

University of Tennessee College of Law

Legal Scholarship Repository: A Service of the Joel A. Katz Law Library

UTK Law Faculty Publications

1-2016

The Death of an LLC: What's Trending in LLC Dissolution Law

Joan M. Heminway

Follow this and additional works at: https://ir.law.utk.edu/utklaw_facpubs



Part of the Law Commons



DATE DOWNLOADED: Wed Apr 20 13:34:25 2022

SOURCE: Content Downloaded from [HeinOnline](#)

Citations:

Bluebook 21st ed.

Joan MacLeod Heminway, The Death of an LLC: What's Trending in LLC Dissolution Law, 2016 Bus. L. TODAY 1 (2016).

ALWD 7th ed.

Joan MacLeod Heminway, The Death of an LLC: What's Trending in LLC Dissolution Law, 2016 Bus. L. Today 1 (2016).

APA 7th ed.

Heminway, J. (2016). The death of an llc: what's trending in llc dissolution law. Business Law Today, 2016(1), 1-4.

Chicago 17th ed.

Joan MacLeod Heminway, "The Death of an LLC: What's Trending in LLC Dissolution Law," Business Law Today 2016, no. 1 (January 2016): 1-4

McGill Guide 9th ed.

Joan MacLeod Heminway, "The Death of an LLC: What's Trending in LLC Dissolution Law" (2016) 2016:1 Bus L Today 1.

AGLC 4th ed.

Joan MacLeod Heminway, 'The Death of an LLC: What's Trending in LLC Dissolution Law' (2016) 2016(1) Business Law Today 1

MLA 9th ed.

Heminway, Joan MacLeod. "The Death of an LLC: What's Trending in LLC Dissolution Law." Business Law Today, vol. 2016, no. 1, January 2016, pp. 1-4. HeinOnline.

OSCOLA 4th ed.

Joan MacLeod Heminway, 'The Death of an LLC: What's Trending in LLC Dissolution Law' (2016) 2016 Bus L Today 1

Provided by:

University of Tennessee College of Law Joel A. Katz Law Library

-- Your use of this HeinOnline PDF indicates your acceptance of HeinOnline's Terms and Conditions of the license agreement available at

<https://heinonline.org/HOL/License>

-- The search text of this PDF is generated from uncorrected OCR text.

-- To obtain permission to use this article beyond the scope of your license, please use:

[Copyright Information](#)

BUSINESS LAW TODAY

The Death of an LLC: What's Trending in LLC Dissolution Law?

By [Joan MacLeod Heminway](#)

Any scholarly and practical excitement and anxiety associated with business entity governance usually focuses on fiduciary duty law and, more specifically, the interface of fiduciary duties with management and control rights in the firm. After all, these important aspects of entity law engage with the day-to-day business of a business association in powerful, compelling ways. Often forgotten in the routine hustle and bustle of entity laws' interactions with the life cycle of the business, however, are the all-important fundamental (or basic) change transactions. These include things like charter amendments, mergers, and dissolutions—important changes in the firm that often require both management and nonmanagement owner consent. The lack of analytical attention to these fundamental change transactions is perhaps most common in the unincorporated forms of business association, including the various forms of partnership and the limited liability company (LLC).

As a means of addressing this deficiency, albeit in a limited way, this article presents and illustrates two key trends in LLC dissolution law. My observations here reflect my recent work on a book chapter for the *Research Handbook on Partnerships, LLCs and Alternative Forms of Business Organizations*, an Edward Elgar Publishing resource edited by Robert Hillman and Mark

Loewenstein released in 2015. That earlier work identified corporate law norms and freedom of contract principles as two factors that influence LLC dissolution law. After a brief introduction, the article outlines, in turn, each of these LLC law influences in the dissolution context.

LLC Dissolution Law Background

As a component of LLC law, dissolution rules originally were anchored in federal income tax law norms. Specifically, an important catalyst for, and root of, original dissolution components in state-adopted LLC statutes was the need to provide for dissolution of the LLC upon the dissociation of a member—the separation of an LLC member from the LLC—in order to help ensure the availability of partnership income taxation to the LLC before the Internal Revenue Service (IRS) adopted its check-the-box rules. (In short, the check-the-box rules, an important current feature of the U.S. law governing LLCs, allow multimember unincorporated business associations to choose between partnership and corporate taxation.)

With the January 1, 1997, effectiveness of the check-the-box rules adopted by the IRS, state legislatures were less constrained by federal tax law rules in constructing LLC dissolution regimes. Innovations in uniform and prototype LLC acts and state LLC stat-

utes predictably followed. The National Conference of Commissioners on Uniform State Laws adopted its Uniform Limited Liability Company Act (ULLCA) in 1996 (with an awareness of the impending changes in the federal income tax treatment of LLCs) and its Revised Uniform Limited Liability Company Act (RULLCA) in 2006. In 2011, the Revised Prototype Limited Liability Company Act Editorial Board of the LLCs, Partnerships and Unincorporated Entities Committee of the American Bar Association introduced a Revised Prototype Limited Liability Company Act (RPLLCA). The RPLLCA responded to significant changes in LLC law introduced in Delaware, the leading state in the development of LLC law. Overall, state LLC statutory innovations both preceded and emanated from changes introduced in these uniform and prototype LLC acts. Current state LLC statutes include both dissolution provisions from these uniform and prototype acts and dissolution rules individually crafted by state legislatures, presumably in response to state policy concerns.

These legislative efforts are significantly shaped by the status of dissolutions as fundamental change transactions. Fundamental change transactions alter the entity in foundational ways. They make changes to the firm that are so basic that, under histori-

cal norms, non-manager owners were given complete control over their approval and adoption through a right to vote or consent. This complete control through unanimous consent was a core value of what became known as the “vested rights doctrine.” Under that doctrine, business entity owners were deemed to have certain core rights in that capacity that could not be altered without their consent. The vested rights doctrine had been, but no longer is, a corporate law norm. Consent rights have largely evolved from requiring unanimous approval of fundamental change transactions toward a majority approval model.

Dissolution is a fundamental change transaction because, absent intervening actions or occurrences, it triggers the windup of a firm that results in its termination. It is important to note that, contrary to the common usage of the term, dissolution itself is not the actual termination of the firm. It does, however, without more, precipitate the windup and termination of the firm.

Because LLC dissolutions are fundamental change transactions, legislatures considering adopting or amending LLC dissolution rules necessarily focus on the nature of the authority to dissolve the firm. Specifically, legislative attention to LLC rules tends to focus on the voting or consent rights enjoyed by LLC managers and nonmanagement owners in the dissolution context and the extent to which private ordering—agreements among the members embodied in operating agreements (also known under Delaware LLC law and other LLC statutory regimes as limited liability company agreements)—can alter the statutory rules relating to those voting or consent rights. The summaries of LLC dissolution doctrine that follow therefore focus on rules governing the approval rights of LLC members over LLC dissolutions and the extent to which those rules are default rules that can be customized through private ordering in LLC operating agreements.

The Influence of Corporate Law Norms

Dissolution rules in LLC statutes originated in partnership law as a means of ensuring partnership treatment for LLCs under the then applicable federal income tax rules.

Accordingly, because partnership norms provided for dissolution in the event of the dissociation of a partner from the firm, LLC law incorporated that rule. This avoided the continuity of existence characteristic of the corporate form, which was important because pass-through income tax status under federal law then was based in part on limited (as opposed to perpetual) entity existence. The adoption of the check-the-box rules left uniform and prototype law drafters and state legislators free to propose and adopt dissolution events that allow for perpetual existence. And so they moved into that void.

In fact, the LLC statutory norm now is perpetual existence. The initial uniform act changes in this regard were created almost simultaneously with the adoption of the check-the-box rules. Under Section 801 of the ULLCA, while the dissociation of an LLC member has the potential to dissolve the LLC, dissolution is not an automatic effect of LLC member dissociation. The RULLCA and the RPLLCA carry this change forward in a more direct way. Section 104(c) of the RULLCA and Section 104(b) of the RPLLCA each provides that “[a] limited liability company has perpetual duration.”

Like the uniform and prototype LLC acts, state LLC statutes incorporate perpetual existence, which was a long-held corporate norm. Under Section 18-201 of the Delaware Limited Liability Company Act, “[a] limited liability company . . . shall be a separate legal entity, the existence of which as a separate legal entity shall continue until cancellation of the limited liability company’s certificate of formation,” and Section 18-801(a)(1) of that act consistently provides for perpetual existence of Delaware LLCs. Section 605.0108(3) of the Florida Revised Limited Liability Company Act similarly provides that “[a] limited liability company has an indefinite duration.”

Corporate law dissolution norms embodied in Section 14.30(a)(2) of the American Bar Association’s Model Business Corporation Act (MBCA), incorporated into the corporate law statutes in many states, allow for shareholders to apply to a court for dissolution in certain situations set forth in

those laws. Many of these statutory shareholder-initiated judicial dissolution events have been a part of the MBCA for as many as 50 years. The current MBCA restricts these shareholder-initiated dissolution applications to privately held corporations.

Along similar lines, the ULLCA and RULLCA provide that LLC members can apply to a court for dissolution of the LLC under specified circumstances, including frustration of the LLC’s economic purpose, the conduct of another member making continuation of the business with that member reasonably impracticable, the reasonable impracticability of conducting the company’s business in conformity with the articles of organization and the operating agreement, and illegal, oppressive, fraudulent, or unfairly prejudicial managerial action. States have broadly, but variously, adopted these uniform and prototype act provisions allowing for member applications for judicial dissolution.

In 1990, the MBCA was modified to include a repurchase right exercisable by the corporation or remaining shareholders as an alternative to a shareholder-initiated dissolution under MBCA Section 14.30(a)(2), as a reflection of evolving state judicial decisions involving dissolutions of closely held corporations. Buyout obligations also exist under modern LLC law. Specifically, while member dissociation does not generally trigger dissolution of the LLC, it does typically result in a buyout of the member’s interest under Article 7 of the ULLCA. (The buyout alternative also was included in the Revised Uniform Partnership Act adopted in 1997 but was omitted in the drafting of the RULLCA.) While the repurchase rights provided for in the ULLCA, adopted in many states, differ from the buyout options available to shareholders in privately held firms under corporate law, they reflect similar concerns relative to the exit of an owner from the firm and the continued existence of the firm in that circumstance.

Dissolution is one of the few actions or transactions involving the corporation for which corporate shareholders have statutory approval rights. General corporate law norms reflected in, e.g., Section 275 of the

General Corporation Law of the State of Delaware and Section 14.02 of the MBCA allow for dissolution of the corporation after the approval of the board of directors and the shareholders, typically by majority vote unless the corporate charter otherwise provides. Under the vested rights doctrine, a unanimous vote of shareholders had been required. But, as noted above, state corporate law has evolved to a majority vote norm for dissolutions and other corporate fundamental change transactions.

Modern LLC acts also allow members to consent to dissolve the LLC. For example, Section 801(a)(2) of the ULLCA provides for dissolution of the LLC upon the “consent of the number or percentage of members specified in the operating agreement.” Section 701(a)(2) of the RULLCA and Section 706(b) of the RPLLCA each includes the consent of all of the members as a default dissolution event.

Some state LLC statutes go further than the most recent uniform and prototype acts by expressly providing that dissolutions require less than unanimous approval of the members of the LLC by default. Delaware law, for example, provides for dissolution under Section 18-801(a)(3) “upon the affirmative vote or written consent of the members of the limited liability company . . . by members who own more than ⅔ of the then-current percentage or other interest in the profits of the limited liability company owned by all of the members,” unless the limited liability company agreement otherwise provides. Under Section § 48-249-603 of its Revised Limited Liability Company Act, Tennessee provides for several default nonjudicial dissolution events, including dissolution by vote of a majority of the members at a meeting properly called for that purpose.

These examples illustrate the evolution of LLC dissolution norms from the earlier partnership model that linked an owner’s separation from the firm with the firm’s dissolution to the more current closely held corporate model that offers greater owner control over firm dissolution through judicial dissolution applications. Some state nonjudicial dissolution provisions in state LLC statutes

also exemplify the corporate law movement away from the unanimous consent requirement under the vested rights doctrine. None of this means, however, that LLCs are identical to closely held corporations. Rather, LLC law, as it evolves, is apparently borrowing, in relevant contexts, norms established under corporate law as sensible ways of handling emergent issues under the as-yet relatively new law of LLCs.

The Influence of Freedom of Contract

As a general rule, freedom of contract is a highly valued proposition in LLC law. Section 18-1101(b) of the Delaware Limited Liability Company Act famously provides that “[i]t is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.” Although LLC dissolution law general permits freedom of contract, that freedom is limited in some respects by express statutory provision. In general, however, the continuity of existence of an LLC and most statutory dissolution and windup rules are default rules that are subject to modification through private ordering.

In the uniform and prototype acts, as well as most state LLC statutes, the freedom to engage in private ordering is evidenced by an express rule in the LLC statute acknowledging the supremacy of provisions of the LLC operating agreement, subject to limited exceptions, and the gap-filling role served by most rules set forth in the statute. Section 103 of the ULLCA and Section 110 of the RULLCA and RPLLCA are examples of this kind of statutory scheme. While state LLC statutes do vary on this point, many follow the structure of the uniform and prototype acts. Section 322C.0110 of the Minnesota Revised Uniform Limited Liability Company Act is one illustration.

The perpetual duration of an LLC is subject to private ordering under model, prototype, and state LLC statutes. In describing the definition of an operating agreement under the RULLCA, the comments note that, “[s]ubject to the operating agreement, that duration is perpetual” (emphasis added). The comment to RULLCA Section

104(c) (quoted here without the embedded statutory cross-references) makes additional relevant observations:

In this context, the word “perpetual” is a misnomer, albeit one commonplace in LLC statutes. Like all current LLC statutes, this Act provides several consent-based avenues to override perpetuity: a term specified in the operating agreement; an event specified in the operating agreement; member consent. In this context, “perpetuity” actually means that the Act does not require a definite term and creates no nexus between the dissociation of a member and the dissolution of the entity.

Delaware law expresses the same concept differently. Section 18-801(a) of the Delaware Limited Liability Company Act states that “[a] limited liability company is dissolved and its affairs shall be wound up . . . [a]t the time specified in a limited liability company agreement, but if no such time is set forth in the limited liability company agreement, then the limited liability company shall have a perpetual existence” (emphasis added).

For the most part, dissolution events can be set forth or varied in the LLC operating agreement. The RPLLCA allows for unfettered private ordering in its dissolution rules. The ULLCA and RULLCA include limited restrictions on the ability to agree around the statutory dissolution events. Comments to the ULLCA’s dissolution provisions note that “[t]he dissolution rules of this section are mostly default rules and may be modified by an operating agreement. However, an operating agreement may not modify or eliminate the dissolution events specified in subsection (a)(3) (illegal business) or subsection (a)(4) (member application).” The RULLCA does not substantially change that overall arrangement, although the specifics of the dissolution events are different under the RULLCA.

State rules on private ordering in the LLC dissolution context vary widely. Many state LLC statutes follow the general scheme used in the ULCA and RULLCA—fash-

ioning most dissolution events as default rules but preserving as immutable a few key dissolution triggers. Some state LLC laws, however, allow fewer modifications to dissolution rules than are permitted under the uniform and prototype acts, especially in the area of member-initiated judicial dissolutions. Sections 605.0105(3)(i) & (j) of the Florida Revised Limited Liability Company Act (which reference in pertinent part Sections 605.0702 & 605.0709(5) of that law), for example, broaden the set of immutable events to court-supervised windup applications brought by managers, transferees of membership interests, and creditors. Other state LLC laws, like Delaware's, allow an LLC's operating agreement to effectively be the exclusive source of LLC dissolution events.

These provisions manifest a spectrum of different approaches to freedom of contract under LLC dissolution rules. It is important to note, however, that even in Delaware and other jurisdictions that allow substantial freedom of contract, the judiciary typically is afforded, through statutory or decisional law, the discretion to dissolve the LLC under specific circumstances—in application or, in some cases, *sua sponte*. Section § 18-802 of the Delaware Limited Liability Company Act, for example, instructs that, “[o]n application by or for a member or manager the Court of Chancery may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement.” This type of judicial discretion over dissolution may be, and often is, narrowly construed and infrequently exercised.

Conclusion

Although LLC dissolution law rules—and the fundamental change provisions in LLC laws more generally—have not received widespread attention in scholarly articles and practical legal commentary, they represent an interesting and important laboratory for legal experimentation. LLC law continues to innovate and evolve. There are broad areas of convergence among various LLC regimes, but specific rules tend to vary

from state to state. Distinct, individualized state experience with LLC law and related policy considerations may underlie these differences.

In this environment, corporate law rules and freedom of contract principles appear to hold some significant sway. Specifically, general continuing trends in LLC dissolution law worth watching include the incorporation of corporate law norms and the fostering (or cabining) of the freedom of contract foundation of the LLC form. It may be that LLC dissolution rules continue to be path-dependent as individual states refine their policy orientations. It also may be, however, that as state-based experiments in LLC dissolution law succeed or fail in meeting the overall objectives of the LLC form of business association, disso-

lution rules will converge more narrowly around specific LLC law “best practices.” In either event, LLC dissolution rules are an engaging microcosm of LLC law and worth more attention than they have been accorded to date in legal scholarship and analysis.

Joan MacLeod Heminway is the W.P. Toms Distinguished Professor of Law at the University of Tennessee College of Law, where she teaches business law courses and engages in related research and writing. She is licensed to practice in Tennessee and serves on the Business Entity Study Committee and Executive Committee of the Business Law Section of the Tennessee Bar Association.

ADDITIONAL RESOURCES

For other materials related to this topic, please refer to the following.

Business Law Section Program Library

The Legal Death of a LLC: A Nationwide Hodgepodge of Rules and Practices (PDF) (Audio)

Presented by: LLCs, Partnerships and Unincorporated Entities
Location: 2015 Committee Meeting

The Crossroads of LLCs and Bankruptcy—A Treacherous Interaction (PDF) (Audio)

Presented by: LLCs, Partnerships and Unincorporated Entities, Business Bankruptcy, Middle Market and Small Business
Location: 2015 Spring Meeting

The LLC & Partnership Reporter

Single Member's Death Results in Dissolution of Alabama LLC

By Doug Bately
Vol. 31, No. 1 September 2014

* * *

The Business Lawyer

Judicial Dissolution: Are the Courts of the State that Brought You In the Only Courts that Can Take You Out?

By Peter B. Ladig and Kyle Evans Gay
Vol. 70, No. 4 Fall 2015

* * *

Business Law Today

Delaware Insider: When Deciding Whether to Judicially Dissolve an LLC, the Court May Find the “Purpose” of the LLC to Be Different Than What Is Stated in the LLC Agreement

By Jason Jowers
Vol. 25, No. 4 December 2015