

Acme Inc. manufactures building materials, including concrete, for sale to construction companies. To create a market for its building materials, Acme enters into agreements with construction companies under which Acme and the construction company agree to form a member-managed limited liability company (LLC). The LLC builds the project, purchasing building materials from Acme and contracting for construction services with the construction company.

The operating agreements for these LLCs always provide that Acme has a 55% voting interest, that Acme and the construction company contribute equally to the capital of the venture, and that the parties share in profits at a negotiated rate. The agreements are silent as to the allocation of losses.

Acme entered into such a relationship with Brown Construction Co. LLC (Brown), forming Acme-Brown LLC (A-B LLC) to build 50 homes. The operating agreement for A-B LLC gives Acme a 55% voting interest and provides for a 20%/80% division of profits in favor of Brown.

A-B LLC built all 50 homes and sold them to homeowners. The members received a distribution of profits from the sales, split between them according to their agreement on the division of profits. However, all the concrete manufactured by Acme and sold to A-B LLC for the foundations of the homes proved to be defective. After a year, the concrete dissolved, collapsing the homes and rendering them worthless. In a class action by the homeowners against A-B LLC, the plaintiffs were awarded a \$15 million judgment. The LLC has no assets with which to pay the judgment.

Although Acme would be liable to A-B LLC for the loss caused by the defective concrete, A-B LLC has not brought a claim against Acme. Acme has the financial resources to pay damages equal to the amount of the \$15 million judgment in the homeowners' lawsuit and to fully cover A-B LLC's liability.

Brown has sent a letter to A-B LLC demanding that A-B LLC bring a claim against Acme to recover those damages and pay the judgment to the plaintiffs, after which A-B LLC would be dissolved. But Acme, as the manager of A-B LLC, has refused to do so.

Acme's lawyer has sent a letter to Brown stating the following:

- (1) Acme has no fiduciary obligations to either A-B LLC or Brown that require it to have A-B LLC bring the concrete claim against Acme.
- (2) Brown cannot bring a claim against Acme.
- (3) Brown does not have sufficient grounds to seek the judicial dissolution of A-B LLC.
- (4) Because the A-B LLC agreement provides for a 20%/80% division of profits, the losses arising from the judgment obtained by the plaintiffs against the LLC should also be allocated 20% to Acme and 80% to Brown.

Is Acme's lawyer correct? Explain.

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Question Presented

Acme manufactures building materials and forms member-managed LLCs with construction companies. It formed A-B LLC with Brown; the operating agreement gives Acme a 55% voting interest and a 20%/80% split of profits favoring Brown, and is silent as to losses.

← *member-managed + 55% control + manager = Acme owes fiduciary duties*

A-B LLC built and sold 50 homes. Acme's concrete was defective; the homes collapsed and homeowners won a \$15M judgment the LLC cannot pay. Acme could cover it but, as manager, refuses to have the LLC sue itself.

← *self-dealing: Acme votes to shield itself at the LLC's expense*

Brown demand that A-B LLC sue Acme; Acme refused. Brown asks whether it may sue and whether it may seek judicial dissolution.

← *demand made + refused (and futile) = derivative suit; oppression = dissolution*

Acme's lawyer asserts: (1) Acme owes no fiduciary obligations requiring it to have the LLC sue Acme.

← *Wrong. A controlling, managing member owes loyalty + care.*

(2) Brown cannot bring a claim against Acme.

← *Wrong. Brown may sue derivatively for the LLC.*

(3) Brown lacks grounds for judicial dissolution.

← *Wrong. Oppression / purpose complete = grounds exist.*

(4) The judgment losses should be split 20/80 like profits.

← *Wrong. Members are not personally liable; profit split is not liability.*

Issue 1: Fiduciary Duty of a Controlling, Managing Member

Issue. Whether Acme, as the controlling and managing member, owes a fiduciary duty that bars it from refusing to have A-B LLC pursue the concrete claim against Acme.

Statement (1).

Rule. G/R: In a member-managed LLC, each member owes the LLC and the other members a duty of loyalty (act in the LLC's best interest, avoid self-dealing and conflicts, and account for benefits) and a duty of care (refrain from grossly negligent or intentional

loyalty + care; self-dealing triggers loyalty

misconduct). A controlling member who sits on both sides of a claim has a conflict and may not advance its own interest at the LLC's expense.

Analysis. Here, Acme is the 55% member and the manager, and it is the very party the LLC would sue. By using its control to block a valid \$15M claim against itself, Acme placed its own interest ahead of the LLC and the minority, saving itself \$15M at the LLC's expense. That is self-dealing and a failure to act in the LLC's best interest.

Conclusion. Therefore, statement (1) is incorrect: Acme owes duties of loyalty and care and may not block the claim.

Acme both controls the vote and profits from the breach

lawyer wrong on (1)

Issue 2: Brown's Derivative Claim

Issue. Whether Brown may bring a claim against Acme.

Rule. G/R: An injury to the LLC belongs to the LLC. A member cannot sue directly on it but may bring a derivative action on the LLC's behalf after making a demand on the managers to pursue the claim, unless demand is excused as futile. Any recovery flows to the LLC.

Analysis. Here, the concrete claim belongs to A-B LLC, so Brown cannot sue in its own right. But Brown made a demand and Acme, the manager, refused; demand is also futile because the wrongdoer, Acme, controls the decision. Brown may therefore pursue the claim derivatively for the LLC.

Conclusion. Therefore, statement (2) is incorrect: Brown may bring a derivative (not direct) claim.

Statement (2).

direct vs derivative; demand or futility

demand refused AND futile

lawyer wrong on (2)

Issue 3: Judicial Dissolution

Issue. Whether Brown has sufficient grounds to seek judicial dissolution of A-B LLC.

Rule. G/R: A member may seek judicial dissolution where the managers or those in control have acted, or are acting, in a manner that is illegal, fraudulent, or oppressive and directly harmful to the member, or where it is not reasonably practicable to carry on the LLC's business. Oppression includes defeating a minority member's reasonable expectations.

Analysis. Here, Acme's refusal to let the LLC recover from Acme

Statement (3).

oppression OR not reasonably practicable

oppression + purpose complete

leaves the LLC insolvent and Brown's investment worthless. That is oppressive and directly harmful to Brown and defeats his reasonable expectation that the LLC would enforce its own claims. The venture's purpose, building the 50 homes, is also complete, so continuing may not be reasonably practicable.

Conclusion. Therefore, statement (3) is incorrect: Brown has sufficient grounds to seek dissolution.

lawyer wrong on (3)

Issue 4: Allocation of the Loss

Issue. Whether the \$15M judgment should be allocated 20%/80% between Acme and Brown because profits are split that way.

Statement (4).

Rule. G/R: Members of an LLC are not personally liable for the LLC's debts and obligations; exposure is limited to their contributions, absent grounds to pierce the veil. A profit-sharing ratio does not, by default, dictate how losses are allocated, and it does not create personal liability for a judgment against the LLC.

limited liability; profit split is not loss allocation

Analysis. Here, the \$15M judgment is the LLC's obligation. Because A-B LLC is a limited liability entity, neither Acme nor Brown is personally liable beyond contributions, and no facts support piercing. The 20/80 profit split is therefore irrelevant to who bears the judgment.

the LLC, not the members, owes the judgment

Conclusion. Therefore, statement (4) is incorrect: the profit split does not control, and neither member is personally liable for the judgment.

lawyer wrong on (4)

Step-by-Step: Testing the Lawyer's Four Assertions

Take each statement in turn; each one fails.

1. Does a controlling, managing member owe fiduciary duties?

→ Yes: loyalty and care to the LLC and its members; no self-dealing. **(1) duties exist**



2. Can the minority member enforce the LLC's claim?

→ The injury is the LLC's; demand was made and refused, and is futile. **(2) derivative suit OK**



3. Are there grounds to dissolve?

→ Oppression, direct harm, and completed purpose supply grounds. **(3) dissolution available**



4. Who bears the \$15M judgment?

→ It is the LLC's debt; members are shielded; the profit split is irrelevant. **(4) no personal liability**



Bottom line

→ Acme's lawyer is incorrect on all four points.