

JUDICIAL DISSOLUTION IN LIMITED LIABILITY COMPANIES: SO WHAT'S HAPPENING IN TENNESSEE?

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I. INTRODUCTION

The Limited Liability Company (“LLC”) has quickly become one of the more popular forms of business entities.¹ In *Judicial Dissolution of the Limited Liability Company: A Statutory Analysis*, Professor Douglas Moll provides a thorough examination of judicial dissolution statutes for this rapidly growing business entity.² As this business entity continues to grow in popularity, dissolution issues will likely become more common, and Professor Moll’s study into these statutes shows what issues might arise, specifically the lack of oppression doctrine.

While multiple uniform LLC codes have been drafted,³ his study shows that the states are far from uniform in their respective statutory schemes.⁴ In this article, I plan to build on Professor Moll’s study and address where the Tennessee LLC statutes fall under his classification. Because Tennessee has two separate sets of laws governing LLCs, this commentary will note where each of these statutes fall under Professor Moll’s classification and the outcomes the different statutes may cause. Following a look into the Tennessee statutes, I will also discuss how

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¹ Douglas K. Moll, *Minority Oppression & the Limited Liability Company: Learning (or Not) from Close Corporation History*, 40 WAKE FOREST L. REV. 883, 886 (2005) (noting that LLC registration grew by 2300% between 1992 and 1996 compared to 13% and 15% for corporations and limited partnerships respectively).

² Douglas K. Moll, *Judicial Dissolution of the Limited Liability Company: A Statutory Analysis*, 19 TENN. J. BUS. L. 81 (2017).

³ See REVISED UNIF. LTD. LIAB. CO. ACT § 701 (2006); REVISED UNIF. LTD. LIAB. CO. ACT § 701 (2006) (amended 2013); UNIF. LTD. LIAB. CO. ACT § 801 (1996).

⁴ See Moll, *supra* note 2, at 83.

Tennessee law treats two of Professor Moll’s potential explanations for the lack of oppression provisions in these statutes across the nation.

II. TENNESSEE LLC STATUTES

As mentioned in the opening, Tennessee operates under two separate acts governing LLCs. The Tennessee Limited Liability Company Act governs LLCs founded before 2006⁵ while the Tennessee Revised Limited Liability Company Act governs LLCs founded after 2006.⁶

A. Pre-2006 Act – Tennessee Limited Liability Company Act

Under Tennessee law, LLC’s organized before 2006 are governed by the Tennessee Limited Liability Company Act.⁷ This act provides the following on judicial dissolutions:

- (a) On application by the attorney general and reporter or by or for a member, the court may decree dissolution, winding up and termination of an LLC whenever it is not reasonably practicable to carry on the business in conformity with the articles and/or the operating agreement.
- (b) The dissolution is effective upon the decree of dissolution becoming final and non-appealable. Such decree shall be filed with the office of the secretary of state and shall serve as a notice of dissolution.⁸

This statute falls into the “or” category of Professor Moll’s analysis, making it one of 16 states to follow a similar scheme.⁹ In the “or” scheme, judicial dissolution is available when continuing the operation of

⁵ TENN. CODE ANN. §§ 48-201-103, 48-249-1002(c).

⁶ *Id.* § 48-249-1002(a)(1) (2012).

⁷ *Id.* § 48-201-103.

⁸ *Id.* § 48-245-902 (2010).

⁹ *See* Moll, *supra* note 2, at 84–85.

the LLC would violate either the articles of organization **or** the operating agreement.¹⁰

While Professor Moll discusses the potential issues in interpreting the construction of the statutes,¹¹ the inclusion of the “and/or” seems to render this a moot point. Whether Tennessee is a “single-condition construction” or a “double-condition construction,”¹² the LLC should be dissolved when the LLC can no longer carry on its business in conformity with either its operating agreement or articles of organization. As a result, for LLCs founded before 2006, judicial dissolution will be available if either criterion is met.

B. Post-2006 Act – Tennessee Revised Limited Liability Company Act

In 2006, Tennessee enacted the Tennessee Revised Limited Liability Company Act, which governs LLCs organized after 2006 or LLCs that elect to be governed by it.¹³ This statute added a unique governance element to LLC in Tennessee as well as changed the language regarding judicial dissolution.

Under this scheme, Tennessee LLCs now have another option in addition to the traditional member managed LLCs and manager managed LLCs, and Tennessee business owners can now elect to have a director

¹⁰ *Id.* (emphasis added).

¹¹ *Id.* at 95–96. (“Depending on how courts construe the statutes, it may be that both ‘and’ and ‘or’ statutory articulations will reach this preferred outcome. An ‘and’ statute with a single-condition construction does, as does an ‘or’ statute with a double-condition construction. Indeed, it may very well be that drafters of both “and” and ‘or’ statutes (whether legislatures or uniform organizations) were all trying to reach this result, but the “and” drafters were thinking of a single-condition construction, while the ‘or’ drafters were thinking of a double-condition construction. Of course, depending on what courts do, it is possible that neither statutory articulation will reach the preferred outcome (e.g., an ‘and’ statute with a double-condition construction, and an ‘or’ statute with a single-condition construction).”).

¹² *See id.* at 94–96.

¹³ *See* TENN. CODE ANN. § 48-249-1002(a)(1) (2012).

managed LLC.¹⁴ This is different from the previous act in Tennessee as well as each of the uniform acts that have been written.¹⁵

The new act also changes the wording of the judicial dissolution statute. Under the new statute, judicial dissolution is available when:

(a) Judicial decree. On application by the attorney general and reporter, or by or for a member, the court may decree dissolution, winding up and termination of an LLC whenever it is not reasonably practicable to carry on the business in conformity with the LLC documents.

(b) Effectiveness of dissolution. The dissolution is effective upon the decree of dissolution becoming final and non-appealable. Such decree shall be filed with the secretary of state and shall serve as a notice of dissolution.¹⁶

This new statute is more ambiguous than the original Tennessee statute. As Professor Moll notes, this statute initially appears to be an “and” statute as LLC documents is in the plural form.¹⁷ However, Professor Moll still classifies the Tennessee statute as an “or” statute because the Tennessee Revised Limited Liability Company Act that states the documents will be either the LLC’s articles or operating agreement.¹⁸ This means that a court could still potentially dissolve a Tennessee LLC if it violates one of its organizing documents.

¹⁴ *Id.* § 48-249-401 (2012).

¹⁵ *Id.* §§ 48-238-101, 48-249-401 (2012). The Tennessee Limited Liability Company Act provides for LLCs to be managed as either a member-managed LLC or a manager-managed LLC. The new Revised Tennessee Limited Liability Company Act adds the third possible management structure with the director-managed LLC.

¹⁶ *Id.* § 48-249-617 (2012).

¹⁷ *See* Moll, *supra* note 2, at n.11.

¹⁸ *Id.*

C. *Key Takeaways from the Tennessee Statutes*

In Tennessee, attorneys will need to pay special attention when working on matters involving an LLC organized under Tennessee law; however, these statutes should create the same requirements for judicial dissolution as noted above and by Professor Moll.

Professor Moll's hypothetical also provides a very interesting drafting issue for Tennessee LLCs. As noted above, an LLC that falls under both the pre-2006 act and post-2006 act, a court will judicially dissolve an LLC when it violates just one of its two organizing documents.¹⁹ Because the LLC could be dissolved by its inability to operate according to one of the organizing documents, more narrow provisions could more easily lead to judicial dissolution. Of course, this analysis relies upon a "double-condition construction."²⁰

Another point to note based on Professor Moll's analysis of statutes across the nation is that both of the dissolution statutes in Tennessee fail to include language for oppressive conduct.²¹ Members of a Tennessee LLC will not be able file for judicial dissolution based on the majority member's oppressive conduct.

III. TENNESSEE LLC EXIT RIGHTS

As Professor Moll also discusses, many states have removed the exit rights of members in the LLC.²² So why do states not include these exit rights that could better prevent a minority member from being stuck in an LLC with no way out? Sandra Miller suggests that the removal of default exit rights could be seen as a justification for allowing the limited liability nature.²³ Miller also suggests that the removal of these default

¹⁹ See *supra* Part II.A-B (discussing TENN. CODE. ANN. §§ 48-245-902, 48-249-617 (2012)).

²⁰ See Moll, *supra* note 2, at 94–96.

²¹ *Id.* at n.11, n.56.

²² *Id.* at 106–07.

²³ 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, 434 (2001).

rights could provide for more stable relationships in business.²⁴ Others note the underlying principle of freedom of contract in LLC laws.²⁵

Professor Moll argues that exit rights can be used to protect an oppressed minority member in an LLC.²⁶ There are other justifications for these exit rights as well. Miller argues for the default exit rights stating the following key reasons:

- (1) the extensive mutual agency powers possessed by LLC members;
- (2) the illiquidity of private investment and the difficulty facing minority partners in negotiating for protection;
- (3) the intended use of the LLC as a vehicle for the informal conduct of a wide variety of business ventures;
- (4) the uncertainty regarding the duty of loyalty and the duty of care in the LLC; and
- (5) the uncertainty regarding judicial actions for breach of the duty of loyalty and/or the duty of care by LLC members and managers.²⁷

Professor Moll notes that most states that do include exit rights as a default statutory provision already included oppression as a reason for judicial dissolution.²⁸ The Tennessee Limited Liability Act includes exit rights for memners.²⁹ Luckily for minority members, the Tennessee

²⁴ *Id.*

²⁵ Joan MacLeod Heminway, *The Death of an LLC: What's Trending in LLC Dissolution Law?*, BUS. LAW TODAY (Jan. 2016), https://www.americanbar.org/publications/blt/2016/01/01_heminway.html.

²⁶ See Moll, *supra* note 2, at 106–07.

²⁷ See Miller, *supra* note 23, at 435.

²⁸ See Moll, *supra* note 2, at 100 (Professor Moll discusses the theory that states might not include oppression as a grounds for dissolution because the state also offers exit rights. His study found that all states that included exit rights in the statute already had oppression as a reason for judicial dissolution of the LLC).

²⁹ TENN. CODE ANN. § 48-216-101 (1999).

Revised Limited Liability Act also provides for exit rights to members of an LLC.³⁰ Members who terminate his or her interest in the LLC retain a financial interest and are entitled to the “fair value of the terminated membership interest as of the date of such termination.”³¹ It should be noted that this fair value is subject to any damages caused by the withdrawing member.³²

Tennessee’s inclusion of this exit right for members seems like a step in the right direction for members of an LLC. Moll and Miller articulate six reasons that appear to outweigh the reasons for allowing the default to not include exit rights. Still, these exit rights can be waived in the LLC documents under the Tennessee Revised Limited Liability Act.³³ So while members never want to imagine the worst at the beginning of a new business, minority members should make sure that exit rights are not eliminated in the LLC documents.

IV. TENNESSEE LLC FIDUCIARY DUTIES

Professor Moll suggests that the nature of fiduciary duties in the LLC is one potential reason for the lack of oppression language in statutes.³⁴ This section will examine how the different statutes in Tennessee codify fiduciary duties as well as how Tennessee courts have handled matters between majority and minority members of an LLC.

Under the Tennessee Limited Liability Company Act, members in an LLC owe duties to the LLC.³⁵ These members must act “(1) [i]n good faith; (2) [w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) [i]n a manner the member reasonably believes to be in the best interest of the LLC.”³⁶ In the event that the LLC is organized as a manager-managed

³⁰ See *id.* §§ 48-249-503(a)(1), 505(c) (2012).

³¹ *Id.* § 48-249-505(c).

³² *Id.* § 48-249-504(2).

³³ *Id.* § 48-249-205(a).

³⁴ See Moll, *supra* note 2, at 108.

³⁵ TENN. CODE. ANN. § 48-240-102(a) (1994).

³⁶ *Id.* at (b).

LLC, the managers owe the same duties mentioned above.³⁷ The Tennessee Court of Appeals furthered the statute by adopting a similar scheme that is applied to partnerships and closely held corporations where members of an LLC owe these duties to other members.³⁸

In *Anderson v. Wilder*, the majority members forced out minority members and then distributed cash to the remaining members.³⁹ This oppressive act was held invalid, and the minority members were protected by the fiduciary duties owed to them under the Tennessee Limited Liability Company Act.⁴⁰

The Tennessee Revised Limited Liability Company Act also provides for fiduciary duties in the LLC setting.⁴¹ In a member-managed LLC, a member only owes the duties of loyalty and care to the LLC and its members.⁴²

Recently, the Nashville Business Court held that the members of the LLC owe these duties to one another in a similar ruling to *Anderson*.⁴³ Under both statutory schemes in Tennessee, it seems that the fiduciary duty doctrine protects the members of the LLC from more oppressive conduct by the majority members.

As Professor Moll suggests, these fiduciary duty protections of minority members in the LLC might present a compelling argument for

³⁷ *Id.* § 48-241-111(a) (1995).

³⁸ *Anderson v. Wilder*, No. E2003-00460-COA-R3-CV, 2003 WL 22768666, at *6 (Tenn. Ct. App. Nov. 21, 2003) (“[W]e are of the opinion that finding a majority shareholder of an LLC stands in a fiduciary relationship to the minority . . .”).

³⁹ *Id.* at *1.

⁴⁰ *Id.* at *10.

⁴¹ TENN. CODE ANN. § 48-249-403 (2012).

⁴² *Id.* at (b)–(c).

⁴³ Memorandum & Ord. at 8, *Ewing v. Miller*, No. 15-1064-BC (Tenn. Ch. Ct. Dec. 22, 2015), http://www.tncourts.gov/sites/default/files/docs/12-22-15_-_sabin_ewing_dds.pdf (“[I]t appears that Tennessee law may recognize that a control group of LLC members owes a fiduciary duty to a member not in control under certain circumstances.”).

the lack of oppression doctrine in either of Tennessee's LLC statutes.⁴⁴ With the *Miller* ruling, Tennessee minority members will likely be protected from oppressive conduct under a breach of fiduciary duty claim.⁴⁵ By protecting members of an LLC in this manner, Tennessee courts have given minority shareholders protection against oppression even though oppressive conduct is not included in the dissolution statute.

V. CONCLUSION

In conclusion, the state of Tennessee provides two distinct issues within LLC dissolution simply because it has two different acts that govern LLCs.⁴⁶ These acts use different constructions to determine what should cause dissolution and those working with an LLC should make sure to research under the applicable act. Based upon Professor Moll's analysis of the statute construction, broad drafting of the LLC documents could prevent judicial dissolution, as perhaps both documents must be violated to trigger judicial dissolution.

While Tennessee does not include language about oppressive conduct by majority members, the state does provide alternatives that Professor Moll suggests as potential reasons for lack of oppression doctrine in the dissolution statute. As noted above, the Tennessee Revised Limited Liability Company Act includes exit rights for members.⁴⁷ Tennessee also holds that members owe one another a fiduciary duty in a member-managed LLC.⁴⁸ Therefore, even though Tennessee does not permit judicial dissolution of an LLC for oppression, minority members of the LLC may still be protected through other laws in the state of Tennessee.

⁴⁴ Douglas Moll, *Minority Oppression in the LLC*, BUS. LAW PROF. BLOG (June 19, 2016), http://lawprofessors.typepad.com/business_law/2016/06/minority-oppression-in-the-llc.html.

⁴⁵ See *Miller*, No. 15-1064-BC, at 6.

⁴⁶ See TENN. CODE ANN. §§ 48-201-103, 48-249-1002(c) (2010); TENN. CODE ANN. § 48-249-1002(a)(1) (2012).

⁴⁷ See *id.* § 48-216-101 (1999).

⁴⁸ See *supra* Part IV.