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Hindsight is 20/20:

A Review of Selected 2015 LLC Cases

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Fortunately for our profession, the only guarantee is that the laws are ever-changing. In 2015, over 200 published decisions involved limited liability companies. This article provides a multi-jurisdictional review of important LLC cases involving topics for every business law practitioner.

PIERCING THE LIMITED LIABILITY VEIL IN DELAWARE

CASE BACKGROUND

In *A.G. Cullen Const., Inc. v. Burnham Partners, LLC*[1], Burnham Partners, LLC (Burnham), an Illinois LLC, was formed by its sole member, Robert Halpin.[2]. In June 2005, Burnham formed Westgate Ventures, LLC (Westgate), a Delaware LLC.[3] The members of Westgate were Burnham, with a 90% interest, and Felix Fukui (Fukui), who owned the remaining 10%.[4]

Westgate was governed by a limited liability agreement (Agreement), which gave Burnham, as the initial manager of Westgate, numerous duties including acquisition, ownership, improvement, sale, and lease of company property.[5] Furthermore, the Agreement required each member to make a capital contribution to Westgate. Burnham never made a capital contribution, but rather, Robert Halpin and his wife, Lori, borrowed money from Northern Trust Bank and then loaned $175,000 to Westgate.[6] Westgate executed a note in the Halpins' favor, which was due upon the sale of a property purchased in Pennsylvania.[7]

Shortly after forming Westgate, Burnham entered into a development and asset management agreement (Development Agreement) with Westgate.[8] Burnham agreed to provide development services, and in return Westgate would pay Burnham a development fee of $400,000.[9]

On November 17, 2005, Westgate contracted with A.G. Cullen Construction, Inc. (Cullen Inc.), a Pennsylvania corporation, to build a warehouse in Pennsylvania.[10] Shortly after entering into the construction contract, Westgate refused to remit $360,000 as payment, and Cullen Inc. filed its demand for arbitration.[11]

Three months prior to the arbitration hearing, Westgate sold the warehouse facility for $3.2 million. After the sale, Halpin began to windup Westgate and liquidate its assets. From the proceeds of the sale, Halpin paid:

- $2,513,984.01 to S & T Bank (a secured creditor)
- $120,000 to Northern Trust for the loan the Halpins made to Westgate
- $400,000 to Burnham for the development fee, which was later transferred to Halpin
- $97,530.44 directly to himself and his wife for reimbursement of advances[12]

In September 2007, the arbitrator entered an award of $448,406.87 in favor of Cullen Inc. and against Westgate. Upon realizing Westgate was unable to satisfy the debt, Cullen Inc. sued Burnham LLC, Lori Halpin, Robert Halpin, and Westgate to recover the amount

owed by Westgate.[13]

During the bench trial, Cullen Inc.'s representative testified he believed Robert Halpin, Burnham, and Westgate "were one and the same." *Id.* On cross-examination, Cullen Inc. acknowledged it never obtained a personal guarantee from Robert Halpin and the construction contract was only with Westgate. *Id.* at 584.

Robert Halpin testified that Westgate and Burnham were separate entities and held separate operating and capital accounts.[14] Halpin acknowledged that under Burnham he was not entitled to compensation for serving as manager of Westgate; but, pursuant to the Development Agreement, he was owed $400,000 as an independent contractor for performing essentially the same duties as the manager.[15]

Lori Halpin testified she did bookkeeping for both Burnham and Westgate, but was not an employee of either company, despite the listing on her LinkedIn profile. *Id.* at 585. Lori Halpin was unable to locate Westgate's books, minutes, and records regarding corporate formalities, business activities, and debt.[16]

At the close of evidence, Cullen Inc. requested an adverse inference against defendants for failing to turn over requested documents and specifically asserted:

- Robert Halpin failed to honor the company structure of Westgate
- Robert Halpin did not treat Westgate and Burnham as separate entities
- Robert Halpin did not keep Burnham and Westgate separate from himself
- The records would have shown Lori Halpin ran Robert Halpin's business for him and Westgate was an alter ego of Robert Halpin, Lori Halpin, and Burnham
- Because Robert Halpin made a loan to Westgate rather than a capital contribution as required, Westgate did not receive reasonably equivalent value in exchange for its payment to the Halpins
- Westgate did not receive reasonably equivalent value in exchange for its $400,000 payment to Burnham and Halpin[17]

The trial court denied Cullen Inc.'s request for an adverse inference against defendants, dismissed the action, and entered final judgment in favor of defendants. The court further found:

Cullen had no claim against defendants under the Delaware Limited Liability Company Act. That Act provides that when winding up a limited liability company, assets "shall be distributed to creditors, including members and managers who are creditors." *Id.* Because Burnham was a member and a creditor, the court found that distributions to Burnham and the Halpins were not impermissible. The court also found defendants did not violate the Pennsylvania Contractor and Subcontractor Payment Act, as Cullen's contract was with Westgate and no privity of contract existed between Cullen, Burnham, and the Halpins.

The court found that the evidence suggested Burnham and Westgate were *bona fide* independent entities that kept proper corporate books and records, and were properly funded. The court stated that Burnham properly earned its $400,000 development fee, which had been deferred for two years and that the Halpins were entitled to be repaid for their $175,000 loan to Westgate, that those disbursements were not made with the intent to hinder or defraud Cullen, and that the mere preference of one creditor over another does not constitute fraud. Lastly, the court stated that Cullen could have contracted to protect itself by, for instance, asking Robert Halpin for a personal guarantee or requiring a performance bond, but failed to do so.[18]

On appeal, Cullen Inc. argued the trial court erred because:

- Burnham and Halpin acted fraudulently under section 5(a) of the Uniform Fraudulent Transfer Act (UFTA) when disbursing $470,129.58 of Westgate's assets to Burnham, and $120,000 to the Northern Trust to repay the Halpins' loan to Westgate
- The limited liability veil should have been pierced under Delaware law due to defendants' fraudulent actions, and because Westgate was an alter ego of Burnham and the Halpins
- Halpin breached its fiduciary duty to Westgate by making fraudulent insider disbursements to Burnham, himself, and his wife
- The appellate court agreed with Cullen Inc. on all points and reversed and remanded the matter back to the trial court[19]

KEY TAKEAWAYS

Uniform Fraudulent Transfer Act

The court considered the 11 factors set forth by UFTA Section (5) when determining if actual intent existed and whether this case involved fraud in fact.[20] The court noted, "Proof of some or even all of the factors included in Section 5(b) does not create a presumption that the debtor had the actual intent to defraud. But the presence of these 'badges of fraud' may, in sufficient number, give rise to an inference or presumption of fraud."[21]

Conducting the factor analysis outlined in UFTA Section 5(b), the court determined:

- Robert and Lori Halpin were respective "insiders" of the LLCs and were in control
- Contrary to the trial court's finding, Halpin did not act in "good faith" or "substantially comply" with the terms of the construction agreement
- There were 9 of the 11 badges of fraud present[22]

Disconcertingly, the court also reviewed the Development Contract between Westgate and Burnham, and the loan agreement between Westgate and the Halpins. The court found Westgate did not receive "reasonably equivalent value" in exchange for the payments in either transaction.[23]

Piercing the LLC Veil Pursuant to Delaware Law

Delaware is known for respecting businesses' contractual rights and "[a]bsent sufficient cause the separate legal existence of a corporation will not be disturbed."[24] Nevertheless, "the corporate veil may be pierced where there is fraud or where a subsidiary is in fact the mere alter ego of the parent."[25]

When determining if an alter ego exists, the court considered:

- whether the company was adequately capitalized
- whether the company was solvent
- whether dividends were paid, company records kept, officers functioned properly, and other company formalities were observed
- whether the majority member siphoned corporate funds
- whether, in general, the company simply functioned as a facade for the majority member[26]

Fiduciary Duty

CONFLICTS-OF-LAW

CASE BACKGROUND

In *Heaps*, employees of Nuriche, a Nevada LLC registered to do business in Utah, sought to hold the managers personally liable for unpaid wages under the Utah Payment of Wages Act (UPWA).[30] The UPWA provides for civil and criminal liabilities on the part of employers for unpaid wages owed. *Id.* The UPWA defines an "employer" as "every person, firm, partnership, association, corporation, receiver or other officer of a court of this state, and any *agent or officer* of any of the above-mentioned classes, *employing any person in this state*."[31]

The managers contended the Utah Revised Uniform Limited Liability Company Act (URULLCA) provides "[t]he law of the jurisdiction of formation of a foreign limited liability company governs... the liability of a member as a member and a manager as manager for a debt, obligation, or other liability of the company."[32]

KEY TAKEAWAYS

WHO CARES WHAT THE OPERATING AGREEMENT SAYS?

Meyer Natural Foods LLC v. Duff,[36] gives us an alternate view

CASE BACKGROUND

Respondents formed Meyer Natural Foods LLC.[37] Accordingly, the parties executed: (1) a Purchase Agreement, (2) an Amended and Restated Operating Agreement, and (3) an Output and Supply Agreement.[38] The Output and Supply Agreement referenced the other two documents, but the Operating

Agreement specifically included an integration clause stating it was the only agreement between the parties.[39]

The majority member, Meyer, sought a judicial dissolution of the company even though the Operating Agreement stated "absent prior written consent of a majority of the interests held by the other [minority] members, the managing member could not cause the Company to undertake or engage in ... the dissolution of the Company."[40]

KEY TAKEAWAYS

WHERE SOCIAL MEDIA DISPUTES BEGIN AND BUSINESS INTERESTS END

With internet capabilities, business owners have unprecedented opportunities to reach customers. Accordingly, practitioners are forced to consider "social media interests" when addressing business succession planning. *Davis v. VCP South, LLC,*[45], highlights the ramifications of drafting broad succession language and what grieving spouses are capable of doing.

CASE BACKGROUND

Davis involved plastic surgeons, Davis and Roth, who formed VCP South, LLC (VCP South). Each surgeon owned a fifty percent membership interest in the joint

"explicit notice of consent from the complaining party."[56] As of the date of this article, *The Vein Guys* had approximately 2,000 "likes" on its Facebook page, which explains the measures taken to have this issue heard at an emergency hearing. Finding Plaintiffs would suffer irreparable harm, the court ordered Davis' widow to have the Facebook page reinstated immediately.[57] After issuing a second order requiring the widow to pay $1,000 per day if the Facebook page was not activated by April 5, 2014, she boldly did not reactivate the Facebook page until April 14, 2014.

ing the expiration of a deceased members' interests and financial rights caused needless delays and additional costs of employing a special master.[58] Additionally, with the major role social media now plays our clients' businesses, we will see increased litigation concerning these outlets. As *Davis* demonstrates, Facebook will not necessarily reinstate a page, even if a judge orders such... twice. The CEO testified that even a 5% downturn in patients would cost the practice $60,000 per month.[59] As practitioners, we must create solutions that proactively protect our clients' "social media interests" because of the potential financial ramifications.

ABOUT THE AUTHOR

A Wyoming native, Marty L. Oblasser (WealthCounsel Member since 2011) attended the University of Wyoming to obtain both her undergraduate and juris doctor degrees. Marty began her career as an associate attorney in the Legacy Planning Department with a law firm in Casper, Wyoming. During that time, she not only focused on building an estate planning and business law practice but she also engaged in trust litigation matters and successfully argued to the Wyoming Supreme Court. Marty is a partner with Wyoming's oldest law firm, Corthell and King, P.C. and is licensed to practice law in the State of Wyoming as well as the United States District Court for the District of Wyoming.

Marty enjoys educating the public about various estate planning and business law matters as well as teaching legal seminars for her local community and presenting continuing legal education courses to her peers for the Wyoming State Bar and the National Business Institute.

Marty, her husband, Erik, and their two dogs reside in Laramie, Wyoming.

ENDNOTES

1 A.G. Cullen Const., Inc. v. Burnham Partners, LLC, 29 N.E.3d 579 (Ill. 2015),
2 Id. at 581
3 Id.
4 Id.
5 Id. at 582.
6 Id.
7 Id.
8 Id.
9 Id
10 Id.
11 Id.
12 Id. at 583.
13 Id.
14 Id.
15 Id.
16 Id.
17 Id.
18 Id. at 585–86.
19 Id. at 586.
20 Id. at 587.
21 Id.
22 Id. at 588.
23 Id. at 588–89.
24 Id. at 590.
25 Id.
26 Id. at 590-91.
27 Id. at 591.
28 Id.
29 Heaps v. Nuriche, LLC, 345 P.3d 655 (Utah 2015)
30 Id. at 656.
31 Id. at 659.
32 Id. at 658 (quoting Utah Code § 48-3a-901(1))
33 Id.
34 Id. at 658.
35 Id. at 658–59.
36 Meyer Natural Foods LLC v. Duff, 2015 WL 3746283 (Del. Ch. June 4, 2015) (unpublished)
37 Id. at *1.
38 Id.
39 Id.
40 Id.
41 Id.
42 Id. at *2.
43 Id. at *3-4.
44 Id.
45 Davis v. VCP South, LLC, 774 S.E.2d 606 (Ga. 2015)
46 Id. at 609.
47 Id.
48 Id.
49 Id.
50 Id.
51 Id.
52 Id. at 609.
53 Id. at 610.
54 Id.
55 Id.
56 Id.
57 Id.
58 Id. at 610.
59 Id. at 612.