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Dissociation of a Member from a Louisiana Limited Liability Company: The Need for Reform

*Susan Kalinka**

The Louisiana Limited Liability Company (“LLC”) Law has no comprehensive provision concerning the dissociation of a member. “Dissociation” is a term of art used by a number of LLC and partnership statutes to refer to a change in the relationship between a member and the LLC.¹ In some cases, the dissociation of a member can terminate all of the rights and responsibilities that attach to a member’s interest. In other cases, dissociation will result in the termination of a member’s right to participate in the business of the LLC or to exercise any of the rights of a member other than the right to share in the LLC’s profits, losses, and distributions.

Unlike the LLC acts of many states,² the Louisiana LLC Law does not include a comprehensive statute designating events that may trigger the dissociation of a member. Instead, the LLC Law

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1. Unif. Ltd. Liab. Co. Act § 601 cmt. (amended 1998), 6A U.L.A. 609 (2003).

2. *See, e.g.*, Ala. Code § 10-12-36 (1999 & Supp. 2004); Ariz. Rev. Stat. Ann. § 29-733 (1998 & Supp. 2004); Ark. Code Ann. § 4-32-802 (2001); Ga. Code Ann. §§ 14-11-601, 14-11-601.1 (2003); Haw. Rev. Stat. § 428-601 (2004); Idaho Code Ann. § 53-641 (1994); 805 Ill. Comp. Stat. Ann. 180/35-45 (2004); Ind. Code Ann. § 23-18-6-5 (West 2005 & Supp. 2005); Ky. Rev. Stat. Ann. § 275.280 (West 2003); Me. Rev. Stat. Ann. tit. 31, § 692 (1996 & Supp. 2004); Minn. Stat. Ann. § 322B.306 (West 2004); Mo. Rev. Stat. § 347.123 (2001 & Supp. 2005); Mont. Code Ann. § 35-8-803 (2003); N.H. Rev. Stat. Ann. § 304-C:27 (2005); N.J. Stat. Ann. § 42-2B-24 (West 2004); N.M. Stat. Ann. § 53-19-38 (Lexis 1978 & Supp. 2001); N.C. Gen. Stat. § 57C-3-02 (2003); N.D. Cent. Code § 10-32-30 (2001); Ohio Rev. Code Ann. § 1705.15 (1994 & Supp. 2005); Or. Rev. Stat. Ann. § 63.265 (West 2003 & Supp. 2005); S.C. Code Ann. § 33-44-601 (Supp. 2004); S.D. Codified Laws § 47-34A-601 (2000); Vt. Stat. Ann. tit. 11, § 3081 (1997); Va. Code Ann. § 13.1-1040.1 (1999 & Supp. 2004); Wash. Rev. Code Ann. § 25.15.130 (West 2005); W. Va. Code § 31B-6-601 (2003); Wis. Stat. Ann. § 183.0802 (West 2002 & Supp. 2004).

provides individual statutes designating several dissociation events and the effects of such dissociation.³ The current dissociation statutes under the Louisiana LLC Law are problematic. This article discusses some dissociation events that are not, but should, be included in the Louisiana LLC Law and discusses the problems that may arise under the current rules.

Many, if not most, LLCs are classified as partnerships or, in the case of a single-member LLC, as an entity that is disregarded as a separate entity from its member, for federal and state income tax purposes.⁴ A partnership does not pay tax on its income.⁵ Instead, each partner reports its share of the partnership's items of income, gain, loss, deduction, and credit on the member's federal income tax return.⁶ The uncertainty as to whether or under what circumstances a member's economic rights in a Louisiana LLC may terminate can create obvious problems in accounting for and reporting each member's share of the LLC's income.⁷ Because there is some uncertainty as to whether a member can be expelled from an LLC, there are cases where a member will continue to share in the profits of and distributions from an LLC without performing services that had been expected by the other members, but not explicitly required under the terms of a written operating agreement.⁸

3. See La. R.S. 12:1325 (voluntary withdrawal of a member), 1333 (death, interdiction, dissolution, or termination of a member) (1994 & Supp. 2005).

4. A business entity that is not classified as a corporation under Treasury Regulation section 301.7701-2(b) is classified as a partnership if the entity has two or more members, or as an entity that is disregarded as an entity separate from its owner if the entity has only one owner, unless the entity elects to be classified as a corporation for federal tax purposes. Treas. Reg. § 301.7701-3 (as amended in 2005). An unincorporated business entity organized under the laws of the United States or any state generally is not classified as a corporation under Treasury Regulation section 302.7701-2(b). Thus, a domestic LLC is classified as a partnership for federal tax purposes if it has two or more members and a disregarded entity if it has only one member. An LLC is classified as a partnership or a disregarded entity for state income tax purposes if it is classified as such for federal tax purposes. La. R.S. 12:1368 (1994).

5. I.R.C. § 701 (2005).

6. *Id.* §§ 701, 702(a).

7. See, e.g., Susan Kalinka, *Assignment of an Interest in a Limited Liability Company and the Assignment of Income*, 64 U. Cin. L. Rev. 443 (1996) (discussing some of the tax accounting problems that may result on the dissociation of a member).

8. The author has served as a consultant in two cases involving an LLC that offered professional services where the operating agreement provided that

There is no provision in the Louisiana LLC Law that triggers the termination of all of a member's rights and responsibilities on the bankruptcy of the member, the expulsion of a member, or the sale of the member's entire interest in the LLC. Under the Louisiana LLC Law, a member may voluntarily withdraw from an LLC and receive a distribution in an amount equal to the fair market value of the member's interest.⁹ The Louisiana LLC Law also provides that a member's management rights terminate on the death, interdiction, dissolution, or termination of a member.¹⁰ However, the member's economic interest in the LLC continues after the death, interdiction, dissolution, or termination of the member and are assigned to the former member's legal representative or successor in interest.¹¹

The lack of a comprehensive dissociation statute can create uncertainties and problems for persons who deal with an LLC, and for LLCs, LLC members, and families of LLC members. While an LLC's articles of organization or operating agreement may provide that all of a member's rights and responsibilities terminate on the occurrence of certain events, there is no guarantee that a court will enforce such a provision, especially in the case of the bankruptcy, death, interdiction, dissolution, or termination of a member.

Before it was amended in 1997, section 12:1334(3) of the Louisiana Revised Statutes provided that, unless otherwise provided in the LLC's articles of organization or a written operating agreement, an LLC dissolved on "[t]he death, interdiction, withdrawal, expulsion, or dissolution of a member or the occurrence of any other event which terminate[d] the continued membership of a member" in the LLC unless within ninety days after the event, the LLC was continued by the unanimous consent

all of the LLC's profits, losses, and distributions would be shared equally by the members. In each case, the operating agreement contained no provision that would prohibit a member from receiving distributions if the member ceased to provide services for the LLC.

9. See La. R.S. 12:1325(B)-(C) (1994 & Supp. 2005) (member of an LLC that is not entered into for a term may withdraw upon thirty days written notice and receive distribution from the LLC). The rights of a member to withdraw from an LLC that is entered into for a term (a "term LLC") are more limited. The provisions of the Louisiana LLC Law concerning the withdrawal or resignation of a member are discussed *infra* notes 255-332 and accompanying text.

10. La. R.S. 12:1333 (1994).

11. *Id.*

of the remaining members.¹² Under the former law, the events that triggered the termination of a member's membership in the LLC could cause the LLC to dissolve. Presumably, the dissolution of an LLC would terminate both the management and economic interests of each of the LLC's members.¹³ However, even under the former law, it was not certain whether the termination of a member's membership in the LLC terminated both the management and economic rights of the member if the other members consented to continue the LLC after the dissociation event.

Section 12:1334(3) was included in the Louisiana LLC Law to ensure that a Louisiana LLC would be treated as a partnership for federal tax purposes under former Treasury regulations that required an LLC to lack certain "corporate characteristics" to achieve partnership tax status.¹⁴ Under Treasury regulations issued in 1977, an unincorporated organization was classified as a partnership for federal tax purposes if the organization lacked two of the following four "corporate characteristics:" (1) continuity of life; (2) centralization of management; (3) limited liability; and (4) free transferability of interests.¹⁵ For this purpose, an organization lacked continuity of life if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member would cause a dissolution of the organization unless the remaining members agreed to continue the organization.¹⁶

In 1996, the United States Treasury Department issued the so-called "check-the-box" regulations, under which a domestic LLC is automatically classified as a partnership for federal tax purposes, regardless of whether the LLC has corporate characteristics, unless the LLC elects to be classified as a corporation.¹⁷ Because it was

12. La. R.S. 12:1334(3) (1994), *repealed by* 1997 La. Acts No. 717, § 2.

13. *See* La. R.S. 12:1336-1337 (1994) (requiring the winding up of an LLC's affairs and the distribution of its assets after dissolution of the LLC).

14. Former Treas. Reg. § 301.7701-2(a)-(b), T.D. 7515, 42 Fed. Reg. 55612 (Oct. 18, 1977) (as amended by T.D. 7889, 48 Fed. Reg. 18804 (Apr. 26, 1983)) (as amended by T.D. 8475, 58 Fed. Reg. 28501 (May 14, 1993)) (as amended by T.D. 8697, 61 Fed. Reg. 66584 (Dec. 18, 1996)). In 1994, the Internal Revenue Service ruled that an LLC formed under the former Louisiana LLC Law was classified as a partnership under the former regulations. Rev. Rul. 94-5, 1994-1 C.B. 312. *See* Susan Kalinka, Limited Liability Companies and Partnerships: A Guide to Business and Tax Planning §§ 4.2-4.11, in 9 Louisiana Civil Law Treatise 449 (3d ed. 2001 & Supp. 2005).

15. Former Treas. Reg. § 301.7701-2(a) (1977).

16. Former Treas. Reg. § 301.7701-2(b).

17. Treas. Reg. §§ 301.7701-1 to .7701-3, T.D. 8697, 61 Fed. Reg. 66584 (Dec. 18, 1996).

no longer necessary for a Louisiana LLC to lack corporate characteristics to be classified as a partnership, the Louisiana Legislature was able to ensure that the dissociation of a member would not interrupt an LLC's business operations by repealing former section 12:1334(3). When it repealed section 12:1334(3), however, the Louisiana Legislature failed to enact a statute concerning the effect of the expulsion or bankruptcy of a member. The Louisiana LLC Law never has included a provision terminating a member's management rights on the sale or exchange of the member's entire economic interest in an LLC. These omissions in the law can create significant problems for persons owning interests in and operating an LLC.

This article compares the current provisions (or lack thereof) in Louisiana LLC Law with the dissociation provisions of the Prototype Limited Liability Company Act ("Prototype Act")¹⁸ and the Uniform Limited Liability Company Act ("ULLCA").¹⁹ The Prototype Act was drafted in 1992 by the Working Group on the Prototype Limited Liability Company Act of the Subcommittee on Limited Liability Companies of the Committee on Partnerships and Unincorporated Business Organizations of the American Bar Association's Section of Business Law. The provisions of the Prototype Act are written as default provisions. In other words, many of the statutes begin with the words, "Except as otherwise provided in the articles of organization" or "Except as provided in the articles of organization or a[n] [written] operating agreement,"²⁰ or otherwise allow the members of an LLC to alter the statutory rules by a provision in the articles of organization or an operating agreement. Under the Prototype Act, the parties may alter the provisions under the Act affecting the management of the LLC's affairs, the conduct of its business, and the relationships among the members by including a different provision in the LLC's articles of organization or an operating agreement.

Neither the House of Delegates and the Board of Governors of the American Bar Association ("ABA") nor the Sections or

18. Prototype Ltd. Liab. Co. Act (Working Group on the Prototype Ltd. Liab. Co. Act, Am. Bar Assoc. Proposed Draft 1992), *reprinted in* 3 Larry E. Ribstein & Robert R. Keatinge, Ribstein and Keatinge on Limited Liability Companies App. C-1 (2d ed. 2004).

19. Unif. Ltd. Liab. Co. Act § 103(a) (amended 1998), 6A U.L.A. 567 (2003).

20. Prototype Ltd. Liab. Co. Act (Working Group on the Prototype Ltd. Liab. Co. Act, Am. Bar Assoc. Proposed Draft 1992), *reprinted in* 3 Larry E. Ribstein & Robert R. Keatinge, Ribstein and Keatinge on Limited Liability Companies App. C-1 (2d ed. 2004).

Committees of the ABA ever approved the Prototype Act or the policies discussed in the drafters' comments to the Prototype Act. Nevertheless, a number of states have used the Prototype Act as a model in drafting their LLC statutes.²¹

The National Conference of Commissioners on Uniform State Laws adopted the ULLCA in 1994 and the amendments made to the ULLCA in 1995 and 1996.²² Like the Prototype Act, the ULLCA was drafted to allow the parties flexibility; the ULLCA provisions also are written as default rules.²³ As of this writing, several states have adopted the ULLCA.²⁴

The basic theory underlying the dissociation statutes is the principle of *delectus personae*, that partners have the right to choose their associates.²⁵ The principle is especially important in the context of a general partnership because such partnerships tend to be closely held and managed by their owners.²⁶ The act of any partner in the ordinary course of the partnership's business

21. The drafters of the Louisiana LLC Law relied, in part, on the Prototype Act as a model for many, but not all, of the Louisiana statutes.

22. Carter G. Bishop, *The Uniform Limited Liability Company Act: Summary & Analysis*, 51 Bus. Law. 51 (1995-96). The ULLCA was amended in 1996 to give more flexibility to LLC members after the Internal Revenue Service announced its proposal to issue the check-the-box regulations, easing the rules for classifying domestic LLCs as partnerships. I.R.S. Notice 95-14, 1995-1 C.B. 297.

23. Unif. Ltd. Liab. Co. Act § 103(a) (amended 1998), 6A U.L.A. 567 (2003). The ULLCA, however, provides that there are certain rules that may not be altered by an agreement of the members. The rules that an operating agreement may not alter include provisions that: (1) unreasonably restrict the right of a member or an assignee to information or access to records; (2) eliminate certain fiduciary duties and the good faith requirement of members and managers; (3) vary a member's right to seek judicial dissociation of another member for certain types of conduct; (4) vary the requirement to wind up the LLC's business because it is unlawful to operate the business or to allow a member or an assignee to seek judicial dissolution of the LLC in certain cases; or (5) restrict the rights of a person, other than a manager, member, and transferee of a member's interest. *Id.* § 103(b), 6A U.L.A. 567-68 (2003).

24. The states that have adopted the ULLCA include Hawaii, South Carolina, South Dakota, Vermont, and West Virginia. Haw. Rev. Stat. § 428-101 to -1302; Mont. Code Ann. § 35-8-101 to -1307; S.C. Code Ann. § 33-44-101 to -1208; S.D. Codified Laws § 47-34A-101 to -1207; Vt. Stat. Ann. tit. 11, § 3001-3184; W. Va. Code § 31B-1-101 to -13-1301.

25. 2 Alan R. Bromberg & Larry E. Ribstein, *Bromberg and Ribstein on Partnership* § 7.01(a) (Supp. 2004).

26. *Id.*

generally binds the partnership.²⁷ Moreover, the act of one partner may cause each of the other partners to incur personal liability because each partner in a general partnership is personally liable for a virile share of all partnership debts and obligations.²⁸

The principle of *delectus personae* may be less compelling in the LLC context because members of an LLC are not personally liable for the debts or obligations of the LLC.²⁹ Nevertheless, the LLC acts of a number of states include comprehensive dissociation provisions because, in many cases, LLCs, like general partnerships, tend to be closely held, member-managed, and acts of each member of a member-managed LLC generally are binding on the LLC.³⁰

Like the Prototype Act and the ULLCA, the Louisiana LLC Law is drafted, in large part, to provide default rules that may be altered by a provision in the LLC's articles of organization or an operating agreement.³¹ Indeed, the Louisiana Legislature's stated policy in enacting the Louisiana LLC Law is to give maximum effect to the principle of freedom of contract.³² Thus, it would seem that the members of an LLC could establish any rules they prefer concerning the causes of and effect of the dissociation of a member in the LLC's articles of organization or a written operating agreement. However, it is likely that many Louisiana LLCs will not have detailed operating agreements that take into account the lack of a dissociation statute in the Louisiana LLC Law.

Many Louisiana LLCs are closely held business organizations formed by unrelated persons. In many cases, the members of closely held LLCs are unable or unwilling to incur the cost of counsel to draft an operating agreement that is most suitable for such an organization. Most written operating agreements are lengthy and complicated because they contain rules intended to comply with the federal tax regulations

27. See La. Civ. Code art. 2814 ("partner is a mandatary of the partnership for all matters in the ordinary course of its business other than the alienation, lease, or encumbrance of partnership immovables").

28. La. Civ. Code art. 2817.

29. La. R.S. 12:1320(B) (1994).

30. See La. R.S. 12:1317(A) (1994) (each member of a member-managed LLC is a mandatary of the LLC for all matters in the ordinary course of the LLC's business other than the alienation, lease, or encumbrance of its immovables).

31. La. R.S. 12:1315(A) (1994).

32. La. R.S. 12:1367(B) (1994).

concerning the allocation of an LLC's items of income, gain, loss, deduction, and credit among the members.³³ Individuals often avoid entering into operating agreements because they cannot understand the language of the documents. The Louisiana LLC Law should be drafted to include provisions that most small business owners would prefer,³⁴ particularly with respect to the addition and dissociation of members with whom the owners must work.

The Louisiana LLC Law should be amended to include a comprehensive provision delineating the events that may trigger the dissociation of a member from the LLC and the consequences of dissociation. The law concerning the dissociation of a member should be drafted, to the greatest extent possible, to give LLC members flexibility in negotiating the terms of the voluntary or involuntary dissociation of a member. This article discusses some of the problems that may arise under the current statute in cases involving the bankruptcy of a member, the expulsion of a member, the sale of all of a member's economic interest in the LLC, the voluntary withdrawal of a member, and the death, interdiction, dissolution, or termination of a member. This article also suggests that the Louisiana LLC Law should be amended to reduce the potential problems for closely held LLCs that result under the LLC law provisions (or lack thereof) concerning the dissociation of a member.

33. A glance at the number of pages of Treasury regulations concerning the many intricate rules governing allocations of items of income, gain, loss, deduction, and credit of an entity classified as a partnership gives the reader an indication of the amount of space that must be devoted to allocations in an operating agreement. *See* Treas. Reg. §§ 1.704-1, 1.704-2, 1.704-3, 1.704-4 (as amended in 2005). *See also* Susan Kalinka, *Limited Liability Companies and Partnerships: A Guide to Business and Tax Planning* §§ 5.10-5.14, 5.37-5.48, 5.50-5.53, in *9A Louisiana Civil Law Treatise* 28, 98, 160 (3d ed. 2001 & Supp. 2005).

34. General Considerations Underlying the Prototype Limited Liability Company Act Project, *reprinted in* 3 Ribstein & Keatinge, *Limited Liability Companies*, *supra* note 18, at App. C-2. *See also* Unif. Ltd. Liab. Co. Act Prefatory Note, 6A U.L.A. 554-56, *reprinted in* 3 Ribstein & Keatinge, *Limited Liability Companies*, *supra* note 18, at App. D-2-3.

I. BANKRUPTCY OF A MEMBER³⁵

Unlike the Louisiana LLC Law, the LLC acts of many other states provide that the bankruptcy of a member triggers a dissociation of the member from the LLC or that the nondebtor members may expel a member who becomes a debtor in bankruptcy.³⁶ While the bankruptcy estate may succeed to the member's economic interest in an LLC, the LLC law in many states provides that the member's management rights cease when a member files a petition in bankruptcy or when a petition in

35. For a discussion of the problems that may arise on the bankruptcy of a member of an LLC or a partner, see Kalinka, *Limited Liability Companies and Partnerships*, *supra* note 14, 140–58; 2 Frank R. Kennedy, Vern Countryman & Jack F. Williams, Kennedy, Countryman & Williams on Partnerships, *Limited Liability Entities and S. Corporations in Bankruptcy* § 11.09 (2000 & Supp. 2002); Laurence D. Cherkis, *Recommendations of the National Bankruptcy Review Commission: Partnership as Debtor, Partner as Debtor*, 5 *Am Bankr. Inst. L. Rev.* 381 (1997); Sally S. Neely, *Partnerships and Partners and Limited Liability Companies and Members in Bankruptcy: Proposals for Reform*, 71 *Am. Bankr. L.J.* 271 (1997); Larry E. Ribstein, *Partner Bankruptcy and the Federalization of Partnership Law*, 33 *Wake Forest L. Rev.* 795 (1998); Steven A. Waters & Eric Terry, *Bankruptcy and Insolvency Issues for Partnerships, LLCs, and Their Owners—The Good, The Bad, and The Ugly*, 39-SPG *Tex. J. Bus. L.* 51 (2003).

36. *See, e.g.*, Ala. Code § 10-12-36(b)(1) (1999 & Supp. 2004); Alaska Stat. § 10.50.225(a) (2004); Ariz. Rev. Stat. § 29-733(4) (1998 & Supp. 2004); Ark. Code Ann. § 4-32-802(a)(4)(b)-(f) (2001); Conn. Gen. Stat. Ann. § 34-180(b)(4) (West 1997 & Supp. 2005); Ga. Code Ann. §§ 14-11-601(b)(5), 14-11-601.1(a)(4) (2003); Haw. Rev. Stat. Ann. § 428-601(6)(a) (2004); Idaho Code Ann. § 53-641(1)(d) (1994); 805 Ill. Comp. Stat. Ann. 180/35-45(7) (2004); Ky. Rev. Stat. Ann. § 275.280(1)(d) (West 2003); Me. Rev. Stat. Ann. tit. 31, § 692(1)(D) (1996 & Supp. 2004); Minn. Stat. Ann. § 322B.306(viii) (West 2004); Miss. Code Ann. § 79-29-307(1)(d) (2001); Mo. Rev. Stat. Ann. § 347.123(4)(b) (2001 & Supp. 2005); Mont. Code Ann. § 35-8-803(7) (2003); N.H. Rev. Stat. Ann. § 304-C:27(1)(d) (2005); N.J. Stat. Ann. § 42:2B-24(a)(3)(a) (West 2004); N.M. Stat. Ann. § 53-19-38(B)(1) (Lexis 1978 & Supp. 2001); N.C. Gen. Stat. § 57C-3-02(3) (2003); N.D. Cent. Code § 10-32-30(1) (2001); Ohio Rev. Code Ann. § 1705.15(c) (1994 & Supp. 2005); Or. Rev. Stat. Ann. § 63.265(1) (West 2003 & Supp. 2005); S.C. Code Ann. § 33-44-601(7)(I) (Supp. 2004); S.D. Codified Laws § 47-34A-601(7)(I) (2000); Vt. Stat. Ann. tit. 11, § 308(6)(A) (1997); Va. Code Ann. § 13.1-1040.1(6)(a) (1999 & Supp. 2004); Wash. Rev. Code Ann. § 25.15.130(1)(d) (West 2005); W. Va. Code § 31B-6-601(7)(I) (2003); Wis. Stat. Ann. § 183.0802(1)(d) (West 2002 & Supp. 2004).

bankruptcy is filed for the member by the member's creditors.³⁷ The lack of a provision in the Louisiana LLC Law terminating a member's management rights in the LLC upon the bankruptcy of the member may be problematic in some cases.

In many cases, nondebtor members of an LLC will prefer that a member's management rights terminate upon the member's bankruptcy, especially if a trustee is appointed to manage the bankrupt member's estate. A trustee in bankruptcy is likely to manage the debtor member's interest in a manner that serves the best interests of the member's creditors, rather than the best interests of the LLC or its other members. Moreover, a trustee may lack the knowledge, experience, and skills necessary to operate the LLC's business.

The default rules of the Louisiana LLC Law might prohibit a trustee in bankruptcy from assuming the debtor member's management powers. The Bankruptcy Code provides that, upon the filing of a petition in bankruptcy, the debtor's property is transferred to the bankruptcy estate.³⁸ The transfer of an LLC interest to a bankruptcy estate should trigger the provisions of the Louisiana LLC Law that restrict the powers of a transferee of a member's interest. Under the default provisions of the Louisiana LLC Law, the transferee (or "assignee") of the member's interest may not exercise the rights of a member or participate in the management of the LLC unless the nonassigning members unanimously agree in writing.³⁹ Thus, the nondebtor members of a Louisiana LLC may be able to prevent a trustee in bankruptcy from exercising the debtor member's management powers by withholding their consent.⁴⁰

In most cases, the Bankruptcy Code should not override state law restrictions on the transfer of a member's management rights

37. *Id.*

38. 11 U.S.C.A. § 541 (2004).

39. La. R.S. 12:1332(A)(1) (1994).

40. *See, e.g.*, In re The IT Group, Inc., 302 B.R. 483 (D. Del. 2003) (assignment of debtor member's economic interest in an LLC was permissible under the Bankruptcy Code); Millford Power Co., L.L.C. v. PDC Millford Power, L.L.C., 866 A.2d 738 (Del. Ch. 2004) (filing of petition in bankruptcy caused debtor member of an LLC to become an assignee, entitled only to economic interest in the LLC). *But see* Movitz v. Fiesta Invs., LLC (In re Ehmann), 319 B.R. 200 (Bankr. D. Ariz. 2005) (operating agreement assumable by a trustee in bankruptcy); In re Albright, 291 B.R. 538 (Bankr. Colo. 2003) (trustee had the authority to control the management of, liquidate, and sell the properties of a single-member LLC whose owner was a debtor in bankruptcy).

to a trustee.⁴¹ Because state law prohibits the assignment of a member's management rights, the nondebtor members should not be required to accept the trustee as a managing member of the LLC. In an analogous case, the United States Court of Appeals for the Fifth Circuit held that a trustee in bankruptcy for the estate of a debtor partner in a Louisiana partnership could not assume a partnership agreement because Louisiana partnership law provides that a partner may not make another person a partner without the consent of the other partners in the partnership.⁴²

Where the debtor member remains in possession of the member's interest in the LLC, a court might hold that the so-called "debtor in possession" retains all of the member's pre-bankruptcy management rights with respect to the LLC interest. A trustee is appointed in a Chapter 11 case only when a trustee is needed.⁴³ As the debtor in possession, the debtor remains the representative of the bankruptcy estate and has the rights (other than the right to compensation), powers, and duties of a trustee.⁴⁴ Where a member remains a debtor in possession, there has been no transfer of the member's LLC interest. In *N.L.R.B. v. Bildisco and Bildisco*,⁴⁵ the United States Supreme Court has held that the filing of a bankruptcy petition does not cause the debtor to become a different legal entity.

The nondebtor members might prefer the management rights of a member to terminate upon the member's bankruptcy even if the member is a debtor in possession. While a member of an LLC has

41. Bankruptcy law generally overrides provisions contained in contracts and state law that automatically alter a person's rights in an "executory contract" if the person becomes a debtor in bankruptcy. See 11 U.S.C.A. §§ 365(e)(1), (f)(3), 541(c) (2004). An operating agreement may fall within the definition of an executory contract if it requires a member or members to perform services or contribute property in the future. A managing member's authority to manage an LLC's business provided in an operating agreement usually causes the operating agreement to be considered an executory contract. The prohibition on termination or modification of an executory contract, however, does not apply if applicable law excuses a party, other than the debtor, to such contract from accepting performance from or rendering performance to the trustee or an assignee of such contract and the party does not consent to the assignment. *Id.* § 365(c).

42. *Stumpf v. McGee* (In re O'Connor), 258 F.3d 392 (5th Cir. 2001).

43. See 11 U.S.C.A. § 1104(a)(1) (2004) (authorizing the appointment of a trustee for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management).

44. *Id.* § 1107(a).

45. 465 U.S. 513, 528, 104 S. Ct. 1188, 1197 (1984).

fiduciary duties to exercise management rights in the best interests of the LLC and its members,⁴⁶ a member who is a debtor in possession will have fiduciary duties to the member's creditors that may conflict with the member's fiduciary duties under LLC law.⁴⁷ Thus, members of a Louisiana LLC may want to include a provision in a written operating agreement providing that the member's management powers will cease when the member becomes a debtor in bankruptcy.

The legislative history of the Bankruptcy Code provides some guidance as to whether a debtor in possession who is a member of an LLC should be permitted to continue to manage the LLC, based on the facts and circumstances of the case.⁴⁸ The Code, however, provides rules that sometimes are interpreted literally to deny a debtor in possession the right to continue to exercise management rights if state law excuses the nondebtor members and the nondebtor members refuse to allow the debtor to continue to manage the LLC.⁴⁹ Courts have reached differing conclusions on this issue.⁵⁰ Because the Louisiana LLC Law lacks a provision terminating a bankrupt member's right to continue to manage the LLC, however, there is a good chance that nondebtor members of a Louisiana LLC will have no recourse if a debtor member mismanages the LLC as a result of the bankruptcy filing.

There are two alternative theories under which a court may hold that bankruptcy law preempts state law with respect to the continuation of a debtor member's right to continue to manage an

46. La. R.S. 12:1314(1) (1994 & Supp. 2005).

47. *Cf. Skeen v. Harms* (In re Harms), 10 B.R. 817, 822 (Bankr. D. Colo. 1981) (sole general partner of a limited partnership who becomes a debtor in possession generates an inherent conflict of interest that precludes him from remaining as a general partner because partners owe fiduciary duty to co-partners and debtors in possession owe fiduciary duty to creditors). *See also* In re Map 1978 Drilling P'ship, 95 B.R. 432, 435 (Bankr. N.D. Tex. 1989); In re Royal Gorge Ass'n., 77 B.R. 277, 278 (Bankr. D. Colo. 1987).

48. *See infra* note 67 and accompanying text.

49. 11 U.S.C.A. § 365(e)(1) (2004), discussed *infra* notes 156–88 and accompanying text.

50. *Compare* In re Garrison-Ashburn, L.C., 253 B.R. 700 (Bankr. E.D. Va. 2000) (member's bankruptcy caused member's interest in an LLC to terminate in accordance with state law); Broyhill v. DeLuca, (In re DeLuca) (*DeLuca I*) 194 B.R. 65 (Bankr. E.D. Va. 1996) (same); JTB Enters., L.C. v. D & B Venture, L.C. (In re DeLuca) (*DeLuca II*), 194 B.R. 79 (Bankr. E.D. Va. 1996) (same) *with* In re Daugherty Constr., Inc., 188 B.R. 607 (Bankr. D. Neb. 1995) (notwithstanding state law to the contrary, member's bankruptcy did not cause member's interest in the LLC to terminate).

LLC. On the one hand, a court may hold that an LLC's operating agreement constitutes an executory contract⁵¹ that may be assumed by the trustee or debtor in possession notwithstanding state law or a provision in the operating agreement to the contrary. On the other hand, a court may hold that a provision in an operating agreement requiring the LLC interest of a member to terminate on the member's bankruptcy constitutes an unenforceable *ipso facto* clause. An *ipso facto* clause is a clause in a contract or lease that requires a person to forfeit rights under the contract or lease in the event of bankruptcy.⁵²

The Bankruptcy Code does not define the term "executory contract." Under nonbankruptcy law, the term "executory contract" refers to contracts on which performance remains due by either party.⁵³ Most bankruptcy courts have adopted the definition suggested by Professor Vern Countryman, that an executory contract is a contract under which the obligations of the debtor and the other party are both so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.⁵⁴

Several bankruptcy courts have held that an LLC operating agreement is an executory contract.⁵⁵ Where a member has an obligation to contribute capital in the future or has an obligation to manage the LLC, the operating agreement is likely to fall within the definition of an executory contract.

Alternately, if the operating agreement contains a provision that the LLC dissolves on the bankruptcy of a member or that the bankruptcy of a member terminates the member's interest in the LLC, a court may find that the provision is an "*ipso facto*," or forfeiture, clause that may be unenforceable under section 365(e)(1) of the Bankruptcy Code. Section 365 of the Bankruptcy

51. The term "executory contract" is not defined by the Bankruptcy Code. The judicial construction of this term is discussed *infra*.

52. The Bankruptcy Code's *anti-ipso facto* provisions are discussed *infra*.

53. 53 C.J.S. *Contracts* § 8 (2005); 77A C.J.S. *Sales* §§ 214, 223; 92 C.J.S. *Vendor and Purchaser* §§ 144, 146.

54. Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1972-73). Professor Westbrook has suggested that courts should adopt a "functional analysis," rather than an executory contract analysis, in determining whether a trustee or debtor in possession may assume or reject a partnership agreement or an operating agreement. Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 Minn. L. Rev. 227 (1989-90). Courts, however, have not adopted Professor Westbrook's approach.

55. See, e.g., *DeLuca I*, 194 B.R. 65; *DeLuca II*, 194 B.R. 79; *Daugherty*, 188 B.R. 607.

Code overrides statutory or contractual arrangements that prohibit the modification of a contract where the contract is contingent on the bankruptcy of a party.⁵⁶ Under section 365, a trustee or debtor in possession may reject, assume, or assign an executory contract of the debtor.⁵⁷ Notwithstanding any provision in an executory contract or in applicable law to the contrary, an executory contract generally may not be terminated or modified, and any right or obligation under such a contract may not be terminated or modified solely because of a provision in the contract that is conditioned on (a) the insolvency or financial condition of the debtor; (b) the commencement of a bankruptcy case; or (c) the appointment of a trustee or custodian.⁵⁸

However, a provision in an operating agreement or under state law triggering the dissolution of an LLC or the dissociation of a member upon the member's bankruptcy may be enforceable if the provision constitutes a personal contract.⁵⁹ A personal contract is a contract as to which applicable law excuses a party to the contract, other than the debtor, from accepting performance from or rendering performance to the trustee or an assignee of the contract, and that party does not consent to the assumption or assignment.⁶⁰

56. 11 U.S.C.A. § 365(b)(2) (2004 & Supp. 2005).

57. *Id.* § 365(a), (f)(1) (2004).

58. *Id.* § 365(e)(1) (2004). The Bankruptcy Code contains a number of anti-*ipso facto* provisions in addition to section 365(e)(1). In general, the anti-*ipso facto* provisions render ineffective contractual or statutory provisions that would modify or terminate a debtor's rights in the event of bankruptcy. *See, e.g., id.* §§ 541(c)(1) (interest of the debtor becomes property of the estate, notwithstanding any provision that restricts or conditions the transfer of the interest by the debtor or that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a bankruptcy case, or on the appointment or taking possession by a bankruptcy trustee or a custodian), 363(b)(1) (trustee generally may use, sell, or lease property, notwithstanding any provision in a contract, lease, or applicable law that is conditioned on the financial condition or bankruptcy of the debtor), 365(f)(3) (rendering ineffective provision in an executory contract or unexpired lease that permits a party other than the debtor to terminate or modify the contract or lease or any right or obligation thereunder on account of the assignment of the lease or contract where the lease or contract is assigned to the trustee).

59. *See id.* § 365(e)(2) (anti-*ipso facto* rule of 11 U.S.C.A. § 365(e)(1) does not apply to a personal contract, i.e., if applicable state law excuses a party from accepting performance from the debtor in possession).

60. *Id.*

Bankruptcy courts have disagreed on the effect of the personal contract exception where the debtor is a member of an LLC.⁶¹ A similar issue arises in the partnership context. Courts also have disagreed as to whether a provision in a partnership agreement or under state law triggering dissolution of the partnership upon the bankruptcy of a partner or terminating the bankrupt partner's interest constitutes an unenforceable *ipso facto* or forfeiture clause.⁶² Most, if not all, of the cases concerning whether bankruptcy law overrides state LLC laws concerning these issues have been based on analogous partnership cases.⁶³

A. Policy Considerations

An important policy of the anti-*ipso facto* provisions is to facilitate the debtor's rehabilitation.⁶⁴ Contractual or statutory provisions that terminate rights or obligations in the event of bankruptcy could prematurely terminate a promising business of the debtor or destroy the possibility of future success. The anti-*ipso facto* provisions were recommended by the Commission on the Bankruptcy Laws of the United States⁶⁵ that was established by

61. See *infra* notes 127–55 and accompanying text.

62. For cases holding that the bankruptcy of a general partner dissolves the partnership and strips the debtor general partner of management rights see, e.g., *Breeden v. Catron* (In re Catron), 25 F.3d 1038 (4th Cir. 1994), *aff'd*, 158 B.R. 629 (E.D. Va. 1993), *aff'd*, 158 B.R. 624 (Bankr. E.D. Va. 1992); *Phillips v. First City, Texas-Tyler, N.A.* (In re Phillips), 966 F.2d 926 (5th Cir. 1992); In re *Doddy*, 164 B.R. 276 (Bankr. S.D. Ohio 1994); *Normadin v. Normadin* (In re Normadin), 106 B.R. 14 (Bankr. Mass. 1989); In re *Tip O Texas RV Vill.*, 87 B.R. 195 (Bankr. M.D. Fla. 1988); In re *Sunset Developers*, 69 B.R. 710 (Bankr. D. Idaho 1987); In re *Minton Group, Inc.*, 27 B.R. 385 (Bankr. S.D.N.Y. 1983), *aff'd*, 46 B.R. 222 (S.D.N.Y. 1985). For cases holding that a general partner's bankruptcy does not dissolve the partnership or strip the general partner of management rights, see, e.g., In re *Clinton Court*, 160 B.R. 57 (Bankr. E.D. Pa. 1993); In re *Corky Foods Corp.*, 85 B.R. 903 (Bankr. S.D. Fla. 1988); In re *BC & K Cattle Co.*, 84 B.R. 69 (Bankr. N.D. Tex. 1988); In re *Rittenhouse Carpet, Inc.*, 56 B.R. 131 (Bankr. E.D. Pa. 1985); *Quarles House Apartments. v. Plunkett* (In re Plunkett), 23 B.R. 392 (Bankr. E.D. Wis. 1982).

63. See cases discussed *infra* notes 127–55 and accompanying text.

64. See H.R. Rep. No. 95-595, at 1 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6304.

65. Comm'n. on the Bankr. Laws of the U.S., Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, at 17, 193 (1973), *reprinted in* 2 Bankruptcy Reform Act of 1978: A Legislative History (Alan N. Resnick & Eugene M. Wypyski eds., 1979).

Congress in 1970 to “study, analyze, evaluate, and recommend changes” in federal bankruptcy law.⁶⁶ The Commission’s report explains:

Lease agreements typically contain “bankruptcy clauses” that terminate the lease automatically upon the lessee’s bankruptcy or grant the lessor the option to terminate upon that event. As a result, a debtor may be forced to give up operating quarters or other premises vital to the success of a reorganization plan or submit to new terms unilaterally imposed by the lessor as a condition of continued occupancy.

The Commission recommends that both executory contracts . . . and unexpired leases be enforceable in business reorganization cases, notwithstanding such a “bankruptcy clause” or anti-assignment clause

The . . . policy is justified on the ground that in reorganization cases the purpose of assumption is the continuation of the business. In [that] situation the reorganization of the debtor should be paramount, provided that the nondebtor party is protected.⁶⁷

In the case of a managing member of an LLC, the fees that the member receives in managing the LLC’s business may be the member’s sole source of livelihood. Termination of the member’s interest on the member’s bankruptcy could jeopardize the member’s rehabilitation.

On the other hand, if a managing member is a debtor in possession in a Chapter 11 bankruptcy case, the debtor member will have duties to creditors that conflict with the member’s fiduciary duties to the LLC and to the other members. An insolvent member may have greater incentive to sell LLC assets and distribute the proceeds than to preserve LLC assets for greater long-term benefits to the LLC and its nondebtor members.⁶⁸ A

66. Pub. L. No. 91-354, 84 Stat. 468 (1970).

67. Comm’n. on the Bankr. Laws of the U.S., Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, at 198 (1973), reprinted in 2 Bankruptcy Reform Act of 1978: A Legislative History (Alan N. Resnick & Eugene M. Wypyski eds., 1979).

68. Cf. Ribstein, *supra* note 35, at 800-01:

Insolvent partners have an incentive to manage for a quick payoff (such as selling the partnership’s property), despite the attendant risks and the potentially adverse effects on long-term profits [T]hey may have little incentive to create long-term wealth for the firm. The debtor may not care about the firm’s gains because most or all of any increase in

member's bankruptcy also may terminate the member's responsibility for capital and credit contributions to the LLC, at least while the bankruptcy case is pending, which may be important components of the members' financial arrangement.⁶⁹ The continued exercise by a debtor member of the member's management rights may be particularly troubling for the nondebtor members of a professional LLC if the bankruptcy distracts the debtor member from the member's responsibilities to clients.⁷⁰

If the bankruptcy distracts the debtor member's exercise of the member's management authority over the LLC, the members may desire to expel the debtor member for mismanagement or breach of fiduciary duties under provisions of the operating agreement that do not constitute *ipso facto* clauses. However, the members may not be able to obtain relief until after the bankruptcy case is concluded. The filing of a bankruptcy petition operates as a stay to prevent all suits against the debtor,⁷¹ except for a few narrowly construed cases, such as the continuation of a criminal action against the debtor,⁷² the exercise by the government of its police or regulatory powers,⁷³ and the collection of alimony or child support.⁷⁴

The Bankruptcy Code provides some protection to nondebtor members of LLCs. Section 365(b) of the Bankruptcy Code provides, in part:

(1) If there has been a default in an executory contract . . . of the debtor, the trustee may not assume such contract . . . unless, at the time of the assumption of such contract . . . , the trustee—

value in the partner's interest, whether or not attributable to the debtor's post-bankruptcy actions, will go into the bankruptcy estate and ultimately into creditors' pockets. Moreover, a debtor partner whose interest is subject to sale in the bankruptcy proceeding has a shorter time horizon than the other partners. Partners naturally would want to avoid injury from these conflicts by providing for the severance of bankrupt partners in the partnership agreement.

69. Cherkis, *supra* note 35, at 390.

70. *Id.* at 390. A discharge in bankruptcy, however, will not terminate a bankrupt member's liability for post-bankruptcy debts. 11 U.S.C.A. § 524(a)(1)-(2) (2004).

71. *Id.* § 362(a).

72. *Id.* § 362(b)(1).

73. *Id.* § 362(b)(4).

74. *Id.* § 362(b)(2)(A).

- (A) cures, or provides adequate assurance that the trustee will promptly cure, such default . . . ;
- (B) compensates, or provides for adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract . . . , for any actual pecuniary loss to such party resulting from such default; and
- (C) provides adequate assurance of future performance under such contract⁷⁵

It is not certain how adequate the protection under section 365(b) will be. For example, if an operating agreement provides that the debtor member is to manage the LLC's business and the debtor is distracted by the bankruptcy from properly managing the LLC, there is no assurance under section 365(b) that "compensation" will be due to the nondebtor members. Moreover, if the debtor member decides to authorize distributions, rather than using the LLC's profits to fund projects to ensure the future expansion of the LLC's business, it is likely that the nondebtor members will not be able to prove that they have not been adequately compensated or suffered an actual pecuniary loss. In such a case, the nondebtor members will receive monetary distributions when they are authorized by the debtor managing member.

The concerns of nondebtor members may be less compelling if the identity of a managing member is not so significant because the member's duties do not require special skill, experience, or knowledge. For example, if an LLC's only asset is an office building that is subject to a long-term lease and the duties of the managing member are merely clerical in nature, there may be no need to remove the member from his or her management position. Some commentators have suggested that a debtor member who is a debtor in possession should not be entitled to continue to exercise management rights in the LLC unless the LLC's business is a modern business venture where management is essentially fungible.⁷⁶

75. *Id.* § 365(b)(1).

76. Kennedy et al., *supra* note 35, § 11.09. See, e.g., In re Antonelli, 148 B.R. 443 (D. Md. 1992). A court also should not weigh the policies when a debtor in bankruptcy is the sole member of a single-member LLC. See, e.g., In re Albright, 291 B.R. 538 (Bankr. Colo. 2003) (trustee in bankruptcy had the authority to control the management of, liquidate, and sell the property of a single-member LLC). In that case, there are no nondebtor members whose interests could be harmed by the operation of the LLC by a trustee or a debtor in possession. For a discussion of *Albright*, see Susan Kalinka, In re Albright:

The policies concerning the bankruptcy of a partner in a general partnership might be more compelling than the policies concerning the bankruptcy of an LLC member. Each partner in a Louisiana general partnership is personally liable for a virile share of all partnership debts and obligations,⁷⁷ and each of the partners generally is a mandatary of the partnership for all matters in the ordinary course of the partnership's business.⁷⁸ Thus, the exercise of management rights by a debtor partner in a general partnership could cause the other partners to incur personal liability. Moreover, the effect of bankruptcy on a general partner's liability for partnership debts changes the terms of the partners' agreement.⁷⁹

In contrast, members of an LLC are not personally liable for the LLC's debts and obligations.⁸⁰ Nevertheless, a member of a member-managed LLC or a member who is a manager of a manager-managed LLC, like a general partner, is a mandatary of the LLC.⁸¹ Moreover, courts have precluded general partners who become debtors in bankruptcy from continuing to manage limited partnerships, even though the limited partners are not personally liable for partnership debts or obligations.⁸² Indeed, the drafters of the Prototype Act were not so sure that bankruptcy should dissociate LLC members.⁸³ They only included a provision triggering the dissociation of a member upon the filing of a petition in bankruptcy for the member because they thought it might be necessary for tax classification purposes under the pre-check-the-box regulations that were in effect when the Prototype Act was drafted.⁸⁴

The legislative history of the anti-*ipso facto* provisions of the Bankruptcy Code admonishes courts to be sensitive to the rights of the nondebtor party to an executory contract and to insure that the

Bankruptcy Court Decision Portends Problems for Single-Member LLCs, Individuals and Passthrough Entities, 81 Taxes 15 (2003).

77. La. Civ. Code art. 2817.

78. La. Civ. Code art. 2814.

79. Prototype Ltd. Liab. Co. Act, *supra* note 18, § 802 cmt.

80. La. R.S. 12:1320(B) (1994).

81. La. R.S. 12:1317(A) (1994).

82. See, e.g., *Phillips v. First City, Texas-Tyler, N.A.* (In re Phillips), 966 F.2d 926 (5th Cir. 1992); *Skeen v. Harms* (In re Harms), 10 B.R. 817, 822 (Bankr. D. Colo. 1981); In re Royal George Assn., 77 B.R. 277, 278 (Bankr. D. Colo. 1987).

83. Prototype Ltd. Liab. Co. Act, *supra* note 18, § 802 cmt.

84. *Id.*

trustee's performance (or presumably, the performance of the debtor in possession) under the contract gives the other contracting party the full benefit of the bargain.⁸⁵ Some courts have taken these policy concerns into account in determining whether to treat as unenforceable provisions in partnership agreements, in operating agreements, or under local law that trigger dissolution of the partnership or LLC and terminate the partner's or member's interest in the firm in the event of the bankruptcy of a partner or member.⁸⁶ In such cases, a court may take into consideration the potential harm to the nondebtor partners or members if the debtor is permitted to retain management authority with respect to the partnership or LLC.

In somewhat analogous cases, the Louisiana Legislature has expressed its concern for protecting nondebtor members. Under the Louisiana LLC Law, the sole remedy available to a judgment creditor of an LLC member is to obtain a charging order against the member's LLC interest.⁸⁷ When a creditor charges a member's LLC interest, the creditor has only the rights of an assignee,⁸⁸ *i.e.*, to share in the LLC's profits and losses and receive distributions to the extent that the member was entitled.⁸⁹

The charging order provisions do not apply, however, in a case in which a petition in bankruptcy is filed for an LLC member. Creditors do not seize a member's LLC interest when the bankruptcy petition is filed; instead, the interest passes to the bankruptcy estate.⁹⁰ As explained earlier, when a member remains a debtor in possession, there has been no transfer of the member's LLC interest. It is curious that the Louisiana Legislature did not anticipate the problems that could arise upon the bankruptcy of an LLC member.

When a petition in bankruptcy is filed for a member of an LLC, however, the member's creditors should obtain some financial benefit for the member's interest in the LLC, which, along with all of the debtor's other property, is transferred to the bankruptcy

85. H.R. Rep. No. 95-595, at 348-49 (1978), *reprinted in* 1978 U.S.C.A.N. 5963, 6304-05.

86. *See, e.g.*, *JTB Enters., L.C. v. D & B Venture, L.C.* (In re DeLuca) (*DeLuca II*), 194 B.R. 79, 91 (Bankr. E.D. Va. 1996); In re Antonelli, 148 B.R. 443, 448 (Bankr. D. Md. 1992), *aff'd.*, 4 F.3d 984 (4th Cir. 1993); In re Rittenhouse Carpet, Inc., 56 B.R. 131 (Bankr. E.D. Pa. 1985).

87. La. R.S. 12:1331 (1994).

88. *Id.*

89. La. R.S. 12:1330(A), 1332(A) (1994).

90. 11 U.S.C.A. § 541(a) (2004).

estate.⁹¹ The Louisiana Partnership Law, like the Prototype Act and the ULLCA, requires the partnership to purchase a bankrupt member's interest.⁹²

Under the Louisiana Partnership Law, the amount of the purchase price for a partner's interest is the value of the interest at the time that the partner's membership ceased.⁹³ An interest in a Louisiana partnership, however, might not have significant value. Under the Louisiana Partnership Law, the buyout price of a partner's interest may be determined in accordance with any method prescribed in the partnership agreement.⁹⁴ In the absence of an agreed buyout price, any interested party may apply for a judicial determination of the value of the withdrawing partner's interest in the partnership.⁹⁵

In *Shopf v. Marina Del Ray Partnership*,⁹⁶ the Louisiana Supreme Court held that the term "value" as used in the Louisiana Partnership Law means fair market value.⁹⁷ For this purpose, the court defined the term "fair market value" as the price that a "willing buyer would pay a willing seller for a certain piece of property, in an arm's length transaction, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."⁹⁸ The court determined that the \$3,552.63 per point, paid by another individual for interests in the partnership at the time that the partner withdrew, was significant in determining the fair market value of the withdrawing partner's interest in the partnership.⁹⁹ However, the court, *sua sponte*, determined that this

91. *Id.*

92. Compare La. Civ. Code arts. 2823–2824 (former partner, successors, or creditor that seizes the former partner's interest is entitled to payment from the partnership in an amount equal to the value of the former partner's interest at the time membership ceased) with Prototype Ltd. Liab. Co. Act, *supra* note 18, § 602 (LLC must purchase the interest of a dissociated member of the member's interest as of the date of dissociation based on the member's right to share in distributions from the LLC unless the dissociation causes the LLC to dissolve); Unif. Ltd. Liab. Co. Act § 701(a) (amended 1998), 6A U.L.A. 614 (2003) (LLC must purchase dissociated member's distributional interest for fair value (in at-will LLC at the time of dissociation or in a term LLC at the time of expiration of the LLC's term)).

93. La. Civ. Code art. 2823.

94. La. Civ. Code art. 2823, cmt. (a).

95. La. Civ. Code art. 2825.

96. 549 So. 2d 833 (La. 1989).

97. *Id.* at 838.

98. *Id.* at 839 (citing Black's Law Dictionary 537 (5th ed. 1979)).

99. *Id.* at 840.

price had to be adjusted for other considerations, and in particular for the fact that the withdrawing partner's twelve percent interest in the partnership represented a minority interest in a closely held partnership.¹⁰⁰ The court then discounted the \$3,552.63 per point value of the purchased interests in the partnership to \$2,368.42 per point in the case of the withdrawing partner, without providing any rationale for determining the amount of the discount.¹⁰¹

The ULLCA requires the LLC to purchase a dissociated member's interest for its "fair value."¹⁰² If a member is dissociated by an LLC that is not entered into for a term (an "at-will LLC"), the member's interest must be purchased for its fair value as determined as of the date of the member's dissociation.¹⁰³ If the LLC is entered into for a term (a "term LLC"), the member's interest must be purchased at the expiration of the specified term that existed on the date of the member's dissociation and for its fair value as of the date of the expiration of the LLC's term (unless the dissociation causes the LLC to dissolve).¹⁰⁴

The ULLCA does not define the term "fair value." However, if a dissociated member and the LLC cannot reach an agreement as to the fair value of the interest, the ULLCA allows for a judicial determination.¹⁰⁵ Under the ULLCA, the court is authorized to consider, among other relevant evidence, the going concern value of the LLC, any agreement among some or all of the members fixing the price or specifying a formula for determining the value of the LLC interests for any other purpose, the recommendations of any appraiser appointed by the court, and any legal constraints on the LLC's ability to purchase the interest.¹⁰⁶ The drafters' comments to the ULLCA explain that the "fair value" standard is a broad concept under which

a court is free to determine the fair value of an LLC interest on a fair market, liquidation, or any other method deemed appropriate under the circumstances. A fair market value standard is not used because it is too narrow, often

100. *Id.*

101. *Id.*

102. Unif. Ltd. Liab. Co. Act § 701(a) (amended 1998), 6A U.L.A. 614 (2003).

103. *Id.* § 701(a)(1), 6A U.L.A. 614 (2003).

104. *Id.* § 701(a)(2), 6A U.L.A. 614 (2003).

105. *Id.* § 702(a), 6A U.L.A. 616 (2003).

106. *Id.* § 702(a)(1), 6A U.L.A. 614 (2003).

inappropriate, and assumes a fact not contemplated by [ULLCA]—a willing buyer and a willing seller.¹⁰⁷

The ULLCA has been criticized for providing such a vague standard for determining the value of a dissociated member's interest in an LLC.¹⁰⁸ Professor Larry E. Ribstein has argued:

If there is some policy reason why [the willing buyer/willing seller] standard would not be appropriate, the statute should clarify deviations from the market standard. For example, the statute could explicitly eliminate any “minority discount” by providing that the value should be determined on the basis of the member's pro rata share of the value of the firm. This would deter oppression of minority holders and eliminate the need for open-ended remedies. As phrased the section [under ULLCA] creates unnecessary litigation on many issues¹⁰⁹

The ULLCA is even more troubling when a member's dissociation from an LLC that is entered into for a term (a “term LLC”) is triggered by bankruptcy. The ULLCA treats the bankruptcy of a member before the expiration of an LLC's term as a “wrongful” dissociation.¹¹⁰ If a member wrongfully dissociates from an LLC governed by the ULLCA, the dissociated member is liable to the LLC and the other members for damages caused by the dissociation.¹¹¹ The ULLCA does not describe what sort of damages could be caused to an LLC by a member's dissociation, but damages could result if the member's dissociation relieves the member of any obligation to make future capital contributions to the LLC or if the member was the sole manager of the LLC and the LLC incurs costs replacing the bankrupt member. Under the ULLCA, damages sustained by an LLC as a result of a member's wrongful dissociation must be offset against distributions otherwise due to the member after dissociation.¹¹² Thus, the ULLCA could significantly hinder the rehabilitation of a member of a term LLC who becomes a debtor in bankruptcy and could

107. *Id.* § 701 cmt., 6A U.L.A. 614 (2003).

108. Larry E. Ribstein, *A Critique of the Uniform Limited Liability Company Act*, 25 *Stet. L. Rev.* 311, 367 (1995).

109. *Id.* at 367–68 (footnotes omitted).

110. *Unif. Ltd. Liab. Co. Act* § 602(b)(2)(iii) (amended 1998), 6A U.L.A. 611 (2003).

111. *Id.* § 602(c), 6A U.L.A. 611 (2003).

112. *Id.* § 602(d), 6A U.L.A. 611 (2003).

reduce the amount that is available to the debtor member's creditors as a result of the bankruptcy.

In contrast, the Prototype Act does not distinguish between a term LLC and an LLC that is not entered into for a term (an "at-will LLC"). The default rules of the Prototype Act provide that a bankrupt member who is dissociated from the LLC is entitled to receive any distribution to which the member was entitled to receive prior to the bankruptcy and the fair value of the member's interest in the LLC as of the date of the member's dissociation based on the member's right to share in distributions from the LLC.¹¹³ The drafters' comments explain that the concept of "fair value," in this context, does not apply a minority discount or control premium as might be the case with "fair market value."¹¹⁴

Commentators disagree as to whether a buyout price under the terms of a partnership agreement (or an operating agreement, in the case of an LLC) for a dissociated member should control in a bankruptcy case. Some argue that the buyout price of a member's interest for all dissociation purposes, as negotiated before bankruptcy, should control.¹¹⁵ For example, Professor Ribstein has explained:

The partners have an interest in not only removing bankrupt partners, but also in doing so by paying a below-market price for their interests. A sudden obligation to buy out a member's interest may force the firm to liquidate and lose going concern value. Moreover, the difficulty of valuing closely held firms may make it hard for would-be continuing partners to borrow the buyout price and might trigger disputes and protracted litigation over valuation. This is particularly true in partnerships whose value depends significantly on the partners' human capital. Where, at the time the partnership agreement is drafted, the partners do not know who will be the first to leave, sub-market-value buyout provisions may maximize the expected value of all their interests by reducing expected future transaction costs.

To be sure, these dynamics are changing as partnership-type firms evolve. Limited liability reduces the partners' need to choose their associates. Nevertheless, *ipso facto* provisions are still important in the modern

113. Prototype Ltd. Liab. Co. Act, *supra* note 18, § 602.

114. *Id.* cmt.

115. See, e.g., Ribstein, *supra* note 35, at 801-02.

partnership-type firm. As long as interests in these firms are not publicly traded, internal incentive and monitoring structures must compensate for the lack of monitoring through the securities markets.¹¹⁶

Other commentators warn that any provision for a buyout of a partner's interest triggered by the commencement of a case under Title 11 of the Bankruptcy Code should be scrutinized and construed to assure fair compensation to the parties affected by the resulting change in the relationship.¹¹⁷ The ULLCA seeks to accommodate all parties involved by authorizing a judicial determination of the buyout price.¹¹⁸ Inasmuch as the parties already will be in bankruptcy court, a judicial determination of the buyout price would be appropriate. Among the factors to be considered by the court in determining the buyout price under the ULLCA is any agreement among some or all of the members fixing the price or specifying a formula for determining the value of a member's interest in the LLC.¹¹⁹ However, the court may take into account any other factors in determining the buyout price, including (but not limited to) the recommendations of a court-appointed appraiser and any legal constraints on the LLC's ability to purchase the interest.¹²⁰ The ULLCA further seeks to accommodate the desires of the nondebtor members to allow continuity of the business by authorizing the court to specify the terms of the purchase, including, if appropriate, terms for installment payments, and subordination of the purchase obligation to the rights of the LLC's other creditors.¹²¹ On the other hand, the court may accommodate the interests of the debtor member's creditors and the bankruptcy estate by requiring the LLC to provide security for a deferred purchase price.¹²²

Recommendations have been made to amend the Bankruptcy Code to specifically address the treatment of partners and LLC members in bankruptcy.¹²³ Some of these proposals would

116. *Id.*

117. *See, e.g.*, Kennedy et al., *supra* note 35, § 11.07; 6A William L. Norton, Jr., Norton Bankruptcy Law and Practice 2d § 155:2 n. 61 (2005) (citing *In re Manning*, 831 F.2d 205, 210–11 (10th Cir. 1987)).

118. Unif. Ltd. Liab. Co. Act § 702 (amended 1998), 6A U.L.A. 616 (2003).

119. *Id.* § 702(a)(1), 6A U.L.A. 614 (2003).

120. *Id.*

121. *Id.* § 702(a)(2), 6A U.L.A. 614 (2003).

122. *Id.*

123. *See, e.g.*, Nat'l. Bankr. Rev. Comm'n, *Bankruptcy: The Next Twenty Years, Final Report* (1997); Neely, *supra* note 35.

encourage the courts to weigh the interests of a debtor member's creditors, the Bankruptcy Code's policy of debtor rehabilitation, and the interests of the nondebtor members of an LLC.¹²⁴ They would provide much better guidance than the current executory contract and anti-*ipso facto* provisions under the Bankruptcy Code.

As of this writing, however, Congress has not adopted any of the recommendations concerning the treatment under the Bankruptcy Code of partners or LLC members who become debtors in bankruptcy.¹²⁵ In the meantime, confusing case law continues to apply to the treatment of an LLC member in bankruptcy.¹²⁶

The Louisiana LLC Law does not even consider the potential problems raised when a petition in bankruptcy is filed for a managing member of an LLC. Because the Louisiana LLC Law lacks a provision triggering the dissociation of a bankrupt LLC member, it is likely that a member of a Louisiana LLC who becomes a debtor in possession will continue to exercise the member's management rights, notwithstanding any potential harm to the nondebtor members.

This article, however, is concerned with the rights of a debtor member and the nondebtor members of a multi-member LLC seeking to avoid the exercise of a member's management rights after the member has become a debtor in possession under the bankruptcy law. Accordingly, the article will focus on these issues, and not issues concerning the bankruptcy of the only member of a single-member LLC.

B. Case Law Concerning the Bankruptcy of an LLC Member

As of this writing, no cases could be found in which a federal court in the Fifth Circuit has decided whether the Bankruptcy Code overrides an *ipso facto* clause in an LLC operating agreement or under state law. Courts in other jurisdictions are split on this issue. Most courts, however, have reached equitable results, either in

124. See, e.g., Nat'l. Bankr. Rev. Comm'n, *Bankruptcy: The Next Twenty Years, Final Report* (1997); Cherkis, *supra* note 35, at 381; Neely, *supra* note 35; Ribstein, *supra* note 35.

125. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 8, 109th Cong., 1st Sess (2005), does not include any of the Commission's recommendations.

126. For a discussion of the conflicting cases concerning the ability of a managing member to continue to exercise the member's management rights, see *infra* notes 127-55 and accompanying text.

denying or allowing an LLC member who is a debtor in possession to continue to exercise the member's management rights.

For example, in the case of *In re Daugherty Construction, Inc.*,¹²⁷ the debtor was a member of a number of LLCs, including two that were formed to develop apartment complexes. In each of the two LLCs, the debtor's capital contribution consisted of a promise to provide general contractor services for construction of the apartment buildings. The nondebtor members of the two LLCs treated the debtor's bankruptcy filing as an event of dissolution and voted to continue the respective LLCs and terminate the debtor as a general contractor on the respective LLC construction projects. In addition, the nondebtor members voted to remove Rick Daugherty (the president and sole shareholder of the debtor) as the general manager of each LLC. The bankruptcy court held that the Bankruptcy Code preempted the state law provision that triggered dissolution of an LLC on the bankruptcy of a member because the state law was in conflict with the anti-*ipso facto* provisions of the Bankruptcy Code.¹²⁸

There was no indication in *Daugherty* that the debtor, through its sole shareholder, who was not a debtor in bankruptcy, would have difficulty continuing to perform its general contractor construction services for the LLCs. There also was no indication that the debtor had mismanaged the LLCs before the bankruptcy filing. Moreover, the debtor was a construction company. Presumably, its sole source of income was attributable to the performance of general contracting services, a large part of which would be paid by the LLCs. The court did not mention whether retention of the debtor's LLC interests was necessary to ensure the debtor's rehabilitation. However, the court explained that allowing the debtor to continue to manage the construction projects would not create problems for the nondebtor members because section 365(b) of the Bankruptcy Code fully assured that the legitimate expectation interest of the other members of the LLCs was fully protected and realized if the executory contracts were assumed.¹²⁹

Other courts have held that the Bankruptcy Code did not override *ipso facto* clauses under state LLC law where a member who was a debtor in possession might cause harm to the nondebtor members if the debtor member continued to manage the LLC. For example, in *Broyhill v. DeLuca (In re DeLuca) (DeLuca I)*,¹³⁰ Robert and Marilyn DeLuca, had been the managing members of a

127. 188 B.R. 607 (Bankr. D. Neb. 1995).

128. *Id.*

129. *Id.* at 613.

130. 194 B.R. 65 (Bankr. E.D. Va. 1996).

Virginia LLC formed to develop a shopping center and an office development. The original members of the LLC were the DeLucas and Joel T. Broyhill. The operating agreement required the DeLucas and Broyhill each to contribute \$1,000,000 to the LLC (a total of \$2,000,000 in capital contributions). The amount of capital actually contributed was significantly less. The source for the capital contributions from Broyhill and the DeLucas was a \$1,500,000 loan from Nations Bank. While Broyhill testified that he understood that the entire loan proceeds would be paid to the LLC, only \$200,000 of the loan proceeds were deposited in the LLC's bank account.

Later, the DeLucas solicited North Virginia Realty, Inc. ("NVRI") to become a member of the LLC and offered it a fifteen-percent interest in the LLC in exchange for a \$600,000 cash investment. NVRI accepted the offer and contributed \$600,000 to the LLC. Within one week, \$594,300 of these funds were transferred to other DeLuca-related entities or to Robert DeLuca personally. The DeLucas also placed a \$3,000,000 deed of trust against the LLC's property without Broyhill's knowledge.

Broyhill and NVRI executed a document purporting to remove the DeLucas as managers of the LLC and electing Broyhill as manager. Subsequently, the DeLucas filed a voluntary Chapter 11 petition and filed a Chapter 11 bankruptcy petition on behalf of the LLC.

The Bankruptcy Court for the Eastern District of Virginia held that the pre-petition removal of the DeLucas as managers of the LLC was in accordance with Virginia law and was effective.¹³¹ However, the appointment of a new manager was ineffective because the LLC's operating agreement required the unanimous consent of the LLC's members (including the DeLucas) to appoint a new manager.¹³² Nevertheless, Virginia law provided that the filing of the DeLucas' bankruptcy petition triggered dissolution of the LLC unless, within ninety days after the filing, the remaining members consented to continue the LLC and elected a new manager.¹³³

In determining whether the provision of the operating agreement should be enforced, the bankruptcy court relied on case law concerning the issue of whether to enforce a provision in a partnership agreement triggering dissolution of the partnership upon the bankruptcy of a general partner. In *DeLuca*, the court chose a pragmatic, case-by-case analysis in which a court may

131. *Id.*

132. *Id.*

133. *DeLuca I*, 194 B.R. at 70.

look at the specific partnership in question and the nature of the debtor's responsibilities to determine whether the partnership agreement is enforceable.¹³⁴ In such cases, a provision in a partnership agreement that triggers dissolution of the partnership on the bankruptcy of a partner is enforceable if the identity of the bankrupt partner is a material condition of the contract when considered in the context of the obligations that remain to be performed under the agreement.¹³⁵

On the other hand, if the project of a partnership is mature, requiring only routine management and leasing functions, the partner, as a debtor in possession, may assume management rights under the partnership agreement.¹³⁶ The court held that the operating agreement in *DeLuca* was an executory contract because the development of the shopping center and office development had not been accomplished and the parties had ongoing duties and responsibilities to bring the project to successful conclusion and that the nature of the parties' duties and responsibilities were such as to make the contract one for personal services.¹³⁷ The court explained:

Particularly in view of the highly questionable conduct of the DeLucas in having allowed a deed of trust to be recorded against the company's property to secure a personal loan and in having siphoned out of the company essentially all of NVRI's \$600,000 investment within a week of its having been paid in, and given that the Parc City Centre project is still very much in the development phase, with important decisions to be made with respect to the sale or lease of parcels and possible further financing (which, as with the current financing, could very well require the personal guarantees of members), there is no way the identity of the DeLucas would not be material to the other members and to the success of the project.¹³⁸

134. *Id.* at 76; *see, e.g.*, *In re Antonelli*, 148 B.R. 443, 448 (Bankr. D. Md. 1992), *aff'd*, 4 F.3d 984 (4th Cir. 1993).

135. *Antonelli*, 148 B.R. at 448.

136. *Id.* at 449.

137. *DeLuca I*, 194 B.R. at 77.

138. *Id.* at 77-78. In *JTB Enters., L.C. v. D & B Venture, L.C.* (In re *DeLuca*) (*DeLuca II*), 194 B.R. 79, 91 (Bankr. E.D. Va. 1996), the court reached a similar conclusion as in *DeLuca I*, but seemed to adopt a more textual approach. In holding that the DeLucas, as debtors in possession, could not assume their management rights under the D & B Venture operating agreement, the court relied on *Breeden v. Catron* (In re *Catron*), 25 F.3d 1038 (4th Cir.

Other courts have held that an operating agreement did not constitute an executory contract.¹³⁹ Such courts, however, have disagreed as to whether bankruptcy law overrides an anti-*ipso facto* clause in an operating agreement or under applicable state law.

In the case of *In re Garrison-Ashburn, L.C.*,¹⁴⁰ Stephen H. Chapman, a non-managing LLC member who had filed a voluntary petition in bankruptcy, requested the reconsideration of an order authorizing the sale of real estate owned by the LLC. At the time of the request, the LLC also was a debtor in bankruptcy. In court, Mr. Chapman challenged the authority of the LLC's managing member to effect the sale without Mr. Chapman's approval.¹⁴¹

The court determined that under the Virginia LLC Act, Mr. Chapman's bankruptcy triggered his dissociation from the LLC and therefore, terminated his right to participate in the management of the LLC.¹⁴² While Mr. Chapman's bankruptcy estate succeeded to all of his management and economic rights in the LLC interest, those rights under state law constituted the rights of an assignee unless otherwise provided in the Bankruptcy Code.¹⁴³

The issue in *Garrison-Ashburn* was whether the anti-*ipso facto* provisions of section 365(c) or (e) of the Bankruptcy Code precluded the extinction of Mr. Chapman's management rights under state LLC law. Both sections 365(c) and (e) prevent the enforcement of a bankruptcy *ipso facto* provision in leases and executory contracts.¹⁴⁴

The court held that sections 365(c) and (e) were inapplicable because the operating agreement in question did not constitute an

1994). In *Catron*, the Fourth Circuit held that a debtor in possession could not assume management rights under a partnership agreement because the debtor in possession was a separate entity from the debtor. *DeLuca II*, 194 B.R. at 89–90 (citing *Breeden v. Catron (In re Catron)*, 25 F.3d 1038 (4th Cir. 1994), *aff'd*, 158 B.R. 629 (E.D. Va. 1993), *aff'd*, 158 B.R. 624 (Bankr. E.D. Va. 1992)). R & M argued that *Catron* was wrongly decided. *Id.* at 91. The *DeLuca II* court, however, did not have the authority to disregard *Catron* because Fourth Circuit precedent is the controlling authority for that district. *Id.*

139. See, e.g., *Movitz v. Fiesta Invs., LLC (In re Ehmann)*, 319 B.R. 200, 201 (Bankr. D. Ariz. 2005); *In re Garrison-Ashburn, L.C.*, 253 B.R. 700, 709 (Bankr. E.D. Va. 2000).

140. *Garrison*, 253 B.R. at 702.

141. *Id.*

142. *Id.* at 704.

143. *Id.*

144. *Id.* at 708.

executory contract.¹⁴⁵ The court determined that the operating agreement merely provided the structure for the management of the LLC. The operating agreement did not require members to provide additional capital, to participate in the management of the LLC, or to provide any personal expertise or services to the LLC. In fact, the operating agreement specifically authorized members to resign as officers or committee members at any time. Accordingly, the court upheld the provisions of the Virginia statute triggering dissociation on the bankruptcy of a member.

It is likely that the *Garrison-Ashburn* court would have reached the same conclusion even if the court had held that the operating agreement constituted an executory contract. The operating agreement in *Garrison-Ashburn* did not specifically give Mr. Chapman (a nonmanaging member) the authority to block the sale of the LLC's property. Instead, it vested the sole and complete control and management of the LLC in the "Operating Manager" who had the authority to execute contracts on behalf of the LLC.¹⁴⁶ The operating agreement required the signatures of two officers, the Operating Manager and the "Assistant Operating Manager," to execute deeds.¹⁴⁷ Mr. Chapman was not the Operating Manager, and there was no evidence that he was the Assistant Operating Manager, of the LLC. Moreover, the court determined that the effect of his bankruptcy was to cause him to be dissociated from the LLC.¹⁴⁸

Unlike the *Garrison-Ashburn* court, the Bankruptcy Court for the District of Arizona, in the case of *In re Ehmman*,¹⁴⁹ held that a trustee in bankruptcy was entitled to assume the management rights of a debtor who was a nonmanaging member of an LLC where the court concluded that the operating agreement was not an executory contract. The *Ehmman* court reached its conclusion because the debtor member did not have any obligation to make capital contributions or provide services to the LLC.¹⁵⁰

It is not certain, however, whether the *Ehmman* opinion was based on the executory contract analysis or whether the court considered the conduct of the nondebtor members to be egregious. The LLC in *Ehmman* had been formed by the debtor's parents as

145. *Id.* at 709.

146. *Id.* at 703.

147. *Id.*

148. *Id.* at 704.

149. *Movitz v. Fiesta Invs., LLC (In re Ehmman)*, 319 B.R. 200, 201 (Bankr. D. Ariz. 2005).

150. *Id.* at 205.

part of an estate plan.¹⁵¹ The stated purpose for forming the LLC was to “accumulate investments for the benefit of our children after our deaths.”¹⁵² The LLC never made interim distributions to its members.

Shortly after the bankruptcy case was filed, however, the LLC distributed over \$500,000 to the other members: \$374,500 as loans to members or to corporations owned or controlled by other members, and \$42,500 and \$124,000, respectively in redemption of two other members’ interests in the LLC.¹⁵³ The court opined that the outflow of over half a million dollars was inconsistent with the original goal of the LLC.

The trustee in bankruptcy had neither assumed nor rejected the operating agreement. The court held that assumption was not necessary because the operating agreement was not an executory contract.¹⁵⁴ Instead, the debtor’s interest in the LLC became part of the bankruptcy estate when the bankruptcy petition was filed. Accordingly, the court held that the trustee had the same rights as the debtor member, including a right to redemption of the LLC interest; the appointment of a receiver to operate the LLC in accordance with the operating agreement; or to sue to dissolve the LLC, wind up its affairs, and liquidate.¹⁵⁵

The exercise of any one of these rights could cause serious harm to the nondebtor members of the LLC. However, the result in *Ehmann* seems equitable in light of the conduct of the nondebtor members.

C. Fifth Circuit Precedent

As explained earlier, no cases could be found in which a court in the Fifth Circuit has decided whether the Bankruptcy Code’s anti-*ipso facto* provisions should supersede provisions in an operating agreement or under state law that alter the management rights of an LLC member in the event of the member’s bankruptcy. It is likely however, that, if and when a decision is required, courts will follow Fifth Circuit precedent concerning the effect of state partnership law on the bankruptcy of a partner.¹⁵⁶

151. For a discussion of the use of an LLC in an estate plan, see *infra* notes 383–408 and accompanying text.

152. *Ehmann*, 319 B.R. at 202.

153. *Id.*

154. *Id.* at 206.

155. *Id.*

156. As explained earlier, most, if not all, of the decided cases concerning the issues of whether an operating agreement constitutes an executory contract and

The United States Court of Appeals for the Fifth Circuit seems to interpret literally the Bankruptcy Code provisions that prohibit a trustee or a debtor in possession from assuming an executory contract that prohibits or restricts assignment of rights or delegation of duties if “applicable law excuses a party, other than the debtor, to such contract . . . from accepting performance from or rendering performance to [the trustee or an entity other than the debtor] . . . and . . . such party does not consent to such assumption”¹⁵⁷ For example, in the case of *In re O’Connor*,¹⁵⁸ the Fifth Circuit held that a trustee in bankruptcy did not succeed to the management rights of a debtor partner because applicable state law (the Louisiana Partnership Law)¹⁵⁹ prohibited a partner from substituting another as a partner.¹⁵⁹

The partnership in *O’Connor* was a general partnership formed by four individuals, including the debtor, Mickey O’Connor. The partnership agreement included four restrictions on a partner’s right to transfer or assign the partner’s interest in the partnership: (1) the partner could not substitute another person as a partner without the written consent of a majority of the partners; (2) a majority of the partners was required to give written consent before a partner could assign, mortgage, or sell the partner’s interest in the partnership or its assets; (3) the sale, exchange, transfer, or assignment of a partner’s right to share in partnership profits or losses would be valid only if the partner’s interest were first offered to the partnership, and then to the other partners; and (4) any transaction in violation of the restrictions would be null and void.¹⁶⁰

Approximately five years after the partnership had been formed, Mr. O’Connor filed a petition for relief under Chapter 11 of the Bankruptcy Code. Mr. O’Connor remained a debtor in possession for almost four years until a trustee was appointed for his estate. When the trustee met with one of the partners in 1991, the partner transferred to the trustee \$155,000, which represented Mr. O’Connor’s share of partnership distributions for 1991 that had been held for the benefit of Mr. O’Connor’s bankruptcy estate. The partner also offered to purchase Mr. O’Connor’s partnership

whether a trustee or debtor in possession may assume an operating agreement have relied on analogous cases involving the bankruptcy of a partner. *See supra* notes 127–155 and accompanying text.

157. 11 U.S.C.A. § 365(c)(1)(A)-(B), (e)(2)(A)(i)-(ii) (2004).

158. *Stumpf v. McGee (In re O’Connor)*, 258 F.3d 392 (5th Cir. 2001).

159. *Id.* at 394–95; *see also* La. Civ. Code art. 2812.

160. *In re O’Connor*, 258 F.3d at 395.

interest. However, the trustee responded that he could not sell the interest without court approval and that he had to determine the value of the interest.¹⁶¹

During the pendency of the bankruptcy proceedings, Mr. O'Connor's partners engaged in various transfers of partnership interests. The trustee did not assume or reject the partnership agreement. Instead, the trustee sought to invalidate the transfers of the partnership interests and to exercise Mr. O'Connor's management rights in his partnership interest.¹⁶²

The trustee argued that the debtor's partnership interest passed through to the bankruptcy estate, along with all of the debtor's economic and management rights in the interest. The district court had held that the trustee could not assume the debtor's management rights in the partnership interest because the partnership agreement was not assumable.¹⁶³ The Fifth Circuit affirmed, holding that the focus of whether the partnership agreement was subject to assumption is applicable law.¹⁶⁴ In reaching this result, the Fifth Circuit relied on section 365(c)(1) of the Bankruptcy Code, which provides, in part:

The trustee may not assume or assign any executory contract . . . of the debtor, whether or not such contract . . . prohibits or restricts assignment of rights or delegation of duties, if . . . applicable law excuses a party, other than the debtor, to such contract . . . from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession . . . and . . . such party does not consent to such assumption¹⁶⁵

Because Louisiana law provides that a partner cannot make a third person a member of the partnership without the consent of the other partners and because the other partners did not consent to the assignment of the debtor partner's management rights in the partnership, the Fifth Circuit held that the trustee could not exercise any of the debtor partner's management rights.¹⁶⁶

Under the Louisiana Partnership Law, a partner can share with another the partner's economic rights in the partnership interest.¹⁶⁷ The Fifth Circuit opined that the trustee could have sued to recover

161. *Id.*

162. *Id.* at 396.

163. *Id.*

164. *Id.* at 402.

165. 11 U.S.C.A. § 365(c)(1)(A)-(B) (2004).

166. *In re O'Connor*, 258 F.3d at 402.

167. La. Civ. Code art. 2812.

the economic rights that attached to the debtor's partnership interest. However, the trustee had not sought to recover the debtor's economic rights and had not sued the partnership for those rights. Instead, the trustee sought only a declaration that certain transfers of partnership interests by the other partners were invalid, a declaration of the bankruptcy estate's proportionate share of ownership of the terminated interests of the transferee partners, and an accounting for partnership distributions that the transferee partners received attributable to the interest-transfers. The Fifth Circuit held that the trustee could not exercise the debtor's rights to challenge the transfer of partnership interests after the trustee was appointed.¹⁶⁸

O'Connor should protect members of a Louisiana LLC from the assumption of a debtor member's management rights by a trustee in bankruptcy. Like the Louisiana Partnership Law, the Louisiana LLC Law provides that an assignee of a member's interest in an LLC may not become a member of an LLC or exercise any of the rights or powers of a member unless the other members unanimously consent in writing.¹⁶⁹

O'Connor, however, may not protect the nondebtor members of an LLC where a member has become a debtor in possession. As explained earlier, a debtor in possession is not a person other than the debtor. Thus, there is no assignment of a member's interest when a bankruptcy petition is filed for the member and the member becomes a debtor in possession. If the Louisiana Legislature enacted a provision prohibiting an LLC member from exercising the member's management rights when a petition in bankruptcy is filed for the member, such a provision is likely to be upheld by the Fifth Circuit.

In *Phillips v. First City, Texas-Tyler (In re Phillips)*,¹⁷⁰ the Fifth Circuit held that a provision of the Texas Uniform Partnership Act, prohibiting a bankrupt general partner from filing a voluntary bankruptcy petition on behalf of the partnership, was not preempted by federal bankruptcy law. The partners in *Phillips*, Harry S. Phillips (Harry) and Martha J. Phillips (Martha), were divorced in 1976. Instead of dividing their extensive real estate and mineral interests, they created Phillips & Phillips, Ltd., (P & P) by transferring the community property to P & P. The partnership agreement provided that Harry and Martha each owned half of P & P, and Harry was the sole general partner.¹⁷¹

168. *In re O'Connor*, 258 F.3d at 404.

169. La. R.S. 12:1332(A) (1994).

170. 966 F.2d 926, 927-28 (5th Cir. 1992).

171. *Id.* at 298.

In February 1988, a Texas court issued a final judgment in accord with a jury's findings that Harry had breached the partnership agreement and his fiduciary duties to Martha. The court awarded damages to Martha, dissolved P & P, and directed Harry, as general partner of P & P to wind up P & P within ninety days. Harry appealed from the part of the court's order that dissolved P & P, and Martha appealed from the court's award of damages.¹⁷²

While the appeal was pending, Harry filed a voluntary petition under Chapter 11 of the Bankruptcy Code for his personal estate. Later, and two days before a Texas court was to consider Martha's motions for contempt and appointment of a receiver for P & P, Harry filed a voluntary petition for protection under Chapter 11 for P & P.¹⁷³ The issue in *Phillips* was whether Harry had authority to file a voluntary bankruptcy petition on behalf of P & P.¹⁷⁴

At the time that Harry filed the bankruptcy petition on behalf of P & P, the partnership had been dissolved by order of the Texas court.¹⁷⁵ Section 35(3)(b) of the Texas Uniform Partnership Act provided that a "partnership is in no case bound by any act of a partner after dissolution . . . [w]here the partner has become bankrupt."¹⁷⁶ The Fifth Circuit interpreted this language to prohibit Harry from placing P & P in Chapter 11 proceedings after the Texas court dissolved P & P and Harry secured Chapter 11 protection for himself.¹⁷⁷

The Fifth Circuit also held that federal bankruptcy law did not preempt state partnership law on this issue.¹⁷⁸ The district court had held that Federal Bankruptcy Rule 1004(a) negated the effect of section 35(3)(b) of the Texas Act.¹⁷⁹ Bankruptcy Rule 1004(a) provides, "A voluntary petition may be filed on behalf of the

172. *Id.*

173. *Id.*

174. *Id.* at 297.

175. *Id.* at 928. Harry's filing of a bankruptcy petition for his personal estate also would have caused the partnership to dissolve under Texas law. The Texas Uniform Partnership Act that was in effect at the time that Harry filed the bankruptcy petitions provided that the bankruptcy of a partner caused the partnership to dissolve. *Id.* at 929 (citing Tex. Rev. Civ. Stat. Ann. art. 6132b § 31(5) (Vernon 1970)).

176. *Id.* at 929 (quoting Tex. Rev. Civ. Stat. Ann. Art. 6132b § 35(3)(b) (Vernon 1970)).

177. *Id.*

178. *Id.* at 927.

179. *Id.* at 933.

partnership by one or more general partners if all general partners consent to the petition.”¹⁸⁰

No federal law, however, defines the term “general partner.” Because a definition is lacking under federal law, the Fifth Circuit determined that state partnership law must provide the definition.¹⁸¹ The Texas Uniform Partnership Act defined a general partner as a partner that has “all the rights and powers and [is] subject to all the restrictions and liabilities of a partner in a partnership without limited partners.”¹⁸² The Fifth Circuit reasoned that because section 35(b) of the Texas act constituted one of the restrictions that defines the term “partner” in Texas, an entity that has all of the rights and responsibilities of a general partner under Texas law, but also can act on behalf of the partnership after filing a bankruptcy petition, is something more than, and therefore not, a general partner under Texas law.¹⁸³

Harry also argued that section 365(e) of the Bankruptcy Code conflicted with, and therefore preempted, Texas law. As explained above, section 365(e)(1) disallows modification or termination of an executory contract solely because of a provision in the contract that is conditioned on the commencement of a case under Title 11. Section 365(e)(2), however, provides, in part:

(2) Paragraph (1) of this subsection [section 365(e)(1)] 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 . . . 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 assignment¹⁸⁴

Relying on section 365(e)(2), the Fifth Circuit held section 365(e)(1) inapplicable because there was no contract that deprived Harry of the right to act on P & P’s behalf after declaring personal

180. *Id.* (citing Fed. Bankr. R. 1004(a)).

181. *Id.* at 933 (citing *Westover Hills, Ltd.*, 46 B.R. 300, 303–05 (Bankr. D. Wyo. 1985) (applying Wyoming law to determine whether a partner is a limited partner or a general partner for purposes of rule 1004(a)).

182. *Id.* at 933 (quoting Tex. Rev. Civ. Stat. Ann. art 6132a § 10(a)).

183. *Id.*

184. 11 U.S.C.A. § 365(e)(2) (2004).

bankruptcy; instead, Texas law had that effect.¹⁸⁵ The issue in *Phillips* was whether a bankrupt partner was eligible to file a voluntary bankruptcy petition on behalf of a dissolved partnership. The Texas statute specifically prohibited a bankrupt partner from acting on behalf of a dissolved partnership. It is not certain whether the Fifth Circuit will limit *Phillips* to its facts. However, the language in *Phillips* is broad enough to prevent preemption under section 365(e) of the Bankruptcy Code of a state law prohibiting a general partner or a member of an LLC from participating in the management of the partnership or LLC.

Unlike the Texas partnership law that was not preempted in *Phillips*, the Louisiana LLC Law has no provision restricting the management rights of an LLC member for which a petition in bankruptcy has been filed. If the members of a Louisiana LLC wish to restrict the management rights of a bankrupt LLC member, they must include a provision to that effect in the LLC's articles of organization or in an operating agreement. Where the bankruptcy of a member triggers a provision restricting the member's management rights under the terms of an operating agreement, rather than a state law provision to that effect, the Fifth Circuit may hold that the provision constitutes an *ipso facto* clause and may be disregarded under federal bankruptcy law.

Nevertheless, it is more likely that the Fifth Circuit will allow a member of a Louisiana LLC who is a debtor in possession to continue to exercise the member's management rights because the Louisiana LLC Law does not excuse the other members from accepting performance from or from rendering performance to a bankrupt member, as required by section 365(e)(2) of the Bankruptcy Code.

In both *O'Connor* and *Phillips*, it seems that the Fifth Circuit reached an equitable result. The other partners in *O'Connor* did not seek to divest the debtor of his economic rights in his partnership interest; distributions were withheld and paid over to the trustee on Mr. O'Connor's behalf, and the partners were willing to purchase Mr. O'Connor's partnership interest. Indeed,

185. *In re Phillips*, 966 F.2d at 935. Some courts, however, have construed § 365(e)(2) as if it were to be read *in pari materia* with § 365(c) as not allowing partners (or LLC members) to avoid management of the business by a member who is a debtor in possession. The United States Court of Appeals for the First Circuit has argued that to do otherwise would lead to an "absurd result:" "there would be no contractual right left for a debtor or debtor in possession to assume [an operating agreement] under § 365(c)(1) because it would already have been terminated automatically under § 365(e)." *Summit Inv. & Dev. Corp. v. Leroux*, 69 F.3d 608, 613 (1st Cir. 1995).

the trustee had not even attempted to assume the partnership agreement, but instead sought to exercise Mr. O'Connor's management rights without obtaining them under proper bankruptcy procedures.

In *Phillips*, there was evidence that the debtor had mishandled partnership affairs to the detriment of the limited partner. It appeared that the debtor filed a bankruptcy petition only to hinder the limited partner's ability to pursue her claims against his mismanagement. It was necessary to divest Mr. Phillips of his management rights in order to protect his wife's economic interests from abuse.

It would be better, as a matter of policy, if the Fifth Circuit would weigh the policies on a case by case basis in determining whether a trustee or a debtor in possession may assume the debtor's management rights with respect to an interest in an LLC. Bankruptcy courts, by their nature, are courts of equity.¹⁸⁶ The court also could decide a case by reference to the good faith standard of bankruptcy law. Indeed, the Fifth Circuit has described the "good faith" standard that is applied in bankruptcy cases as follows:

Every bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings (citation omitted). Such a standard furthers the balancing process between the interests of debtors and creditors which characterizes so many provisions of the bankruptcy laws and is necessary to legitimize the delay and costs imposed upon parties to a bankruptcy. Requirement of good faith prevents abuse of the bankruptcy by debtors whose overriding motive is to delay creditors without benefitting them in any way or to achieve reprehensible purposes. Moreover, a good faith standard protects the jurisdiction integrity of the bankruptcy courts by rendering their power equitable weapons (i.e., avoidance of liens, discharge of debts, marshalling and turnover of assets) available only to those debtors and creditors with "clean hands." The Supreme Court aptly summarized the bankruptcy court's responsibility to enforce a standard of good faith when it stated:

"A court of equity may in its discretion in the exercise of the jurisdiction committed to it grant or deny relief upon

186. *Young v. United States*, 535 U.S. 43, 50, 122 S.Ct. 1036, 1041 (2002).

performance of a condition which will safeguard the public interest." . . . These principles are a part of the control which the court has over the whole process of formulation and approval of plans of composition or reorganization¹⁸⁷

The Fifth Circuit, however, has not articulated application of the good faith standard in any of its opinions concerning partners who become debtors in bankruptcy. Instead, the Fifth Circuit seems to take a textual approach in determining whether a partnership agreement is an executory contract and whether a trustee or debtor in possession may assume the partnership agreement. In both *Phillips* and *O'Connor*, the Fifth Circuit relied on the literal language of the Bankruptcy Code, providing that executory contracts may be assumed or rejected, notwithstanding *ipso facto* clauses, unless applicable law excuses a party from the assumption and the party exercises the right.

If the Fifth Circuit, in fact, is taking a textual approach to the executory contract provisions, the Louisiana Legislature can either protect nondebtor members or leave them to potential conflicts of interest that may arise when a petition in bankruptcy is filed for a managing member of the LLC. If the Legislature enacted a provision triggering the dissociation of a member that becomes a debtor in bankruptcy, a court later might be able to fashion an equitable remedy, either allowing the member to continue to manage the LLC or preventing the member from exercising management rights, depending on the circumstances of the case. Without a provision in the Louisiana LLC Law triggering the dissociation of a bankrupt member, a court, relying on Fifth Circuit precedent, might not protect nondebtor members from mismanagement by a debtor member.

Admittedly, there will be some cases in which members of an LLC do not mind the continuance of the exercise of management powers by a member who is a debtor in possession. An amendment to the Louisiana LLC Law providing for the termination of a member's management rights on the bankruptcy of the member would not preclude the members from agreeing to allow a member to continue to exercise management rights after a petition in bankruptcy has been filed for the member. Section 365(e) only allows an *ipso facto* provision to apply in cases where applicable law excuses the members from accepting performance

187. *Little Creek Dev. Co. v. Commonwealth Mortgage Corp.* (In re *Little Creek Dev. Co.*), 779 F.2d 1068, 1071-72 (5th Cir. 1986) (quoting *American United Mut. Life Ins. Co. v. City of Avon Park*, 311 U.S. 138, 145, 61 S.Ct. 157, 161 (1940)).

from or rendering performance to the debtor *and* the other members do not consent to the continued performance of the bankrupt member's management rights.¹⁸⁸

II. EXPULSION; SALE OF A MEMBER'S ENTIRE ECONOMIC INTEREST

The Louisiana LLC Law does not include a provision allowing members to expel another member, describing the circumstances under which a member may be expelled or prescribing whether an expelled member retains any economic interest in the LLC. The LLC Law also lacks a provision describing other effects of the expulsion of a member and fails to provide any protection to a minority member to prevent a wrongful expulsion by the majority. Members of an LLC can anticipate the problems of having to continue to work with an unwanted member by including such provisions in the LLC's articles of organization or an operating agreement.¹⁸⁹ As explained earlier, however, the LLC law should be drafted with closely held businesses in mind. The LLC Law should include provisions that are most likely to meet the reasonable expectations of persons who are less likely to be able to afford or appreciate the need for sophisticated counsel in arranging the affairs of the business.

Under the Louisiana LLC Law, members of an LLC should be able to vote to expel a member even if an operating agreement lacks a provision authorizing the expulsion¹⁹⁰ as long as the expulsion does not violate the fiduciary obligation to deal in good faith with other members.¹⁹¹ On the other hand, a majority of the members may amend the operating agreement to allow them to expel a member "with or without cause."¹⁹² Alternatively, a vote of a majority of the members to expel another member could be

188. 11 U.S.C.A. § 365(e)(2) (2004).

189. *See* La. R.S. 12:1301(A)(16) (defining the term "operating agreement" to mean any agreement, written or oral, of the members as to the affairs of an LLC and the conduct of its business), 12:1305(C)(6) (1994 & Supp. 2005) (articles of organization shall set forth any provision, not inconsistent with law, that the members elect to set forth in the articles of organization).

190. *See* La. R.S. 12:1318 (1994) (default rules provide that members are entitled to one vote per member and majority vote of the members necessary to make all decisions).

191. La. R.S. 12:1314(A)(1) (1994 & Supp. 2005). *Cf.* 2 Alan R. Bromberg & Larry E. Ribstein, Bromberg and Ribstein on Partnership § 7.02(f) (2003-1 Supp.).

192. *See* La. R.S. 12:1318(B)(6) (1994) (vote of a majority of the members of an LLC required to amend the operating agreement).

treated as an amendment to the operating agreement.¹⁹³ In all cases, the good faith standard should apply in determining whether an expulsion is wrongful. However, the Louisiana LLC Law does not specifically provide any remedy for a member who is wrongfully expelled from an LLC.

Indeed, it is not even certain whether a member who is expelled from a Louisiana LLC may receive a payment for the member's interest. Section 12:1325 of the Louisiana Revised Statutes provides that a member that withdraws from an at-will LLC is entitled to a distribution from the LLC on withdrawal.¹⁹⁴ However, there is no statute in the Louisiana LLC Law defining the term "withdrawal." If an expulsion is treated as an involuntary withdrawal within the meaning of section 12:1325, an expelled member should be entitled to a distribution.

Even if an expelled member is entitled to receive a distribution, the amount of the distribution under section 12:1325 is only the fair market value of the member's interest.¹⁹⁵ A member who is expelled by the majority, by definition, owns a minority interest in the LLC. As explained earlier, a court is likely to apply discounts for a minority interest and lack of marketability in determining the fair market value of a minority interest in an LLC.¹⁹⁶

A majority of the members also may effectively expel, or freeze-out, another member by effecting a merger of the LLC with another LLC.¹⁹⁷ A "freeze-out" merger is a transaction in which majority shareholders force minority shareholders to relinquish their shares in the corporation in exchange for cash, notes, or other

193. See La. R.S. 12:1301(16) (defining the term "operating agreement" as any agreement, written or oral, of the members as to the LLC's affairs and the operation of its business), 12:1318(B)(6) (1994 & Supp. 2005) (majority vote of the members required to amend the operating agreement).

194. La. R.S. 12:1325(B)-(C) (1994 & Supp. 2005). For a discussion of the rules under the Louisiana LLC Law that apply to a voluntary withdrawal from an LLC, see *infra* notes 255-262 and accompanying text.

195. La. R.S. 12:1325(C) (1994 & Supp. 2005).

196. Cf. *Shopf v. Marina Del Ray Partnership*, 549 So. 2d 833 (La. 1989) (fair market value of the interest of a partner owning a minority interest in the partnership determined by taking into account a discount to reflect the lack of control that may be exercised by a minority partner).

197. See La. R.S. 12:1357 (authorizing the merger of an LLC with or into a domestic LLC, partnership in commendam, partnership, or business or nonprofit corporation), 12:1359(A)(1) (1994 & Supp. 2005) (authorizing approval of an LLC merger by a majority of the members in accordance with La. R.S. 12:1318).

types of property.¹⁹⁸ Majority shareholders in closely held corporations have effected freeze-outs of minority members by forming a shell corporation and transferring their voting shares to the corporation.¹⁹⁹ After the transfer, the majority shareholders own 100 percent of the newly-organized corporation. Then, the majority shareholders have their directors vote to merge the two corporations, cashing out the minority shareholders.²⁰⁰

A similar technique could be used by the members of a Louisiana LLC to freeze out a minority member. While the freeze-out would require payment to the minority, it could deprive the member of any salary or payments for services that the member had provided to the LLC prior to the merger. Moreover, it is likely that the minority member would receive only the fair market value of the member's interest²⁰¹ (or less, if an operating agreement provided for a smaller amount on the buyout of a member's LLC interest). Unlike the Louisiana Business Corporation Law, however, the Louisiana LLC Law does not provide that members have dissenters' rights in the event that an LLC merges with another entity.²⁰²

While a wrongfully expelled member might have a right to sue for damages and might even have a right to receive a payment for goodwill,²⁰³ there is no statutory provision in the Louisiana LLC Law authorizing such a suit. Indeed, allowing a majority of the LLC members to expel another member without cause invites

198. Glenn G. Morris & Wendell H. Holmes, *Business Organizations* § 36.10, in 8 *Louisiana Civil Law Treatise* 268 (1999 & 2005 Supp.).

199. *Id.*

200. *See, e.g.,* *Coggins v. New England Patriots Football Club, Inc.*, 492 N.E.2d 1112, 1114–15 (Mass. 1986) (discussed in Franklin A. Gevurtz, *Squeeze-Outs and Freeze-Outs in Limited Liability Companies*, 73 *Wash. U. L.Q.* 497, 523 (1995)).

201. Louisiana Revised Statutes 12:1325(C) (1994 & Supp. 2005), requiring an LLC to pay a withdrawing member the fair market value of the member's LLC interest, is the only statute in the Louisiana LLC Law providing for a buyout of a member's interest.

202. *See* La. R.S. 12:131 (1994 & Supp. 2005) (allowing a minority shareholder to dissent from a merger unless eighty percent of the total voting power of the corporation has voted to approve the merger). The eighty percent threshold may effectively eliminate a minority shareholder's ability to dissent from a merger. The limitations of dissenters' rights in the context of a freeze-out merger under the Louisiana Business Corporation Law are discussed in Morris & Holmes, *supra* note 198, at 269–70. *See also id.* §§ 38.01–38.12.

203. 1 Larry E. Ribstein & Robert R. Keatinge, *Ribstein and Keatinge on Limited Liability Companies* § 11:2 (2d ed. 2004).

majority oppression and squeeze-outs of minority members.²⁰⁴ A "squeeze-out" is a transaction in which the majority owners of a business organization use their control to deprive the minority of any managerial control over and any economic return from the entity.²⁰⁵

In contrast, the Louisiana Partnership Law provides that a partnership may expel a partner for just cause.²⁰⁶ The Revision Comments to the partnership law explain that expulsion of a partner is allowed when the conduct of a partner is detrimental to the interests of the partners or the partnership.²⁰⁷ The Revision Comments list the following examples of a partner's conduct that would constitute "just cause" for expulsion: failure to perform obligations, engaging in activities that prejudice the business of the partnership, or willful or repeated breach of the partnership agreement.²⁰⁸ A partner who is expelled for just cause may be

204. Franklin A. Gevurtz, *Squeeze-Outs and Freeze-Outs in Limited Liability Companies*, 73 Wash. U. L.Q. 497, 511 (1995).

205. *Id.* at 498.

206. La. Civ. Code art. 2820.

207. La. Civ. Code art. 2820 cmt. (a).

208. *Id.* Professors Morris and Holmes express skepticism as to whether the Revision Comments to Louisiana Civil Code article 2820 on "just cause" state the law accurately. Glenn G. Morris & Wendell H. Holmes, *Business Organizations* § 4.09, in 7 Louisiana Civil Law Treatise 142-47 (1999). Louisiana Civil Code article 2821 allows a partner to withdraw from a partnership that has been constituted for a term without the consent of the other partners prior to the expiration of the term if the member seeking to withdraw has "just cause" arising out of the failure of another partner to perform an obligation. Professors Morris and Holmes observe that the Revision Comments to article 2821 explain that "[j]ust cause . . . is limited to causes that arise out of the failure of a partner to perform an obligation and does not cover the broader range of causes such as the hardship of the partner, the nonprofitability of the partnership, or the failure of the partnership to realize its objectives." *Id.* See La. Civ. Code art. 2821 cmt. (a). Professors Morris and Holmes argue that the term "just cause" should have the same meaning under both article 2820 and article 2821 and should have a meaning related to the function it serves. *Id.* Accordingly, they conclude that in both statutes, the term "just cause" should be understood to mean wrongful behavior by the other partner or partners that is serious enough to justify the action being taken, i.e., expulsion or withdrawal. *Id.* They explain:

In both cases, the expelling or withdrawing parties are seeking essentially the same thing: a dissolution of their existing contractual relationship with the other partners on grounds of alleged breaches of fiduciary duty by those other partners. In neither case should the acting partner(s)' own financial motivations, unconnected to the wrongful

liable to the partnership for damages that result from the partner's misconduct.²⁰⁹ Nevertheless, an expelled partner is protected to a certain extent because the expelled partner is entitled to receive a distribution from the partnership in an amount equal to the value of the partner's interest at the time of the expulsion (presumably, reduced by the amount of any damages for which the expelled partner is liable to the partnership).²¹⁰

The Louisiana LLC Law seems to follow the corporate model in this regard, and is silent with respect to member misconduct, except for the requirement that a member who manages an LLC has a "good faith" fiduciary duty to the LLC and the other members.²¹¹ The good faith standard of the Louisiana LLC Law requires only that a member not engage in gross negligence, or reckless disregard of, or carelessness amounting to indifference to the best interests of the LLC or its members.²¹² Under this standard, it may be difficult to prove that a member has been expelled in bad faith.

Moreover, a nonmanaging member of a manager-managed LLC does not have fiduciary duties to the LLC or the other members.²¹³ Admittedly, the Louisiana Civil Code imposes a duty

behavior of the other partners, be considered "just cause." However, serious misconduct by a partner should be grounds for terminating the partnership relationship with that partner, regardless of whether the termination is perceived as an expulsion of the guilty partner(s) or a withdrawal by the innocent partner(s).

Id. (footnote omitted).

209. La. Civ. Code art. 2820 cmt. (b). See La. Civ. Code arts. 2808–2810.

210. La. Civ. Code art. 2823 & cmt. (a). The amount that an expelled partner will receive, however, is its fair market value (which may be determined by taking into account discounts for a minority interest and lack of marketability). See, e.g., *Shopf v. Marina Del Ray Partnership*, 549 So. 2d 833 (La. 1989).

211. La. R.S. 12:1314 (1994 & Supp. 2005).

212. La. R.S. 12:1314(C) (1994 & Supp. 2005). See, e.g., *In re Provenza*, 316 B.R. 225, 230 (Bankr. E.D. La. 2003) (managing member of a Louisiana LLC who later filed a petition in bankruptcy did not breach his fiduciary duties when he agreed to guarantee LLC liabilities, incurring *in solido* liability with the other members, even though the debtor member had outstanding tax liabilities and a pending divorce; taxes were assessed after debtor member guaranteed the notes and the effect of the divorce proceedings was unknown at the time the notes were guaranteed).

213. Louisiana Revised Statutes 12:1314(A) provides that members of a member-managed LLC and managers of a manager-managed LLC stand in a fiduciary relationship to the LLC and its members. La. R.S. 12:1314(A) (1994

to deal in good faith on all parties to an obligation or contract (which should include an operating agreement).²¹⁴ However, it is not certain whether or under what circumstances a court will hold that nonmanaging members (or managing members, for that matter) who have expelled a member of a Louisiana LLC without cause have acted in bad faith.

Some courts in states whose partnership law authorizes the expulsion of a partner pursuant to the terms of a partnership agreement have refused to enforce an expulsion provision in a partnership agreement where such expulsion is in bad faith.²¹⁵ An expulsion of a partner may be in bad faith where the expulsion results in a substantial forfeiture of the expelled partner's interest or the purpose of the expulsion is solely to benefit the expelling partners.²¹⁶

For example, in *Winston & Strawn v. Nosal*,²¹⁷ Chester W. Nosal, a partner in a law firm, received notice from Gary Fairchild, the firm's then-managing partner, that he was being "outplaced," or discharged from the firm, essentially for economic reasons. The case was decided by the lower court on summary judgment in favor of the law firm. Mr. Nosal argued that he was expelled solely because of his persistent requests to inspect the firm's books and records. According to Mr. Nosal, the law firm's records would have revealed secretive self-dealing on the part of the partnership's executive committee and fraudulent conduct by Mr. Fairchild.

From 1988 until his outplacement on April 2, 1992, Mr. Nosal made repeated requests through Mr. Fairchild to view the partnership's financial statements, point allocation and project compensation figures, executive committee meeting minutes, and partnership compensation records. The partnership agreement entitled all partners to "access the firm's books and records." There was no dispute that Mr. Fairchild refused to cooperate with Mr. Nosal's requests, other than to furnish him the firm's audited financial statements.

In late 1991, Mr. Fairchild raised the issue of "partner outplacement" before the firm's executive committee, indicating

& Supp. 2005). The statute does not require any duties of a nonmanaging member of a manager-managed LLC. *Id.*

214. La. Civ. Code art. 1983.

215. See cases cited in 2 Bromberg & Ribstein, *supra* note 191, at § 7.02(f) n.90.

216. *Id.* at nn.91, 91a.

217. 664 N.E.2d 239 (Ill. App. Ct. 1996), *disposition denied*, 671 N.E.2d 745 (1996).

that there would be a “modest re-sizing” to position the firm “to meet the new demands of the 1990’s marketplace.”²¹⁸ On March 23, 1992, approximately nineteen partners received notice that they were being outplaced by the firm. Mr. Nosal, however, was assured by another partner that he was not a candidate for outplacement. The partner sent a memorandum to Mr. Fairchild stating that Mr. Nosal’s recent contribution to the firm exceeded projections and recommended that Mr. Nosal be given an increase in ownership “points.”

At a partnership meeting on March 24, 1992, Mr. Nosal distributed a memorandum to the partners expressing his dissatisfaction with the executive committee’s decision to expel partners, stating that it was in violation of the partnership agreement, and indicating that, before he would endorse the expulsion, he would require an accounting and disclosure of all financial records regarding the partnership from 1987 to date.

In March 1992, Mr. Nosal made a final request for partnership documents and presented Mr. Fairchild with a draft complaint seeking enforcement of his right to inspect partnership records, damages for breach of fiduciary duty, and a declaratory judgment as to the partnership agreement. Mr. Nosal received his notice of outplacement on April 2, 1992. In depositions, Mr. Fairchild and two other partners stated that Mr. Nosal was outplaced because his interest in a two-pronged tax and international trade practice was incompatible with the interests and resources of the firm and because he had engaged in “disturbing” conduct.

Mr. Nosal claimed that the documents he sought would have revealed the executive committee’s plan to retain much of the firm’s wealth and management power in the hands of its members. He alleged that the documents would have proved that upon assuming control, and without generally notifying the other partners, the executive committee dramatically increased the number of partnership “points,” or portions of ownership interest in the firm, and then awarded themselves large increases.

The Illinois Appellate Court for the First Circuit noted that the record substantiated that the executive committee voted its members substantial increases in individual points that were not given to the other partners. In addition, the evidence indicated that the other partners were never notified about the action, and that when Mr. Nosal and another partner who was expelled, along with Mr. Nosal, repeatedly sought to learn about it, they were

218. *Id.* at 244.

repeatedly denied documents that were guaranteed them under the partnership agreement.

The appellate court held that summary judgment was inappropriate in the case because Mr. Nosal had sufficiently raised a triable issue that his expulsion occurred in breach of the other partners' fiduciary duty to exercise good faith and fair dealing.²¹⁹ According to the appellate court, Mr. Fairchild's steadfast denial of Mr. Nosal's access to records, his role in the outplacement, and the fact that it occurred just after Mr. Nosal threatened a lawsuit, raised an inference that Mr. Nosal was expelled solely because he persisted in invoking rights belonging to him under the partnership agreement and that the reasons advanced by the firm were pretextual.²²⁰

However, even where a purpose of expelling a partner is to benefit the expelling partners, this must be the *sole* cause for the expulsion.²²¹ Courts have held that a "bad faith" expulsion of a partner occurs only where the partners expel a partner for self-gain.²²² In this context, self-gain exists only where the expulsion lacks any legitimate business purpose and transfers to the expelling partners some significant economic benefit or right that the expelled member otherwise would have enjoyed; even if the expulsion prejudices the interests of the expelled partner, courts have upheld the expulsion where the other partners considered the expelled partner disruptive or damaging to the business.²²³ For example, in *Waite v. Sylvester*,²²⁴ the New Hampshire Supreme Court held that partners in a limited partnership did not breach

219. *Id.* at 246.

220. *Id.*

221. *Id.*

222. *See, e.g.,* *Bohatch v. Butler & Binion*, 905 S.W.2d 597, 602 (Tex. Ct. App. 1995), *aff'd*, 977 S.W.2d 543 (Tex. 1998) (citing *Day v. Sidley & Austin*, 394 F. Supp. 986, 992-94 (D.C. Cir. 1975)); *Lawlis v. Kightlinger & Gray*, 562 N.E.2d 435, 440-43 (Ind. Ct. App. 1990); *Leigh v. Crescent Square, Ltd.*, 608 N.E.2d 1166, 1169-71 (Ohio Ct. App. 1992); *Waite v. Sylvester*, 560 A.2d 619, 622-23 (N.H. 1989); *Levy v. Nassau Queens Med. Group*, 476 N.Y.S.2d 613, 614 (N.Y. App. Div. 1984); *Gelder Med. Group v. Webber*, 363 N.E.2d 573, 577 (N.Y. 1977); *Holman v. Coie*, 522 P.2d 515, 523-24 (Wash. Ct. App. 1974), *review denied*, 84 Wash. 2d 1011 (1974), *cert. denied*, 420 U.S. 984, 95 S. Ct. 1415 (1975).

223. *See* cases cited in 1 Carter G. Bishop & Daniel S. Kleinberger, *Limited Liability Companies: Tax and Business Law* ¶ 8.03[2][d] nn.206-07 (2003 & Supp. 2005).

224. 560 A.2d 619, 623 (N.H. 1989).

their fiduciary duties in expelling a partner because they were dissatisfied with his performance.

The rationale for allowing partners to expel another without cause lies in the principle of *delectus personae*, *i.e.*, that partners may choose with whom they are to be associated.²²⁵ This principle is especially important in professional firms, where expulsion of a partner may be necessary to protect relationships, both inside the firm and with clients.²²⁶ In *Lawlis v. Kightlinger & Gray*,²²⁷ where a law firm had expelled a partner after his successful struggle against alcoholism, the court explained:

The lifeblood of any partnership contains two essential ingredients, cash flow and profit, and the prime generators of that lifeblood are “good will” and favorable reputation. The term “good will” generally is defined as the probability that old customers of the firm will resort to the old place of business where it is well-established, well known, and enjoys the fixed and favorable consideration of its customers. An equally important business adjunct of a partnership engaged in the practice of law is a favorable reputation for ability and competence in the practice of that profession. A favorable reputation not only is involved in the retention of old clients, it is an essential ingredient in the acquisition of new ones. Any condition which has the potential to adversely affect the good will or favorable reputation of a law partnership is one which potentially involves the partnership’s economic survival. Thus, if a partner’s propensity toward alcohol has the potential to damage his firm’s good will or reputation for astuteness in the practice of law, simple prudence dictates the exercise of corrective action, . . . since the survival of the partnership itself potentially is at stake.²²⁸

225. See, e.g., *Levy*, 476 N.Y.S.2d at 614.

226. *Bohatch*, 977 S.W.2d at 551 (Hecht, J., concurring).

227. 562 N.E.2d 435 (Ind. Ct. App. 1990).

228. *Id.* at 442 (citations omitted). See also *Bohatch*, 977 S.W.2d 543 (Tex. 1998), *aff’g* 905 S.W.2d 597 (Tex. Ct. App. 1995) (partner in a law firm reported to the managing partner what she, in good faith, thought was overbilling by another partner in violation of the rules for professional conduct; after an inquiry by the firm and notice to the client, there was no evidence of overbilling and the client was satisfied with the fees; “whistle-blower” partner was expelled; expulsion held not in bad faith; after allegations of unethical conduct, relationship of trust necessary for both the existence of the firm and the

Both the ULLCA and the Prototype Act provide that a member may be expelled in accordance with a provision in an operating agreement.²²⁹ As explained earlier, an LLC law should be designed to meet the reasonable expectations of small business owners who are unlikely to have an operating agreement in effect. Most members of a closely held LLC would expect that they may be expelled only for cause. Allowing members of an LLC to draft an agreement to allow the expulsion of a member without cause does not present a problem to such persons. In some cases, members of an LLC might prefer to include such a provision in an operating agreement to provide greater certainty to the members concerning their rights in the LLC, reducing the expenses that would be associated with the expulsion of a member only for just cause.²³⁰ Requiring members of an LLC to show just cause for the expulsion inevitably invites litigation over the issue of whether there was sufficient cause for expelling a member.²³¹ Where an operating agreement allows expulsion without cause, all members of the LLC should be aware of the limitations on their rights.

The ULLCA allows members to expel another in certain other cases, but only by a unanimous vote.²³² The unanimity requirement should offer some degree of protection to minority members. On the other hand, requiring a unanimous vote of the members to expel another member, even for cause, might be cumbersome. Where a majority of the members cannot agree with another member, it might be better to allow the majority to expel the dissenting member. On the other hand, a minority member who opposes the decisions of the majority, may find it intolerable to remain a member in the firm. In that case, both the ULLCA and the Louisiana LLC Law allow the dissenting member to withdraw from the firm without cause upon providing notice (if the LLC is not entered into for a term) and receive a payment in liquidation of the member's interest in the LLC.²³³

representation of clients could not continue if the whistle-blower remained a partner in the firm).

229. Unif. Ltd. Liab. Co. Act § 601(4) (amended 1998), 6A U.L.A. 608 (2003); Prototype Ltd. Liab. Act, *supra* note 18, § 802(A)(3)(I) (1992).

230. *Cf.* Morris & Holmes, *supra* note 208, at 142-47.

231. *Id.*

232. Unif. Ltd. Liab. Co. Act § 601(5) (amended 1998), 6A U.L.A. 608 (2003).

233. *Id.* §§ 601(1), 603(a), 6A U.L.A. 608, 612 (2003); La. R.S. 12:1325(B)-(C) (1994 & Supp. 2005).

Under the ULLCA, members may vote to expel a member if it is unlawful to carry on the LLC's business with the member.²³⁴ This provision obviously is appropriate. The expulsion of such a member will ensure the continued operation of the LLC's business. As explained earlier, the ULLCA ensures that the expelled member at least will receive a distribution in an amount equal to the fair value of the member's LLC interest.²³⁵

The ULLCA also authorizes the members of an LLC to expel another member if there has been a transfer of substantially all of the member's economic interest in the LLC (other than for security purposes or pursuant to a creditor's charging order which has not been foreclosed).²³⁶ This provision has been criticized because it is likely to trigger litigation over the issue of whether a member has transferred "substantially all" of the member's economic interest in the LLC.²³⁷

The better rule would allow members to expel a member for cause unless an operating agreement provides otherwise. If the transfer of a significant portion of a member's economic interest in an LLC is not likely to cause harm to the LLC, for example, because the member is a non-managing member that does not own a significant economic interest in the LLC, the members arguably would not have just cause for expelling the member.

In contrast, the Prototype Act authorizes a majority of the members to expel another member when the member assigns all of the member's economic interest in the LLC.²³⁸ Under the ULLCA, a transfer of "all" of the member's economic interest in the LLC is an event that automatically causes the member's dissociation from the firm, divesting the member of management rights, as well.²³⁹ A member might transfer the member's entire economic interest in

234. *Id.* § 601(5)(i), 6A U.L.A. 608 (2003).

235. *Id.* § 701(a), 6A U.L.A. 614 (2003).

236. *Id.* § 601(5)(ii), 6A U.L.A. 608 (2003).

237. Ribstein, *supra* note 108, at 363. *See also* 1 Bishop & Kleinberger, *supra* note 223, at ¶ 8.03[2][b].

238. The Prototype Act provides that a majority of the members may expel a member who has assigned all of the member's "interest" in the LLC without designating that the interest so assigned is an economic interest only. Prototype Ltd. Liab. Co. Act, *supra* note 18, § 802(A)(3)(II). However, under the Prototype Act, a member can only assign the member's economic interest in the LLC. *Id.* § 704(A)(2). An assignee of a member's interest may become a member (and therefore, exercise the management rights of the former member) only if the other members unanimously consent. *Id.* § 706(A).

239. Unif. Ltd. Liab. Co. Act § 601(3) (amended 1998), 6A U.L.A. 608 (2003).

an LLC, for example, by gift, by sale, or when a creditor “charges” interest and forecloses. Under both the ULLCA and the Louisiana LLC Law, a judgment creditor of a member may apply to a court to charge the member’s interest in the LLC with payment of the unsatisfied amount of the judgment with interest.²⁴⁰ A charging order gives the creditor the rights of an assignee, *i.e.*, the right to receive distributions from the LLC to the extent that the member was entitled, in an amount up to the amount of the debt.²⁴¹ However, when a creditor forecloses on a member’s LLC interest and the entire interest is sold, the purchaser will succeed to the member’s entire economic interest in the LLC.²⁴²

Expulsion, or automatic dissociation in the case of a transfer of the member’s entire economic interest in an LLC, may be warranted. A member who has sold or otherwise transferred the member’s entire economic interest in the LLC is less likely to manage the LLC or vote on LLC matters in a manner that is consistent with the best interests of the LLC and the other members. In such a case, the member’s vote is likely to be more closely aligned with the interests of the purchaser of the interest or the charging creditor that has foreclosed on the member’s interest.

A unanimous vote of the members may effect the expulsion of a corporate member under the ULLCA if the member fails to obtain a revocation of the certificate of dissolution, or a reinstatement of its charter, or its right to conduct business, within ninety days after the LLC notifies a corporate member that it will be expelled because it has filed a certificate of dissolution or the equivalent, or its charter has been revoked, or the member’s right to conduct business has been suspended by the jurisdiction of its incorporation. Under the ULLCA, unanimous vote of the members may effect the expulsion of a corporate member if the member has filed a certificate of dissolution or the equivalent, or its charter has been revoked, or the corporation’s right to conduct business has been suspended and the corporate member fails to obtain a revocation of the certificate of dissolution, or reinstatement of its charter, or right to conduct business.²⁴³ Members of an LLC organized under the ULLCA also may expel,

240. *Id.* § 504, 6A U.L.A. 607 (2003); La. R.S. 12:1331 (1994).

241. *Id.* §§ 503(e), 504, 6A U.L.A. 605–07 (2003); La. R.S. 12:1330–1332 (1994).

242. *See id.* § 502, 6A U.L.A. 604 (2003) (transferee of a member’s LLC interest entitled only to receive distributions from the LLC).

243. *Id.* § 601(5)(iii), 6A U.L.A. 608 (2003). The ULLCA allows the corporate member a grace period of ninety days within receiving notification of the expulsion to obtain a revocation or reinstatement of its charter. *Id.*

by a unanimous vote, a partnership or LLC that is a member, has been dissolved, and its business wound up.²⁴⁴ If the members do not vote to expel the dissolved member, its successor(s) in interest will obtain the member's LLC interest by transfer.²⁴⁵ In that case, the successor(s) in interest will be transferee(s) with no right to participate in the management of the business or vote on LLC matters unless the other members vote to admit the successor(s) in interest as member(s).²⁴⁶ Under the ULLCA, a transferee is entitled only to receive distributions from the LLC to the extent that the member was entitled.²⁴⁷

Thus, the ULLCA gives the remaining members a choice when an entity that is a member is dissolved. On the one hand, they can vote to expel the dissolved member and purchase the member's interest for its fair value.²⁴⁸ On the other hand, the remaining members can simply allow the successor(s) in interest to share in the profits, losses, and distributions of the LLC, but not in the management of the business.²⁴⁹

Unlike the ULLCA, the Louisiana LLC Law does not authorize the purchase of a dissolved member's LLC interest. Instead, the legal representative or successor of the dissolved member has the rights of an assignee, *i.e.*, the right to share in the LLC's profits and losses and to receive distributions if an operating agreement or a vote of the members authorizes the distribution.²⁵⁰ The legal representative or successor of a dissolved member of a Louisiana LLC may not participate in the management of the LLC, vote on LLC matters, or even inspect LLC records unless the other members unanimously consent in writing to admit the

244. *Id.* § 601(5)(iv), 6A U.L.A. 608 (2003).

245. When a corporation, partnership, or LLC dissolves, the entity is liquidated and its assets are distributed (*i.e.* transferred), first to creditors in satisfaction of the entity's debts, and then to the owners. La. Civ. Code art. 2833 (dissolution of a partnership); La. R.S. 12:145(F) (1994 & Supp. 2005) (corporation); La. R.S. 12:1337 (1994 & Supp. 2005) (LLC).

246. Unif. Ltd. Liab. Co. Act §§ 502, 503(a) (amended 1998), 6A U.L.A. 604-05 (2003).

247. *Id.* § 502, 6A U.L.A. 604 (2003).

248. *Id.* § 603(a), 6A U.L.A. 612 (2003).

249. Under the ULLCA, the successor(s) in interest of a dissolved member are transferees of the member's interest and, as such, have the right to receive distributions from the LLC to which the dissolved member would have been entitled. *Id.* § 502, 6A U.L.A. 604 (2003).

250. La. R.S. 12:1324(A), 1330(A), 1333 (1994).

representative or successor as a member of the LLC.²⁵¹ The problems concerning the lack of a buyout requirement on the dissolution or termination of a member are discussed later.²⁵²

Under the ULLCA, an LLC or a member also may apply to a court for a judicial expulsion of another member who has: (1) engaged in wrongful conduct that adversely and materially affected the LLC's business; (2) willfully or persistently committed a material breach of the operating agreement or of a fiduciary duty owed to the LLC or the other members; or (3) engaged in conduct relating to the LLC's business that makes it not reasonably practicable to carry on business with the member.²⁵³ The ULLCA provisions for judicial expulsion of a member offer an opportunity for the members to expel a member who is causing harm to the business. At the same time, however, the ULLCA offers some

251. La. R.S. 12:1332(A) (1994). Cf. *Kinkle v. R.D.C., L.L.C.*, 04-1092 (La. App. 3d Cir. 12/08/04), 889 So. 2d 405 (on the death of an LLC member, the member's legal representative was an assignee under La. R.S. 12:1333 and was not permitted to participate in the management of the LLC).

252. See *infra* notes 334-82 and accompanying text. The effect of dissociation under the ULLCA differs significantly from the effect of dissociation under the Louisiana LLC Law in other ways. Unlike the Louisiana LLC Law, the ULLCA provides detailed rules concerning the effect of a member's dissociation from an LLC. If a member dissociates from an LLC organized under a statute that corresponds to the ULLCA, the dissociation generally terminates the member's right to participate in the management and conduct of the LLC's business and the member's duty to refrain from competing with the LLC's business. Unif. Ltd. Liab. Co. Act § 603(b)(1)-(2) (amended 1998), 6A U.L.A. 612 (2003). If the dissociation of the member was not wrongful, however, the member, the member's legal representative, or the assignee of the member's interest in the LLC may participate in the winding up of the LLC when the LLC dissolves. *Id.* §§ 603(b)(1), 803(a), 6A U.L.A. 612, 624 (2003). The member's duties of loyalty and care also terminate prospectively unless the dissociated member participates in the winding up of the LLC's business. *Id.* § 603(b)(2)-(3), 6A U.L.A. 612 (2003). Upon dissociation, a member of a ULLCAN LLC has only the rights of an assignee of a member's interest, i.e., a right to receive distributions from the LLC. *Id.* §§ 502, 603(b)(1), 6A U.L.A. 604, 612 (2003). Dissociation of a member also triggers a buyout requirement. *Id.* §§ 603(a), 701, 6A U.L.A. 612, 614 (2003). If an LLC is an at-will LLC, the LLC must purchase the dissociated member's interest for the fair value of the interest at the time of the dissociation. *Id.* §§ 603(a)(1), 701(a)(1), 6A U.L.A. 612, 614 (2003). An LLC that is entered into for a term must purchase the dissociated member's interest when the LLC dissolves, or if later, when the LLC's term expires. *Id.* §§ 603(a)(2), 701(a)(2), 6A U.L.A. 612, 614 (2003).

253. *Id.* § 601(6), 6A U.L.A. 608 (2003).

protection to a member from arbitrary expulsion by other members because the expulsion triggers a buyout requirement.²⁵⁴

The ULLCA rules concerning the expulsion of a member offer a model for Louisiana. A default rule that allows a majority of the members to expel another member without cause invites squeeze-outs and freeze-outs of minority members. While members should be permitted to include such a provision in an operating agreement, most members of a closely held business would not expect that they can be expelled from an LLC without cause. The ULLCA, however, does not offer a perfect model for Louisiana. Listing the reasons for which members may expel another is risky. There might be some other good reason to expel a member that is omitted from the list. While allowing members to expel another “for cause” is likely to generate litigation, any provision allowing expulsion, even for a stated reason, is likely to do so. Thus, it would be better for the statute to provide that members may expel another member for cause.

Of course, the remedy for a wrongfully expelled member of a closely held LLC is not reinstatement. Reinstatement would only leave all of the members, including the expelled member, in an untenable position, having to deal with persons they no longer trust. A member who is wrongfully expelled from an LLC should be entitled to collect tort damages, including, *inter alia*, compensation for lost wages and lost profits.

III. VOLUNTARY WITHDRAWAL²⁵⁵

The default rules of the Louisiana LLC Law give a member broad withdrawal rights unless the LLC is constituted for a term. A member of an at-will LLC may withdraw from the LLC in accordance with the terms of a written operating agreement.²⁵⁶ Unless otherwise provided in a written operating agreement, a member of an at-will LLC may withdraw by providing at least thirty days written notice to the LLC at its registered office and to each member and manager at the member’s or manager’s address as it appears on the LLC’s records.²⁵⁷

A member of a term LLC may not withdraw before the expiration of the LLC’s term without the consent of the other

254. *Id.* § 603(a), 6A U.L.A. 612 (2003).

255. For a discussion of some of the problems that may arise on the withdrawal of a member from a Louisiana LLC, see Kalinka, *supra* note 14, at 38–50.

256. La. R.S. 12:1325(B) (1994 & Supp. 2005).

257. *Id.*

members unless the member has just cause arising out of the failure of another member to perform an obligation.²⁵⁸ There is a policy reason for limiting the ability of a member to withdraw from a term LLC. If an LLC is entered into for a term, it is likely that the members intended the LLC to retain all of the members' capital contributions for the duration of the term to ensure the successful completion of a business project. Early withdrawal of a member from a term LLC is likely to damage the LLC's business and prejudice the interests of the remaining members.²⁵⁹ However, the Louisiana LLC Law is silent as to the meaning of the term "just cause."

It is likely that a court will define the term to have the same meaning as it does under the Louisiana Partnership Law. Like the Louisiana LLC Law, the Louisiana Partnership Law provides that a partner may withdraw from a term partnership without the consent of the other partners if the partner has just cause arising out of the failure of another partner to perform an obligation.²⁶⁰ The Revision Comments explain that just cause is limited to causes that arise out of the failure of a partner to perform an obligation and does not cover the broader range of causes such as the hardship of a partner, the nonprofitability of the partnership, or the failure of the partnership to realize its objectives.²⁶¹

The Louisiana LLC Law is silent as to when a member of a term LLC may withdraw without the consent of the other members and without just cause. By negative implication, it would seem that a member of a term LLC may withdraw from the LLC after the expiration of the LLC's term, regardless of whether the other members decided to extend the term. However, no cases could be found interpreting the provisions of the Louisiana LLC Law concerning whether or when a member may withdraw from a term LLC.

The Louisiana LLC Law does not specify that a member that desires to withdraw from a term LLC may do so when the term that was in existence at the time the member joined the LLC expires. Under the Louisiana LLC Law, a majority of the members of a term LLC may extend the term beyond the LLC's initial term by amending the LLC's articles of organization.²⁶² Where the other members continue to vote to extend an LLC's

258. La. R.S. 12:1325(A) (1994 & Supp. 2005).

259. La. Civ. Code art. 2821 cmt. (a).

260. La. Civ. Code art. 2821.

261. La. Civ. Code art. 2821 cmt. (a).

262. See La. R.S. 12:1318(B)(6) (1994) (majority vote of the members may amend the articles of organization).

term, a member of the LLC may not be able ever to withdraw from the LLC. The Louisiana LLC Law should be amended to allow a member to withdraw from a term LLC on the date of the expiration of the LLC's term that was specified when the member expressed his intention to withdraw.

Section 12:1303(B) of the Revised Statutes provides, in part that "every limited liability company shall have perpetual existence, unless a limited period of duration is stated in the articles of organization."²⁶³ The quoted language implies that an LLC is not a term LLC unless the LLC's articles of organization state that the LLC will be constituted for a limited term. In that case, the default rule providing for perpetual existence of an LLC would indicate that unless otherwise provided in an LLC's articles of organization, an LLC is an at-will LLC. Under such a reading of section 12:1303(B), members of an LLC that has perpetual existence should have withdrawal rights unless otherwise provided in a written operating agreement.

Section 12:1303(B), providing for the perpetual existence of an LLC, was enacted in 1997²⁶⁴ and probably was intended to reinforce the repeal of section 12:1334(3) of the Louisiana Revised Statutes that was effected by the same Act.²⁶⁵ As explained earlier, section 12:1334(3), before its repeal, provided that unless otherwise provided in an LLC's articles of organization or a written operating agreement, an LLC dissolved upon the death, interdiction, withdrawal, expulsion, bankruptcy, or dissolution of a member or the occurrence of any other event terminating the membership of a member unless, within ninety days after such event, the LLC was continued by the unanimous consent of the remaining members. The provision that an LLC have a perpetual existence underscores the fact that an LLC formed after July 8, 1997, will not dissolve on any event terminating a member's interest in the LLC.

It is likely that section 12:1303(B) also was intended to clarify the law concerning term LLCs. Under former law, it seemed that an LLC could be constituted for a term by an oral agreement.²⁶⁶ In that case, there could be arguments and litigation concerning the issue of whether such an agreement had been reached and whether a member could withdraw from the LLC without the consent of the

263. La. R.S. 12:1303(B) (1994 & Supp. 2005).

264. 1997 La. Acts No. 717, § 1.

265. 1997 La. Acts No. 717, § 2.

266. Before Louisiana Revised Statutes 12:1303(B) was enacted, there was no provision in the Louisiana LLC Law requiring an LLC's term to be provided in the articles of organization or an operating agreement.

other members. Section 12:1303(B) indicates that an LLC can be constituted for a term only if the LLC's articles of organization state a limited period of duration for the LLC. Otherwise, an LLC should have perpetual existence, *i.e.*, the LLC should be an LLC that is not entered into for a term.

Requiring an LLC's articles of organization to declare whether the LLC has been entered into for a term and, if so, the length of the term, provides notice to the members and to persons who do business with the LLC. An LLC's articles of organization, and any amendments thereto, must be filed with the Secretary of State.²⁶⁷ Thus, the articles of organization provide notice to LLC members as to whether their rights to withdraw from a Louisiana LLC are limited. The articles of organization also provide notice to persons who conduct business with the LLC as to whether and when the LLC may dissolve.

The ULLCA allows a member of an at-will LLC or a term LLC to withdraw from the LLC by providing notice to the LLC.²⁶⁸ If a member withdraws from a term LLC, however, the member is not entitled to receive payment from the LLC for the member's interest before the expiration of the date of the LLC's term.²⁶⁹ The ULLCA ensures that the withdrawing member will receive a payment for the member's interest by providing that the time for payment is the expiration of the LLC's term specified at the time of the member's dissociation.²⁷⁰ A member that withdraws from a term LLC, however, shares the same market risk as the other members of the LLC. Under the ULLCA, the purchase price for the LLC interest of a member that withdraws from a term LLC is the fair value of the interest as of the date of the expiration of the specified term that existed on the date of the member's dissociation if the expiration of the term does not result in a dissolution and winding up of the LLC.²⁷¹ The withdrawal of a member before the expiration of an LLC's term, however, is "wrongful" under the ULLCA.²⁷² As explained earlier, a member whose dissociation is wrongful is liable to the LLC and to the other members for damages caused by the dissociation.²⁷³ Such damages may further

267. La. R.S. 12:1304(A), 1309(C) (1994 & Supp. 2005).

268. Unif. Ltd. Liab. Co. Act § 601(1) (amended 1998), 6A U.L.A. 608 (2003).

269. *Id.* § 603(a)(2)(ii), 6A U.L.A. 612 (2003).

270. *Id.*

271. *Id.* § 701(a)(2), 6A U.L.A. 614 (2003).

272. *Id.* § 602(b)(2)(i), 6A U.L.A. 610 (2003).

273. *Id.* § 602(c), 6A U.L.A. 611 (2003).

reduce any distribution otherwise allowable to the member.²⁷⁴ In contrast, a member that withdraws from an at-will LLC formed under the ULLCA is entitled to receive the fair value of the member's interest, determined at the time of the member's dissociation unless the dissociation causes the LLC to dissolve.²⁷⁵

If the expiration of the term causes an LLC formed under the ULLCA to dissolve, the LLC's business is wound up, and its assets are applied first to satisfy the LLC's obligations to creditors.²⁷⁶ Any amount remaining after discharging obligations to creditors is then distributed to each member in an amount equal to a return of all the member's contributions that have not been returned.²⁷⁷ Finally, any remaining amount is distributed to the members in equal shares.²⁷⁸

The ULLCA seems to offer more rights to a member or a dissociated member of a term LLC than the Louisiana LLC Law. Under the ULLCA, a member of a term LLC may apply to a court for judicial dissolution of the LLC if the member can prove any of the following:

- (i) the economic purpose of the company is likely to be unreasonably frustrated;
- (ii) another member has engaged in conduct relating to the company's business that makes it not reasonably practicable to carry on the company's business with that member;
- (iii) it is not otherwise reasonably practicable to carry on the company's business in conformity with the articles of organization and the operating agreement;
- (iv) the company failed to purchase the petitioner's [LLC] interest [for its fair value determined as of the date of the expiration of the term that existed on the date of the member's dissociation]; or
- (v) the managers or members in control have acted, are acting, or will act in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the petitioner.²⁷⁹

274. *Id.* § 602(d), 6A U.L.A. 611 (2003).

275. *Id.* § 701(a)(1), 6A U.L.A. 614 (2003).

276. *Id.* § 806(a), 6A U.L.A. 625 (2003).

277. *Id.* § 806, 6A U.L.A. 625 (2003).

278. *Id.*

279. These are some of the grounds for judicial dissolution of an LLC on application of a member or a dissociated member. *Id.* § 801(4)(v), 6A U.L.A. 619 (2003).

Dissolution of an LLC is an extreme remedy. The drafter's comments to the ULLCA explain that a member seeking dissolution of an LLC bears the burden of proving any one of the listed reasons for requesting a judicial dissolution of the LLC.²⁸⁰ A court has discretion to dissolve an LLC under subsection (i), above, when the LLC has a very poor financial record that is not likely to improve.²⁸¹ The drafter's comments explain that in such a case, dissolution is an alternative to placing the LLC in bankruptcy.²⁸² Thus, judicial dissolution upon proof that "the economic purpose of the LLC is likely to be unreasonably frustrated" should be limited to extreme cases.

The drafter's comments also recommend that a court should take into account other rights and remedies a member may have before authorizing a dissolution of the LLC.²⁸³ Of course, if the LLC is an at-will LLC, a member may withdraw from the LLC at any time under both the ULLCA and the Louisiana LLC Law.²⁸⁴ Thus, there may be no need for a member of an at-will LLC to seek judicial dissolution of the LLC. The drafter's comments to the ULLCA, however, suggest that judicial dissolution or some other remedy, such as a buyout right, might be appropriate in cases where:

one or more members have (i) engaged in fraudulent or unconscionable conduct, (ii) improperly expelled a member seeking an unfair advantage of a provision in an operating agreement that provides for a significantly lower price on expulsion than would be payable in the event of involuntary dissociation, or (iii) engaged in serious misconduct and the applicant member is a member of a term company and would not have the right to have the company purchase that member's . . . interest on dissociation until the expiration of the company's specified term.²⁸⁵

Practically all of the reasons listed in the ULLCA statute for authorizing the judicial dissolution of an LLC should constitute the failure of a member to perform an obligation, which would entitle

280. *Id.* § 801 cmt. para. 4, 6A U.L.A. 620 (2003).

281. *Id.* cmt. para. 5.

282. *Id.*

283. *Id.* cmt. para. 6.

284. *Id.* § 601(1), 6A U.L.A. 608 (2003); La. R.S. 12:1325(B) (1994 & Supp. 2005).

285. Unif. Ltd. Liab. Co. Act § 801, cmt. para. 6 (amended 1998), 6A U.L.A. 620 (2003).

a member to withdraw from a Louisiana LLC that is entered into for a term. Like the ULLCA, the Louisiana LLC Law permits a member to seek 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.”²⁸⁶

A member of a term LLC, however, should not be permitted to seek judicial dissolution of an LLC if the economic purpose of the LLC is likely to be unreasonably frustrated, even if the economic condition of the LLC is so bad that bankruptcy is imminent. The most important reason for forming a term LLC is to ensure that the members cannot remove capital from the LLC before the LLC’s purpose has been accomplished.²⁸⁷ If a majority of the members of a Louisiana LLC agree that the LLC is in such bad financial straits that dissolution is warranted, they may vote to dissolve the LLC.²⁸⁸ A member should not be entitled unilaterally to cause the LLC to dissolve. The other members might think that bankruptcy of the LLC would offer a better economic alternative to dissolution.

The withdrawal rights of a member under the Louisiana LLC Law are similar to the rights of a partner who withdraws from a Louisiana partnership. As explained earlier, a partner of a partnership that is constituted for a term, like a member of a term LLC, may withdraw from the partnership without the consent of the other partners only if the partner has just cause arising out of the failure of another partner to perform an obligation.²⁸⁹ If a partnership is constituted without a term, a partner, like a member of an at-will LLC, may withdraw at any time.²⁹⁰ The Louisiana Partnership Law requires a withdrawing partner to give the other partners “reasonable notice in good faith,”²⁹¹ instead of the thirty days written notice required by the Louisiana LLC Law.²⁹² The question of whether a partner’s notice is “reasonable” depends on

286. La. R.S. 12:1335 (1994).

287. The most important distinction between a term LLC and an at-will LLC is that the ability of a member of a term LLC is limited. Thus, a member of a term LLC may not receive a distribution from the LLC in liquidation of the member’s interest before the expiration of the LLC’s term unless the other members of the LLC consent to the withdrawal or the member has just cause to withdraw arising out of the failure of another member to perform an obligation. La. R.S. 12:1325(A) (1994 & Supp. 2005).

288. La. R.S. 12:1318(B)(1), 1334(2) (1994 & Supp. 2005).

289. La. Civ. Code art. 2821.

290. La. Civ. Code art. 2822.

291. *Id.*

292. La. R.S. 12:1325(B) (1994 & Supp. 2005).

the circumstances. Reasonable notice may vary from a few days or weeks to a few months.²⁹³

Unlike the Louisiana LLC Law, the Louisiana Partnership Law recites that a partner may not withdraw from a partnership at a time that is unfavorable to the partnership.²⁹⁴ If a partner attempts to withdraw from a partnership but fails to give reasonable notice in good faith or attempts to withdraw at an unfavorable time, the partner remains a partner and may be liable for damages caused by the attempted withdrawal.²⁹⁵ Failure to give reasonable notice in good faith at a favorable time is considered a breach of the partner's fiduciary duty to the partnership.²⁹⁶

The good faith requirement for the withdrawal of a partner under the Louisiana Partnership Law seems to be similar to the duty of members and managers of a Louisiana LLC to act in good faith.²⁹⁷ A member's attempted withdrawal from an LLC could constitute a breach of the member's fiduciary duty if the member attempts to withdraw at a time that is unfavorable to the LLC. Unlike a nonmanaging partner of a Louisiana partnership, however, a nonmanaging member of an LLC does not have a fiduciary duty to the LLC or its members.²⁹⁸ Thus, a court might hold that the attempted withdrawal by the member would not constitute a breach of such duties. On the other hand, the withdrawal of a nonmanaging member could constitute a breach of contract or a violation of the good faith standard required of every person who enters into a contract under the Louisiana Civil Code,²⁹⁹ especially if such a withdrawal causes harm to the LLC.

The ULLCA attempts to reconcile the potential problem by providing that a member who wrongfully dissociates from an LLC is liable to the LLC and to the other members for damages caused by the dissociation.³⁰⁰ Under the ULLCA, a member's dissociation is wrongful only if:

293. La. Civ. Code art. 2822 cmt. (a).

294. *Id.*

295. *Id.* cmt. (b).

296. *Id.* cmt. (a).

297. La. R.S. 12:1314(A)(1) (1994 & Supp. 2005).

298. *See* La. R.S. 12:1314(A) (1994 & Supp. 2005) (member of a member-managed LLC or manager of a manager-managed LLC has fiduciary duties to the LLC and the members; by negative implication, nonmanaging member of a manager-managed LLC has no fiduciary duties).

299. La. Civ. Code art. 1983.

300. Unif. Ltd. Liab. Co. Act § 602(c) (amended 1998), 6A U.L.A. 611 (2003).

- (1) it is in breach of an express provision of the [operating] agreement;
- (2) before the expiration of the specified term of a term [LLC]:
- (i) the member withdraws by express will;
 - (ii) the member is expelled by judicial determination . . . ;
 - (iii) the member is dissociated by becoming a debtor in bankruptcy;
 - (iv) in the case of a member who is not an individual, trust other than a business trust, or estate, the member is expelled or otherwise dissociated because it willfully dissolved or terminated its existence.³⁰¹

If an LLC does not dissolve as a result of a member's wrongful dissociation, the ULLCA provides that the amount of damages for which the dissociated member is liable must be offset against distributions otherwise due to the member upon dissociation.³⁰² Presumably, the parties will have to assess the damages, if any, caused by a member's dissociation. In many cases, it is likely that the amount of damages caused by a member's dissociation will be left to judicial determination.

As explained earlier, there seems to be no policy reason for automatically treating the bankruptcy of a member as a wrongful dissociation.³⁰³ In many cases, a member will seek protection under the bankruptcy laws for reasons that are not wrongful. In other cases, a member's creditors will file the bankruptcy petition. In that case, the dissociation triggered under the ULLCA will be involuntary. An involuntary dissociation should not be considered wrongful.

Unless an operating agreement requires future capital infusions by a member, the withdrawal of a nonmanaging member should not cause harm to the LLC or its members that is serious enough to constitute a breach of contract for which damages should be awarded. A member who does not participate in the management of an LLC is less likely to take valuable know-how, secret formulas, or valuable clients from the firm when the member departs. While a withdrawing member may be entitled to take capital from the LLC equal to the fair market value of the member's interest in the LLC, the Louisiana LLC Law protects the LLC, its members, and its creditors by prohibiting the LLC from making any distribution to a withdrawing member if the

301. *Id.* § 602(b), 6A U.L.A. 610–11 (2003).

302. *Id.* § 602(d), 6A U.L.A. 611 (2003).

303. *See supra* notes 110–12 and accompanying text.

distribution would cause or increase the LLC's insolvency.³⁰⁴ Under the default rules of the Louisiana LLC Law, a distribution to a withdrawing member also is disallowed if it would compromise the LLC's ability to satisfy the preferential rights of other members upon dissolution which are superior to the rights of the withdrawing member.³⁰⁵

Like a member of an LLC, a partner who withdraws from a partnership is entitled to receive the value of his or her interest in the partnership at the time of the withdrawal.³⁰⁶ The Louisiana Partnership Law is similar to the Louisiana LLC Law in that it allows the partnership agreement to provide a method for determining the amount that a withdrawing partner may receive.³⁰⁷ Unlike the LLC Law, which provides that the LLC must make the distribution "within a reasonable time" after the member's withdrawal,³⁰⁸ the Louisiana Partnership Law requires the partnership to pay a withdrawing partner the amount of money that is owed, as well as interest at the legal rate accruing from the time of the withdrawal, to the partner as soon as the amount is determined.³⁰⁹ Under the Louisiana LLC Law, the parties may restrict or eliminate a member's withdrawal rights with respect to an at-will LLC by including a provision in the LLC's written operating agreement that denies such rights.³¹⁰

While the default provisions of the Louisiana LLC Law recite that a member who withdraws from an at-will LLC is entitled to receive the fair market value of the member's interest as of the date of the withdrawal,³¹¹ the law does not define what constitutes "fair market value" for this purpose. The standard that a court is likely to use is the price that a willing buyer would pay to a willing seller for the interest, neither being under compulsion to buy or sell and

304. Louisiana Revised Statutes 12:1327(A)(1)-(2) provides that an LLC may not make a distribution if, after giving effect to the distribution, the LLC would not be able to pay its debts as they become due in the ordinary course of business or if the LLC's assets would be less than the sum of its total liabilities. La. R.S. 12:1327(A)(1)-(2) (1994).

305. La. R.S. 12:1327(A)(2) (1994).

306. La. Civ. Code art. 2823.

307. See La. Civ. Code art. 2823 cmt. (a) (the value of the withdrawing partner's interest may be set by the partnership agreement).

308. La. R.S. 12:1325(C) (1994 & Supp. 2005).

309. La. Civ. Code art. 2824.

310. La. R.S. 12:1325(C) (1994 & Supp. 2005) (written operating agreement of an LLC).

311. *Id.*

both having knowledge of relevant facts.³¹² Of course, a willing buyer will take into account the value of the LLC interest, but a willing buyer also may consider such factors as the LLC's potential for growth and whether the interest is a minority interest, a majority interest, or carries with it the power to cast a "swing vote."

Under the willing buyer-willing seller standard, the fair market value of a member's interest also might be subject to a discount for lack of marketability. Under the Louisiana LLC Law, a person that purchases the interest of an LLC member may not participate in the management of the LLC, vote on LLC matters, or exercise any of the rights or powers of a member unless the other members unanimously consent in writing to admit the purchaser as a member of the LLC.³¹³ A willing buyer would have knowledge of the limitations on the buyer's management rights and would take these limitations into account in negotiating the purchase price for the member's interest.

As explained earlier, the Louisiana Supreme Court has applied a minority discount in determining the fair market value of a dissociated partner's interest in a Louisiana partnership.³¹⁴ Lower courts are likely to assume that similar discounts should be applied in determining the fair market value of a member that withdraws from a Louisiana LLC.

The application of a minority discount in valuing a partnership interest has been criticized.³¹⁵ As Professor Glenn G. Morris has explained, to the extent that a minority discount "is an 'illiquidity' discount, reflecting merely the difficulty of turning the investment involved into cash, . . . the discount ignores the very purpose of the mandatory buyout rule: to provide a cash buyer where none would be available in the market."³¹⁶ Professor Morris also has noted that the application of a minority discount in a buyout of a partner's interest also may encourage a partner owning a minority interest to argue that the buyout actually constituted a liquidation of the partnership in which a partner is entitled to a proportionate amount

312. Cf. *Shopf v. Marina Del Ray Partnership*, 549 So.2d 833, 839 (La. 1989). The willing-buyer, willing-seller standard also requires that neither party must be under any compulsion to buy or sell and both must be aware of all relevant facts. *Id.*

313. La. R.S. 12:1330(A), 1332(A) (1994).

314. See discussion of *Shopf*, *supra* notes 96–101 and accompanying text.

315. See Glenn G. Morris, *Agency, Partnerships & Corporations*, 51 La. L. Rev. 217, 224–29 (1990).

316. *Id.* at 224.

of partnership assets remaining after creditors' claims have been satisfied.³¹⁷

A similar argument could be made with respect to a buyout of a member's interest in an LLC. Since a buyout of a partner's interest in a partnership or a member's interest in an LLC often is an alternative to dissolving the business entity, it is appropriate to pay the retiring partner or member the value of the interest determined by reference to a proportionate share of the value of the entity's assets, without any discount.³¹⁸

Others have criticized the application of a minority discount in determining the value of an investor's interest in a closely-held corporation.³¹⁹ Such a discount imposes a penalty on a person who owns a minority interest in a firm simply because the minority

317. *Id.* at 225.

318. Professor Morris also observes that application of a minority discount in valuing the interest of a retiring partner becomes circular: to the extent that courts apply minority discounts in valuing the interests of departing partners, minority interests are worth less in the marketplace. If no judicial discount were applied, a potential purchaser of a minority interest would pay more for the interest because the purchaser would be entitled to receive an undiscounted amount in liquidation of the interest. *Id.* at 227-29. Any purchaser of a partnership interest (or an interest in an LLC) will only have the rights to share in the economic rights attributable to the interest unless the purchaser is admitted as a member of the partnership (or LLC). *Id.* at 225 n. 32. However, to the extent that the restricted rights of a purchaser of an interest in a partnership (or LLC) would diminish the "market" price of the interest, an appropriate discount for nontransferability should apply only if market prices truly are to control. *Id.*

319. See, e.g., American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* § 7.22 cmt. (e) (1994) (criticizing the application of minority discounts in valuing the stock of shareholders who dissent to a corporate merger); Steven C. Bahls, *Resolving Shareholder Dissent: Selection of the Appropriate Equitable Remedy*, 15 J. Corp. L. 285, 302 (1990) (arguing that courts should not apply a minority discount in most cases involving shareholders who purchased the stock at its original issue and their heirs or estates because the discount will frustrate the reasonable expectations of the minority shareholders); Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and Its Impact Upon Valuation of Minority Shares*, 65 Notre Dame L. Rev. 425 (1990) (arguing that a minority discount is inaccurate because the equitable remedies developed by the courts and legislatures imposing fiduciary duties on controlling shareholders and permitting minority shareholders to receive payment for their shares in the event of majority oppression have enhanced the value of minority shares).

owner lacks control. A discount provides unjust enrichment to those who already enjoy a controlling interest in the firm.³²⁰

Professor Douglas Moll has criticized the use of minority discounts and discounts for lack of marketability in the context of shareholder oppression suits.³²¹ Professor Moll observes:

The central problem in [valuing a minority investor's interest at] fair market value is that the conditions assumed in a fair market value appraisal are not actually present in an oppression setting. A fair market value appraisal assumes the presence of a willing seller and a willing buyer who are under no obligation to act. That description utterly fails to reflect the actual circumstances surrounding buyouts in the oppression context. A willing, no-obligation seller contemplates a person who voluntarily offers to sell—i.e., a person selling because he wants to do so, not because he has to do so. The seller in a buyout setting, however, is typically an aggrieved minority shareholder who, one should presume, would have preferred to remain a shareholder in the company absent the oppressive conduct. Stated differently, it is the oppression itself that forces the minority to seek an exit from the corporation. The lawsuit leading to the buyout “sale” stems from the minority's view . . . that conditions in the company have become intolerable. Thus, valuing the minority's shares on the basis of a hypothetical sale makes little sense when the minority investor was not looking to sell in the first place.³²²

These arguments apply in any case where the dissociation of an LLC member is involuntary, for example, on the expulsion, bankruptcy, death, interdiction, involuntary dissolution, or involuntary termination of a member. Where a member voluntarily withdraws from an LLC, it might be necessary to determine the context of the dissociation. For example, minority LLC members may “voluntarily” withdraw in oppression cases.

In other cases, a voluntary withdrawal may be attributable to a member's selfish interests, detrimental to the LLC and its members. For example, a member may withdraw from an LLC to

320. American Law Institute, *supra* note 319, § 7.22 cmt. (e); Bahls, *supra* note 319, at 302.

321. Douglas K. Moll, *Shareholder Oppression and “Fair Value”: Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, 54 Duke L.J. 293 (2004).

322. *Id.* at 319–20.

become affiliated with another company or withdraw the member's investment from the LLC if the member is concerned that the value of the firm is decreasing because of economic conditions. The withdrawal of capital actually could speed the company's demise, even if there is a chance that the LLC's business might rebound. Where a member's dissociation is willful and causes damages to the LLC and the other members, the withdrawing member should be required to pay damages to the LLC or its members.

A Louisiana LLC might have a right to damages in such cases under tort law. Alternatively, a member's wrongful withdrawal might be treated as a breach of the member's fiduciary duties to the LLC. The Louisiana LLC Law applies a good faith standard that only requires a member of a member-managed LLC or a manager of a manager-managed LLC to pay damages for breach of fiduciary duties if the member's or manager's conduct is grossly negligent.³²³ Under the Louisiana LLC Law, a member or manager has acted in a grossly negligent manner if the member or manager acts with reckless disregard or a carelessness amounting to indifference to the best interests of the LLC or its members.³²⁴ In some cases, a court could find a wrongful dissociation grossly negligent.

Professor Moll also argues that the value of the investment that a minority shareholder relinquishes on a sale of the shareholder's stock to the corporation is, at a minimum, the shareholder's pro rata portion of the company's overall value as an operating business.³²⁵ He notes that the dollar amount of the claim is what the investor would have received over time by remaining a shareholder in the business, *i.e.*, the shareholder's percentage share of the company's value through dividends, salary, acquisition consideration, and other distributions.³²⁶

Moreover, Professor Moll maintains that the identity of the purchaser in the case of a redemption negates any justification for minority discounts and discounts for lack of marketability.³²⁷ In the case of a buyout, the purchaser either is a majority shareholder or the corporation. Unlike a third party that purchases a minority interest in a closely held company, if the buyer is a majority shareholder, the buyer, post purchase, will not own a minority stake in the venture.³²⁸ Where the purchaser is the corporation, the

323. La. R.S. 12:1314(B) (1994 & Supp. 2005).

324. La. R.S. 12:1314(C) (1994 & Supp. 2005).

325. Moll, *supra* note 321, at 322-23.

326. *Id.* at 323.

327. *Id.* at 327-28.

328. *Id.* at 327.

justification for marketability discounts also is lacking because the company is not an investor in its own shares.³²⁹ These arguments also apply in the case of the dissociation of a minority member of an LLC.

Courts in jurisdictions other than Louisiana have rejected the use of a minority discount in valuing the stock of a dissenting shareholder in a closely-held corporation.³³⁰ Many of these courts have instead valued the stock as the shareholder's proportionate interest in the value of the corporation as a going concern.³³¹ As the Delaware Supreme Court has explained:

to fail to accord to a minority shareholder the full proportionate value of his shares imposes a penalty for lack of control and unfairly enriches the majority shareholders who may reap a windfall from the appraisal process by cashing out a dissenting shareholder, a clearly undesirable result.³³²

The same unfair enrichment results with respect to the majority owners of an LLC when a minority discount is applied in valuing the interest of a member who withdraws from the LLC. The default rules of the Louisiana LLC Law should be amended to provide that a member who withdraws from an at-will LLC is entitled to receive an amount equal to the member's pro rata share of the LLC's value as a going concern at the time of the withdrawal. In the case of a term LLC, the Louisiana LLC Law should specify that a member may withdraw from the LLC at the expiration of the term specified at the time that the member provides notice to the LLC of the member's intent to withdraw and

329. *Id.* at 331.

330. *See, e.g.*, *Rigel Corp. v. Cutchall*, 511 N.W.2d 519 (Neb. 1994); *MT Properties, Inc. v. CMC Real Estate Corp.*, 481 N.W.2d 383 (Minn. Ct. App. 1992); *Charland v. Country View Golf Club, Inc.*, 588 A.2d 609 (R.I. 1991); *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137 (Del. 1989); *In re Valuation of Common Stock of McLoon Oil Co.*, 565 A.2d 997 (Me. 1989); *Hunter v. Mitek Indus.*, 721 F. Supp. 1102 (E.D. Mo. 1989); *In re Friedman v. Beway Realty Co.*, 661 N.E.2d 972 (N.Y. 1995); *Robblee v. Robblee*, 841 P.2d 1289 (Wash. Ct. App. 1992); *Walter S. Cheesman Realty Co. v. Moore*, 770 P.2d 1308 (Colo. Ct. App. 1988); *Columbia Mgmt. Co. v. Wyss*, 765 P.2d 207 (Or. App. 1988); *Brown v. Allied Corrugated Box Co.*, 154 Cal. Rptr. 170 (1979); *Woodward v. Quigley*, 133 N.W.2d 38, *modified on other grounds*, 136 N.W.2d 280 (Iowa 1965).

331. *See generally* cases cited *infra* note 330.

332. *Cavalier*, 564 A.2d at 1145.

that the value of the interest shall be determined as of the date of the expiration of the term so specified.

The Louisiana LLC Law also should allow an LLC to pay for the dissociated member's interest in installments if the buyout price is too high for the LLC to pay all at once. For this purpose, a court should be authorized to settle any valuation disputes and to arrange for installment payments to the dissociated member. These rules would provide some measure of fairness, both to the dissociated member and to the LLC.

IV. DEATH, INTERDICTION, DISSOLUTION, OR TERMINATION OF A MEMBER³³³

A. *The Problem Under the Louisiana LLC Law*

Section 12:1333 of the Louisiana Revised Statutes provides that if a member of an LLC who is an individual dies or is adjudicated incompetent, the member's membership in the LLC ceases, and the member's executor, administrator, or other legal representative is treated as an assignee of the member's interest.³³⁴ Similarly, if a member that is an entity such as a corporation or a trust is dissolved or terminated, the member's membership in the LLC ceases, and the member's legal representative or successor is treated as an assignee of the member's interest.³³⁵

As an assignee of the member's interest, the member's legal representative has no right to participate in the management of the LLC or to vote on LLC affairs, no right to inspect the LLC's books and records, and no right to compel a distribution from the LLC unless the articles of organization or a written operating agreement provides otherwise.³³⁶ Except as otherwise provided in a written

333. For a discussion of some of the problems that may arise on the death or incapacity of a member of a Louisiana LLC, see Kalinka, *supra* note 14, at 121-29; Susan Kalinka, *Louisiana LLC Law on the Death or Incapacity of a Member Sets a Trap for the Unwary*, 28 State Tax Notes 645 (May 25, 2003); Susan Kalinka, *Death of a Member of an LLC*, 57 La. L. Rev. 451 (1997).

334. La. R.S. 12:1333 (1994).

335. *Id.*

336. La. R.S. 12:1330(A) (1994). *See, e.g.*, *Kinkle v. R.D.C. L.L.C.*, 04-1092 (La. App. 3d Cir. 12/08/04), 889 So. 2d 405. *Kinkle* was decided under former law, and the LLC dissolved on the death of a member unless the LLC was continued by the unanimous consent of the members. In *Kinkle*, a member of an LLC died, and the members unanimously consented to continue the LLC. While the LLC had made monthly distributions to the decedent member during his life, the LLC ceased to make distributions after his death. The decedent's

operating agreement, an assignee cannot become a member or exercise the rights of a member unless the remaining members unanimously consent in writing.³³⁷

An assignee of a member's interest is entitled only to receive distributions from the LLC to which the member was entitled, to share in the profits and losses of the LLC, and to receive allocations of income, gain, loss, deduction, or credit to which the member was entitled.³³⁸ The foregoing rules do not necessarily entitle the legal representative or successor in interest of a dissociated member to receive distributions from the LLC. The Louisiana LLC Law provides that a member is entitled to receive LLC distributions before the LLC is dissolved ("interim distributions") only to the extent provided in an operating agreement or as authorized by the members.³³⁹ If an LLC does not have an operating agreement or the LLC's operating agreement contains no provision requiring interim distributions, it will not be possible for the legal representative or successor in interest of a deceased, incompetent, dissolved, or terminated member to compel a distribution.³⁴⁰

Even if an LLC's operating agreement requires interim distributions, the legal representative or successor in interest of a dissociated member may not inspect the LLC's records to ensure that the LLC actually is distributing the required amount to the representative or successor.³⁴¹ Moreover, the remaining members may amend an operating agreement to discontinue interim distributions and instead pay higher salaries to LLC members.³⁴²

legal representative argued that, in her capacity as the legal representative, she was entitled to a proportionate share of all interim distributions from the time of the decedent's death, as well as an accounting of all distributions made to the members from that date on. The court held that, under Louisiana Revised Statutes 12:333, the legal representative was entitled to distributions to the same extent that the decedent was entitled, but that the legal representative was not entitled to an accounting. *Id.* at 413. The court held that the right to inspect a Louisiana LLC's books and records is reserved to the members of the LLC under Louisiana Revised Statutes 12:1319(B)(1). *Id.*

337. La. R.S. 12:1332(A)(1) (1994).

338. La. R.S. 12:1330(A) (1994).

339. La. R.S. 12:1324(A) (1994).

340. *See, e.g., Kinkle*, 889 So. 2d at 413.

341. *Id.*

342. *See* La. R.S. 12:1318(B)(6) (1994) (majority vote of the members required to amend the articles of organization or operating agreement).

*Kinkle v. R.D.C., L.L.C.*³⁴³ illustrates the problems faced by the heirs of a dissociated member of a Louisiana LLC who has died. The decedent in *Kinkle*, Richard Kinkle, had been a member of R.D.C., L.L.C. ("RDC"), a Louisiana LLC that was formed to construct a prison, which the LLC leased to the State of Louisiana. In addition to lending the R.D.C. \$496,767.81 and guaranteeing \$1,165,000 of a \$2 million loan from Stearns Bank of Minnesota to RDC, Mr. Kinkle had purchased a fifteen percent interest in RDC.

As a member of the RDC, Mr. Kinkle received monthly distributions out of RDC's surplus income. The monthly distributions ceased, however, after Mr. Kinkle died on January 29, 2003. Shortly after Mr. Kinkle died, Stearns Bank made a claim against Mr. Kinkle's continuing guarantee, which was partially disallowed by the probate court because the loan was not in default.

Mary Kinkle, the personal representative of Mr. Kinkle's estate, filed a petition seeking a judgment declaring that the estate was entitled to its proportionate share of distributions of RDC's surplus income and to an accounting of RDC's activities since January 29, 2003. Ms. Kinkle also sought a judgment of fifty-five percent of all surplus income distributions made to any member after Mr. Kinkle's death.

The trial court held that, in accordance with RDC's operating agreement, RDC had been reconstituted after Mr. Kinkle's death on the unanimous vote of the remaining members to continue the business. The trial court also held that under the terms of the operating agreement, RDC was required to pay Mr. Kinkle's estate a proportionate value of Mr. Kinkle's interest in the LLC. The court held that Ms. Kinkle, as Mr. Kinkle's legal representative, was not entitled to share in any distributions made by RDC after Mr. Kinkle's death and was not entitled to an accounting from the LLC.

The Louisiana Third Circuit Court of Appeal reversed. The third circuit interpreted the operating agreement to provide that RDC did not dissolve on Mr. Kinkle's death because the remaining members voted to continue the LLC. The court further determined that the operating agreement did not include any provision or procedure for the liquidation of a member's interest in the event that the member should die or become incapacitated.

The court held that under Louisiana Revised Statutes 12:1333, Ms. Kinkle had only the rights of an assignee.³⁴⁴ As explained

343. 889 So.2d 405.

344. *Id.* at 412.

earlier, in her capacity as an assignee, Ms. Kinkle had the right to receive distributions from RDC, to share in its profits and losses, and to receive allocations of the LLC's items of income, gain, loss, deduction, and credit, to the extent that Mr. Kinkle was entitled.

Ms. Kinkle was fortunate that the operating agreement required distributions to be made to the members in proportion to the balances in their capital accounts at the end of each fiscal year. Under the terms of the operating agreement, distributions were to be made annually or as approved by a majority of the members. Accordingly, the court held that Ms. Kinkle was entitled to receive distributions of RDC's net cash from the LLC annually (or monthly if approved by the members) in proportion to the balance of Mr. Kinkle's capital account at the end of each fiscal year.³⁴⁵ In addition, Ms. Kinkle was entitled to receive judicial interest from the date of the judicial demand.³⁴⁶ However, the court held that, as an assignee, Ms. Kinkle was not entitled to an accounting from RDC because she was not entitled to inspect the LLC's records.³⁴⁷ Without the right to inspect RDC's records, however, Ms. Kinkle may never be sure that she will receive Mr. Kinkle's proportionate share of RDC's net cash.

If the operating agreement in *Kinkle* had not required annual distributions, Ms. Kinkle might not have received anything after Mr. Kinkle died. Indeed, after the third circuit's opinion, the remaining members of RDC could have amended the operating agreement to disallow all distributions and, instead, voted to pay themselves salaries out of the LLC's operating profits. It does not seem that Ms. Kinkle would be entitled to claim that the members had breached a fiduciary duty to her in such a case. While a member of a member-managed LLC and a manager of a manager-managed LLC have fiduciary duties to the LLC and all of its members,³⁴⁸ no member or manager of an LLC has any fiduciary duty to an assignee of a member's interest.³⁴⁹ Because a member's right to a fiduciary duty from another member is not transferable under the Louisiana LLC Law, the good faith requirement of the

345. *Id.* at 412–13.

346. *Id.* at 413.

347. *Id.*

348. La. R.S. 12:1314(1) (1994 & Supp. 2005).

349. Louisiana Revised Statutes 12:1314, which sets forth the duties of members and managers of a Louisiana LLC, does not include a provision stating that a member or a manager of an LLC has any statutory duty to an assignee.

Louisiana Law of Obligations might not extend to a legal representative or successor of a dissociated LLC member.³⁵⁰

In *Kinkle*, the third circuit seemed to entertain the idea that the operating agreement could have provided for the liquidation of a member's interest upon the death or interdiction of the member.³⁵¹ However, there does not appear to be any statute in the Louisiana LLC Law that authorizes such a provision. As drafted, Louisiana Revised Statutes 12:1333, does not seem to allow the parties to include a provision in an LLC's articles of organization or an operating agreement that provides rights other than the rights of an assignee to the legal representative or successor in interest of a member that has died, been adjudicated incompetent, dissolved, or terminated. No cases could be found in which a court has held that a provision in an operating agreement may alter the rules of Louisiana Revised Statutes 12:1333.

Moreover, Louisiana Revised Statutes 12:1330 (A) provides, in part, "[a]n assignment of a membership interest shall not entitle the assignee to become or to exercise any of the rights or powers of a member until such time as he is admitted in accordance with the provisions of this Chapter [the Louisiana LLC Law]."³⁵² Thus, it seems that there is no way for an operating agreement to afford more rights to a dissociated member's legal representative or successor (such as the right to inspect LLC records) unless all of the remaining members agree in writing to admit the legal representative or successor as a member of the LLC or the LLC's articles of organization or an operating agreement provides other means of admitting the heir as a member.³⁵³

Mr. Kinkle might have avoided the problems that resulted after his death if he had consulted an attorney who was familiar with this problem in the Louisiana LLC Law. Under the Louisiana LLC Law, the members can designate that the LLC will dissolve on the death of a member by including a provision in the LLC's articles of organization or a written operating agreement.³⁵⁴

As explained above, however, dissolution can be disruptive to an LLC's business and to all of the employees, suppliers, and clients of the firm. Alternatively, the members can include a

350. See La. Civ. Code art. 1765 (every obligation is deemed heritable as to all parties, except when the contrary results from the terms or from the nature of the contract); La. Civ. Code art. 1766 (obligation is strictly personal when its performance can be enforced only by the obligee).

351. 889 So. 2d at 411–12.

352. La. R.S. 12:1330(A) (1994).

353. La. R.S. 12:1330(A), 1332(A) (1994).

354. La. R.S. 12:1334(1) (1994 & Supp. 2005).

provision in the LLC's articles of organization or a written operating agreement that a person who obtains the rights of an assignee of a member's interest on the death or incapacity of the member will have a right to receive a distribution or distributions paid out in installments from the LLC under a formula or as a fixed amount.³⁵⁵ A written operating agreement also could require the remaining member to admit the successor in interest of the former member as a member of the LLC with all of the rights held by the former member. Anecdotal evidence indicates, however, that a number of Louisiana LLCs do not have written operating agreements, even where the members can afford to pay a lawyer to draft such an agreement.³⁵⁶

Even if members of an LLC hire an attorney to draft an operating agreement, there is no guarantee that the attorney will be familiar enough with the Louisiana LLC Law to anticipate all of the potential problems that may result to the members of the LLC. The practice of law has become highly specialized in recent years as the laws, both at the state and federal level, have become more complex. In some cases, attorneys have drafted operating agreements for their own firms that did not contemplate the problems they would face under the Louisiana LLC Law.³⁵⁷

Dissociation on dissolution of a member can be problematic, especially if the member is administratively "dissolved." For example, the Secretary of State may revoke a Louisiana corporation's articles of incorporation and franchise and may revoke an LLC's articles of organization if the entity has failed to designate and maintain a registered agent for a period of ninety consecutive days or has failed to file an annual report for three consecutive years.³⁵⁸ The Secretary of State, however, may

355. La. R.S. 12:1330(A) (1994).

356. *See Sage v. Radiology and Diagnostic Servs., LLC*, 01-2445 (La. App. 1st Cir. 11/08/02), 831 So.2d 1053 (LLC organized by a group of doctors to offer radiology services lacked a written operating agreement).

357. The author is familiar with at least two confidential cases in which attorneys included a provision in the LLC's articles of organization that the LLC would be constituted for a term. A member of a term LLC may not withdraw from the LLC before the expiration of the term without the consent of the other members unless the member seeking to withdraw has just cause arising out of the failure of another member to perform an obligation. La. R.S. 12:1325(A) (1994 & Supp. 2005). In each case, the attorney in question desired to withdraw from the LLC before the expiration of the LLC's term and was not able to prove just cause for the withdrawal. The attorneys in question did not anticipate the potential problem when they agreed to form a term LLC.

358. La. R.S. 12:163(A), 1308.2(A), 1363(A) (1994 & Supp. 2005).

reinstate a corporation's articles of incorporation and franchise and an LLC's articles of organization in certain cases where the defect is cured.³⁵⁹ In such cases, reinstatement is retroactive.³⁶⁰ If administrative revocation of a corporation's articles of incorporation and franchise or an LLC's articles of organization is treated as a dissolution within the meaning of Louisiana Revised Statutes 12:1333, there is no guidance under the Louisiana LLC Law as to whether the reinstated entity may resume exercising its management powers.

The provision concerning the death, interdiction, dissolution, or termination of a member can be particularly troubling for the successor(s) in interest of the former owner of the only interest in a single-member LLC. When any one of the events occurs with respect to the former member, the LLC no longer will have any members. By definition, an LLC must have at least one member.³⁶¹ If the heirs of the deceased owner of a single-member LLC continue to operate the business, a court may find that because the LLC has ceased to exist, the successors in interest are operating the business as a general partnership (or, in the case of a single successor, as a sole proprietorship or as a direct owner of the business). In that case, each successor in interest will be personally liable for a virile share of the business's debts and obligations (or, in the case of a sole successor in interest, all of the business's debts and obligations).³⁶²

On the other hand, a court might find that an LLC continues to exist as a *de facto* LLC on the death, interdiction, dissolution, or termination of the single member. However, there is no guarantee of this result. The death or interdiction of the only member of an LLC could trigger uncertainties, litigation, and the associated costs of litigation.

The rules concerning the termination of a member's interest in an LLC differ from both the corporate and the partnership provisions of Louisiana law. Unlike stock in a corporation,³⁶³ a member's managing rights in an LLC are not heritable or transferable.³⁶⁴ The transfer of stock to a shareholder's legal

359. La. R.S. 12:163(E)(1), 1308.2(C)(1), 1363 (E)(1) (1994 & Supp. 2005).

360. La. R.S. 12:163(E)(2), 1308.2(C)(2), 1363 (E)(2) (1994 & Supp. 2005).

361. La. R.S. 12:1301(A)(10) (Supp. 2005).

362. La. Civ. Code art. 2817.

363. See La. R.S. 12:603 (1994) (stock in a corporation is heritable). Unless some transfer restriction is contained in a corporation's articles of incorporation or by-laws or in a shareholder agreement, corporate stock is freely transferable and heritable. La. R.S. 12:24(C)(3), 28(B), 29(A), 58(A) (1994 & Supp. 2005).

364. La. R.S. 12:1332(A) (1994).

representative or successor, unlike the transfer of a member's interest, generally confers upon the transferee all of the original shareholder's rights and powers with respect to the stock.³⁶⁵

The Louisiana Partnership Law is similar to the LLC Law in that a partner ceases to be a member of a partnership upon the partner's death or interdiction.³⁶⁶ There is no provision under the Louisiana Partnership Law triggering the cessation of a partner's membership in the partnership upon the dissolution or termination of a partner that is an entity. The Louisiana Partnership Law, however, allows the partners to include a provision in the contract of partnership delineating other circumstances under which a partner's membership ceases.³⁶⁷ Unlike the Louisiana LLC Law, the Louisiana Partnership Law requires the partnership to purchase the interest of the former partner from the successor in interest.³⁶⁸ This rule applies regardless of whether the dissociated partner was a general partner or a limited partner.³⁶⁹

As explained earlier, the provisions of the Louisiana LLC Law should be fashioned with small businesses in mind. Most Louisiana LLCs are small businesses owned by a few members at most. In many cases, it will be in the best interests of individuals who operate their business as an LLC to alter the default rules to allow a member's successor or legal representative to receive a distribution from the LLC in liquidation of the LLC interest.

The disallowance of a liquidating distribution under such circumstances could prevent a member from providing for his or her heirs through the member's interest in an LLC or providing for the member, in the case of incompetency. Whether the former member owned a minority or a majority interest in the LLC, the

365. Compare La. R.S. 12:1332(A) (1994) (unless an LLC's articles of organization or a written operating agreement provides otherwise, an assignee of a member's interest does not become a member of the LLC or participate in its management without the unanimous written consent of the other members) with 12:79 (1994) (registered owner may be treated as the person exclusively entitled to have and exercise all rights and privileges incident to the ownership of the stock) and 10:8-401 (2003) (requiring registration of a stock transfer upon request if the stock was transferred rightfully or to a bona fide purchaser).

366. La. Civ. Code art. 2818(A).

367. La. Civ. Code art. 2818(B).

368. La. Civ. Code art. 2823 (former partner or his successors are entitled to an amount equal to the value that the share of the former partner had at the time membership ceased).

369. See La. Civ. Code art. 2836 (provisions concerning general partnerships apply to partnerships in commendam to the extent that they are consistent with the partnership in commendam rules).

member's legal representative or successor will have no voting rights and no inspection rights with respect to the interest and could be subject to abuse by the remaining members. At the time that the LLC is formed, none of the parties will be able to predict which member will be the first to die, be adjudicated incompetent, dissolved, or terminated. Accordingly, it will be in the best interests of each member to ensure that the member's legal representative or successor has a right to liquidate the member's interest when the membership ceases.

Indeed, both the Prototype Act and the ULLCA require an LLC to purchase the interest of a member who has died or been adjudicated incompetent.³⁷⁰ Under the Prototype Act, the LLC also is required to purchase the interest of a member that is another LLC or a corporation that has dissolved or an estate that has distributed its entire interest in the LLC.³⁷¹ As explained earlier, the ULLCA allows the other members of an LLC to expel a member that is a corporation that has dissolved or terminated.³⁷² If the members vote to expel the former corporate member, the LLC must purchase its interest.³⁷³ The ULLCA also includes the following in the list of dissociation events for which the buyout requirement is triggered: (1) a distribution by a trust or estate's entire economic interest in the LLC; and (2) the termination of the existence of a member that is not an individual, estate, or trust other than a business trust.³⁷⁴ As in other cases in which a member is dissociated from an LLC formed under a statute corresponding to the ULLCA, the LLC must purchase the member's interest.³⁷⁵

Unlike the Louisiana LLC Law and the Prototype Act, the ULLCA also offers additional protection to the legal representative or successor(s) in interest of a dissociated member. Under the

370. Prototype Ltd. Liab. Co. Act, *supra* note 18, §§ 602, 802 (A)(6); Unif. Ltd. Liab. Co. Act §§ 601(8), 701(a) (amended 1998), 6A U.L.A. 609, 614 (2003). The Prototype Act, however, also provides that upon the death or interdiction of a member, the member's executor, administrator, guardian, conservator, or other legal representative has the rights of an assignee of the member's interest. Prototype Ltd. Liab. Co. Act, *supra* note 18, § 707. The comments explain that an operating agreement may provide that death is not an event of dissociation and therefore, does not trigger a buyout requirement. *Id.* §§ 707 cmt. para. 4 & 802 cmt. para. 10.

371. *Id.* §§ 602, 801 (A)(8)-(10).

372. Unif. Ltd. Liab. Co. Act § 601(5)(iii) (amended 1998), 6A U.L.A. 608 (2003).

373. *Id.* § 603(a), 6A U.L.A. 612 (2003).

374. *Id.* § 601(9)-(11), 6A U.L.A. 609 (2003).

375. *Id.* § 603(a), 6A U.L.A. 612 (2003).

ULLCA, an LLC must furnish the legal representative of a deceased member or a member under legal disability information concerning the LLC's business or affairs reasonably required for the proper exercise of the member's rights and duties under the operating agreement or under the ULLCA.³⁷⁶ This information must be furnished to the legal representative even if the legal representative has not requested it.³⁷⁷ If a legal representative demands other information concerning the LLC's business or affairs, the LLC must furnish this information, except to the extent the demand or information demanded is unreasonable or otherwise improper under the circumstances.³⁷⁸ Thus, the ULLCA ensures that the legal representative is provided the information necessary to determine whether distributions have properly been made to the former member or a deceased member's estate and to determine whether the buyout price proffered by the LLC is proper.

The ULLCA further protects the interests of the legal representative or successor(s) of a member by allowing them, as well as any other assignee of a member's interest, a right to apply for judicial dissolution of an LLC: (1) after the expiration of a specified term, if the LLC was for a specified term at the time the applicant became an assignee by reason of the dissociation of a member, a transfer of the LLC interest, or upon the entry of a charging order that gave rise to the transfer; or (2) at any time, if the LLC was at-will at the time the applicant became an assignee by reason of a member's dissociation, transfer, or entry of a charging order that gave rise to the transfer.³⁷⁹

The legal representative or successor(s) of a dissociated member should have the rights guaranteed to them under the ULLCA. Under the Louisiana LLC Law, the legal representative or successor(s) of a dissociated member cannot ascertain whether the LLC has made distributions to them to which they are entitled under the law because they are not permitted access to the LLC's books and records. Moreover, the Louisiana LLC Law provides no measures for protecting a legal representative or successor(s) of a dissociated member in the event that the remaining members have denied them distributions or any buyout right otherwise allowed under the operating agreement.

376. *Id.* § 408(b)(1), 6A U.L.A. 599 (2003).

377. *Id.*

378. *Id.* § 408(b)(2), 6A U.L.A. 599 (2003).

379. *Id.* § 801(5), 6A U.L.A. 619 (2003).

The ULLCA also grants a right to the successor of a dissociated member to seek judicial dissolution of an LLC.³⁸⁰ The prospect of judicial dissolution might encourage members of an LLC to purchase the LLC interest of a dissociated member from the member's successor and discourage them from oppressive conduct. As explained earlier, the drafter's comments to the ULLCA explain that when a member or a member's successor seeks judicial dissolution of the LLC, the court may prescribe a less drastic remedy, such as a buyout of the interest.³⁸¹

The successor of a member, however, should not be entitled to seek judicial dissolution of an LLC if the economic purpose of the LLC is likely to be unreasonably frustrated. Such a decision requires business judgment and should be left to the judgment of a majority of the LLC's members.

It is likely that members of a closely held LLC would prefer to require an LLC to purchase the interest of a dissociated member, rather than to allow the member's legal representative or successor(s) in interest to continue to exercise the dissociated member's management rights. Allowing a member's successor in interest to continue to vote on LLC affairs and participate in the management of the LLC (like the heirs of a shareholder in a corporation) could create problems for a small business. The original investors in a small business are unlikely to desire a member's heirs or legal representative, who may have no experience in the business, to make important decisions that affect the operation of the LLC.

On the other hand, a buyout provision, requiring an LLC to purchase the interest of a dissociated member, could disrupt the business, especially if the member owned a large interest in the LLC. An LLC may not have sufficient cash flow in the year of the member's dissociation to pay for the interest in full and may not have the resources to borrow an amount necessary to fund the buyout at that time. It might be better to require the LLC to purchase the member's interest in installments, based on the size of the member's interest. For example, if a decedent owned an interest in ten percent or less of the LLC's capital, the LLC law

380. *Id.* § 801 cmt. para. 3, 6A U.L.A. 620 (2003). Section 801(4) sets forth the reasons for which a court might authorize the dissolution of an LLC at the request of a member or an assignee of a member's interest. *Id.* § 801(4), 6A U.L.A. 619 (2003). For a discussion of section 801(4) in the context of rights granted to a member of a term LLC under the ULLCA, see *supra* notes 268–79 and accompanying text.

381. Unif. Ltd. Liab. Co. Act § 801 cmt. para. 6 (amended 1998), 6A U.L.A. 619 (2003).

might require the LLC to purchase the interest in the year of the member's death. However, a two-year payout period might be required in the case of an interest in more than ten percent, but not more than twenty percent in the LLC's capital. Where a member owned an interest of at least twenty percent, but not more than thirty percent in the LLC's capital, a three-year payout period might be appropriate. A four-year payout period might be required where the dissociated member owned an interest of at least thirty percent, but not more than forty percent in the LLC's capital. The Louisiana LLC Law might require a five-year payout period in the case of a deceased member who owned an interest in fifty percent or more of the LLC's capital.

Such a provision, however, could add too much complexity and inflexibility to the Louisiana LLC Law. It might be better to amend Louisiana Revised Statutes 12:1333 to require a buyout of a former member's interest and to allow the parties to negotiate the terms of the payment.

It is ironic that the Louisiana LLC Law allows a member of an LLC to receive a payment from the LLC if the member voluntarily withdraws from an LLC, but the LLC Law does not require any payment when a member's withdrawal is involuntary as a result of the member's death, interdiction, dissolution, or termination. To receive payment from an LLC, a withdrawing member must furnish thirty days prior written notice of the intent to withdraw from the LLC.³⁸² The only way for a member's estate or legal representative to receive a payment from the LLC is for the estate or legal representative to anticipate the death, interdiction, dissolution, or termination of the member within thirty days before the event. It may be difficult to furnish notice of intent to withdraw if a member dies suddenly, for example, as a result of a heart attack or an automobile accident.

B. Section 12:1333 and Estate Planners

Louisiana Revised Statutes 12:1333 seems to have been drafted with estate planners in mind. The federal estate tax is imposed on the transfer of the decedent's "taxable estate,"³⁸³ the value of which is determined by subtracting deductible expenses from the value of the gross estate.³⁸⁴ For purposes of the estate tax, the value of property is its fair market value at the time of the

382. La. R.S. 12:1325(B) (1994 & Supp. 2005).

383. I.R.C. § 2001(a) (2002).

384. *Id.* §§ 2051, 2053–2056 (2000 & Supp. 2005).

decedent's death or the alternate valuation date.³⁸⁵ For this purpose, the term "fair market value" is defined as the price at which the property would change hands between a willing buyer and a willing seller, neither being under a compulsion to buy or sell and both having reasonable knowledge of relevant facts.³⁸⁶

In determining the amount to pay for a decedent's interest in a Louisiana LLC, a willing buyer would take into account the fact that the buyer would have only the rights of an assignee of the member's interest. Thus, a large discount for lack of marketability, liquidity, and management rights should apply in determining the fair market value of an interest in a Louisiana LLC for federal estate tax purposes.

If the Louisiana LLC Law provided that the heirs of a member were entitled to receive a distribution in liquidation of the former member's interest in the LLC, the interest would have a larger value for estate tax purposes than under current law. Estate planners could not alter the estate tax consequences on the transfer of an interest by including a provision in an operating agreement or in the LLC's articles of organization restricting the rights of the member's heirs to receive any distribution when the member died. Under section 2704(b) of the Internal Revenue Code, where an interest in a family-controlled LLC is transferred to a member of the controlling family, any restriction that effectively limits the ability of the LLC to liquidate is disregarded in determining the value of an interest in the LLC.³⁸⁷ Such a restriction is not disregarded, however, if the restriction on liquidation is no more restrictive than the limitations that would apply under the state law generally applicable to LLCs in the absence of the restriction.³⁸⁸ Thus, if an LLC's articles of organization or a written operating agreement restricted the rights of the heir of a deceased member to receive a distribution from the LLC to a greater extent than the LLC law otherwise provided, section 2704(b) would allow the Internal Revenue Service (the "IRS") to disregard the restriction in determining the fair market value of the decedent's interest in the LLC for estate tax purposes.

Even deeper discounts might be available for interests in a term LLC.³⁸⁹ A term LLC is particularly well suited for use in an estate

385. Treas. Reg. § 20.2031-1(b) (as amended in 1965).

386. *Id.*

387. I.R.C. § 2704(b) (2000).

388. Treas. Reg. § 25.2704-2(b) (1992).

389. Estate planners prefer to use term LLCs because they can claim deep discounts in determining the value of an interest in a term LLC. A willing buyer is likely to pay very little for an interest in a term LLC, knowing that the buyer

plan. Because of the restrictions on the ability of a member to withdraw from a term LLC before the expiration of the LLC's term, a willing buyer is likely to pay even less for an interest in a term LLC than for an interest in an LLC that is not constituted for a term. As explained earlier, a member of a term LLC may not withdraw from the LLC before the expiration of the LLC's term without the consent of the other members unless the member has just cause arising from the failure of another member to perform an obligation.³⁹⁰ A term LLC is particularly suitable for an estate plan because the members of the older generation that forms the LLC can reduce their exposure to federal gift and estate taxes by giving the members of the younger generation small interests in the LLC on an annual basis. For gift tax purposes, a donor is entitled to exclude from taxable gifts up to \$11,000 worth of property transferred to each donee.³⁹¹

For gift tax purposes, property is valued in the same way that it is valued for estate tax purposes, *i.e.*, the price at which property would be transferred between a willing buyer and a willing seller, neither being under compulsion to buy or sell, and both having knowledge of relevant facts.³⁹² In determining the fair market value of an interest in a term LLC under the willing buyer-willing seller standard, a discount should be allowed for the fact that the buyer of such an interest will not be entitled to receive a distribution from the LLC until the LLC's term expires.

Furthermore, the interests in a term LLC that have been transferred as *inter vivos* gifts will not be included in the gross estate of any member of the older generation, thereby reducing the liability for estate taxes when a member of the older generation dies. Finally, when a member of the older generation dies, the estate should be entitled to a discount on the transfer of the deceased member's interest because the heirs will not receive a payment in liquidation of the decedent's LLC interest until the LLC's term expires. As explained earlier, a willing buyer of the LLC interest of a deceased member would take into account the

will have to wait until the expiration of the LLC's term to receive a liquidating distribution from the LLC.

390. La. R.S. 12:1325(A) (1994 & Supp. 2005).

391. Section 2503 allows a \$10,000 annual exclusion from taxable gifts. I.R.C. § 2503(b)(1) (2000). The \$10,000 exclusion is adjusted for inflation. *Id.* § 2503(b)(2) (2000). For gifts made in the calendar year 2003, the annual exclusion for gifts has been adjusted to \$11,000. Rev. Proc. 2002-70 § 3.24(1), 2002-2 C.B. 845.

392. Treas. Reg. § 25.2512-1 (1992).

fact that the buyer may not receive a distribution from the LLC on the date of the decedent's death, but will have to wait until the LLC's term expires.

The original drafters of the Louisiana LLC Law might have declined to adopt a provision allowing the buyout of a deceased member's interest for at least two reasons. When the Louisiana LLC Law was first adopted, the law did not contain a provision limiting the withdrawal rights of a member of a term LLC.³⁹³ Thus, the limitation on the withdrawal rights of a legal representative of a deceased or incompetent member allowed estate planners to claim deep discounts when valuing an interest in an LLC for estate and gift tax purposes.

Moreover, as originally drafted, Louisiana Revised Statutes 12:1334 (3) provided that an LLC dissolved on the death, interdiction, withdrawal, expulsion, bankruptcy, or dissolution of a member, or any event that terminated the continued membership of the member unless within ninety days after the event, the LLC was continued by the unanimous consent of the remaining members.³⁹⁴ The original drafters might have assumed that the successors in interest of a member of an LLC that was organized without a written operating agreement were protected by Louisiana Revised Statutes 12:1334 (3) because it would be unlikely that the members of such an LLC would be aware of the requirement to consent to continue the LLC within ninety days of the death or interdiction of a member. Thus, the member's death or interdiction could cause the LLC to dissolve, triggering a distribution to the member's successors in interest of an amount equal to the member's share of the LLC's capital remaining after payment to the LLC's creditors.³⁹⁵

In 1997, however, the Louisiana Legislature repealed Louisiana Revised Statutes 12:1334 (3).³⁹⁶ In 1997, the Legislature might have failed to consider the consequences to the successors in interest of a deceased or incompetent member. It is time to amend the law to provide some protection to such persons. It seems, however, that estate planners think that deeper discounts can be achieved for estate and gift tax purposes if the dissociation of an LLC member does not trigger a buyout right under any circumstances.³⁹⁷

393. 1992 La. Acts. No. 780.

394. La. R.S. 12:1334(3) (1993), *repealed by* 1997 La. Acts No. 717, § 2.

395. *See* La. R.S. 12:1337(A) (1994).

396. 1997 La. Acts No. 717, § 2.

397. Laurel Wheeling Farrar & Susan Pace Hamill, *Dissociation from Alabama Limited Liability Companies in the Post Check-the-Box Era*, 49 Ala. L.

The policy of the Louisiana LLC Law is to give maximum effect to the principle of freedom of contract.³⁹⁸ Any revision of Louisiana Revised Statutes 12:1333 should at least allow the parties to agree among themselves as to the rights that will be granted to their heirs or a legal representative in the event that one of the members dies or is adjudicated incompetent. Nevertheless, the revision should be drafted with an eye to the expectations that most persons would have when forming an LLC with unrelated persons to operate a small business venture.

Professor Sandra K. Miller has suggested that LLC statutes should be drafted with small business owners in mind, regardless of the concerns of estate planners.³⁹⁹ To appease the desires of estate planners, Professor Miller suggests that states should eliminate buyout rights for partners in limited partnerships.⁴⁰⁰ Alternatively, she suggests that states should enact legislation creating a new form of business entity designed only for estate planning purposes.⁴⁰¹

Colorado has enacted such a statute, creating the Colorado Limited Partnership Association.⁴⁰² Under the default rules of the Colorado statute, an interest in a limited partnership association may be transferred only as specified in the by-laws; otherwise, an interest in a limited partnership association is non-transferable.⁴⁰³ A member may not resign or withdraw from a limited partnership association.⁴⁰⁴ Other than a person who formed a limited partnership association or was admitted as a member, no transferee, representative of the estate of a deceased, incompetent, insolvent, or bankrupt member, or other successor in interest of a member or against a member has the right to participate in the management of the business and affairs of the limited partnership association.⁴⁰⁵ A transferee, representative, or successor in interest of a member has only the rights to share in distributions when and

Rev. 909, 934-38 (1998); Sandra K. Miller, *What Buy-Out Rights, Fiduciary Duties, and Dissolution Remedies Should Apply in the Case of the Minority Owner of a Limited Liability Company?*, 38 Harv. J. on Legis. 413, 432 (2001).

398. La. R.S. 12:1367(B) (1994).

399. Miller, *supra* note 397.

400. *Id.* at 442.

401. *Id.* at 443.

402. Colorado Limited Partnership Association Act, Colo. Rev. Stat. § 7-63-101 to -117 (1999).

403. *Id.* § 7-63-114(4) (1999).

404. *Id.*

405. *Id.*

to the extent that the member otherwise would be entitled.⁴⁰⁶ As Professor Miller observes, the creation of a special entity without buyout rights serves the dual purpose of providing a vehicle for achieving estate and gift tax savings, while placing investors on notice that their dissociation rights may be eliminated.⁴⁰⁷

The Louisiana Legislature easily could enact a law like the Colorado Limited Partnership Association statute. Such a statute would eliminate the need to restrict a member's right to a buyout under the Louisiana LLC Law. If the default rules of the Louisiana LLC Law are amended to require an LLC to purchase the interest of a dissociated member, the amendment should be prospective only. A prospective amendment should not preclude estate planners who have formed LLCs before the amendment from claiming discounts for estate and gift tax purposes.

V. CONCLUSION

The dissociation statutes of the Louisiana LLC Law were not drafted with small business owners in mind, *i.e.*, the type of persons who are most likely to form an LLC for business ventures with unrelated persons. The Louisiana LLC Law lacks statutes providing any protection to minority members from oppression. There is no protection to a member from expulsion by a vote of the majority of the LLC's members. The buyout provision under section 12:1325 of the Louisiana Revised Statutes invites majority oppression by limiting the amount to which a member may be entitled on withdrawal from an LLC.

On the other hand, the Louisiana LLC Law does not protect the LLC in the event that the buyout price at fair market value could be so large as to trigger dissolution of the LLC in order to make the payment. If a member who owns a majority of the interests in the LLC withdraws, the fair market value of the member's interest might be enhanced by a control premium. The Louisiana LLC Law should authorize a court to require the purchase of a member's interest in installments in such cases.

The Louisiana LLC Law does not include an affirmative rule concerning the ability of a member to withdraw from a term LLC. The law should be amended to clarify that a member of a term LLC may withdraw without the consent of the other members on the expiration of the term that was in existence when the member evidenced an intent to withdraw. The statute also should describe

406. *Id.*

407. Miller, *supra* note 397, at 443.

a method whereby a member of a term LLC could evidence an intent to withdraw. If the Louisiana LLC Law were so amended, members of term LLCs would have some assurance that they may withdraw when they reasonably expected to have that right when they joined the LLC.

Section 12:1333, providing that the legal representative or successor(s) in interest of a member that has died, been adjudicated incompetent, dissolved, or terminated succeeds only to the economic interest of the dissociated member, invites oppression and is inconsistent with the reasonable expectations of small business owners. The default provisions of the Louisiana LLC Law should require a buyout of the dissociated member's interest and a right to the legal representative or successor(s) of the dissociated member to inspect the LLC's records to ensure that the buyout price is consistent with the requirements of the law. Both the fair market value buyout provision of section 12:1325 on the voluntary withdrawal of a member from an at-will LLC and the lack of any buyout right for the legal representative or heirs of a deceased member may allow individuals who form an LLC as part of an estate plan to claim large discounts on the transfer of an interest for estate and gift tax purposes. However, they deny rights to unrelated persons who form an LLC to operate a closely held business.

The default rules of the Louisiana LLC Law also should be amended to require an LLC to purchase the LLC interest of a dissociated member, notwithstanding the concerns of estate planners. Such a provision is consistent with the reasonable expectations of unrelated persons who form an LLC to operate a closely held business. At the same time, the Louisiana Legislature could provide estate planners another option by amending the partnership in commendam statutes to eliminate buyout rights or by creating a new entity like the Colorado Limited Partnership Association.

The lack of a provision triggering dissociation of a member upon the member's bankruptcy is the most difficult omission to assess. There are policy reasons for allowing a member who is a debtor in possession to retain the right to continue to manage the LLC's business and enjoy the ongoing benefits of the debtor member's economic interest in the LLC. On the other hand, management of an LLC by a debtor in possession can cause harm to the nondebtor members. A debtor in possession who is a nonmanaging member of an LLC is likely to cause little harm unless the operating agreement requires the debtor to make future capital contributions to the LLC. This potential problem also is present any time a bankruptcy petition is filed for a partner.

Congress has not specifically addressed the potential problems to partnerships and LLCs when members become bankrupt. In the meantime, the courts are left to decide the issue.

It seems that the only way the Louisiana Legislature can protect nondebtor members in the event of a member's bankruptcy is to enact a provision triggering the dissociation of a member upon the filing of a petition in bankruptcy or the appointment of a trustee in bankruptcy. This rule would give a bankruptcy court in the Fifth Circuit the legal means to deny a debtor in possession the right to continue to manage the LLC. If the Louisiana LLC Law required the buyout of a dissociated member's interest, as proposed in this article, the debtor member and the debtor's creditors would at least realize some reasonable economic value for the member's LLC interest. It is hoped that courts in the Fifth Circuit, like some courts in other circuits, will weigh the policies before automatically treating the bankruptcy of an LLC member as a dissociation event, notwithstanding an amendment to the Louisiana LLC Law.

There are a number of other provisions of the Louisiana LLC Law that should be amended to make the law more amenable to the needs of small business owners.⁴⁰⁸ However any discussion of other proposals to amend the law are beyond the scope of this article.

408. See Susan Kalinka, *The Louisiana Limited Liability Company Law After "Check-the-Box"*, 57 La. L. Rev. 715 (1997), for some amendments that have been proposed in a previous article by the author.