Business Divorce: I Love You — Not Part 2

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When marital partners have irreconcilable differences, either party can end the marriage through "no fault" dissolution. But for California business owners–whether corporate shareholders or limited liability company owners–getting out when conflicts arise can be difficult.

In Part 1 of this series, I covered remedies available to shareholders of California corporations. In this article, I cover remedies available to unhappy owners of California limited liability companies.

Although the limited liability company form of entity is much newer than the corporate form, disputes between a faction that has effective control of the company and a faction that does not frequently arise in much the same circumstance as with corporations. If the parties did not establish a buy out mechanism while they were friendly, they must look to the statutes for answers when a dispute arises.

As with corporations, each situation is different. This article examines general principles involved where owners of a limited liability company are in conflict.

Corporations Code 17350(b)[1], governing the voluntary dissolution of a limited liability company, is similar to Section 1900 with respect to corporations. However, unlike Section 1900, voluntary dissolution requires the vote of a majority

1 Section references are to the California Corporations Code.

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in interest of the members–not merely 50%. In addition, the members can agree in the articles of organization or operating agreement to a higher percentage. Thus, voluntary dissolution of a limited liability company can be more difficult to achieve than voluntary dissolution of a corporation.

Another important ground for dissolution is under Section 17350(c): "Entry of a decree of judicial dissolution pursuant to Section 17351." Corporations Code Section 17351 is often regarded as the analog for limited liability companies to Sections 1800 and 2000. The typical grounds for involuntary dissolution are:

(1) The business of the company has been abandoned or it is no longer reasonably practicable to carry on the business in conformity with the company's governing documents.

(2) Dissolution is reasonably necessary to protect the rights or interests of the complaining members.

(3) Management is deadlocked or subject to internal dissention.

(4) Those in control of the company have been guilty of, or have knowingly countenanced persistent and pervasive fraud, mismanagement, or abuse of authority.

These the grounds are very similar to those set forth in Section 1800. However, because limited liability companies are governed by operating agreements, frequently attempts are made to limit or eliminate some or all of the above grounds. At this writing, there are no reported cases but the enforceability of those attempts is questionable: In contrast to Section 17350(b), neither Section 17350(c) nor Section 17351 provides for the possibility of a stricter standard in the articles of organization or an operating agreement.

Assuming that the moving party has grounds for dissolution, the appraisal process is nearly identical to that under Section 2000, with these exceptions:

(1) What is appraised is the "fair market value of the membership interests owned by the moving parties." This appears to be an important distinction because the term "fair market value" suggests that the Legislature had a different standard in mind than "fair value" under Section 2000.

(2) What is appraised is the membership interest of the moving party, rather than the underlying assets or business of the company. Again, this is a different standard.

(3) There is no mention of a possible sale of the underlying business "as a going concern," which is part of the valuation standard of Section 2000.

These differences suggest that the Legislature intended to have the usual rules regarding fair market value of an ownership interest in a business apply to the appraised value of a membership interest under Section 17351, such as minority interest and lack of marketability discounts. However, some have argued that Section 17351 was clearly derived from Sections 1800 and 2000, and that the case law under Section 2000 should be applied to cases under Section 17351. In general, one would expect the latter argument to be espoused by the moving parties, who would seek the highest possible value. Although one would expect that a court would take notice of the differences in language between Section 2000 and Section 17351, in the absence of reported cases, this disagreement is likely to continue.

In the same manner as with a corporation, once a value has been set by the court, the court will give the non-moving parties a limited period in which to complete the purchase the membership interests of the moving parties, and in the event they fail to do so, dissolution will be ordered.

Moving for dissolution of a California limited liability company involves a complex process which requires a careful analysis of risks. The unique facts of each situation will affect the desirability of pursuing remedies under the described statutory remedies, or other remedies.

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