LLC and had also become vice president of RCC. During negotiations with WRT, an agreement arose that neither the LLC nor RCC would contest the foreclosure of the Assets, provided that WRT granted an option to acquire the parking garage from WRT at WRT's cost. WRT prepared a document evidencing the option agreement ("Option #1"), but it went unsigned and undated by either the LLC or WRT. Eventually, WRT and Cadden (in his capacity as RCC's vice president) executed a written and signed option agreement ("Option #2") granting RCC the option to acquire the parking garage. WRT obtained a foreclosure judgment and purchased the Assets at a foreclosure sale. Subsequent to the foreclosure, the holder of the second mortgage took control of the LLC's voting rights, removed Gouletas as the LLC's manager, and ended Cadden's role as the LLC's vice president. The LLC filed a complaint against Cadden, alleging breach of fiduciary duties he owed to the LLC as its vice president. The LLC contended that Cadden owed it fiduciary duties for two reasons: by virtue of Cadden's title as vice president and because Cadden exercised managerial control over the LLC. The trial court entered summary judgment in favor of Cadden on the basis that he owed no fiduciary duties to the LLC or alternatively that the evidence did not establish a breach of any fiduciary duty.

The first issue addressed by the court of appeals was whether the trial court erred in concluding that Cadden did not owe the LLC any fiduciary duties. The LLC contended that Cadden owed it fiduciary
duties for two reasons: by virtue of Cadden’s title as vice president and because Cadden exercised managerial control over the LLC. With respect to the first reason, the LLC argued that neither the Illinois LLC Act nor any relevant agreement was intended to supplant the common-law doctrine that an officer of a corporation owes fiduciary duties to the corporation. The court’s analysis of this first argument focused primarily on relevant provisions of the Illinois LLC Act, the operating agreement, and the Certificate. Because the Illinois LLC Act directly addresses who does and does not owe fiduciary duties in the context of a manager-managed limited liability company, the court concluded that the common-law considerations and analogies to corporations cited by the LLC were not relevant. The court reviewed the statutory provisions addressing fiduciary duties owed to a manager-managed limited liability company and pointed out that the statute provides that such duties reside in the manager alone and not in a non-manager member solely by reason of being a member. 805 ILCS 180/15-1(c), 180/15-3(g)(1). Furthermore, the court pointed out that Section 15–5 of the Illinois LLC Act allows a limited liability company to enter into an operating agreement to regulate the affairs and business of the company and the relations among the members, managers, and company. 805 ILCS 180/15-5(a). In this case, the LLC’s operating agreement, which was adopted in accordance with the Illinois LLC Act, specified that Gouletas was the sole manager and empowered him to appoint officers. Section 5.9 of the LLC’s operating agreement detailed the responsibilities of these officers and provided:

The Managing Member shall elect officers (“Officers”) to carry out the policies and objectives of the Managing Member. Subject to the policies and objectives prescribed by the Managing Member, the Officers shall establish operating procedures for, and administer and direct, the day to day operations of the Company. The powers of the Officers may be broadened or limited from time to time in the discretion of the Managing Member and each Officer shall, at a minimum, be empowered to carry out (and shall carry out) any activity expressly authorized in a written resolution of the Managing Member. … Each Officer shall serve until removed by the Managing Member. The Managing Member may remove any Officer at any time for any reason. … No Officer shall receive any compensation for such Officer’s services to the Company.

Although the operating agreement stated that Cadden, as an officer, was charged with the “day to day operations” of the LLC, the court stated that Cadden had “no free rein” in any respect to control the LLC and was authorized to do only what the manager ordered. The Certificate appointed Cadden as vice president “in accordance with the provisions of Section 5.9 of the Operating Agreement” and ordered him to take specific action with respect to the leasehold interest. Because all power and duties resided in the manager, the court characterized the title of vice president in this context as irrelevant. Based on the Illinois LLC Act, the LLC’s operating agreement, and the Certificate, the court concluded that Cadden owed no fiduciary duties to the LLC.

Next, the court addressed the LLC’s argument that Cadden owed it fiduciary duties because he exercised managerial control over the company. The appellate court’s analysis continued despite noting that the LLC was procedurally prohibited from making this argument on appeal because it was not pled in the company’s complaint. In support of this second argument, the LLC relied on Section 15–3(g)(3) of the Illinois LLC Act, which states that, in a manager-managed limited liability company, fiduciary duties may be imposed on a person other than a manager, but only if that person “is a member who exercises some or all of the authority of a manager . . . .” 805 ILCS 180/15-3(g)(3). According to the LLC, Cadden “[r]an most of [Gouletas’s] companies” and therefore exercised sufficient managerial control to impose fiduciary duties under subsection (g)(3). The court acknowledged that Section 15–3(g)(3) is an exception to the general rule that only a manager owes fiduciary duties to a manager-managed limited liability company. Subsection (g)(3) contains a two-prong requirement in order to impose fiduciary duties on a person other than a manager of a manager-managed LLC: (1) the person is a member, and (2) that member exercises the same control and authority as the manager. 805 ILCS 180/15-3(g)(3). Because the record made clear that Cadden was not a member of the LLC, the court concluded that subsection (g)(3) was inapplicable. Still, assuming “for whatever unfathomable notion” that Cadden was a member, the court set forth additional support for its conclusion that Cadden did not exercise the requisite managerial control and authority under the statute: (1) Cadden was an officer without control of any facet of the LLC; (2) pursuant to the Illinois LLC Act, the LLC’s operating agreement, and the Certificate, Cadden had no power to act
without the direction of the manager; and (3) the LLC was not dependent on Cadden to run the company because this duty fell solely to the manager, who governed the business, as well as the contents and duration of Cadden’s employment as officer. The court thus concluded that Cadden did not exercise managerial control over the LLC sufficient to impose fiduciary duties on him.

The second issue that the court of appeals addressed was whether the trial court erred in concluding that Cadden, assuming he did owe fiduciary duties to the LLC, did not breach those duties. The LLC contended that Cadden breached his fiduciary duties in two respects: by purposely diverting the parking garage option away from the LLC to a separate entity and “underhandedly” trading out the marina from the lease for no compensation. The court reviewed relevant Illinois case law and pointed out that a fiduciary is obligated to first disclose potential opportunities to the company and is prohibited from taking advantage of business opportunities that belong to the company. The court also pointed out that Illinois case law defines such opportunities as those in which the company has the capacity to engage and are reasonably incident to the company’s present or future business prospects. The court’s analysis of this contention focused on applying the definition of “business opportunities” to the parking garage option and marina (separately and independently). With respect to the parking garage option, the court noted that the LLC’s operating agreement stated that it “shall engage in no other business [other than a leasehold interest in the Assets]” until both the first and second mortgages were fully repaid. The LLC’s involvement with WRT and the consent foreclosure concerned only the first mortgage. Following the consent foreclosure, however, the LLC remained liable to and in default on the second mortgage. The court determined that, at that point in time and according to its own operating agreement, the LLC could not engage in any business, including obtaining the parking garage option. As a result, the court then determined that the parking garage option was not incident to the LLC’s business prospects because Option #1 was never a firm agreement. The court concluded that the parking garage option was not an opportunity in which the LLC could engage, and the parking garage option was not an opportunity reasonably incident to the LLC’s business prospects. Thus, the parking garage option was not a business opportunity that belonged to the LLC, and Cadden could not have breached a fiduciary duty with respect to the parking garage option.

The court applied similar reasoning to the LLC’s claim that Cadden breached his fiduciary duties to the company by underhandedly trading out the marina from the deal for no compensation. The court noted that according to the LLC’s operating agreement, the company was specifically formed to acquire a leasehold interest in the Assets (the commercial space and parking garage). Therefore, the court concluded that the LLC was never intended to obtain an interest in the complex’s three remaining components: the marina, the apartment complex, or the surface parking lot. As a result, the court found that the marina was not a business opportunity for the LLC. Furthermore, the record indicated that the initial lease included rights to the marina, the lease was then amended by the LLC’s manager and members to remove the marina from the deal, and then (via the Certificate) Cadden was specifically ordered and directed to proceed with the amended lease for the Assets only and not the marina. The court stated that it failed to see how Cadden could breach a fiduciary duty with respect to a marina the LLC was never intended to possess.

The court further noted that, even if the parking garage option or the marina were business opportunities for the LLC, there was no evidence in the record to show that Cadden failed to disclose them to the company or derived personal gain from his alleged diversion from the LLC. In fact, the court noted that the evidence supported disclosure (the LLC’s manager and all members attested that they knew Cadden was negotiating on behalf of it and RCC) and the absence of personal gain (Cadden testified that he never obtained any personal benefit).


The court held that the rights of the estate of a deceased member of a Delaware LLC were limited by the LLC agreement to the rights of an assignee notwithstanding Section 18-705 of the Delaware Limited Liability Company Act, which provides that a deceased member’s personal representative may exercise all of the rights of the member for the purpose of settling the member’s estate or administering
the member’s property. The court also held that the estate was not owed fiduciary duties by the managing member of the LLC.

Alex Calderwood formed an LLC with Ecoplace LLC (“Ecoplace”), an LLC controlled by Stefanos Economu. Calderwood died unexpectedly. At the time of his death, Calderwood held a majority stake in the LLC, which Ecoplace offered to purchase. The estate refused the offer and sued the LLC, Ecoplace, and Economu asserting numerous causes of action. The motion court dismissed several of the estate’s claims, and the estate appealed.

The appellate court first rejected the estate’s argument that it was a member of the LLC, concluding that the estate had only the rights provided by the LLC agreement, which limited the estate’s rights to those of an assignee. The court next concluded that the estate’s claim for a declaration that it was owed fiduciary duties by the managing member was based on a “strained interpretation” of Delaware law and was properly dismissed by the motion court. The estate characterized itself as a party bound by the LLC agreement and argued that Ecoplace, as a managing member of the LLC, and Economu, who controlled Ecoplace, owed the estate fiduciary duties. (In a footnote, the court noted that the estate did not, and could not, argue that the LLC owed it a fiduciary duty because an LLC does not owe a fiduciary duty to a member and thus does not owe a duty to a non-member.) The estate relied on Feeley v. NHAOCG, LLC, 62 A.3d 649, 661 (Del. Ch. 2012) and Sections 18-1101 and 18-1104 of the Delaware LLC Act for the proposition that LLC managers owe fiduciary duties to others bound by the LLC agreement unless the duties are expressly disclaimed. The court stated that the estate's pronouncement that it was a party bound by the LLC agreement and its reliance on _default_ fiduciary duties were unfounded. The court said the Feeley court did not explain what is meant by _otherwise bound by a limited liability company agreement_ in Section 18-1101(c). The court said the case law considering the term has arisen in the context of creditors of the LLC rather than a successor-in-interest, and the court also stated that the Delaware Supreme Court has called into question the Delaware LLC Act imposes “default” fiduciary duties, citing Gatz Properties, LLC v. Auriga Capital Corp., 59 A.3d 1206, 1219 (Del. 2012). (The court did not discuss the amendment of Section 18-1104 after the Gatz case to provide that _the rules of law and equity relating to fiduciary duties ... shall govern._) The court pointed out that the court in Feeley was dealing with a dispute between a managing-member and a nonmanaging-member and did not address if or when fiduciary duties are owed by a member to a nonmember. The court stated that its decision did not impact causes of action asserted by the estate in its amended complaint for breach of contract based on the duty of good faith and fair dealing related to its rights to distributions and its alleged right to call Ecoplace’s interest.

The court stated that the estate’s claims for constructive trust and an accounting were governed by New York law. The court held that the claim for an accounting was properly dismissed because the estate was not owed fiduciary duties by the defendants, and the claim for constructive trust was properly dismissed because the estate did not show that the defendants held any interest or property obtained through unjust enrichment.

Finally, the estate had no right to inspect the LLC’s books and records because it was not a member of the LLC.

_**Miller v. FiberLight, LLC**, 808 S.E.2d 75 (Ga. App. 2017)._  

A minority member of a Delaware LLC sued the majority members and chair of the board for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing in connection with amendments to the operating agreement, termination of his employment and redemption of his interest, and rejection of offers to purchase the company. Although the court rejected the defendants’ argument that provisions of the LLC agreement eliminated fiduciary duties, the court affirmed the trial court’s summary judgment that the defendants did not breach any default fiduciary duties in connection with the amendments or the termination of the plaintiff's employment and redemption of his interest. At the time of the first amendment of which the plaintiff complained, the defendants were not yet majority members owing any fiduciary duties. The subsequent actions taken by the defendants when they owed fiduciary duties were expressly allowed by the LLC agreement as previously amended, so there was no
breach of fiduciary duty or breach of the implied covenant of good faith and fair dealing. As for the plaintiff's claim relating to the rejection of purchase offers for the LLC, there was a dispute as to whether any purchase offers were received; therefore, summary judgment was not appropriate on that claim.

Miller and several other parties entered into an operating agreement for a Delaware LLC, and the agreement was amended on multiple occasions. Miller complained that he was coerced by economic duress (threats of termination) to agree to the third, fourth, and fifth amended and restated operating agreements. The amended operating agreements enabled the defendants to reduce his interest and redeem it when he eventually was terminated.

Miller relied on default fiduciary duties under Delaware law in asserting his breach-of-fiduciary-duty claims. The defendants argued that fiduciary duties were eliminated by provisions of the operating agreement, but the court held that none of the provisions relied upon by the defendants explicitly eliminated fiduciary duties. In support of the defendants’ claim that the default duty of care was eliminated, the defendants relied on exculpation provisions of the operating agreements that provided there would be no right, claim, or cause of action against any director or member for acting or failing to act in accordance with the director’s or member’s rights or obligations under the operating agreement. In support of their contention that the default duty of loyalty was eliminated, the defendants relied on a provision of the operating agreement allowing members to participate in other business opportunities and compete with the LLC. The defendants also argued that the entire-agreement clause eliminated default fiduciary duties. The court rejected the defendants’ arguments and stated that none of the provisions relied upon by the defendants plainly, unambiguously, or explicitly eliminated default fiduciary duties. Thus, default fiduciary duties applied to the decisions challenged by Miller in this case. The court went on to conclude, however, that most of Miller’s claims for breach of fiduciary duty failed.

The third amended agreement made many changes, including converting more than $10 million in debt owed to the LLC’s largest creditors into equity, thereby making the creditors the majority members of the LLC. The amendments also added a provision requiring redemption of an individual member’s interest on termination of the individual’s employment as well as provisions changing the structure and voting of the board so that appointees of the new majority members would have unilateral authority to take action, including amendment of the LLC agreement (which previously required unanimous consent of the members). Miller claimed that the defendants breached fiduciary duties to him by coercing him to sign the third amended operating agreement by threats of termination, but this claim failed because the defendants were not majority members when Miller signed the third amended agreement and thus owed him no fiduciary duties at the time. Furthermore, the defendants did not have the authority to terminate Miller at that time.

The court next addressed Miller’s claim that the fourth and fifth amended agreements, pursuant to which his interest was diminished, should be disregarded because his consent to those agreements was coerced. The court held that the failure of Miller’s claim as to the third amended agreement defeated his claims that the defendants breached their fiduciary duties by enforcing the fourth and fifth amended agreements because the third amended agreement gave the majority members the unilateral right to enact the fourth and fifth agreements regardless of whether Miller consented. The court said that it had found no Delaware authority to support the proposition that a party breaches a fiduciary duty by taking action specifically authorized under an LLC agreement. The court said Delaware law was clear that provisions in an LLC’s operating agreement supersede default fiduciary duties.

The court also rejected Miller’s claim that the defendants breached default fiduciary duties by redeeming his interest in the LLC upon his termination, again relying on the proposition that a party who takes action specifically authorized under an LLC agreement does not breach a default fiduciary duty.

Miller argued that whether the defendants breached their fiduciary duties to him by rejecting offers to purchase the LLC depended on disputed issues of fact, and the appellate court agreed with Miller on this point. The defendants asserted, and the trial court found, that the LLC never received any offers, but there was conflicting testimony on this point. Thus, the appellate court found that whether the
defendants breached default fiduciary duties by rejecting offers to purchase the LLC depended on disputed issues of material fact.

Miller next argued that the trial court erred in granting the defendants summary judgment on his claim for breach of the implied covenant of good faith and fair dealing. The trial court ruled that there was no breach because the agreements allowed the defendants to terminate Miller and redeem his membership interests. Miller argued that he should be allowed to pursue this claim regardless of whether the agreements allowed redemption of his membership interests because the covenant protects reasonable expectations, and he expected and was given reassurance that he would receive a substantial return on his investment in LLC. The court rejected this argument on the basis that the implied covenant cannot be used to override express provisions of a contract. Miller also argued that his claim for breach of the implied covenant was supported by a provision of the agreement stating that removal of an officer did not affect the rights of the officer as a member, but the court stated that the specific language in a contract controls over the general, and the agreement specifically allowed redemption of Miller's interest.

Indemnification


A former employee sued a restaurant-chain LLC and its parent corporation seeking indemnification for expenses incurred in defending against federal charges. The district court held that the former employee was not entitled to indemnification under the governing documents of either entity and the business judgment rule protected the LLC’s decision to deny indemnification on the grounds that the former employee engaged in fraud and willful misconduct.

Autumn Lee Tangas began working for International House of Pancakes, LLC (“IHOP”) in 1991 and became a “franchise bureau consultant” (FBC) in 2003. As an FBC, Tangas acted as a liaison to franchisees who operated restaurants in her multi-state territory, helped franchisees boost sales, and ensured that they adhered to IHOP operating standards. In September 2011, the FBI raided the home of a franchisee whose operations Tangas oversaw. After the raid, IHOP opened its own investigation to determine if the company itself might be a target of the FBI investigation or a potential victim of wrongdoing. In 2012, DineEquity’s in-house counsel communicated to Tangas’s lawyer that Tangas was obligated to cooperate with the internal investigation under the IHOP code of conduct and a refusal to do so would result in termination. After Tangas’s lawyer responded that Tangas would not answer any questions, IHOP fired Tangas for violating the IHOP code of conduct and refusing to participate in the interview. A federal grand jury subsequently indicted Elkafrawi, Tangas, and others. The indictment, which charged Tangas with money laundering, conspiring to harbor illegal aliens, and mail fraud, essentially alleged that Tangas used her position as an FBC to hide Elkafrawi’s criminal activities from IHOP. The criminal case against Tangas proceeded for more than two years until the U.S. Attorney’s Office dismissed the charges without prejudice in 2014. At that time, Tangas had incurred more than $130,000 in legal fees. In 2015, Tangas demanded that IHOP pay these legal fees. After the FBI provided part of its investigative file to IHOP, the LLC denied her request in light of “the allegations in the indictment and supported by the evidence in the government interviews.”

The first issue that the district court addressed was whether Tangas had a right to indemnification under DineEquity's corporate bylaws, which provided that the corporation must indemnify a person who is or may be a party to any suit “by reason of the fact that [s]he is or was a director or officer of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise[.]” Therefore, in order to qualify for indemnification, Tangas was required to show that she was a director of DineEquity, that she was an officer of DineEquity, or that she served at the request of DineEquity as an employee of another corporation (i.e., that DineEquity requested Tangas to serve as an FBC for IHOP). The court held that Tangas did not have a right to indemnification under the DineEquity bylaws because she was neither a director nor an officer of the parent corporation, she did not serve IHOP at the request of DineEquity, and she was employed by the subsidiary LLC and not its parent corporation.
Tangas next argued that Delaware corporate law required DineEquity to indemnify her because she was successful in defending the criminal case. The court noted that, at one time, Delaware did require corporations to indemnify any director, officer, employee, or agent who was successful on the merits or otherwise in defense of any action. Under current law, however, the mandatory obligation to indemnify applies only to officers and directors. 8 Del. C. § 145(c). The court held that this mandatory indemnification provision did not apply to Tangas because she “was not an officer of any company, let alone DineEquity…”

Next the district court addressed whether Tangas had a right to indemnification under IHOP’s LLC agreement. Both sides relied on the language of IHOP’s LLC agreement, which provided that:

the Company shall indemnify and hold harmless each Covered Person from and against any and all losses, claims, demands, liabilities, expenses, judgments, fines, settlements and other amounts arising from any and all claims, demands, actions, suits or proceedings, civil criminal administrative or investigative (“Claims”), in which the Covered Person may be involved, or threatened to be involved as a party or otherwise, by reason of its management of the affairs of the Company or which relates to or arises out of the Company or its property, business or affairs. A Covered Person shall not be entitled to indemnification under this Section 8.2 with respect to (i) any Claim with respect to which such Covered Person has engaged in fraud, willful misconduct, bad faith or gross negligence[.]

The LLC agreement defined “Covered Persons” to include “the Member [i.e., DineEquity], any officers, directors, stockholders, partners, employees, affiliates, representatives, or agents of any of the Member,” or “any officer, employee, representative, or agent of the Company [i.e., IHOP].” Because the parties agreed that Tangas was a “Covered Person” until she was fired in 2012, the court focused on determining if Tangas was entitled to indemnification of expenses incurred post-termination.

DineEquity and IHOP argued that Tangas’s indemnification rights did not continue post-termination because the Delaware LLC statute, unlike the corporate statute, does not provide a default rule that requires continuation of indemnification rights after a person ceases to be an employee, and such rights were not provided in IHOP’s LLC agreement. Tangas argued that IHOP impliedly agreed to cover expenses of former employees by failing to specify that the indemnification clause does not exclude former employees, but the court was not persuaded by Tangas’s interpretation of the indemnification clause because the interpretation was logically flawed (all categories of persons not defined as “Covered Persons” could claim indemnification) and unsupported by case law (absent explicit language inclusive of former employees, Delaware courts interpret “employee” as referring to current employees only). The court noted that the operating agreement had a provision limiting IHOP’s ability to amend the agreement to strip Covered Persons of their existing indemnification rights, but the language forbidding IHOP from retroactively stripping a Covered Person of existing indemnification rights did not prohibit IHOP from discontinuing indemnification once a person ceased to be a Covered Person. Tangas also argued that she had a vested right to indemnification that continued after her firing, but the court distinguished Delaware cases in which the courts determined that an indemnification right became vested and could not be terminated. The only right that could have vested in this case was Tangas’s right to be indemnified while she was a Covered Person involved or threatened to be involved in a proceeding. Because Delaware law did not prohibit IHOP from limiting its indemnification obligations in this manner and nothing in the LLC agreement required IHOP to indemnify a former employee whom it had fired, Tangas was not entitled to indemnification under the IHOP LLC agreement as a matter of law.

Finally, assuming arguendo that IHOP’s LLC agreement required it to indemnify Tangas, the district court addressed whether IHOP reasonably declined to indemnify Tangas on the basis that her conduct amounted to fraud or willful misconduct. IHOP and DineEquity argued that Delaware’s business judgment rule protected their decision not to indemnify Tangas, but Tangas argued that the business judgment rule was inapplicable because the LLC agreement entitled her to indemnification. The court concluded that the business judgment rule was applicable to the issue of whether Tangas engaged in
fraud or willful misconduct. Because IHOP had the power to deny indemnification in those circumstances, the court stated that Tangas was asking the court to second guess the propriety of an action that IHOP had the authority to take and that Tangas must thus show IHOP’s decision to deny indemnification was not the product of reasoned, well-informed decision making. The court concluded that the undisputed evidence established that IHOP made a reasonable decision to deny indemnification after investigating the situation and concluding that Tangas engaged in fraud “with respect to” the criminal case against Tangas. Additionally, the court concluded that IHOP and DineEquity made a reasoned business judgment not to indemnify Tangas on the ground that her refusal to participate in the interview as required by IHOP’s code of conduct was willful misconduct “with respect to” the criminal case.


The court of appeals affirmed the judgment of the trial court that a Delaware LLC owed indemnity to its officer and that a settlement agreement precluded further collection of the judgment against the officer.

Jim Sandt, a former officer and member of Energy Maintenance (a Delaware LLC), sued Energy Maintenance, Timothy Nesler (the company’s CEO), and other officers claiming that the defendants had committed fraud and breach of fiduciary duty by wrongfully diluting his ownership interest. While Sandt’s suit was pending, the Energy Maintenance board agreed in a company resolution to indemnify Nesler for any liability arising out of or related to the Sandt litigation. The board resolution stated that the board agreed to indemnify Nesler after reviewing the Sandt litigation and discussing it with the company’s officers and attorneys. The resolution also stated that the board had determined that Nesler acted in good faith and in a manner that he reasonably believed was in the company’s best interest.

A jury found in favor of Sandt and against Energy Maintenance and Nesler. While an appeal was pending, the company’s primary creditor took control and terminated Nesler from his position as CEO. The new board of directors then voted to revoke the prior indemnification as of the date it was purportedly granted. The rationale for the revocation was, in part, that Nesler had misrepresented to the board the facts related to the Sandt matter. After the company refused to provide indemnification, it filed suit against Nesler seeking a declaration that it did not owe him indemnity and claiming that the jury’s findings of fraud and breach of fiduciary duty against him alleviated the company’s indemnification obligation. Nesler counterclaimed for breach of contract.

The trial court ruled that Nesler was entitled to indemnification and that the company’s failure to provide it was a breach of contract. Because a settlement agreement between the company and Sandt stated that Sandt could not recover any further, directly or indirectly, from the company, the trial court further declared that Sandt could not pursue Nesler for any amounts that the company had to indemnify. Both the company and Sandt appealed.

On appeal, the court noted that Energy Maintenance was a Delaware LLC; thus, Delaware law controlled the interpretation of the company’s formation agreement. The court cited a number of Delaware law propositions, including (1) “[u]nder Delaware law, a limited liability company may indemnify any member, manager, or another ‘against any and all claims and demands whatsoever,’ subject to whatever standards or restrictions are included in its company agreement”; (2) “[f]or limited liability companies, Delaware law ‘defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification’”; (3) “[w]hen interpreting the provisions of a limited liability company agreement, ordinary contract interpretation rules apply; the court’s role is to effect the parties’ intent based on the plain meaning of the agreement’s terms”; and (4) “[a] court cannot rewrite or add omitted provisions in the guise of interpreting a contract.”

The court noted that Article VIII of the Energy Maintenance company agreement contained provisions for indemnification and advancement of expenses. Although the provisions obligated Energy Maintenance to indemnify persons who acted in good faith, it vested the board with the authority to decide if they did act in good faith. The agreement expressly specified that an adverse judgment did not create a presumption of bad faith, and it stated a company policy of indemnifying corporate officers to the fullest
extent legally possible. According to the court, “Energy Maintenance’s company agreement does not, in express and affirmative terms, make members and directors ineligible for indemnification previously granted simply because a jury finds that they did not act in good faith, and we cannot rewrite its company agreement to say something it does not.” In addition, the court concluded that unless Energy Maintenance had a contractual right to reconsider its decision to indemnify Nesler, it could not rescind its earlier determination. Because “[n]either its company agreement nor the board’s 2007 indemnity resolution reserved a right to revisit Nesler’s right to indemnity,” the court concluded that the company “could not rescind its agreement to indemnify him.”

Despite the company agreement provisions that vested the board with the authority to determine whether the conditions for authorizing indemnification had been met, Energy Maintenance contended that the jury’s unfavorable verdict and the judgment against Nesler for fraud disproved his good faith and thereby provided a basis for the board to revoke its earlier grant of indemnity. The company relied on Delaware decisions construing that state’s corporate indemnification statute, 8 Del. Code § 145, for the proposition that a jury’s finding of fraud negates good faith as a matter of public policy. The court disagreed, noting that the statutes governing Delaware corporations and Delaware limited liability companies were different. Unlike Section 145, which applied to corporations, the statute governing limited liability companies allowed indemnity “against any and all claims and demands whatsoever,” subject only to the express terms of the company agreement. This statute did not purport to adopt or incorporate Delaware’s public policy regarding indemnity in the corporate context, and it deferred instead to the contracting parties to place limits on indemnification.

Although the court decided that the company was obligated to indemnify Nesler from liability in the Sandt litigation, it also concluded that Sandt, in a settlement agreement, agreed to forego any collection of the judgment against Nesler for which the company would be liable. The settlement agreement provided that Sandt “will not seek to execute and will not accept recovery, in each case whether directly or indirectly, against” Energy Maintenance for any remaining liability arising from the suit. The trial court reasoned that Energy Maintenance owed indemnity to Nesler, and thus an attempt to collect the remaining money that Nesler owed under the Sandt judgment would violate the settlement agreement’s clause barring Sandt from recovering any additional sum from Energy Maintenance “directly or indirectly.” In light of this clause and others, the court of appeals concluded that the trial court correctly interpreted the settlement agreement: “In sum, the settlement agreement bars Sandt from recovering from Nesler because it would result in an indirect recovery from Energy Maintenance, which is obligated to indemnify Nesler for the Sandt judgment.”

**Interpretation of Operating Agreement or Partnership Agreement**


The court of appeals held that the removal of an individual as co-manager of an LLC was effective where half of the members signed a written consent voting to remove the individual as manager, and the remaining members (one of whom was the individual who was being removed) did not object after receiving written notice of the written consent. The court also held that the subsequent expulsion of the individual as a member from a related LLC was valid under the terms of the company agreement of that LLC.

Pak was the majority member of Villas on Raiford Carrollton Senior Housing, LLC (“Villas CSH”) and Villas on Raiford, LLC (“Villas Manager”), the ownership and management entities of a low-income senior housing project. Pak and AD Villarai, LLC, an entity controlled by Anderson, were co-managers of Villas Manager. After various acts of mismanagement by Pak came to light, the Villas entities sued Pak. Certain members of Villas Manager took action to remove Pak as a manager and member of that entity, and members of Villas CSH subsequently took action to expel Pak as a member from that entity. The issues were tried in a bench trial, and the trial court concluded that Pak was validly removed as co-manager of Villas Manager and that Pak breached his fiduciary duties to Villas CSH and Villas Manager and materially breached the company agreements of each entity. However, the trial court found that the member consent expelling Pak as a member of Villas CSH did not comply with the company agreement and was not effective. Both sides appealed.
On appeal, Pak argued that his removal as co-manager of Villas Manager was not effective because he did not vote as a member in favor of his removal as a manager. The company agreement provided for the removal of a manager with the vote of a majority of the members and defined a majority as more than 50% of the number of members. At the time, Villas Manager had four members, and two of them signed a written consent removing Pak as a manager and member and appointing AD Villarai, LLC as sole manager of Villas Manager. The company agreement of Villas Manager contained a provision authorizing action by the members without a meeting as follows:

Any action required by the BOC [Business Organizations Code] to be taken at a meeting of the Members, or any action which may be taken at a meeting of the Members, may be taken without a meeting, without prior notice, and without a vote if a written consent or consents in writing, setting forth the action so taken, shall have been signed by the Members entitled to vote with respect to the action which is the subject matter of the consent, and such consent shall have the same force and effect as a unanimous vote of the Members.

This provision additionally required that a written consent be signed, dated, and delivered as required by the BOC. Finally, the provision stated that “prompt notice” of any action taken by members without a meeting by less than unanimous consent must be given to those members who did not consent in writing to the action. The court stated that the provision thus contemplated situations in which members would take action without a meeting and without unanimous written consent. In such cases, the agreement required that “prompt notice” be given to those who did not consent, but the agreement did not address the effect of giving such notice. The court then discussed Section 101.359 of the Texas Business Organizations Code, which governs an LLC unless the LLC’s company agreement provides otherwise. Section 101.359 provides that members and managers may take action without a meeting in various ways, and Section 101.359(2)(A) provides that an action is effective if it is taken with the consent of each member, “which may be established by: (A) the member’s failure to object to the action in a timely manner, if the member has full knowledge of the action.” Because nothing in the company agreement of Villas Manager provided that consent could not be established by failure to object as provided by the statute, and the plain wording of the company agreement did not conflict with applying the statute to the member actions in this case, the court concluded that a member’s failure to object after being given written notice of the written consent was deemed consent to the action taken by the written consent such that the action became effective. The evidence showed that Pak and the other member who did not sign the written consent were given written notice three days after the action removing Pak as co-manager, and neither of them objected. Pak argued that the written consent was signed while the two sides were in litigation, and the court of appeals held that the evidence conclusively established that Pak was properly expelled. The company agreement of Villas CSH contained the following expulsion provision:

If a Member willfully violated any term of provision of this Agreement and fails or cannot cure such violation within ten (10) business days after having been given notice of the violation by the Company, then the Managers shall have the right, but not the obligation, to expel such Member as a Member of Company, provided, however, that the remaining Members unanimously vote to expel such Member.

The undisputed evidence showed that Pak was given notice of specified violations of the company agreement and that sixteen days later, after Pak failed to cure all the violations, a written consent expelling Pak as a member of Villas CSH was signed by AD Villarai, LLC—the remaining manager of Villas Manager (the manager of Villas CSH)—and the three other members of Villas CSH.
The court of appeals explained that the trial court had erroneously concluded that Pak’s vote as well as that of AD Villarai, LLC was required for Villas Manager to act. Although Pak and AD Villarai, LLC had been co-managers of Villas Manager, Pak was validly removed as co-manager of Villas Manager several months before the execution of the written consent expelling Pak as a member from Villas CSH. Thus, at the time of Pak’s expulsion, AD Villarai, LLC was the sole manager with authority to act for Villas Manager. Once AD Villarai, LLC, as sole manager of Villas Manager, voted to expel Pak, the company agreement required the “remaining” members to vote unanimously to expel Pak. The court stated that it was clear in this context that “remaining” members meant members other than Pak. The consent was signed by the three members other than Pak as well as Villas Manager as the manager of Villas CSH. Thus, the court held that the written consent properly expelled Pak as a member.


In a dispute regarding the ownership of a limited partnership and its general partner, the court of appeals concluded that: (1) the trial court erred in submitting a jury question inquiring whether the parties to written assignments of interests in the limited partnership and its LLC general partner agreed to an alleged oral condition because the alleged condition contradicted the unambiguous terms of the assignments and was thus precluded by the parol evidence rule; (2) the language of certain assignments did not transfer any interest in the LLC general partner of the limited partnership; (3) certain purported transfers of interest in the LLC general partner were null and void ab initio because they were prohibited under the company agreement, and subsequent consent or ratification could not operate to give life to an attempted transfer that was null and void; (4) certain purported transfers of interests in the limited partnership were valid even if the transfers were prohibited by the partnership agreement because the partnership agreement allowed the general partner to recognize a transfer that would otherwise be null and void under the terms of the agreement.

Osama Abdullatif (Latif) and Ali Mokaram entered into a real estate investment venture by forming Mokaram Latif West Loop, L.P. (“ML Partnership”) in which Mokaram and Latif were each 49.5% limited partners and Mokaram-Latif General, LLC (“ML General”) was the 1% general partner. Mokaram and Latif were the managers and equal members of ML General. Mokaram and Ali Choudhri became friends and engaged in business transactions together, including transactions in 2008 and 2010 involving ML Partnership and ML General.

The 2008 transaction included an agreement in which Mokaram purported to transfer to Choudhri a limited partnership interest in ML Partnership, and the 2010 transaction included purported assignments by Mokaram to Choudhri of interests in ML Partnership and ML General. Disputes regarding these transactions arose, and eventually Latif purchased all of Mokaram’s interests in ML Partnership and ML General along with all of Mokaram’s claims against Choudhri relating to interests in the entities. Mokaram agreed to continue to pursue his claims against Choudhri in this lawsuit in which Mokaram, Latif, Choudhri, and ML Partnership were parties. The trial court entered a declaratory judgment regarding the ownership of the entities, and Mokaram and Latif appealed.

The first issue the court of appeals addressed was whether the trial court erred in submitting a jury question inquiring whether Mokaram and Choudhri agreed that the 2010 assignment was not effective and that Mokaram would return the money paid by Choudhri to Mokaram. Because the unambiguous language of the assignment provided that it was effective immediately and did not indicate that it was contingent on any condition, the court of appeals concluded that the testimony regarding an alleged oral condition was precluded by the parol-evidence rule from contradicting the unambiguous language of the assignment. Thus, the trial court should not have submitted any question inquiring into the enforceability of the oral condition. The court stated that the parol-evidence rule would not have precluded the trial court from submitting a question about an alleged subsequent agreement to rescind, but the jury question that was submitted did not ask about a subsequent agreement to rescind. The court also stated that the evidence did not raise a genuine fact issue as to whether Mokaram and Choudhri agreed to rescind the assignment after they executed it.
The court next addressed the argument that the trial court lacked jurisdiction over the declaratory judgment claims regarding Choudhri's ownership and management rights in ML General because ML General was not a party. The court of appeals held that the trial court did not lack jurisdiction over the claims. Although the declaratory judgment did not bind ML General, it was binding on the parties in this action.

Next the court of appeals discussed whether the trial court erred in declaring that Choudhri had owned an interest in ML General since the date of the 2008 assignment. Based on the language of the documents executed in 2008, which purported to transfer to Choudhri an interest in ML Partnership and certain real property, the court concluded that Mokaram did not purport to transfer any interest in ML General. The documents indicated that Mokaram and Choudhri thought that ML Partnership owned the real property referred to in the assignments and that they intended to transfer an indirect interest in the real property by transferring an interest in ML Partnership. However, assuming that ML Partnership owned the real property referred to in the assignments, that would not mean that ML General had any ownership in the property, and the court concluded that the evidence did not show that Mokaram transferred any interest in ML General to Choudhri by virtue of the 2008 assignments.

The 2010 assignments purported to transfer from Mokaram to Choudhri interests in both ML General and ML Partnership. Both the company agreement of ML General and the partnership agreement of ML Partnership contained restrictions on transfer, and the court discussed the effect of the purported transfers by Mokaram.

The ML General company agreement prohibited a member from transferring any of its membership interest except in limited circumstances, such as with the approval of members having more than 66.67% of the interests of all members. The company agreement stated that a transfer in violation of its provisions was "null and void ab initio." Assuming Mokaram's execution of the assignments represented his approval of the transfers, there was no evidence that Latif, the other 50% member at the time, approved the assignments and that there was no evidence that any of the other circumstances under which a transfer was permitted were present. Choudhri relied on a 2011 consent signed by Latif as manager and member of ML General in which Latif consented to any prior transfers by Mokaram to Choudhri of a membership interest in ML General. The court concluded that the purported assignments were null and void from the outset under the unambiguous language of the company agreement, and as such the purported transfers could not be ratified or validated after the fact. Thus, the trial court erred in declaring that Choudhri had owned 50% of ML General and had been a manager of ML General from and after the 2010 assignments.

The ML Partnership agreement also contained prohibitions on transfer, and the court next addressed the effect of purported assignments in 2010 by Mokaram to Choudhri of a limited partnership interest in ML Partnership. Section 10.1 of the partnership agreement prohibited a limited partner from transferring all or any portion of the limited partner's interest without the prior written consent of the general partner. Section 10.2 of the partnership agreement contained a right-of-first-refusal provision in favor of the other partners in the event a limited partner received a bona fide offer to purchase all or any portion of the limited partner's interest. Section 10.3 provided for certain "Permitted Transfers" (to a trust for the benefit of the limited partner, the guardian or estate of a limited partner, or a person approved by all the partners) notwithstanding the consent otherwise required by Section 10.1. Section 10.6 provided that a transfer that was not permitted under the partnership agreement "shall be null and void and of no effect whatever; provided that if the Partnership is required to recognize a Transfer that is not permitted (or if the Partnership, in its sole discretion, elects to recognize a Transfer that is not permitted)," the transferred interest was limited to the transferor's rights to allocations and distributions. Finally, Section 10.10 provided that the partnership was not required to recognize the interest of any transferee who obtained a purported transferred interest pursuant to a transfer that was not authorized by the partnership agreement, and such a transfer was "null and void for all purposes."

The court stated that the plain meaning of "null and void and of no effect whatever" would preclude a transfer that was not permitted by the partnership agreement from being subject to ratification, confirmation, or waiver, but the court concluded that the phrase "null and void and of no effect whatever"
was not used in its ordinary sense given that the agreement unambiguously provided that the partnership could elect to recognize a transfer that was not permitted and thus was or would have been “null and void and of no effect whatever.” The court noted the difference between the ML General company agreement (which the court had held did not permit ratification of a null and void transfer) and the ML Partnership agreement and concluded that the two agreements were separate and independent agreements that should not be construed together as one. Further, assuming the agreements should be construed as a single contract, the provisions unambiguously allowed the recognition of an otherwise void transfer of a partnership interest but did not allow the recognition of a void transfer of a membership interest.

Because Mokaram signed the assignment of his interests to Choudhri not only as assignor, but in his capacity as manager of ML General, the general partner of ML Partnership, under a legend stating that the transfer was consented to by the general partner, the court concluded that ML Partnership recognized the transfer of the interests. Relying on the language of the ML General company agreement (which provided that the managers shall have the sole and exclusive control of the management of ML General and shall make all decisions not otherwise provided for in the company agreement) and Section 101.254 of the Business Organizations Code (which provides that each governing person is an agent of the LLC for the purpose of its business), the court stated that Mokaram’s signature as manager was binding on ML General, and ML Partnership thus recognized the transfer as valid and effective as provided by Section 10.6 of the partnership agreement. The court concluded that an earlier purported transfer in 2008 by Mokaram to Choudhri of a limited partnership interest was not effective because there was no evidence that the transfer was permitted under any of the provisions of the partnership agreement nor was there any evidence that the partnership was required to recognize the transfer or exercised its discretion to recognize the transfer.

Finally, the court concluded that the trial court did not err in refusing to clarify what rights Choudhri had as a result of his ownership of an interest in ML Partnership. The trial court declared that Choudhri owned 49.5% of ML Partnership from and after the 2010 assignments and that he had “all beneficial rights and interests” that flowed from his ownership of an interest in ML Partnership. The court stated that the interests transferred to Choudhri were limited to rights to allocations and distributions under the unambiguous language of Section 10.6 of the partnership agreement, and neither Section 10.2 nor 10.6 gave Choudhri the right to become a limited partner under the assignments. The trial court did not declare that Choudhri was a limited partner, and although the “beneficial rights and interests” were significantly limited by the agreement, the trial court did not inaccurately characterize them. Thus, the court of appeals concluded that the trial court did not err in making the declaration and in refusing to clarify it.


The court of appeals held that the trial court erred in entering a judgment that a member of three LLCs was entitled to one-third of the profits of each of the LLCs because the Texas Business Organizations Code provides that profits and losses are allocated to the members based on the agreed value of the members’ contributions as stated in the company’s records, and none of the LLCs had a record of the member’s alleged contribution. Although the member testified that he contributed cash to the LLCs, and the jury found that the member was entitled to a one-third profit distribution from each LLC, the court of appeals stated that allowing the member’s oral testimony to establish his entitlement to one-third of the profits of the LLCs in the absence of any written records of his contributions would be contrary to the plain language of the LLC statute.

Nizar Sunesara and Anis Virani started selling smoking accessories and devices in flea markets on the weekends in 2002, and the next year they established a brick-and-mortar retail shop called “Zig Zag Smoke Shop.” Sunesara created MNA Corporation to operate Zig Zag, and Virani and Sunesara offered Manisch Sohani (a supplier of Zig Zag) an ownership interest in the business. The three men each owned one third of MNA Corporation, and profits of Zig Zag were distributed in cash each month. Sunesara and Virani both took positions with Sohani’s company, and Sunesara transitioned out of the day-to-day business of Zig Zag while Virani continued to manage Zig Zag’s day-to-day operations as well as working for Sohani’s company. Zig Zag did well, and in 2012, Virani and Sunesara started a second
retail location, which they called “Burn Smoke Shop” (“Burn I”). Sunesara testified that he contributed $10,000 cash to the start up of Burn I. He stated that he gave the money to Virani and did not request any receipt or documentation of his contribution. SSV Corporation, which was incorporated by Sunesara in 2007, owned the assets of both Zig Zag and Burn I. Sunesara and Virani each owned 50% of SSV Corporation, but records showed that Sohani shared equally with Sunesara and Virani in profit distributions, and Sunesara testified that Sohani was considered a partner even though he was not a formal owner.

Toward the end of 2012, Sunesara, Virani, and Sohani agreed to buy an existing retail smoke shop, whose name they changed to “Burn Smoke Shop Two” (“Burn II”). Sunesara testified that he contributed $10,000 cash to the start up of Burn II, again giving the money to Virani without obtaining any receipt or documentation of his contribution. Before the purchase of Burn II was finalized, Sohani and Virani asked Sunesara to file paperwork with the Texas Secretary of State to form three LLCs to run the three smoke shops. Each certificate of formation, which was signed by Sunesara but not the other two men, listed Sohani, Virani, and Sunesara as governing persons. Signature cards and depository resolutions for the bank accounts for the three LLCs listed all three men as members and were signed by all three men. Virani and Sohani claimed that Sunesara handled the paperwork for forming the LLCs and opening the bank accounts, and Virani and Sohani claimed that they should have been listed as the only two members of the LLCs. The franchise tax public information report for 2013 listed all three men as members of the LLCs, but the franchise tax report for 2014 as well as federal income tax returns for 2013 and 2014 only listed Virani and Sohani as members or owners of the LLCs.

Sohani and Virani testified that Sunesara did not contribute anything to the three shops. They also testified that they never received any profit distributions from the LLCs because the profits went to Sohani’s company to pay back inventory Sohani contributed and to pay other vendors and creditors of the LLCs.

After federal law enforcement officers began targeting sellers of synthetic marijuana and raiding retailers, wholesalers, and distributors in the smoke shop industry, Sunesara became concerned because Sohani’s company and the three retail shops sold synthetic marijuana. Sunesara wanted Sohani’s company and the shops to stop selling the product. Sohani’s company was raided in 2013, and Sunesara took a leave of absence from the company and did not return. After the raid, Sohani and Virani realized that they lacked important documentation for the LLCs, such as operating agreements, and (after conducting internet research) the two men drafted and signed form operating agreements listing them as members and stating that they each made 50% of contributions and owned 50% of profits and assets. Sunesara’s name did not appear in any of the three agreements, and he was not involved in the drafting of the agreements. Sunesara testified that he received monthly profit distributions for the first five months of 2013 and inquired regularly "what the situation was with profit distributions" after the raid but was given excuses why there were no distributions until October of 2013, when the parties ceased communicating. The parties disagreed over whether Sunesara had a share of the business, and Sohani and Virani were unable to open new bank accounts or obtain loans for the LLCs without Sunesara’s authorization and signature. In 2015, Virani and Sohani sued Sunesara asserting various causes of action, including a claim for a declaratory judgment that Sunesara was not a member of the LLCs. Sunesara counterclaimed for a declaration that he was a member of the LLCs, was entitled to one-third of the profits of the LLCs, and was entitled to examine the LLCs’ books and records.

The jury answered “yes” to three questions inquiring whether Sunesara was a member entitled to a one-third profit distribution of each of the LLCs at the time they were formed. No definitions or instructions accompanied these questions. The jury also found that Sohani and Virani were estopped to deny Sunesara was a member of the LLCs and that Sunesara did not commit fraud against Virani and Sohani. After the verdict, Virani and Sohani moved to dismiss the action for lack of subject-matter jurisdiction based on documentation that they argued demonstrated the combined total of one-third profit distributions from the three LLCs exceeded $200,000, the upper limit of the county court's jurisdictional limits. Sohani and Virani also argued that Sunesara presented only his self-serving testimony that he was a member and had made contributions to the LLCs but presented no evidence of an oral or written operating agreement entitling him to membership and one-third of the profits of the LLCs. Virani and Sohani relied on Tex. Bus. Orgs. Code § 101.201, which provides that profits and losses of an LLC shall
be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company's records. The trial court entered judgment in favor of Sunesara declaring that he was a member of the LLCs and entitled to one-third of the profits from the LLCs.

The court of appeals analyzed the contention of Sohani and Virani that the trial court's judgment, which declared that Sunesara was a member of each of the LLCs and was entitled to one-third of the profits from each of the LLCs, conflicted with Section 101.201 of the Business Organizations Code, which states that an LLC's allocation of profits and losses are to be made on the basis of the agreed value of the contributions made by each member, as stated in the company's records. Sohani and Virani argued that there was no written record reflecting Sunesara's contributions to the LLCs or demonstrating that he was entitled to one-third of the profits. The court reviewed the definitions of a "member," "membership interest," "governing documents," "company agreement," and "contribution," and pointed out that the Business Organizations Code does not require a person to make a contribution in order to be admitted as a member or acquire a membership interest. The court also pointed out that the statutory provisions addressing allocation of profits and losses and the sharing of distributions provide that such matters are based on the agreed value of each member's contributions as stated in the company's records required to be kept under the statute. Tex. Bus. Orgs. Code §§ 101.201, 101.203. Section 3.151 of the Business Organizations Code contains general recordkeeping requirements for filing entities, and Section 101.501 has specific requirements for LLCs that include maintaining a record of the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member. Tex. Bus. Orgs. Code § 101.501(a)(7).

The court's analysis of Sohani's and Virani's contention focused on the "plain meaning" of Sections 101.201 and 101.501 of the Business Organizations Code. At trial, Sunesara testified that he made contributions to the LLCs in the form of $10,000 cash contributions and deferred profits to the startup of Burn I and the acquisition of Burn II. Sunesara did not, however, offer any documentary evidence reflecting those contributions. The record contained no writing setting out the specific contributions made by any of the three members or stating that Sunesara was entitled to one-third of the profits from the LLCs. The company agreements for each of the LLCs were admitted into evidence, but they listed only Sohani and Virani as members and stated, under each of their names, Made 50% of contributions, Owns 50% of profits and assets. The court construed Section 101.501 of the Business Organizations Code to require an LLC to include a statement of the amount of cash contributions made by each member and a statement of the agreed value of any other contribution made by each member in the written records of the company and construed Section 101.201 to provide that these records establish the allocation of a member's share of the profits and losses of the company. Because Sunesara did not introduce any records of the LLCs reflecting the contributions that he made to the LLCs, the court concluded that he presented no evidence that he is entitled to one-third of the profits of the LLCs under Section 101.201.

Sunesara argued that his testimony that he made contributions to the LLCs sufficed to demonstrate his entitlement to one-third of the profits of the LLCs, but the court stated that the plain language of Section 101.201 requires profits and losses to be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company's records required under Section 101.501, and the plain language of Section 101.501 requires an LLC to maintain a written record of the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member.

Sunesara pointed to the 2008 tax return of MNA Corporation (which stated that Sunesara, Virani, and Sohani were each allocated one-third of the profits for that corporation) and the records of SSV Corporation (which stated that Sunesara and Virani each owned fifty percent of that corporation) and argued that, when the LLCs were created and took over operation of the smoke shops, these records became a part of the records for the LLCs and satisfied the writing requirement of Section 101.201. But the court stated that the corporations and LLCs were all separate and distinct entities, and Sunesara cited no law supporting the proposition that the records from the earlier-formed entities became records of the new LLCs when they began operating the smoke shops. The court stated that the documentary evidence
reflecting that Sunesara had a one-third ownership interest in MNA Corporation and a one-half interest in SSV Corporation established only that he was entitled to distributions from MNA Corporation and SSV Corporation, not that he made contributions to the LLCs or that he was entitled to one-third of the profits from the LLCs. Thus, the court held that the trial court erred to the extent that it ruled that Sunesara was entitled to one-third of the profits from each of the LLCs. “Because Sunesara was not assigned a share of profits in the company agreements and presented no evidence that he was entitled to a one-third share of profits in the LLCs, he was not entitled to a share in profits as a matter of law.”


A former employee sued a restaurant-chain LLC and its parent corporation seeking indemnification for expenses incurred in defending against federal charges. The district court held that the former employee was not entitled to indemnification under the governing documents of either entity and the business judgment rule protected the LLC’s decision to deny indemnification on the grounds that the former employee engaged in fraud and willful misconduct.

Autumn Lee Tangas began working for International House of Pancakes, LLC (“IHOP”) in 1991 and became a “franchise bureau consultant” (FBC) in 2003. As an FBC, Tangas acted as a liaison to franchisees who operated restaurants in her multi-state territory, helped franchisees boost sales, and ensured that they adhered to IHOP operating standards. In September 2011, the FBI raided the home of a franchisee whose operations Tangas oversaw. After the raid, IHOP opened its own investigation to determine if the company itself might be a target of the FBI investigation or a potential victim of wrongdoing. In 2012, DineEquity’s in-house counsel communicated to Tangas’s lawyer that Tangas was obligated to cooperate with the internal investigation under the IHOP code of conduct and a refusal to do so would result in termination. After Tangas’s lawyer responded that Tangas would not answer any questions, IHOP fired Tangas for violating the IHOP code of conduct and refusing to participate in the interview. A federal grand jury subsequently indicted Elkafrawi, Tangas, and others. The indictment, which charged Tangas with money laundering, conspiring to harbor illegal aliens, and mail fraud, essentially alleged that Tangas used her position as an FBC to hide Elkafrawi’s criminal activities from IHOP. The criminal case against Tangas proceeded for more than two years until the U.S. Attorney’s Office dismissed the charges without prejudice in 2014. At that time, Tangas had incurred more than $130,000 in legal fees. In 2015, Tangas demanded that IHOP pay these legal fees. After the FBI provided part of its investigative file to IHOP, the LLC denied her request in light of “the allegations in the indictment and supported by the evidence in the government interviews.”

After rejecting Tangas’s argument that she was entitled to indemnification under DineEquity’s bylaws or the Delaware corporate statute, the district court addressed whether Tangas had a right to indemnification under IHOP’s LLC agreement. Both sides relied on the language of IHOP’s LLC agreement, which provided that:

> the Company shall indemnify and hold harmless each Covered Person from and against any and all losses, claims, demands, liabilities, expenses, judgments, fines, settlements and other amounts arising from any and all claims, demands, actions, suits or proceedings, civil criminal administrative or investigative (“Claims”), in which the Covered Person may be involved, or threatened to be involved as a party or otherwise, by reason of its management of the affairs of the Company or which relates to or arises out of the Company or its property, business or affairs. A Covered Person shall not be entitled to indemnification under this Section 8.2 with respect to (i) any Claim with respect to which such Covered Person has engaged in fraud, willful misconduct, bad faith or gross negligence[.]

The LLC agreement defined “Covered Persons” to include “the Member [i.e., DineEquity], any officers, directors, stockholders, partners, employees, affiliates, representatives, or agents of any of the Member,” or “any officer, employee, representative, or agent of the Company [i.e., IHOP].” Because the parties agreed that Tangas was a “Covered Person” until she was fired in 2012, the court focused on determining if Tangas was entitled to indemnification of expenses incurred post-termination.
DineEquity and IHOP argued that Tangas’s indemnification rights did not continue post-termination because the Delaware LLC statute, unlike the corporate statute, does not provide a default rule that requires continuation of indemnification rights after a person ceases to be an employee, and such rights were not provided in IHOP’s LLC agreement. Tangas argued that IHOP impliedly agreed to cover expenses of former employees by failing to specify that the indemnification clause does not exclude former employees, but the court was not persuaded by Tangas’s interpretation of the indemnification clause because the interpretation was logically flawed (all categories of persons not defined as “Covered Persons” could claim indemnification) and unsupported by case law (absent explicit language inclusive of former employees, Delaware courts interpret “employee” as referring to current employees only). The court noted that the operating agreement had a provision limiting IHOP’s ability to amend the agreement to strip Covered Persons of their existing indemnification rights, but the language forbidding IHOP from retroactively stripping a Covered Person of existing indemnification rights did not prohibit IHOP from discontinuing indemnification once a person ceased to be a Covered Person. Tangas also argued that she had a vested right to indemnification that continued after her firing, but the court distinguished Delaware cases in which the courts determined that an indemnification right became vested and could not be terminated. The only right that could have vested in this case was Tangas’s right to be indemnified while she was a Covered Person involved or threatened to be involved in a proceeding. Because Delaware law did not prohibit IHOP from limiting its indemnification obligations in this manner and nothing in the LLC agreement required IHOP to indemnify a former employee whom it had fired, Tangas was not entitled to indemnification under the IHOP LLC agreement as a matter of law.

Finally, assuming arguendo that IHOP’s LLC agreement required it to indemnify Tangas, the district court addressed whether IHOP reasonably declined to indemnify Tangas on the basis that her conduct amounted to fraud or willful misconduct. IHOP and DineEquity argued that Delaware’s business judgment rule protected their decision not to indemnify Tangas, but Tangas argued that the business judgment rule was inapplicable because the LLC agreement entitled her to indemnification. The court concluded that the business judgment rule was applicable to the issue of whether Tangas engaged in fraud or willful misconduct. Because IHOP had the power to deny indemnification in those circumstances, the court stated that Tangas was asking the court to second guess the propriety of an action that IHOP had the authority to take and that Tangas must thus show IHOP’s decision to deny indemnification was not the product of reasoned, well-informed decision making. The court concluded that the undisputed evidence established that IHOP made a reasonable decision to deny indemnification after investigating the situation and concluding that Tangas engaged in fraud “with respect to” the criminal case against Tangas. Additionally, the court concluded that IHOP and DineEquity made a reasoned business judgment not to indemnify Tangas on the ground that her refusal to participate in the interview as required by IHOP’s code of conduct was willful misconduct “with respect to” the criminal case.


Two men orally agreed to form an LLC in which one of them would take an active role as the manager and the other would not take part in the day-to-day business. The men also agreed to recruit an employee from a competing business with a view towards later admitting her as a member. The individual who agreed to manage the LLC recruited the employee and formed the LLC. After a written operating agreement was prepared with terms satisfactory to the parties, the inactive individual refused to sign the written operating agreement. Initially, the refusal was based on his desire to keep his role in the business a secret, but later the refusal was based on financial difficulties of the LLC. The individual who formed the LLC operated it for a period of time and eventually agreed to sell all the LLC’s assets to another company after the LLC’s financial difficulties continued. The purchasing company acquired the LLC’s assets in exchange for assumption of the LLC’s debts, which greatly exceeded the LLC’s assets. The individual and the employee of the LLC filed suit alleging that they were members of the LLC since its inception and that they were improperly expelled. The trial court concluded that the plaintiffs never became members of the LLC, interpreting the oral agreement between the two men to require that the plaintiffs sign the written operating agreement to become members. The Idaho Supreme Court affirmed.
Johnson and Crossett agreed to form an LLC to operate a business similar to a business Johnson’s brother-in-law (“Brother-In-Law”) had started. Under the oral agreement reached by Johnson and Crossett (the “Oral Agreement”), Crossett would be the sole agent and manager, receive a fixed salary, and own a 46% interest. Johnson would not be involved in day-to-day operations or receive compensation but would own a 44% interest. The two men also agreed that Crossett would contact Cousins, an employee of Brother-In-Law’s company, to recruit her to work for their company. Cousins was hired in May 2013 and was to receive a 10% interest in the company at some point, but she was not a party to the Oral Agreement.

Crossett filed a certificate of organization to form the company as a single-member LLC in June 2013. By the end of July 2013, a written operating agreement (“Written Agreement”) was prepared and approved by Crossett and Johnson, but the agreement was never signed. The LLC opened for business in July 2013 and was sued by Brother-In-Law’s company. Johnson refused to sign the Written Agreement because he did not want Brother-In-Law or other members of his family to know he was associated with the LLC. The LLC’s business grew quickly and ran into cash flow problems, bad publicity from Brother-In-Law’s lawsuit, and large legal fees from defending the lawsuit. Cousins resigned in October 2014 and was paid all the money she was owed.

Late in 2014, Crossett insisted that Johnson sign the Written Agreement and join him in personally guaranteeing some of the legal fees owed the LLC’s attorneys. Johnson refused and stated that these problems must be solved by Crossett. Johnson said he would not sign until the problems were resolved. Johnson and Crossett did not come to terms, and Crossett continued to operate the LLC as a single-member LLC. Johnson was eventually repaid what he invested in the LLC, but the LLC continued to have financial difficulties. Crossett outsourced the LLC’s business to a new LLC he formed with another individual, and eventually Crossett agreed to sell the LLC’s assets to the new company in exchange for the new company’s assumption of the LLC’s debts, which far exceeded the value of the LLC’s assets.

After a two-day bench trial, the trial court found that the Oral Agreement served as an operating agreement for the LLC in that it was an agreement to operate the LLC until the Written Agreement was ready to be signed. Specifically, the district court found that the Oral Agreement provided that Johnson and Cousins would only become members once they signed the Written Agreement. The trial court also concluded that Crossett did not breach any fiduciary duties (because the plaintiffs were not members and were paid what they were owed) and was not liable for money he withdrew from the LLC (because the withdrawals did not exceed what he was owed for his managerial duties).

The court also rejected the plaintiffs’ contention that the trial court erred in interpreting or applying the Idaho Uniform Limited Liability Company Act (the “LLC Act”) by allowing the unsigned Written Agreement to undercut the parties’ Oral Agreement. The plaintiffs argued that the trial court ignored the provision of the LLC Act that provided an operating agreement may be oral. The court stated that the plaintiffs took certain statements by the trial court out of context and that the trial court did not hold that an oral operating agreement may be undermined by the mere drafting of a written agreement. The court said the trial court “made clear that it was not the mere drafting of the Written Agreement, in the abstract, that undermined the Oral Agreement; rather, per the Oral Agreement, once the Written Agreement was ready to be signed, Appellants could only become members by signing.”

Finally, the court held that the trial court did not err by awarding attorney’s fees to Crossett under an Idaho statute that allows a prevailing party to recover attorney’s fees when the gravamen of the lawsuit is a commercial transaction. The court cited a case in which members of an LLC brought individual and derivative claims against the founder of the LLC, and the court affirmed an award of attorney’s fees on the individual claims pursuant to the statute regarding a commercial transaction and an award of attorney’s fees on the derivative claims pursuant to the LLC Act. The court distinguished cases in the partnership and corporate context where attorney’s fees were not recoverable because the gravamen of the actions related to enforcement of statutory provisions. Although the LLC Act was related to this action, the court said the gravamen of the action was a dispute over a claimed breach of contract, i.e., the Oral Agreement, which was a commercial transaction.
The court held that the rights of the estate of a deceased member of a Delaware LLC were limited by the LLC agreement to the rights of an assignee notwithstanding Section 18-705 of the Delaware Limited Liability Company Act, which provides that a deceased member's personal representative may exercise all of the rights of the member for the purpose of settling the member’s estate or administering the member's property.

Alex Calderwood formed an LLC with Ecoplace LLC (“Ecoplace”), an LLC controlled by Stefanos Economu. Calderwood died unexpectedly. At the time of his death, Calderwood held a majority stake in the LLC, which Ecoplace offered to purchase. The estate refused the offer and sued the LLC, Ecoplace, and Economu asserting numerous causes of action. The motion court dismissed several of the estate's claims, and the estate appealed.

First, the appellate court addressed the motion court's dismissal of the estate's claim for a declaration that the estate was a member of the LLC with all of Calderwood's rights. The defendants relied on the LLC agreement, but the estate argued that the Delaware LLC statute conferred the estate with all of Calderwood's rights notwithstanding the LLC agreement.

Section 9.7(b) of the LLC agreement provided:

Upon the death or disability of a Member ..., the Withdrawing Member shall cease to be a Member of the Company and the other Members and the Board shall ... have the right to treat such successor(s)-in-interest as assignee(s) of the Interest of the Withdrawing Member, with only such rights of an assignee of a limited liability company interest under the Act as are consistent with the other terms and provisions of this Agreement and with no other rights under this Agreement. Without limiting the generality of the foregoing, the successor(s)-in-interest of the Withdrawing Member shall only have the rights to Distributions provided in Sections 4 and 10.3, unless otherwise waived by the other Members in their sole discretion.

Section 18-705 of the Delaware LLC Act states:

If a member who is an individual dies ..., the member's personal representative may exercise all of the member's rights for the purpose of settling the member's estate or administering the member's property, including any power under a limited liability company agreement of an assignee to become a member.

The estate argued that the statutory provision permitted the estate to exercise all of Calderwood's rights notwithstanding the limitations in the LLC agreement, but the court responded by recognizing that the parties to an LLC agreement have substantial latitude to shape their own affairs and that the primary function of the statute is to fill gaps in the LLC agreement. The estate argued that Section 18-705 controlled over the LLC agreement because Section 18-705 does not contain the proviso “unless otherwise provided in the limited liability company agreement,” but the court rejected that argument on the basis of Delaware case law finding that another provision of the LLC statute lacking such a proviso was nonetheless permissive and subject to modification. The court also found it notable that Section 18-705 contains the phrase “may exercise,” which Delaware case law has stated indicates a “voluntary, not mandatory or exclusive, set of options.” The court also rejected the estate's argument that the policy of protecting vulnerable heirs supported the conclusion that Section 18-705 is mandatory under Delaware law. The court quoted Delaware case law stressing the primacy of contract in the LLC context and concluded: “[W]hether section 18-705 is mandatory or permissive, we, nonetheless, find that in this case it does not override section 9.7(b) of the LLC Agreement.”

The court next rejected the estate’s contention that the LLC agreement did not unambiguously abrogate Section 18-705 of the Delaware LLC Act. First, the court noted that any conflict between the
LLC agreement and the statute should be resolved in favor of the LLC agreement. Second, the court concluded that the LLC agreement was not susceptible to different interpretations, but clearly stated the consequences of the death of a member.

The estate also argued that a determination that the estate was not a member of the LLC would lead to an absurd result because the majority owner would have no participation or control rights while the minority owner would have full control. The court did not view such a result as absurd, pointing to Delaware case law recognizing the distinction between tolerating a new passive co-investor that one did not choose and enduring a new co-manager without consent.

The court next concluded that the estate’s claim for a declaration that it was owed fiduciary duties by the managing member was based on a “strained interpretation” of Delaware law and was properly dismissed by the motion court. The estate characterized itself as a party bound by the LLC agreement and argued that Ecoplace, as a managing member of the LLC, and Economou, who controlled Ecoplace, owed the estate fiduciary duties. (In a footnote, the court noted that the estate did not, and could not, argue that the LLC owed it a fiduciary duty because an LLC does not owe a fiduciary duty to a member and thus does not owe a duty to a non-member.) The estate relied on Feeley v. NHAOCG, LLC, 62 A.3d 649, 661 (Del. Ch. 2012) and Sections 18-1101 and 18-1104 of the Delaware LLC Act for the proposition that LLC managers owe fiduciary duties to others bound by the LLC agreement unless the duties are expressly disclaimed. The court stated that the estate’s pronouncement that it was a party bound by the LLC agreement and its reliance on _default_ fiduciary duties were unfounded. The court said the _Feely_ court did not explain what is meant by _otherwise bound by a limited liability company agreement_ in Section 18-1101(c). The court said the case law considering the term has arisen in the context of creditors of the LLC rather than a successor-in-interest, and the court also stated that the Delaware Supreme Court has called into question wether the Delaware LLC Act imposes “default” fiduciary duties, citing _Gatz Properties, LLC v. Auriga Capital Corp.,_ 59 A.3d 1206, 1219 (Del. 2012). (The court did not discuss the amendment of Section 18-1104 after the _Gatz_ case to provide that _the rules of law and equity relating to fiduciary duties ... shall govern._) The court pointed out that the court in _Feely_ was dealing with a dispute between a managing-member and a nonmanaging-member and did not address if or when fiduciary duties are owed by a member to a nonmember. The court stated that its decision did not impact causes of action asserted by the estate in its amended complaint for breach of contract based on the duty of good faith and fair dealing related to its rights to distributions and its alleged right to call Ecoplace’s interest.


The appellate court affirmed the convictions of two individuals on multiple theft charges based on checks written on the operating account of a real estate development LLC controlled by the individuals. The checks at issue represented expenditures on development projects other than the project specifically identified in the LLC’s operating agreement. The individuals argued that the operating agreement and Utah Revised Limited Liability Company Act authorized the use of LLC funds on other projects, but the court rejected these arguments.

A Utah couple (the “Victims”) agreed to sell twenty-nine acres (the “Property”) to Equity Partners LLC (“Equity Partners”), which was indirectly owned and controlled by two individuals (the “defendants”). The Victims and the defendants formed Tivoli Properties, LLC (“Tivoli”) to develop the Property. Equity Partners was the managing member and owned 75% of Tivoli, and the Victims owned 25% of Tivoli. Unbeknownst to the Victims, Tivoli entered into an agreement to develop other property and spent thousands of dollars on expenditures for projects unrelated to the Property. The defendants were charged with and convicted of multiple theft charges based on the expenditures. Under Utah law, theft requires proof that a defendant “obtains or exercises unauthorized control over the property of another with a purpose to deprive him thereof.” The defendants argued that their actions were authorized by Tivoli’s operating agreement (the “OA”) and the Utah Revised Limited Liability Company Act (the “LLC Act”).
The appellate court first addressed the defendants’ argument that the trial court should have determined as a matter of law that the OA authorized the defendants’ use of Tivoli funds for other development projects. The court discussed provisions of the OA that addressed Tivoli’s purpose and business and concluded that the broad description of the LLC’s business could be read to be limited by a provision that described the purpose of the LLC with reference to the Property or any other enterprise upon which the members mutually agreed. In view of this purpose provision, the court stated that there was a reasonable basis to conclude that the LLC’s authorized business activities were limited to development of the Property unless the members mutually agreed otherwise, and the OA did not unambiguously authorize joint ventures between Tivoli and other entities for development of property other than the Property.

The court also addressed a related question regarding the defendants’ managerial authority to make the expenditures that were the basis of the theft convictions. The defendants relied on broad provisions in the OA addressing powers of managers, policies, and conduct of the company, but the State pointed to other provisions that limited the managers’ authority to take certain actions. The court stated that these constraints could reasonably be interpreted to apply to the defendants’ actions. Given the limitations imposed by the OA on the broad authority conferred on the managers, the court was not persuaded that the OA unambiguously authorized the defendants to make the non-Property-related expenditures that were the basis of the theft convictions.

The court acknowledged that there were provisions from which the jury might reasonably have concluded that the parties to the OA intended to engage broadly in real estate development and make expenditures like those at issue, but there were other provisions reasonably supporting a conclusion that the parties intended Tivoli’s business to be limited to development of the Property. There was extensive evidence presented at trial regarding the meaning of the OA. Given the ambiguity of the OA and the substantial conflicting evidence regarding its meaning, the court held that the trial court properly submitted to the jury the issue of whether the defendants were authorized to make the expenditures based on the language of the OA and other evidence regarding the parties’ intent.

The defendants alternatively argued that the LLC Act authorized the defendants’ decisions to use Tivoli’s funds for other projects. Because this issue was not preserved by the defendants for appeal, the defendants had to establish plain error or ineffective assistance of counsel for relief based on this contention. The appellate court was not persuaded that it would have been obvious to the trial court or counsel for the defendants that the LLC Act dictated a result different from the result in this case.

The defendants contended that the LLC Act authorized their use of Tivoli’s funds to make the expenditures at issue because the defendants indirectly owned 75% of Tivoli, and the LLC Act permits members owning 2/3 of the interests in an LLC to take actions in contravention of the operating agreement or the stated purpose of the LLC. The defendants relied on Section 804(4) of the LLC Act, which provides that no manager has authority to do any act in contravention of the articles of organization or operating agreement except as provided by subsection (6)(g). Subsection (6)(g) states that “unless otherwise provided by the operating agreement:.....(g) approval by:....(ii) members holding 2/3 of the profits interests in the company, and 2/3 of the managers shall be required for all matters described in” subsection 803(3) of the LLC Act. Subsection 803(3) lists actions, including an act outside the ordinary course of business or substantial change to the business purpose of the company, that may be taken with 2/3 approval of the members. The defendants argued that the most logical interpretation of subsection 804(4)’s proviso excepting management actions described in subsection 804(6)(g) from the constraints of an operating agreement, requires that subsection 804(6)’s prefatory proviso, that the actions may be taken _unless otherwise provided in the operating agreement,_ not apply once subsection 804(4) has been invoked. The defendants argued that the reference to subsection (6)(g) means (6)(g) alone, without the prefatory proviso of subsection (6). According to the defendants, subsection 804(4) would never be applicable if the 804(6) prefatory proviso applies, because a manager could never act in contravention of an operating agreement since an action in contravention of the operating agreement would mean that the operating agreement “otherwise provides” a prohibition against the action. The defendants also argued that the State’s contrary interpretation (which would give effect to an OA provision that required consent of all members for any amendment to the OA, change in character
of the business, significant and material purchase, or act that would make it impossible to carry on the ordinary business) was circular and inconsistent with the purposes of the LLC Act to afford flexibility to LLC members. According to the defendants, one way to achieve flexibility to the members “is to permit those with the biggest stakes ... in conjunction with those who have been given management authority to take actions in a more flexible and timely manner.’

The court acknowledged that there was some logic to the defendants’ interpretation and that it revealed a potential inconsistency in the statute if subsection 804(6)’s introductory proviso is included when subsection 804(4) is invoked. However, it was not obvious to the court that 804(4) is meant to incorporate 804(6)(g) without 804(6)’s qualification giving primacy to the operating agreement, especially in light of the LLC Act’s overarching policy elevating the provisions agreed to by members in the operating agreement over the default provisions of the Act. The court also was not convinced that giving effect to the introductory proviso with (6)(g) necessarily renders subsection 804(4) a nullity. Even assuming that it would, however, the court was not persuaded that the trial court committed plain error by submitting the issue to the jury or that the defendants’ trial counsel performed deficiently by failing to make the argument that the defendants now made on appeal given the LLC Act’s express statement that the Act is intended to give maximum effect to freedom of contract and the enforceability of operating agreements and the presence of other provisions in the Act aimed at giving primacy to the operating agreement over contrary default provisions in the statute.


A minority member of a Delaware LLC sued the majority members and chair of the board for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing in connection with amendments to the operating agreement, termination of his employment and redemption of his interest, and rejection of offers to purchase the company. Although the court rejected the defendants’ argument that provisions of the LLC agreement eliminated fiduciary duties, the court affirmed the trial court’s summary judgment that the defendants did not breach any default fiduciary duties in connection with the amendments or the termination of the plaintiff’s employment and redemption of his interest. At the time of the first amendment of which the plaintiff complained, the defendants were not yet majority members owing any fiduciary duties. The subsequent actions taken by the defendants when they owed fiduciary duties were expressly allowed by the LLC agreement as previously amended, so there was no breach of fiduciary duty or breach of the implied covenant of good faith and fair dealing.

Miller and several other parties entered into an operating agreement for a Delaware LLC, and the agreement was amended on multiple occasions. Miller complained that he was coerced by economic duress (threats of termination) to agree to the third, fourth, and fifth amended and restated operating agreements. The amended operating agreements enabled the defendants to reduce his interest and redeem it when he eventually was terminated.

Miller relied on default fiduciary duties under Delaware law in asserting his breach-of-fiduciary-duty claims. The defendants argued that fiduciary duties were eliminated by provisions of the operating agreement, but the court held that none of the provisions relied upon by the defendants explicitly eliminated fiduciary duties. In support of the defendants’ claim that the default duty of care was eliminated, the defendants relied on exculpation provisions of the operating agreements that provided there would be no right, claim, or cause of action against any director or member for acting or failing to act in accordance with the director’s or member’s rights or obligations under the operating agreement. In support of their contention that the default duty of loyalty was eliminated, the defendants relied on a provision of the operating agreement allowing members to participate in other business opportunities and compete with the LLC. The defendants also argued that the entire-agreement clause eliminated default fiduciary duties. The court rejected the defendants’ arguments and stated that none of the provisions relied upon by the defendants plainly, unambiguously, or explicitly eliminated default fiduciary duties. Thus, default fiduciary duties applied to the decisions challenged by Miller in this case. The court went on to conclude, however, that most of Miller’s claims for breach of fiduciary duty failed.
The third amended agreement made many changes, including converting more than $10 million in debt owed to the LLC’s largest creditors into equity, thereby making the creditors the majority members of the LLC. The amendments also added a provision requiring redemption of an individual member’s interest on termination of the individual’s employment as well as provisions changing the structure and voting of the board so that appointees of the new majority members would have unilateral authority to take action, including amendment of the LLC agreement (which previously required unanimous consent of the members). Miller claimed that the defendants breached fiduciary duties to him by coercing him to sign the third amended operating agreement by threats of termination, but this claim failed because the defendants were not majority members when Miller signed the third amended agreement and thus owed him no fiduciary duties at the time. Furthermore, the defendants did not have the authority to terminate Miller at that time.

The court next addressed Miller’s claim that the fourth and fifth amended agreements, pursuant to which his interest was diminished, should be disregarded because his consent to those agreements was coerced. The court held that the failure of Miller’s claim as to the third amended agreement defeated his claims that the defendants breached their fiduciary duties by enforcing the fourth and fifth amended agreements because the third amended agreement gave the majority members the unilateral right to enact the fourth and fifth agreements regardless of whether Miller consented. The court said that it had found no Delaware authority to support the proposition that a party breaches a fiduciary duty by taking action specifically authorized under an LLC agreement. The court said Delaware law was clear that provisions in an LLC’s operating agreement supersede default fiduciary duties.

The court also rejected Miller’s claim that the defendants breached default fiduciary duties by redeeming his interest in the LLC upon his termination, again relying on the proposition that a party who takes action specifically authorized under an LLC agreement does not breach a default fiduciary duty.

Miller next argued that the trial court erred in granting the defendants summary judgment on his claim for breach of the implied covenant of good faith and fair dealing. The trial court ruled that there was no breach because the agreements allowed the defendants to terminate Miller and redeem his membership interests. Miller argued that he should be allowed to pursue this claim regardless of whether the agreements allowed redemption of his membership interests because the covenant protects reasonable expectations, and he expected and was given reassurance that he would receive a substantial return on his investment in LLC. The court rejected this argument on the basis that the implied covenant cannot be used to override express provisions of a contract. Miller also argued that his claim for breach of the implied covenant was supported by a provision of the agreement stating that removal of an officer did not affect the rights of the officer as a member, but the court stated that the specific language in a contract controls over the general, and the agreement specifically allowed redemption of Miller’s interest.


The court of appeals affirmed the judgment of the trial court that a Delaware LLC owed indemnity to its officer and that a settlement agreement precluded further collection of the judgment against the officer.

Jim Sandt, a former officer and member of Energy Maintenance (a Delaware LLC), sued Energy Maintenance, Timothy Nesler (the company’s CEO), and other officers claiming that the defendants had committed fraud and breach of fiduciary duty by wrongfully diluting his ownership interest. While Sandt’s suit was pending, the Energy Maintenance board agreed in a company resolution to indemnify Nesler for any liability arising out of or related to the Sandt litigation. The board resolution stated that the board agreed to indemnify Nesler after reviewing the Sandt litigation and discussing it with the company’s officers and attorneys. The resolution also stated that the board had determined that Nesler acted in good faith and in a manner that he reasonably believed was in the company’s best interest.

A jury found in favor of Sandt and against Energy Maintenance and Nesler. While an appeal was pending, the company’s primary creditor took control and terminated Nesler from his position as CEO.
The new board of directors then voted to revoke the prior indemnification as of the date it was purportedly granted. The rationale for the revocation was, in part, that Nesler had misrepresented to the board the facts related to the Sandt matter. After the company refused to provide indemnification, it filed suit against Nesler seeking a declaration that it did not owe him indemnity and claiming that the jury’s findings of fraud and breach of fiduciary duty against him alleviated the company’s indemnification obligation. Nesler counterclaimed for breach of contract.

The trial court ruled that Nesler was entitled to indemnification and that the company’s failure to provide it was a breach of contract. Because a settlement agreement between the company and Sandt stated that Sandt could not recover any further, directly or indirectly, from the company, the trial court further declared that Sandt could not pursue Nesler for any amounts that the company had to indemnify. Both the company and Sandt appealed.

On appeal, the court noted that Energy Maintenance was a Delaware LLC; thus, Delaware law controlled the interpretation of the company’s formation agreement. The court cited a number of Delaware law propositions, including (1) “under Delaware law, a limited liability company may indemnify any member, manager, or another ‘against any and all claims and demands whatsoever,’ subject to whatever standards or restrictions are included in its company agreement”; (2) “for limited liability companies, Delaware law ‘defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification’”; (3) “when interpreting the provisions of a limited liability company agreement, ordinary contract interpretation rules apply; the court’s role is to effect the parties’ intent based on the plain meaning of the agreement’s terms”; and (4) “[a] court cannot rewrite or add omitted provisions in the guise of interpreting a contract.”

The court noted that Article VIII of the Energy Maintenance company agreement contained provisions for indemnification and advancement of expenses. Although the provisions obligated Energy Maintenance to indemnify persons who acted in good faith, it vested the board with the authority to decide if they did act in good faith. The agreement expressly specified that an adverse judgment did not create a presumption of bad faith, and it stated a company policy of indemnifying corporate officers to the fullest extent legally possible. According to the court, “Energy Maintenance’s company agreement does not, in express and affirmative terms, make members and directors ineligible for indemnification previously granted simply because a jury finds that they did not act in good faith, and we cannot rewrite its company agreement to say something it does not.” In addition, the court concluded that unless Energy Maintenance had a contractual right to reconsider its decision to indemnify Nesler, it could not rescind its earlier determination. Because “[n]either its company agreement nor the board’s 2007 indemnity resolution reserved a right to revisit Nesler’s right to indemnity,” the court concluded that the company “could not rescind its agreement to indemnify him.”

Despite the company agreement provisions that vested the board with the authority to determine whether the conditions for authorizing indemnification had been met, Energy Maintenance contended that the jury’s unfavorable verdict and the judgment against Nesler for fraud disproved his good faith and thereby provided a basis for the board to revoke its earlier grant of indemnity. The company relied on Delaware decisions construing that state’s corporate indemnification statute, 8 Del. Code § 145, for the proposition that a jury’s finding of fraud negates good faith as a matter of public policy. The court disagreed, noting that the statutes governing Delaware corporations and Delaware limited liability companies were different. Unlike Section 145, which applied to corporations, the statute governing limited liability companies allowed indemnity “against any and all claims and demands whatsoever,” subject only to the express terms of the company agreement. This statute did not purport to adopt or incorporate Delaware’s public policy regarding indemnity in the corporate context, and it deferred instead to the contracting parties to place limits on indemnification.

Although the court decided that the company was obligated to indemnify Nesler from liability in the Sandt litigation, it also concluded that Sandt, in a settlement agreement, agreed to forego any collection of the judgment against Nesler for which the company would be liable. The settlement agreement provided that Sandt “will not seek to execute and will not accept recovery, in each case whether directly or indirectly, against” Energy Maintenance for any remaining liability arising from the suit.
The trial court reasoned that Energy Maintenance owed indemnity to Nesler, and thus an attempt to collect the remaining money that Nesler owed under the Sandt judgment would violate the settlement agreement’s clause barring Sandt from recovering any additional sum from Energy Maintenance “directly or indirectly.” In light of this clause and others, the court of appeals concluded that the trial court correctly interpreted the settlement agreement: “In sum, the settlement agreement bars Sandt from recovering from Nesler because it would result in an indirect recovery from Energy Maintenance, which is obligated to indemnify Nesler for the Sandt judgment.”

**Entity Nature of LLC; LLC Property**


The appellate court affirmed the convictions of two individuals on multiple theft charges based on checks written on the operating account of a real estate development LLC controlled by the individuals through another entity that owned 75% of the LLC and was the managing member. The checks at issue represented expenditures on development projects other than the project specifically identified in the LLC’s operating agreement. The individuals argued that the operating agreement and Utah Revised Limited Liability Company Act authorized the use of LLC funds on other projects, but the court rejected these arguments. The defendants argued that the trial court should have instructed the jury that the value of the allegedly stolen property was not more than 25% of the checks at issue because the defendants owned 75% of the allegedly stolen funds. The court rejected this argument because it is no defense to theft under Utah law that the actor has an interest in the stolen property if another person also has an interest that the actor is not entitled to infringe. The court relied on a case in which it had previously rejected a similar argument in the partnership context, and the court further relied on the separate legal existence of an LLC from its members and the distinction between LLC property and the interest of the members.

**Assignment of Interest**


In a dispute regarding the ownership of a limited partnership and its general partner, the court of appeals concluded that: (1) the trial court erred in submitting a jury question inquiring whether the parties to written assignments of interests in the limited partnership and its LLC general partner agreed to an alleged oral condition because the alleged condition contradicted the unambiguous terms of the assignments and was thus precluded by the parol evidence rule; (2) the language of certain assignments did not transfer any interest in the LLC general partner of the limited partnership; (3) certain purported transfers of interest in the LLC general partner were null and void ab initio because they were prohibited under the company agreement, and subsequent consent or ratification could not operate to give life to an attempted transfer that was null and void; (4) certain purported transfers of interests in the limited partnership were valid even if the transfers were prohibited by the partnership agreement because the partnership agreement allowed the general partner to recognize a transfer that would otherwise be null and void under the terms of the agreement.

Osama Abdullatif (“Latif”) and Ali Mokaram entered into a real estate investment venture by forming Mokaram Latif West Loop, L.P. (“ML Partnership”) in which Mokaram and Latif were each 49.5% limited partners and Mokaram-Latif General, LLC (“ML General”) was the 1% general partner. Mokaram and Latif were the managers and equal members of ML General. Mokaram and Ali Choudhri became friends and engaged in business transactions together, including transactions in 2008 and 2010 involving ML Partnership and ML General.

The 2008 transaction included an agreement in which Mokaram purported to transfer to Choudhri a limited partnership interest in ML Partnership, and the 2010 transaction included purported assignments by Mokaram to Choudhri of interests in ML Partnership and ML General. Disputes regarding these transactions arose, and eventually Latif purchased all of Mokaram’s interests in ML Partnership and ML General along with all of Mokaram’s claims against Choudhri relating to interests in the entities. Mokaram
agreed to continue to pursue his claims against Choudhri in this lawsuit in which Mokaram, Latif, Choudhri, and ML Partnership were parties. The trial court entered a declaratory judgment regarding the ownership of the entities, and Mokaram and Latif appealed.

The first issue the court of appeals addressed was whether the trial court erred in submitting a jury question inquiring whether Mokaram and Choudhri agreed that the 2010 assignment was not effective and that Mokaram would return the money paid by Choudhri to Mokaram. Because the unambiguous language of the assignment provided that it was effective immediately and did not indicate that it was contingent on any condition, the court of appeals concluded that the testimony regarding an alleged oral condition was precluded by the parol-evidence rule from contradicting the unambiguous language of the assignment. Thus, the trial court should not have submitted any question inquiring into the enforceability of the oral condition. The court stated that the parol-evidence rule would not have precluded the trial court from submitting a question about an alleged subsequent agreement to rescind, but the jury question that was submitted did not ask about a subsequent agreement to rescind. The court also stated that the evidence did not raise a genuine fact issue as to whether Mokaram and Choudhri agreed to rescind the assignment after they executed it.

The court next addressed the argument that the trial court lacked jurisdiction over the declaratory judgment claims regarding Choudhri’s ownership and management rights in ML General because ML General was not a party. The court of appeals held that the trial court did not lack jurisdiction over the claims. Although the declaratory judgment did not bind ML General, it was binding on the parties in this action.

Next the court of appeals discussed whether the trial court erred in declaring that Choudhri had owned an interest in ML General since the date of the 2008 assignment. Based on the language of the documents executed in 2008, which purported to transfer to Choudhri an interest in ML Partnership and certain real property, the court concluded that Mokaram did not purport to transfer any interest in ML General. The documents indicated that Mokaram and Choudhri thought that ML Partnership owned the real property referred to in the assignments and that they intended to transfer an indirect interest in the real property by transferring an interest in ML Partnership. However, assuming that ML Partnership owned the real property referred to in the assignments, that would not mean that ML General had any ownership in the property, and the court concluded that the evidence did not show that Mokaram transferred any interest in ML General to Choudhri by virtue of the 2008 assignments.

The 2010 assignments purported to transfer from Mokaram to Choudhri interests in both ML General and ML Partnership. Both the company agreement of ML General and the partnership agreement of ML Partnership contained restrictions on transfer, and the court discussed the effect of the purported transfers by Mokaram.

The ML General company agreement prohibited a member from transferring any of its membership interest except in limited circumstances, such as with the approval of members having more than 66.67% of the interests of all members. The company agreement stated that a transfer in violation of its provisions was “null and void ab initio.” Assuming Mokaram’s execution of the assignments represented his approval of the transfers, there was no evidence that Latif, the other 50% member at the time, approved the assignments before Mokaram purported to assign his interest, and there was no evidence that any of the other circumstances under which a transfer was permitted were present. Choudhri relied on a 2011 consent signed by Latif as manager and member of ML General in which Latif consented to any prior transfers by Mokaram to Choudhri of a membership interest in ML General. The court concluded that the purported assignments were null and void from the outset under the unambiguous language of the company agreement, and as such the purported transfers could not be ratified or validated after the fact. Thus, the trial court erred in declaring that Choudhri had owned 50% of ML General and had been a manager of ML General from and after the 2010 assignments.

The ML Partnership agreement also contained prohibitions on transfer, and the court next addressed the effect of purported assignments in 2010 by Mokaram to Choudhri of a limited partnership interest in ML Partnership. Section 10.1 of the partnership agreement prohibited a limited partner from
transferring all or any portion of the limited partner’s interest without the prior written consent of the general partner. Section 10.2 of the partnership agreement contained a right-of-first-refusal provision in favor of the other partners in the event a limited partner received a bona fide offer to purchase all or any portion of the limited partner’s interest. Section 10.3 provided for certain “Permitted Transfers” (to a trust for the benefit of the limited partner, the guardian or estate of a limited partner, or a person approved by all the partners) notwithstanding the consent otherwise required by Section 10.1. Section 10.6 provided that a transfer that was not permitted under the partnership agreement “shall be null and void and of no effect whatever; provided that if the Partnership is required to recognize a Transfer that is not permitted (or if the Partnership, in its sole discretion, elects to recognize a Transfer that is not permitted),” the transferred interest was limited to the transferor’s rights to allocations and distributions. Finally, Section 10.10 provided that the partnership was not required to recognize the interest of any transferee who obtained a purported transferred interest pursuant to a transfer that was not authorized by the partnership agreement, and such a transfer was “null and void for all purposes.”

The court stated that the plain meaning of “null and void and of no effect whatever” would preclude a transfer that was not permitted by the partnership agreement from being subject to ratification, confirmation, or waiver, but the court concluded that the phrase “null and void and of no effect whatever” was not used in its ordinary sense given that the agreement unambiguously provided that the partnership could elect to recognize a transfer that was not permitted and thus was or would have been “null and void and of no effect whatever.” The court noted the difference between the ML General company agreement (which the court had held did not permit ratification of a null and void transfer) and the ML Partnership agreement and concluded that the two agreements were separate and independent agreements that should not be construed together as one. Further, assuming the agreements should be construed as a single contract, the provisions unambiguously allowed the recognition of an otherwise void transfer of a partnership interest but did not allow the recognition of a void transfer of a membership interest.

Because Mokaram signed the assignment of his interests to Choudhri not only as assignor, but in his capacity as manager of ML General, the general partner of ML Partnership, under a legend stating that the transfer was consented to by the general partner, the court concluded that ML Partnership recognized the transfer of the interests. Relying on the language of the ML General company agreement (which provided that the managers shall have the sole and exclusive control of the management of ML General and shall make all decisions not otherwise provided for in the company agreement) and Section 101.254 of the Business Organizations Code (which provides that each governing person is an agent of the LLC for the purpose of its business), the court stated that Mokaram’s signature as manager was binding on ML General, and ML Partnership thus recognized the transfer as valid and effective as provided by Section 10.6 of the partnership agreement. The court concluded that an earlier purported transfer in 2008 by Mokaram to Choudhri of a limited partnership interest was not effective because there was no evidence that the transfer was permitted under any of the provisions of the partnership agreement nor was there any evidence that the partnership was required to recognize the transfer or exercised its discretion to recognize the transfer.

Finally, the court concluded that the trial court did not err in refusing to clarify what rights Choudhri had as a result of his ownership of an interest in ML Partnership. The trial court declared that Choudhri owned 49.5% of ML Partnership from and after the 2010 assignments and that he had “all beneficial rights and interests” that flowed from his ownership of an interest in ML Partnership. The court stated that the interests transferred to Choudhri were limited to rights to allocations and distributions under the unambiguous language of Section 10.6 of the partnership agreement, and neither Section 10.2 nor 10.6 gave Choudhri the right to become a limited partner under the assignments. The trial court did not declare that Choudhri was a limited partner, and although the “beneficial rights and interests” were significantly limited by the agreement, the trial court did not inaccurately characterize them. Thus, the court of appeals concluded that the trial court did not err in making the declaration and in refusing to clarify it.

The court held that the rights of the estate of a deceased member of a Delaware LLC were limited by the LLC agreement to the rights of an assignee notwithstanding Section 18-705 of the Delaware Limited Liability Company Act, which provides that a deceased member’s personal representative may exercise all of the rights of the member for the purpose of settling the member’s estate or administering the member’s property.

Alex Calderwood formed an LLC with Ecoplace LLC (“Ecoplace”), an LLC controlled by Stefanos Economu. Calderwood died unexpectedly. At the time of his death, Calderwood held a majority stake in the LLC, which Ecoplace offered to purchase. The estate refused the offer and sued the LLC, Ecoplace, and Economu asserting numerous causes of action. The motion court dismissed several of the estate’s claims, and the estate appealed.

First, the appellate court addressed the motion court’s dismissal of the estate’s claim for a declaration that the estate was a member of the LLC with all of Calderwood’s rights. The defendants relied on the LLC agreement, but the estate argued that the Delaware LLC statute conferred the estate with all of Calderwood’s rights notwithstanding the LLC agreement.

Section 9.7(b) of the LLC agreement provided:

Upon the death or disability of a Member ... (the “Withdrawing Member”), the Withdrawing Member shall cease to be a Member of the Company and the other Members and the Board shall ... have the right to treat such successor(s)-in-interest as assignee(s) of the Interest of the Withdrawing Member, with only such rights of an assignee of a limited liability company interest under the Act as are consistent with the other terms and provisions of this Agreement and with no other rights under this Agreement. Without limiting the generality of the foregoing, the successor(s)-in-interest of the Withdrawing Member shall only have the rights to Distributions provided in Sections 4 and 10.3, unless otherwise waived by the other Members in their sole discretion.

Section 18-705 of the Delaware LLC Act states:

If a member who is an individual dies ... the member’s personal representative may exercise all of the member’s rights for the purpose of settling the member’s estate or administering the member’s property, including any power under a limited liability company agreement of an assignee to become a member.

The estate argued that the statutory provision permitted the estate to exercise all of Calderwood’s rights notwithstanding the limitations in the LLC agreement, but the court responded by recognizing that the parties to an LLC agreement have substantial latitude to shape their own affairs and that the primary function of the statute is to fill gaps in the LLC agreement. The estate argued that Section 18-705 controlled over the LLC agreement because Section 18-705 does not contain the proviso “unless otherwise provided in the limited liability company agreement,” but the court rejected that argument on the basis of Delaware case law finding that another provision of the LLC statute lacking such a proviso was nonetheless permissive and subject to modification. The court also found it notable that Section 18-705 contains the phrase “may exercise,” which Delaware case law has stated indicates a “voluntary, not mandatory or exclusive, set of options.” The court also rejected the estate’s argument that the policy of protecting vulnerable heirs supported the conclusion that Section 18-705 is mandatory under Delaware law. The court quoted Delaware case law stressing the primacy of contract in the LLC context and concluded: “[W]hether section 18-705 is mandatory or permissive, we, nonetheless, find that in this case it does not override section 9.7(b) of the LLC Agreement.”
The court next rejected the estate’s contention that the LLC agreement did not unambiguously abrogate Section 18-705 of the Delaware LLC Act. First, the court noted that any conflict between the LLC agreement and the statute should be resolved in favor of the LLC agreement. Second, the court concluded that the LLC agreement was not susceptible to different interpretations, but clearly stated the consequences of the death of a member.

The estate also argued that a determination that the estate was not a member of the LLC would lead to an absurd result because the majority owner would have no participation or control rights while the minority owner would have full control. The court did not view such a result as absurd, pointing to Delaware case law recognizing the distinction between tolerating a new passive co-investor that one did not choose and enduring a new co-manager without consent.

Finally, the estate argued that Ecoplace (as a managing member of the LLC) and Economou (who controlled Ecoplace) owed the estate (as a party bound by the LLC agreement) fiduciary duties. The court concluded that the estate’s claim for a declaration that it was owed fiduciary duties by the managing member was based on a “strained interpretation” of Delaware law and was properly dismissed by the motion court.

**Derivative Suits**


The Virginia Supreme Court held that amendments to the provisions of the Virginia LLC statute on derivative suits in 2011 did not abolish the futility exception to the demand requirement.

Before it was amended in 2011, § 13.1-1042 of the Virginia Code authorized a member to bring a derivative action on behalf of the LLC “if members or managers with authority to do so have refused the action or if an effort to cause those members or managers to bring the action is not likely to succeed.” This language effectively codified, in the LLC context, Virginia case law in the corporate context requiring demand on the board of directors subject to a futility exception. As amended, § 13.1-1042 imposes a written demand requirement and 90-day waiting period before a member may file a derivative suit on behalf of the LLC, and § 13.1-1042 makes no mention of any futility exception. However, § 13.1-1044, which sets forth pleading requirements for a member derivative suit, requires the complaint to “set forth with particularity the effort of the plaintiff to secure commencement of the action by a member or manager with the authority to do so or the reasons for not making the effort.” (Emphasis added.) The court observed that this language would be superfluous absent a futility exception. In addition, the court pointed out that § 13.1-1001(A) provides that “the principles of law and equity supplement” the LLC statute except where displaced by particular provisions of the statute. Because derivative actions, including the futility exception, “developed on the equity side of the court” and are thus “principles of equity,” the court concluded that the 2011 amendment “had the effect of replacing an express textual reference in Code § 13.1-1042 with an incorporation by reference of a rule drawn by case law.” In sum, the court held that the General Assembly did not abolish the futility exception when it amended § 13.1-1042 in 2011.


The court of appeals held that the trial court abused its discretion in holding that a former member of a closely held LLC had standing to pursue derivative claims. The court rejected the former member's argument that the Legislature in Subchapter J of Chapter 101 of the Texas Business Organizations Code intended to eliminate any requirement of present member status with respect to a “derivative proceeding” on behalf of a closely held LLC.

Dunster Live, LLC ("Dunster"), the plaintiff in the action underlying this mandamus action, sued individually and derivatively complaining that the defendant members of LoneStar Logo & Signs, LLC ("LoneStar 1") acted wrongfully in forming a new LLC, which did not include the plaintiff as a member, to perform a new contract that essentially continued the business in which LoneStar 1 was previously
engaged. The defendants acknowledged that the majority owners of LoneStar 1 deliberately sought to exclude Dunster from their dealings relating to the new contract but maintained that they possessed the legal right and good reason to do so. The immediate focus of this mandamus proceeding was the threshold question of Dunster’s standing to pursue its derivative claims.

The defendants in the underlying proceeding sought summary judgment on the basis that Dunster’s interest in LoneStar 1 had been redeemed due to failure to pay a capital call before Dunster filed its lawsuit and that Dunster thus did not have standing to pursue its derivative claims. Dunster disputed the effectiveness of the redemption based on the terms of the company agreement and alleged breaches of fiduciary duty and lack of a valid business purpose, but the trial court ruled that Dunster’s membership interest in LoneStar 1 was validly redeemed and that Dunster ceased being a member of LoneStar 1 before the lawsuit was filed. The trial court declined to dismiss Dunster’s derivative claims, however, concluding that Dunster had standing because Dunster was a member at the time its derivative claims accrued.

The court of appeals began its analysis by noting that “the legal principles governing derivative claims brought on behalf of LLCs are, at least with respect to this case, materially identical extensions or analogues of those that have developed in regard to shareholder-derivative actions on behalf of corporations.” The court reviewed the historical roots, purposes, and requirements of a derivative action, including “the rule, recognized in Texas as elsewhere, that a corporate shareholder (and, by logical extension, an LLC member) must have and maintain that ownership status in order to have standing to prosecute derivative claims on the entity’s behalf.” The court acknowledged that “Texas courts have recognized an equitable exception to this ownership requirement where a shareholder’s interest is ‘destroyed’ involuntarily without a valid business purpose,” but the court stated that “the district court has determined that this exception is not applicable here by granting partial summary judgment recognizing that the redemption had been effective in causing Dunster to ‘cease[ ] being a member of LoneStar Logo & Signs, LLC . . . .’”

The court generally reviewed the matters covered by Subchapter J of Chapter 101 of the Texas Business Organizations Code (Sections 101.451 through 101.463), which addresses derivative proceedings in the LLC context and parallels the statutes governing derivative proceedings involving for-profit corporations in Subchapter L of Chapter 21 of the Texas Business Organizations Code. The court called attention to the standing requirements of Section 101.452, which include the so-called “contemporaneous ownership” requirement. Section 101.463, however, contains provisions specifically applicable to LoneStar 1 as a “closely held LLC” (an LLC with fewer than 35 members and no membership interests listed on a national securities exchange or regularly quoted in an over-the-counter market). Section 101.463 provides that Sections 101.452-101.459 do not apply to closely held LLCs. The court explained that the Texas Supreme Court has determined that the analogous provisions in the corporate context codified a version of the shareholder-derivative action that permits a shareholder of a closely held corporation to bring an action on behalf of the corporation free of the statutory standing, demand, and mandatory-dismissal requirements that would otherwise apply.

The court explained that “[t]he gravamen of Dunster’s standing theory is that Sections 101.463 and 101.451, as the Texas Supreme Court has construed this same language in regard to shareholder-derivative suits, codifies a version of the derivative action that also eliminates any requirement that a claimant presently possess member status in order to assert derivative claims on behalf of a closely held LLC.” Dunster argued that it satisfied the contemporaneous-ownership requirement in Section 101.452 because it still had member status when the derivative claims accrued, and the district court relied on this rationale in denying summary judgment on the standing issue. Dunster’s arguments rested upon the premise that the Legislature in Subchapter J intended to eliminate any requirement of present member status from the “derivative proceeding” it codified, but the court of appeals concluded that “[t]he statutory language does not go that far, nor has the Texas Supreme Court so held.”

In explaining its rejection of Dunster’s standing theory, the court of appeals initially observed that the implications of Dunster’s theory should give some pause in that its theory seemed to imply that a
litigant need not meet standing requirements of any kind in order to bring a derivative suit on behalf of a closely held LLC. The court rejected Dunster’s argument that the import of Section 101.463’s provision allowing a court to treat a derivative action brought by a member of a closely held LLC as a direct action for the member’s own benefit is that a plaintiff’s standing to bring a derivative claim is contingent on its standing to bring a direct claim. The court pointed out that the Texas Supreme Court has held that “the proceeding still must be derivative” under the parallel language governing closely held corporations, and the court of appeals presumed that the Legislature codified its statutory versions of “derivative actions” with awareness that a fundamental feature of such an action is the claimant’s possession of an interest in the entity on whose behalf it sues such that the plaintiff has a stake in the outcome. The court said the text of Subchapter J contemplated rather than abrogated this fundamental feature as reflected by its text, including references in Section 101.463 to “a derivative proceeding brought by a member of a closely held limited liability company’ and ‘a recovery in a direct or derivative proceeding by a member,’” and additional prerequisites to standing that apply under Section 101.452 to one who is presently a “member.” The court pointed out that sister courts of appeals have held that the parallel corporate provisions require that shareholder status be maintained throughout the suit, and recent decisions of the Texas Supreme Court addressing derivative suits brought on behalf of closely held corporations “have uniformly presumed a plaintiff who is presently a shareholder.”

In conclusion, the court held that (1) the trial court abused its discretion in holding that Dunster had standing as a former member to pursue derivative claims on LoneStar 1’s behalf and (2) the relators lacked an adequate remedy by appeal after final judgment. Thus, mandamus relief was appropriate, and the court conditionally granted the writ and directed the trial court to vacate its previous order and dismiss Dunster’s derivative claims for want of standing.

**Charging Order**

*Sky Cable, LLC v. DIRECTV, Inc.*, 886 F.3d 375 (4th Cir. 2018).

After a judgment against an LLC and its sole member went unsatisfied, the district court entered an amended judgment that reverse pierced the veil of three other LLCs owned by the individual and made them co-judgment debtors with the individual. On issues of first impression, the court of appeals affirmed the district court’s decision and held that Delaware law permits the remedy of reverse veil piercing when the LLC is the alter ego of its member.

In 2000, Randy Coley, through his subsequently-defunct East Coast Cablevision, LLC (“ECC”), contracted with DIRECTV, Incorporated (“DIRECTV”) to provide its programming to 168 rooms at a Virginia resort. In 2011, an investigation by DIRECTV revealed a fraudulent scheme pursuant to which ECC and Coley received payment for cable services provided by DIRECTV to over 2,500 units at the resort while continuing to pay DIRECTV only for those services provided to the 168 units. DIRECTV eventually obtained a judgment for $2.4 million against Coley and ECC for violations of federal communications law based on the unauthorized receipt and distribution of DIRECTV’s programming.

Coley dissolved ECC after the district court entered its judgment, and DIRECTV was unable to collect any payment from Coley, who had few personal assets. Discovery in the post-judgment phase of the case revealed that several LLCs owned and managed by Coley held title to or managed Coley’s assets. DIRECTV filed a motion in the district court to reverse pierce three LLCs owned and managed by Coley in order to obtain access to the assets of these LLCs. These three companies were not parties to the case and had not been served with process. In 2016, the district court entered an amended judgment rendering the three LLCs co-judgment debtors with Coley and held that: (1) under Delaware law, the three LLCs were alter egos of Coley; (2) Delaware would recognize reverse veil piercing under such circumstances; and (3) DIRECTV’s failure to serve process on the three LLCs did not prevent the court from exercising jurisdiction over them. Coley and one of the three LLCs appealed, arguing that Delaware law does not permit reverse piercing of a corporate veil even when the corporation is the alter ego of the judgment debtor, and that Delaware’s LLC charging order statute provides the exclusive remedy for a judgment creditor seeking access to the financial interest of an LLC’s member.
The court of appeals reviewed de novo whether Delaware law would permit reverse piercing of an LLC. The court first discussed corporate and LLC veil piercing in general and distinguished the various types of veil piercing. The court explained that traditional veil piercing permits a court to hold an owner liable for a judgment against the entity, whereas reverse veil piercing imposes liability on the entity for a judgment against an owner. The court further explained that an additional classification of reverse piercing concerns the origin of a request to the court to disregard the entity’s form: “insider” reverse piercing applies when the entity’s controlling owner makes such a request, whereas “outsider” reverse piercing (relevant here) applies when an outsider/third party (often a creditor) makes the request.

Because the law of the state in which an entity is “incorporated” generally governs the question of whether a court may pierce an entity’s veil, and the parties did not dispute that Delaware law applied to the reverse piercing claim, the court relied on Delaware case law to analyze whether Delaware permits reverse veil piercing. The court discussed Delaware’s recognition of traditional veil piercing as an equitable remedy in exceptional circumstances and noted that the purpose of reverse piercing is to hold a company liable for a member’s actions to prevent fraud or injustice. The court stated that reverse piercing is particularly appropriate when an LLC has a single member because there are no other members whose interests are affected. According to the court, “because Delaware courts apply the alter ego theory only in exceptional circumstances, recognition of reverse veil piercing for the limited purpose of preventing fraudulent conduct would not threaten the general viability of the corporate form in Delaware.” The court noted Delaware’s “powerful interest. . . in preventing entities that it charters from being used as vehicles for fraud,” and the court discerned that Delaware courts have “signaled some willingness to apply a theory of reverse veil piercing.” Thus, the court concluded that “Delaware would recognize outsider reverse veil piercing of an LLC’s veil when the LLC is the alter ego of its sole member.”

The court next analyzed Coley’s contention that Delaware’s LLC charging order statute precluded reverse piercing of his LLC based on the following “exclusivity” provision of the statute:

The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or a member’s assignee may satisfy a judgment out of the judgment debtor’s limited liability company interest and attachment, garnishment, foreclosure or other legal or equitable remedies are not available to the judgment creditor, whether the limited liability company has 1 member or more than 1 member.

6 Del. Code § 18-703(d).

Although Delaware courts have not interpreted this provision, the court found it to be clear that piercing the veil of an alter ego was not the type of remedy the statute was intended to prohibit. The court applied the statutory construction rule of “ejusdem generis” and concluded that the general reference to “other legal or equitable remedies” applied only to types of remedies that are similar to those specifically listed, i.e., “attachment, garnishment, [and] foreclosure.” Reverse veil piercing of an LLC when the LLC is the alter ego of its sole member permits the court to treat the LLC as “identical” to its member and effectively eliminates the legal status of the LLC in narrow circumstances involving fraud or injustice. Therefore, the court considered reverse piercing to be unlike the common-law seizure remedies listed in the exclusivity provision of the charging statute. Additionally, the court determined that Coley’s interpretation of the charging order statute would impermissibly limit Delaware’s ability to prevent the entities that it charters from being used as vehicles for fraud.

The court then analyzed Coley’s contention that the district court erred in reverse piercing the veil of Coley’s LLC because the district court failed to make a finding of fraudulent purpose. The appellate court stated that in order to prevail under an alter ego theory, a plaintiff is not required to show “actual fraud but must show a mingling of the operations of the entity and its owner plus an ‘overall element of injustice or unfairness.’” The court stated that an inference may be drawn that entities are one and the same if they fail to follow corporate formalities when doing business with one another. In a footnote, the court noted that “LLCs must observe fewer internal formalities than corporations, but the principle that they should follow ordinary formalities and norms when doing business with other entities is the same.” The court described evidence of commingling of funds, lack of proper accounting records, unexplained
transfers of funds, and payments by one LLC of another LLC's or Coley's expenses or obligations. The court also concluded that an "overall element of injustice or unfairness" was present because DIRECTV had not yet received any payment on its judgment obtained more than four years ago. Based on this evidence, the appellate court concluded that the district court's finding of alter ego was not clearly erroneous.

Next the court rejected Coley's contention that the district court erred in holding that Coley's participation in the post-judgment proceedings permitted the district court to exercise jurisdiction over his LLC despite the fact that the LLC was not served with process. The appellate court reasoned that when reverse veil piercing a single-member LLC, the individual is already before the district court, and there is no concern that the alter-ego LLC must receive independent notice of a legal action. Thus, the court held that an LLC that is the alter ego of its sole member is properly before the court when the court has jurisdiction over the member.

Finally, the court rejected Coley's argument that the district court erred in applying the doctrine of equitable estoppel in the post-judgment proceedings with respect to the contention that Mrs. Coley was also a member of his LLC. During the pre-judgment proceedings, Mrs. Coley represented that she was not an owner of any of Coley's business entities and was not a member of the LLC. Coley also testified that he was the sole member of the LLC and produced an operating agreement that indicated he was the sole member. DIRECTV relied on these representations in dismissing Mrs. Coley. After the judgment was entered, the Coleys sought to establish that Mrs. Coley was a member (in order to oppose reverse piercing the LLC on the basis that it would prejudice Mrs. Coley as an innocent owner), and the court concluded that "[t]he Coleys' shifting positions reflected an attempt to assert whatever position would advance their quest to avoid liability and place their personal assets beyond the reach of DIRECTV." Thus, the court held that the district court did not abuse its discretion in estopping the assertion of Mrs. Coley's interest in the LLC in the post-judgment proceedings.


The court of appeals held that the trial court did not abuse its discretion in ordering the turnover of a judgment debtor's interest in a limited partnership and an LLC.

In a personal injury action that Teresa Heckert brought against her ex-husband Clyde Heckert, a jury awarded Teresa $381,342.27. Teresa filed a motion seeking the turnover of any of Clyde's nonexempt assets, including his interest in a limited partnership (A2R, Ltd.) and a single-member LLC (Averse 2 Risk, LLC). Both entities were formed after the divorce while Teresa's personal injury suit was pending against Clyde. The LLC was the general partner of the limited partnership, and Clyde was the sole limited partner. Clyde was also the sole member of the LLC. The limited partnership owned stock that was awarded to Clyde in the divorce.

The court determined that Clyde’s ownership interests in the entities were nonexempt. Nevertheless, Clyde argued that the interests were not susceptible to turnover because, according to Clyde, “sections 101.112 and 153.256 of the Business Organizations Code provide that the exclusive remedy by which a judgment creditor of a limited partnership or limited liability company may satisfy a judgment out of the judgment debtor's interest in that limited partnership or limited liability company is a charging order.”

The court agreed that "[t]he plain language of sections 101.112(d) and 153.256(d) provides that a charging order is generally the exclusive remedy by which to satisfy a judgment out of the judgment debtor's interest in a limited partnership or limited liability company." Nevertheless, the court noted that "courts have held that there are some exceptions to this rule." For example, the Dallas Court of Appeals held that the sections do not preclude turnover of a person’s distributions from an LLC or limited partnership. In addition, the Houston (14th) Court of Appeals held that “turnover of a member’s interest in a limited liability company was not precluded by section 101.112 'when the judgment creditor seeking the membership interest is the entity from which the membership interest derives,' and when the turnover order 'involves an explicit award of the membership interest itself from one party to the other as part of
the judgment.” According to the Heckert court, “[t]his is because in these types of situations, the purpose of a charging order has not come into play: the charging order was developed to prevent a judgment creditor’s disruption of an entity’s business by forcing an execution sale of the partner’s or member’s entity interest to satisfy a debt of the individual partner or member.”

The Heckert court determined that “the same reasoning applies here because neither A2R, Ltd. nor Averse 2 Risk, LLC is an operating business; both entities appear to have been formed by Clyde for the sole purpose of taking ownership of nonexempt assets awarded to him in the divorce.” The court noted that “[n]o other party’s interest will be disrupted by the turnover of those interests and the stock owned by A2R, Ltd.,” and it observed that “Clyde has already assigned his interests and the [stock] to the receiver, subject to his right of appeal.” As a result of this analysis, the court held that the trial court did not abuse its discretion in ordering the turnover of Clyde’s interest in the limited partnership and the LLC.


An individual’s tax returns showing income from an LLC and filings made by the LLC with the Ohio Division of Liquor Control naming the individual as “owner,” “manager,” and “partner” of the LLC were not “records of the limited liability company” for purposes of determining that the individual was a member. When determining whether a person is a member of an LLC, a court must consider records that are maintained by the LLC for the purpose of its corporate governance and that name owners entitled to receive distributions and share in profits and losses of the LLC.

A judgment creditor obtained charging orders against the judgment debtor’s alleged interests in three LLCs. Although the operating agreements of the LLCs did not list the judgment debtor as a member, the tax returns of the judgment debtor showed income from the three LLCs, and documents filed by the LLCs with the Ohio Department of Commerce–Division of Liquor Control listed the judgment debtor alternately as “owner,” “manager,” and “partner.” On appeal, the judgment debtor argued that the operating agreements established that he was not a member and that the trial court erred in granting the charging orders.

The Ohio LLC statute permits a judgment creditor of a member to apply for an order charging the membership interest of the member, and the statute defines a “member” as “a person whose name appears on the records of the limited liability company as the owner of a membership interest in that company.” Ohio Rev. Code § 1705.01(G). A “membership interest” is “a member’s share of the profits and losses of a limited liability company and the right to receive distributions from that company.” Ohio Rev. Code § 1705.01(H). The judgment debtor argued that the operating agreements conclusively established that he was not a member of the LLCs, but the judgment creditor argued that the records from the Division of Liquor Control were “records of the limited liability company” because the statute does not define the phrase or limit such records to the operating agreement. The judgment creditor argued that “records of the limited liability company” should include any document that “records or documents past events” of the LLC—in essence, any document generated by the LLC in the normal course of business.

The court rejected the judgment creditor’s proposed definition of “records of the limited liability company” as unworkably broad and found it instructive to look at the statutory provision listing the records required to be kept by an LLC at its principal office. The court said that all of the listed records are required to be maintained for purposes of the LLC’s corporate governance. According to the court, limiting “records of the limited liability company” to documents involving corporate governance that establish a membership interest in an LLC is consistent with the statutory record keeping requirement, provides the most reliable information regarding the LLC’s structure and operation, and guides the trial court as to what records to examine to determine whose name appears as an owner “entitled to receive distributions and share in the profits and losses.” Thus, to determine who is a member of an LLC for purposes of issuance of a charging order, a court must consider records that are maintained by the LLC for the purpose of its corporate governance and that name those owners entitled to receive distributions and share in the profits and losses of the company.
Based on the definition of “records of the limited liability company” adopted by the court, the judgment creditor failed to produce evidence that the judgment debtor was a member of any of the three LLCs at issue. The filings with the Division of Liquor Control were documents relating to the LLC’s business operation, not its corporate governance, and the judgment debtor’s tax returns were not documents of any of the three LLCs. The only “records” of the three LLCs before the trial court were the operating agreements, which showed that the judgment debtor was not a member of any of the three LLCs. The trial court thus erred when it granted the motion for the charging orders.

**Governing Law**

See *Estate of Calderwood v. ACE Grp. Int’l, LLC*, 157 A.D.3d 190, 67 N.Y.S.3d 589 (App. Div. 1st Dept. 2017), under the headings “Admission of Member,” “Fiduciary Duties,” and “Interpretation of Operating Agreement or Partnership Agreement,” in which the court applied Delaware law in determining whether the estate of a deceased member of a Delaware LLC became a member of the LLC and whether fiduciary duties were owed to the estate by the managing member, but held that the estate’s claims for constructive trust and an accounting were governed by New York law.
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]

   (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. See Price v. Gurney 324 U.S. 100 (1945). With respect to general partnerships, the federal bankruptcy rules once provided that a bankruptcy petition could be filed by any general partner, provided that all general partners consented, see former Fed. Bankr. R. § 1004(a), but that rule was deleted because it was inappropriate for the bankruptcy rules to attempt to define what is essentially a state law governance rule. In the corporate context, the power to file a petition 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 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 a debtor in a Chapter 7 bankruptcy case. 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. 3, 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.

Two 2010 cases address the status of persons as members authorized to participate in the bankruptcy filing decision. In In re Wyatt & McAlister, PLLC, 2010 WL 1709920 (Bankr. S.D. Miss. Apr. 23, 2010), a member resigned as an employee of a professional limited liability company but preserved her ownership interest in the LLC. The court held that because she had not resigned and therefore remained a member, she was entitled to vote on whether to put the LLC into bankruptcy, and because she was a 50% member, the other member did not have authority to file the bankruptcy petition without her approval. In In re Lake County Grapevine Nursery Operations, 441 B.R. 653 (Bankr. N.D. Cal. 2010), a member that had pledged his entire membership interest and was in default on the underlying loan was found to have authority as a member because the pledge did not have the effect of acting to defease the member of his status as such without further action to confer membership status on the creditor.

A 2013 Virginia case applied the ipso facto provision of § 365 of the Bankruptcy Code to declare ineffective the Virginia LLC Act’s bankruptcy dissociation provision and give effect to a filing, but this case dealt with the status of a member at the time of the filing, rather than the member’s statutory power. In this case, the debtor’s personal bankruptcy case had been dismissed, and the question was whether the LLC of which he was a member had a properly authorized bankruptcy petition, given that he may have ceased to be a member when his petition was filed. The court concluded that the debtor’s approval of the LLC filing was valid because the debtor’s non-economic interest in the LLC was the property of the estate because the ipso facto clause invalidated the effect of the operating agreement and the Virginia LLC act. However, having said that the ipso facto clause rendered those provisions invalid, as if the rights were never divested, the court then spoke of the rights as “revesting” in the debtor. See In re Virginia Broadband, LLC, 498 B.R. 90 (Bankr. W.D. Va. 2013). Contrast this case with In re B&M Land and Livestock, LLC, 498 B.R. 262 (Bankr. D. Nev. 2013) (Chapter 7 debtor as the sole member of an LLC did not have power to file a Chapter 11 petition for the LLC).
2. **Contractual Power to File.** The value of a contractual provision limiting the authority of managers or members to file a bankruptcy petition was made 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 case, 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 case, 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 was 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).

A Virginia bankruptcy case reached a similar result. In *In Re Loudoun Heights, LLC*, 2014 Bankr. LEXIS 2085 (Bankr. E.D. Va. June 26, 2014), the bankrupt LLC had two members, including another LLC with a 93% membership interest. However, prior to the bankruptcy filing, that LLC had been administratively terminated for failure to file its annual report and pay its annual fee, and therefore was deemed under the Virginia LLC Act to have dissociated as a member of the bankrupt LLC. The bankruptcy filing was authorized by the sole remaining member, and even though the other member LLC had been reinstated subsequent to the bankruptcy filing, the court refused to give that reinstatement effect for the purposes of determining whether the bankruptcy filing had been properly authorized at the time of the filing several months before.

Two cases also emphasize the importance of providing more explicitly for the possibility of an LLC’s bankruptcy. In both cases, had the operating agreements been more explicit, the court’s analysis would have been unnecessary. See *In re 210 West Liberty Holdings, LLC*, 2009 WL 1522047 (Bankr. N.D.W. Va May 29, 2009) (provision that “all decisions” be made by majority vote is sufficient to allow bankruptcy filing over member objection because the objecting member’s approval was not necessary to constitute majority); *In re Ice Oasis, LLC*, 2008 WL 5753555 (Bankr. N.D. Cal. Nov. 7, 2008) (in two member LLC with 50/50 ownership, both members were required to approve the bankruptcy filing because the operating agreement provided for “all decisions” to be approved by a majority, and bankruptcy is not an ordinary course decision that may be approved by the managing member).

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 case.

In In re Quad-C Funding LLC, 498 B.R. 135 (S.D.N.Y. 2013), a dissident LLC member challenged the filing of a Chapter 11 petition for the LLC on the basis that the requisite supermajority vote of members had not approved the filing. The other members of the LLC had circumvented the dissident member’s effective veto right by raising additional capital and issuing additional LLC units that eliminated the dissident member’s ability to block the filing. The dissident member asked the court to consider the validity of the issuance of the additional units (based on the lack of accredited investor status of the new investors), but the court concluded that in bankruptcy, it was not obligated to investigate the non-bankruptcy legal status of the voting rights of each LLC member.

3. Effect of Non-Bankruptcy Law.

State receivership law and other state remedies can also affect the way in which LLC laws interact with bankruptcy.

The court in In re Orchard Village Investments, LLC, 405 B.R. 341 (D. Ore. 2009) was required to consider whether non-bankruptcy state receivership law could be used to prevent the filing of a bankruptcy petition. Following the creation of the state receivership, the receiver was granted broad authority that arguably divested the members of the authority to file a bankruptcy petition. The LLC’s operating agreement specifically denied the LLC’s manager the authority to file a bankruptcy petition, and reserved that power to the members by majority consent. In this case, the disputed bankruptcy petition was filed by the manager, and ratified post-petition by the members. The court held the post-ratification approval sufficient under the operating agreement, and held that the state receivership proceeding could not trump the ability to file the federal bankruptcy petition.


The effectiveness of creditor efforts to utilize bankruptcy-remote single purpose entities (SPEs) and contractual restrictions on bankruptcy filings to limit the ability of an LLC to file for bankruptcy requires careful drafting, and these techniques may not always be honored by courts.
confronted with them.

The creditors involved in *In re Crossover Financial I, LLC*, 477 B.R. 196 (Bankr. D. Colo. 2012) had extracted an agreement by the debtor LLC and its sole member pledging the member’s interest and providing the creditors with voting rights by proxy in the event of default. However, the court concluded that the creditors exercising these rights simply became assignees or transferees under the Colorado LLC statute, and did not have the right to participate in management or otherwise to divest the sole member of his status as a member. For that reason, the sole member’s adoption of a unanimous consent directing the filing of the LLC’s bankruptcy petition was within the member’s legal power.

Another case emphasizes the importance to creditors of carefully drafting provisions intended to cover bankruptcy filings. In *In re General Growth Properties, Inc.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009), several hundred SPEs had been established with “independent managers” who had the power to consent or withhold consent to a bankruptcy filing by each SPE. Before the bankruptcy petitions were filed against the ultimate parent and the numerous subsidiaries, the independent managers were discharged and replaced, in a manner that apparently complied with the provisions of the SPEs’ operating agreements. Because the new independent managers arguably had more expertise than the prior independent managers, the court concluded that this maneuver could not be deemed to be in bad faith, and refused to dismiss the bankruptcy petitions on that basis.

The practical effect of a unanimity requirement was at issue in a dispute over the bankruptcy of a regional sports network, *In re Houston Regional Sports Network, L.P.*, 2014 WL 554824 (Bankr. S.D. Tex. Feb. 12, 2014). In that case, the bankrupt limited partnership had an LLC general partner, and the general partner was controlled by four “directors”. The directors represented differing interests and owners of the LLC, and certain decisions, including bankruptcy reorganization, required director unanimity. One of the directors argued that the bankruptcy petition should be dismissed because its unwillingness to reorganize the partnership rendered the proceeding fatal, but the court concluded that despite disclaimers of fiduciary duties in the limited partnership agreement, and the fact that the directors were one step removed as directors of a general partner, the directors all owed fiduciary duties to the limited partnership bankruptcy estate. Accordingly, the court refused to dismiss the proceeding because of its expectation that all the directors would take future actions consistent with their fiduciary duties to the debtor.

Two different bankruptcy courts rendered decisions in 2016 that had the effect of overriding operating agreement provisions that empowered a creditor or a nominee of a creditor to utilize a bankruptcy approval requirement to block a bankruptcy filing by a debtor LLC. In *In re Lake Michigan Beach Pottawattamie Resort LLC*, 547 B.R. 899 (Bankr. D. Ill. 2016), the operating agreement had been amended, following a loan default by the Michigan LLC, to permit the lender to designate a "special member" of the LLC. The special member's consent was required in order to take certain actions, including the filing of a bankruptcy petition, and the amendment also purported to absolve the special member from considering any interests other than those of the creditor. In a somewhat convoluted decision, the court determined that the waiver of fiduciary duties was not valid under Michigan law, but nevertheless held that the purported elimination of fiduciary duties was fatal to the creditor's contractual approval right. On
public policy grounds, the court upheld the validity of the bankruptcy filing. In *In re Intervention Energy Holdings, LLC*, 2016 WL 3185576 (Bankr. D. Del. 2016), the court conducted a more extensive analysis of the public policy disfavoring waivers of the right to file bankruptcy, and treated as invalid an operating agreement provision that required unanimous member consent, where the Delaware LLC's lender had been admitted to the LLC and issued a single ownership unit. Without discussing whether the operating agreement at issue actually contained a waiver of fiduciary duties, the court focused on the absence of fiduciary duties as the basis for finding, again on public policy grounds, that the bankruptcy filing was valid. Interestingly, in both cases, the LLCs and their non-creditor members had failed even to consult the creditor members regarding the bankruptcy filings, so that the creditor members were not even given the opportunity to demonstrate that their participation in the bankruptcy filing decision was conducted in accordance with the kinds of fiduciary duties that would typically be expected to apply.

Similar issues have arisen in two 2017 cases. One recent case to weigh a bankruptcy blocking mechanism is *Squire Court Partners L.P. v. Centerline Credit Enhanced Partners LP*, Case No, 4:16CV00935 JLH, 2017 U.S. Dist. LEXIS 105032 (E.D. Ark. Jul. 7, 2017). In this partnership case, the limited partnership consisted of three partners, and the sole general partner filed a voluntary petition. That partner held a 0.01 percent interest in the partnership, while the interests of the two limited partners were 99.98 percent and 0.01 percent. The partnership contained a provision that required unanimous partner (including the limited partners) consent for a bankruptcy filing, and the general partner, which was also the guarantor of the partnership’s indebtedness, attempted to obtain the limited partners’ approval. They did not agree, and in fact were in the process of invoking the guaranty in another proceeding to ensure that the partnership’s indebtedness did not remain in default.

The general partner invoked the outcomes in both *Intervention Energy Holdings* and *Lake Michigan Beach* to challenge the validity of the unanimous approval requirement. The partner asserted that the fact that limited partners do not owe fiduciary duties to the limited partnership rendered their right to veto a bankruptcy proceeding void. The general partner also claimed that the sole general partner had inherent power to act for the partnership in filing the petition. The court rejected both arguments. As to the fiduciary duties claim, the court distinguished *Lake Michigan Beach* by noting that no external parties, and particularly no creditor, were involved. Nothing in state law prohibited a limited partnership from giving limited partners an approval right over major decisions such as bankruptcy. With respect to the general partner’s attempt to liken itself to a corporate board of directors with inherent governance authority, the court acknowledged that the usual situation would give a general partner that power, but that the partners had agreed among themselves to order things differently. The court concluded that it “is one thing for the courts to overrule a creditor that seeks to block a debtor from filing bankruptcy; it is quite another for the courts to overrule the owners of the entity.”

The most recent LLC decision balancing the jurisdictional prerequisite with public policy concerns is *In re Lexington Hospitality Group, LLC*, Case No. 17-51568, 2017 Bankr. LEXIS 3129 (Bankr. E.D. Ky. Sept. 15, 2017). The debtor was a Kentucky LLC subject to a voluntary bankruptcy petition filed by its largest percentage member, which was also the primary manager.
of the LLC. However, when the LLC borrowed the funds needed to acquire a hotel property from what appears to have been a non-institutional lender – PCG Credit Partners (PCG) – the lender apparently required that its affiliate 5532 Athens LLC (5532) be given a thirty percent interest in the LLC in what was labeled an “equity kicker.” At the time of the loan the operating agreement was also amended to add a requirement for an independent manager, who was named in the agreement and given the sole duty to act as a manager with the power to approve or disapprove a proposed bankruptcy petition. The independent manager and its replacements could be appointed by the majority member, subject to what seem to be reasonably strong independence standards, and not subject to lender approval. However, the operating agreement (though an addendum added at the time of the loan) provided that the independent manager would have fiduciary duties to the creditors and the company, but not the other members, and must consider the interests of 5532 (the lender-affiliated member) when exercising its sole bankruptcy-related duty.

The voting requirements for bankruptcy approval added at the time of loan origination evinced a belt-and-suspenders approach, with overlapping and somewhat conflicting standards:

- A requirement that the Independent Manager approve any bankruptcy,
- A negative covenant in the operating agreement addendum that prohibited the LLC from filing for bankruptcy without the consent of PCG (the lender, not 5532, its representative member) and unanimous member consent, and
- A provision in the addendum stating that the company could declare bankruptcy only if the Independent Manager authorized it, “and then only upon a 75% vote of the Members” (with 5532 as a 30% member).

In connection with a post-default forbearance, a second addendum to the operating agreement may have been entered into, and that addendum purported to transfer an additional 20% interest to 5532.

The debtor’s non-independent manager filed the LLC’s bankruptcy petition without obtaining or even seeking the independent manager or supermajority member approvals, and PCG objected that the petition had been filed without authorization. The court held that the various bankruptcy-remote provisions constituted a void bankruptcy waiver, and assessed the manager’s authority to file as if the offending provisions had been excised from the operating agreement. The court did not cite Price, nor did the word “jurisdiction” appear anywhere in the opinion. The court treated the key question as whether insufficient authority existed for the filing, because without finding authority the court would be compelled to dismiss the petition under Section 1112 of the Bankruptcy Code. By characterizing the set of bankruptcy-remote provisions as an attempt to extract a complete bankruptcy waiver, rather than viewing the provisions individually, the court reached a debtor-friendly result by concluding that it could ignore all of the special approval provisions as void. That result might not have been foreordained had the provisions been better drafted. First, 5532 apparently held a bona fide equity interest of at least 30 percent of the total equity value (net of the loan) of the hotel project. The original interest was granted concurrently with the loan origination, but also represented a real equity investment by the lender affiliate, and was presumably part of the bargain by which the lender assessed the risk of the loan it was making. The provisions governing the interest did not provide for it to disappear once the loan was repaid, but only after both loan repayment and redemption of the interest by the LLC.
Second, the value of the interest, as equity, was necessarily lower in priority than any indebtedness of the hotel project, including trade debt or any other obligations other than the lender’s mortgage. Third, the independent manager requirement did not give the lender, or 5532, any voice in the appointment of that manager, and so there was no expectation that the independent manager would be affiliated with or otherwise beholden to either the lender or 5532. Fourth, that independent manager, in making the bankruptcy filing decision, would have been obligated to take into account the interests of both the LLC and the LLCs creditors, and the consideration of creditors requirement did not limit that consideration to the mortgage holder alone. In sum, nothing about establishing this bankruptcy-remote structure, which gave a truly independent manager the right to consent to any bankruptcy filing, comes across as sufficient basis for ignoring either the jurisdictional prerequisite or the contractual bargain among the lender, its affiliate, and the borrower.

None of the cases addressing bankruptcy approval requirements as jurisdictional prerequisites, or alternatively, as invalid bankruptcy waivers, have been decided at the appellate level. There was hope that a similar corporate case would change that, following certification of several questions to the Fifth Circuit by the court in In re Franchise Services of North America, Inc., 2018 Bank. LEXIS 105 (Bankr. S.D. Miss. Jan. 17, 2018). That case involved a corporate “blocking right” in favor of a creditor-related party that held a class of preferred stock in a Delaware corporation. The preferred stockholder had made a significant equity investment in the corporation, and the court upheld the validity (under both bankruptcy law and Delaware law) of the voting provision and dismissed the bankruptcy filing as unauthorized (specifically describing the authorization issue as one of subject-matter jurisdiction). The relationship between the preferred stockholder and a related creditor did not affect the outcome in this “two hat” situation. However, the appellate court ducked the ultimate issue by viewing the case as one that did not present the usual blocking right dilemma because of the substantial, bona fide voting equity interest held by the creditor-related party. The court held that ruling on the legality of blocking provisions would constitute an “advisory opinion,” and observed that “[t]here is no provision in federal bankruptcy law against granting a preferred shareholder the right to prevent a voluntary bankruptcy filing just because the shareholder also happens to be an unsecured creditor.” The court also pointed out that a different result might have been reached if “a creditor with no stake in the company” held the blocking right. In re Franchise Services of North America, Inc., 891 F.3d 198 (5th Cir. 2018).

C. Venue

In re Blixseth, 484 B.R. 360 (Bankr. App. 9th Cir. 2012), involved an involuntary bankruptcy petition brought by a state department of revenue. The debtor resided in the state of Washington, and owned interests in a Nevada LLC and a Nevada LLLP. The assets of these entities were in turn located outside Nevada. The question arose whether Nevada was the state in which the debtor’s principal assets were located. The lower court concluded that the intangible entity interests should be deemed located in the debtor’s state of residence (Washington), but the appeals court reversed that decision, concluding that having elected the benefit of Nevada’s laws in establishing the entities, the interests in which constituted the principal bankruptcy assets, venue was proper in...
the state of formation of those entities. A dissent in the case asserted that the case was wrongly decided because it ignored the effect of Article 9 in specifying the situs of intangible property rights.

D. 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 as a matter of state law.

2. Composition of the Bankruptcy Estate.

The “estate” of a bankrupt LLC 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 with 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 attempt to claw back 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.

In In re Carr & Porter, LLC, 416 B.R. 239 (Bankr. E.D. Va. 2009), an attorney who owned the debtor law practice organized as an LLC sold his interest back to the Company. The debtor agreed to pay Porter $1 million in multiple payments over several years and accordingly made regular installment payments to Porter until the debtor LLC filed for bankruptcy. Trustee claimed that these payments were transfers to an insider in violation of Section 547(b) of the Bankruptcy Code and that Porter was required to turn over assets he received from the debtor. The court held that as a former member, Porter was not an insider within the meaning of Section 547(b) and granted summary judgment in his favor. Even though after the sale of his interest, Porter remained an important attorney with the debtor, was responsible for the debtor’s most significant client and helped obtain a loan for the debtor, Porter relinquished all of his executive authority and no longer functioned in a managerial capacity. Therefore, payments made to Porter were not transfers to an insider and did not have to be turned over to the trustee. Interestingly, the trustee failed to pursue what should have been a more viable claim – that the debt was incurred and/or the payments made by the LLC “in respect of” an LLC interest at a time when such distributions were wrongful under Virginia’s LLC statute.

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.

A different result was reached by the court in In re Tristar Esperanza Properties, LLC, 488 B.R. 394 (Bankr. App. 9th Cir. 2013). In that case, the court concluded that the former member’s arbitration award in respect of the former member’s interest was required to be treated for bankruptcy purposes as a claim for damages arising from the purchase or sale of a security of the debtor or an affiliate of the debtor. Thus, the former member’s claim was required to be subordinated to those of other creditors. This result was applied even though the former member had withdrawn three years prior to bankruptcy.

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. Similarly, in In re Resource Energy Technologies, LLC, 419 B.R. 746 (Bankr. W. D. Ky. 2010), the court concluded that discovery orders against the member of a bankrupt LLC did not violate the stay because the stay did not extend to the members, even though the orders obligated the members to obtain information from the LLC.

By contrast, in In re Saxby’s Coffee Worldwide, LLC, 440 B.R. 369 (Bankr. E.D. Pa. 2009), the court issued an injunction to bar actions against the owners of the debtor LLC. At the time of its bankruptcy filing, seven lawsuits were pending against the debtor’s members and entities owned by the debtor’s members. The members filed a motion for preliminary injunction under Section 105 of the Bankruptcy Code to stop the defendants from prosecuting these actions. Although an automatic stay generally may not be invoked to protect non-debtors, Section 105 provides that “[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a). Accordingly, the court held that in this case an injunction was warranted to stop actions against members of the LLC because their time, energy and commitment were necessary for the formulation of a reorganization plan, which would be jeopardized if the debtor’s members had to defend themselves from pending lawsuits. However, the court refused to issue an injunction with respect to actions against entities owned by the debtor’s members because these entities did not play a significant role in the operation of the debtor. See also In re Gander Partners LLC, 432 B.R. 721 (Bankr. N.D. Ill. 2010) (issuance of stay involving state law proceeding against guarantor in interest of the bankruptcy estate).

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 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 original 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
distinct 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.

A different result was reached in In re Campbell, 475 B.R. 622 (Bankr. N.D. Ill. 2012), where the court found that although the rights of members of a member-managed LLC became part of the bankruptcy estate based on Illinois state law defining property rights, the status of one of the bankrupt members as the manager (as opposed to member-manager) of a manager-managed LLC was not a property right, so that the management rights could not be exercised by the trustee unless and until the trustee removed and replaced the manager in accordance with the operating agreement.

A unique situation was presented by In re Lee, 2015 WL 4724944 (S.D. Ind. Aug. 10, 2015), where the bankrupt member had no economic interest in the LLC, but had majority voting rights. The court concluded that the voting rights constituted property of the estate, because the effect of that result would be to protect other economic benefits available to the debtor, including his continued status as the employed manager of the LLC, and his ability to award himself (by virtue of his majority vote) incentive and bonus payments.

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.

4. 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 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.

6. 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 (Bankr. S.D.N.Y. 2008). 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 case. 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.

A similar result obtained in Manchester CP v. Konstanrinou, 2017 U.S. Dist. LEXIS 189534 (D. Vt. Nov. 16, 2017), in which an individual debtor sought to use both Section 362(a) of the Bankruptcy Code and the court’s equitable power under § 105 to justify extension of the automatic stay to a corporation and LLC in which the debtor held non-controlling interests. The underlying claims advanced by the creditor were based on alter ego and successor liability theory, and the court concluded that the claims involved direct liability of the entities, rather than derivative claims against the debtor. Even though the success of the debtor’s plan depended on his income from those entities, the court held that the court’s equitable power did not extend to staying or enjoining actions against these non-debtor entities. This district court decision reversed the outcome at the bankruptcy court level, which reached the exact opposite conclusion. See In re Konstaninou, 2017 WL 83350 (Bankr. D. Vt. Jan. 6, 2017).

Several other cases yielded similar results affirming separateness. In In re Aldape Telford Glazier, Inc., 410 B.R. 60 (Bankr. D. Ida. Jul. 23, 2009), a bankrupt corporation was the sole member of the non-bankrupt LLC and listed the assets of the LLC as its own assets in the corporation’s bankruptcy petition schedules. The court held that the winding up of the LLC had not been completed (which would have involved the payment of the LLC’s creditors and evidence of actual distribution to the member). The assets of the LLC could not be deemed to be the assets of the debtor because they had not been distributed to the debtor. Similarly, in In re Harder, 413 B.R. 827 (Bankr. D. Ore. 2009), the debtor requested that the court issue an injunction barring the creditors of numerous LLCs, in which the debtor was a member, from pursuing lawsuits against the LLCs. The debtor argued that an injunction was warranted under Section 105 of the Bankruptcy Code because without it, any plan of reorganization would be jeopardized. The court declined to order the injunction. First, the court emphasized that the real estate holdings of the LLCs were property of LLCs that were not in bankruptcy. They were not the debtor’s property and the court needed to evaluate any prejudice to the debtor’s reorganization, not to the LLCs’ reorganization. Additionally, even though the debtor’s rights in the LLCs would generally be a part of his estate and would be affected by any lawsuits against the LLCs, this was not such a case because the debtor had assigned his ownership interests in the LLC to a workout expert. Finally, issuing an injunction would unnecessarily prejudice the LLCs’ creditors and would result in a greater harm to them than to the debtor. Substantially the same result was reached in In re Campbell, 475 B.R. 622 (Bankr. N.D. Ill. 2012), where the primary assets of an LLC owned by two bankrupt members were interests in other LLCs and a limited partnership. In this case, the court concluded that the interests of those entities were owned by the LLC, and not by the members, and therefore were not property of the bankruptcy estate.

Many cases involving an attempt to ignore the separateness of an LLC by drawing a non-bankrupt LLC’s assets into a bankrupt member’s LLC estate constitute efforts by the bankrupt to enlarge the bankruptcy estate, but In re Goreham, 2009 Bankr. LEXIS 2995 (Bankr. D. Neb. Sept. 16, 2009) involved a case in which a member successfully transferred assets away from his non-bankrupt LLC, to the detriment of creditors. The debtor was the sole member of an LLC that
owned a piece of real estate. Within ninety days before the bankruptcy filing, the debtor caused the LLC to transfer the real estate to a corporation owned by the debtor’s son. The court refused to set aside this transfer, holding that although the debtor’s interest in the LLC was his personal property and thus property of his bankruptcy estate, the LLC’s underlying property was not. The transfer made by the LLC could not be avoided as a preferential transfer under Section 547(b) because it was not attributable to the debtor.

3. **Winding Up an LLC In Which a Bankrupt Member Owns an Interest.**

As discussed below, there are a number of decisions surrounding the extent to which a bankrupt member can continue to participate in the management activities of an LLC. However, once an LLC is dissolved and is in the process of winding up, the outcome may be different. In *In re LaHood*, 2009 WL 803558 (Bankr. C.D. Ill. Mar. 19, 2009), aff’d in part, 437 B.R. 330 (C.D. Ill. 2010), the court concluded that a non-bankrupt member of a dissolved LLC continued to have the right to participate in the winding up process. Michael and Richard Lahood each owned 50% membership interest in an LLC. Michael filed for bankruptcy, and Richard (also a creditor of Michael’s) declared the LLC dissolved pursuant to a provision of the operating agreement that provided for member bankruptcy as a dissolution event. Without seeking relief from stay, Richard then caused the LLC to wind up by conveying the LLC’s real property to himself and Michael in equal shares. The court held that the distribution of the real estate was invalid because it violated the LLC statutory provision that prescribes that creditors of the LLC should be paid first when winding up the LLC’s affairs.

The trustee also asserted that Michael had the right to participate in the LLC’s winding up of its affairs under Illinois law because Michael’s dissociation was not wrongful. The court agreed and found that Michael’s dissociation was not in breach of any provision of the LLC’s operating agreement.

A second case emphasizes the power of even a bankrupt member to manage the winding up process. In *In re Greeson*, 2009 Bankr. LEXIS 1732 (Bankr. D. Kan. Jun. 2, 2009), the court allowed the distribution of the bankrupt LLC’s assets to the member, even though the bankrupt member had sold and distributed the assets of the LLCs to the bankruptcy estate without satisfying the statutory requirement that creditors be paid first. The debtors dissolved the LLC before bankruptcy. They then filed for bankruptcy and took the position that upon the dissolution of the LLC, the LLC’s assets became their property and part of their bankruptcy estate. To strengthen their position, the debtors effectuated formal transfers, pursuant to which the LLC conveyed its equipment and accounts receivables to the debtors. Creditors objected to the debtors’ position because under Kansas statutory scheme of distribution priorities when winding up an LLC, an LLC’s property must first be used to satisfy creditors’ claims. The court declined to apply the “trust fund doctrine” and found that even though the debtors violated the Kansas LLC act, the creditors could vindicate their rights against the assets in the bankruptcy process. But see *In re Williams*, 455 B.R. 485 (Bankr. E.D. Va. 2011), where the court confronted the issue of how to wind up and liquidate an LLC when both of the LLC’s members had filed individual bankruptcy petitions. The court concluded that under the Virginia LLC statute, both members had dissociated as members upon their bankruptcy, and therefore had only the rights of assignees. Because there were no remaining members, the court concluded that it had the authority to appoint a liquidating trustee.
The court in *In re Nedrick*, 2017 WL 1207507 (Bankr. E.D. Va. Mar. 31, 2017), raised some interesting issues about the winding-up process. That case involved a four-member LLC, where two of the members, including the sole manager, were bankruptcy debtors. The trustee auctioned the LLC’s property as successor to the rights of the bankrupt manager, but confronted with a question of how the auction proceeds should be distributed, the court recognized that it still needed to address numerous other issues, including whether the order allowing the sale also empowered the trustee to proceed with winding up, whether the operating agreement was an executory contract and how that conclusion would affect the “management rights” of the trustee, and most interestingly, the possibility that allowing a trustee in the shoes of the bankrupt manager to conduct the winding up presented a conflict of duties. That conflict between the duty of the trustee to the bankruptcy estate and the duty of the trustee-manager to the LLC and its other members might be irreconcilable.

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 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 amount of the preference into the bankruptcy estate).

2. Exercise of Rights as Member or Manager.

Without substantive discussion of the question, 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 Klinger, 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, 412 B.R. 715 (Bankr. D. Md. 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.

In re Altman, 2018 WL 3133164 (Bankr. App. 9th Cir. June 26, 2018) addressed the ability of a minority holder of an economic interest in an LLC to pursue a state receivership proceeding involving an LLC in which the bankrupt majority member held sole managerial power. Holding that the right to manage was an asset of the estate, the court held that the effect of the stay was to preempt the receivership action.

By contrast, in In re Hickory Ridge, LLC, 2010 WL 1727968 (Bankr. N.D.W. Va. Apr. 27, 2010), the court simultaneously gave effect to state law provisions regarding the dissociation of a member upon bankruptcy but then held that the bankruptcy trustee succeeded to the dissociated member’s management rights, and therefore had the right to control the LLC’s actions in its own bankruptcy. Likewise, in In re Kang, 663 Fed. Appx. 336 (4th Cir. 2016), the court held that the trustee could step into the shoes of the owners of a parent LLC in order to assert a claim that under Virginia law, a transfer of interests in subsidiary LLCs was void because the transfer violated contractual restrictions.

3. Exercise by LLC of Contractual and Statutory Rights Notwithstanding Automatic Stay. In Siegal v. Everett, 2018 Bankr. LEXIS 2374 (Bankr. D. Md. Aug. 18, 2018), the Court held that the invocation of an operating agreement provision that required a member
requesting records to pay for the costs of production of a document request did not violate the automatic stay applicable with respect to the bankrupt member.


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.

An operating agreement was found to be an executory contract in In re DeVries, 2014 WL 4294540 (Bankr. N.D. Tex. Sept. 27, 2014). The operating agreement related to the operation of a business that operated a dairy farm, and among the obligations of the members were the obligations to make additional capital contributions and to provide loan guarantees. The court concluded that those obligations were executory, because the debtor member’s obligations to contribute capital and to execute guarantees were not hypothetical, given both the volatile nature of the dairy industry and the fact that loan guarantees had been required in the past. The court went further to find that a separate cross-purchase agreement to which the members were parties was not severable from the operating agreement, and that the two would need to be treated as a single indivisible agreement. Having found that the operating agreement was an executory contract, the court found that by failing to assume either of the agreements, the trustee was deemed to have rejected them under § 365. Under § 365(g), the rejection of an executory contract constitutes a breach, and the operating agreement provided that a breaching member would have the status of a mere assignee. Accordingly, the court held that the trustee had no ability to exercise the non-economic rights available under the operating agreement, because those were reserved for “active” members of the LLC. The court concluded that it did not need to address the effect of the ipso facto clause prohibition because of the deemed rejection of the agreement.

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). In that case, the court permitted the non-bankrupt members to utilize a right of first refusal found in the operating agreement. A court’s analysis of operating agreement obligations (or the lack thereof) yielded the same result in In re Warner, 480 B.R. 641 (Bankr. N.D.W. Va. 2012). However, by contrast, the court in In re Strata Title, LLC, 2013 WL 1773619 (Bankr. D. Ariz. Apr. 25, 2013), held both that an operating agreement that contained a purchase option was an executory contract, and that the exercise of that option, which was triggered by the bankrupt member’s filing, was an invalid ipso facto clause. The Strata Title court did not engage in an extensive analysis of § 365. The executory contract determination was based in large part on the fact that the LLC owned property that was being actively marketed, and that the participation of the members (including the debtor) was necessary to address a variety of issues, including approval of a sale.

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.

In re Wilson, 2014 WL 3700634 (Bankr. N. D. Tex. July 24, 2014) similarly found an operating agreement not to be an executory contract. The court, citing Ehmann, noted that neither the bankruptcy trustee nor any member of the LLC considered the agreement an executory contract (the argument was being advanced by a creditor), and found that the absence of obligations to make additional capital contributions as well as the fact that the management powers of the members were rights but not obligations meant that the rights under the operating agreement were not executory duties of the type found in an executory contract.

In In re Prebul, 2011 WL 2947045 (Bankr. E.D Tenn. Jul. 19, 2011), a functional test was used to determine whether an LLC operating agreement constituted an executory contract. The court treated future contribution obligations as remote and hypothetical duties, and concluded that the agreement was not executory.

The analysis utilized by a number of courts that have found LLC operating agreements to be executory contracts was directly rejected in In re Denman, 513 B.R. 720 (W.D. Tenn. 2014). In that case, the debtor was a 70% owner of an LLC, and the operating agreement provided that any other member would have the option to purchase another member’s interest upon a “triggering event” that included member bankruptcy. When the debtor member filed for bankruptcy, another member sought to enforce that provision. The court discussed the Countryman standard and several cases concluding that LLC operating agreements are not per se executory contracts, and conducted a relatively extensive analysis of the Tennessee LLC act on the way to determining that operating agreements under the Tennessee statute are distinct from typical executory contracts. The court noted that obligations under a Tennessee LLC operating agreement are not bilateral because a member’s failure to perform does not excuse performance of the other members, because Tennessee LLC operating agreements may be entered into in connection with single member LLCs, when there is no mutual assent or consideration, because operating agreements may be amended without the approval of all members, and because operating agreements can bind new members without their explicit assent. The court then considered the operating agreement at issue, and finding that the membership interests were analogous to corporate securities and that the agreement did not contain any material member obligations, concluded that the agreement was not an executory contract. The court went further to determine that the purchase right was an invalid ipso facto clause because it created a right that was triggered only upon the bankruptcy.

A 2015 bankruptcy case involving a general partnership distinguished the Denman result. In Sullivan v. Mathew, 2015 WL 1509794 (N.D. Ill. Mar. 30, 2015), the court was confronted with a situation in which the exercise of certain rights under the partnership agreement depended upon the bankruptcy trustee’s having properly assumed a partnership agreement that the court determined to be an executory contract. The trustee had not assumed the partnership agreement
within 60 days after the order for relief, which under the Bankruptcy Code causes a deemed rejection. See §365(d)(1). The court considered the Countryman definition of executory contracts, and determined that there were sufficient additional duties under the partnership agreement that were “significant, ongoing obligations.” The court found that the failure to perform those obligations would be a material breach, and concluded that an executory contract existed, and that the agreement had been deemed rejected because it had not been timely assumed. The court indicated its belief that “the Denman decision is tethered to the particular qualities of Tennessee LLC agreements,” that the Denman reasoning was not applicable to partnerships, and that the Denman result was therefore unpersuasive.

A 2009 case addressed, in relatively summary fashion, the executory contract status of an operating agreement provision designating a member as “Vice President” of an LLC. The court concluded that an operating agreement provision that terminated the member’s status as an officer upon the filing of his personal bankruptcy petition was not an invalid “ipso facto” clause because the member’s service as an officer should be thought of as a personal service contract, not an assignable executory contract. See JD Factors, LLC, v. Freightco, LLC, 2009 WL 3401965 (N.D. Ind. Oct. 16, 2009).


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 § 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.

A 2015 case decided by the Supreme Court of Washington addressed the interplay between these Bankruptcy Code provisions and state law. In *Northwest Wholesale, Inc. v. PAC Organic Fruit, LLC*, 357 P.3d 650 (Wash. 2015), the court was tasked with determining whether a former member could assert a derivative claim on behalf of the company. The case turned on the state law and bankruptcy law effect of language in the Washington LLC statute that treated the debtor-member as dissociated as a member of the LLC at the time of the bankruptcy filing, so that the interest succeeded to would be deemed the interest of an assignee, rather than the interest of a member (only members have standing to bring in derivative suit). The court concluded, relying on *Garrison-Ashburn*, that the bankruptcy estate received the interest as defined by state law. The court went further and determined that it was unnecessary to decide whether §365(e)(1) would invalidate that clause because §365 applies to executory contracts, and even if the operating agreement at issue was an executory contract, §365(e)(2) would excuse performance because the remaining member would not be required to accept performance from a former member or his or her successor in bankruptcy.

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.

As noted elsewhere in this outline, a more recent case from the bankruptcy court in the Western District of Virginia reached a different result than the DeLuca cases. That court
held that the noneconomic management rights in the LLC were property of the bankrupt member, and without mentioning or even analyzing the DeLuca cases, held that the statutory provision that would otherwise have deemed the bankrupt member a mere assignee was an invalid ipso facto provision under Bankruptcy Code §541(c)(1)(B).


7. Enforcement of Membership Interest Purchase Options in Bankruptcy.

Several cases have addressed situations in which non-bankrupt members have attempted to claim the benefit of purchase options that would allow the redemption or acquisition of a bankrupt member’s interest. For example, in In re Capital Acquisitions & Management Corp., 341 B.R. 632 (Bankr. N.D. Ill. 2006), the court found that an operating agreement was not an executory contract, and on that basis, that the provisions of § 365 were not applicable to render a right of first refusal to purchase an LLC interest an invalid ipso facto provision. However, the court also noted that even if the operating agreement were an executory contract, the right of first refusal would still not apply. The right was not actually triggered by the bankruptcy filing itself, or the appointment of a trustee or receiver, but by the election to sell the bankrupt member’s interest. This seems to be a bit of hair-splitting, but the court concluded that because the provision at issue was not itself triggered by the bankruptcy filing, but by a subsequent action during the bankruptcy proceeding, the sale provision did not constitute an invalid ipso facto clause. Other cases involving rights of first refusal and purchase options discussed elsewhere in this outline include In re Denman, 513 B.R. 720 (W.D. Tenn. 2014) and In re Strata Title, LLC 2013 WL 1773619 (Bankr. D. Ariz. Apr. 25, 2013).

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. In In re Pickel, 487 B.R. 289 (Bankr. D.N.M. 2013), the court followed the logic of the Albright case in concluding that § 541(c)(1) trumped a provision of the Virgin Islands LLC statute that caused a bankrupt member to be dissociated. The LLC was a single-member LLC, and the court noted that giving effect to the LLC provision would leave the company without a member or manager. The same result obtained in In re Cleveland, 519 B.R. 304 (Bankr. D. Nev. 2014), where the court held that a possible “personal services” exemption that might otherwise prevent a trustee from stepping in to operate an LLC did not apply when the trustee sought to sell the assets of and liquidate the LLC.
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). See also *In re Soderstrom*, 484 B.R. 874 (M.D. Fla. 2013), where the court held that a non-bankrupt member of an LLC could object to a trustee’s proposed sale of the bankrupt debtor’s interest in the LLC because that sale purported to include the bankrupt member’s management rights. The court briefly analyzed the interplay of § 365 with an operating agreement that constituted an executory contract, and upheld a bankruptcy court determination that § 365 should be applied to prevent the estate’s ability to assume the debtor’s management interest in the LLC.

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. In the *JD Factors* case noted above, the court also concluded that under § 365(c)(1), an Indiana law provision to the effect that a person cannot become a member without the consent of all the other members would be likely to be given effect.

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 LLCs.
Case Law Update (Non-Delaware)

2018 LLC Institute
LLCs, Partnerships and Unincorporated Entities Committee
Business Law Section
American Bar Association

October 11-12, 2018

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**Relevant Jurisdiction:** North Carolina

**Key takeaway:** North Carolina’s appellate courts have not yet addressed whether the principles governing judicial dissolution under the corporation act apply to judicial dissolution under the LLC act.

In this consideration of the plaintiff’s motion to dismiss a number of counterclaims made by the defendants, the court denied the plaintiff’s motion to dismiss the defendant’s counterclaim seeking dissolution of Pure Body, LLC. Interestingly, the court’s denial was based primarily on a lack of judicial interpretation of the North Carolina LLC Act’s provisions regarding judicial dissolution.

The key defendant was an individual, Dino Crnalic, who formed Pure Body, LLC with another individual in 2013 to operate a gym outside of Charlotte, North Carolina. Crnalic served as the CEO and as a director of the LLC until August of 2016, when he contends he was forced by other members of the LLC to resign, to sign documents consenting to an amendment to the LLC’s operating agreement and to sign a written consent of the LLC’s board members.

Crnalic’s counterclaim seeking judicial dissolution was made pursuant to Section 57D-601(4) of the North Carolina LLC Act, which provides that an LLC is dissolved in a proceeding brought by a member upon the entry of a judicial decree on the grounds that it is not practicable to conduct the LLC’s business in conformance with the operating agreement and the LLC Act or liquidation of the LLC is necessary to protect the rights and interests of the member. While Crnalic argued that dissolution could be granted on either of the grounds identified in the statute, the court focused most of its analysis on whether liquidation was necessary to protect Crnalic’s rights and interests. In doing so, the court considered Crnalic’s reliance on and reference to a North Carolina Supreme Court case that analyzed the judicial dissolution provisions of the North Carolina Business Corporation Act, which similarly provides for dissolution when “liquidation is reasonably necessary for the protection of the rights or interests of the complaining shareholder.” In the Supreme Court case, the court concluded that dissolution of a close corporation is appropriate when the actions of the managers or controlling shareholders “disappoints the minority shareholder’s reasonable expectations.”

Notwithstanding the similarity between the judicial dissolution provision in the corporate statute and the judicial dissolution provision in the LLC Act, the court noted that the North
Carolina appellate courts have not yet addressed whether a claim under the provisions of the LLC Act are governed by the same principles as the corporate act. As a result, the court held that without clear guidance from the appellate court regarding the factors to be considered in a claim for judicial dissolution under the LLC Act, it was premature to dismiss the plaintiff’s counterclaim at this stage of the litigation. Instead, the court believed it more prudent to allow the record to be more fully developed beyond the allegations in the pleadings so that the court could better determine whether there was sufficient support for a dissolution claim on the ground that liquidation is necessary to protect Crnalic’s rights and interests.
2. **Case:** *Spa Creek Services, LLC v. S.W. Cole, Inc.*, 239 So.3d 730 (Fla.5th DCA 2017) **Relevant Jurisdiction:** Florida

**Key takeaway:** In contrast with the Delaware LLC Act, the Florida LLC Act permits an LLC to continue to prosecute and defend actions or proceedings even after a statement of termination has been filed with respect to the LLC.

Spa Creek was an LLC engaged in the pest control business in central Florida. In 2002, Spa Creek purchased all the assets of five branch offices of S.W. Cole, which was also engaged in the pest control business in central Florida. As a part of the purchase agreement between Spa Creek and S.W. Cole, confidentiality, non-solicitation and non-competition agreements running to the benefit of Spa Creek were also executed by S.W. Cole and certain of its officers.

At some later time, Spa Creek sued S.W. Cole and its officers for tortiously interfering with the non-compete agreements, tortiously interfering with its business relationship, civil conspiracy and breach of the non-compete and non-solicitation agreements. Spa Creek then sold most of its assets to another pest control company, and later, assigned its remaining assets and liabilities – including the lawsuit against S.W. Cole – to SC Services, a Delaware LLC. In December 2012, while the suit was still pending, SC Services was dissolved and a certificate of cancellation was filed in Delaware.

While one of the key issues was whether a chose in action was assignable when the contract underlying the action was not itself assignable, the dissolution discussion focused on whether SC Services could maintain an action after it filed its certificate of cancellation in Delaware. The court notes that, in Delaware, “the dissolution of the corporation [sic] and the filing of the certificate of cancellation are separate steps” and a dissolved LLC is permitted to prosecute and defend suits only until the filing of the certificate of cancellation.

In Florida, prior to 2014, the cancellation of the articles of organization of an LLC was an administrative step that immediately followed dissolution but did not affect pending court proceedings involving the LLC. The new Florida LLC Act, adopted in 2014, requires the filing of articles of dissolution upon the occurrence of an event of dissolution, and then provides for the filing of a statement of termination after the LLC has finished winding up its affairs. So, while the statement of termination is similar to the certificate of cancellation in Delaware, the Florida LLC Act still does not prohibit the LLC from continuing to prosecute or defend court proceedings after the statement of termination has been filed. As a result, regardless of the fact that SC Services had filed a certificate of cancellation in Delaware, it was still permitted to maintain the action against S.W. Cole in Florida.

Key takeaway: To be successful in a special proceeding seeking judicial dissolution in New York, the petitioner has to provide sufficient pleadings, papers and admissions to support the petition.

In this appeal of a New York Supreme Court (i.e., trial court) order granting the petition’s request for judicial dissolution of a limited liability company, the appellate court reversed the trial court on the basis that judicial dissolution was not warranted by the evidence accompanying the petition. The case highlights the requirements of a special rule of New York civil procedure applicable to LLC judicial dissolution proceedings.

The parties to this proceeding were members of 3 Covert, LLC, which owned a mixed-use building in Brooklyn. The stated purpose of the LLC, as set forth in its operating agreement, was “to purchase and sell residential and commercial real estate and to engage in all transactions reasonably necessary or incidental to the foregoing.” In their petition for judicial dissolution, the petitioners (who owned 62.5% of the LLC) alleged that Homapour (who owned a 12.5% interest in the LLC) had taken full control of the LLC, including specifically collecting rents and depositing them into a bank account over which he had sole signatory authority, and had been uncooperative with the agreed-upon sale of the Brooklyn building, causing the sale to fall through. Homapour denied the allegations and opposed dissolution on the grounds that, among other things, the LLC had been operating at a profit.

The trial court granted the petition for dissolution, concluding that it was not “reasonably practicable” for the LLC to continue because its management was unable or unwilling to permit or promote the stated purpose of the LLC to be realized or achieved. Thereafter, a judgment was entered upon the order for dissolution, declaring the LLC dissolved and appointing a receiver.

Section 702 of the New York LLC Law provides for judicial dissolution of an LLC “whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement.” The courts in New York have determined that, to satisfy the requirements of Section 702, the member seeking judicial dissolution must establish that either the management of the entity is unable or unwilling to reasonably permit or promote the stated purpose of the entity to be realized or achieved or that continuing the entity is financially unfeasible. As noted, the trial court held that the former of those two factors was satisfied.

However, the appellate court emphasized that in a special proceeding governed by Rule 409 of the New York rules of civil procedure – such as a proceeding for judicial dissolution of an LLC – the court has to make a summary determination “upon the pleadings, papers and admissions to the extent that no triable issues of fact are raised.” While there is no specific discussion of it in the appellate court’s opinion, the underlying record appears to show that the only evidence provided by petitioners were sworn affirmations from their attorneys regarding Homapour’s actions, as well as a string of (presumably unfriendly) emails between Homapour and the petitioners. Because a petition in a special proceeding must be accompanied by competent evidence, and the appellate court found that in this case, the petition for judicial dissolution did
not contain sufficient evidence to support the grounds for dissolution, the appellate court reversed the trial court’s order granting judicial dissolution of the LLC.
This opinion addresses the defendants’ motion to dismiss the plaintiff’s action for dissolution and winding up of T-N-B Marble-N-Granite, LLC. The defendants argued that the plaintiff lacked standing because she was not a member of the LLC. The plaintiff was the widow and executrix of the estate of her deceased husband, who was a member of the LLC. The LLC did not have a written operating agreement, leaving the provisions of the Connecticut Uniform Limited Liability Company Act to govern.

On July 1, 2017, Connecticut became the 17th state to enact a version of the Uniform LLC Act. With the adoption of its version of ULLCA, the provision regarding the status of a successor to a deceased member’s interest changed. Under the prior LLC law in Connecticut, nearly all of a member’s membership rights passed to the member’s legal successor upon the occurrence of a dissociation event (including the death of the member). However, under the Connecticut ULLCA, unless there is a written operating agreement providing otherwise, the legal successor to a deceased member is given only the status of a transferee, rather than a member.

Under Section 34-267(a)(4)(B) of the Connecticut ULLCA, which is the provision under which the plaintiff sought judicial dissolution, an LLC may be dissolved “on application by a member” on the grounds that “it is not reasonably practicable to carry on the company’s activities and affairs.” The defendants argued that the plaintiff was not a member of the LLC, and therefore, could not seek judicial dissolution of the LLC. The plaintiff argued that the defendants misinterpreted the Connecticut ULLCA, and that the intended meaning of the language of the relevant provision of the Connecticut ULLCA allowed the plaintiff to act as a member in her capacity as a personal representative of her husband’s estate. The court disagreed and found that as the legal representative of a dissociated member with the status of a transferee, the plaintiff lacked the statutory authority to pursue judicial dissolution of the LLC, and granted the defendants’ motion to dismiss.
5. **Case:** *Schauf v. Schauf*, 247 So.3d 172 (La. Ct. App., 2d Cir. 2018)  
**Relevant Jurisdiction:** Louisiana

**Key takeaway:** If an operating agreement provides that only members can vote for voluntary dissolution, then despite the principle in Louisiana law that individuals cannot be forced to remain co-owners in indigination of an asset or real property, non-members are out of luck because only members can seek judicial dissolution in Louisiana.

The Schauf Family LLC was formed as a family business in early 2001 by the matriarch of the Schauf family. She retained a 50% ownership interest in the LLC, and the other 50% ownership interest was split evenly between each of her four children. The only asset of the LLC was a piece of farm land. When the matriarch died, her interest was split evenly among her four children, leaving them each with a 25% interest in the LLC. Thereafter, two of the siblings also died, leaving their interests in the LLC to their respective spouses.

As is often the case with family LLCs, the relationship among the members began to fray, and three of the members (one original member and the two surviving spouses) wanted to dissolve the LLC, sell the farm land and distribute the proceeds equally among the four members. The fourth member, who was one of the original members, twice refused to buy out the interests of the other three members, and voted against dissolution of the LLC. The other three members voted in favor of dissolution and appointed one of the surviving spouses as liquidator of the LLC. Shortly thereafter, the fourth member filed suit against the other three, asking for the court to declare null and void the vote to dissolve the LLC and the appointment of a liquidator. The defendants responded and filed a counterclaim seeking judicial dissolution of the LLC.

After the lawsuit was filed, the last original member who had voted for dissolution of the LLC, died. For the defendants, this left the two surviving spouses holding the interests they had inherited, as well as the interest of the third deceased sibling, because one of the surviving spouses had been named executrix of the third sibling’s estate. The defendants filed a motion for substitution, seeking to have the executrix represent the third deceased sibling’s interest in the proceeding. Then the plaintiff and the defendants each filed motions for summary judgment, and the trial court granted the plaintiff’s motion and denied the defendants’ motion on the basis that the defendants did not have the authority to dissolve the LLC.

Under a de novo standard of review, the appellate court reviewed the record and determined that the language of the LLC’s Operating Agreement was clear and unambiguous regarding dissolution, providing that dissolution could be approved only by a majority of the ownership interests. As heirs and legal representatives of the three deceased members, the Louisiana LLC Law bestowed only the status of assignees to the defendants, unless the Operating Agreement provides otherwise (which it did not here). Further, without language to the contrary in the Operating Agreement, an assignee of a member’s interest may not become a member or participate in the management of the LLC unless the other members unanimously consent in writing to the admission of the assignee as a member. Given the state of the relationship between the plaintiff and the defendants, it was clear that the plaintiff, the lone surviving member, had not given that consent.
While the court concluded that the defendants could not have voted to dissolve the LLC pursuant to
the terms of the Operating Agreement, it then turned to the question of whether the defendants’
counterclaim seeking to dissolve the LLC was viable. The Louisiana LLC Law provides for
dissolution on application “by or for a member...whenever it is not reasonably practicable to carry on
the business” of the LLC. Interestingly, the court noted that under Louisiana law, individuals cannot
generally be forced to remain co-owners in indivision of an asset or real property. However, because
the owners of an LLC do not own the real property or assets held by the LLC, those owners cannot
seek partition of the assets held by the LLC. Instead, only members of the LLC can apply to the
courts for judicial dissolution.

Having already determined that the defendants were not members of the LLC, the court noted that
one of the defendants – the third sibling who passed away – was alive and was a member at the time
the counterclaim was filed. While she died during the pendency of the litigation, her death did not
terminate the dissolution proceeding and her executrix could continue the proceeding as her
representative. As a result, the court remanded the case to the lower court for consideration of
whether the facts of the case met the standard for judicial dissolution based on the grounds that it
was not reasonably practicable for the LLC to carry on its business.
Sean P. Ducharme


Following a decade of protracted litigation, DIRECTV obtained a $2.4 million judgment against Randy Coley for the receipt and unauthorized distribution of satellite television programming at a resort in Virginia. After Mr. Coley failed to satisfy the judgment against him, DIRECTV sought to outside reverse pierce the veil of three Delaware LLCs of which Mr. Coley was the sole member contending that they were Mr. Coley’s alter egos. No Delaware court had previously recognized or prohibited reverse veil piercing as a remedy. After an extensive review of the facts, the district court held that (i) the three LLCs were the alter egos of Mr. Coley, (ii) Delaware would recognize reverse veil piercing under the egregious facts of this case, (iii) Mr. Coley and his wife were equitably estopped from arguing that Ms. Coley was a co-owner of the LLCs and (iv) DIRECTV’s failure to serve process on the LLCs did not prevent the court from exercising jurisdiction over them. The Coleys and one of the LLCs appealed to the Fourth Circuit Court of Appeals.

The court reviewed de novo the issue of whether Delaware law would allow reverse veil piercing of an LLC. The court distinguished “insider” reverse piercing from “outsider” reverse piercing. “Insider” reverse piercing is when a controlling owner wants to disregard the entity in which the owner has an interest. “Outsider” reverse piercing is when a third party such as a creditor wants to hold an entity liable for a judgment against its owner. The court noted that while courts have often opposed “insider” reverse piercing under the theory that it would allow the entity veil to be pierced by a person who formed the entity, many courts have allowed “outsider” reverse piercing by creditors for the same reasons traditional veil piercing has been recognized. The court explained that states that disallow “outsider” reverse piercing have frequently done so based on potential harm to innocent owners. The court acknowledged that a single-member LLC would be especially vulnerable to reverse piercing claims when the LLC is the alter ego of its sole member because there are no innocent owners. The court recognized that Delaware has a powerful interest in preventing entities formed in Delaware from being used as vehicles for fraud. Finally, the court noted that Delaware courts have shown some willingness to recognize reverse piercing claims. The court concluded that “Delaware would recognize outsider reverse piercing of an LLC’s veil when the LLC is the alter ego of its sole member.”

The court explained that its conclusion was not affected by the defendants’ argument that Delaware’s charging order statute is the exclusive remedy of an LLC member’s creditor seeking rights against the LLC. Delaware’s charging order statute provides that “attachment, garnishment, foreclosure or other legal or equitable remedies” are not available to a creditor. The court noted that, although no Delaware court has interpreted this exclusivity provision, the “other legal or equitable remedies” language in the statute refers to similar types of traditional common law remedies as those specifically listed, and not the remedy of piercing the veil which effectively disregards the legal existence of the LLC altogether. The court concluded that Delaware’s charging order statute
“does not prevent a court from reverse piercing the veil of an LLC that serves only as an alter ego of its sole member, because such an LLC is a ‘sham entity’.”

The court addressed Mr. Coley’s argument that the district court erred in holding that the LLC was his alter ego. The court noted that to prevail under an alter ego theory under Delaware law, a plaintiff “must show a mingling of the operations of the entity and its owner plus an overall element of injustice or unfairness.” The court explained that the evidence that Mr. Coley commingled his assets with the LLC was abundant. The court also concluded that an overall element of injustice or unfairness was present in this case because DIRECTV won a judgment against Mr. Coley more than four years ago and had not yet received any payment. The court upheld the district court’s finding that Mr. Coley and the LLC were alter egos.

The court addressed the defendants’ argument that the district court erred in exercising jurisdiction over the LLC because the LLC never received service of process. Citing Fourth Circuit precedent, the court noted that in traditional veil piercing cases, a court may exercise jurisdiction vicariously over an individual if the court has jurisdiction over the individual’s alter ego company. The court reasoned that the fundamental jurisdictional inquiry concerns whether a particular party is before the court, and when a company is an alter ego of its sole member, they are effectively the same party. Therefore, the court concluded that an LLC that is the alter ego of its sole member is properly before the court when the court has jurisdiction over the member.

Finally, the court addressed the defendants’ argument that the district court erred in holding that the Coleys were equitably estopped from asserting that Ms. Coley was a co-owner of the LLC. If Mrs. Coley were a co-owner, then she would be able to assert that allowing reverse veil piercing of the LLC as a remedy to enforce the judgment against Mr. Coley would harm her in her capacity as an innocent owner. The court examined the district court record and noted that in the pre-judgment proceedings, Mrs. Coley represented that she had no ownership interest in the LLC, and DIRECTV relied on her representation in dismissing its claims against Ms. Coley. The court stated that the Coleys’ shifting positions reflected an attempt to avoid liability and place their personal assets beyond the reach of DIRECTV. The court upheld the district court’s finding that in the post-judgment proceedings, Ms. Coley was equitably estopped from alleging that she had an ownership interest in the LLC, which would be in direct contradiction to her representations in the pre-judgment proceedings.


Several providers of oilfield goods and services that were affiliates of Weatherford International, Inc. sued a well operator, Amerill Energy, LLC (an Oklahoma LLC), for breach of contract, among other claims, in connection with Amerill’s failure to pay for labor and materials provided by Weatherford. Weatherford sought to pierce the veil of Amerill and hold its principal owner, U.S. KingKing, LLC (a Delaware LLC), liable for Amerill’s contractual obligations under an alter ego theory. The trial court granted summary judgment in favor of Weatherford on these claims, holding that KingKing was Amerill’s alter ego and both entities were jointly and severally liable to Weatherford. KingKing appealed, arguing that the trial court erred in rendering summary judgment because Weatherford did not conclusively establish that (i) Amerill was KingKing’s alter ego and (ii) KingKing used Amerill to perpetrate an actual fraud on Weatherford for KingKing’s direct personal benefit.
The court began by examining veil piercing law in Texas. The court noted that the standard for piercing the veil of an LLC in Texas is a statutory one and is the same rule used for piercing the veil of a corporation. (The court was silent about why it applied Texas law to the piercing analysis, rather than the law of the state in which the LLC was organized (Oklahoma) under the internal affairs doctrine applicable to foreign entities under the Texas Business Organization Code.) In the LLC context, the general statutory rule is that a member of an LLC is not liable for any contractual obligation of the LLC on the basis that the member was the alter ego of the LLC or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory. However, the statute provides that the general rule does not limit the liability of a member if the obligee demonstrates that the member caused the LLC “to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee for the direct personal benefit” of the member. For veil piercing purposes, Texas courts have construed the term “actual fraud” as “involving dishonesty of purpose or intent to deceive.”

The court stated that to pierce the veil and impose liability under an alter ego theory, the plaintiff must demonstrate that (i) the LLC is the alter ego of the debtor and (ii) the LLC was used for an illegitimate purpose to perpetrate an actual fraud on the plaintiff for the defendant’s direct personal benefit. The court noted that Texas courts have applied the alter ego theory “when there is such unity between corporation and individual that the separateness of the corporation has ceased and holding only the corporation liable would result in injustice.” The court stated that alter ego is determined from the “total dealings” of the corporation and the individual owner, including the degree to which corporate and individual property have been kept separate, the amount of financial interest, ownership and control the individual maintains over the corporation and whether the corporation has been used for personal purposes. The court noted that parties are not liable for a corporation’s debts just because they were part of a single business enterprise or due to centralized control, mutual purposes and shared finances. There must also be exceptional circumstances such as “fraud, evasion of existing obligations, circumvention of statutes, monopolization, criminal conduct, and the like.”

The court first analyzed whether Weatherford had conclusively established that Ameril was the alter ego of KingKing. The court assessed the relationship between the entities using various factors including whether (i) the entities shared common business names, offices or employees, or centralized management, (ii) one entity paid the wages of the other entity’s employees, (iii) one entity’s employees rendered services on behalf of the other entity, (iv) one entity made undocumented transfers of funds to the other entity and (v) the allocation of profits and losses between the entities was unclear. Citing Texas appellate court precedent, the court noted it could also consider as proof of alter ego (a) the payment of alleged corporate debts with personal checks or other commingling of funds, (b) representations that the individual will financially back the corporation, (c) the diversion of company profits to the individual for his personal use, (d) inadequate capitalization and (e) other failures to keep corporate and personal assets separate.

Examining the facts of this case, Weatherford alleged that (i) employees of Ameril routinely handled duties for KingKing and vice versa, (ii) KingKing controlled Ameril’s bank accounts, and the two entities had a centralized accounting system with an unclear allocation of profits and losses, (iii) KingKing and Ameril shared a website and had the same mailing address and (iv) KingKing and Ameril routinely swapped assets for no consideration. However, the court noted that Ameril and KingKing did not share a common business name, and Weatherford did not provide evidence that (a) Ameril or KingKing paid wages of employees of the other, (b) employees of Ameril routinely handled duties of KingKing, (c) Ameril and KingKing engaged in undocumented transfers of funds
or routinely swapped assets or (d) KingKing used funds collected by Amerril for KingKing’s own purposes unrelated to Amerril. The court acknowledged that Weatherford provided some evidence supporting an alter ego finding. However, the court held that Weatherford did not meet its summary judgment burden by conclusively establishing as a matter of law that Amerril was the alter ego of KingKing.

The court also analyzed whether Weatherford conclusively established that KingKing caused Amerril to be used for the purpose of perpetrating, and did perpetrate, an actual fraud on Weatherford primarily for KingKing’s direct personal benefit. Weatherford alleged that Amerril gave Weatherford a balance sheet for KingKing that grossly exaggerated KingKing’s assets. Examining the record, the court noted that Weatherford provided no evidence about how it obtained the balance sheet, the circumstances under which it received Amerril’s credit application, whether the balance sheet was attached to the credit application, or whether it relied on KingKing’s balance sheet in extending credit to Amerril. Moreover, the court noted that “Weatherford provided no evidence that Amerril knowingly submitted a false and inaccurate balance sheet of its member and parent company in order to receive credit from Weatherford for itself.” Based on the record, the court concluded that Weatherford did not conclusively establish as a matter of law that Amerril and KingKing acted with dishonesty of purpose or intent to deceive.

As a result, because Weatherford failed to meet its summary judgment burden of conclusively establishing that Amerril was KingKing’s alter ego and that KingKing caused Amerril to be used for the purpose of perpetrating, and did perpetrate, an actual fraud on Weatherford primarily for KingKing’s direct personal benefit, the court held that the trial court erred in piercing Amerril’s veil and holding KingKing jointly and severally liable for Amerril’s contractual obligations to Weatherford. The court reversed the trial court’s judgment and remanded for further proceedings.


Insight Health Corp. leased a magnetic resonance imaging (MRI) machine to Marquis Diagnostic Imaging of North Carolina, LLC (a North Carolina LLC). Additionally, Insight entered into a letter of intent to purchase the MDI-NC’s assets. When negotiations regarding the potential asset purchase broke down, MDI-NC sold its assets to a third party and stopped performing on the MRI lease with Insight. After the asset sale, MDI-NC continued to pay other creditors and transferred money to its sole member, Marquis Diagnostic Imaging, LLC (a Delaware LLC), MDI’s two member-managers (John Kenneth Luke and Gene Venesky), and other entities controlled by the two member-managers.

Prior to trial, Insight voluntarily dismissed its fraudulent transfer and wrongful distribution claims. At trial, the court granted the defendants’ motion for a directed verdict in favor of the defendants on Insight’s unfair and deceptive trade practice claim, holding that Insight’s claim did not fall within the scope of the state statute. At the conclusion of the trial, the court granted summary judgment in favor of Insight, finding that MDI-NC breached the MRI lease with Insight. The jury found that Luke and Venesky (i) breached their fiduciary duties to Insight as a creditor by causing MDI-NC to fail to pay Insight its pro rata share of the amount paid to other creditors and (ii) committed constructive fraud by using their positions as managers of MDI-NC, an LLC that was winding up its business, to enter into transactions benefitting themselves while injuring Insight. The jury also found that the elements for piercing the veils of MDI-NC and MDI to hold Luke and Venesky personally liable for MDI-NC’s breach of contract had been satisfied. The court ordered further briefing on Insight’s request to pierce the veils.

The court explained that the Supreme Court of North Carolina has adopted the “instrumentality rule” for piercing the veil of corporations, and that the North Carolina Court of Appeals has held that the rule applies to LLCs as well. Under the instrumentality rule, a plaintiff must prove three elements: (i) complete domination and control of finances, policy and business so that the entity has no separate mind, will or existence of its own, (ii) such control is used to commit a fraud or wrong, or to perpetrate a violation of a statutory or other positive legal duty or a dishonest and unjust act in violation of plaintiff’s legal rights and (iii) such control was the proximate cause of the plaintiff’s injury. Additionally, the court pointed to four main factors used to evaluate the first element of the instrumentality rule: (a) inadequate capitalization, (b) non-compliance with corporate formalities, (c) complete domination and control of the corporation so that it has no independent identity and (d) excessive fragmentation of a single enterprise into separate corporations. The court was careful to note that these factors may be weighed differently when seeking to pierce the veil of an LLC, rather than a corporation.

The court considered defendants’ request that the court refuse to pierce the veils of the LLCs, notwithstanding the jury’s verdict, because doing so would be unjust, inequitable and inconsistent with the liability protections afforded by the North Carolina LLC Act. In a footnote, the court noted that all parties agreed that North Carolina law applied to Insight’s request to pierce the veils of both MDI-NC and MDI, even though MDI was a Delaware LLC. The court explained that since North Carolina courts have not ruled definitively on choice of law for veil piercing, the court elected to follow North Carolina appellate precedent by applying North Carolina veil-piercing law to both MDI-NC and MDI.

The court explained that North Carolina law was unclear regarding whether a court can choose not to pierce the veil as a matter of equity when a jury has found the elements of the instrumentality rule were satisfied. The court noted that the Supreme Court of North Carolina has highlighted two competing policy considerations – on one hand, the instrumentality rule is an equitable doctrine allowing for great discretion in granting or denying relief, while on the other hand, the purpose of the rule is to achieve uniformity and predictability by allowing the fact finder to determine whether the veil should be pierced. The court looked to other jurisdictions for guidance. State and federal courts in Nevada, Colorado, Alabama, Idaho and Kentucky leave the decision to pierce the veil to the trial court. However, in Florida, Massachusetts and Tennessee, case law allows juries to decide whether to pierce the veil. The court noted that no jurisdiction addressed whether equitable considerations would permit a court to override a jury’s findings under a piercing doctrine similar to the instrumentality rule. The
court concluded that North Carolina case law suggests that the jury decides whether to pierce a corporate veil through factual findings, and the trial court should enter judgment accordingly. However, the court also recognized that piercing relief may be subject to equitable defenses in certain cases.

The court next turned to the defendants’ three arguments against piercing the veils of MDI-NC and MDI. First, defendants argued that the breach of contract claim against MDI-NC did not merit veil piercing because Insight voluntarily contracted with MDI-NC without seeking or obtaining personal guarantees from MDI’s member-managers, and Insight was already able to recover from the member-managers through the breach of fiduciary duty and constructive fraud claims. The court did not find these arguments persuasive, explaining that balancing the equities favors piercing when weighing Insight’s strong showing (and jury’s determination) that the LLCs were mere instrumentalities of Luke and Venesky, on the one hand, against the defendants’ arguments that Insight failed to contract personally with the individual defendants and had available remedies for other claims against the defendants, on the other hand.

Second, defendants argued that exclusion of evidence of the failed asset purchase makes it inequitable to pierce the veils of MDI-NC and MDI because the jury was unable to hear about defendants’ belief that they were justified in breaching the MRI lease after Insight backed out of the asset purchase. Defendants also asked the court to consider this evidence on its own to conclude as a matter of law that piercing the veils would be inequitable. The court denied both arguments, stating that the court would not consider evidence previously deemed irrelevant when entering judgment against defendants. The court noted that even if it were to consider this evidence, the balancing of the equities would still favor piercing as an appropriate remedy.

Third, defendants argue that Insight should not be able to recover through veil piercing because Insight was aware of MDI-NC’s financial condition and LLC form before entering into the MRI lease. Analyzing North Carolina appellate case law precedent cited by the defendants, the court explained that while the general rule is that the piercing analysis should focus on the actions of the corporate entity, and the extent to which others exercised control over it, and that the conduct of the plaintiff seeking to pierce the veil is typically not relevant to the analysis, there is a narrow equitable exception when the plaintiff has unclean hands. The court noted that it previously determined that the defendants’ unclean hands defense was deficient as a matter of law. The court found that Luke and Venesky could not avoid personal liability by focusing on Insight’s knowledge and conduct rather than their own.

The court concluded that, to the extent North Carolina law leaves the determination of veil piercing to the jury through its factual findings on the factors and elements of the instrumentality rule, the jury findings in this case would mandate that the veils MDI-NC and MDI be pierced that that judgment be entered for Insight. To the extent the court has the ability to engage in a post-trial balancing of the equities in making a final determination on veil piercing, the court would refuse to exercise its discretion in granting equitable relief to the defendants and reach the same conclusion regarding veil-piercing. As a result, the court pierced the veils of MDI-NC and MDI and held Luke, Venesky, MDI-NC and MDI jointly and severally liable for Insight’s damages.
James Calvert executed a power of attorney naming his son, Danny Calvert, as his attorney in fact. Danny executed a number of property transfers not authorized under the power of attorney. James’ estate filed an action against Danny challenging those property transfers, resulting in a judgment against Danny for more than $343,000. After entry of the judgment, James’ estate filed an action seeking to enforce the judgment against Lindan, LLC (a Kentucky LLC), an entity that Danny controlled and in which he had an ownership interest, under a reverse veil piercing theory. The trial court granted summary judgment in favor of Lindan, concluding that Lindan was not liable for the judgment against Danny. James’ estate appealed.

On appeal, the court reviewed Kentucky’s veil piercing jurisprudence. Kentucky permits traditional veil piercing under an instrumentality or alter ego theory when two elements are met: (i) domination of the corporation resulting in a loss of corporate separateness; and (ii) circumstances under which continued recognition would sanction fraud or promote injustice. The court explained that in evaluating the first element of traditional veil piercing, courts must look for certain factors including undercapitalization, failure to observe corporate formalities, overpaying or not paying dividends, siphoning corporate funds by a shareholder, and personal guarantees of corporate debt by major shareholders. Courts may also consider other factors, including: (i) failure to issue stock, (ii) insolvency of the debtor corporation; (iii) nonfunctioning of the other officers or directors; (iv) absence of corporate records; (v) commingling of funds; (vi) diversion of assets from the corporation by or to a stockholder or other person or entity to the detriment of creditors; (vii) failure to maintain arm’s-length relationships among related entities; and (viii) whether the corporation is a mere facade for the operation of the dominant stockholders.

In addressing the second element of traditional veil piercing, the court noted that proof of actual fraud is not required, but the injustice must be something beyond the mere inability to collect a debt from a corporation.

The court noted that Kentucky has never recognized the concept of reverse piercing. So the court examined applicable case law in other states, noting that a majority of jurisdictions addressing reverse piercing allowed the remedy and recognized that the same considerations that justify traditional piercing may justify reverse piercing. A minority of jurisdictions rejected reverse piercing and concluded that the remedy would bypass normal debt collection procedures and unfairly prejudice the rights of innocent shareholders.

The trial court assumed that Kentucky would recognize reverse piercing but declined to extend relief to James’ estate in this case. The appellate court agreed that this case was not the appropriate one to recognize reverse piercing because James’ estate failed to present sufficient proof to warrant traditional veil piercing.

The court noted that there were a number of factors supporting the first element of traditional veil piercing, including that: (i) Lindan was capitalized solely through Danny’s assets; (ii) Danny was the sole manager; (iii) Danny lived in a house on Lindan’s property; (iv) Lindan did little business beyond passively owning the property; (v) the other members of Lindan – Danny’s ex-wife and three children – had little involvement in the operation of Lindan; and (vi) Danny failed to observe corporate formalities with Lindan.
The court examined the second element of traditional veil piercing and noted that a court considering reverse piercing must, in addition to typical equitable considerations, weigh the impact on innocent owners and consider the availability of alternative, adequate remedies. The court noted that the record showed that Lindan was formed for a proper purpose (estate planning) and that none of Lindan’s assets were proven to be related to Danny’s misconduct. The court also noted that Danny’s ex-wife and children claimed ownership interests in Lindan. Finally, the court noted that Danny could have pursued claims directly against Danny’s ownership interest in Lindan but chose not to do so. Because innocent owners could be harmed and alternative remedies were available, the court found that reverse veil piercing would be inequitable in this case and affirmed the trial court’s summary judgment in favor of Lindan.

In a separate opinion, one appellate judge concurred with the majority’s decision to decline to recognize reverse piercing, but dissented regarding the decision to affirm the trial court’s entry of summary judgment due to concerns that summary judgment would effectively preclude James’ estate from seeking a charging order against Danny’s ownership interest in Lindan. The judge noted that while James’ estate’s direct claim against Danny’s ownership interest in Lindan was inartfully pleaded in the complaint, it was sufficiently pleaded under Kentucky’s rules of civil procedure. As a result, the judge would have reversed and remanded the matter back to the trial court for resolution of unresolved issues concerning a charging order claim.


A group of people allegedly defrauded by a Ponzi scheme run by Nathan Reuter through Vertical Group, LLC (a Missouri LLC) sued Nathan and Vertical to recover their lost investments. Nathan filed for bankruptcy, and the bankruptcy court awarded the creditors actual and punitive damages against Nathan. The district court entered a final judgment against Vertical with damages. Nathan and Vertical did not satisfy these judgments. So the creditors filed a creditors’ bill in the district court naming Nathan’s wife, Kathleen Reuter, as a defendant, in an attempt to satisfy the judgments by targeting assets owned by Kathleen that formerly belonged to the Reuters as tenants by the entirety. The creditors claimed that Vertical was a “sham company” owned by a partnership consisting of the Reuters, as tenants by the entirety, and other individuals. The creditors sought to pierce Vertical’s veil to reach the partnership and levy on the Reuters’ assets, which were then owned by Kathleen individually. The district court granted summary judgment in favor of the Reuters, and the creditors appealed.

The appellate court first addressed the creditors’ attempt to pierce the veil of Vertical to reach the partnership and its partners’ assets. The creditors argued that Nathan’s interest in Vertical was created, funded and held by the Reuters as tenants by the entirety in a partnership with other individuals, and that because all partners in a partnership are jointly and severally liable for a partnership’s debts, the Reuter entirety was liable for the creditors’ judgment against Vertical. Assuming the creditors were able to pierce the veil, the creditors’ argument hinged on proving that Nathan’s interest in the partnership belonged to the Reuters as a married couple, rather than to Nathan individually. The court explained that Missouri courts have recognized a partnership interest held by two spouses as tenants by the entirety only when there has been clear evidence of the spouses’ intent to hold the partnership interest as a married couple. The court concluded that the record was insufficient for a reasonable jury to conclude that the Reuters intended to participate in the partnership as a married couple. As a result, the court held that the creditors’ tenancy by the entirety theory failed under Missouri law. The court affirmed the district court’s
grant of summary judgment in favor of the Reuters on the creditors’ claim to pierce Vertical’s veil and reach Kathleen’s assets that formerly belonged to the Reuters as a married couple.

In a separate opinion, one appellate judge concurred with the court’s judgment but disagreed with the court’s rationale. The judge noted that to reach Kathleen’s assets to satisfy the judgment against Vertical, the creditors relied on a two-step argument. First, the creditors had to pierce Vertical’s veil to reach the partnership. Second, the creditors had to show that Nathan’s share of the partnership was owned by the Reuters as tenants by the entirety. The judge noted that the court did not address step one but concluded that step two failed. The judge did not join the court’s rationale on step two but concluded that step one failed. The judge noted that Missouri law requires a plaintiff in a piercing claim to prove that an entity is either the instrumentality or alter ego of the defendant. The judge noted that the creditors disclaimed any reliance on an alter ego theory, and although the creditors advanced an instrumentality theory, they did not argue that the facts met the three-part instrumentality test under Missouri law. As a result, the judge concluded that the creditors did not establish grounds to pierce Vertical’s veil under Missouri law.


WinCo Foods, LLC sued KDN Management Inc. (a Utah corporation) d/b/a “KD Concrete Design” for breach of contract alleging that KDN overcharged WinCo for concrete floor work that KDN performed for WinCo. WinCo also sued KDN’s sole shareholder, Kym Nelson, on theories of pre-incorporation activities and undisclosed principal, as well as two affiliated entities – SealSource International, LLC (a Utah LLC) and KD3 Flooring LLC (a Utah LLC) – on veil piercing theories. The trial court found that KDN had overcharged WinCo and awarded WinCo more than $2.9 million in damages. The trial court also held Nelson, SealSource and KD3 jointly and severally liable for WinCo’s damages. The defendants appealed, among other things, whether (i) the trial court abused its discretion by denying the defendants motion for a jury trial, (ii) the trial court erred when it imposed personal liability on Nelson and (iii) the trial court abused its discretion by finding that the defendants were alter egos of one another.

Regarding the motion for jury trial, the court analyzed Idaho rules of civil procedure and the parties’ pleadings, concluding that the trial court acted within its discretion by denying the motion. The court pointed to the trial court’s reasons for denying a jury trial, which included the “number and interweaving of complex equitable issues” and the number of related motions in limine.

Regarding the imposition of personal liability on Nelson, the court noted that the trial court found that KDN was not formed until after WinCo entered into a contract with Nelson acting on behalf of “KD Concrete Design,” the assumed name of KDN. Citing the applicable Idaho statute governing liability for pre-incorporation activities, the court affirmed the trial court’s holding that Nelson was jointly and severally liable with KDN for breach of contract damages. The court did not address whether Nelson could also be held liable as an undisclosed principal.

Regarding the trial court’s finding that Nelson, KDN, SealSource and KD3 were alter egos of one another, the court examined applicable veil-piercing law. Citing the Restatement (Second) of Conflicts, the court noted that there was no dispute that Utah law governed the theories of veil-piercing and alter ego liability because KDN was a Utah corporation and SealSource and KD3
were Utah LLCs. The court noted that under Utah law, two requirements must be met to pierce the veil. First, there must be such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist. Second, the observance of the corporate form must sanction a fraud, promote injustice or cause an inequitable result. The court also noted that the Utah Supreme Court has adopted eight “Coleman factors” to consider in piercing the veil: (i) undercapitalization of a one-man corporation; (ii) failure to observe corporate formalities; (iii) nonpayment of dividends; (iv) siphoning of corporate funds by the dominant stockholder; (v) nonfunctioning of other officers or directors; (vi) absence of corporate records; (vii) use of the corporation as a facade; and (viii) use of the corporate entity in promoting injustice or fraud. The court explained that the “Coleman factors” are guidelines and not required elements.

The defendants argued that the basis of the trial court’s alter ego determination was that Nelson, SealSource and KD3 siphoned off KDN’s assets, and this finding was erroneous because (i) Nelson and KDN were unaware of any liability to WinCo when the assets were conveyed to Nelson and her affiliates and (ii) due to KDN’s status as an S-corporation, Nelson could spend KDN’s money as if it were her own. The court was not persuaded by either argument. The court explained that the trial court’s record showed overwhelming evidence of several “Coleman factors,” including undercapitalization, failure to follow corporate formalities, a nonfunctioning board member, lack of corporate records and fund withdrawals without legitimate purpose. The court also noted that Nelson and KD3’s accountant referred to KDN as a “holding company” for KD3, and that Nelson consistently referred to KD3 as a division of SealSource. Citing the trial court’s finding that Nelson, KDN, SealSource and KD3 were “so intertwined in their interest and ownership that separate personalities no longer existed,” the court affirmed the trial court’s holding that joint and several alter ego liability was appropriate in this case.
“You say potato, I say ‘Operating Income’”

**Case Name/Court/Date/Citation:**

Ocean Tomo, LLC v. PatentRatings, LLC  
United States District Court for the Northern District of Illinois, Eastern Division  
June 14, 2017  
262 F. Supp. 3d 553; 2017 U.S. Dist. LEXIS 91243; 2017 WL 258843

**LLC State of Organization:**

Ocean Tomo – Illinois  
PatentRatings – California

**Brief Factual Background:**

Jonathan Barney (“Barney”) founded PatentRatings, which developed proprietary software for evaluating patents. In connection with a software license from PatentRatings to Ocean Tomo, Ocean Tomo became a member of PatentRatings and Barney became a member of Ocean Tomo. Litigation between the two entities and Barney has been ongoing since 2012. This is a decision on Ocean Tomo’s motion for summary judgment on various counterclaims asserted by Barney, including one for breach of Ocean Tomo’s Operating Agreement provision relating to the distribution of profits.

**Key Issues:**

The scope of a manager’s discretion to classify income.
Relevant Language from LLC Agreement, Statute or Both:

Agreement:

"Net Profits from Operations" and "Net Losses from Operations" shall mean, for each Fiscal Year or other period, such portion of the Company's Net Profits (or Net Losses) attributable to the ordinary course operation of the Company's business for such period; provided that, (1) such amount shall exclude any Net Profits or Net Losses resulting from the sale of all or substantially all of the Company's assets, and (2) such amount shall be subject to any other modification (including any modification that would otherwise be inconsistent with the definition set forth in this paragraph) as determined by the Board of Managers (but shall not in any event include profits from the sale of all or substantially all of the Company's assets). The portion of the Company's Net Profits (or Net Losses) constituting Net Profits from Operation (or Net Losses from Operations) shall be determined by the Board of Managers in its sole discretion and such determination shall be conclusive on the Members. The [LLC] shall, to the extent permissible, elect to be treated as a partnership for federal, state and local income tax purposes, and each Member and the [LLC] shall file all tax returns and shall otherwise take all tax and financial reporting positions in a manner consistent with such treatment, and no Member shall take any action inconsistent with such treatment.

Analysis:

Ocean Tomo classified the sale of interests in two subsidiaries – ICAP and IXPI – as profit from “operations” rather than “other profits”. Not surprisingly, 75% of net profits from operations were distributable by the Board of Managers in its discretion, while the other 25% was according to ownership percentages, whereas “other net profits” were distributable strictly in accordance with ownership percentages. Barney claimed that the Board Managers abused its discretion by classifying proceeds from these two transactions as profits from operations. The Court had no difficulty reaching the conclusion that there was no ambiguity regarding the scope of the Board’s discretion.

However, the Court quickly noted that “[w]hen one party to a contract is vested with contractual discretion, it must exercise that discretion reasonably and with proper motive, and may not do so arbitrarily, capriciously or in a manner inconsistent with the reasonable expectations of the parties.” The Court went on to note that “the duty of good faith and fair dealing cannot override an express term of a contract,” nor is it “an independent source of duties for the parties to a contract,” but rather is “used as a construction aid in determining parties’ intent” with respect to the duties or obligations imposed by the contract’s terms. In that regard, the Operating Agreement also provided that “no Member shall have priority over any other Member with respect to return of Capital Contributions or as to Net Profits, Net Losses or distributions.” The Court found that that this language could, in fact, impose an independent constraint on the discretion of the Board.

Two pieces of evidence were particularly relevant to the Court’s denial of summary judgment to Ocean Tomo. The first was an email among the majority owners of Ocean Tomo evidencing a lack of good faith by the Managers in which it was suggested that:
There is one other way to do it: treat the sale like an operating item instead of a sale item. An argument could be made for that too. If we did that I'd bet we get a number close to the above because you own so much of the firm and because our ET value generation is not far off of our ownership percentages. If anything, you'll gain at JB's expense.

The other factor that the Court found particularly relevant was Ocean Tomo’s argument that no profits were received from sale of one of the subsidiaries (IXPI), so the Board of Managers could not possibly has abused its discretion (at least with respect to that sale). In contrast to that assertion, the Court made the following observation:

Ocean Tomo also admits that its two majority owners received “adjustments to [their] partner capital accounts as a result of a change in the value of Ocean Tomo's partial ownership of IPXI.” Ocean Tomo argues that Barney did not receive these adjustments “because he was not entitled to receive distributions as a result of his breach of the confidentiality and non-compete provisions of the Operating Agreement. These arguments, however, imply that Ocean Tomo did receive profits from the IPXI transaction that would have been distributed to Barney but for Ocean Tomo’s contention that he was in breach of the Operating Agreement. It may be that Barney was in breach of the Operating Agreement, and that Barney's breach was a justification for Ocean Tomo to disregard the agreement. But that question has not been briefed on this motion. Since there is evidence that Ocean Tomo may have received profits from the IPXI transaction, and that Barney did not receive a share of those profits, the Court denies summary judgment to Ocean Tomo on Barney's claim for breach of the Operating Agreement in Count I.

**Drafting Implications:**

- Care should be taken to not place too much reliance on a Manager’s discretion, and to not provide too much discretion with respect to decisions that could yield a disproportionate bottom line impact.
- To the extent that the nature of income (ordinary, capital, etc.) is subject to some judgment call, it may be advisable to vest the authority for making those judgments in an appropriate professional (permissive or mandatory).
“If you thought it was freezing in Delaware, you should visit Massachusetts”

**Case Name/Court/Date/Citation:**

Allison v. Eriksson

Supreme Judicial Court of Massachusetts

May 30, 2018

479 Mass. 626; 98 N.E.3d 143; 2018 Mass. LEXIS 349

**LLC State of Organization:**

Massachusetts (pre-merger)/Delaware (post-merger)

**Brief Factual Background:**

In 1999, Allison (a corporate attorney) and Eriksson (a plastic surgeon) formed Jonathan Barney (“Barney”) founded Applied Tissue Technologies as a Massachusetts LLC (“ATT-MA”). Allison initially held 25%, and Eriksson 75%. In 2012, Eriksson (without notice to or consent of Allison) engineered a merger of the Massachusetts LLC into a newly-formed Delaware LLC (ATT-DE), and through additional investments, diluted Allison’s ownership to 3.32%. Allison brought suit in Massachusetts to enjoin the merger and asserted claims for breach of contract, intentional interference with advantageous relations, breach of fiduciary duty, civil conspiracy, and declaratory judgment. The trial court granted equitable relief for breach of fiduciary duty by reforming the terms of the ATT-DE Operating Agreement. The Supreme Court affirmed.

**Key Issues:**

The availability of equitable relief in the context of a freeze-out merger.

**Relevant Language from LLC Agreement, Statute or Both:**

**Agreement:**

ATT-MA Agreement:

In 2003, Allison and Eriksson each decided to transfer a portion of their respective interests in ATT-MA into trusts for the benefit of their families. To that end, Allison and Eriksson also executed a new operating agreement that was lengthier and more sophisticated than the original. It contained several important changes: (1) it created a manager position, to be elected by voting members; (2) it defined the term, “Original Members,” as Allison and Eriksson; (3) both original members had to agree to the addition of any new members; (4) any change to the operating agreement required consent from both original members; (5) any change to the operating agreement that had the effect of reducing a member's interest in ATT-MA or interest in distribution from a sale of assets or cash flow required consent from the affected member; and (6)
a vote of at least sixty per cent of the membership was required to make significant business decisions. The agreement further provided that members were entitled to examine ATT-MA's books and records at any and all reasonable times, and that members had a duty to conduct company affairs in good faith. The new operating agreement also maintained a provision from the original agreement that required both Allison and Eriksson to consent to any further capital contributions.

ATT-DE Agreement:

Section 6.01: “The business and affairs of [ATT-DE] shall be managed by or under the direction of the Board [of Directors], which shall have the right, power and authority to exercise all of the powers of [ATT-DE] except as otherwise provided by law or this Agreement... . Except as may be expressly provided otherwise elsewhere in this Agreement or pursuant to nonwaivable provisions of [Delaware's limited liability company act], the Members shall have no voting rights ....”

Section 6.04(a): “The Members' respective obligations to each other are limited to the express obligations set forth in this Agreement, subject only to the implied contractual covenant of good faith and fair dealing. No Member shall have any duties or liabilities, including fiduciary duties, to [ATT-DE] or to any other Member, or to the Board or any Director, and the provisions of this Agreement, to the extent that they restrict or otherwise modify, or eliminate, the duties and liabilities, including fiduciary duties, of the Members otherwise existing at law or in equity, are agreed by the Members to replace such other duties and liabilities of the Members. Any standard of care or duty imposed by or under the Act or any other law, rule or regulation (or any judicial decision based on or interpreting the same) shall be modified, waived or limited, to the extent permitted by law, as required to permit each Member to act under this Agreement and to make any decision such Member is authorized to make hereunder in such manner as such Member may determine in his, her or its sole and absolute discretion, subject only to the implied contractual covenant of good faith and fair dealing.”

Section 7.01: “Except as otherwise expressly provided in this Agreement, no Member shall have any right of access to any of the books or records of [ATT-DE] or to receive any information about the business, affairs, properties or ownership of [ATT-DE] unless the Board determines, in its discretion in compliance with [§6.04(b)], to grant such access or to provide such information to one or more Members.”

Statute:

Massachusetts Limited Liability Company Act, Section 60(b):

(b) The exclusive remedy of a member of a domestic limited liability company, which has voted to consolidate or to merge with another entity under the provisions of sections fifty-nine to sixty-three, inclusive, who objects to such consolidation or merger, shall be the right to resign as a member and to receive any distribution with respect to his limited liability company interest, as provided in sections thirty-one to thirty-seven, inclusive. Such members and the resulting or surviving entity shall have the rights and duties, and shall follow the procedure set forth in said sections.
Massachusetts Limited Liability Company Act, Section 63(b):

(b) To the extent that, at law or in equity, a member or manager has duties, including fiduciary duties, and liabilities relating thereto to a limited liability company or to another member or manager, (1) any such member or manager acting under the operating agreement shall not be liable to the limited liability company or to any such other member or manager for the member’s or manager’s good faith reliance on the provision of the operating agreement, and (2) the member’s or manager’s duties and liabilities may be expanded or restricted by provisions in the operating agreement.

Analysis:

Under the ATT-MA Operating Agreement, Eriksson had effective voting control, and thus could approve the merger into ATT-DE. However, the Court found that this provision applies only to a merger undertaken in conformance with all statutory requirements, including discharge and satisfaction of fiduciary duties. Accordingly, the “sole remedy” limitation for dissenting equity owners applies only when all other conditions are satisfied, concluding that “if it was the Legislature's understanding that merger would provide a unilateral means for majority members to extinguish fiduciary duties and freeze out minority members from LLCs, it would have said so expressly.”

Interestingly, the Court analogized the relationship among LLC members to those applicable to Massachusetts close corporations, noting that:

[C]lose corporations often involve a small number of owners, who are “quite dependent on one another for the success of the enterprise[,] ... the relationship among the stockholders must be one of trust, confidence and absolute loyalty if the enterprise is to succeed. The nature of these close corporations imposes a duty of “utmost good faith and loyalty”. The minority protections in ATT-MA's operating agreement established an analogous relationship and duty among its members, and thus, the close corporation doctrine, and the strict fiduciary duty it imposes, applies here.

Finally, the Court approved the equitable reformation remedy imposed by the trial court. Specifically, the trial court ordered “the following amendments to the operating agreement of ATT-DE: (1) the rescission of § 6.01, such that members shall have voting rights as provided under Delaware law; (2) the rescission of § 6.04 to the extent that it eliminated members' fiduciary duties to one another, and to directors, officers, and shareholders; (3) the rescission of the first two sentences of § 7.01, such that members may access the company's books and records; (4) the addition of a provision requiring the directors to “report to Allison either orally or in writing on the business and affairs of” ATT-DE, to timely advise him of anticipated extraordinary business events, and to provide him with a copy of ATT-DE's annual financial statements, if any. The judge also ordered that the combined membership interest of Allison and the Allison Trust be “grossed up” to five per cent and not be subject to dilution without a bona fide outside investment. Any such dilution must be on the same terms as holders of common or preferred shares of ATT-DE. If ATT-DE should be liquidated before receiving any outside investment, Allison's interest must be “treated pari passu with the preferred shareholders.”
Drafting Implications:

- Disclaim any implication of fiduciary duties (especially those “borrowed” from corporate statutes). Any duties should be identified as “contractual obligations” only.

- Provide for robust alternate dispute resolution process and remedy that could be pursued by minority members.

- Do not rely on a contract to excuse bad behavior. A Court will always find some way to a remedy.
“An eye for an eye – and perhaps an arm and a leg too”

Case Name/Court/Date/Citation:

Retina Assocs. of Greater Phila. v. Retinovitreous Assocs.

Superior Court of Pennsylvania

December 7, 2017


LLC State of Organization:

Pennsylvania (Case Decided under Repealed LLC Statute)

Brief Factual Background:

This was an appeal of certain trial court rulings in multi-year litigation stemming from the approval of the LLC’s sale of substantially all of its assets to an affiliated entity and its subsequent dissolution. Claims for breach of fiduciary duty and oppression were asserted by two minority members against the majority members of the LLC who approved the sale and dissolution.

Key Issues:

What is the nature and extent of duties owed by limited liability company members to each other?

Relevant Language from LLC Agreement, Statute or Both:

Statute:

15 Pa. C.S.A. § 8943(b)(2): “[A] member [of a limited liability company] who is not a manager shall have no duties to the company or to the other members solely by reason of acting in his capacity as a member.”

Agreement:

Section 5.01(a):

Exclusive Responsibility. Except as otherwise expressly provided herein, (i) the management of the business and affairs of the Company shall be the sole and complete responsibility of the Managers, (ii) a Member, as such, shall not take part in, or interfere in any manner with, the management, conduct or control of the business and affairs of the Company, and shall not have any right or authority to act for or bind the Company, and (iii) the Company may act only by actions taken by or under the direction of the Managers in accordance with this Agreement.
Individual Managers shall have only such authority and perform such duties as the Managers may, from time to time, delegate to such individual Managers.

Section 6.06:

Certain Company Matters Requiring Member Approval.

(a) Specific Matters. Notwithstanding anything in this Agreement to the contrary, the approval of the following matters shall require the affirmative vote of the Members by a Majority Vote:

. . .

(v) The sale, exchange or transfer of all or substantially all, of the assets of the Company.

. . .

(viii) The dissolution of the Company pursuant to Section 10.01(i). . . .

Analysis:

The Court agreed with the following proposition as advanced by the minority members:

“The majority voted to sell all of the assets of the business to another entity which they controlled, to the exclusion of the two minority members. Had the same thing happened in a closely held corporation, a partnership or a joint venture, there would be no question that the conduct is actionable and unlawful. No different result should obtain merely because the entity in question was a limited liability company.”

The Court went to great lengths to distinguish act of the majority members “as members” versus those in which the majority essentially acts “as manager”, and held that the statute did not afford liability protection in the latter situation. It then adopted “the following summary of the duties of members of a manager-managed limited liability company provided by a leading treatise on the subject:

The courts have generally held that if a member is acting solely as such, he or she generally does not have any of the fiduciary duties of managers described in this chapter. Thus, the duties above in this section do not apply to members who do no more than approve the actions of designated managers. Members acting solely as such may breach [a] general duty of good faith . . ., although the courts often characterize the conduct as a breach of fiduciary duty. For example, it may be a breach of duty for the members to squeeze out or expel a member or for controlling members to appropriate benefits from minority members by exercising or selling control. . . . Non-managing members may have other duties, which may or may not be considered aspects of the good faith duty. Whether or not a member is involved in management, the member has no right to appropriate property belonging to the LLC for personal use. Also, members may have a duty to disclose in transactions with each other, as on sale of an interest in the LLC.

Although these theoretical distinctions are largely reflected in the holdings of cases, the language of the opinions does not always clearly distinguish between the duties of members as such and
those of managing members. Thus, courts sometimes impose what are labeled as "fiduciary" duties on non-managing members.
1 Ribstein & Keatinge § 9.6, at 588-92.

In a separate footnote, the Court noted that “if this case had arisen under the 2016 statute, the questions presented might be more easily resolved. The 2016 Act provides that a member of a limited liability company is subject to a contractual duty of good faith and fair dealing when discharging duties and obligations or exercising rights under the Act or the company's operating agreement. 15 Pa. C.S. § 8849.1(d), (i). This provision is not made retroactive, however, and thus is inapplicable to this case. Cf. Hanaway, 168 A.3d at 157-58.

**Drafting Implications:**

- Specify duties and standards applicable to member actions as member (i.e. members can vote in “self-interest”), and any intention to impose a higher standard or duty by reason of the fact that the member also has some managerial authority.

- Disclaim conflation of implied covenant of good faith and fair dealing with fiduciary duties.
- Set-up “cleanse” procedure for independent approval of conflicted transactions.
“Holy Papayas Batman, I didn’t know we had to keep everything in the bat cave a secret!”

Case Name/Court/Date/Citation:
Super Starr Int'l, LLC v. Fresh Tex Produce, LLC
Court of Appeals of Texas
July 20, 2017
531 S.W.3d 829; 2017 Tex. App. LEXIS 6801; 2017 WL 3084294

LLC State of Organization:
Texas

Brief Factual Background:
An LLC was formed between an importer and a distributor under which the distributor would act as exclusive distributor for a proprietary variety of hybrid papayas. After expiration of the exclusivity period, the importer terminated its distribution agreement with the LLC began to distribute directly. The LLC obtained a broad injunction against competitive activities by the importer, and importer appealed. This is the decision on appeal.

Key Issues:
Determining the existence, nature and scope of fiduciary duties from the language of the Operating Agreement and extrinsic evidence.
Interplay between expiration of exclusivity clause and misappropriation of Trade Secrets.

Relevant Language from LLC Agreement, Statute or Both:

Statute:
(c) An association or organization is not a partnership if it was created under a statute other than:
   (1) this title and the provisions of Title 1 applicable to partnerships and limited partnerships;
   (2) a predecessor to a statute referred to in Subdivision (1); or
   (3) a comparable statute of another jurisdiction.
Texas Uniform Trade Secrets Act § 134A.002(6) (definition of “trade secret”) information, including a formula, pattern, compilation, program, device, method, technique, process, financial data, or list of actual or potential customers or suppliers, that:

(A) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and

(B) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Texas Uniform Trade Secrets Act § 134A.002(3) (definition of “misappropriation”)

(C) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means [Form 1]; or
(D) disclosure or use of a trade secret of another without express or implied consent by a person who:

(i) used improper means to acquire knowledge of the trade secret [Form 2];
(ii) at the time of disclosure or use, knew or had reason to know that the person's knowledge of the trade secret was:

(a) derived from or through a person who had utilized improper means to acquire it [Form 3];
(b) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use [Form 4]; or
(c) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use [Form 5]; or

(iii) before a material change of the person's position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake [Form 6].

Agreement:

The [LLC] shall, to the extent permissible, elect to be treated as a partnership for federal, state and local income tax purposes, and each Member and the [LLC] shall file all tax returns and shall otherwise take all tax and financial reporting positions in a manner consistent with such treatment, and no Member shall take any action inconsistent with such treatment. The [LLC] shall not be deemed a partnership or joint venture for any other purpose.

15.1 Exclusive Contract for Distribution. [The LLC] shall serve as the sole and exclusive distributor of papayas exported into the United States by [the Importer] and/or other existing or, future companies of Lance Peterson and/or David Peterson pertaining in whole or in part to the growing, production, shipping or packaging of papayas. This portion of the Agreement shall apply for two years at which time the parties agree to meet to review the agreement and negotiate in good faith to renew the Business Operations terms of the Agreement.
6.4 **Inspection of Records.** All [the LLC] books and records shall be kept in the principal place of business of the [LLC] and shall be open to inspection and copying by the Members or their authorized representatives at all reasonable times.

3.5 **Other Business.** Except as prohibited by Section 3.4 above, the Members and the Manager hereby acknowledge and agree that each Manager and Member may engage in any activity whatsoever (as an owner, employee, consultant or otherwise) whether or not such activity competes with or is enhanced by the Company's business and affairs, and no Manager or Member shall be liable or accountable to the Company or any other Manager or Member for any income, compensation, or profit that such Manager or Member may derive from such activity. Further, no Manager or Member shall be liable or accountable to the Company or any other Manager or Member for failure to disclose or make available to the Company any business Opportunity that such Manager or Member becomes aware of in such Manager's or Member's capacity as a Manager or Member or otherwise.

**Analysis:**

The Court classified the injunctive relief in two broad categories. The first were those aspects of the order grounded in a breach of by the importer of the exclusivity provision in what the distributor alleged was a “partnership” or “joint venture” between the parties. The Court made short work of the distributor’s characterization of the relationship as a partnership, citing not only the clear language of the Texas BOC and Operating Agreement noted above, but also citing with approval existing precedent to the effect that “the term ‘partner’ is regularly used in common vernacular and may be used in a variety of ways,” and “[r]eferring to . . . a ‘partner' in a colloquial sense is not legally sufficient evidence of expression of intent to form a business partnership.” Nor did the Court find the language of the exclusivity provision ambiguous, finding that the words “this portion” referred to the term of the exclusivity, and that the remaining language relating to the obligation to renegotiate the “Business Operations” provision did not imply an obligation to negotiate an extension of the exclusivity.

The second category were those aspects based upon alleged misuse of confidential information, including breach of fiduciary duty. Again the Court made short work of the fiduciary duty claim, finding that the lack of ambiguity in the two year limitation on exclusivity essentially mooted any corresponding claim based on breach of fiduciary duty, and that the pre-emption provisions of the TUTSA also precluded use of fiduciary duty as a separate ground of relief. However, some portions of the injunction that were based upon alleged violations of the TUTSA did stand (at least in concept).

The Court first found itself unable to conclude as a matter of law that the inspection rights in the Company Agreement “gives the Importer the absolute right to talk all of the LLC’s confidential information without regard to any trade secret protection.” The Court found equally unpersuasive the importer’s argument that the provision under which it is permitted to pursue business opportunities somehow allowed the members to exploit the Company’s trade secrets for its own benefit, citing in support of its ruling Section 3.5 of the Company’s agreement, which states that “[a]ll property owned by [the LLC], tangible or intangible, shall be deemed to be owned by [the LLC] as an entity, and no Member shall have any ownership of such property individually.” As further support for that proposition, the Court noted that “the business organizations code provides
that the member of a limited liability company or an assignee of a membership interest in a limited liability company does not have an interest in any specific property of the company.”

**Drafting Implications:**

- Distinguish contracted business terms (such as exclusivity) from “duties”. For example, are definite competitive restrictions “in lieu of” or “in addition to” other duties.

- Review applicable trade secret law and draft around possible duplicate or preempted provisions of the agreement.
Excuse me, do I know you?

Case Name/Court/Date/Citation:

MVW Mgmt., LLC v. Regalia Beach Developers LLC

Court of Appeals of Florida

September 6, 2017


LLC State of Organization:

Regalia Beach Developers LLC (Florida)

MVW Management LLC (Florida)

Brief Factual Information:

Regalia Beach Developers, LLC ("Regalia") owns a real estate development known as the Regalia Beach Condominium (the "Project"). Louis Montella ("Montella") was initially the Manager of Regalia. Montella was also the principal of MVW Management LLC ("MVW"), which had a separate management agreement with Regalia to act as the "Project Manager".

Regalia filed an action against both Montello and MVW for mismanagement, each of whom, in turn, sought advancement of their litigation expenses pursuant to the indemnity provisions of the Regalia operating agreement and the Regalia-MVW management agreement. The trial court granted Montello advancement under the Regalia operating agreement, but denied advancement to MVW under both the Regalia operating agreement and the Regalia-MVW management agreement. MVW filed an interlocutory appeal.

Relevant Language from LLC Agreement, Statute or Both:

Regalia Operating Agreement:

Expenses. To the fullest extent permitted by applicable law, expenses (including legal fees) incurred by a Covered Person in defending any claim, demand, action, suit or proceeding shall, from time to time, be advanced by the Company prior to the final disposition of such claim, demand, action, suit or proceeding upon receipt by the Company or an undertaking by or on behalf of the Covered Person to repay such amount if it shall be determined that the Covered Person is not entitled to be indemnified as authorized in [this Agreement].

Covered Person. A Member, any Affiliate of a Member, any Manager, any
officers, directors, shareholders, partners, employees, representatives, or agents of a Member, any affiliate of a Member, any employee or agent of the Company or its Affiliates, any Tax Matters Representative of the Company, or any officer of the Company that is not an employee.

*Regalia – MVW Management Agreement:*

Owner agrees to defend, indemnify and hold harmless Manager and each of Manager's members, officers, directors, employees and agents (collectively, including Manager, the "Manager Indemnified Parties" and each individually an "Indemnified Manager Party"), from, against and in respect of any and all demands, claims, actions or causes of action, losses, liabilities, obligations, penalties, damages, assessments, deficiencies, taxes, judgments, costs and expenses, including, without limitation, interest, penalties and reasonable attorneys' fees and expenses incurred by any such Manager Indemnified Party in connection with the defense of any action, suit or other proceeding (including any administrative proceeding) (collectively, the "Indemnified Amounts"), as incurred, asserted against, imposed upon or paid, incurred or suffered by Manager or any Indemnified Manager Party as a result of the services performed by Manager pursuant to this Agreement provided that Manager or such Manager Indemnified Party acted in good faith and in a manner he, she or it reasonably believed to be in or not opposed to the best interests of Owner with respect to the Project, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his, her or its conduct was unlawful.

**Analysis:**

With respect to Regalia, MVW asserted “Covered Person” status under two alternate theories. The first was that it was a “Manager” by virtue of its obligations under the Regalia-MVW Management Agreement. The Court made short work of that argument, noting that under the Regalia Operating Agreement, a “Manager” is “any Person as described in Article 6 and elected by the Members in accordance with the provisions of [this Agreement.]” MVW’s status as counter-party to a management agreement clearly did not square with that definition. Alternatively, MVW argued that it was the “agent” of Montello. The Court noted that the drafters of the Operating Agreement could have included “agents” or “Affiliates” of the “Manager” in the definition of “Covered Person.” The fact that it did not do so reflected its intention to restrict the class of Covered Persons to those identified in the definition, especially in light of the fact that Affiliates of Members were included in the definition, but Affiliates of the Manager were not.

In response to MVW’s argument that it was entitled to advancement under the Regalia-MVW management agreement, the Court first noted that in Florida, contractual indemnification is generally limited to third-party claims, and at least in this context, the right of advancement is co-extensive with the right to indemnification. The Court then noted the general view (as articulated by the trial court) that if general indemnity language was automatically construed to include indemnity for first-party claims, “a garden variety indemnity clause to be used to exculpate a contracting party from liability to the other party to the agreement.” In the absence of a clear language evidencing an intent to indemnify for first party actions, the Court will not infer that intention.
Drafting Implications:

- Carefully review scope of defined “Covered Persons”, especially in the context of contracted relationships with Affiliates.

- Carefully first party – third party claim distinctions when drafting indemnification and advancement clauses, particularly in the context of derivative claims.
That Delaware Court of Chancery is Really Sumpin’

Case Name/Court/Date/Citation:
Miller v. Fiberlight, LLC
Court of Appeals of Georgia
October 31, 2017
343 Ga. App. 593, 808 S.E.2d 75

LLC State of Organization:
Fiberlight LLC - Delaware

Brief Factual Information:
Founder, minority member and former president Michael Miller (“Miller”) sued majority member and others alleging breach of fiduciary duty and related causes of action. Over the course of approximately six years, Miller saw his equity stake diluted from approximately twenty-five percent (25%) to one-half of one percent (.5%) and got fired. Over that same period, there were five iterations of Fiberlight’s Amended and Restated limited liability company agreement. However, it was the events surrounding the third amended and restated agreement that formed the gravamen of the Miller’s complaint. At that time, Thermo Telecom Partners (“Thermo”) and NT Assets, each formerly a minority member, converted their Ten Million Dollar ($10,000,000) debt position to equity.

The first and second versions of the LLC Agreement required unanimous consent of the members for amendment. The third Amended and Restated Agreement vested amendment authority with the majority equity holders.

Thermo and NT Assets were granted summary judgment on all counts, and Miller appealed.

Relevant Language from LLC Agreement, Statute or Both:

Agreement:

each Director shall have one (1) vote at all board meetings, except that so long as Thermo and NT Assets collectively hold a majority of the Percentage Interests, the following rules shall apply to any votes taken by the Board at any duly called Board meeting: (a) if there is one (1) Thermo/NT Assets Designee on the Board, then such Thermo/NT Assets Designee shall have three (3) votes; (b) if there are two (2) Thermo/NT Assets Designees on the board, then each such Thermo/NT Assets Designee shall have two (2) votes; and (c) if there are three (3) Thermo/NT Assets Designees on the Board,
then each such Thermo/NT Assets Designee shall have one (1) vote. For any actions to be adopted by the Board, such action must be either (i) approved by the affirmative of Directors totaling at least three (3) votes at a duly called board meeting, or (ii) approved by written consent of all Directors then serving on the Board.

Limited Liability; Exculpation. Except as expressly set forth in this Agreement or required by law, no Member shall be personally liable for any debt, obligation, or liability of the Company, whether arising in contract, tort, or otherwise, solely by reason of being a Member of the Company. Neither the Company nor any Director or officer shall have any right, claim, or cause of action against any Member of the Company arising out of such Member having acted or failed to act in accordance with such Member's rights or obligations as a Member hereunder.

Members May Participate in Other Activities. Members and their Affiliates and Directors, either individually or with others, shall have the right to participate in other business ventures of every kind, whether or not such other business ventures compete with the Company. No Member, acting in the capacity of a Member, shall be obligated to offer to the Company or to the other Members any opportunity to participate in any such other business venture. Neither the Company nor the other Members shall have any right to any income or profit derived from any such other business venture of a Member.

Entire Agreement. This Agreement, including the schedules attached hereto, and any subscription agreement executed by the Members relative to their respective Membership Interests, constitute the entire agreement among the Members with respect to the subject matter hereof, and supersede all prior and contemporaneous agreements, representations, and understandings of the parties. No party hereto shall be liable or bound to the other in any manner by any warranties, representations, or covenants with respect to the subject matter hereof except as specifically set forth herein.

Analysis:

The plaintiff’s claims all were grounded in breach of fiduciary duty. The defendants claimed that the language of the operating agreement (as noted above) evidenced the parties’ intent to eliminate fiduciary duties. The plaintiff’s position did not rest on the terms of the operating agreement, but rather on the imposition of default fiduciary duties. The court performed a thorough analysis of the evolution of Delaware case law (and ultimately the amendment of the Delaware LLC statute) to reach the (correct) conclusion that in fact, default fiduciary duties did apply to the majority members by virtue of their effective control of the Company following adoption of the third Amended and Restated Agreement. The Court also concluded that none of the language in the Operating Agreement was insufficient to disclaim these duties, noting the requirement that the disclaimer of fiduciary duties will not be inferred, but must be clearly manifested. In a footnote to its analysis, and ostensibly to bolster its reliance on Feeley and cases cited therein, the Court cited the following language from the Delaware
The Delaware Court of Chancery is widely recognized as the nation's preeminent forum for the determination of disputes involving the internal affairs of thousands upon thousands of Delaware corporations and other business entities through which a vast amount of the world's commercial affairs is conducted. Its unique competence in and exposure to issues of business law are unmatched.

Wrapped in this blanket of expertise exuding from the Delaware Courts, the Court ruled that the majority members did in fact owe fiduciary duties of loyalty and care to Miller.

The Court went on to address the specific actions of Thermo and NT Assets which Miller claimed constituted a breach of those duties.

As to Miller’s claim that he was under economic duress and therefore coerced into signing the Third Amended and Restated LLC Agreement, the Court noted that prior to conversion of the debt, both Thermo and NT Assets were minority members and creditors, and in neither capacity were they subject to fiduciary duties. Miller’s claims that he was threatened with termination if he did not sign the Third Amended Agreement were equally without merit, because prior to execution of the Agreement (which included the control provisions noted above), neither Thermo nor NT Assets had the unilateral authority to terminate (or to direct the termination of) Miller.

Miller next claimed that Thermo and NT Assets breached their fiduciary duties by diluting his economic interest. The Court noted that the dilution of Miller’s economic interest occurred in connection with and following the execution of the Third Amended Agreement, and that the adoption of the Fourth and Fifth Amended Agreements (which contained the provisions that effected the adverse result) was authorized by the terms of the Third Amended Agreement. Because default fiduciary duties could not be used to override the express provisions of the Agreement, Miller’s claims relating to his termination, as well as his claims based on the implied covenant of good faith and fair dealing, were all rejected using a similar rationale.

In what may be viewed as a pyrrhic victory for Miller, the court did find that his claims based upon disputed evidence regarding possible sale transactions (including Miller’s own purchase offer) were not appropriately disposed of on summary judgment, and thus reversed on that limited issue for further development of the record.

**Drafting Implications:**

- Disclaimers of fiduciary duties must be clearly drafted.
- Amendment procedures should be carefully considered.
- If a minority member can flip into control based on a debt conversion or other events, consider whether any “pre-planned” defensive options (supermajority or similar protections) should be implemented.
2018 SUMMARY OF DELAWARE CASE LAW

RELATING TO

ALTERNATIVE ENTITIES¹

Louis G. Hering
David A. Harris
Tarik J. Haskins
Morris, Nichols, Arsh & Tunnell LLP
Wilmington, Delaware

September 20, 2018

¹ Morris Nichols maintains a Cumulative Survey of Delaware case law relating to alternative entities which is updated annually, organized by subject area and includes most cases that address significant alternative entity issues. The entire Cumulative Survey and annual updates are available on the Morris Nichols website at www.mnat.com/practices/commercial under EPublications.
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14. *In re Energy Transfer Equity L.P. Unitholder Litigation*, C.A. No. 12197-VCG (May 17, 2018) (V.C. Glasscock) ........................................................................................................ 281


In this case, defendants, who were the largest holders of membership units in Trumpet Search, LLC, a Delaware limited liability company (“Trumpet”), filed a motion to dismiss an action seeking relief under the implied covenant of good faith and fair dealing. Plaintiffs claimed that HCP & Company, together with its affiliates (collectively, the “HCP Entities”) violated the implied covenant of good faith and fair dealing when the HCP Entities controlled board of managers of Trumpet (the “Board”) sold Trumpet without conducting an auction or open sales process designed to achieve the highest value reasonably available for all of the members of Trumpet. The operating agreement of Trumpet set out a distribution waterfall for determining members’ returns on capital investment in the event of a sale or otherwise. The HCP Entities held 78.5% of the Class E units and 87.5% of the Class D units, which were entitled to a first-position payout and second-position payout, respectively. Under this distribution waterfall scheme, if Trumpet were sold roughly 90% of the first $30 million in sales proceeds would go to the HCP Entities. After the first $30 million in sales proceeds, other classes of members would receive millions of dollars in proceeds before the HCP Entities would again share pro rata in the sales price.

Less than a year after the operating agreement was adopted, an unaffiliated third party, MTS Health Partners, L.P. (“MTS”) made an initial offer of $31 million to purchase Trumpet. The HCP-affiliated managers elected not to run an open sales process and gave the non-affiliated managers little time to find alternative buyers. Nonetheless, this abbreviated sales process led MTS to increase its initial offer from $31 million to $41 million and Trumpet was eventually sold to MTS for $43 million. Plaintiffs claimed that the HCP Entities breached the implied covenant of good faith and fair dealing in approving the sale of Trumpet to MTS by refusing to pursue an open sales process designed to achieve the highest value reasonably available for all of the members of Trumpet and instead agreeing to a below-market sale that allowed the HCP Entities to achieve a quick exit from Trumpet and a 200% return on their investment due to the waterfall payment scheme set forth in the operating agreement.

In the first step of its implied covenant analysis, the court looked to whether the operating agreement in fact contained a gap that must be filled. The court initially noted that the operating agreement explicitly waived default fiduciary duties in accordance with the Delaware LLC Act, and that the operating agreement did not, by its terms, require the Board to conduct an open market sales process designed to achieve the highest value reasonably available for all members of Trumpet. Defendants argued that the operating agreement was not “truly silent” as to how Trumpet could be marketed and sold because Section 8.06(a) explicitly addressed the issue of how Trumpet could be sold. This provision stated that “the Board shall determine in its sole discretion the manner in which [a sale of all Trumpet membership units to an independent third party] shall occur, whether as a sale of assets, merger, transfer of Membership Interests or otherwise.” Defendants argued that this provision expressly permitted the Board to sell Trumpet without an open-market sales process, so long as the sale was not to an affiliated party.
Plaintiffs argued that there remained a gap in the operating agreement as to the type of sales process the Board could conduct because Section 8.06(a) addressed only the “form” of a sale and not the methods that could be employed in marketing Trumpet. In the alternative, plaintiffs argued that even if Section 8.06(a) addressed the methods the Board may employ in marketing the sale of Trumpet, the implied covenant required that the Board exercise that discretion reasonably and in good faith.

The court held that the operating agreement did not contain a gap as to how Trumpet could be marketed and sold. The court found plaintiffs reading of Section 8.06(a) to be “unreasonable” and stated that the plain and unambiguous meaning of that provision was that the Board can market the company in whatever manner it chooses to an independent third party, and that such discretion included decisions about the form of the transaction. Turning to plaintiffs’ second argument, the court first acknowledged that when a contract confers a discretionary right on one party, the implied covenant requires that right to be exercised reasonably and in good faith. However, the court rejected this argument because the operating agreement specified the scope of the Board’s discretion by providing it with sole discretion to determine how to conduct a sales process, so long as the sale was to an unaffiliated third party. The court held that because the scope of discretion had been specified by the parties, there was no gap in the operating agreement as to the scope of discretion and therefore no reason for the court to invoke the implied covenant to determine how discretion should be exercised.

Additionally, in support of its claim for breach of the implied covenant of good faith and fair dealing, plaintiffs cited several cases for the proposition that the implied covenant applies with particular force to contractual grants of sole discretion. The court noted that some courts have applied the implied covenant to sole discretion clauses because an unqualified grant of sole discretion presents the opportunity that a party entitled to exercise that discretion may abuse it for self-interested reasons and thereby deprive the other party of the benefit of its bargain. However, the court found that those cases were not controlling because the parties to the operating agreement had explicitly addressed this concern by providing that the Board did not retain sole discretion to sell the company to affiliates or insiders and therefore the parties had recognized and filled that gap that some courts have found in contracts that provide for an unqualified grant of sole discretion.

Finally, the court noted in dicta that even if plaintiffs were correct and the operating agreement contained a gap as to how Trumpet could be sold, the implied covenant claim would still fail because plaintiffs’ reasonable expectations were not frustrated by defendants’ conduct during the sales process. The court specifically noted that the express terms of the operating agreement, such as the requirement that the Board notify the members of a sale and the lack of an information right of members for an ongoing sales process, suggested that the parties actually contemplated that Trumpet may be sold through private negotiation rather than an open-market process. The court stated that adding an auction sales process requirement would alter rather than enforce the deal actually struck since “the members agreed to a process that would enable investors to structure and time an exit at a very substantial premium to their investment, in a way that encouraged investment at the cost of fiduciary protections for earlier equity holders.”
On appeal, the Supreme Court disagreed with the Chancery Court’s finding that the operating agreement did not contain a gap as to how Trumpet could be marketed and sold, and held that the terms of Section 8.06(a) did not displace the implied covenant entirely. However, the Supreme Court affirmed the Chancery Court’s decision because it agreed with the “essential holding that the implied covenant could not be used to imply Revlon-type sale requirements”, particularly when the operating agreement expressly eliminated fiduciary duties.


In this case, defendant George Bouri (“Bouri”) fraudulently induced Rakesh Kishan (“Kishan”), a management consultant looking for an investor or partner for his consulting firm, into forming Trascent Management Consulting, LLC (“Trascent”) and making Bouri a manager and member of Trascent. Bouri was terminated without cause from his prior employment with Time Warner after an investigation was launched due to complaints about Bouri’s management style. Some of the complaints alleged that Bouri was unreasonable, aggressive and disrespectful and that he made and engaged in inappropriate sexual comments and conduct in the workplace. After Bouri’s termination, he struggled financially. When Kishan initiated negotiations with Bouri, Bouri explained he resigned from Time Warner because he was being micromanaged. Further, Bouri represented himself as a man of “substantial financial means,” by talking in detail about his property and family wealth.

Bouri insisted he would only go into business with Kishan if the parties formed an entity that made Bouri an equity partner. In April 2013, Kishan formed UMS Advisory, LLC, which later changed its name to Trascent Management Consulting, LLC. Rather than contributing cash to Trascent, Bouri convinced Kishan to let him sign a promissory note. Trascent’s operating agreement became effective January 1, 2014, and Bouri was made a manager and unitholder of Trascent. Bouri was in charge of finances and HR for Trascent, and he dug Trascent into a financial hole. He substantially increased overhead costs, refused to contribute any cash, requested several advancements on his paychecks and forged a letter from a client so he could submit a personal expense as a business expense. Kishan terminated Bouri’s employment for cause after Bouri fabricated an HR investigation and involved a client in the matter. Trascent then sought rescission of Bouri’s employment agreement procured by fraud, a declaration that the LLC agreement was unenforceable by Bouri and attorneys’ fees and costs. The court granted all of Trascent’s requests, but opted to award some, not all, of the attorneys’ fees and costs as a sanction for bad faith litigation conduct.

As for the fraudulent inducement claim, the court rejected Bouri’s first argument that the claim must fail because the misrepresentations predated the LLC’s existence. The court applied the two-part test outlined in Nye Odorless Incinerator Corp. v. Felton, 162 A. 504 (Del. Super. 1931): an entity can maintain a claim based on misstatements made before its formation when (1) the fraudulent statements were made to an innocent individual to induce him/her to form an entity and have that entity take certain actions, and (2) that individual forms the entity and causes it to take said action. The court found the Nye test to be satisfied because Bouri’s statements regarding his prior employment
with Time Warner induced Kishan to form an entity and to make Bouri a manager and unitholder. The court found that Trascent satisfied its burden of proving the elements of fraudulent inducement. The court reasoned that Bouri made misrepresentations he knew were false with the intent to induce action by Trascent and that Trascent justifiably relied on those statements. Further, the court deemed the misrepresentations to be material because a reasonable person would have considered it important to know that a potential member and manager to a new entity was struggling financially and was previously terminated from his last job after an investigation into his management style. Finally, Trascent was damaged by the justifiable reliance because the company entered into the employment agreement and LLC agreement.

The court also rejected Bouri’s argument that legal rescission of the employment agreement would be improper because (1) Trascent would reap the benefits of his contributions while he would lose all the benefits and protections and (2) he abided by the eighteen-month post-termination non-compete provision. The court agreed Bouri contributed to Trascent’s business but also found that he cost them a significant amount of money by increasing the size of the firm from ten to eighteen employees and not producing a profit for Trascent in 2014. The court found it was possible to return the parties to status quo because the benefits bestowed by Bouri and the expenses incurred by Trascent were comparable. Accordingly, the court rescinded the employment agreement.

Next, the court granted Trascent’s motion to declare the LLC agreement unenforceable by Bouri. When there is fraud in the inducement, a contract is enforceable against at least one party and “voidable” at the option of the innocent party. The court rejected Bouri’s argument that the LLC agreement was not procured by fraud holding that once Bouri gave an explanation for his departure from Time Warner, he had to give a full and open disclosure around those circumstances. Additionally, once Bouri volunteered information that gave Kishan a false impression about his financial status, Bouri had to correct that impression. The court found it inconceivable that Kishan would have made Bouri a member of Trascent had he known the truth about Bouri’s financial status. Kishan was looking for members to invest cash in Trascent when necessary. Further, Kishan testified the only reason he accepted a promissory note in exchange for Bouri’s equity was that he believed Bouri was a wealthy man. The court also found it hard to believe Kishan would have formed Trascent, made Bouri a member and offered him complete independence and decision-making had Bouri been truthful about why he departed from Time Warner and the particular allegations against him. Thus, the court found that Bouri could not enforce the LLC agreement.

Finally, the court addressed Trascent’s request for attorneys’ fees and costs. First, the court denied Trascent’s request for return of the attorneys’ fees and costs advanced to Bouri because he was entitled to advancement under both the employment agreement and LLC agreement. The court explained Bouri was entitled to advancement until a final, non-appealable order was entered in the action. Second, the court denied Trascent’s request for its own attorneys’ fees and costs because Trascent did not argue that an exception to the American Rule applied. However, Trascent successfully sought sanctions against Bouri for repeatedly misrepresenting in discovery and before the court the nature of his departure from Time Warner. As a result, the court awarded Trascent its
reasonable attorneys’ fees and costs in bringing the Motion for Sanctions and two-fifths of its reasonable attorneys’ fees and costs incurred in the litigation.


In March 2017, the Supreme Court reversed a decision of the Court of Chancery in which it had dismissed plaintiff’s challenge to a conflicted dropdown transaction where the parent (“Enbridge”) of the general partner (the “GP”) of Enbridge Energy Partners L.P., a master limited partnership (the “MLP”), sold its interest in a pipeline joint venture, which it had acquired from the MLP six years earlier, back to the MLP at a higher price than it had originally paid the MLP (the earlier Chancery decision is referred to herein as “Brinckerhoff IV” and the Supreme Court’s decision reversing the Chancery decision is referred to herein as “Brinckerhoff V”). In doing so, the Supreme Court “provided certain definitive constructions of the [MLP’s] LPA, defined the boundaries of the contractual good faith standard imposed by that contract and remanded for further proceedings consistent with its guidance.” After Brinckerhoff V, the Court of Chancery permitted Mesirov to be substituted as lead plaintiff and an amended complaint to be filed, which included the following defendants: the MLP; the GP; Enbridge Energy Manager, L.L.C., which managed the MLP and was owned in part by the GP (“Enbridge Management”); Enbridge; the individual directors of the GP and Enbridge Management, two of whom were the members of the Special Committee of the GP; and Piper Jaffray & Co., successor by merger to Simmons & Company International, which served as financial advisor to the Special Committee (“Simmons”). Plaintiff’s amended complaint asserted breaches of the LPA and the implied covenant against the GP and Enbridge Management (plaintiff had dropped those same claims against Enbridge and the individual directors following Brinckerhoff IV), aiding and abetting and tortious interference with the GP’s performance of the LPA against Enbridge, the individual directors, Enbridge Management and Simmons and breach of residual fiduciary duty against Enbridge and the individual directors, and sought reformation or rescission of the transaction. Defendants moved to dismiss the amended complaint for failure to make demand on the GP’s board to prosecute the claims derivatively and for failure to state legally viable claims.

Plaintiff challenged the MLP’s repurchase of an interest in the Alberta Clipper pipeline (the “AC Interest”) from Enbridge for $1 billion. Plaintiff alleged that the Special Committee and Simmonds knew but ignored the fact that the MLP was overpaying for the AC Interest and provided three metrics to support its assertion. First, despite a decrease in EBIDTA in the AC Interest by almost 20% between Enbridge’s purchase in 2009 and the MLP’s repurchase in 2015 and the fact that the 2009 transaction included rights to expand the pipeline and the 2015 transaction did not, the EBITDA multiple associated with the MLP’s repurchase price was higher than the EBITDA multiple associated with Enbridge’s initial purchase price. Second, the “rate base” of the pipeline, which the court noted was a meaningful proxy for current market and fair value, implied a value of $674 to $707 million at the time of the repurchase. Third, the MLP paid an amount that was well above the GP management’s own DCF equity value for the AC Interest. Additionally, plaintiff argued that the deal was not fair to the MLP because the GP was paid the equity portion of the deal in new Class E units that had a unique tax benefit that allocated over half of the gross income associated with the transaction away...
from the Class E unitholder to the other unitholders and a unique liquidation preference (the “Class E Attributes”) and the Special Committee and Simmons allocated no value to those Class E Attributes.

The court first addressed defendants’ motion to dismiss for plaintiff’s failure to make a demand on the GP’s board. The court noted that in Brinckerhoff IV, the court held that the complaint adequately pled demand futility, and the Supreme Court in Brinckerhoff V did not overrule that finding. Thus, demand futility was well-pled and the court refused to grant defendants’ motion to dismiss for failure to make a demand.

The court next addressed plaintiff’s direct and derivative breach of contract claims. Under Tooley, to determine whether a claim is direct or derivative, one must analyze who suffered the alleged harm and who would receive the benefit of any recovery. A claim could be “dual-natured” if there was an improper transfer of both economic value and voting power from minority equity holders to majority equity holders. Here, plaintiff’s core theory was that the MLP was injured when it overpaid for the AC Interest. Further, the alleged breach was of Section 6.6(e) of the LPA, which required that GP and its affiliates to act in a manner that was “fair and reasonable to the Partnership.” Finally, plaintiff did not allege any voting harm that could lead to a dual-natured claim. Thus, the court dismissed the direct breach of contract claims. It refused to dismiss the derivative breach of contract claims against the GP, noting that the Supreme Court held in Brinckerhoff V that plaintiff’s allegations were sufficient to state a claim for breach of Section 6.6(e) and, therefore, that was the law of the case.

The court also held that in Brinckerhoff IV, it incorrectly dismissed the breach of contract claims against “Affiliates” and “Indemnitees” under the LPA on the grounds that such persons were not parties to the LPA. The Supreme Court in Brinckerhoff V had found that the transaction was expressly governed by Section 6.6(e) of the LPA, which stated that neither the GP nor its Affiliates (which term included Enbridge) could sell any property to or purchase any property from the MLP unless the transaction was fair and reasonable to the MLP. Further, under the LPA, Indemnitees (defined to include the GP, Affiliates of the GP such as Enbridge and Enbridge Management, and the individual directors) were not liable for monetary damages for actions taken in good faith. The court addressed these LPA provisions in its first and third Brinckerhoff decisions, finding that plaintiff’s claims could survive a motion to dismiss if it well-pled facts suggesting defendants acted in bad faith, and the Supreme Court did not overturn this holding in Brinckerhoff V. Thus, the court held that plaintiff could reinstate claims for breach of Section 6.6(e) against Enbridge, Enbridge Management and the individual directors in an amended complaint.

The court next addressed the breach of implied covenant claim, noting that its prior dismissal of this claim was undisturbed by Brinckerhoff V, which noted that the transaction was “expressly governed by Section 6.6(e),” leaving no room for the implied covenant to operate. Thus, the court granted defendants’ motion to dismiss plaintiff’s implied covenant claim.

The court then turned to the “secondary” claims, that is, if a party were not liable under a theory noted above, it would be liable as an aider and abettor, for tortious interference
with a contract or for breach of residual fiduciary duties—and found that these claims failed as a matter of law. Under Delaware law, one generally cannot aid and abet a breach of contract. There is an exception for aiding and abetting breaches of “contractual fiduciary duties” that applies if the LPA does not expressly eliminate all fiduciary duties. Here, the court found that the LPA did not expressly eliminate all fiduciary duties. In so finding, it pointed to Brinckerhoff V and noted that the Supreme Court (1) interpreted the “fair and reasonable” standard in Section 6.6(e) to something akin to the entire fairness standard of review and (2) refused to “upset” the “settled interpretation” that a partnership agreement like the MLP’s that provided that standards of care and duty imposed by the partnership agreement or applicable law were modified, waived or limited to permit a general partner to act “so long as such action is reasonably believed by the General Partner to be in the best interests of the Partnership” provided a contractual fiduciary duty standard. While an aiding and abetting claim theoretically could be brought under this LPA, the aiding and abetting claims were against Enbridge, Enbridge Management and the individual directors who, under the express terms of Section 6.6(e), owed duties directly to the MLP. Thus, they could not be liable for aiding and abetting. The same defendants also could not be liable for tortious interference because they were not strangers to the LPA or the transaction. Further, Enbridge and the individual directors could not be liable for breach of residual fiduciary duties. These defendants were bound by Section 6.6(e), which expressly governed the transaction and replaced common law duties with contractual fiduciary duties similar to entire fairness. The Supreme Court did not overturn the court’s determination in its first and third Brinckerhoff decisions that claims against these persons would survive dismissal if plaintiff well-pled that such defendants acted in bad faith. Thus, Enbridge and the individual directors could not be liable for breach of residual fiduciary duties when they were bound by the terms of the Section 6.6(e), which supplanted common law fiduciary duties. The remaining claims were against Simmons for aiding and abetting breach of contractual fiduciary duties and for tortious interference with the LPA. Neither claim had been brought previously; thus, Brinckerhoff V did not address them. The court held that the aiding and abetting claim could not be dismissed, as plaintiff adequately pled that Simmons knowingly participated in the GP’s and Enbridge Management’s breaches of the LPA’s contractual fiduciary duties. In so holding, the court pointed to, inter alia, plaintiff’s allegations that Simmons created an “informational vacuum” by ignoring and failing to address the economic metrics outlined previously and the Class E Attributes and relied on the GP’s management’s “fully baked” EBIDTA projections in providing its fairness opinion. The court then addressed the tortious interference claim, noting that Delaware follows the Restatement (Second) of Torts and that, under the Restatement, (1) Simmons’ “sole motive” must have been to interfere with the LPA, (2) Simmons was entitled to the “advisor’s privilege” (which allows an advisor to provide advise without fear that its advice will give rise to a tortious interference claim), and (3) Simmons could only face tort liability if it counseled the GP and Enbridge in bad faith to breach the LPA. As plaintiff’s complaint did not make these allegations, the court dismissed the tortious interference claim against Simmons.

Finally, the court addressed plaintiff’s claims for rescission or reformation and refused to dismiss such claims on the grounds that the Supreme Court “made clear that the LPA
does not ‘limit equitable remedies’” even if the GP was found to have acted in good faith and therefore was not liable for monetary damages under the LPA.


In this case, plaintiffs, who were two members of the Board of Managers (the “Board”) of HMS Holdings 3, LLC (“Holdco 3”), acted by written consent to terminate defendant Harley Franco from his positions as President and CEO of Harley Marine Services, Inc., a Washington corporation (“HMS Inc.”). In 2008, Franco sold a significant equity stake in HMS Inc. to Macquarie Capital, a private equity firm. In connection with Macquarie’s investment in HMS Inc., the parties created a complex, multi-tiered ownership structure. At the time they took action by written consent, plaintiffs also comprised two of the four members of the board of managers of two additional Delaware limited liability companies: HMS Holdings 1, LLC (“Holdco 1”) and HMS Holdings 2, LLC (“Holdco 2”). The three Holdco entities constituted a three-tiered holding company structure for HMS Inc. Holdco 1 owned 100% of the equity of HMS Inc., Holdco 2 owned a 76.64% member interest in Holdco 1, and Holdco 3 owned an 82.22% member interest in Holdco 2. Macquarie owned a 15.44% membership interest in Holdco 3 and HMS Partners, LLC, an entity controlled by Franco (“Franco Partners”), owned an 84.56% member interest in Holdco 3.

Each Holdco was a manager-managed LLC governed by a board of managers consisting of four managers and each LLC agreement specified that two managers were to be selected by Franco Partners (each, a “Franco Manager”), one manager was to be selected by Macquarie (the “Macquarie Manager”) and one manager was to be independent of Macquarie and Franco Partners (the “Independent Manager”). Plaintiffs were the Macquarie Manager and Independent Manager. The Holdco 3 LLC agreement differed from the other Holdco LLC agreements in three key respects. First, Franco executed the Holdco 3 LLC agreement personally and became a party in his individual capacity for purposes of the “Personal Commitment Provision.” The Personal Commitment Provision required Franco to cause Franco Partners to perform all of its obligations under the Holdco 3 LLC agreement, to at all times maintain control of Franco Partners and to abide by the provisions set forth in each Holdco LLC agreement that applied to him in his personal capacity. Second, the Holdco 3 LLC agreement contained language authorizing the Board to select the officers of Holdco 3’s subsidiaries. Third, the Holdco 3 LLC agreement contained language obligating the parties to that agreement to conform the governing boards of all of Holdco 3’s subsidiaries to the composition of the Board.

After investigating allegations that Franco had misappropriated fund from HMS Inc., plaintiffs, in their capacities as the Independent Manager and Macquarie Manager of Holdco 3, purported to take action by written consent on behalf of the boards of managers of the Holdcos, the board of directors of HMS Inc. and the governing boards of each of HMS Inc.’s subsidiaries (the “Written Consent”). The Written Consent purported to terminate Franco’s employment with HMS Inc. for cause pursuant the employment agreement between Franco and HMS Inc., and remove Franco as President, CEO and the Chairman of the Board of each Holdco, HMS Inc. and ten subsidiaries of HMS Inc.
The court first held that terminating Franco under the employment agreement constituted an “Interested Party Decision” under Section 1.10 of the Holdco 3 LLC agreement and that, as a result, the votes of the Independent Manager and the Macquarie Manager were the only votes required to terminate Franco under his employment agreement with HMS Inc. pursuant to the terms of the Holdco 3 LLC agreement. Plaintiffs next sought a declaration that the Independent Manager and the Macquarie Manager could act by written consent to make the decision to terminate Franco. Section 4.3(d) of the Holdco 3 LLC Agreement permitted the Board to take any action that could be taken at a meeting by written consent if the consent was signed by the number of Board members required to approve such action at a meeting held by the Board at which a quorum was present. The court found that the need for a quorum to meet and discuss the proposed action before valid action could be taken at a meeting did not apply to action taken by written consent. The court interpreted the quorum provision in Section 4.3(d) to mean that if the individuals who signed the consent could have approved the action at a hypothetical meeting of the Board at which a quorum was present, then the consent would be valid, and granted summary judgment for the plaintiffs on this issue.

Plaintiffs also sought a declaration that the Written Consent constituted valid and effective action to terminate Franco’s employment at HMS Inc. and remove him from his positions as President and CEO of that entity. The court held that under the governance structure that the parties crafted, the parties to the Holdco 3 LLC agreement made contractual commitments to implement certain decisions at Holdco 3’s various subsidiaries. The court rejected Franco’s argument that the provisions in the Holdco 3 LLC agreement purporting to let the Board address the rights of other entities were a legal nullity. Franco argued that only the governing body of an entity can make decisions regarding that entity’s rights, so therefore the Board could not address any rights other than the rights of Holdco 3. However, the court noted that the Holdco 3 LLC agreement’s provisions that required that certain decisions made by the Board of Holdco 3’s to be implemented by each of its subsidiaries were not unlike the voting agreements that a corporation makes with its stockholders in a stockholder agreement, and that such contractual agreements are generally enforceable; so too with these Holdco 3 LLC agreement provisions. The court also noted that under Franco’s argument, several provisions of the Holdco 3 LLC agreement, including the definition of an “Interested Party Decision” and the related mechanics for the Board to make Interested Party Decisions would be illusory. Additionally, the court found that the inclusion of the Personal Commitment Provision supported this structure—by binding Franco personally to the Holdco 3 LLC agreement, the parties ensured that Franco would have a contractual obligation to abide by the provisions of the Holdco 3 LLC agreement and to implement decisions made by the Board in accordance with those provisions. However, the court declined to address the question of whether a party to the Holdco 3 LLC agreement would be obligated to comply with a contractual obligation under that agreement notwithstanding competing obligations (like fiduciary duties to a subsidiary). The court noted that because HMS Inc. was a Washington corporation, Franco’s compliance with a contractual obligation under the Holdco 3 LLC agreement could raise issues under Washington law, particularly if Franco were to assert that compliance would cause him to breach his fiduciary duties to HMS Inc.
The court rejected plaintiffs’ argument that the action of the Board had a direct effect on Franco’s status at HMS Inc. and automatically resulted in his termination as President and CEO of that entity. The court held that the contractual commitments contained in the Holdco 3 LLC agreement to implement certain decisions made by the Holdco 3 Board at Holdco 3’s subsidiaries were not self-executing and required formal action at the relevant subsidiaries. The court noted that accepting plaintiffs’ position would contravene the “bedrock principle of corporate separateness.”


Defendant, Nimesh S. Shah (“Shah”), was a member of a management company, Domain Associates, LLC (the “Company”), a venture capital firm. The other members of the Company (together with the Company, plaintiffs in this case) voted to force Shah to withdraw as member of the Company and, upon his withdrawal, paid Shah the value of his capital account. Plaintiffs sued, seeking a declaratory judgment that Article VII of the Company’s Limited Liability Company Agreement (the “LLC Agreement”) specified the payment Shah was entitled to receive, and Shah counterclaimed for breach of contract, arguing that Article VII did not specify the payment he was entitled to receive and that under the Delaware Limited Liability Company Act (the “Act”), he was owed the fair value of his membership interest.

Shah initially joined the venture capital firm as an employee, but in November 2014 he was invited to become a member of the Company. When Shah was admitted as a member in January 2015, he made a capital contribution of $25,000 to become an equity partner and he signed the LLC Agreement, knowing that it was not negotiable. By December 2015, and until Shah’s withdrawal, Shah’s membership interest in the Company was 12.1%. In January 2016, Shah was asked to leave the Company because his expertise was no longer needed. Shah and the other members of the Company tried to negotiate a severance package for months following the members’ decision to ask Shah to leave, but they could not come to an agreement. As a result, in April 2016 all of the members of the Company except Shah voted to require Shah to withdraw from the Company. The members believed that Shah was entitled to a payment equal to his capital account in return for his membership interest at the time of his forced withdrawal and sent Shah a check for that amount. Shah asserted that, instead, he was entitled to 12.1% (the percentage of his membership interest) of the Company’s cash on hand at the time of his withdrawal.

Plaintiffs argued that under Article VII of the LLC Agreement Shah was entitled to receive the value of his capital account. Article VII provided, in part, as follows:

Any Member may retire from the Company upon not less than 90 days’ prior written notice to the other Members. Any Member may be required to withdraw from the Company for or without cause at any time upon written demand signed by all of the other Members except for any one other such Member, so long as such demand shall have been approved at a meeting of Members held for such purpose, to which all Members shall be given written notice in advance . . . If the remaining Members continue the business of the
Company, the Company shall pay to any retiring Member, or to the legal representative of the deceased, insane or bankrupt Member, as the case may be, in exchange for his entire interest in the Company, an amount equal to (A) such Member’s capital account, to be determined as of the date of a Member’s death or retirement, or his withdrawal from the Company (such date of death or withdrawal being referred to herein as the “Withdrawal Date”), which capital account, for purposes of such determination, shall be computed on the cash and disbursements basis of accounting, shall take into account, without limitation, the aggregate amount of cash contributed to the capital of the Company by such Member, plus the aggregate amount of such Member’s share, as in effect from time to time, of the net profits of the Company through the last day of the month next preceding the Withdrawal Date, less the aggregate amount of such Member’s share, as in effect from time to time, of the net losses of the Company through the last day of the month next preceding the Withdrawal Date, less the aggregate amount of distributions to such Member through the Withdrawal Date in respect of the net profits or capital of the Company, or both; less (B) the aggregate amount, if any, of indebtedness of such Member to the Company at the Withdrawal Date.

The court held that Article VII was unambiguous and did not set forth the required payment for a member that is forced to withdraw. The court explained that while Article VII included forced withdrawal as a means by which a member’s status as such could be terminated, Article VII was silent about payment following a forced withdrawal and the payment formula in Article VII only applied to a retiring member or the legal representative of a deceased, insane or bankrupt member. The court also stated that even if Article VII was not plain and unambiguous, the court would not look to extrinsic evidence. Instead, because the LLC Agreement was drafted solely by one side and was presented on a “take-it-or-leave-it” basis, the doctrine of contra proferentem would apply and the LLC Agreement would be interpreted against the drafters. Plaintiffs argued that interpreting Article VII to say that a member that was forced to withdraw would receive a greater compensation than a member that withdrew for other reasons would lead to an irrational result. The court, however, disagreed, explaining that members may have been worried about disputes with other members and wanted protection from being forced out by other members. To protect themselves from being forced out, the court held that it was rational for forced-withdrawal to be excluded from the scenarios that are covered under Article VII’s payout formula.

Because the LLC Agreement was silent on the payment Shah should have received when he was forced to withdraw, the default provisions of the Act controlled. Shah argued that he should be paid the fair value of his membership interest under Section 18-604 of the Act. The court held that Section 18-604 applied only to voluntary withdrawal and not to forced withdrawal. Because Section 18-604 did not apply, the court turned to the default principles of law under Section 18-1104 and held that “the rules of law and equity… shall govern.” The court stated that this was a question of first impression under the Act, but relied on Hillman v. Hillman, 910 A.2d 262, 271-78 (Del. Ch. 2006), a case in which
then-Vice Chancellor Strine interpreted Section 15-701 of the Delaware Revised Uniform Partnership Act (the “Partnership Act”), which states that an expelled partner is owed an amount “equal to the fair value of such partner’s economic interest as of the date of dissociation based upon such partner’s right to share in distributions from the partnership.” The court held that the same analysis applied here and that, because the Company was member-managed, the governance structure resembled a partnership and, therefore, the application of the Partnership Act was especially appropriate. The court elaborated by giving the following guidance: (i) when a limited liability company is member-managed, then the parties should expect a court to draw on analogies to partnership law, (ii) when a limited liability company has a single managing member with other generally passive, non-managing members, then the parties should expect a court to draw on analogies to limited partnership law and (iii) when a limited liability company has a manager-managed entity, and it operating agreement created a board of directors and adopted other corporate features, then the parties should expect a court to draw on analogies to corporate law. In this case, the court applied partnership law because the Company was member-managed; therefore, the court found that Shah was owed the fair value of his membership interest. Because Shah was paid the value of his capital account instead of the fair value of his membership interest, the court held that plaintiffs breached the LLC Agreement and Shah was entitled to the difference between the fair value of his membership interest in the Company and the payment he received.

The court held that the individual members were jointly and severally liable for the damages awarded. The court explained that a party to a contract is liable when it breaches such contract and because the individual plaintiffs were members of the Company and parties to the LLC Agreement, they were liable for breaching the LLC Agreement. Plaintiffs argued that the individuals could not be held liable because Section 18-303 of the Act said “no member or manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.” The court, however, held that Section 18-303 was not applicable because (i) Section 18-303 only applies to liability to a third party and Shah was not a third party, (ii) the liability to Shah was not a liability of the Company because the LLC Agreement did not expressly create an obligation on the part of the Company to pay Shah and (iii) the members were not passive actors or so uninvolved in management of the Company that it would have been unfair to hold them liable.

In conclusion, the court held that, because plaintiffs failed to pay Shah the fair value of his membership interest in the Company after his forced withdrawal, they breached the LLC Agreement, Shah was entitled to damages based on the fair value of his membership interest and the remaining members of the Company were jointly and severally liable for such damages.


In the 1970s, two individuals formed a partnership to present Broadway-style shows in San Francisco. The families of those founders have operated that company, currently known as the Shorenstein Hays-Nederlander Theatres LLC, a Delaware limited liability
company (the “Company”), for the past fifty years through their ultimate ownership of the two entities that are both fifty-percent members of the Company, CSH Theatres L.L.C. (“CSH”), which is controlled by the Shorenstein-Hays family (including Carole and Jeff Hays, referred to herein as “Carole” and “Jeff”), and NSF Associates (“NSF”), which is controlled by Robert Nederlander (“Robert”). Carole and Jeff also served as CSH-appointed managers of the Company.

The Company had been leasing the Curran Theatre to show some of the Company’s Broadway-style productions. When the Curran came up for sale, the families could not agree on whether to buy it, so the Hays family purchased it with the consent of the Nederlander family. The parties, however, disputed the terms surrounding that consent. Those on the Nederlander family’s side of the dispute alleged that Carole agreed to continue to rent the Curran to the Company. Those on the Hays family’s side of the dispute disagreed. The relationship between the two families deteriorated, and the Hays family eventually cut ties with the Company and began operating the Curran itself. In this case, the parties asked the Court to determine whether there was an enforceable promise by the Hays family to continue leasing the Curran to the Company, whether CSH and its controllers, Jeff and Carole, breached the LLC agreement’s provisions on competing with the Company and whether Carole and Jeff breached fiduciary duties they owed to the Company as managers.

The court found that there was not an enforceable contract or promise to lease the Curran to the Company. NSF and Robert, counterclaim plaintiffs, advanced four legal theories to support their allegations that Carole promised to continue to lease the Curran to the Company after her purchase of the Curran—that there was an enforceable contract to renew the lease, that there was an enforceable oral lease renewal, that Carole’s alleged promise to continue the Company’s lease should be enforced under the doctrine of promissory estoppel and that Carole made an enforceable promise to negotiate in good faith the Company’s renewal of the Curran lease. All four theories revolve around a discussion that Carole and Robert had when Carole was attempting to purchase the Curran. The only evidence of the substance of that discussion was oral testimony, and the court found that the evidence submitted by counterclaim plaintiffs failed to satisfy their burden to show that Carole made any promise to renew the Company’s lease of the Curran. Thus, the court found that all four claims relating to the lease renewal failed.

The court also found that CSH, Jeff and Carole did not breach the LLC agreement’s provision on competing with the Company by showing Broadway-style shows at the Curran through their venture and not through the Company. The court began its analysis by noting that CSH, Jeff and Carole (part of the “Shorenstein Entity” as defined in the LLC agreement) were bound by the LLC agreement’s provisions on competing with the Company. These provisions included not only Section 7.02(a), which required the Shorenstein Entity to devote its efforts “to maximize the economic success of the Company”, but also Section 7.06, which permitted Carole and Jeff to compete with the Company, subject to certain restrictions that prohibited staged productions that Carole and Jeff controlled within a certain geographic area unless that production already played at one of the Company’s theaters, NSF’s representatives turned down the production or the Company shared in the profits of the production. Robert and NSF claimed that Carole violated these restrictions. However, while the evidence was clear that Carole
staged a production she controlled within the geographic area specified in the LLC agreement, Robert and NSF provided no evidence regarding whether NSF turned down the production or whether the Company shared in the profits of the production. Further, Robert and NSF provided no evidence of damages. Thus, their breach of contract claim failed.

Finally, the court found that Jeff and Carole breached fiduciary duties they owed to the Company. Jeff and Carole, as managers of the LLC, owed common law fiduciary duties because the LLC agreement did not disclaim those duties. The court found that Carole breached her fiduciary duties by placing her interests above those of the Company. She played “hardball” with the Company during board meetings, used her fiduciary position to prevent the Company from pursuing opportunities that Carole wanted to pursue herself and instructed Company employees of the Company not to communicate with other employees and managers about Company business. The court found that Jeff breached his fiduciary duties by taking actions that were not in the best interests of the Company—notably, he shared confidential information with direct competitors of the Company and attempted to secure confidential information to hire away employees of the Company. Accordingly, the court granted Robert and NSF’s requested declaratory relief that Carole and Jeff breached their fiduciary duties to the Company while serving as managers of the Company, awarded nominal damages for the breach of fiduciary duty, and enjoined Carole and Jeff from using any confidential information gained while they were fiduciaries of the Company to compete with the Company.


Plaintiff Triple H Family Limited Partnership was a holding company formed for investments made indirectly by Jeffrey Hoops (“Hoops”), a businessman in the coal mining industry. Defendant Jerry Neal (“Neal”) was an insurance agent who owned an insurance company he formed. Neal and Hoops, who went to high school together, were reunited at their school’s fortieth reunion. During that night, Hoops and Neal agreed to start Omni Insurance Group, LLC (“Omni”), an insurance agency, whereby Hoops would purchase insurance for his coal mining business and Neal would operate the company and source additional commissions, the profit of which would be split amongst the two. The relationship quickly soured when Neal failed to timely secure insurance coverage for the coal mining business, resulting in a brief lapse of coverage for Hoops. The lapse subjected Hoops and his coal company to an immense amount of liability and Hoops informed Neal that Omni would not be moving forward. The relationship having soured, the parties sued each other for claims of breach of contract, breach of fiduciary duties, fraud and judicial dissolution of Omni.

Omni never had a formal written operating agreement. Thus, the court primarily used email correspondence and trial testimony to glean information regarding the terms of the limited liability company relationship that was intended between the parties. As part of this process, the court noted that it placed heavy weight on the testimony of Hoops, who had proven to be a reliable and honest source of information, over the testimony of Neal, who, in the view of the court, would “say whatever he needs to, regardless of veracity . . . .” The court further stated that because the parties repeatedly relied on extrinsic evidence
to support their arguments about the terms of the oral limited liability company agreement, all extrinsic evidence therefore became fair game for the court to review in order to divine the extent of the agreement.

Having established what it considered to be the terms of the Omni operating agreement through analysis of extrinsic evidence and email correspondence, the court turned to the issue of breach of fiduciary duty. In order to determine whether a breach of fiduciary duty occurred, the court first needed to establish whether the parties owed such duties at all. Delaware case law has recognized that a person who is not named as a manager in a limited liability company’s governing documents may nonetheless be deemed a de-facto manager and fiduciary of the company. In WaveDivision Hldgs., LLC v. Millenium Digital Media Sys., L.L.C., 2010 WL 3706624 (Del. Ch. Sept. 17, 2010), a person who had “unfettered access” to information and took actions relating to a limited liability company’s strategy was held to be a de-facto manager and fiduciary of the LLC. Relying on WaveDivision, the court held that both Neal and Hoops were de-facto managers and fiduciaries of Omni based upon the managerial roles that each took in developing Omni. Hoops disagreed, arguing that he was not a de-facto manager because Neal was designated as “President and CEO” of Omni and thus had to be the manager. The court countered this argument, noting that an LLC may have more than one manager and that, in any event, a person other than a named officer can also be a de-facto manager under WaveDivision.

Having determined the scope of Omni’s operating agreement and the duties owed by each party, the court held that Neal breached the operating agreement and violated his duties of loyalty and care by (i) failing to obtain promised insurance coverage and misleading his only customer (Hoops) about a serious lapse of such insurance and (ii) failing to roll his own existing insurance business into Omni as previously agreed. The court further held that judicial dissolution of Omni was unnecessary because Hoops and Neal had already agreed to dissolve the company pursuant to email correspondence that amounted to a written consent to dissolve and instead ordered that Omni commence the winding up process.


Plaintiff, A&J Capital, Inc., a California corporation, was the manager of defendant company LA Metropolis Condo I, LLC, a Delaware limited liability company (the “Company”). Plaintiff was removed as manager of the Company by a majority of the Company’s members for cause. After its removal, plaintiff filed an action for improper removal and filed a motion for summary judgment seeking declaratory judgment that it was improperly removed as manager under contract law and Delaware common law.

The Company received capital from 200 foreign investors that became Class B Members of the Company. Plaintiff was named as the Class B Manager of the Company pursuant to the operating agreement of the Company (the “Operating Agreement”) and the management agreement between, inter alia, the Company and plaintiff (the “Management Agreement”). The Operating Agreement had two provisions regarding the removal of managers, which stated “the Class B Members, by Majority Vote, shall have the sole and exclusive right to approve or disapprove the following . . . (f) Subject to 5.3,
appointment, reappointment and removal, as applicable of any Manager” and “[t]he Class B Manager may be removed by Majority Vote of the Class B Members for gross negligence, intentional misconduct, fraud or deceit, all as more fully set forth in the Management Agreement.” In addition, the Management Agreement stated “[t]he Class B Manager may be removed by Majority Vote (as defined in the Operating Agreement) of the Class B Members for gross negligence, intentional misconduct, fraud or deceit; provided that in any of such events as specified in this Section 12(b), without limiting any of their respective rights and remedies, the Members shall be entitled to exercise their respective powers under the Operating Agreement to appoint a new Class B Manager and to cause the Company to issue written notice of termination to the Class B Manager hereunder.” The court explained that these three provisions “comprise the universe of contractual provisions that govern the procedure for removal of the Class B Manager.”

In March of 2018, plaintiff was notified through a letter that a majority of the Class B Members voted to remove it as manager and that the Law Office of Krug was appointed as the interim manager. The notice did not state a reason for plaintiff’s removal and did not give any further details regarding the members’ vote. Prior to the notice, plaintiff did not receive any notice of alleged default or the intent to hold a vote for its removal.

Plaintiff argued that the Operating Agreement and Management Agreement required the Class B Members to deliver plaintiff a notice of intent to remove it as manager and provide plaintiff an opportunity to be heard prior to removal. In addition, plaintiff argued that even if the agreements did not expressly provide it the right to notice and the opportunity to be heard, Delaware common law provides those rights and such common law should alter the Operating Agreement and Management Agreement. Defendants, on the other hand, argued that the provisions in the Operating Agreement and Management Agreement were clear and unambiguous and that the governance scheme, a product of the parties’ contracts, could not be altered by common law.

The court held that the terms of the Operating Agreement and Management Agreement regarding the removal of a manager were clear and unambiguous and did not provide the right for plaintiff to receive notice prior to its removal or the opportunity to respond. The court clarified that the only “notice” required under the agreements was after-the-fact notice of termination. The fact that the Management Agreement expressly provided for notice of termination after the Class B Members vote, but was silent regarding prior notice and an opportunity to be heard, proved that the parties did not contract for pre-removal notice. Plaintiff maintained that even if the pre-removal rights were not expressly stated, the rights were embedded in the Operating Agreement and Management Agreement because the common meaning of being removed “for gross negligence, intentional misconduct, fraud or deceit” requires notice prior to removal. The court, however, explained that operating agreements for non-corporate business entities will normally provide for pre-removal protections if the parties intend for them to apply and if those provisions do not exist, the court will not infer them.

The court also held that common law regarding pre-removal notice in corporate law decisions did not alter the terms of the Operating Agreement or Management Agreement. Plaintiff contended that because certain corporate law cases in Delaware held that a director of a Delaware corporation must receive pre-removal notice and an opportunity to respond before such director can be removed for cause, the same rights and protections should exist.
for managers of a Delaware limited liability company. The court, however, explained that the Delaware Limited Liability Company Act (the “Act”) grants limited liability companies broad discretion in drafting their operating agreements and ensures that those agreements, with specific exceptions, will be respected. The court further explained that, unlike a Delaware corporation, “the scope, structure and very personality of [a limited liability company] is set almost exclusively by its operating agreement”. In addition, plaintiff argued that Section 18-1104 of the Act, which states “[i]n any case not provided for in this chapter, the rules of law and equity, including the rules of law and equity relating to fiduciary duties and the law merchant, shall govern,” reflects the General Assembly’s belief that a purely contractarian view must give way to common law. The court held that plaintiff’s interpretation of 18-1104 was incorrect, stating that “Delaware’s pro-contractarian policy in the alternative entity space is alive and well.”

The court further noted that in governance disputes among constituencies in a limited liability company, the court’s role is to interpret the contract and effectuate the parties’ intent, not to rewrite the contact. When operating agreements use corporate elements, the courts may view that as a signal that the parties intended to use a corporate structure for the alternative entity; however, the court is careful not to interpret the similarities too broadly or without close analysis because contractual flexibility is a key feature of the limited liability company structure. In this case, the court held that the facts were distinguishable from cases where the court borrowed from corporate law when construing governance rights under a limited liability company operating agreement. For the court to impose the requested additional procedures for “for cause” removal, the court would have to rewrite clearly written contracts that reflected the terms the parties bargained for. In addition, the Company was expressly “uncorporate” in its governance structure because it was managed by a single managing member and the Class B Members maintained the right to approve and disapprove several operational decisions. Because the parties did not intend to borrow from corporate law to alter or supplement the bargained for rights and obligations, the court held that common law did not rewrite the Operating Agreement and Management Agreement.

In conclusion, the court held that as the terms of the Operating Agreement and the Management Agreement were clear and unambiguous and did not provide the manager pre-removal notice rights or the right to be heard before removal, and common law could not be used to rewrite the Operating Agreement and the Management agreement because the governance structure of the Company was not analogous to that of a corporation, plaintiff’s motion for summary judgment was denied.


Plaintiffs were limited partners of Blue Bell Creameries, L.P., a Delaware limited partnership (“Blue Bell”). Blue Bell was managed by its general partner, Blue Bell Creameries, Inc. (“BB GP”), a wholly owned subsidiary of Blue Bell Creameries USA, Inc. (“BB USA”). Blue Bell manufactured and sold ice cream products in the southern United States, and as of 2014, Blue Bell was the third largest ice cream manufacturer in the United States. In January 2015, South Carolina state health inspectors discovered Listeria monocytogenes bacteria (“Listeria”) in a routine sampling of Blue Bell products, and shortly thereafter, the Food & Drug Administration and other state health agencies
found Listeria contamination in other Blue Bell ice cream products. Further, it was determined that Blue Bell had discovered Listeria on its own in 2013, but had failed to conduct any analysis of the source of the bacteria. The discovery of Listeria had a devastating impact on Blue Bell’s business.

Plaintiffs brought a derivative action on behalf of Blue Bell based on conduct relating to the Listeria disaster setting forth four counts: (1) against BB GP, for breach of Blue Bell’s partnership agreement; (2) against BB USA, “as controller, principal, and joint venturer” of BB GP, and against certain directors and officers of BB GP and BB USA (the “Individual Defendants”), as “controllers” of BB GP, “for causing BB GP to breach the partnership agreement”; (3) against BB USA and the Individual Defendants, for aiding and abetting BB GP’s breach of its “contractual fiduciary duties” under the partnership agreement; and (4) against BB USA and the Individual Defendants, “for breach of common law fiduciary duties” owed to Blue Bell. In response, defendants moved to dismiss the complaint for failure to state a claim and for failure to make a pre-suit demand on BB GP.

The court began its discussion with the claim that BB GP violated Section 6.01(e) of Blue Bells’ limited partnership agreement (the “LPA”). The pertinent part of Section 6.01(e) of the LPA provided that BB GP shall use its “best efforts” to conduct Blue Bell’s business “in accordance with sound business practices in the industry.” The court found that under Section 6.01(e)’s plain meaning, BB GP was required to endeavor diligently to conduct Blue Bell’s business in accordance with practices that (1) were based on thorough knowledge of and experience with the dairy industry or (2) agreed with accepted views within the dairy industry. Defendants argued that the language of Section 6.11(d) modified or negated BB GP’s obligation under Section 6.01(e). Section 6.11(d) provided that:

any standard of care and duty imposed by this agreement or under DRULPA or any applicable law, rule or regulation shall be modified, waived or limited, to the extent permitted by law, as required to permit BB GP to act under this agreement or any other agreement contemplated by this Agreement and to make any decision under the authority prescribed in this agreement, so long as the action is reasonably believed by BB GP to be in, or not inconsistent with, Blue Bell’s best interests.

The court noted that the Delaware Supreme Court has confirmed that language such as that contained in Section 6.11(d) of the LPA eliminates all common law standards of care and fiduciary duties, and replaces them with a contractual good faith standard of care. However, the court held that the contractual good faith standard did not modify the affirmative language in Section 6.01(e) because Section 6.01(e) created an express contractual obligation for BB GP to follow and the contractual good faith standard operated only in spaces of the LPA without express standards of care. Thus, the court denied defendants’ motion to dismiss the first count because the court found that the express contractual language required BB GP to conduct Blue Bell’s business in accordance with sound business practices in the dairy industry as set forth in Section 6.01(e).
The court then held that plaintiffs’ veil piercing, agency and joint venturer liability theories failed. The court stated that plaintiffs’ veil piercing claim failed because the complaint did not allege or suggest that BB GP existed solely as a vehicle for fraud. Further, the court held that plaintiffs’ attempt to hold BB USA liable for BB GP’s alleged breach of the LPA under an agency theory failed because Delaware law does not recognize a theory under which a principal can be vicariously liable for its agent’s non-tortious actions. Finally, the court stated that the terms of the LPA clearly stated that the arrangement was not a joint venture and there was no reasonable inference that the conduct of BB GP and BB USA amended the LPA to make the arrangement a joint venture. The court thus held that the plaintiffs’ joint venturer theory failed.

The court also dismissed plaintiffs’ aiding and abetting claims. The court stated that BB GP’s obligations under the LPA were contractual and therefore plaintiffs’ claim was for aiding and abetting a breach of contract. Because Delaware law does not recognize a claim for aiding and abetting a breach of contract, the court dismissed this count.

The court then addressed plaintiffs’ breach of fiduciary duties claim against BB USA and the Individual Defendants. Plaintiffs claimed that BB USA and the Individual Defendants breached their common law fiduciary duties that were owed to Blue Bell under the In re USACafes, L.P. Litigation, 600 A.2d 43 (Del. Ch. 1991) line of cases, which stand for the proposition that a corporate general partner’s fiduciary duties to the limited partnership may extend to the general partner’s controllers if such persons exercise control over the limited partnership’s property. The court stated that this rule had limited, if any, application in this context because the LPA eliminated all common law fiduciary duties, and therefore neither BB USA nor the Individual Defendants owed any fiduciary duties directly to Blue Bell even if they exercised control over Blue Bell’s property. Thus, the court dismissed these claims.

Finally, the court addressed whether demand on BB GP was excused for plaintiffs’ derivative claims. The court stated that demand was futile in this case because there was reasonable doubt that BB GP could have properly exercised independent and disinterested business judgment in evaluating a demand to bring this derivative action. The court noted that the exculpatory language in the LPA did not provide a basis in this case for overcoming properly pled allegations supporting demand futility.


Primary defendant Kentucky Retirement System (“KRS”) was the sole limited partner in four Delaware limited partnerships. KRS exercised its right to remove the general partner of each limited partnership “for Cause” and gave notice of such exercise to the general partners (who collectively comprise the plaintiffs in this action). Plaintiffs filed suit in Delaware to obtain declarations that their removal was improper (the “Delaware Litigation”). Shortly thereafter, KRS filed an action in Kentucky seeking a declaration that removal was proper (the “Kentucky Litigation”).

KRS moved to dismiss the Delaware Litigation on the grounds that the forum selection clause in the partnership agreement of each limited partnership required plaintiffs to litigate in Kentucky. The combined governing law and forum selection clause (the
“Forum Clause”) stated that “except as otherwise provided by the [DRULPA], this Agreement and the rights and obligations of the parties hereunder shall be governed by and interpreted, construed and enforced in accordance with the laws of the Commonwealth of Kentucky . . . . Each of the Partners hereby consents to the jurisdiction of the courts of the Commonwealth of Kentucky and further consents that venue shall lie in the Franklin Circuit Court located in Franklin County, Kentucky.”

Plaintiffs countered that the Forum Clause was not an exclusive venue provision and that, in the alternative, even if the Forum Clause did require KRS to bring claims exclusively in Kentucky, it would be unenforceable because it violated DRULPA Section 17-109(d), which prohibits limited partners from waiving their right to litigate matters relating to the internal affairs of the limited partnership in Delaware.

The court began its analysis by noting that Delaware courts defer to forum selection clauses and grant motions to dismiss based on improper forum if the application of such a clause is relevant. However, given that each partnership agreement chose Kentucky law as the governing law, the court queried whether Kentucky courts treat forum selection clauses in the same way. Confirming that they did, the court declined to engage in a choice of law analysis given there was no conflict of laws. The court noted that all parties agreed to the application of Kentucky law to this dispute.

Having found no conflict of laws, the court turned to whether the Forum Clause was permissive or mandatory in regard to KRS’s right to bring claims. The court noted that the Forum Clause stated that “each Partner hereby consents” to the jurisdiction of Kentucky courts. Such language did not expressly state or otherwise imply that Kentucky courts were the exclusive forum for the resolution of questions of internal affairs of the limited partnership. The court therefore denied defendants’ motion to dismiss that was premised upon the enforcement of the Forum Clause.

Although a stay of proceedings was not requested by defendants, the court nonetheless imposed a stay sua sponte pending resolution of the Kentucky action. The court noted that, in situations where a Delaware action is filed first or simultaneously with action in another jurisdiction, Delaware courts will consider the same factors considered in a motion to dismiss for forum non conveniens to determine whether a stay is appropriate. The court also noted that, although a first-filed Delaware action typically weighs in favor of moving forward with Delaware litigation, in situations where the actions are filed relatively close in time, the factual scenario surrounding the filings should be taken into account. Applied here, the court noted that it may have been the case that the Delaware Litigation was filed in order to “scuttle or confound” the Kentucky Litigation that plaintiffs suspected KRS was preparing to file. Given that the partnership agreements chose to be governed by Kentucky law (and that substantive questions about the proper or improper removal would be questions of Kentucky law interpretation) and that both the Delaware Litigation and Kentucky Litigation were focused on the same issues, the court found the stay appropriate.

The court further rejected plaintiffs’ argument that litigating the dispute outside of Delaware would violate Delaware public policy. The court stated that had the General Assembly intended for Section 17-109(d) to mandate litigation of internal affairs of
limited partnerships in Delaware, it could have done so. KRS could have litigated in Delaware but chose not to and that choice was to be respected.


Plaintiffs filed an action seeking approximately $470,000 from defendants for accrued salaries. Plaintiffs were managers of IF Technologies, Inc. (“IF Technologies”) and its predecessor entities before IF Technologies sold substantially all of its assets in exchange for RemitDATA, Inc. (“RemitData”) stock (the “Transaction”). In connection with the Transaction, IF Technologies dissolved and transferred its liabilities and the RemitDATA stock to defendant IFTHC, LLC (“IFTHC”) and the stockholders of IF Technologies became unitholders of IFTHC. The board of directors of IF Technologies (the “IFT Board”), which was composed of the same persons who constituted the board of directors of IFTHC, approved an amendment to IFTHC’s operating agreement (the “Operating Agreement”) which stated that in the event of dissolution, all of the debts, liabilities and obligations of IFTHC must be paid. After the approval of the amendment and after speaking to plaintiffs, IFTHC’s counsel added the following parenthetical to that provision: “(including without limitation, the compensation obligations owed to [plaintiffs] in the aggregate amount of $464,000 and all expenses incurred in liquidation).” The Board then distributed an information statement to the IF Technologies’ stockholders seeking their approval of the Transaction and agreement to be bound by the Operating Agreement (which included the parenthetical). The stockholders approved the Transaction, the Transaction closed and plaintiffs requested payment for their accrued salaries. IFTHC refused to pay, and plaintiffs sued.

Plaintiffs moved for partial judgment on the pleadings as to their claim for breach of the Operating Agreement. Plaintiffs argued that the parenthetical in the amended Operating Agreement provided that plaintiffs must be paid immediately for their accrued salaries. Defendants argued that the parenthetical was unenforceable because the Board did not approve it and the stockholders did not know the Board did not approve it when they approved the amendment. As a result, defendants contended that there were “serious doubts concerning the validity and enforceability” of the parenthetical. The court explained that it would grant a motion for judgment on the pleadings when “there are no material issues of fact and movant is entitled to judgment as a matter of law.” The court held that because defendant raised a question of fact as to whether the parenthetical was operative, plaintiffs did not establish as a matter of law that there was a contractual obligation for defendants to pay plaintiffs’ accrued salaries. Plaintiffs also argued that even if the parenthetical was not operative, the Operating Agreement provided that the plaintiffs should be paid their accrued salaries. They argued that the requirement for IFTHC to pay all debts, liabilities and obligations of IFTHC included the accrued salaries. Defendants argued, on the other hand, that a 2011 purchase agreement, which stated that accrued salaries were to be paid from future profits with approval by the IFT Board, was not altered by the amendment to the Operating Agreement. Therefore, defendants argued that they did not owe plaintiffs payment for the accrued salaries because IF Technologies was not profitable. The court held that there were factual disputes as to whether plaintiffs’ accrued salaries were debts and liabilities under the
Operating Agreement. Because there were factual disputes, the court denied partial judgment on the pleadings.


Obeid was a member and manager of Gemini Real Estate Advisors, LLC (the “Company”) and, following disputes arising with other managers of the Company, sought books and records of the Company relating to distributions to investors, management fees and operating subsidiary accounts (the “Information”) pursuant to the Company’s LLC Agreement and Section 18-305 of the Delaware Limited Liability Company Act (the “LLC Act”).

The court found that Obeid was entitled to the Information in his capacity as a manager of the Company under Sections 18-305(a) and (b) of the LLC Act, which provide managers with the right to examine information regarding the status of the business and financial condition of an LLC for a purpose reasonably related to the position of manager. The court noted that this language was “tantamount” to that used in Section 220 of the Delaware General Corporations Law and that the cases interpreting Section 220 were an analogue to Section 18-305 inspection rights. The court stated that it presumes that sitting directors are entitled to “unfettered access” to company books and records. Obeid was a manager of the Company, so he made a prima facie case for access to the Information. It was then up to defendants to carry the “rather substantial burden” of proving that Obeid was not motivated by a proper purpose, which could be shown by “concrete evidence” that Obeid would use the Information to harm the Company in violation of his fiduciary duties. Defendants pointed to one prior act by Obeid (he filed noticed of pendency against the Company’s properties during the course of active litigation) and asserted that Obeid was using this books and records action to make an end-run around the discovery process in a separate litigation proceeding in a North Carolina court. The court found that neither of these reasons was sufficient to warrant denying Obeid’s access to the Company’s books and records, particularly since Obeid agreed to a confidentiality order that prohibited him from using the Information in the North Carolina litigation absent Delaware and North Carolina court approval. Thus, defendants were unsuccessful in their claims of improper purpose against Obeid.

Defendants further argued that they provided Obeid with the information he needed to discharge his fiduciary duties to the Company. The court found that this was not a valid defense, noting again that directors’ and managers’ access to company information is “essentially unfettered” absent valid contractual restrictions.

The court also found that Obeid was entitled to the Information under Section 8.6.1 of the Company’s LLC Agreement as a member of the Company. Section 8.6.1 of the Company’s LLC Agreement provided that “[a]ll of the records and books of account of the Company . . . shall be open to the inspection and examination of the Members or their representatives during reasonable business hours.” Defendants tried again to argue that Obeid had an improper purpose in seeking the Information as a member. The court noted that the implied covenant of good faith and fair dealing would permit defendants to raise an improper purpose defense absent express language in the LLC Agreement to the contrary. To successfully assert this defense, defendants would have to show that Obeid
was seeking the Information for a personal purpose that was also adverse to the interests of the Company. Defendants failed to satisfy this burden.

Specifically with respect to the information requested relating to operating subsidiary accounts, the court noted that the Company used its records database to maintain books and records of its operating subsidiaries. These operating subsidiaries did not have their own employees and relied on the Company to carry out their management functions and maintain responsibility over their funds and assets, and the court found that such “unity of control and management composition is sufficient to subject operating subsidiary information to a proper request by a parent Manager in accordance with Section 18-305(b)” (quoting RED Capital Inv. L.P. v. RED Parent LLC, 2016 WL 612772, at *5 (Del. Ch. Feb. 11, 2016)). Thus, the court held that Obeid was entitled to theInformation.


Plaintiff, Richard Kay (“Kay”), and defendant, Stanley Campbell (“Campbell”), sought to form a business venture to market certain medical diagnosis and prescription technology that Campbell had developed. Under the principal terms of the business venture that were outlined in two letter agreements, Campbell would contribute to the venture stock in his wholly-owned subsidiaries and certain intellectual property, and Kay would contribute cash. For nearly a year, the parties negotiated the terms of a contribution agreement (the “Contribution Agreement”) and operating agreement of Eagle Force Holdings LLC (the “Operating Agreement,” and together with the Contribution Agreement, the “Transaction Documents”), each of which contained a forum selection clause pursuant to which the parties consented to personal jurisdiction in the Delaware courts. Kay and Campbell eventually signed the Transaction Documents, but the parties dispute whether such signed documents represent binding contracts. Following the execution of the Transaction Documents, Kay and Campbell were unable to resolve the remaining open items regarding the Transaction Documents, and Campbell sought to move on from his business venture with Kay. Consequently, Kay caused Eagle Force Holdings LLC to file suit against Campbell for breach of contract and fiduciary duty and sought specific performance of Campbell’s obligations under the Transaction Documents. Campbell argued that the Court of Chancery could not assert personal jurisdiction over him because the only basis to support personal jurisdiction over him was the forum selection clause in each of the Transaction Documents. However, according to Campbell, the signing of those documents did not create binding contracts. A full trial was held to determine whether Campbell was bound by the Transaction Documents and therefore subject to the court’s personal jurisdiction. The court found that the Transaction Documents did not include agreement on material terms such as the intellectual property to be contributed, and contracts to be assigned to Eagle Force Holdings LLC and the equity interests in Eagle Force Holdings LLC to be issued to each party. Therefore, the court agreed with Campbell that the parties did not form binding contracts because essential terms of the Transaction Documents were missing. Consequently, the court held that it could not assert personal jurisdiction over Campbell, and plaintiff’s complaint was dismissed.
On appeal, the Supreme Court reversed and remanded the case back to the Court of Chancery, noting that the Court of Chancery must analyze whether the Transaction Documents were valid, binding contracts under the Osborn test. In Osborn ex rel. Osborn v. Kemp, 991 A.2d 1153 (Del. 2010), the court held that “a valid contract exists when (1) the parties intended that the contract would bind them, (2) the terms of the contract are sufficiently definite, and (3) the parties exchange legal consideration.” With respect to the Contribution Agreement, the Supreme Court provided guidance to the Court of Chancery on the first prong of the Osborn test, noting that a signature on a document generally indicates assent absent fraud, duress, mutual mistake or unconscionability. However, there was also evidence that suggested that the parties may not have intended to be bound by the Contribution Agreement, including blank schedules and “DRAFT” on the top of the Contribution Agreement.

With respect to the second prong of Osborn, whether the contract’s material terms are sufficiently definite, the court stated that this was a question of law. The court adopted the test from the Restatement (Second) of Contracts § 33(2), which states that terms are sufficiently definite if they “provide a basis for determining the existence of a breach and for giving an appropriate remedy.” While the Court of Chancery determined that the parties failed to agree on the precise scope of consideration of the Contribution Agreement, the Supreme Court disagreed, reasoning that the terms of the Contribution Agreement allowed the court to ascertain the consideration, the remedies if the consideration was not provided and the manner to enforce the agreement. Notably, the court stated that the Contribution Agreement recitals articulated the consideration, which was also reiterated in the body of the agreement. Additionally, the court noted that the Contribution Agreement provided that Campbell must contribute all right, title and interest in and to, any and all “Intellectual Property”, which was defined as the “Transferred IP”, and all “Targeted Companies Securities”. As these terms were defined in the Contribution Agreement and the Contribution Agreement specified that all “Intellectual Property” and “Targeted Companies Securities” must be contributed by Campbell, the court held that the Contribution Agreement consideration was sufficiently definite. Additionally, the court noted that the negotiations between the parties did not create ambiguity as the language regarding the consideration was definitive. In addition, the court found that Kay had recourse if Campbell did not contribute the required assets through actions for breaches of the warranty or indemnification provisions. Thus, the court held that the second prong of Osborn was satisfied. With respect to the third prong of Osborn, the court noted that the parties did not dispute that legal consideration exists and therefore the third prong of Osborn was satisfied.

In regards to the Operating Agreement, similar to the Contribution Agreement analysis, the Supreme Court noted that, as in the Contribution Agreement, the parties signed the Operating Agreement, which provides evidence that the parties did intend to be bound by the Operating Agreement. Additionally, the Operating Agreement provided that each member intended to be bound by the document. On remand, the Supreme Court stated that the Court of Chancery should consider the policy of the Delaware Limited Liability Company Act to give maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements. With respect to the second and third prongs of Osborn, the court held that because the parties did not contest these prongs, the two prongs were satisfied.
This litigation arose out of the private placement issuance of convertible units to some of the unitholders, most of whom were insiders, in Energy Transfer Equity, L.P., a Delaware limited partnership ("ETE"), in return for which the unitholders gave up their rights to certain distributions for a time on their common units (the "Issuance"). Defendants asserted that the Issuance was a necessary device used to prevent a downgrade by credit rating agencies without cutting distributions on ETE’s units. Plaintiffs asserted that the issuance was a hedge designed to protect insiders from possible bad effects of ETE’s planned merger with The Williams Companies, Inc. ("Williams Co.") and a downturn in the energy sector. In making this assertion, plaintiffs advanced two theories of liability.

First, they argued that the Issuance was a “distribution” under ETE’s partnership agreement (the “LPA”), that the LPA required that distributions be made pro rata to unitholders and that the Issuance violated this provision because the securities were not issued pro rata to unitholders. Second, plaintiffs argued that the Issuance violated the provisions of the LPA applicable to conflicted transactions because defendants did not comply with the “safe harbor” provisions of the LPA and the Issuance was not “fair and reasonable” to ETE.

In two prior decisions in this matter in 2017, the court denied the parties’ cross-motions for summary judgment, finding that a more developed factual record was needed to determine whether the “special approval” safe harbor for a conflicted transaction in the LPA had been met and whether the Issuance was a “distribution” under the LPA. Trial on those and related issues commenced in February 2018, during which additional facts were revealed. The relevant facts that emerged in depositions and at trial follow.

ETE was managed by its general partner, LE GP, LLC (the “General Partner”), which was in turn managed by a board of directors (the “Board”), which appointed ETE’s executive officers. Many of the individual defendants were members of the Board or officers of ETE and current or former directors or officers of other companies in the ETE family. Plaintiffs were an individual and an entity that held ETE common units at all relevant times. In September 2015, ETE entered into an agreement to merge with Williams Co., wherein Williams Co. would receive cash financed by ETE through new debt. Once the merger was consummated, ETE’s consolidated debt would increase by over $30 billion. After the merger was announced, the energy market took a nosedive, the credit market for energy companies experienced significant stress and energy companies’ access to credit was reduced. This was bad for ETE, which distributed all of its available cash every quarter to its unitholders and depended heavily on capital markets access to fund its growth. The credit rating agencies expected ETE’s debt-to-EBITDA ratio (“D/E”) not to exceed 4.0x. ETE’s CFO informed the rating agencies that an equity issuance would be on the table if this occurred. However, if the Williams Co. merger closed, ETE’s D/E would likely reach 4.7x. Thus, ETE was facing a credit rating downgrade that would significantly harm ETE’s competitiveness and commercial reputation and significantly increase its interest expense. ETE explored deleveraging options like issuing equity, renegotiating the Williams Co. merger to require less cash up front, selling assets and cutting distributions. Some of the options (like asset sales) were not feasible given market conditions. ETE also tried and failed to renegotiate the merger
In February 2016, the Board considered a public offering of securities that guaranteed $0.11 in cash or accrual if common unit distributions were less than $0.11; if common unit distributions were above $0.11, participating unitholders would receive $0.11 in cash and an accrual, redeemable for common units, for the amount exceeding $0.11 (the “Initial Terms”). On February 13, Williams Co.’s CFO informed ETE’s CFO that the public offering required Williams Co.’s consent, which he did not think would be provided, and that he would not permit Williams Co.’s auditors to release the financial statements needed to file the S-3, which was required for the public offering. Email correspondence from that same day shows that ETE’s general counsel and its president were aware of Williams Co.’s CFO’s position. On February 15, Latham & Watkins, ETE’s counsel, sent ETE updated documents for the public offering. Notably, these revised documents increased the quarterly accrual for units from $0.11 to $0.285 (the “Revised Terms”), a “massive hedge” for participating unitholders if ETE cut distributions that ETE’s financial adviser described as “a ‘wealth transfer’ to subscribers in case distribution[sic] were cancelled.” That same day, the Board held a telephonic meeting. The unredacted portion of the minutes did not include any discussion of the Revised Terms. The resolutions included Board approval of the public issuance on “substantially the terms set forth in the term sheet previously provided to the Board,” which were the Revised Terms that the Board was informed of on the date of the meeting. ETE’s CFO testified that he provided the Board with a report on his conversation with Williams Co.’s CFO at the Board meeting. Thus, evidence showed that the Board knew on February 15 that Williams Co. likely would not consent to the public offering. Indeed, on February 18, Williams Co.’s CFO informed ETE’s CFO that the Williams Co. board, acting unanimously, refused to consent to the public offering. ETE’s Board members testified that they were “floored” and “very disappointed” by this; the court found that testimony not credible given that the Board already knew of Williams Co.’s position.

On February 22, the Board met and agreed to pursue a private offering of securities, which would not require Williams Co.’s consent. The terms of the private offering largely mimicked the Revised Terms for the public offering. The Board approved the private offering on February 28.

At the February 22 Board meeting, the Board established a conflicts committee consisting of three individuals (Williams, Turner and Collins). Williams was an engineer that had never served on a conflicts committee. As was later discovered, Turner and Collins were directors of affiliates of the General Partner and thus, under the terms of the LPA, were ineligible to serve on the conflicts committee. After the meeting, Turner told another Board member, who told ETE’s general counsel, that he (Turner) was ill and could not serve on the conflicts committee. On February 24, ETE’s general counsel told their investment bank that Collins and Williams were on a two-person conflicts committee, despite the fact that the Board never designated a two-person committee. Latham discovered Collins’ and Turner’s ineligibility to serve on the conflicts committee on February 26, the date of the first conflicts committee meeting. It also realized that a
separate committee—audit and conflicts ("A&C")—needed to approve the Issuance. A&C was a standing committee also consisting of Williams, Turner and Collins. Latham and Akin Gump decided to create “revised resolutions” for the February 22 meeting that purportedly would reflect the Board’s decision to appoint Williams as a one-man conflicts committee and for Williams and Collins to serve as the members of the A&C committee. However, the minutes of the February 22 meeting did not match those resolutions and there was no evidence that the Board ever adopted those “revised” resolutions. Further, the Board never met to reconstitute or approve the constitution of the conflicts committee as a one-man committee consisting of Williams.

The conflicts committee purported to meet on February 26, when Williams and an attorney from Akin Gump met telephonically. Phone records and testimony do not match regarding the length of this meeting, which could have lasted anywhere from twenty-seven seconds (per the phone records) to twenty minutes (per the testimony). On the morning of this meeting, Collins, who was ineligible to serve on the conflicts committee, signed an engagement letter with a financial adviser for the conflicts committee; apparently Collins was not informed that he was not a member of the conflicts committee until February 27, though it does not appear that Collins attended the February 26 meeting. On February 27, the conflicts and A&C committees held a joint telephonic meeting, attended by Williams, Collins, the financial adviser and Akin Gump, and met again that afternoon for a presentation on the proposed issuance by the financial adviser. The committees met a final time on February 28. The financial adviser gave one last presentation, notably devoid of any explanation of how the specific terms of the private offering were desirable as compared to any other terms. The record contains no evidence that either committee considered whether the terms were fair to ETE. Williams’ testimony made clear that he did not understand key aspects of the transaction he was approving. Both committees voted to approve the Issuance. Later that same day, the Board met to discuss the Issuance. At this meeting, an Akin Gump attorney told the Board that Williams, Turner and Collins had acted as a “special committee” of the Board. However, there was no evidence that ETE ever formed a “special committee” or that such a committee was involved in the Issuance. The Board approved the Issuance and documents relating thereto. Notably, while the Board resolutions from the meeting contained “whereas” clauses referencing the Board’s purported prior formation of a one-man conflicts committee, no actual resolutions ratified the decision to use such a committee.

The private placement was offered to individuals—at least 70% of whom were affiliated with ETE or related to an individual with an ETE affiliation—and 3 of the 400 institutional investors that ETE had at the time. One institutional investor decided to participate. The rating agencies reacted positively to the Issuance. ETE announced that it was going to cut distributions. However, ETE terminated the merger agreement with Williams Co. on June 29, 2016 and subsequently did not cut distributions. In fact, ETE increased quarterly distributions twice during the Issuance plan period. The plan period expired on May 18, 2018, at which time the securities would convert into common units in accordance with their terms.

The court first addressed plaintiffs’ argument that the private issuance was a “distribution” under the LPA and, as such, was required to be made pro rata to all
unitholders. The court noted that Section 5.8 of the LPA provided the General Partner with the discretion to issue securities on terms the General Partner found appropriate. Further, the court found that the term “distribution” was not ambiguous and the term referred “to something transferred to the unitholders, as, for instance, a payment; rather than something that is offered to the unitholders for sale, which they may accept or reject.” Such a definition comported with the LPA as a whole, especially in light of Section 5.8. Therefore, the court found that the Issuance did not constitute a distribution and thus was not prohibited under the provisions of the LPA that required distributions to be made pro rata.

The court next determined whether the Issuance was “fair and reasonable” to ETE as required under Section 7.6(f) of the LPA for transactions with affiliates, which the Issuance was. The LPA provided that the General Partner could conclusively establish that a transaction was fair and reasonable if it complied with one of the safe harbor provisions in the LPA. One safe harbor was to receive “Special Approval” (i.e., approval of a properly constituted conflicts committee). Unfortunately, as outlined in the summary of the facts above, a conflicts committee was never properly constituted. The conflicts committee that the Board established and approved included two individuals who were not, under the terms of the LPA, eligible to serve. The Board never reconstituted that committee, nor did not ratify the purported establishment of a one-man conflicts committee consisting of Williams. The court noted that the actions of then-counsel for ETE’s committees created “a record which is at best misleading . . . . Suffice it to say that these actions are not helpful to the Defendants, at all.”

The court then turned to a second safe harbor, which provided that an affiliate transaction was deemed fair and reasonable to ETE if the terms of the transaction were no less favorable to ETE than those generally being provided to unrelated third parties. Defendants argued that the private placement was offered to three institutional investors; therefore, it was conclusively fair and reasonable. The court disagreed. However, the court agreed with ETE’s position that one could satisfy the safe harbor by comparing the challenged transaction to similar arms-length transactions. However, that option was not available here, as defendants created a “unique and complex security” offered to selected parties simultaneously. There were neither “generally” similar transactions with which to compare the terms of the Issuance nor similar securities being offered in the market. Because defendants did not satisfy any safe harbor, the court turned to analyzing whether the Issuance was fair and reasonable to ETE.

The court found that the contractual “fair and reasonable” standard invoked a review similar to that of entire fairness. Thus, the Issuance must evidence a fair process and be undertaken at a fair price. The court found that defendants failed to show that the Issuance was entirely fair to ETE. In so determining, the court found that the Initial Terms would have provided significant benefit to ETE while providing a benefit that likely would induce investors to subscribe, and that the Initial Terms were fair to ETE. However, the Initial Terms were replaced with the Revised Terms, which neither the Board nor the committees discussed in relation to the Initial Terms. The Revised Terms were introduced at a time when the Board knew that Williams Co. likely would not consent to a public offering. Further, defendants were unable to explain how the Revised Terms originated or were placed before the Board or how they determined that the
Revised Terms were necessary for the success of the public offering. The court adopted a “reasonable supposition” that ETE’s CFO informed insiders that, based on the likelihood that Williams Co. would not consent to the public offering, a private offering would be an alternative and that distribution cuts loomed, and insiders seized the opportunity to hedge against these cuts. The Revised Terms were “not fair in terms of process, and nothing in the Board’s actions indicated that it was fair as to price.” Thus, the securities, to the extent transferred to the General Partner or its affiliates, breached the LPA and defendant Directors caused the General Partner to breach the LPA by issuing those securities.

The court then turned to the remedy for that contractual breach. Plaintiffs sought only equitable relief in the form of cancellation of the securities. The court found that equitable relief was not warranted. The terms of the Issuance that the court found to be unfair—the Revised Terms—would have resulted in harm to ETE and value to the Issuance’s subscribers only if ETE reduced distributions during the plan period of the Issuance. This did not occur; ETE increased distributions during that time. Therefore, the unfair terms caused ETE no damages, and the court found that rescission of the securities would be disproportional to the “loss” (which was nothing).


Primary defendant Keith Goggin (“Goggin”) was sole manager of East Coast Miner LLC (the “Company”), an entity formed for the purpose of purchasing a senior debt note from U.S. Coal (“US Coal”). Pursuant to the note purchase, the Company obtained the right to credit bid the value of the note for the assets of Licking River, a division of US Coal, in the event US Coal entered bankruptcy. Plaintiff MHS Capital LLC held a 23.75% interest in the Company and was told repeatedly by Goggin that it would receive a majority stake in Licking River’s assets in the event the credit bid was exercised.

In May of 2014, US Coal entered bankruptcy. However, instead of having the Company exercise the credit bid, Goggin formed two additional entities and had one of those entities exercise the credit bid. As a result, the proceeds of the Licking River assets were shared between the newly formed entities and the Company, ultimately resulting in a dilution of the interest plaintiff expected to receive. The credit bid was approved by the United States Bankruptcy Court for the Eastern District of Kentucky.

In the weeks leading up to the credit bid, efforts were made by plaintiff to ascertain information regarding its investment in the Company and the rationale behind the decision to exercise the credit bid. These efforts were either rebuffed or ignored by the Company and Goggin. A consent package was circulated less than twenty-four hours before the required Company vote on the exercise of the credit bid but did not include any financial information relevant to evaluating the bid. The consent package also requested that all members of the Company ratify all prior acts of Goggin, though it did not detail what exactly those actions were.

Plaintiff sued defendants for monetary damages and requested equitable relief based on a variety of theories including breach of contract, breach of fiduciary duty, fraud, breach of the implied covenant, tortious interference with contract and unjust enrichment. Defendants moved for dismissal, claiming among other things that Goggin, as manager of
the Company, was exculpated from liability for monetary damages for breach of duties owed under the Company operating agreement.

With respect to defendants' motion to dismiss the breach of contract claim, the Company’s operating agreement replaced traditional fiduciary duties with a contractual standard providing that: “[Goggin] shall discharge his . . . duties in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner [Goggin] reasonable believes to be in the best interests of the Company.” The operating agreement also exculpated Goggin from liability to the Company or any member for monetary damages for breach of any duty as manager, except otherwise required under the Delaware LLC Act. Given that defendants did not argue that plaintiff failed to state a claim for breach of contract, the court was permitted to assume that the complaint properly stated such claim and thus denied defendants’ motion to dismiss.

However, the court did grant defendants’ motion to dismiss for the breach of fiduciary duty claim based on the fact that the claim was duplicative of the breach of contract claim. The court noted that when a dispute arises based on obligations that are expressly addressed by a contract, a breach of fiduciary duty claim is superfluous. Here, the court held that any conduct that would conceivably give rise to a fiduciary duty claim would be covered by the duties expressly set forth in the operating agreement.

Plaintiff’s implied covenant claim was premised on the fact that Goggin usurped corporate opportunities from the Company when he shared the profits of the credit bid. Defendants argued that the operating agreement expressly required Goggin to act in good faith, which would obviously prevent the usurpation of corporate opportunities. The court agreed and dismissed the implied covenant claim, stating that the contract directly addressed the issue and left no gap to fill.

With respect to plaintiff’s books and records claim, the court dismissed this claim without prejudice on the grounds that such a claim should be litigated in

*Eames v. Quantlab Grp. GP, LLC*, No. CV 2017-0792-JRS (Del. Ch. May 1, 2018) (V.C. Slights)

This case concerned a voting trustee’s, acting on behalf of 96% of the voting limited partnership interests of Quantlab Group, LP (the “Partnership”), purported action to remove Quantlab Group GP, LLC (“Quantlab GP”) as general partner of the Partnership and add Quantlab Group GP II, LLC (“Quantlab GP II”) as general partner of the Partnership. Simultaneously with this action, Plaintiff Bruce Eames (“Eames”), in his capacity as a manager of Quantlab GP, consented to Quantlab GP II’s addition as general partner of the Partnership. Under the Partnership’s limited partnership agreement (the “Partnership Agreement”), the general partner could be removed without cause only if there was one other general partner and the new general partner’s admission was consented to by the removed general partner. Under the limited liability company agreement of Quantlab GP (the “Quantlab GP Agreement”), the managers could act unilaterally to transact business on behalf of and for the benefit of Quantlab GP. This was restricted by the requirement that managers of Quantlab GP could not take any action that would make it impossible to carry on the ordinary business of Quantlab GP or
change the nature of Quantlab GP’s business, which was to act as the general partner of the Partnership. On the same day as the purported removal and admission, plaintiffs filed this complaint under 6 Del. C. § 17–110 to confirm that Quantlab GP was removed as general partner of the Partnership and Quantlab II GP was admitted as general partner of the Partnership. Plaintiffs argued that Quantlab GP II was the sole general partner of the Partnership.

Defendant Quantlab GP, in its motion for partial summary judgement, argued that these actions were invalid under the terms of the Partnership’s limited partnership agreement (the “Partnership Agreement”) and thus Quantlab GP was still the sole general partner of the Partnership. The court agreed. The court held that the clear and unambiguous terms of the Partnership Agreement did not allow for a simultaneous removal and replacement of the general partner, reasoning that the Partnership Agreement required that a second general partner must be admitted before Quantlab GP could be removed as general partner. Additionally, the court held that Eames did not have authority to unilaterally consent on behalf of Quantlab GP to Quantlab GP II being added as a general partner. Plaintiffs argued that Eames could take action to add Quantlab GP II as general partner because he was acting for the benefit of Quantlab GP and the action did not change the business of Quantlab GP. The court disagreed, reasoning that Eames did not have the unilateral authority to take this action under the Quantlab GP Agreement because he could not take any action that would make it impossible to carry on the ordinary business of Quantlab GP or change the nature of Quantlab GP’s business. The court stated that the sole purpose of Quantlab GP was to act as the general partner of the Partnership; therefore, by adding Quantlab GP II as a general partner of the Partnership, Eames changed the business from acting as the general partner of the Partnership to acting as a general partner of the Partnership. Additionally, the court held that his action was not for the benefit of the Quantlab GP, which was required for unilateral action by a manager. Therefore, the court granted defendant’s motion for partial summary judgement.

Capone v. LDH Management Holdings LLC, C.A. No. 111687-VCG (Del. Ch. Apr. 25, 2018) (V.C. Glasscock)

In this case, the court addressed the requirements of Section 18-804(b) of the Delaware Limited Liability Company Act (the “LLC Act”), which requires an LLC that has been dissolved to, among other things, pay or make reasonable provision to pay claims known to the LLC. Plaintiffs were unitholders in an LLC that held a fifteen percent profits interest in another LLC (referred to herein as “LDH”). Plaintiffs’ employment was terminated, triggering a call right held by the LLC. The LLC agreement included several relevant provisions that applied to the exercise of the call right. First, the call right was required to be exercised at the “Fair Market Value” as of the last day of the last fiscal year preceding the fiscal year in which the call notice was given. The notice was given and the units were redeemed in early 2011; thus, the relevant “as of” date for determining Fair Market Value was December 31, 2010. Second, “Fair Market Value” was defined as the amount that would be distributed if all of the assets of LDH and its subsidiaries had been sold at their “Gross Asset Value” (adjusted immediately prior to such deemed sale by the LLC’s board in good faith in consultation with LDH’s board), the proceeds had been distributed to the members of LDH (including the LLC) and the amount of the LLC’s distribution had been distributed to its members in accordance with its LLC
agreement. Third, the determination of Gross Asset Value was to be made promptly following the relevant date and based on the LLC’s financial statements for the fiscal quarter ending on the relevant date or during which the relevant date occurred, unless otherwise determined by the board.

LDH had two divisions: a midstream asset division and a merchant trading business. LDH retained bankers to explore a sale of its midstream assets in November 2010. In December 2010, LDH sent an information memorandum to potential bidders. Prior to sending out the memorandum, Energy Transfer Partners (“ETP”) expressed to LDH its interest in buying LDH’s midstream assets and asked whether LDH would entertain an exclusive deal with ETP. Plaintiffs testified that they learned in December 2010 that ETP was interested in buying the midstream assets for around $2 billion and that they shared these rumors with members of LDH’s management. In the meantime, management was valuing LDH’s business as a whole for purposes of determine the price to be paid for plaintiffs’ units in connection with the LLC’s exercise of its call right. The valuation was finalized on December 23, 2010 and the board approved it—LDH as a whole was valued at $1.744 billion and its midstream assets were valued at $1.43 billion, all as of December 31, 2010. LDH continued to pursue a sale of its midstream assets. Twenty-three bids were submitted on January 14, 2011. The median bid was $1.8 billion and all but one were higher than the $1.43 billion valuation approved by the board. About a week later, one of the plaintiffs told LDH’s CEO and certain members of management that he thought it was legal error not to take account of the bids in valuing the midstream assets for purposes of the call right valuation. On February 4, 2011, the other plaintiff wrote a letter to LDH’s CEO questioning the call right valuation and noting that if the midstream assets were significantly undervalued in that valuation, it would be “devastating” to the repurchase of his units and “something I would need to review and perhaps formally question.” On March 22, 2011, LDH sold its midstream assets for $1.925 billion. On April 12, 2011, defendants redeemed plaintiffs’ units in the LLC using the $1.744 billion valuation of LDH (including the $1.43 billion valuation of its midstream assets). The two plaintiffs continued to reach out to management to question the valuation and seek information as to how the call right valuation was determined. On December 31, 2012, LDH was acquired by third-party investors. The same day, the LLC and its managing member (another LLC) were cancelled, purportedly as part of the restructuring necessary to consummate the LDH acquisition. Defendants did not notify plaintiffs of the cancellations and did not reserve any funds in connection with plaintiffs’ claims.

On May 21, 2015, plaintiffs sued the LLC, its managing member and some members of management in New York for breach of contract, alleging, among other things, that defendants failed to determine in good faith the fair market value of LDH and plaintiffs’ units in the LLC. Plaintiffs also commenced a Delaware action asserting various claims and seeking an order nullifying the certificates of cancellation of the LLC and its managing member so that plaintiffs could pursue their breach of contract claims in New York. The parties cross-moved for summary judgment on the nullification issue, and the New York court stayed the breach of contract claim before it pending a ruling from the Delaware Court of Chancery on the nullification claim. Plaintiffs argued that the defendants violated Section 18-804(b) of the LLC Act by cancelling the LLC and its managing member without setting aside any reserve to cover plaintiffs’ breach of contract claims. Plaintiffs contended that, at the time of the cancellations, defendants knew of
those claims or were aware of facts that made those claims likely to arise. Defendants argued that the dissolutions were accomplished in accordance with the LLC Act, but they did not argue that, should the court find their actions violated the LLC Act, nullification would be improper.

The court first provided an overview of the relevant provisions of the LLC Act and common law. It noted that Sections 18-804(b)(1) and (b)(3) require an LLC to “pay or make reasonable provision to pay all claims and obligations, including all contingent, conditional or unmatured contractual claims, known to the limited liability company” and “make such provision as will be reasonably likely to be sufficient to provide compensation for claims that . . . are likely to arise or to become known to the limited liability company within 10 years after the date of dissolution.” Further, the court stated that Delaware case law permits a court to nullify the certificate of cancellation of an LLC that is not wound up in accordance with the LLC Act. The court emphasized that a dissolved LLC must provide for all claims (even contingent or unmatured) irrespective of the likelihood that such claims will vest, and that the term “claims” includes contract, tort or statutory claims whether or not reduced to a judgment. The court also noted that the LLC Act provides flexibility for those making provision for such claims by prescribing a reasonableness standard. Whether the provision made was reasonable depends on several factors, including the potential amount of a claim and the likelihood of a claim actually becoming a liability for which the company must answer. The court explained that the minimal likelihood of a given claim actually arising or vesting could justify making no or minimal provision for the payment of such a claim. However, the court noted that standard must also be applied in the context of the purpose of Section 18-804 of the LLC Act, which is to provide “mandatory protection to creditors” of an LLC when the LLC dissolves and winds up.

The court reviewed plaintiffs’ claims and the evidence relating to those claims. Plaintiffs alleged that defendants breached the LLC’s operating agreement by redeeming plaintiffs’ units based on a bad-faith estimate of LDH’s value as of December 31, 2010. Plaintiffs put forward evidence that the valuation was done on December 23, 2010, prior to the valuation date of December 31, 2010, when the LLC’s operating agreement required the valuation to be performed “promptly following” the valuation date. Further, plaintiffs argued that between December 23, 2010 valuation of LDH and the April 2011 redemption of their units, “highly probative evidence” (in the form of the multiple bids for the midstream assets) emerged that showed that the midstream assets were worth almost $500 million more than the call right valuation suggested. Further, the record contained no evidence that the midstream assets increased in value during that timeframe. Finally, evidence existed showing that plaintiffs made their concerns about the valuation known to LDH management prior to the dissolution of the LLC.

The court then applied the LLC Act and common law to plaintiffs’ claims and related evidence. The court found that plaintiffs’ breach of contract claims were “known to the limited liability company” for purposes of Section 18-804(b)(1) of the LLC Act when the LLC and its managing member were dissolved, pointing to the communications between plaintiffs and high-ranking officers of LDH and other management in which plaintiffs accused defendants of acting “in bad faith under the contract” and “with malice” in breaching the LLC’s operating agreement and asserted that it was legal error not to
consider the midstream asset bids when undertaking the valuation for the call right. The court also found that defendants did not “make reasonable provision to pay” for those known claims as required under Section 18-804(b)(1) of the LLC Act because they did not set aside any funds for those claims. Such a zero-dollar reserve was not reasonable because the court found that plaintiffs’ claims were not meritless, despite defendants’ arguments to the contrary.

Because defendants violated the requirement of Section 18-804(b)(1) of the LLC Act to create a reasonable reserve to address known claims, the court granted plaintiffs the relief they sought and nullified the LLC’s and its managing member’s certificates of cancellation, enabling plaintiffs to pursue their breach of contract claims in the New York action.


In this case, defendant, Invenergy Wind LLC (“Invenergy”) exercised a right under Invenergy’s limited liability company agreement (the “LLC Agreement”) to call the membership interests of Leaf Invenergy Company (“Leaf”). Under the LLC Agreement, Invenergy could not engage in an asset sale of a specified magnitude (the “Material Partial Sale”) unless Invenergy either obtained Leaf’s consent or paid Leaf an amount sufficient for Leaf to achieve an agreed upon rate of return (the “Target Multiple”). The court referred to the requirement that Invenergy obtain Leaf’s consent as the “Series B Consent Right.” The court had previously granted Leaf’s motion for judgment on the pleadings on the question of whether Invenergy had breached the LLC Agreement by engaging in a Material Partial Sale without obtaining Leaf’s consent or paying Leaf its Target Multiple.

The court’s decision in this case concerned the proper damages award to Leaf as a result of Invenergy’s breach of the Series B Consent Right. Leaf sought to recover its Target Multiple as a remedy for Invenergy’s breach of the Series B Consent Right despite the fact that the LLC Agreement did not include a liquidated damages provision or specify a remedy for breach of the Series B Consent Right. Leaf had argued that the parties’ subjective beliefs were that Invenergy would be required to pay the Target Multiple in the event of a breach of the Series B Consent Right. Although the court found that both Leaf and Invenergy did subjectively believe that Invenergy would be required to pay the Target Multiple if it engaged in a Material Partial Sale without obtaining Leaf’s consent, the court held that these subjective beliefs were not controlling unless they were implemented in a remedial provision in an agreement, such as a liquidated damages clause.

The court noted that Leaf must show that it suffered actual harm from the breach of the Series B Consent Right in order to recover damages. The court set forth two ways that Leaf could prove actual damages. Leaf could prove that the Material Partial Sale itself harmed their interests, or, in the alternative, Leaf could prove that if Invenergy had respected the Series B Consent Right, then Leaf could have bargained for consideration in exchange for granting its consent. In order to prove that the Material Partial Sale itself harmed Leaf’s interests, Leaf would need to show that it was worse off than it would
have been had the Material Partial Sale not taken place. The court held that Leaf failed to show that it suffered actual harm as a result of the breach of the Series B Consent Right, and in fact actually benefitted from the transaction and awarded Leaf one dollar in nominal damages.

As to whether Leaf could have bargained for consideration in exchange for granting its consent, Leaf conceded that any steps taken to withhold their consent would not have been to protect Leaf from an economic downside or threatened harm, but rather to act as “leverage to ask for something in return.” The court observed that under its prior decision in *Fletcher International, Ltd. v. Ion Geophysical Corporation*, 2013 WL 6327997, at *18 (Del. Ch. Dec. 4, 2013), a consent right does not give the holder the “opportunity to coerce value” from a counterparty “in circumstances where [the holder of the consent right] believed that the transaction it was being asked to consent to was highly beneficial.” However, the court noted that Leaf could still demonstrate actual damages under *Fletcher* by showing that it could have negotiated for consideration for waiving its consent if given the opportunity. The court held that Leaf would not have been able to extract any payment in return for its consent and therefore did not suffer any actual damages as a result of Invenergy’s breach of the Series B Consent Right. Specifically, the court noted that Invenergy had various alternative options to the transaction that triggered the Series B Consent Right, was not facing any financial pressure and therefore would have had significant leverage in any negotiations with Leaf. Additionally, Leaf would have had no real ability to block the deal since Invenergy needed to obtain other investor consents in order for the transaction to close and testimony had shown that Leaf had no intention of delaying or jeopardizing the transaction.

Invenergy also sought a declaratory judgment that Leaf had breached certain put-call provisions of the LLC Agreement that required the parties to “negotiate in good faith” to determine the price at which Invenergy would purchase Leaf’s interests by making an aggressive opening demand for the exercise price. Invenergy pointed to Leaf’s opening bid of $214 million as evidence of bad faith since this figure was between three and five times as high as the figure offered by certain independent appraisal firms. However, the court found that this figure was supportable and not outside the realm of reason, and held that Leaf’s aggressive opening bid alone was not enough to establish bad faith.

Additionally, the court dismissed Invenergy’s alternative claim that Leaf breached the implied covenant of good faith and fair dealing by not conducting the appraisal “in good faith.” The court first noted that Invenergy did not engage in a methodical analysis of the implied covenant and did not expressly identify the gap it sought to fill, or the terms with which it sought to fill the alleged gap. Invenergy claimed that Leaf breached an implied term to conduct the appraisal in good faith by instructing an independent appraisal firm to determine “Fair Market Value” as the “highest” price that anyone would pay for the company. However, the contractual definition of “Fair Market Value” in the LLC Agreement when Leaf originally invested specifically contemplated that “Fair Market Value” would be determined as the highest price that Invenergy could obtain for the company. The definition of “Fair Market Value” in the LLC Agreement subsequently dropped the “highest price” component. However, the court found that given the history of this provision, it was not unreasonable for Leaf to instruct the independent appraisal
firm to determine “Fair Market Value” as the highest price that could be obtained by Invenergy.


Plaintiff brought an action against, among others, his brother, Johny, and three Delaware LLCs formed by Johny, alleging that defendants engaged in a fraudulent scheme and conspiracy to deprive plaintiff of his inheritance from his parents’ estate. The court granted defendants’ motion to dismiss based on a number of factors, including, in relevant part, due to lack of personal jurisdiction over Johny.

Plaintiff’s father built El Rosado Group (the “Group”), one of the largest commercial groups in Ecuador, and structured the Group as a web of companies owned directly and indirectly by himself, his wife, and his three children that were parties to this action. Plaintiff’s father died intestate in Ecuador in 2003 and his mother died in intestate in 2013. Plaintiff brought this action in Delaware because he alleged that Johny wrongfully transferred Group stock that should have been part of the inheritance to British Virgin Island entities and then redomesticated the British Virgin Island entities into the defendant Delaware LLCs.

The court held that it lacked personal jurisdiction over Johny. Plaintiff argued that the court had personal jurisdiction over Johny under 10 Del C. § 3104, Delaware’s long-arm statute, because Johny “formed his Delaware LLCs in Delaware in furtherance of a fraudulent scheme and the formation of Johny’s Delaware LLCs is an integral part of the actions giving rise to Danny’s claims.” The court explained that under 10 Del C. § 3104(c)(1), Johny would have to have transacted business in Delaware and that act of transacting business needed to be an integral component of the transaction to which the cause of action relates. Even though Johny formed the defendant LLCs in Delaware, plaintiff would need to prove that the formation was integral to the alleged fraudulent scheme. The court explained, however, that the formation of the Delaware LLCs was not an integral part of the scheme because the scheme was completed when the Group stock was transferred to British Virgin Island entities, before the Delaware entities were created. In addition, the LLCs had no offices or employees and did not conduct business in Delaware and therefore had not transacted business in Delaware after their formation.

The court also lacked personal jurisdiction over Johny under Delaware LLC Act Section 18-109, the implied consent statute for non-resident managers of Delaware LLCs. In order to exercise personal jurisdiction under Section 18-109, “the Court must find that: (1) the claims at issue focus on the manager’s ‘rights, duties, and obligations’; (2) the resolution of the matter is ‘inextricably bound up in Delaware law’; and (3) Delaware has a strong interest in providing a forum for the resolution of the type of dispute at issue”.

The court held that in this action, none of those factors were met. First, as stated above, the alleged fraud was committed outside of Delaware and was not based on Johny’s rights, duties or obligations as manager of the Delaware LLCs. Second, the alleged fraud commenced in Ecuador, was completed in the British Virgin Islands and the wrongful removal claims are matters of Israeli or Ecuadorian law, and therefore, was not inextricably linked to Delaware law. Finally, under principles of comity Delaware was
not the proper forum when a foreign court already made a substantive ruling relating to
the controversy and it is a dispute over foreign assets governed by foreign law.


In an earlier proceeding, plaintiffs Greg MacDonald and Dennis Smythe had been
granted summary judgment (the “Entitlement Decision”) entitling them to
indemnification from defendants Quizmark LLC and QCE Gift Card LLC arising from
losses incurred defending claims filed in Colorado (the “Colorado Action”). The
Entitlement Decision did not quantify the indemnification award, instead instructing
plaintiffs and defendants to attempt to negotiate an agreement on the amount. The parties
could not reach an agreement and an application was filed for a determination under
Court of Chancery Rule 88. Consumer Capital Partners LLC (“Consumer Capital”),
the entity that had paid all of plaintiffs’ legal expenses to date, was a movant in the
application and asserted its right of subrogation against defendants.

The court agreed with defendants’ initial argument that plaintiffs could not recover any
amounts in their own right because they themselves did not pay for any expenses out of
pocket. Plaintiffs therefore lacked standing to assert any indemnification claim. To
recover the legal fees, Consumer Capital, as the payor, would have to seek subrogation.
A claim for subrogation requires a showing that (i) defendant is primarily obligated for
the loss, (ii) that the subrogee is secondarily responsible for the loss and (iii) that by
paying the loss, the subrogee satisfied defendant’s liability for the loss.

Defendants’ first argument related to prong (ii) above, that Consumer Capital was not
secondarily responsible for the loss. Defendants pointed to the fact that one of the
ancillary indemnity agreements entered into between Consumer Capital and Dennis
Smythe (the “Smythe Agreement”) did not contain explicit language otherwise found in a
sister agreement entered into between Consumer Capital and Greg MacDonald (the
“MacDonald Agreement”). The MacDonald Agreement stated that the rights provided
therein were “supplemental and secondary” to the rights the indemnitee had against the
primary indemnitor. Defendants argued that the inclusion of the language in the
MacDonald Agreement and the exclusion of the language in the Smythe Agreement had
to be given meaning. This meaning, defendants asserted, was that the Smythe Agreement
did not make Consumer Capital’s indemnification obligation secondary. The court
disagreed, stating that despite the lack of the explicit “secondary language,” the Smythe
Agreement nonetheless evidenced clear intent to establish a secondary subrogation
relationship rather than a primary indemnification relationship. As the court stated, “the
language in MacDonald’s agreement [was] thus a better version, but the language in
Smythe’s agreement [did] the trick.”

Defendants next argued that Consumer Capital acted as a volunteer when it paid
plaintiffs’ legal expenses before entering into the above-referenced agreements, making it
ineligible for subrogation. Although the court hesitated to apply the volunteer exception,
it noted that to the extent the exception did apply, Consumer Capital did not act as a
volunteer because Consumer Capital had an existing relationship with the indemnitees
and made payment to preserve and further that relationship.
Defendants further claimed that expenses incurred by plaintiffs in connection with a bankruptcy proceeding were unrelated and not subject to indemnification. The court disagreed, noting that plaintiffs were forced to intervene in the bankruptcy action in order to protect their rights in the proceedings to which indemnification directly applied.

Defendants next argued that a fee-sharing arrangement entered into between plaintiffs and the other eight defendants in the Colorado Action (whereby plaintiffs would be responsible for 20% of the legal fees) applied in such a way that defendants’ indemnification obligation was similarly limited to 20% of the total amount of that litigation. The court agreed, noting that an allocation agreement cannot be “recut . . . so as to impose a greater burden on the third party than they would have borne themselves.”

Consumer Capital also sought to recover certain fees-on-fees in its capacity as subrogee of plaintiffs. The court noted that under Delaware law, successful enforcement of indemnification rights entitles plaintiffs to fees-on-fees and Consumer Capital’s status as subrogee was sufficient to entitle it to similar recovery. Consumer Capital sought roughly 39% of the total expenses incurred by plaintiffs when pursuing the claims as fees-on-fees. Fees-on-fees awards must be reasonably proportionate to the level of success achieved. Applying this standard, the court first halved the total expenses of plaintiffs based on the fact that one group of claims failed and the other group of claims succeeded. That halved amount was further reduced by the court to reflect the fact that roughly 20% of the total amount of expenses sought by plaintiffs in the current action was actually awarded. The court then multiplied 20% (representing the amount awarded) by 50% (representing the total expenses minus the failed claims) to reach 10%, which the court held was the proper percentage of fees-on-fees to be awarded from the total expenses and represented a reasonable amount given the degree of success achieved by plaintiffs.

Finally, the court granted pre-judgment interest only from the date at which plaintiffs asserted their rights under the relevant operating agreements. Plaintiffs claimed that such interest should accrue from the time they initially made demand for reimbursement. Defendants posited, and the court agreed, that pre-judgment interest should not be awarded from the date of a demand for reimbursement when such demand does not specify the source of promise to pay underlying the demand.

*REJV5 AWH Orlando, LLC v. AWH Orlando Member, LLC*, No. CV 2017-0708-JRS (Del. Ch. Feb. 28, 2018) (V.C. Slights)

Plaintiff REJV5 AWH Orlando, LLC’s predecessor-in-interest and defendant AWH Orlando Member, LLC entered into an LLC Agreement (the “LLC Agreement”) for the purpose of pursuing a hotel redevelopment project (the “Project”). Plaintiff and defendant’s dispute centered on plaintiff’s ability to unconditionally remove defendant as manager of the Project if the Project was not completed by a deadline described in the LLC Agreement. Defendant argued that plaintiff could not remove defendant as manager when it was plaintiff’s conduct that caused the failure to complete the Project on time. In an oral ruling on February 1, 2018 (the “Ruling), the court held that plaintiff was entitled to remove defendant as manager based on the express terms of the LLC Agreement. In
response, defendant filed an application for certification of an interlocutory appeal or, alternatively, for entry of partial final judgment.

Delaware Supreme Court Rule 42(b)(i) provides that “[n]o interlocutory appeal will be certified by the trial court or accepted by [the Delaware Supreme] Court unless the order of the trial court decides a substantial issue of material importance that merits appellate review before a final judgment.” Defendant presented seven different appeal issues to the court in its application. First, defendant argued that the court improperly applied the “prevention doctrine.” The court denied the application on this issue, holding that it only applied the prevention doctrine to the facts at hand in the Ruling and did not extend or restrict the doctrine as would be required to grant the application. Plaintiff’s second argument was that the court erroneously held that defendant was required to plead a culpable mental state for purposes of pleading bad faith in the implied covenant defense context. The court denied the application on this issue because defendant mischaracterized the Ruling. The court held that the Ruling correctly acknowledged the pleading standard for the implied covenant in Delaware, which requires that facts that support a reasonable inference that a party failed to act in a manner reasonably believed to be in the best interests of the LLC. The third, fourth, fifth and sixth appeal issues were related to the court’s interpretation of the LLC Agreement. The court denied plaintiff’s application on these issues, stating that issues of contract interpretation are not worthy of interlocutory appeal. The seventh appeal issue was in regards to the court’s refusal to find that plaintiff waived arguments that were not properly argued by plaintiff in the briefs. The court held that as this was matter within the court’s discretion, it was not an issue for interlocutory appeal. Thus, the court denied defendant’s application for certification of an interlocutory appeal. The court also denied defendant’s motion for entry of partial final judgment because there were outstanding claims and issues that needed to be resolved before entering final judgement.


In December 2017, the Delaware Supreme Court reversed the judgment of the Court of Chancery in a case where plaintiff challenged a merger (the “Merger”) between Regency Energy Partners LP (“Regency”) and Energy Transfer Partners, L.P. (“ETP”), each of which were entities in the Energy Transfer family. The Supreme Court found that plaintiff pled facts raising sufficient doubt about the Regency general partner’s ability to use certain safe harbor provisions in Regency’s Amended and Restated Limited Partnership Agreement (the “Regency LPA”) when attempting to obtain the requisite approval to consummate the Merger.

Following the Supreme Court’s decision, plaintiff filed an amended complaint asserting the following: (1) that Regency’s general partner (the “General Partner”) and its general partner (the “Regency GP” and, together with the General Partner, the “GPs”) breached the Regency LPA by approving the Merger when the GPs did not believe the merger was in the best interests of the Partnership (“Count I”), (2) that the GPs breached the implied covenant of good faith and fair dealing by approving the Merger (“Count II”), (3) that the other defendants, who were entities in the Energy Transfer family and the members of the Board of Directors of the Regency GP, aided and abetted the breach of the Regency LPA (“Count III”) and (4) that those same defendants tortiously interfered with the Regency
LPA (“Count IV”). Defendants moved to dismiss all counts. The court denied defendants’ motion to dismiss Count I and granted defendants’ motion to dismiss Counts II, III and IV.

With respect to Count I, the court found that plaintiff pled sufficient facts that made it reasonably conceivable that the GPs did not subjectively believe the merger was in the best interests of Regency. These facts included, among other things: (1) Regency had a bright future as a standalone entity and there was no need to complete the Merger to lower its cost of capital, which was the only purported benefit listed in the proxy statement; (2) the transaction was largely accretive to ETP, not Regency; (3) Regency’s conflicts committee was composed in a “musical chairs” fashion, as the members of the committee overlapped or very nearly overlapped in their service as members of Regency’s conflicts committee and as members of the Board of Directors of Sunoco, which was also a member of the Energy Transfer family; (4) the merger negotiations were compulsory and spanned no more than a week; and (5) the financial advisor pre-selected by Regency’s CFO and used by Regency’s conflicts committee provided a wide range of services to ETP and its affiliates in recent years.

In granting defendant’s motion to dismiss Count II (the implied covenant claim), the court noted that the good faith provision in the Regency LPA set a contractual standard by which to evaluate the GPs’ actions so there was no gap for the implied covenant to fill. In granting defendant’s motion to dismiss Count III (aiding and abetting), the court stated that Delaware law does not recognize a claim for aiding and abetting a breach of contract. The court noted that an exception to this rule applies where a contract creates fiduciary duties. However, the court found that the exception did not apply because the Regency LPA expressly eliminated all fiduciary duties and replaced them with a contractual good faith standard, establishing a “purely contractual relationship.” Finally, in granting defendant’s motion to dismiss Count IV (tortious interference with a contract), the court stated that simple allegations that a director caused her or his company to breach a contract is insufficient to support a tortious interference claim and that analysis would not change here merely because the General Partner, a pass-through entity, sat between the Regency GP’s Board of Directors and Regency. Further, with respect to the other non-GP and non-director defendants, plaintiff failed to allege facts from which the court could infer that defendants had the requisite mental state or took any intentional acts to tortiously interfere with the Regency LPA.


Plaintiffs, Edward M. Weil, William M. Kahane, Nicholas S. Schorsch and Peter M. Budko, served as senior officers at VEREIT, Inc (“VEREIT”), which conducted all of its business through defendant, VEREIT Operating Partnership, L.P., a Delaware limited partnership. Plaintiffs brought suit to enforce advancement rights and moved for summary judgement. The court granted partial summary judgment for plaintiffs.

Plaintiffs sought advancement under defendant’s partnership agreement (the “Partnership Agreement”) after plaintiffs were subject to civil actions, internal investigations, and government investigations as a result of financial reporting irregularities and errors in
VEREIT’s securities filings. For the purpose of summary judgment, the court divided the claims into eight categories and focused on defendant’s objections to advancement, not specific amounts due to plaintiffs. The court explained that Section 17-108 of the Delaware Revised Uniform Limited Partnership Act (“DRULPA”) gives limited partnerships wide freedom of contract with respect to indemnification and advancement schemes. The Partnership Agreement grants mandatory advancement rights “for reasonable expenses incurred by an Indemnitee who is a party to a proceeding in advance of the final disposition of the proceeding” upon the receipt of certain written affirmations. An Indemnitee is defined in the Partnership Agreement as any person “made a party to a proceeding by reason of its status as . . . a director, manager or member of the General Partner or an officer or employee of the Partnership or the General Partner.”

The court first decided whether plaintiffs could recover all of the advancements they sought with respect to the civil actions. Defendant agreed that the civil actions were covered proceedings and that some of the civil action claims were brought against plaintiffs in their covered capacity. Defendants argued, however, that some of the claims were brought against plaintiffs in their capacity as agents of VEREIT’s manager, which was not covered under the advancement provision. The court held that, despite the fact that some of the claims were brought against plaintiffs in a non-covered capacity, plaintiffs were entitled to advancement for all of the civil claims. These claims were intertwined and broadly related to plaintiffs’ actions in multiple capacities. Figuring out which claims related to plaintiffs’ covered capacities could not realistically be done without significant burden on the court, and counsel certified that it would not be practicable to differentiate. Therefore, the court said it would not determine which claims were covered and which were excluded at the advancement stage and any doubts should be resolved in favor of advancement. Even though the court held that plaintiffs were entitled to advancement for all work performed on their behalf, the court said that the fees and expenses relating to non-covered persons performed by plaintiffs’ counsel was not entitled to advancement. The court stated that “[w]hen counsel represents both covered and non-covered persons, counsel must allocate fees and expenses depending on whether the activity benefitted the party holding the advancement right.” Plaintiffs’ counsel must make a good faith determination regarding which fees would have been incurred if plaintiffs were the sole defendants compared to which fees did not benefit plaintiffs.

Next, the court denied summary judgment regarding the government investigation claims. The advancement provision in the Partnership Agreement explicitly stated that the indemnitee must be a party to the proceeding to receive advancement. At this stage in the proceedings, plaintiffs did not definitively know that they were parties to the investigative proceedings. A reasonable belief that an individual could become a target of the investigation was not enough to grant advancement. The court also found that defendant could not unilaterally impose terms on plaintiffs’ advancement rights, such as billing guidelines, litigation budgets and a mandatory discount, that were not included in the Partnership Agreement.

Defendant also argued that plaintiffs sought advancement for fees in derivative actions that had already been paid. Defendant reallocated fees previously paid to plaintiffs’ counsel for a different purpose and stated that those payments would cover “nearly all” of
the costs for the derivative actions. The court held that, under the Partnership Agreement, this type of reallocation was not allowed and summary judgment was granted for plaintiffs. In addition, defendant withheld advancement of certain fees that defendant claimed plaintiffs received from other sources. Plaintiffs did not provide details on the terms of the settlement, causing defendant to take a blanket deduction from the advancement request. Because a dispute of material facts regarding the settlement remained, the court did not decide this issue on summary judgment.

In addition to the above arguments, defendant claimed that plaintiffs’ counsel’s fees were unreasonable. Specifically, defendant alleged the rates of staff attorneys were too high, the matter was overstaffed and overworked, and the descriptions of work were too vague. The Partnership Agreement stated that advancement was provided for “reasonable expenses”. The court noted that, in determining whether fees are reasonable, it must consider the factors set for in the Delaware Lawyers’ Rules of Professional Conduct and whether the number of hours is “excessive, redundant, duplicative or otherwise unnecessary. However, it should not independently assess each amount that was charged. The court explained that it would be hazardous for a court to second guess an attorney’s judgment and, specifically in an advancement proceeding, it should not engage in a detailed, analytical review of the fees, strategy and staffing. Instead, “[p]laintiffs’ counsel must make a good faith determination regarding the fees and expenses to which its clients are entitled.”

The court decided that for legal charges going forward, the senior member of the Delaware bar representing each side would assume responsibility for the advancement process and the court laid out the Fitracts procedures for the parties to follow. Finally, the court concluded that plaintiffs were entitled to fees on fees for their successes, which the court stated were indemnification, not advancement payments. Because plaintiffs had only limited success, the award was reduced proportionately to plaintiffs’ entitlement and reasonableness.

*In re Oxbow Carbon LLC Unitholder Litigation*, C.A. No. 12447-VCL (Del. Ch. February 12, 2018) (V.C. Laster)

This case involved a dispute over the interpretation and application of provisions of a limited liability company agreement (the “LLC Agreement”) governing the forced sale of Oxbow Carbon LLC (the “Company”). When making their initial investment in the Company in 2007, two minority members of the Company (the “Minority Members”), negotiated for a liquidity right that would provide the Minority Members with the option (i) to put (the “Put Right”) their limited liability company interests (the “Units”) to the Company (the “Put”) or (ii) if the Put were rejected by the Company, to cause all members of the Company and/or the Company to sell (the “Exit Sale Right”) all, but not less than all, of the outstanding securities of the Company and/or all of the assets of the Company to a non-affiliated third-party in a bona fide arms'-length transaction equal to or exceeding Fair Market Value (as defined in the LLC Agreement) (the “Exit Sale”). The Exit Sale Right was conditioned, however, on the requirement that the other members of the Company receive 1.5 times their aggregate capital contributions, accounting for any prior distributions to such members (the “1.5x Clause”). The court found that the Minority Members had negotiated for these liquidity rights due to their
minority position in the Company and the control that William Koch (“Koch”) and certain affiliated entities (collectively with Koch, the “Majority Member”) retained over the Company and the Company’s board of directors (the “Board”).

Several years after the Minority Members made their investment, the Majority Member sought to have the Company admit two minority members, a limited liability company benefiting certain family members of Koch (the “Family LLC”) and a limited liability company benefiting certain employees of the Company (the “Executive LLC” and together with the Family LLC, the “Small Holders”), in exchange for capital contributions from the Small Holders. The Minority Members did not object to the admission of the Small Holders and the Board proceeded to authorize their admission. However, the Board failed to follow the formalities specified in the LLC Agreement for the admission of the Small Holders as members of the Company, including failing to set the terms and rights that would apply to the Small Holders.

Following the admission of the Small Holders, the relationship between the Minority Members and Koch began to deteriorate. The Minority Members sought to wrest control of the Company from Koch and pursued a path to liquidity for their Units, soliciting offers from investors, including ArcLight Capital Partners LLC (“ArcLight”). Koch resisted what he perceived as attempts to take away his control over the Company and was antagonistic towards the Minority Members and any attempted Exit Sale. The Minority Members ultimately exercised the Put Right, which the Majority Member rejected, and the Minority Members exercised the Exit Sale Right. In connection with the Exit Sale, the only offer that appeared to satisfy the Exit Sale terms, and that was also supported by the Minority Members, came from ArcLight. The Exit Sale, however, was impeded by Koch, who disrupted the sales process by presenting interpretations of the LLC Agreement that would preclude the Minority Members from forcing an Exit Sale or at the very least hinder the sales process with ArcLight. Koch also obstructed the Exit Sale by filing the suit that is the subject of this litigation.

In its opinion, the court first addressed whether the Small Holders were properly admitted as members of the Company. If they were not, then the issue over the 1.5x Clause would be moot because the 1.5x Clause was satisfied with respect to all other members. The Minority Members contended that the Board failed to obtain the necessary approvals and follow the requisite formalities when issuing Units to the Small Holders and admitting them as members. The LLC Agreement provided that the Board could admit new members to the Company on such terms as the Board determined so long as any such new member executed a counterpart signature page to the LLC Agreement. The Small Holders only provided such signature pages after litigation commenced, several years after receiving Units. Additionally, since the issuance of Units to the Family LLC was a related-party transaction, the LLC Agreement required approval by a supermajority vote of the Board (rather than the majority vote that was obtained), meaning the Minority Members’ Board representatives would have had to approve the issuance. The court noted, however, that the LLC Agreement did not provide that the issuance and admission with respect to the Small Holders would have been void if the foregoing formalities were not followed and, therefore, the admission of the Small Holders was voidable and could be validated by the equitable defense of laches. The court held that laches applied to the Minority Members and that the Small Holders were members of the Company despite
their admission not strictly complying with the formalities set forth in the LLC Agreement. In so ruling, the court found that all the parties treated the Small Holders as members of the Company after their purported capital contribution and admission—the Small Holders were listed on the Company’s financial statements, received monthly reports that went to all members and received distributions—and that the Minority Members accepted that the Small Holders were members for years and only challenged their status as members after the start of litigation.

The court next ruled on the proper interpretation of the Exit Sale provision and the 1.5x Clause considering the following options: (i) the Exit Sale could proceed without the Small Holders (the “Leave Behind Option”); (ii) the Exit Sale could not proceed without Small Holders because the provision called for a sale of all securities or assets of the Company (the “Blocking Option”); (iii) the Exit Sale could proceed only if the Small Holders received additional funds to satisfy the 1.5x Clause, either by the Minority Members, or another source, providing additional consideration to the Small Holders that would not be given to any other member (the “Seller Top Off”) or by the sale proceeds first being used to satisfy the 1.5x Clause, with the remaining proceeds going the members pro rata (the “Waterfall Top Off” and together with the Seller Top Off, the “Top Off Options”); and (iv) the Exit Sale could proceed only if each member received the highest amount needed to satisfy the 1.5x Clause for each member, since the LLC Agreement required that an Exit Sale be on the same terms and conditions for each member (the “Highest Amount Option”). The parties had previously filed summary judgment motions seeking the court’s interpretation of the 1.5x Clause and the court issued an order at that time holding that the proper interpretation of the LLC Agreement favored the Highest Amount Option. As the court more fully explained in this post-trial opinion, the Exit Sale was defined as an all or nothing sale and therefore no member could be left behind, eliminating the Leave Behind Option and leaving only the Blocking Option and consequently either the Top Off Option or the Highest Amount Option. The Top Off Option created a conflict with a provision of the LLC Agreement requiring that members receive the same terms and conditions in an Exit Sale because the Small Holders would receive greater consideration than other members as a result of the Top Off Option. This left the Highest Amount Option, which would permit the 1.5x Clause to be satisfied while providing all members the same terms in the sale offer.

The Minority Members argued, however, that under the Highest Amount Option, the Exit Sale price would be prohibitively high for ArcLight, and any other commercially reasonable party, thereby nullifying the liquidity right that the Minority Members had negotiated when they initially invested in the Company. The Minority Members therefore contended that the implied covenant of good faith and fair dealing should be applied to the LLC Agreement to permit the Top Off Option. The court agreed and held that the LLC Agreement contemplated that additional members could be admitted on such terms as determined by the Board, but the Board failed to specify precise terms and rights when admitting the Small Holders, creating a gap to be filled by the implied covenant. Had formalities been followed, there likely would have been opportunities for the parties to fill the gap that was created when the Board failed to provide clear terms in respect of the Small Holders’ Units. The court concluded that the parties would have bargained for a Seller Top Off at the time of the admission of the Small Holders, since that was what the Minority Members argued was the most commercially reasonable
option. Due to issues of compelling fairness, the court imposed on the parties the implied term of the Seller Top Off to fill the gap created when the Small Holders were admitted, i.e., the confusion over the application of the 1.5x Clause.

With the issues around the application of the 1.5x Clause resolved, the court addressed whether the Majority Member breached its obligations to use reasonable efforts to effect the sale under the Exit Sale provision. The court held that the Majority Member breached the reasonable efforts clause by purposefully seeking to obstruct, derail and delay the Exit Sale process. The court cited to, among other things, Koch (i) delaying the engagement of a bank and law firm to represent the Company with the sale, (ii) creating a constrained process for the banker and the other parties, (iii) firing employees who were viewed by him as facilitating the sale, (iv) instructing employees to depress forecasts, (v) slowing the flow of information to ArcLight and the other parties and (vi) commencing this litigation. Importantly, the court found that, but for Koch’s actions, the Company would have entered into a deal with ArcLight and the Minority Members would have received at least the value of the ArcLight offer.

The court instructed the parties to brief the issue of what remedies would be warranted as a result of the court’s rulings.


Plaintiff CompoSecure, L.L.C. sought a declaratory judgment that a marketing agreement entered into with defendant Cardux, LLC (the “Marketing Agreement”) was not properly authorized under plaintiff’s limited liability company agreement (the “LLC Agreement”) and as a result was invalid and unenforceable. Defendant counterclaimed for breach of contract, arguing that the Marketing Agreement was enforceable and that plaintiff had failed to pay amounts due thereunder.

Under the terms of the Marketing Agreement, plaintiff (a metal credit card manufacturer) had contracted with defendant (a marketing company) to help increase sales of plaintiff’s metal credit cards to large banks by developing co-branding relationships with recognizable companies. Due to industry-specific concerns, the Marketing Agreement was structured in a way that could potentially result in large windfalls for either side unrelated to such party’s performance under the contract. At the time of execution, the parties did not focus on or even recognize restrictive language in plaintiff’s LLC Agreement that provided that certain transactions could only be entered into if “at arm’s length and approved by the Board, the Investors and the Class A Majority” (the “Related Party Provision”). The Marketing Agreement clearly fell within the Related Party Provision, but no formal approvals of the Board, the Investors or the Class A Majority were obtained. After signing the Marketing Agreement, both plaintiff and defendant treated it as a valid contract and performed their duties thereunder for several months. However, disagreement eventually arose as to certain windfalls that, per the specific terms of the Marketing Agreement, were owed to defendant but that plaintiff saw as unfair and unjustified given they were arguably unrelated to defendant’s actions. Plaintiff wanted out of the deal. Eventually, this disagreement came to a head when plaintiff’s counsel sent a letter to defendant asserting for the first time that the Marketing
Agreement never received proper approval under the Related Party Provision of the LLC Agreement and was therefore invalid and void.

The court began by recognizing that the Marketing Agreement was governed by New Jersey law. Thus the threshold question was whether the validity of the Marketing Agreement should be governed by New Jersey law or Delaware law, given that the authorization issue turned on the Delaware law governed LLC Agreement itself. The court determined that the question of whether plaintiff’s agent had actual authority to sign the Marketing Agreement on behalf of the company was governed by Delaware law as a matter of the internal affairs doctrine.

The court noted that the LLC Agreement limited the ability of any agent of plaintiff to bind plaintiff to a transaction falling within the scope of the Related Party Provision. Neither party disputed this fact. Since no formal approvals were obtained as required under the Related Party Provision, the court held that the agent did not have actual authority to execute the Marketing Agreement. Plaintiff attempted to circumvent such conclusion by arguing that formal approval was unnecessary. The court noted that the Board could only approve transactions at a meeting or by written consent and neither method was employed. Furthermore, the court noted that the agent signing the Marketing Agreement on behalf of defendant should have been aware of the applicability of the Related Party Provision because he was actually party to plaintiff’s LLC Agreement, as both a member and manager. Such knowledge was therefore imputed to defendant at the time of execution. Defendant argued that even if the execution was unauthorized, it should be entitled to rely on a provision in the Marketing Agreement that provided that any person dealing with plaintiff could rely on an officer’s signature (such officer having been authorized by the Board) being conclusive evidence of such officer’s authority to sign on behalf of plaintiff and bind plaintiff to the agreement. The court disagreed, reiterating that the record showed no document evidencing that plaintiff’s agent had been authorized by the Board to execute the Marketing Agreement.

Despite the lack of actual authority for plaintiff’s agent to sign the Marketing Agreement, the court noted that the validity of the Marketing Agreement was not defeated solely as a result of improper authorization under the LLC Agreement. Delaware law distinguishes between void and voidable acts, that latter of which can be validated through equitable defenses such as ratification and acquiescence. Given that defendant invoked the doctrine of implied ratification (rather than formal ratification, which would have implicated the internal affairs doctrine under Delaware law), the court applied New Jersey law to hold that the Marketing Agreement was merely voidable because plaintiff, as an entity, had the requisite power to enter into the contract and could have done so, but for the defective authorization. Therefore, given that both parties performed under the Marketing Agreement for a substantial time following the invalid execution under the assumption it was a valid contract, the Marketing Agreement was deemed enforceable under New Jersey law because the parties had ratified the contract by their conduct.

Plaintiff attempted to counter the court’s conclusion by arguing that defendant had unclean hands because its agent acted disloyally, therefore making equitable ratification improper. The court disagreed, noting that the LLC Agreement expressly eliminated all fiduciary duties. Plaintiff responded by claiming that a contractual duty of loyalty existed
by “equating ‘good faith’ as manifested in the implied covenant of good faith and fair
dealing with ‘good faith’ as a subsidiary element of the duty of loyalty.” The court noted
that it viewed those concepts as separate and distinct (and not to be equated), further
stating in a footnote that it did not believe that Dieckman v. Regency GP LP, 155 A.3d
358 (Del. 2017) supported the use of the implied covenant as a fiduciary duty equivalent.
However, the court did not reach a final conclusion on that issue because even if a duty of
loyalty existed, it did not believe defendant’s agent breached it as a factual matter.


Nominal defendant U.S. Russian Telecommunications L.L.C., a Delaware limited
liability company (“USRT”), engaged plaintiff Dennis Reid (“Reid”) to help USRT
procure financing. After unsuccessful attempts to get financing in the United States,
USRT sought financing from the Italian government. Defendants Vincenzo Davide
Siniscalchi (“Siniscalchi”) and Giorgio Capra (“Capra”) assisted USRT in receiving this
financing. The Italian government offered to provide financing through defendant
Finmeccanica, SpA (“FIN”), which was an Italian state-controlled entity.

In his complaint, Reid argued that FIN, Siniscalchi and Capra conspired to
misappropriate the satellite project from USRT for the benefit of FIN. FIN responded by
filing a motion to dismiss on the grounds of lack of personal jurisdiction. Reid argued
that the court had personal jurisdiction over FIN through the conspiracy theory of
personal jurisdiction doctrine, alleging that FIN, Siniscalchi and Capra misrepresented
that USRT must be Italian-owned to obtain financing from the Italian government. To
satisfy this ownership requirement, Capra and Siniscalchi formed USRT Holdings,
L.L.C., a Delaware limited liability company (“Holdings”), to take control and ownership
of USRT. Reid alleged that Siniscalchi’s act of forming Holdings in Delaware to further
the conspiracy between FIN, Siniscalchi and Capra should be imputed to FIN for
purposes of determining whether there was personal jurisdiction over FIN.

In this decision, the court ruled on defendants’ motion for summary judgement on the
grounds of lack of personal jurisdiction. Defendants argued that, based on the evidence
found in discovery, the conspiracy claimed by Reid was untrue and thus the action of
forming Holdings should not be imputed to FIN for jurisdictional purposes. The court
noted that under “the conspiracy theory of personal jurisdiction, the parties to a
conspiracy are treated as each other’s agents with respect to acts in furtherance of the
conspiracy.” The court agreed that the conspiracy claimed by Reid was a sham based on
evidenced unearthed during the discovery process. The court found that Reid had not
proffered any evidence proving the essential fact in Reid’s conspiracy theory that FIN,
Siniscalchi and Capra misrepresented that USRT had to be Italian-owned to receive
financing from the Italian government. Conversely, the court found evidence that it was
Reid who proposed that USRT become Italian-owned. Additionally, FIN was not aware
that Holdings acquired USRT until after the fact because Reid took actions preventing
FIN from finding out this fact. Accordingly, FIN’s motion for summary judgement was
granted.
This case involved a dispute regarding distributions to partners of a Delaware limited partnership (the “Partnership”) pursuant to the terms of its limited partnership agreement (the “Agreement”), which provided that excess distributions in any given year would be treated as prepayment of distributions in later years. The Partnership experienced financial distress during the economic downturn in 2009 and the general partner decided to refinance the Partnership’s debt. In preparation for the refinancing, the general partner realized that, under prior leadership, it had made excess distributions to partners of the Partnership that were not treated as prepayments of distributions in later years. The general partner reclassified these distributions accordingly; thus, the limited partners were not owed any amounts in connection with the refinancing. The general partner also determined that the refinancing would result in a rather large tax liability for the owners of the general partner. Therefore, the general partner proposed an amendment to the Agreement that would allow the Partnership to apply proceeds from the refinancing to cover that liability, which amendment a majority of the limited partners approved.

Plaintiff, a trust established to hold limited partner interests in the Partnership, objected both to the reclassification of the distributions on grounds that the prepayment terms did not reflect the intent of the original agreement between the general partners and limited partners and the amendment to the Agreement on grounds that the amendment required unanimous approval of the limited partners. In this decision, the court addressed plaintiff’s motion to amend its complaint, which the court denied, and defendants’ motion to dismiss, which the court granted.

The court first addressed plaintiff’s motion to amend, which the court denied because Rule 15(aaa) does not permit a plaintiff to amend a complaint after filing an answering brief to a motion to dismiss. Plaintiff filed its answering brief and did not put forth any evidence that it uncovered new information after filing its brief. Therefore, the court denied plaintiff’s motion to amend.

The court next addressed each of the five counts of plaintiff’s complaint—one count for reformation of the Agreement, three counts for breach of contract against the general partner for enacting the amendment without unanimous limited partner approval, seeking a cash distribution from the Partnership and advancing legal fees, and one count for breach of fiduciary duty against the directors and owners of the general partner for a disclosure allegedly made in bad faith when seeking the limited partners’ approval of the amendment.

The court held that plaintiff failed to state a claim for reformation of the Agreement. Plaintiff alleged scrivener’s error, stating that the person drafting the agreement made a mistake when he included the prepayment mechanism in the Agreement. Plaintiff attempted to support those claims by noting that the general partner, while under prior leadership, made distributions without accounting for prior overpayments and that the signatory to the original Agreement verified that plaintiff’s complaint was true and correct. The court was unpersuaded. It noted that plaintiff did not explain what error was made in drafting or what the correct language in the Agreement should have been. Further, the court stated that the prepayment mechanism was clear on its face and was
included in three other distribution provisions in the Agreement, none of which plaintiff addressed. Therefore, the court dismissed plaintiff’s claim for reformation of the Agreement based on an alleged scrivener’s error. The court also addressed plaintiff’s alternative claim that defendants breached the implied covenant, noting that the Agreement spoke directly with respect to the prepayment mechanism and plaintiff offered no evidence or explanation of how defendants acted unreasonably to frustrate the fruits of the bargain evidenced by the terms of the Agreement.

The court also dismissed plaintiff’s claim that the general partner breached the Agreement by failing to receive unanimous limited partner approval of the amendment. The Agreement required unanimous approval for any amendment that would change the liability of or reduce the interests of the partners in Partnership capital, profits or losses. The amendment provided that gain from the proposed refinancing transaction would be allocated to the general partner in accordance with existing provisions of the Agreement. Because the allocations would be made in accordance with the Agreement’s existing terms, the court held that the amendment did not change the allocation of gains under the Agreement.

The court also dismissed plaintiff’s claim that the general partner breached the agreement by advancing legal fees to defendants. The Agreement provided that attorneys’ fees “may be paid as incurred” which, under Delaware case law, permits advancement of attorneys’ fees.

Finally, the court dismissed plaintiff’s breach of fiduciary duty claim. Plaintiffs alleged that the owners and directors of the general partner acted in bad faith, violating the duty of loyalty, by causing the general partner to disclose that the general partner would incur tax liability as a result of the refinancing transaction when the liability was to the owners of the general partner. The court noted that a general partner generally owes fiduciary duties to limited partners, but liability for breach may be restricted or eliminated in the limited partnership agreement. The Agreement here provided that the owners and directors were liable for actions constituting fraud, bad faith, willful misconduct or gross negligence. Plaintiff alleged bad faith of the owners and directors. The court noted that the general partner initially disclosed that the refinancing likely would not be viable in the absence of the amendment because the general partner would incur a tax liability that it would be unable to pay. The general partner subsequently clarified that the owners of the general partner were the ones that would incur the liability. The court noted that plaintiff pled no facts to support its allegation of bad faith, and therefore, the court dismissed the claim.
Plaintiff, Aloha Power Company, LLC, brought an action to compel inspection or production of certain books and records against defendant, Regenesis Power, LLC (the “Company”), under the Company’s operating agreement (the “Operating Agreement”) and Section 18-305 of the Delaware LLC Act. Plaintiff sought the following books and records: (i) copies of the Company’s balance sheet, income statement, and statement of changes in financial position from 2011 to 2017; (ii) information that was necessary for plaintiff to complete its federal and state income tax or information returns, and a copy of the Company’s federal, state, and local income tax or information returns from 2011 to 2017; (iii) minutes of all meetings of the members; (iv) copies of any powers of attorney pursuant to which the Operating Agreement or any amendments thereto were executed; (v) copies of the operating statements and general ledgers of the Company, if any, for the six most recent fiscal years; (vi) a current list of the full name and last known business or residence address of each member and economic interest owner set forth in alphabetical order, together with the capital contributions, capital account, number of units and percentage interest of each member and economic interest owner; and (vii) the Company’s books and records as they related to the internal affairs of the Company for at least the current and past four fiscal years. The court divided the books and records into two different categories—books and records that the Operating Agreement required the Company to produce without the need for demand, and books and records that required members to show a proper purpose for inspection.

Books and records that the Company was required to produce without demand included copies of the Company’s balance sheet, income statement, and statement of changes in financial position from 2011 to 2017, information necessary for plaintiff to complete its federal and state income tax or information returns, the Company’s income tax or information returns, minutes of all meetings of the members, and copies of any powers of attorney pursuant to which the Operating Agreement or any amendments thereto were executed. The Operating Agreement explicitly stated that the governing members were required to, or were required to cause the Company to, prepare and distribute these four categories of books and records and did not contain a requirement for demand from the members. The court, therefore, held that plaintiff was entitled to inspect the Company’s books and records described in clauses (i)-(iv) in the preceding paragraph.

Plaintiff requested the remaining books and records under the section of the Operating Agreement which, similar to Section 18-305, granted plaintiff access for purposes reasonably related to its interest as a member of the Company. Plaintiff argued that it required the books and records to value its membership interest, to understand the dilution of its membership interest and to investigate mismanagement. Defendant, on the other hand, claimed that the reasons given by plaintiff did not represent plaintiff’s actual purpose, which defendant claimed was to harass the Company because of a 2009 lawsuit between the parties in which defendant prevailed. The court stated that defendant did not show that harassment was the sole purpose for the request and, therefore, plaintiff was not barred from inspecting the books and records if plaintiff proved it had any proper purpose for the inspection.
Plaintiff noted that it requested operating statements and general ledgers for the six most recent fiscal years in order to assess the value of plaintiff’s membership interests in the Company. Even though assessing the value of one’s membership interest is a proper purpose, the court stated that plaintiff must establish proof that the category of books and records requested was essential and sufficient for that purpose. The court found that plaintiff did not attempt to explain why the books and records that plaintiff was already entitled to were not sufficient for assessing the value of the membership interest or why the operating statements and ledgers were necessary. Therefore, the court denied plaintiff access to the operating statements and ledgers.

For purposes of understanding the dilution of its membership interest, plaintiff requested a current list of the full name and last known business or residence address of each member and economic interest owner set forth in alphabetical order, together with the capital contributions, capital account, number of units and percentage interest of each member and economic interest owner. Defendant argued that because the dilution of plaintiff’s interest was the subject of the 2009 lawsuit, plaintiff was barred from arguing dilution as a proper purpose for requesting inspection of books and records. Defendant, however, did not provide a reason why the 2009 lawsuit, which was resolved in 2011, would bar inspections for documents related to events after the resolution. The court, therefore, held that plaintiff was entitled to books and records relating to the members and their capital contributions and ownership in order to understand the dilution of its membership interest after 2011.

Finally, plaintiff requested books and records related to the Company’s internal affairs for at least four years. Plaintiff did not explicitly state a reason that it needed these books and records, but the court speculated that it was most likely to allege mismanagement or wrongdoing. Citing *Seinfeld v. Verizon Commc’ns, Inc.*, the court stated that a general purpose to investigate possible mismanagement was not enough to warrant inspection of books and records; instead, plaintiff must present a reasonable basis for the court to infer that mismanagement or waste occurred. Plaintiff did not present a reasonable basis to infer mismanagement or waste, and the court held that plaintiff was not entitled to books and records related to internal affairs.

In addition to inspection of the Company’s books and records, plaintiff requested attorneys’ fees for this action. Even though the American Rule (i.e., that each party must pay their own attorneys’ fees) is usually applied by the Delaware courts, if an LLC’s operating agreement provides for a different allocation of the fees, Delaware courts depart from the general rule to respect the parties’ wishes. In this case, the Operating Agreement stated that the prevailing party in litigation or arbitration in a dispute between the Company and the members “shall be entitled to recover from the other party all reasonable actual fees, costs and expenses of enforcing any right of the prevailing party, including without limitation, reasonable actual attorneys’ fees and expenses.” Unless an agreement explicitly states otherwise, attorneys’ fees are awarded on an all-or-nothing basis. As a result, plaintiff was entitled to attorneys’ fees because it was the prevailing party in this action.
The parties to this action disputed who owned the equity of Cote D’Azur Estate Corporation (“Cote D’Azur”), a Delaware corporation that was converted from a Delaware LLC by defendant Dieter Walter Neupert (“Neupert”) after the death of the original equity owner of Cote D’Azur, Israel Igo Perry (“Perry”). Plaintiff, Perry’s widow, contended that her late husband owned all of the equity of Cote D’Azur at all times prior to his death, that the equity became part of his estate upon his death and passed to her, and that Neupert lacked authority to convert Cote D’Azur from a Delaware LLC to a Delaware corporation after Perry’s death. In contrast, Neupert and Cote D’Azur claimed that before Perry died, he transferred all of the equity of Cote D’Azur pursuant to a Deed of Assignment to a private Liechtenstein foundation (the “Foundation”), which in turn executed an unlimited power of attorney in favor of Neupert, which power of attorney provided him the authority to file the certificate of conversion converting Cote D’Azur from an LLC to a corporation. This decision addressed plaintiff’s motion to join the Foundation as an involuntary counterclaim plaintiff pursuant to Court of Chancery Rule 19. The court held that the Foundation should be joined “for a just resolution of the dispute” and that the Foundation was subject to service of process, as required by Rule 19, pursuant to the Delaware Long-Arm Statute by applying the elements of the Istituto Bancario conspiracy theory of jurisdiction, which it stated largely overlapped with (and therefore satisfied) the two-prong jurisdiction test that must be satisfied for the Delaware Long-Arm Statute to apply.

The court began by reciting a rather lengthy set of facts, the crux of which showed that Neupert only recently took the position that Perry transferred all of the equity in Cote D’Azur to the Foundation prior to his death pursuant to the Deed of Assignment, in contrast to emails and documents sent or drafted by Neupert both before and after Perry’s death in which Neupert took the opposite position, noting that the Deed of Assignment was never executed, the transfer of the equity never occurred and the equity remained an asset of Perry’s estate.

In examining plaintiff’s request to add the Foundation as an involuntary counterclaim plaintiff, the court noted that Cote D’Azur asserted a counterclaim seeking a declaration that the Deed of Assignment validly transferred the equity in Cote D’Azur from Perry to the Foundation and that Neupert and Cote D’Azur asserted the same in their defense of plaintiff’s claims. Therefore, if the court were to grant Cote D’Azur’s requested relief or uphold defendants’ defenses, the court would have to hold that the Foundation was the owner of the equity in Cote D’Azur. Similarly, if the court were to grant plaintiff’s requested relief, the Deed of Assignment would be called into question in order to determine who owned the equity in Cote D’Azur. The court found a substantial risk that complete relief could not be afforded in the Foundation’s absence and, therefore, the Foundation should be joined as a party if feasible.

Court of Chancery Rule 19 limits persons joined to an action to persons who are “subject to service of process.” The court noted plaintiff proposed to serve the Foundation under the Delaware Long-Arm Statute, 10 Del. C. § 3104. The application of the long-arm statute requires a two-prong analysis—first, plaintiff must satisfy the statutory requirements of the Long-Arm Statute and, second, the exercise of personal jurisdiction
must comply with the Due Process Clause of the United States Constitution (i.e., by virtue of a non-resident having sufficient “minimum contacts” with the forum state). The court noted that the Delaware Supreme Court has adopted the conspiracy theory of jurisdiction, which is rooted in the principal that one conspirator’s acts may be attributed to co-conspirators. The five prongs of this theory are enumerated in *Istituto Bancario Italiano SpA v. Hunter Engineering Company*, 449 A.2d 210, 225 (Del. 1982), which provides:

[A] conspirator who is absent from the forum state is subject to the jurisdiction of the court, assuming he is properly served under state law, if the plaintiff can make a factual showing that: (1) a conspiracy to defraud existed; (2) the defendant was a member of that conspiracy; (3) a substantial act or substantial effect in furtherance of the conspiracy occurred in the forum state; (4) the defendant knew or had reason to know of the act in the forum state or that acts outside the forum state would have an effect in the forum state; and (5) the act in, or effect on, the forum state was a direct and foreseeable result of the conduct in furtherance of the conspiracy.

The court noted that Delaware court decisions “have not explained consistently how the conspiracy theory corresponds to the two-prong jurisdictional test” but, in the court’s view, which was bolstered by its analysis of various Delaware cases, the five elements of the *Istituto Bancario* test “functionally encompass” both prongs—the first three elements encompass the statutory prong, while the fourth and fifth elements encompass the constitutional prong.

Ultimately, the court found that the factual record provided adequate support for plaintiff’s claim that the Foundation was part of a conspiracy with Neupert to deprive plaintiff of her right to the equity in Cote D’Azur. Further, the court found that acts occurred in the forum state to further the conspiracy—specifically, Neupert filed in Delaware the certificate of conversion, which converted Cote D’Azur from an LLC to a corporation and purported to install Neupert as President of Cote D’Azur, and the certificate of incorporation, which authorized the issuance of stock, and used the alleged authority conveyed by these instruments to hold a meeting of Cote D’Azur where all of the stock of Cote D’Azur was issued to the Foundation. Finally, the court found it “readily inferable” that the Foundation either knew or should have known of those forum-related acts, particularly because the Foundation, as the purported sole equity owner of Cote D’Azur, granted an unlimited power of attorney in favor of Neupert to perform all legal acts on behalf of Cote D’Azur. Therefore, the court held that the Foundation should be joined as a party.
Plaintiffs Tim and Renee Glick invested their life savings in KF Pecksland LLC (the “Company”), a shell limited liability company holding shares in The Bleachers Corporation (“Bleachers”), a failed and now defunct media streaming company owned by defendant Samuel Klein. Plaintiffs claimed they invested based on (i) fraudulent misrepresentations made by defendant regarding Bleacher’s success and future growth potential and (ii) promises made by defendant to repay any lost investment principal. Defendant took advantage of plaintiffs’ trust and lack of investing experience to convince them to buy interests in the Company and subsequently used plaintiffs’ invested money to pay for personal expenses rather than to attempt to grow the investment. The court found that plaintiffs’ primary claim was for fraudulent inducement, and on this claim the court held for the plaintiffs awarding them the full amount they invested in the Company. Since the court decided this claim under Wyoming law, it is not addressed further. In addition to the fraudulent inducement claim, plaintiffs sought damages for breach of fiduciary duty owed by defendant (as manager of the Company) directly to plaintiffs (as members of the Company).

The default fiduciary duties of loyalty and care were not modified or eliminated pursuant to the Company’s limited liability company agreement and therefore were owed by defendant (in his capacity as manager) to members of the Company. To sustain a claim for breach of fiduciary duty, plaintiffs needed to prove by a preponderance of the evidence that defendant breached a duty owed to them as members of the Company and that they suffered concrete damages as a result of such breach. Plaintiffs contended that defendant breached his fiduciary duties in four ways: (1) failing to maintain adequate books and records; (2) using Company funds as his personal checking account; (3) usurping corporate opportunities; and (4) engaging in a self-interested transaction.

According to the court, defendant’s first alleged breach of fiduciary duty, failure to maintain adequate books and records, was “egregious” and suggestive of the level of gross negligence that would sustain a breach of duty of care (and potentially a breach of good faith) claim. However, the court noted that plaintiffs were not directly harmed by defendant’s failure to maintain records and therefore could not proffer evidence regarding damages suffered directly in relation to such failure.

The court acknowledged that defendant’s second alleged breach of fiduciary duty, use of Company funds for personal gain, may have harmed the Company. However, the court reiterated that no evidence of direct harm to plaintiffs was proffered in connection with such misuse of funds.

Plaintiffs’ third alleged breach of fiduciary duty, that defendant usurped a corporate opportunity from the Company, was premised upon the fact that defendant sold his own personal interests in the Company to third party investors rather than selling actual Bleachers shares held by the Company, which would have resulted in the Company (instead of defendant) receiving consideration for the value of those shares. However, plaintiffs could not prove that any opportunity to make such sales actually existed and, in any event, plaintiffs again did not suffer direct damages as a result of such conduct.
Defendant’s fourth alleged breach of fiduciary duty, that defendant engaged in a self-interested transaction by obligating the Company to pay $6 million dollars to another entity owned by defendant, “ha[d] all the indicia of being unfair to [the Company].” Such indicia included the fact that defendant testified the transaction was being unwound. Despite this unfairness, plaintiffs did not submit any evidence quantifying any amount of direct harm suffered by them in relation to the sham transaction.

In sum, the court noted that although the “fiduciary duty claim rais[ed] many troubling issues concerning defendant’s conduct as a fiduciary” of the Company, no evidence was submitted that plaintiffs were directly harmed by such conduct. Likely due to cost considerations, plaintiffs did not seek to litigate derivative claims on behalf of the Company.

The court also disposed of ancillary negligent misrepresentation and constructive fraud claims because plaintiffs had already fully recovered under the theory of fraudulent inducement.


Plaintiff, Apogee Investments, Inc., was a member of defendant Summit Equities, LLC, a Delaware limited liability company. The only other member in defendant was Evan Seiden (“Seiden”), who was also the managing member of defendant. The LLC agreement of defendant permitted defendant to make a significant loan to Seiden. Approximately five years after plaintiff made its investment in defendant, it was notified that defendant had no assets and would be dissolved. Plaintiff served a demand on defendant requesting documents from defendant for the purpose of evaluating the loan to Seiden and investigating any wrongdoing or mismanagement by Seiden and filed a complaint after defendant failed to provide the requested documents. Plaintiff later made another demand and amended its complaint to reflect the additional demand. Plaintiff then made a third demand and filed a motion to amend its complaint again. Defendant opposed the motion, arguing that amendment would be futile because plaintiff failed to plead mismanagement and the documents plaintiff sought were nonessential to its stated purpose.

The court granted the motion to amend. Court of Chancery Rule 15(a) dictates that (1) leave to amend should be freely given when justice requires, (2) a defendant alleging the proper purpose of mismanagement faces the lowest possible burden and (3) in evaluating those allegations, the court is required to take well-plead facts as true and draw all reasonable inferences in favor of the moving party. A motion to amend may be denied, however, if the amendment would be futile, meaning it appears with reasonable certainty that the plaintiff would not be entitled to relief sought under any reasonable set of facts properly supported by the complaint. The court held that plaintiff’s allegations were sufficient to grant the motion to amend, noting that (i) plaintiff and Seiden were the only members in defendant, (ii) defendant was authorized to extend a loan to Seiden, (iii) plaintiff was advised with little notice or explanation that defendant had no assets and would dissolve and (iv) that plaintiff filed numerous demands for documents that were never provided. The court went on to find that the exculpation provision in defendant’s
limited liability company agreement did not render the amendment futile, as defendant contended, because the parties could argue at trial whether or not the alleged mismanagement was exculpated. Finally, the court rejected defendant’s claim that the documents being requested were nonessential, making the amendment futile, because that would require the court to make factual determinations that were not appropriate in considering a motion to amend.

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