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# Catch You on the Flip Side: A Comparative Analysis of the Default Rules on Withdrawal from a Louisiana Limited Liability Company

## PRELUDE

The greatest albums of all time, such as *Sgt. Pepper's Lonely Hearts Club Band*, *Pet Sounds*, and *Revolver*, are complete works such that you can simply drop the needle on either side of the record and never come across a bad track.<sup>1</sup> Similar to a record, there are two sides in every transaction. When a member withdraws from a limited liability company (LLC), the LLC and its remaining members are on the “flip side” of that transaction. Unfortunately, the current default rules on the withdrawal of a member from a Louisiana limited liability company contain several inequitable provisions that cause the needle on both sides of the record to scratch.

The default rules in Louisiana Revised Statutes section 12:1325 state that a resigning member is entitled to receive the “*fair market value* of the member’s interest as of the date of the member’s withdrawal or resignation.”<sup>2</sup> A very limited number of states<sup>3</sup> join Louisiana in choosing the “fair market value” approach, which results in minority discounts being applied to the membership interest in the limited liability company.<sup>4</sup> Although this valuation method only applies if the LLC’s articles of organization or operating agreement do not provide for another method,<sup>5</sup> as the popularity of LLCs grows, the aggregate level of sophistication of LLC members will likely decrease.<sup>6</sup> Therefore, the effects of the

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1. See ROLLING STONE: THE 500 GREATEST ALBUMS OF ALL TIME 9–14 (Joe Levy ed., 3d ed. 2005).

2. LA. REV. STAT. ANN. § 12:1325 (Supp. 2010) (emphasis added).

3. See NEV. REV. STAT. ANN. § 86.331 (West 2005); N.M. STAT. ANN. § 53-19-37 (West 2003); TENN. CODE ANN. § 48-216-101 (2002).

4. For an explanation of the dynamics of minority discounts, see GLENN G. MORRIS & WENDELL H. HOLMES, BUSINESS ORGANIZATIONS § 38.08, in 8 LOUISIANA CIVIL LAW TREATISE 328 (1999) (“The minority discount is supposed to reflect the market perception that minority shares, because of their lack of control over corporate [or limited liability company] distributions, are worth substantially less than majority shares in the same corporation [or LLC].”).

5. LA. REV. STAT. ANN. § 12:1325.

6. “Sophistication” within this Comment refers to a businessman’s ability to carefully organize and plan a business from a legal perspective. A businessman’s sophistication level is separate from knowledge of the market or skill within a particular trade. As the overall level of sophistication of persons choosing the LLC form decreases, a corresponding increase in the number of

default rules become more important because they will control in more instances.

Scholars consistently criticize the application of minority discounts, and there is a national trend against their use.<sup>7</sup> This issue is especially relevant and timely in the wake of the Louisiana Supreme Court's ruling in *Cannon v. Bertrand*, which signals a shift away from minority and illiquidity discounts of a withdrawing *partner's* interest in a *partnership*.<sup>8</sup> The Louisiana Legislature derived the withdrawal provisions of the Louisiana Limited Liability Company Act from the Louisiana Civil Code articles on withdrawal from a partnership and codified the approach taken by courts in jurisprudence prior to *Cannon*.<sup>9</sup> Because Louisiana partnership law shifted away from the exclusive application of "fair market value" and its resulting discounts,<sup>10</sup> the Louisiana Limited Liability Company Act should follow the principles of the law on which it is based by eliminating the "fair market value" standard.<sup>11</sup>

On the flip side of the transaction, Louisiana's current default rules on withdrawal of a member from an LLC also subject the LLC and its remaining members to a single member's unilateral desire to withdraw without agreement among the parties.<sup>12</sup> The distribution resulting from the member's withdrawal can seriously handicap the LLC's ability to effectively pursue success in the marketplace and eventually lead the company to financial ruin.<sup>13</sup> To combat this defect, the Louisiana Limited Liability Company Act should limit a member's ability to withdraw unilaterally and possibly cause financial harm to the LLC.

The current default rules on withdrawal from a Louisiana limited liability company produce not only unfavorable results on both sides of the transaction but also results that are especially detrimental to the LLC and its remaining members. Amendments

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LLCs formed without stipulating specific procedures for the withdrawal of a member will occur because these businesses will be planned less carefully. With more operating agreements silent on this issue, the default rules control in more instances, and therefore their effects become more important.

7. See MORRIS & HOLMES, *supra* note 4, § 44.19, at 544–45; see also Susan Kalinka, *Dissociation of a Member from a Louisiana Limited Liability Company: The Need for Reform*, 66 LA. L. REV. 365 (2006).

8. *Cannon v. Bertrand*, 2 So. 3d 393 (La. 2009); see also discussion *infra* Parts I–II.A.

9. See *Shopf v. Marina Del Ray P'ship*, 549 So. 2d 833 (La. 1989).

10. See *Cannon*, 2 So. 3d at 396–97.

11. See LA. REV. STAT. ANN. § 12:1325 (Supp. 2010).

12. See discussion *infra* Part II.C.

13. See discussion *infra* Part II.C.

to the default rules that would eliminate this current imbalance and produce more equitable results for the LLC are needed.

In addition to the momentum created by the *Cannon* decision, several states have recently amended their default rules on withdrawal from an LLC.<sup>14</sup> This Comment presents the deficiencies of the Louisiana Limited Liability Company Act's withdrawal provisions, compares Louisiana's approach to the statutory schemes of other states, and posits that Louisiana should ultimately amend its Limited Liability Company Act to reflect Delaware's default rules on withdrawal. The Delaware Limited Liability Company Act's default rules only permit a member's withdrawal from a limited liability company as provided in the operating agreement and require a distribution equal to the "fair value" of such member's limited liability company interest.<sup>15</sup> Among the predominant approaches taken by the states, this is the most balanced for both sides and places a relatively small burden on the judiciary.

Part I of this Comment provides a background on the emergence of the limited liability company, the reasons for the lack of uniformity in American limited liability company law, and the origins of the withdrawal provisions of the Louisiana Limited Liability Company Act. Part II extracts the deficiencies of Louisiana's current default rules on withdrawal from an LLC. Finally, Part III examines the statutory schemes of other states and proposes amendments to the Louisiana Limited Liability Company Act similar to the default rules under the Delaware Limited Liability Company Act.

## I. PRESSING VINYL: BACKGROUND AND DEVELOPMENT OF LLC LAW

For years the business world searched for an entity that provided limited liability to its owners while at the same time avoiding the double taxation that burdened corporations.<sup>16</sup> The

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14. See IDAHO CODE ANN. § 30-6-603 (West Supp. 2009); KY. REV. STAT. ANN. § 275.280 (West, Westlaw through 2010 Sess.); ME. REV. STAT. ANN. tit. 31, §§ 1581, 1583 (West, Westlaw through 2009 2d Reg. Sess.) (effective July 1, 2011); WYO. STAT. ANN. §§ 17-29-601, -603 (West, Westlaw through 2010 Budget Sess.).

15. See DEL. CODE ANN. tit. 6, §§ 18-603 to -604 (West 2006).

16. See Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1460-61 (1998) (discussing the tax benefits of the LLC form); see also LA. REV. STAT. ANN. § 12:1320(B) (Supp. 2010) ("Except as otherwise specifically set forth in this chapter, no member, manager, employee, or agent of a limited liability company is liable in such capacity for a debt, obligation, or liability of the limited liability company.").

emergence of the limited liability company swiftly satisfied the business world's hunger. In the euphoria that followed the Internal Revenue Service's favorable partnership tax classification of limited liability companies in 1988,<sup>17</sup> states quickly enacted their own limited liability company acts before any prototype or uniform law developed.<sup>18</sup> By 1995, 48 states passed limited liability company acts.<sup>19</sup> Soon after in 1996, the National Conference of Commissioners on Uniform Laws promulgated the Uniform Limited Liability Company Act.<sup>20</sup> That same year, Hawaii became the final state to pass its Limited Liability Company Act.<sup>21</sup> Because the states rushed to take advantage of this new business form, a substantial amount of deviation developed among the states on several aspects of limited liability company law.<sup>22</sup>

The provisions on withdrawal of a member within the various limited liability company acts illustrate this high amount of deviation.<sup>23</sup> Because Louisiana enacted its Limited Liability Company Act earlier than most states, the Louisiana Legislature could emulate very few statutory schemes.<sup>24</sup> With little LLC legislation available, the legislature based the withdrawal provisions on the Louisiana Civil Code's articles on the "Cessation of Membership" in a partnership.<sup>25</sup> This resulted in the enactment of Louisiana Revised Statutes section 12:1325.<sup>26</sup>

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17. See Rev. Rul. 88-76, 1988-2 C.B. 360.

18. See Hamill, *supra* note 16, at 1475-77.

19. *Id.* at 1476-77.

20. UNIF. LTD. LIAB. CO. ACT (1996).

21. 1996 Haw. Sess. Laws 92.

22. See MORRIS & HOLMES, *supra* note 4, § 44.01, at 483 ("[M]uch less uniformity exists among the LLC laws of the various states than among their partnership and corporation laws. No uniform act on LLCs was adopted until 1995, after most states had already adopted LLC legislation that, according to a prefatory note to the uniform act, 'display[ed] a dazzling array of diversity.'").

23. See discussion *infra* Parts II-III.

24. Prior to the passage of Louisiana's Limited Liability Company Act in 1992, only eight states had passed Limited Liability Company Acts. See Act. No. 780, § 2, 1992 La. Acts 2083, 2094; see also 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 11:3, at 11-11 (2d ed. 2004).

25. See LA. CIV. CODE ANN. arts. 2818-2825 (2005); see also MORRIS & HOLMES, *supra* note 4, § 44.19, at 543 ("The LLC rules on withdrawal are similar to those in Louisiana partnership law. The analogous 'dissociation' provisions of the draft model statute, which were similar to the common law rules on dissociation in a partnership, were rejected by the Louisiana drafters in favor of the Louisiana partnership rules.").

26. Louisiana Revised Statutes section 12:1325 presently provides:

A. If a limited liability company has been constituted for a term, a member may withdraw without the consent of the other members prior

When one compares the Louisiana Civil Code articles on withdrawal from a partnership to Revised Statutes section 12:1325, the similarities immediately become apparent. Some provisions are identical,<sup>27</sup> while others very closely resemble the corresponding provisions in the partnership articles.<sup>28</sup> Louisiana Civil Code article 2822 states that a partner may withdraw from a non-term partnership without the other partner's consent at any time.<sup>29</sup> Similarly, Louisiana Revised Statutes section 12:1325 allows a member of a non-term LLC to withdraw from the company simply by providing 30 days written notice and does not require the consent of the other members of the company.<sup>30</sup>

Although the ability to withdraw from a non-term partnership or LLC may be the same, the Limited Liability Company Act omits a key phrase found in the partnership articles that provides protection for the remaining partners. Louisiana Civil Code article 2822 requires that the withdrawing partner must give "reasonable notice

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to the expiration of the term, provided he has just cause arising out of the failure of another member to perform an obligation.

B. A member of a limited liability company not entered into for a term may withdraw or resign from a limited liability company at the time or upon the happening of an event specified in a written operating agreement and in accordance with the written operating agreement. *If a written operating agreement does not specify the time or the events upon the happening of which a member may withdraw or resign, a member of a limited liability company not entered into for a term may resign or withdraw upon not less than thirty days prior written notice* to the limited liability company at its registered office as filed of record with the secretary of state and to each member and manager at each member's and manager's address as set forth on the records of the limited liability company.

C. Except as otherwise provided in this Chapter, on withdrawal or resignation, a withdrawing or resigning member is entitled to receive such distribution, if any, to which the member is entitled under a written operating agreement and, if not otherwise provided in a written operating agreement, within a reasonable time after withdrawal or resignation, the *fair market value* of the member's interest as of the date of the member's withdrawal or resignation.

LA. REV. STAT. ANN. § 12:1325 (Supp. 2010) (emphasis added).

27. Compare LA. REV. STAT. ANN. § 12:1325(A), with LA. CIV. CODE ANN. art. 2821. With the exception of substituting "limited liability company" for "partnership" and "member" for "partner," the two provisions on withdrawal from a partnership or LLC constituted for a term are identical.

28. Compare LA. CIV. CODE ANN. arts. 2822–2823, with LA. REV. STAT. ANN. § 12:1325(B)–(C).

29. LA. CIV. CODE ANN. art. 2822.

30. LA. REV. STAT. ANN. § 12:1325(B).

in good faith at a time that is not unfavorable to the partnership.”<sup>31</sup> Despite the fact that the Limited Liability Company Act requires the withdrawing member to provide 30 days written notice, it does not provide the heightened protection for the LLC as Civil Code article 2822 does when a partner withdraws from a partnership.<sup>32</sup>

Louisiana Revised Statutes section 12:1325(C) provides a member’s rights upon withdrawal.<sup>33</sup> It is derived from the corresponding Civil Code articles on partnership and the jurisprudence interpreting those articles.<sup>34</sup> Louisiana Civil Code article 2823 states that a withdrawing partner is “entitled to an amount equal to the value that the share of the former partner had at the time membership ceased.”<sup>35</sup> In the 1989 case of *Shopf v. Marina Del Ray Partnership*, the Supreme Court of Louisiana applied the “fair market value” standard to determine the value of the withdrawing partner’s share in a partnership under article 2823.<sup>36</sup> At the time of drafting, the Louisiana Supreme Court had already used the “fair market value” standard to determine the “value” of a withdrawing partner’s share.<sup>37</sup> Because the redactors of the Louisiana Limited Liability Company Act intended to model it after the partnership articles, the legislature codified that same “fair market value” upon withdrawal standard from partnership law into the Limited Liability Company Act.<sup>38</sup>

For years the partnership law that served as the foundation of Louisiana’s Limited Liability Company Act remained the same. However, that foundation washed away in January of 2009 with the Supreme Court of Louisiana’s ruling in *Cannon v. Bertrand*.<sup>39</sup> *Cannon* significantly altered Louisiana’s valuation of a partner’s interest upon withdrawal and the application of minority discounts in business interests by holding that “fair market value” is not the only valuation method available upon a partner’s withdrawal.<sup>40</sup>

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31. LA. CIV. CODE ANN. art. 2822. According to the comments, whether the partner has given “reasonable notice” depends on the circumstances of withdrawal. *See id.* cmt. (a); *see also* discussion *infra* Part II.C.

32. *See supra* note 31 and accompanying text.

33. LA. REV. STAT. ANN. § 12:1325(C).

34. *Id.*; *see also* LA. CIV. CODE ANN. art. 2823.

35. LA. CIV. CODE ANN. art. 2823.

36. 549 So. 2d 833 (La. 1989).

37. *See id.*

38. LA. REV. STAT. ANN. § 12:1325; *see also* Act No. 780, § 2, 1992 La. Acts 2083, 2094.

39. 2 So. 3d 393 (La. 2009).

40. *Id.*

## II. A BROKEN RECORD: LOUISIANA'S CURRENT STATUTORY SCHEME

### *A. Cannon as a Catalyst for Revising the Louisiana Limited Liability Company Act*

The Supreme Court of Louisiana's 2009 opinion in *Cannon* altered its previous interpretation of the Civil Code articles on withdrawal from a Louisiana partnership, which are the foundation of the Louisiana Limited Liability Company Act's withdrawal provisions.<sup>41</sup> As discussed above, in *Shopf*, the Supreme Court of Louisiana interpreted "value" for purposes of Civil Code article 2823 to mean "fair market value" and applied a one-third minority discount to the withdrawing partner's interest.<sup>42</sup> In *Cannon*, the court retreated from its previous holding in *Shopf* without explicitly overruling the 1989 case. The court stated:

[B]ecause no minority discount was applied by the *Shopf* court, any mention of a minority discount by that court was merely dicta, and cannot be relied upon as precedent. Further, as the matter was not at issue in *Shopf*, the court did not determine that fair market value was the only means of establishing "value" as per C.C. art. 2823.<sup>43</sup>

The court then listed several permissible valuation methods in addition to "fair market value,"<sup>44</sup> noted that partners are free to specify their chosen method of valuation,<sup>45</sup> and refused to fashion a "one size fits all" standard that must apply when the partners fail to specify their method in a partnership agreement.<sup>46</sup> Ultimately, the court refused to use the same "fair market value" method it used 20 years prior in *Shopf*, which in subsequent years was perceived by most as the only valuation method available.<sup>47</sup>

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41. *Id.*

42. *Shopf*, 549 So. 2d at 840; see also discussion *supra* Part I.

43. *Cannon*, 2 So. 3d at 396.

44. *Id.* at 397 ("In sum, we hold that the 'value' of the partnership share of a withdrawing partner may be determined in any of several manners—book value, market value of the underlying partnership assets, fair market value of the partnership share, or other means—depending on the circumstances requiring the valuation.").

45. *Id.* at 397 n.7.

46. *Id.* at 397 ("Because the circumstances surrounding a partnership withdrawal can vary so greatly, this court cannot fashion a 'one size fits all' method of valuation which would be fair in all cases.").

47. *Id.* ("Here, where the remaining partners are to be the buyers of the withdrawing partner's share, market value of the underlying partnership assets is the most equitable manner to value the partnership share.").



Due to Louisiana Civil Code article 9, *Cannon* cannot directly change limited liability company law as expressed in Revised Statutes section 12:1325.<sup>48</sup> Civil Code article 9 states, “When a law is clear and unambiguous and its application does not lead to absurd consequences, the law shall be applied as written and no further interpretation may be made in search of the intent of the legislature.”<sup>49</sup> Because the unambiguous default rules in the Louisiana Limited Liability Company Act state that “a withdrawing or resigning member is entitled to receive . . . the fair market value of the member’s interest,” courts may not apply any other valuation method.<sup>50</sup>

Even though *Cannon* does not have a direct effect on limited liability company law, the court’s reasoning is persuasive and serves as a catalyst to call for revisions on this issue. Because the dynamic of a member’s withdrawal from an LLC is analogous to a partner’s withdrawal from a partnership, much of the logic in the Louisiana Supreme Court’s opinion in *Cannon* applies to the shortcomings of Louisiana’s Limited Liability Company Act.<sup>51</sup>

Louisiana is also one of only three states that permit the withdrawal of a member from an LLC at any time and also require a distribution to the withdrawing member equal to “the fair market value of the member’s interest as of the date of the member’s withdrawal or resignation.”<sup>52</sup> Because there is little support for this approach within its own business law or from other states, a careful examination of the effects of Louisiana’s default rules is warranted.

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48. LA. CIV. CODE ANN. art. 9 (1999); LA. REV. STAT. ANN. § 12:1325 (Supp. 2010).

49. LA. CIV. CODE ANN. art. 9.

50. LA. REV. STAT. ANN. § 12:1325(C).

51. See discussion *infra* Part II.B–C.

52. LA. REV. STAT. ANN. § 12:1325(C); see also N.M. STAT. ANN. § 53-19-37 (West 2003) (“Unless the articles of organization or an operating agreement provide otherwise, a member who elects voluntarily to withdraw pursuant to a right to do so shall be entitled to receive, within a reasonable time following the effective date of such withdrawal, the fair market value of his limited liability company interest.”); TENN. CODE ANN. § 48-216-101(e) (2002) (“If the business and existence of the LLC are continued, any withdrawing or terminating member, whether such withdrawal or termination was wrongful or otherwise, is entitled to receive, subject to the provisions of subsection (d) above, the lesser of the fair market value of the withdrawing or terminating member’s interest determined on a going concern basis or the fair market value of the withdrawing member’s interest determined on a liquidation basis.”).

*B. Louisiana's Current Approach: Impact on the Withdrawing Minority Member*

The main advantage of Louisiana Revised Statutes section 12:1325 from the viewpoint of a member holding a minority interest is that Louisiana's default rules erect very few barriers to a member who wishes to withdraw from a non-term LLC.<sup>53</sup> The statute states that a member of such an LLC "may resign or withdraw upon not less than thirty days prior written notice" if the operating agreement does not specify any required conditions.<sup>54</sup> Despite the flexibility and control that section 12:1325 provides in this respect, the withdrawing member's distributional interest is subject to a significant minority discount upon withdrawal because of the statute's "fair market value" language.<sup>55</sup>

In *Shopf*, the Supreme Court of Louisiana defined "fair market value" as "the price that a willing buyer would pay to 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 the relevant facts."<sup>56</sup> The controversy in *Shopf* arose when a member holding a 12% interest in a partnership withdrew and demanded the value of his share in the partnership per Louisiana Civil Code article 2823.<sup>57</sup> Using "fair market" valuation, the court ultimately applied a one-third discount and held that the minority interest "must be discounted in order to determine the fair market value of [the withdrawing partner's] share in a true arm's length transaction."<sup>58</sup> Louisiana courts accept this definition of "fair market value" and the resulting application of minority discounts and will likely apply this standard again to

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53. LA. REV. STAT. ANN. § 12:1325.

54. *Id.*

55. *Id.*

56. *Shopf v. Marina Del Ray P'ship*, 549 So. 2d 833, 839 (La. 1989) (citing BLACK'S LAW DICTIONARY 537 (5th ed. 1979)).

57. LA. CIV. CODE ANN. art. 2823 (2005); *Shopf*, 549 So. 2d at 836.

58. *Shopf*, 549 So. 2d at 840 ("The most significant adjustment must be made in recognition of the fact that plaintiff's share is a minority interest in a closely held business. The determination of the value of a fractional share in a business entity involves more than fixing the value of the business and multiplying by the fraction being evaluated, especially when the share is a minority interest. A minority interest may be uniquely valuable to the owner, but may have considerably less value to an independent third party, because the interest is relatively illiquid and difficult to market." (citing GLENN M. DESMOND & RICHARD E. KELLEY, BUSINESS VALUATION HANDBOOK ¶¶ 11.01, .07 (1977))).

litigation involving fair market valuation of a member's interest in an LLC.<sup>59</sup>

The inequity of applying minority discounts in compulsory buyout provisions has been criticized by both the Supreme Court of Louisiana and Louisiana scholars.<sup>60</sup> Judicial determination of what percentage to discount the withdrawing member's interest can be characterized as inconsistent, unpredictable, and arbitrary.<sup>61</sup> Because the facts surrounding ownership of an LLC interest vary greatly, courts cannot consistently apply the same percentage discount to all cases.<sup>62</sup> Under the "fair market value" standard, it is uncertain whether the *Shopf* one-third discount applies to all cases involving a minority interest or if a smaller discount applies if the member's percentage share is greater.<sup>63</sup> Because no "willing buyer" actually exists under these circumstances, courts must hypothetically assume the mentality of such a person and rely on expert testimony to determine the percentage of the minority discount.<sup>64</sup> This will undoubtedly lead to highly inconsistent, unpredictable, and inequitable results in litigation.

Finally, the application of minority discounts to the membership interest of a withdrawing member creates a windfall for the LLC and its remaining members. This position finds support in the reasoning of the court in *Cannon*, which stated, "[t]he withdrawing partner should not be penalized for doing something the law allows him to do, and the remaining partners should not thereby realize a windfall profit at his expense."<sup>65</sup> Similar to partnership withdrawal, the withdrawing LLC member's interest is not purchased by a third person in an arms-length

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59. See 1 RIBSTEIN & KEATINGE, *supra* note 24, § 11:3, at 11-11 n.8 (citing TENN. CODE ANN. § 48-216-101 (2001)) ("The Tennessee statute, however, uses 'fair market value.' . . . This language may justify the application of a minority discount.").

60. See *Cannon v. Bertrand*, 2 So. 3d 393, 396 (La. 2009) ("Minority discounts and other discounts, such as for lack of marketability, may have a place in our law; however, such discounts must be used sparingly and only when the facts support their use."); see also MORRIS & HOLMES, *supra* note 4, § 44.19, at 545; Kalinka, *supra* note 7, at 428-35; Susan Kalinka, *The Louisiana Limited Liability Company Law After "Check the Box,"* 57 LA. L. REV. 715, 776 nn.364-65 (1997).

61. See *Thomson v. Thomson*, 978 So. 2d 509, 514-15 (La. Ct. App. 3d 2008) (applying varying levels of discounts to different LLC membership interests within the same community property partition).

62. See MORRIS & HOLMES, *supra* note 4, § 38.08, at 329.

63. See *Shopf*, 549 So. 2d at 840.

64. See MORRIS & HOLMES, *supra* note 4, § 38.08, at 329.

65. *Cannon*, 2 So. 3d at 396-97.

transaction but instead by the LLC itself.<sup>66</sup> This type of buyout actually results in a consolidation of the remaining members' management power.<sup>67</sup> Because the remaining members do not experience the same relative depletion in management power that a willing third-person buyer experiences in such a transaction, those members experience an increase in their management power free of charge to the extent of the percentage discount applied. Due to the probable application of minority discounts under Louisiana's current statutory scheme, the LLC and its remaining members are unjustly enriched at the expense of the withdrawing member.

*C. Louisiana's Current Approach: Impact on the LLC and Its Remaining Members*

Even though the LLC and its remaining members will reap the benefits of the application of minority discounts under Louisiana's fair market value approach, the current default rules of the Louisiana Limited Liability Company Act significantly disadvantage the LLC. By vesting each member with the power to withdraw from a non-term LLC with a mere 30 days notice, section 12:1325 subjects the goals of the company to the selfish whim of any single member.<sup>68</sup> Depending on the percentage of the withdrawing member's interest, the LLC could be exposed to a substantial and detrimental depletion of its capital as a result of that member's withdrawal.<sup>69</sup> Not only could such a distribution

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66. See LA. REV. STAT. ANN. § 12:1325 (Supp. 2010) (requiring a withdrawing member to receive a distribution from the LLC upon withdrawal).

67. See Cannon, 2 So. 3d at 396 ("The buyers of the partnership interest at issue are the two remaining partners in the partnership. These two partners will not be subject to a lack of control as would a third party, as each has an equal say in the control of the partnership, and, because the partners have already determined to purchase the partnership share themselves by opting to continue the partnership and avoid liquidation, neither is lack of marketability an issue.").

68. LA. REV. STAT. ANN. § 12:1325(B) ("A member of a limited liability company not entered into for a term may resign or withdraw upon not less than thirty days prior written notice to the limited liability company at its registered office as filed of record with the secretary of state and to each member and manager at each member's and manager's address as set forth on the records of the limited liability company." (emphasis added)); see also Kalinka, *supra* note 7, at 431–32 ("[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 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.").

69. See GLENN G. MORRIS & WENDELL H. HOLMES, BUSINESS ORGANIZATIONS § 4.07, in 7 LOUISIANA CIVIL LAW TREATISE 138 (1999) ("[W]ithdrawals in [corporations, partnerships, or LLCs] cause similar cash-

send the LLC into a financial tailspin, but it could also prevent the company from seizing a timely opportunity for expansion or growth.<sup>70</sup> An LLC seeking expansion into a new geographic market or an expansion of its product line needs a substantial amount of capital. Under Louisiana's default rules, if a member that holds a minority interest withdraws when the LLC is poised to take advantage of such an opportunity, the company cannot make the moves necessary for success when the opportunity presents itself. Further, the restrictions set forth in Louisiana Revised Statutes section 12:1327 only prohibit distributions that would cause or increase the LLC's insolvency.<sup>71</sup> This provision would not prohibit a distribution upon withdrawal that prevents an LLC from taking advantage of a timely business opportunity and as a result provides insufficient protection for the LLC and its remaining members.

Louisiana's current statutory scheme also leaves the LLC vulnerable because it may require an LLC to make a substantial distribution to a withdrawing member that the company did not affirmatively agree to make. Because a member of a non-term limited liability company may withdraw with merely 30 days notice, the LLC can be blindsided by the member's unilateral decision to withdraw without any agreement among the parties.<sup>72</sup> Thirty days is an extremely short period of time that provides insufficient notice for what in many instances is a significant distribution that results in a substantial depletion of the LLC's capital. Because a considerable amount of money exchanges hands without agreement, the default rules of the Louisiana Limited Liability Company Act should provide more than 30 days notice. In theory, all parties had knowledge of the default rules and their consequences when the LLC was formed.<sup>73</sup> Therefore, an argument can be made that because the written operating agreement did not specify any time or event upon the happening of which a member may withdraw, the parties did agree to allow this

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flow problems and create similar tensions between the interests of withdrawing investors in obtaining fast, reliable, and relatively large liquidation payments and the interests of the remaining investors in preserving the firm's existing capital base.”).

70. See Kalinka, *supra* note 7, at 432 (“The withdrawal of capital actually could speed the company's demise, even if there is a chance that the LLC's business might rebound.”).

71. LA. REV. STAT. ANN. § 12:1327 (1994).

72. *Id.* § 12:1325 (Supp. 2010).

73. See LA. CIV. CODE ANN. art. 5 (1999) (“No one may avail himself of ignorance of the law.”).

sort of withdrawal at any time.<sup>74</sup> However, the rapid increase in the popularity of the limited liability company creates a correlative increase in the amount of unsophisticated businessmen that choose this business form.<sup>75</sup> Therefore, it is inconclusive as to whether an unsophisticated businessman's omission of conditions that vest a member with the power to withdraw within the LLC's operating agreement really constitutes "inaction that under the circumstances is clearly indicative of consent."<sup>76</sup> Due to the significance of the potential depletion of the LLC's capital, the Louisiana Limited Liability Company Act should require the affirmative consent of the LLC and its members in the operating agreement in order for a member to withdraw.<sup>77</sup>

Louisiana's current default rules on withdrawal create results that are extremely unfavorable to both sides. On one side, the "fair market value" standard results in minority discounts for the withdrawing member, which is contrary to national trends and Louisiana law as articulated by the court in *Cannon*.<sup>78</sup> On the flip side, the ability of a member to withdraw with a mere 30 days notice unnecessarily exposes the LLC to an unexpected and sizeable distribution. Although Louisiana's current default rules are prejudicial to all parties involved, the LLC also gets the short end of the stick because a large unexpected capital distribution handicaps its ability to effectively conduct business. Therefore, Louisiana should amend its current default rules and adopt an approach that is less damaging to the LLC and efficiently balances the competing interests on both sides of the member's withdrawal.

### III. BROWSING THE STORE SHELVES: A COMPARATIVE ANALYSIS OF WITHDRAWAL PROVISIONS

Of the predominant statutory schemes formed by limited liability company acts of other states, the default rules of the Delaware Act achieve superior results for both sides of the transaction in the most efficient manner. Contrastingly, the

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74. See *id.* art. 1927 (2008) ("A contract is formed by the consent of the parties established through offer and acceptance. Unless the law prescribes a certain formality for the intended contract, offer and acceptance may be made orally, in writing, or by action or inaction that under the circumstances is clearly indicative of consent." (emphasis added)).

75. Again, sophistication refers to a businessman's ability to carefully plan from a legal perspective.

76. LA. CIV. CODE ANN. art. 1927.

77. See discussion *infra* Part III.C.

78. See *Cannon v. Bertrand*, 2 So. 3d 393, 396 (La. 2009); MORRIS & HOLMES, *supra* note 4, § 44.19, at 544-45.

approach of the Uniform Limited Liability Company Act (ULLCA) exacerbates many of the problems of Louisiana's current default rules and attempts to compensate for these shortcomings in an inefficient manner.<sup>79</sup> The "assignee approach" taken by Ohio and other states improves the LLC's position and achieves more desirable results than the ULLCA.<sup>80</sup> However, the default rules on withdrawal under the Delaware Limited Liability Company Act also achieve this goal but do so in a manner more favorable to the member seeking withdrawal.<sup>81</sup>

*A. ULLCA: Fair Value Distribution; Withdrawal Permitted upon Notice from Member*

Under the limited liability company acts of eight states, a member may withdraw upon giving notice to the LLC and is entitled to receive the "fair value" of his membership interest upon withdrawal.<sup>82</sup> Because four of these states adopted the ULLCA when it was passed in 1996 and all of these states have similar withdrawal provisions, the ULLCA serves as a representative illustration of this approach.<sup>83</sup> Under the ULLCA, a member may withdraw, or in ULLCA terminology "disassociate," from an LLC simply by expressing the desire to withdraw.<sup>84</sup> Under ULLCA section 701, if a member voluntarily withdraws from an "at-will"<sup>85</sup> company, then the limited liability company must purchase the member's interest for its "fair value" as of the date of disassociation.<sup>86</sup> Therefore, the main distinction between the withdrawal provisions of the ULLCA and the Louisiana Limited Liability Company Act is the valuation method. The seemingly benign omission of the word "market" from the ULLCA's valuation provision significantly impacts the amount of the distribution received by the withdrawing member.

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79. See discussion *infra* Part III.A.

80. See discussion *infra* Part III.B.

81. See discussion *infra* Part III.C.

82. HAW. REV. STAT. ANN. §§ 428-701 to -702 (LexisNexis 2004); MASS. GEN. LAWS ch. 156C, § 32 (2005); MONT. CODE ANN. §§ 35-8-804, -808 (2007); 15 PA. CONS. STAT. § 8933 (1995); S.C. CODE ANN. §§ 33-44-602, -701 (2006); VT. STAT. ANN. tit. 11, §§ 3082, 3091 (West 2007); W. VA. CODE §§ 31B-6-601 to -602, -7-701 (2002); WIS. STAT. ANN. §§ 183.0604, .0802 (West 2002).

83. See 1996 Haw. Sess. Laws 92; 1996 S.C. Acts 343; 1996 Vt. Acts & Resolves 179; 1996 W. Va. Acts 256.

84. UNIF. LTD. LIAB. CO. ACT §§ 601-602, 6B U.L.A. 607 (1996).

85. See *id.* § 101(2), 6B U.L.A. 558 ("At-will company' means a limited liability company other than a term company.").

86. *Id.* § 701, 6B U.L.A. 613.

1. ULLCA: Impact on Withdrawing Minority Member

In most instances, a distribution equal to the “fair value” of a minority interest in a business organization will be greater than the “fair market value” of the same membership interest.<sup>87</sup> The committee comment following the passing of the Pennsylvania Limited Liability Company Act articulated this distinction with regard to a member’s interest in an LLC:

The “fair value” of the interest of the member is to be fixed generally with reference to the right of the member to share in distributions from the company. As such, it should not include discounts for lack of marketability or minority interest and thus is different from “fair market value,” which term has been specifically avoided.<sup>88</sup>

Thus, the withdrawing member governed by the default rules of a “fair value” state will not receive the amount that a “willing buyer would pay to a willing seller for a certain piece of property in an arm’s length transaction, neither being under any compulsion to buy or sell.”<sup>89</sup> Instead, much to the delight of the withdrawing member, the membership interest is subject to neither a minority discount nor a discount for lack of marketability because the mindset of the “willing buyer” is not factored into the calculation.<sup>90</sup> The result of the absence of these discounts is a larger gross amount distributed to the withdrawing member, which is more akin to the member’s full interest in the company.

When determining the “fair value” of a withdrawing member’s interest, no concrete test or formula exists.<sup>91</sup> The commentary to ULLCA section 702 states that “[u]nder this broad standard, a court is free to determine the fair value of a distributional interest on a fair market, liquidation, or any other method deemed

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87. See *Denike v. Cupo*, 926 A.2d 869, 884 (N.J. Super. Ct. App. Div. 2007) (“Fair value is not synonymous with fair market value.” (citing *Lawson Mardon Wheaton, Inc. v. Smith*, 734 A.2d 738 (N.J. 1999))), *rev’d on other grounds*, 958 A.2d 446 (N.J. 2008).

88. 15 PA. CONS. STAT. § 8933 cmt. (1995).

89. See *Shopf v. Marina Del Ray P’ship*, 549 So. 2d 833, 839 (La. 1989); see also discussion *infra* Part III.B.

90. See discussion *infra* Part III.B; see also UNIF. LTD. LIAB. CO. ACT § 702 cmt., 6B U.L.A. 616 (“A fair market value standard . . . assumes a fact not contemplated by this section—a willing buyer and a willing seller.”); PROTOTYPE LTD. LIAB. CO. ACT § 602 cmt. (1993) (“The concept of fair value . . . does not apply a minority discount or control premium concept as might be the case with ‘fair market value.’”).

91. See *Denike*, 926 A.2d at 884 (“There is no inflexible test to determine fair value.” (citing *Steneken v. Steneken*, 873 A.2d 501 (N.J. 2005))).



appropriate under the circumstances.”<sup>92</sup> This is consistent with the Supreme Court of Louisiana’s interpretation of the Civil Code’s partnership articles in *Cannon*.<sup>93</sup> Generally, national jurisprudence interprets the “fair value” of a business interest as that person’s pro rata share of the business’s value as a “going concern” at the time of withdrawal.<sup>94</sup> This determination requires a greater inquiry than assessing the company’s book value and balancing its assets and liabilities.<sup>95</sup> Instead, “going concern value” includes the future earning power of the company and the good will that the withdrawing member presumably helped establish.<sup>96</sup> However, with businesses whose value is predominantly composed of real property assets, the undiscounted value of the organization’s underlying assets is the most appropriate.<sup>97</sup> The flexibility of the “fair value” approach allows for the application of the most appropriate method under the circumstances.

In the eyes of the withdrawing member, the approach taken by the ULLCA and these eight states is extremely favorable.<sup>98</sup> Although one state requires a waiting period of six months,<sup>99</sup> the majority of states taking the ULLCA approach permit a member’s withdrawal immediately upon receipt of notice by the LLC and its members of the withdrawal.<sup>100</sup> Regardless of the length of notice required, these statutory schemes impose very little burden on the withdrawing member. By granting the same amount of flexibility and the likelihood of receiving a higher value in their distribution, the “fair value” approach of the ULLCA and these eight states is highly preferable when compared to Louisiana’s approach for members withdrawing from a limited liability company.

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92. UNIF. LTD. LIAB. CO. ACT § 702 cmt., 6B U.L.A. 616.

93. See discussion *supra* Part II.A.

94. See *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289 (Del. 1996).

95. *Id.*

96. *Id.*

97. This was the method applied by the court in *Cannon v. Bertrand*, 2 So. 3d 396 (La. 2009). At issue in *Cannon* was the value of a land partnership. Such a business organization does not have a “going concern value,” which factors in future earnings potential and good will. The Uniform Partnership Act of 1997 articulates a logical standard for choosing what valuation method is most appropriate under the circumstances. It provides that a withdrawing member must receive the pro rata share of liquidation value or the company’s value as a going concern, whichever is greater. See UNIF. P’SHIP ACT § 701, 6 U.L.A. 175 (1997).

98. See *supra* note 82.

99. MASS. GEN. LAWS ch. 156c, § 36 (2005).

100. HAW. REV. STAT. ANN. § 428-601 (LexisNexis 2004); S.C. CODE ANN. § 33-44-601 (2006); VT. STAT. ANN. tit. 11, § 3081 (West 2007); W. VA. CODE § 31B-6-601 (2002); WIS. STAT. ANN. § 183.0802 (West 2002).

## 2. ULLCA: Impact on the LLC and Its Remaining Members

On the flip side of the transaction, the ULLCA approach is extremely prejudicial to the LLC and its remaining members. It exacerbates many of the problems that exist in the current default provisions of the Louisiana Limited Liability Company Act and provides very little relief to compensate for these inequities. Again, under the default rules of the ULLCA and similar acts, members may withdraw from an LLC at any time simply upon providing notice to the LLC and its members.<sup>101</sup> By empowering the member with the same ability to unilaterally withdraw from the LLC on a whim, the ULLCA and similar acts present the same disadvantages on this point as the Louisiana Limited Liability Company Act.<sup>102</sup>

In addition to subjecting the LLC to the whim of the member, the ULLCA's "fair value" method of valuation does not provide the same discounting protection as the Louisiana Limited Liability Company Act.<sup>103</sup> Therefore, an LLC that has not opted out of the default rules provided by the ULLCA exposes itself to an unexpected distribution of an even higher amount than under Louisiana's default provisions. A legislative revision adopting the ULLCA's valuation provisions would only result in a greater risk being imposed on the LLC, and therefore extensive companion revisions are necessary to mitigate these risks.

## 3. ULLCA: Companion Revisions Needed and Policy Considerations

Although the "fair value" approach is more in line with Louisiana's newly articulated policy that disfavors minority discounts, a significant amount of companion revisions would be needed to make the ULLCA's statutory scheme viable in Louisiana.<sup>104</sup> These necessary companion revisions would increase litigation and place an unnecessary burden on the judiciary.

Devoid of the protection afforded to the LLC by minority discounts under the "fair market value" approach, states using a "fair value" method generally provide that the LLC is entitled to offset the member's distribution with damages caused by the

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101. See UNIF. LTD. LIAB. CO. ACT §§ 601–602, 6B U.L.A. 607 (1996).

102. See discussion *supra* Part II.C.

103. See LA. REV. STAT. ANN. § 12:1325 (Supp. 2010); UNIF. LTD. LIAB. CO. ACT § 701; discussion *supra* Part II.C.

104. See *Cannon v. Bertrand*, 2 So. 3d 393, 396 (La. 2009) ("Minority discounts and other discounts, such as for lack of marketability, may have a place in our law; however, such discounts must be used sparingly and only when the facts support their use.").

member's withdrawal.<sup>105</sup> If Louisiana shifted to a "fair value" approach without codifying damage provisions, a limited liability company would have difficulty proving a theory that establishes any offset or compensation.<sup>106</sup> The member's fiduciary duty could possibly establish some liability for the member's detrimental withdrawal, but this will most likely be ineffective.<sup>107</sup>

Because no feasible causes of action exist for the LLC and its remaining members under current law, Louisiana would also have to codify provisions entitling the LLC to damages similar to the ULLCA.<sup>108</sup> A huge drawback to these provisions is that they necessitate a high level of judicial involvement.<sup>109</sup> Enlisting the court system to determine damages caused by a withdrawing member will unnecessarily crowd court dockets. Furthermore, the cost of litigating these issues imposes a heavy burden on both parties to such an action. Due to the resulting increase in litigation and its overall prejudice to the LLC, Louisiana should not adopt the withdrawal provisions of the ULLCA and states with similar approaches.

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105. See UNIF. LTD. LIAB. CO. ACT § 602(c), 6B U.L.A. 610.

106. See LA. CIV. CODE ANN. art. 1893 (2008) ("Compensation takes place by operation of law when two persons owe to each other sums of money or quantities of fungible things identical in kind, and these sums or quantities are liquidated and presently due. In such a case, compensation extinguishes both obligations to the extent of the lesser amount.").

107. In a member-managed LLC, a member is deemed to stand in a fiduciary relationship to the limited liability company and its members. LA. REV. STAT. ANN. § 12:1314. However, if the LLC is manager-managed, then the member does not have a fiduciary duty. Also, the standard for establishing a breach of the member's fiduciary duty is extremely high. A member is not liable for monetary damages resulting from the breach of the member's fiduciary duty unless the member acted in a grossly negligent manner, which is defined as a "reckless disregard of or a carelessness amounting to indifference to the best interests of the limited liability company or the members thereof." *Id.* § 12:1314(B)–(C). Due to this extremely high standard and lack of coverage in a manager-managed LLC, the fiduciary duty of a member does not adequately protect the LLC and its remaining members from a member's unilateral withdrawal.

108. See UNIF. LTD. LIAB. CO. ACT § 602(c), 6B U.L.A. 610 ("A member who wrongfully dissociates from a limited liability company is liable to the company and to the other members for damages caused by the dissociation. The liability is in addition to any other obligation of the member to the company or to the other members.").

109. See Kalinka, *supra* note 7, at 427 ("In many cases, it is likely that the amount of damages caused by a member's dissociation will be left to judicial determination.").

*B. Assignee Approach: No Distribution Equal to Membership Interest upon Withdrawal*

In addition to the limited liability company acts discussed above, 22 more states permit the withdrawal of a member from a limited liability company prior to its dissolution.<sup>110</sup> However, under the default rules of these acts, a member cannot receive any distribution upon withdrawal.<sup>111</sup> Instead, the default rules state that the withdrawn member is treated as an assignee of the membership interest.<sup>112</sup> In 1999, Ohio amended its statute and abrogated its previous approach, which was similar to the default rules of the ULLCA.<sup>113</sup> Ohio Revised Code section 1705.12 serves as a representative example of what hereinafter shall be referred to as the “assignee approach.”<sup>114</sup>

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110. See *infra* note 112.

111. See *infra* note 112.

112. The default rules of most limited liability company acts discussed in Part III.B specifically state that the withdrawing member is treated as an “assignee” of the membership interest. However, some states included in this Section do not expressly treat the withdrawn member as an “assignee,” but similar effects take place. See ALA. CODE § 10-12-36 (2009); ARIZ. REV. STAT. ANN. § 29-707 (Supp. 2008); CAL. CORP. CODE § 17252 (West 2006); COLO. REV. STAT. §§ 7-80-602 to -603 (2006); CONN. GEN. STAT. ANN. §§ 34-159, -180 (West 2005); GA. CODE ANN. §§ 14-11-405, -601.1 (2003); IDAHO CODE ANN. § 30-6-603 (West Supp. 2009); KAN. STAT. ANN. §§ 17-76106 to -76107 (2007); KY. REV. STAT. ANN. § 275.280 (West, Westlaw through 2010 Sess.); ME. REV. STAT. ANN. tit. 31, §§ 1581, 1583 (West, Westlaw through 2009 2d Reg. Sess.) (effective July 1, 2011); MD. CODE ANN., CORPS. & ASS’NS §§ 4A-605, -606.1 (West, Westlaw through 2010 Reg. Sess.); MINN. STAT. § 322B.306 (2004); MO. ANN. STAT. § 347.121 (West 2001); NEB. REV. STAT. § 21-2619 (1997); N.H. REV. STAT. ANN. §§ 304-C:27, -C:41 (2005 & Supp. 2008); N.J. STAT. ANN. §§ 42:2B-24.1, -38 (West 2004); N.D. CENT. CODE § 10-32-30 (2005); OHIO REV. CODE ANN. § 1705.12 (West Supp. 2008); OR. REV. STAT. ANN. § 63.265 (West 2003); R.I. GEN. LAWS ANN. § 7-16-29 (West 2006); S.D. CODIFIED LAWS §§ 47-34A-602 to -603 (2007); WYO. STAT. ANN. §§ 17-29-601, -603 (West, Westlaw through 2010 Budget Sess.).

113. 1999 Ohio Laws 102.

114. Ohio Revised Code section 1705.12 presently provides:

Upon withdrawal, a member withdrawing from a limited liability company has the right to receive any distribution to which the member is entitled under the operating agreement and, except as otherwise provided in that agreement, the withdrawing member shall be treated as if the member were an assignee of all of the member’s membership interest as of the date of withdrawal.

OHIO REV. CODE ANN. § 1705.12.

*1. Assignee Approach: Impact on the Withdrawing Minority Member*

The treatment of an assignee of a limited liability company membership interest is uniform among the states.<sup>115</sup> Under the Louisiana Limited Liability Company Act, an assignee is entitled to “receive such distribution or distributions, to share in such profits and losses, and to receive such allocation of income, gain, loss, deduction, credit, or similar item to which the assignor was entitled to the extent assigned.”<sup>116</sup> Unlike Louisiana’s current approach and that of the ULLCA, withdrawal from an LLC in an “assignee approach” state does not trigger a distribution equal to the value of the member’s share in the company.<sup>117</sup> Instead, a withdrawn member continues to receive the same distributions as if the member did not withdraw from the LLC.<sup>118</sup> This is the result unless the operating agreement provides otherwise or until the company dissolves.<sup>119</sup> These withdrawn members are not permanently deprived of their membership interest in the company, but instead, they continue to receive interim distributions, and the distribution of the member’s interest is deferred until the dissolution and winding up of the limited liability company.<sup>120</sup>

Even though a withdrawn-member-turned-assignee retains the same financial rights, withdrawal from an LLC governed by the default rules in an “assignee approach” state divests the withdrawn member of all other membership rights.<sup>121</sup> Because an assignee cannot exercise any rights or powers of a member,<sup>122</sup> a withdrawn member loses both voting<sup>123</sup> and inspection rights.<sup>124</sup> These powers

115. See 1 RIBSTEIN & KEATINGE, *supra* note 24, § 7:5, at 7-11 to 7-16.

116. LA. REV. STAT. ANN. § 12:1330 (1994). Also note that upon the death of an LLC member, Louisiana’s default rules treat the member’s estate as an assignee of the membership interest. See *id.* § 12:1333.

117. See discussion *supra* Parts II.B, III.A.1.

118. LA. REV. STAT. ANN. § 12:1330; see also MORRIS & HOLMES, *supra* note 4, § 44.20, at 546 (“An assignee of an LLC interest is entitled to receive only those distributions and allocations of profits, losses, and tax items that the assignor member would otherwise have received.”).

119. OHIO REV. CODE ANN. § 1705.12.

120. *Id.* § 1705.10 (West 1994); see also LA. REV. STAT. ANN. § 12:1336 (corresponding Louisiana provision).

121. See OHIO REV. CODE ANN. § 1705.18 (West Supp. 2008) (“An assignment of a membership interest does not dissolve the company or entitle the assignee to become or to exercise any rights of a member.”); see also LA. REV. STAT. ANN. § 12:1330 (corresponding Louisiana provision).

122. OHIO REV. CODE ANN. § 1705.18; see also LA. REV. STAT. ANN. § 12:1330 (corresponding Louisiana provision).

123. OHIO REV. CODE ANN. § 1705.26 (West 1994); see also LA. REV. STAT. ANN. § 12:1318 (corresponding Louisiana provision).

serve as the primary means of controlling the member's invested interest in the company, and without them, the withdrawn member loses all control over his investment. A possible advantage is that withdrawal may also eliminate any fiduciary duty owed to the LLC and its remaining members and any subsequent liability for monetary damages resulting from a breach of that duty.<sup>125</sup>

Compared to the effects of the statutory schemes discussed above, the results of the "assignee approach" are not as advantageous for the withdrawn member.<sup>126</sup> The "assignee approach" does not provide the same flexibility and ability to fully liquidate the member's interest upon withdrawal as in Louisiana and under the ULLCA.<sup>127</sup> The withdrawn member also loses all control over his membership interest upon withdrawal. However, on the flip side, the "assignee approach" does level the playing field and provide some much needed protection to the LLC and its remaining members.

## *2. Assignee Approach: Impact on the LLC and the Remaining Members*

Unlike the default rules of Louisiana and the ULLCA, limited liability company acts of "assignee approach" states adequately protect the LLC and its remaining members from the potential harm caused by a single member's unilateral choice to withdraw and the resulting large distribution.<sup>128</sup> By including "except as otherwise provided in the operating agreement" or equivalent language, "assignee approach" states give LLCs the option of providing a distribution of the member's interest upon withdrawal.<sup>129</sup> However, such a distribution only takes place when it is agreed upon and explicitly stated in the operating

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124. OHIO REV. CODE ANN. § 1705.22; *see also* LA. REV. STAT. ANN. § 12:1319 (Supp. 2010) (corresponding Louisiana provision).

125. In Louisiana only a *member* of a member-managed LLC has a fiduciary duty to the company and its members. LA. REV. STAT. ANN. § 12:1314. Therefore, if a member withdraws, this eliminates the fiduciary duty.

126. *See* discussion *supra* Parts II.B, III.A.1.

127. *See* discussion *supra* Parts II.B, III.A.1.

128. OHIO REV. CODE ANN. § 1705.12 (West Supp. 2008) ("[A] member withdrawing from a limited liability company has the right to receive any distribution to which the member is entitled under the operating agreement and, except as otherwise provided in that agreement, the withdrawing member shall be treated as if the member were an assignee . . .").

129. *Id.*

agreement.<sup>130</sup> By requiring LLCs to affirmatively elect to have this significant and substantial distribution take place, the limited liability company acts of “assignee approach” states eliminate this major pitfall of Louisiana’s current default rules.

Another benefit of limiting these types of large distributions unless affirmatively authorized by the operating agreement is that a withdrawal clause in the operating agreement puts the LLC on notice of the member’s possible withdrawal. Because the other members presumably negotiated for the conditions that empower a member to withdraw, all members have knowledge of these triggering events. This allows the LLC to adequately plan and brace for the impact of making such a distribution. Overall, the “assignee approach” eliminates the imbalanced results that currently harm LLCs under Louisiana’s default rules.

### *3. Assignee Approach: Companion Revisions Needed and Policy Considerations*

Very little, if any, companion revisions would be necessary if Louisiana adopted the “assignee approach.” Unlike the ULLCA, codified damages provisions are not needed to protect the LLC and its members.<sup>131</sup> Because the withdrawn-member-turned-assignee receives the same distributions as a member, the LLC is in the same financial position as if the member has not withdrawn.<sup>132</sup> As a result, the LLC does not suffer any financial injury from the member’s withdrawal regardless of how inopportune the timing. Because no damage provisions are needed, the “assignee approach” does not burden the court system with the task of determining the amount of those damages.<sup>133</sup> Courts also will not be called upon to referee disputes on what discounts are required under Louisiana’s “fair market value” approach.<sup>134</sup> This minimal judicial involvement is attractive because the delays and costs of litigation reduce both the LLC’s capital and the amount of the

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130. For example, the Ohio Limited Liability Company Act states that “a member withdrawing from a limited liability company has the right to receive any distribution to which the member is entitled under the operating agreement.” OHIO REV. CODE ANN. § 1705.12. An “operating agreement” is defined as “all of the valid written or oral agreements of the members . . . as to the affairs of a limited liability company and the conduct of its business.” *Id.* § 1705.1(J). Therefore, the withdrawing member can only receive a distribution with the other members’ consent, which is established in the operating agreement.

131. See discussion *supra* Part III.A.3.

132. OHIO REV. CODE ANN. § 1705.12.

133. See discussion *supra* Part III.A.3.

134. See discussion *supra* Part II.B.

distribution to the withdrawing member.<sup>135</sup> Therefore, an approach that serves judicial economy like the “assignee approach” is more efficient than the above-mentioned statutory schemes.<sup>136</sup>

Overall, treating a withdrawn member as an assignee is much more equitable than both Louisiana’s approach and that taken by the ULLCA.<sup>137</sup> The “assignee approach” limits the LLC’s exposure to the unilateral whim of a single member because the LLC must only make a distribution equal to the value of the withdrawing member’s interest if the member is entitled to such a payment under the LLC’s operating agreement.<sup>138</sup> At the same time, the withdrawing member is not deprived of a full distribution of his interest; instead, that distribution is deferred until the dissolution of the company.<sup>139</sup> The “assignee approach” is a marked improvement over Louisiana’s approach and the default provisions of the ULLCA. The “assignee approach” does not severely disadvantage the LLC like Louisiana’s default rules and the ULLCA. Given its benefits and balanced results, it is easy to see why 22 states choose the “assignee approach.”<sup>140</sup> However, another approach provides greater protection to a member who wishes to withdraw from an LLC while providing the same balance as the “assignee approach.”

### *C. Delaware Approach: No Withdrawal Unless Permitted by the Operating Agreement*

The default rules of 18 states, including traditionally business savvy states like Delaware and New York, permit withdrawal from a limited liability company “only at the time or upon the happening of events specified in a limited liability company agreement.”<sup>141</sup>

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135. Both the cost of defense and any contingent fees assessed by attorneys will reduce the bottom line on both sides of the transaction.

136. See discussion *supra* Part II.A–B.

137. See discussion *supra* Parts II, III.A.

138. See discussion *supra* Part III.B.2.

139. See OHIO REV. CODE ANN. § 1705.46 (West 1994); see also LA. REV. STAT. ANN. § 12:1337 (Supp. 2010) (corresponding Louisiana provision).

140. See *supra* note 112.

141. DEL. CODE ANN. tit. 6, § 18-603 (West 2006). Delaware and several other states refer to the “operating agreement” of the LLC as the “limited liability company agreement.” These terms are synonyms and can be used interchangeably. See also ALASKA STAT. § 10.50.185 (2006); ARK. CODE ANN. § 4-32-802 (West 2004); D.C. CODE § 29-1034 (2001); FLA. STAT. ANN. § 608.427 (West 2007); 805 ILL. COMP. STAT. ANN. 180 / 35-50 (West 2004); IND. CODE ANN. § 23-18-6-6.1 (West 2005); IOWA CODE ANN. § 490A.704 (West 1999); MICH. COMP. LAWS ANN. § 450.4509 (West 2002); MISS. CODE ANN. § 79-29-307 (West 1999); NEV. REV. STAT. ANN. § 86.331 (West 2005); N.Y. LTD. LIAB. CO. LAW § 606



This means that unless the operating agreement specifies a triggering event or date when withdrawal is permissible, a member cannot withdraw from the LLC.<sup>142</sup> Of these 18 limited liability company acts, 13 provide that if the operating agreement permits withdrawal by a member but does not state a valuation method, then the withdrawing member is entitled to “the fair value of such member’s limited liability company interest as of the date of resignation.”<sup>143</sup> As discussed below, this approach puts the burden on the parties involved and focuses on the agreement among the members of the LLC. This approach also possesses all the benefits of the “assignee approach” but provides some additional benefits to the withdrawing member.<sup>144</sup>

*1. Delaware Approach: Impact on the Withdrawing Minority Member*

A member withdrawing from an LLC in a state with the “assignee approach” as its default rule experiences very similar results as a member who wishes to withdraw in Delaware or other states that only permit withdrawal as provided in the limited liability company agreement.<sup>145</sup> Although an “assignee approach”

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(McKinney 2007); N.C. GEN. STAT. § 57C-5-06 (2007); OKLA. STAT. tit. 18, § 2036 (Supp. 2009); TEX. BUS. ORGS. CODE ANN. § 101.107 (West 2009); UTAH CODE ANN. § 48-2c-709 (West 2004); VA. CODE ANN. § 13.1-1032 (West 2007); WASH. REV. CODE ANN. § 25.15.130 (West 2005).

142. See J. WILLIAM CALLISON & MAUREEN A. SULLIVAN, LIMITED LIABILITY COMPANIES: A STATE-BY-STATE GUIDE TO LAW AND PRACTICE § 14:18 (2010) (“[U]nless the limited liability company agreement provides otherwise, members may not resign prior to the LLC’s dissolution and winding up.”).

143. DEL. CODE ANN. tit. 6, § 18-604; see also ARK. CODE ANN. § 4-32-602; D.C. CODE § 29-1027; FLA. STAT. ANN. § 608.427 (West 2009); 805 ILL. COMP. STAT. ANN. 180 / 35-60; IND. CODE ANN. § 23-18-5-5.1; IOWA CODE ANN. § 490A.805; MICH. COMP. LAWS ANN. § 450.4305; MISS. CODE ANN. § 79-29-602; N.Y. LTD. LIAB. CO. LAW § 509; N.C. GEN. STAT. § 57C-5-07; OKLA. STAT. tit. 18, § 2036; TEX. BUS. ORGS. CODE ANN. § 101.205. The exceptions include ALASKA STAT. § 10.50.185; UTAH CODE ANN. § 48-2c-708; VA. CODE ANN. § 13.1-1040.2; and WASH. REV. CODE ANN. § 25.15.130, which all take the “assignee approach” if the operating agreement permits withdrawal. See also NEV. REV. STAT. ANN. § 86.331, which has a default rule requiring a distribution equal to the “fair market value” of the member’s interest if the member may withdraw but the operating agreement does not otherwise provide.

144. See discussion *supra* Part III.B.

145. DEL. CODE ANN. tit. 6, § 18-603 (“A member may resign from a limited liability company only at the time or upon the happening of events specified in a limited liability company agreement and in accordance with the limited liability company agreement.”).

state permits the unilateral withdrawal of a member, Delaware's approach requires a member to postpone withdrawal until the fulfillment of a term or condition in the limited liability company agreement vests him with that right.<sup>146</sup> While waiting until withdrawal becomes permissible, the disgruntled member is in the same financial position as a withdrawn member in an "assignee approach" state.<sup>147</sup> In addition to receiving the same distributions as an assignee, because the member retains full membership, all other rights associated with membership are also retained. These primarily include the member's voting rights<sup>148</sup> and inspection rights.<sup>149</sup> Therefore, when a member desires withdrawal under the default rules of states like Delaware, the member has the same financial rights as in an "assignee approach" state but also retains control over the invested interest in the company.

Another benefit for the withdrawing member under Delaware's default rules is that when a withdrawal that is authorized by the operating agreement takes place, the member receives a distribution equal to the "fair value" of his membership interest.<sup>150</sup> As discussed above, a "fair value" distribution is not subject to the same minority discounts as under the "fair market value" standard.<sup>151</sup> This approach allows the member to recover his full membership interest and is more in line with the policy announced by the Supreme Court of Louisiana in *Cannon*.<sup>152</sup>

A concession for a minority member under Delaware's default rules is that the member does not have the same flexibility to unilaterally withdraw and receive a large distribution at any time like in Louisiana or states with default rules similar to the ULLCA.<sup>153</sup> However, presumably the member negotiated and agreed upon the time or events that trigger his ability to withdraw, which makes his lack of flexibility much less sympathetic.

Even if a group of unsophisticated businessmen form an LLC under Delaware's default rules, a member does have some options that allow immediate liquidation of the membership interest. The

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146. *Id.*

147. *See id.* § 18-601.

148. *Id.* § 18-302; *see also* LA. REV. STAT. ANN. § 12:1318 (Supp. 2010).

149. DEL. CODE ANN. tit. 6, § 18-305; *see also* LA. REV. STAT. ANN. § 12:1319 (1994).

150. DEL. CODE ANN. tit. 6, § 18-604.

151. *See* discussion *supra* Part III.A.1.

152. *See Cannon v. Bertrand*, 2 So. 3d 393, 396 (La. 2009) ("Minority discounts and other discounts, such as for lack of marketability, may have a place in our law; however, such discounts must be used sparingly and only when the facts support their use.").

153. *See* discussion *supra* Parts II.B, III.A.1.

member could either obtain the consent of the other members and withdraw or test the market and find a willing buyer of his membership interest.<sup>154</sup> Under these circumstances, a minority member will likely have to sell and assign his interest at a discounted price.<sup>155</sup> However, this still provides an emergency liquidation option for the member who will receive payment from a third party that is equal to the amount of a withdrawal distribution under Louisiana's current default rules.<sup>156</sup>

Overall, the approach taken by Delaware and similar states puts a minority member of an LLC in a strong position. It provides the member with the same financial benefits as the "assignee approach" but with the enhanced ability to control his investment. Also, if the limited liability company agreement permits withdrawal, then the distribution required by the default rules is not subject to a minority discount as in Louisiana's current default rules and other "fair market value" states. Although it does not provide the member with the same flexibility of unilateral withdrawal as the ULLCA, the Delaware approach does give the withdrawing member significant withdrawal rights while at the same time protecting the LLC and its remaining members.

## *2. Delaware Approach: Impact on the LLC and Its Remaining Members*

By allowing members to withdraw only as provided in the operating agreement, the default rules under limited liability company acts of states such as Delaware provide the LLC and its remaining members with the same protection enjoyed under the "assignee approach."<sup>157</sup> Similar to the "assignee approach," the Delaware default rules only require the LLC to make a distribution equal to the "fair value" of the member's interest if the members

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154. A member can obtain consent that permits withdrawal through an amendment to the LLC's operating agreement. *See* LA. REV. STAT. ANN. § 12:1318 (Supp. 2010); *see also id.* § 12:1330 ("Unless otherwise provided in the articles of organization or an operating agreement, a membership interest shall be assignable in whole or in part.")

155. *See* MORRIS & HOLMES, *supra* note 4, § 38.08, at 328 (discussing the "market perception" that minority interests in business organizations, because of their lack of control over distributions, are worth substantially less than controlling majority interests).

156. If the member tests the market and finds a willing third-person buyer, the member will receive the same price by selling the membership interest as under Louisiana's "fair market value" standard. *See* discussion *supra* Part II.B.

157. DEL. CODE ANN. tit. 6, § 18-603 (West 2006); *see also* discussion *supra* Part III.B.2.

affirmatively permit withdrawal in the operating agreement.<sup>158</sup> This puts the LLC and its members on notice of the time or events that trigger a withdrawal distribution and allows for adequate preparation for such a distribution. If the company ever makes a distribution, it will simply be performing as required by the obligation bargained for under the operating agreement, which requires performance like any other binding obligation.<sup>159</sup> Because its default rules only subject the LLC to making potentially burdensome withdrawal distributions as negotiated in the operating agreement, the Delaware Limited Liability Company Act adequately protects the LLC and its remaining members upon a minority member's withdrawal.

### *3. Delaware Approach: Companion Revisions Needed and Policy Considerations*

The Delaware Limited Liability Company Act's default rules and analogous schemes achieve balanced and equitable results for all parties involved in the member's withdrawal.<sup>160</sup> The approach revolves around the private agreement made among the parties as expressed affirmatively in the company's operating agreement. Because the focus is on the agreement on the front end, there is no need for additional codified damages provisions as in the ULLCA.<sup>161</sup> This reduces the litigation costs surrounding this issue and minimizes the amount of judicial involvement needed.<sup>162</sup> Delaware's default rules shift the burden away from the judiciary and toward the members forming the LLC.

The default rules of the Delaware Limited Liability Company Act eliminate many of the inequities associated with a member's withdrawal in other states, including Louisiana. They eliminate the minority discounts that plague members who receive withdrawal distributions under Louisiana's current default rules.<sup>163</sup> The Delaware Act also protects the LLC from the unilateral and whimsical withdrawal of a member and the resulting distribution that can be detrimental to a Louisiana limited liability company.<sup>164</sup> Unlike the current default rules in Louisiana, the default rules of the Delaware Act do not give the LLC and its remaining members the

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158. DEL. CODE ANN. tit. 6, §§ 18-603 to -604.

159. See LA. CIV. CODE ANN. arts. 1756, 1758 (2008).

160. See discussion *supra* Part III.C.1-2.

161. See discussion *supra* Part III.A.3.

162. See discussion *supra* Part III.B.3 (discussing the benefits of judicial economy in this context).

163. See discussion *supra* Part II.B.

164. See discussion *supra* Part II.C.

short end of the stick. Overall, the default rules of the Delaware Limited Liability Company Act create favorable and balanced results for both sides involved in a member's withdrawal. Louisiana should amend its Limited Liability Company Act and adopt provisions similar to the Delaware Limited Liability Company Act.

#### IV. CONCLUSION: A NEW RELEASE IN LOUISIANA

The time has come for Louisiana to replace the scratched and warped LP that currently wobbles on its record player with a cleaner, fresher piece of vinyl. The Louisiana Limited Liability Company Act needs a revision that eliminates the flaws that adversely affect both sides following a member's withdrawal from an LLC and achieves more balanced results. A comparative analysis of the corresponding provisions from other states reveals that the default rules of the Delaware Limited Liability Company Act are best equipped to achieve these desired results. Because the Delaware Act avoids the major deficiencies of the Louisiana and ULLCA approaches and provides greater benefits to the withdrawing member than the "assignee approach," Louisiana should amend its default rules on withdrawal and adopt provisions similar to the Delaware Limited Liability Company Act. The Delaware Act is a complete statutory scheme that focuses on agreement among the parties, does not burden the court system, and produces the most balanced and favorable results for both sides of the transaction.

On one side, Delaware's default rules avoid minority discounts and allow the withdrawing member to receive a distribution of his full interest in the company. On the flip side, Delaware's default rules adequately protect the LLC from a member's unilateral withdrawal and the resulting disruptive distribution by only permitting withdrawal as authorized by the operating agreement. Unlike Louisiana's current law, the default rules of the Delaware Act avoid the imperfections that cause the record to wobble and the needle to scratch. Instead, either side of the record smoothly produces sounds that are music to the ears of both parties.

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