

Exit Strategies in LLC Agreements: Member Withdrawal, Resignation or Disassociation

Structuring Exit Mechanisms to Maximize LLC Value and Uphold Member Fiduciary Obligations

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YOUR DELAWARE ADVANTAGE

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March 16, 2017

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Delaware Limited Liability Companies

- LLC Act Promotes Freedom of Contract
 - Section 18-1101(b): “It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.”
- Flexibility in Structuring LLCs
 - Exit strategies begin with careful planning and drafting prior to becoming a member.



Drafting Considerations

- Terminology under the Delaware LLC Act
 - Withdrawal and Disassociation not used
- Principles of Contract Interpretation
 - Ambiguous language
 - *Contra Proferentem*



Potential Reasons for Resigning form an LLC

- Monetize investment
- Disagreements with members
- Retirement
- Purpose of LLC Completed



Resignation

- A person's effective resignation as a member terminates that person's membership in a Delaware limited liability company.
 - The LLC Act uses the term “resignation” to signify a person's autonomous withdrawal from the company.
 - Absent a modifying provision in the limited liability company agreement, the statutory rules relating to a member's resignation apply to any transaction of this nature, whether labeled as a “resignation,” as a voluntary “withdrawal,” or otherwise.



Voluntary Resignation

- LLC Act provides, notwithstanding anything to the contrary under applicable law, that a member may not resign from a Delaware limited liability company before the company's dissolution and winding up, unless the limited liability company agreement provides otherwise.



Permitted Resignations

- The limited liability company agreement may confer on a member the unconditional right to resign from the company.
- Any right or power to resign, whether contingent or absolute, must be exercised in accordance with the terms of the limited liability company agreement.



Effect of Resignation on Member

- Default Rule

- Section 18-604 of the Delaware Limited Liability Company Act:

- Except as provided in this subchapter, upon resignation any resigning member is entitled to receive any distribution to which such member is entitled under a limited liability company agreement and, if not otherwise provided in a limited liability company agreement, such member is entitled to receive, within a reasonable time after resignation, the ***fair value of such member's limited liability company interest as of the date of resignation based upon such member's right to share in distributions from the limited liability company.***

- Cessation of Rights



Effect of Resignation on LLC

- What happens to the LLC Interest?
- Dissolution Risk



What Happens if Member cannot Resign?

- Other Relevant Default Rules of LLC Act for Exiting LLCs
 - Assignment of LLC Interest
 - Removal of a Member
 - Bankruptcy of a Member
 - Death or Dissolution of Member
- Deadlock
 - Judicial Dissolution



Assignment of LLC Interest

- Restrictions on Assignment
- Minority Protections Related to Exit Strategies
 - Tag Along Rights
 - Appraisal Rights
 - Approval Rights



Restrictions on Assignment

- LLC Act Default Rules

- Limited liability company agreement may modify the statutory default rule that a limited liability company interest is assignable in whole or in part. The limited liability company agreement may provide that a limited liability company interest may not be assigned prior to the dissolution and winding up of the limited liability company.

- Addressing Restrictions on Exit



Minority Protections Related to Exit Strategies

- Tag Along Rights
- Appraisal Rights
- Approval Rights
- Drafting Considerations



Removal of Member

- Default Rules of LLC Act

- The LLC Act does not expressly grant a right to remove or expel a member. Under the statute, however, “expulsion” is recognized as an event that may terminate a person’s membership.
- The Delaware Court of Chancery has stated that there is no basis at law, apart from a contract provision, for the removal or expulsion of a member of a Delaware limited liability company by other members.
- The LLC Act specifically permits parties to include in the limited liability company agreement a provision that makes a member “subject to specified penalties or specified consequences,” irrespective of whether there has been a breach of the agreement by that member.



Consequences of Removal of Member

- Loss of membership may be one of the consequences specified in the limited liability company agreement.
- Diminution or loss of management and voting rights and powers.
- Dissolution Risk for LLC



Bankruptcy of a Member

- The DLLC Act defines “bankruptcy” as “an event that causes a person to cease to be a member as provided in § 18-304” of the statute.
- Section 18-304 of the LLC Act provides that a person ceases to be a member of a Delaware limited liability company, unless the limited liability company agreement otherwise provides, or with the consent of all members upon happening of certain events.



Death or Dissolution of Member

- Default Rule

- Section 18-705 of the Delaware Limited Liability Company Act:

- If a member who is an individual dies or a court of competent jurisdiction adjudges the member to be incompetent to manage the member's person or property, 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. If a member is a corporation, trust or other entity and is dissolved or terminated, the powers of that member may be exercised by its personal representative.

- Should Death or Dissolution be a resignation event?



Deadlock

- Default Rule

- Section 18-802 of the Delaware Limited Liability Company Act:

- On application by or for a member or manager the Court of Chancery may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement.



Certain Non-Exit Actions under LLC Act

- Pledges of LLC Interests
- Delegation of Management



Fiduciary Duty Considerations in Exit Transactions

- Default Rules of LLC Act
- Conflicts of Interest
- Modification of Fiduciary Duties



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