LLC Member Withdrawal, Resignation or Dissociation
Effect of Withdrawal on Resigning Member and Limited Liability Company

THURSDAY, OCTOBER 24, 2013
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BREAKING-UP IS HARD TO DO
LIMITED LIABILITY COMPANY MEMBER WITHDRAWAL, RESIGNATION OR DISSOCIATION

October 24, 2013

Thomas Rutledge, Stoll, Keenon Ogden, PLLC
Marshall Paul, Saul Ewing LLP
Edward Wender, Venable LLP
DISSOCIATION/WITHDRAWAL
TOPICS OF WEBINAR

- REASONS FOR RESIGNATION/WITHDRAWAL
- ABILITY TO RESIGN/WITHDRAW
- CAN WITHDRAWING MEMBER REQUIRE PURCHASE OF INTEREST
TOPICS

- CAN LLC FORCE PURCHASE OF INTEREST
- EFFECT OF WITHDRAWAL
- CASE STUDIES
- PRACTICE TIPS
- IS THERE ANY DISTINCTION BETWEEN THE TERMS WITHDRAWAL, RESIGNATION AND DISSOCIATION?
REASONS TO WITHDRAW

- CANNOT GET ALONG WITH OTHER MEMBERS
- AVOID LIABILITY FOR BAD ACTS OF LLC OR CO-MEMBERS
REASONS TO WITHDRAW

- AVOID RESPONSIBLE PERSON/FIDUCIARY TAX LIABILITY
- AVOID OTHER STATUTORY LIABILITY
- RETIREMENT
REASONS TO WITHDRAW

- UNWILLINGNESS TO MAKE ADDITIONAL CAPITAL CONTRIBUTIONS
- DISAGREEMENT ON DIRECTION OF BUSINESS OR PLAN OF DEVELOPMENT
QUESTIONS ON WITHDRAWAL

- MAY MEMBER VOLUNTARILY WITHDRAW
  - YES
  - NO
CAN WITHDRAWING MEMBER FORCE BUYOUT (PUT)

- CAN WITHDRAWING MEMBER FORCE LLC TO REDEEM A MEMBER’S INTEREST
  - YES
  - NO
  - IF YES – WHAT IS THE PRICE?
CAN LLC FORCE SALE OF WITHDRAWN MEMBER’S INTEREST (CALL)

- DO LLC OR OTHER MEMBERS HAVE RIGHT TO PURCHASE THE WITHDRAWN MEMBER’S INTEREST
  - YES
  - NO
  - WHAT IS THE PRICE?
ABILITY TO VOLUNTARILY WITHDRAW/DISSOCIATE

- STATUTES PROVIDE DEFAULT RULE IF NOT IN OPERATING AGREEMENT
- DELAWARE – NO § 18-603 (RESIGNATION)
- MARYLAND – YES § 4A-605 (WITHDRAWAL)
- KENTUCKY – YES IF MEMBER MANAGED, NO IF MANAGER MANAGED § 275.280(3)(a)-(b) (DISSOCIATE)
- NEVADA – YES IF IN GAMING INDUSTRY (PART 463)
DISSOCIATION IN UNIFORM LLC ACT AND REVISED UNIFORM LLC ACT

- UNIFORM LLC ACT
  - Section 601 and 602 – Allow “Dissociation” by notice

- REVISED UNIFORM LLC ACT
  - Section 601 – May withdraw rightfully or wrongfully
STATE LAWS VARY

- FOR GENERAL OVERVIEW REFER TO CHART 11-2 IN RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES, (2nd E., JUNE 2013). CHART HAS SIX BASIC VARIATIONS OF LAW WITH 14 NOTES ON STATE VARIATIONS
But That Is Not How It Happens in a ...

- UPA G.P. - §§ 29, 30
  - Withdraw and dissolve the partnership
- RUPA G.P. - § 701(a)
  - Withdraw and receive the “buyout price” for interest in partnership
But That Is Not How It Happens in a

- P.S.C.
  - Withdraw and receive FMV of stock
- RULPA LP - § 603, 604
  - Withdraw and receive fair value of interest in partnership
BUYOUT RIGHT
DEFAULT RULES

- MARYLAND - OPTIONAL (DO NOT WAIT FOR THE CHECK) FAIR VALUE OR KEEP RIGHT TO DISTRIBUTIONS § 4A-606.1
- DELAWARE – FAIR VALUE WITHIN REASONABLE TIME BASED ON SHARE OF DISTRIBUTIONS § 18-604
- KENTUCKY – EVEN IF MAY WITHDRAW, NO RIGHT TO LIQUIDATING DISTRIBUTION – KRS § 275.280(4)
RIGHTS OF WITHDRAWING MEMBER

- BUYOUT OBLIGATION
  - GOVERNED BY OPERATING AGREEMENT
  - OTHERWISE GOVERNED BY STATE LAW DEFAULT RULES
BUYOUT OBLIGATION

- Uniform LLC Act
  - Section 701(a) A Member of an at-will company’s distribution interest shall be purchased for its fair value if the dissociation does not otherwise result in dissolution or winding up.

- Revised Uniform LLC Act
  - Section 603(a) Subject to Section 504 (relating to death) and Article X (mergers etc.), any transferrable interest remains held as transferee.
EFFECT OF WITHDRAWAL

UNLESS OPERATING AGREEMENT PROVIDES OTHERWISE

- NO MANAGEMENT RIGHTS
- NO INFORMATION RIGHTS
- ASSIGNEE
EFFECT OF WITHDRAWAL ON TAX LIABILITY

- EFFECT ON LIABILITY
  - FIDUCIARY TAXES
  - INCOME TAX LIABILITY
QUESTIONS ON RIGHTS OF WITHDRAWING MEMBER

- DOES WITHDRAWING MEMBER OF RIGHT TO INFORMATION ABOUT THE LLC GRANTED TO MEMBERS?
- DOES WITHDRAWING MEMBER HAVE ANY VOTING RIGHTS – CAN THE MEMBERS AMEND THE LLC AGREEMENT TO ELIMINATE THE WITHDRAWING MEMBER’S INTEREST
- WHAT RIGHTS, IF ANY, REMAIN.
CASE STUDIES

- LIEBERMAN v. WYOMING.COM
  82 P.3d 274
  - MEMBER RESIGNED AND WANTED FAIR VALUE FOR INTEREST
  - NO BUY OUT RIGHT IN OP AGT
  - HELD ASSIGNEE HOLDER OF ECONOMIC INTEREST – NO RIGHTS BUT DO NOT LOSE INTEREST IN DISTRIBUTIONS
BRICK PROFESSIONAL, L.L.C. v. NAPOLEON
2009 WL 2176699 (N.J. 2009)

- OPERATING AGREEMENT CONTROLS OVER STATUTE
  - REQUIRED ELECTION TO SUCCEED TO INTEREST ON DEATH
  - OTHERWISE BOUGHT OUT (STATUTE PROVIDES FOR AUTOMATIC ASSIGNMENT).
  - ENFORCED OPERATING AGT
SHOWELL v. PUSEY
2011 WL 3860419 (Del 2011)

- PARTNER IN ACCOUNTING FIRM RETIRED FROM PRACTICE
  - OPERATING AGREEMENT HAD PROVISIONS FOR RETIRING EVENTS (BUT STOPPING PRACTICE WAS NOT A RETIRING EVENT)
  - DEL STATUTE – GET PERCENTAGE OF GOING CONCERN VALUE (DEFAULT RULE)
– OP AGT USES LIQUIDATION VALUE FOR RETIRING EVENT
– MEMBERS AGREED TO PERMIT HOYT TO “RETIRE” BUT DID NOT AMEND RETIRING EVENT LANGUAGE
– COURT GAVE HOYT LIQUIDATION VALUE BY INTERPRETING THE OP AGT AND THE AGT TO PERMIT RETIREMENT
KINKLE v. R. D. C., L.L.C.  
889 So. 2d 405 (2004)

- MEMBER DIED
  - OP AGT. ALLOWED FOR CONTINUATION AFTER DEATH AND DEATH OTHERWISE WAS A LIQUIDATION EVENT
  - MEMBERS ELECTED TO CONTINUE AND CLAIMED DECEASED MEMBER COULD BE BOUGHT OUT AT LIQUIDATION VALUE
– CANNOT PICK AND CHOOSE – IF CONTINUE FORMER MEMBER IS ASSIGNEE
OTT v. MONROE 282 VA. 403 (2011)

- Daughter who inherited was only an assignee
- Provision in operating agreement that allowed for assignment of membership interest on death did not operate to make her a member
- Father had a controlling interest in the LLC
- Daughter had no mgt rights and could not remove managing member
WILLIAMS v. HEINS, MILLS & OLSON, PLC (not reported) 2010 WL 3305017 (Minn.)

- Lawyer resigned from firm.
- Sought to maintain an action for buyout of interest based on fraud.
- Held not a member and therefore could not maintain an action.
BLYTHE v. BELL
2012 WL 6163118

- Court concluded no enforceable Operating Agreement.
- Member “assigned” its interest to other existing members without obtaining consent of other members.
- NC law 57C-5-04(a) requires unanimous consent for admission of an assignee as a member.
NC LLC Law provides:

- Upon assignment, former member ceases to be a member.
- An assignee may become a member only with unanimous consent of members (absent a contrary provision in operating agreement).
- Does not allow for voluntary withdrawal.
Fancher v. Prudhome
112 S. 3d 909 (La. 2013)

- Three person LLC.
- Two of three members entered into a Loan Agreement and other agreements without the knowledge of the third member (Fancher).
- Fancher wanted to withdraw and force a purchase of his interest.
- LA. law provides withdrawing member is entitled to receive fair market value for its interest as of date of withdrawal.
- **COURT HELD:**
  - Member assignor ceases to be a member upon assignment if assignment to an existing member.
  - Member assignor does not cease to be a member upon assignment to a party that is not a member.
  - Assignment could result in change of control.
• Lower court used book value (minority interest was not marketable) - $12,463.74
• Lower court’s decision was affirmed – even though the LLC had $500,000 in cash and made distributions of $166,000 to other members.
• Operating Agreement provided ability to dissociate defaulting members and a formula for valuing the interest.
Park Regency, LLC v. R & D Development of the Carolinas, LLC
741 S.E. 2d 528 (S.C. 2012)

- Members of LLC sought to force dissociation of a member.
- Bought a property as tenants in common and TIC Agreement was the “de facto LLC Agreement.”
- LLC Agreement provided ability to dissociate defaulting members and a formula for valuing the defaulting member’s interest.
PRACTICE POINTS

- AVOID DISAGREEMENTS –
  - DISPUTE RESOLUTION
    - MEDIATION
    - ARBITRATION
    - EXPERT RESOLUTION
- BUY – SELL DISPUTE RESOLUTION
  - PUT/CALL
  - RUSSIAN ROULETTE
- REQUIRE AGT. FOR MAJOR ACTIONS
- Member defaulted in honoring financial obligations.
- Held LLC Agreement is an enforceable contract.
- Lower court crafted an “equitable” result – not based solely on dissociation provision.
- Decision affirmed with slight modification.
CASE LAW LESSONS

- ABSENT PROVISIONS IN THE OPERATING AGREEMENT, WITHDRAWING MEMBER WILL HAVE FEW RIGHTS.
- VALUATION OF THE INTEREST MAY NOT BE SIMPLE.
- RESULTS OF LITIGATION ARE UNPREDICTABLE – COURTS ARE NOT EXPERTS IN LLCs.
PRACTICE TIPS

- Know default rules before withdrawing.
- Advise client of rights of assignee and right to payment.
- Have compelling reasons to withdraw if substantial undistributed income.
- Try to prevent situations from occurring that might lead a member to want to withdraw.
IF PERSONAL SERVICES – PROVIDE FOR RETIREMENT

- PROVIDE FORMULA FOR BUY OUT
  - Book Value
  - Fair Market Value (discounts taken)
  - Fair Value (no discounts taken)
  - Appraise assets and get proportional interest.
  - Terms for Payment (note – security)
  - Other formula (multiple of earnings)

- INSURANCE FOR BUY OUT ON DEATH OR DISABILITY
- INSURANCE FOR BUY OUT ON DEATH OR DISABILITY
- PAY OUT FOR UNDISTRIBUTED EARNINGS
- SELECT METHOD OF APPORTIONING PROFITS AND LOSSES FOR YEAR OF WITHDRAWAL
PROVIDE FOR DISPUTE RESOLUTION MECHANISMS

- REVIEW DECISIONS – SAME MAY REQUIRE RESOLUTION BUT NOT TRIGGER BUY/SELL RIGHTS AND OTHERS ARE “MAJOR”

- MAJOR DECISIONS COULD INCLUDE:
  - SALE OR TRANSFER
  - APPROVAL OF BUDGET
  - APPROVAL OF NEW MEMBER
  - INTERESTED TRANSACTIONS
  - ADDITIONAL CAPITAL CALLS
Potential Dispute Resolution Mechanisms:
- Binding Expert Decision
- If disagree, decision is not implemented
- Trigger for Buy/Sell
- Trigger other marketing or other exit strategy
- Trigger put/call right
PROVIDE PROTECTIONS FROM OPPRESSION

PROTECTIONS FROM OPPRESSION

- SUPER-MAJORITY VOTE FOR CERTAIN ACTIONS

- RESTRICTIONS ON AUTHORITY OF MANAGER/MANAGING MEMBER
- PROVIDE CLARITY WITH RESPECT TO FIDUCIARY DUTIES (IF POSSIBLE)
  - Time devoted to business
  - Ability to engage in competitive/other businesses
  - Limit fiduciary duties

- DISTRIBUTIONS
  - Who controls timing and amount of distributions
  - Provide for tax distributions
PROVIDE FOR DEATH AND OTHER EVENTS THAT MAY LEAD TO WITHDRAWAL

- RIGHT TO BECOME REPLACEMENT MEMBER
- BUY-OUT/ADMISSION OF NEW MEMBER ON DEATH OR DISABILITY
- BUY OUT UPON TERMINATION OF EMPLOYMENT AND OTHER EVENTS WHICH DEAL WOULD DIVIDE INTERESTS OF MEMBERS
THANK YOU

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