

Dissolving and Winding Up Limited Liability Companies

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The best time to prepare for the termination of a limited liability company is at its inception.

SOME LIMITED LIABILITY COMPANIES CONTINUE IN EXISTENCE longer than others, but all cease conducting business operations at some point. The termination of a limited liability company ("LLC") involves three steps: a dissolution, the winding up of the LLC's business, and termination of the exis-

tence of the LLC by the filing of articles of termination.

This article deals with all three steps and considers the substantive law and tax law issues that must be considered in planning for LLC terminations, and in drafting documents that deal with the causes and effects of terminations.

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DISSOLUTION • Dissolution, which is the first step in the termination of the existence of an LLC, can result from a voluntary agreement of the members, from an event specified in the LLC's organizational documents, or from judicial or administrative action. Although dissolution by judicial or administrative action are not issues that require planning when an LLC is organized, consideration does need to be given to dissolution without official action when an LLC's articles of organization and operating agreement are prepared, and those documents should consider both the causes and effects of dissolution.

Dissolution Without Official Action

Under the Uniform Limited Liability Act ("ULLCA") §801(a), an LLC is dissolved without judicial or administrative action upon the occurrence of any of four events:

- The LLC reaches the end of the term stated in its articles of organization;
- The members consent to the dissolution;
- An event occurs causing the LLC to be dissolved under the terms of its operating agreement; or
- An event occurs making it unlawful for the business of the LLC to continue.

The dissociation of a member does not cause an LLC to dissolve under the ULLCA. Rather, the LLC continues in existence but is required to purchase the interest of the dissociated member under the statutory default rule.

Limited Term

If an LLC's articles of organization provide that the LLC is created for a limited term, the LLC will dissolve at the end of the specified term. Dissolution in this situation occurs under ULLCA §801(a)(6).

LLCs formed for the completion of a single project or venture often have limited terms set

forth in their operating agreements. The term for these LLCs is generally based on the estimated time to complete the project or venture.

The articles of organization for an LLC that is not created for a single project or venture may also provide for a limited term if its members want some assurance that they will be in a position to liquidate their investments in the LLC after a given period of time. The problem with using a limited term in this latter situation is, however, that if the members decide to continue the business beyond the limited term, the articles of organization of the LLC must be amended, and this requires not only unanimous consent of members but also a public filing.

The public filing requirement can be avoided if the LLC's articles of organization provide that the term of the LLC is to continue indefinitely but the operating agreement requires dissolution at a specified time absent an agreement of the members to continue the LLC. If the members want to avoid the need to obtain unanimous consent to continue the term of the LLC, the operating agreement can permit extension of the term by majority or supermajority vote of the members.

Although the articles of organization of LLCs do not often provide for limited terms, the ULLCA does provide some advantages to LLCs organized for a specified term.

One advantage is that an LLC with a limited term is not required to purchase the interest of a dissociated member until the expiration of the term under the default rule of ULLCA §701(a)(2). An LLC created for an indefinite term must purchase the interest of a dissociated member at the time of his or her dissociation under ULLCA §701(a)(1).

A second advantage of a limited term is that a transferee of a member's interest cannot obtain a judicial order dissolving an LLC

with a limited term until the expiration of its term under ULLCA §801(a)(5)(i). If an LLC has an indefinite term, judicial dissolution may be ordered at any time at the request of a transferee of a member's interest if dissolution is equitable.

There are, however, ways to accomplish the same results without limiting the term of an LLC. For example, if an LLC with an indefinite term wants to delay paying for the interest of a dissociated member purchased by the LLC for a time to deal with anticipated cash flow problems, the buy-sell provisions of the operating agreement can delay the commencement date of payments for the interest of a dissociated member even though the purchase takes place at the time of the dissociation. An LLC can protect itself against a transferee of a member's interest seeking judicial dissolution by including buy-sell provisions in its operating agreement allowing the LLC or the other members to purchase members' interests before they are transferred to third parties.

Consent of Members

Dissolution of an LLC with consent of the members requires unanimous member action under ULLCA §404(c)(9). This is a statutory default rule, and the vote of members required to approve a dissolution can be changed by the terms of the operating agreement.

In some cases, members of an LLC prefer to allow the LLC to be dissolved with a majority vote of members. This is consistent with the vote ordinarily required to dissolve a corporation, and requiring a majority rather than unanimous approval of members prevents a single member from preventing the other members from terminating the LLC if they no longer wish to continue its business.

A unanimous consent or supermajority vote requirement may, however, be appropriate if members holding a minority of the voting

rights are concerned about protecting their investment in the business of the LLC. Dissolution and winding up of the business of an LLC often involves a sale of the LLC's assets, and the result may be to reduce or eliminate the value of the LLC's goodwill and going concern value. Protecting the interests of all members in the value of the LLC as a going business may require that each member, or at least the holders of substantial minority of the members' voting interests, have the right to prevent dissolution of the LLC.

If an LLC is dissolved with the consent of its members, ULLCA §802(b) permits the members to waive their right to have the business of the LLC wound up any time before the winding up is completed. A decision to waive the right to have the business of an LLC wound up following its dissolution requires the unanimous consent of the members of the LLC and has the effect of restoring the LLC's right to conduct its business.

Operating Agreement

LLC operating agreements often require dissolution upon the occurrence of one or more specified events. For example, an operating agreement may require that an LLC be dissolved if the interest of a member is not purchased following the member's dissociation. Such a provision insures that a member who has dissociated as a result of death or other circumstances beyond the member's control will be able to promptly liquidate his or her interest in the LLC. A dissociated member whose interest is not purchased does have the right seek a judicial dissolution, but seeking judicial dissolution takes time and money, and this remedy may not adequately protect a member whose primary asset is his or her investment in the LLC.

A management deadlock also is sometimes designated as an event causing a dissolution in

LLC operating agreements. If voting rights in a member-managed LLC are equally divided between an even number of members or groups of members, a disagreement between members or groups could render the LLC unable to function. To avoid the potentially serious effects on the LLC's business, the operating agreement might provide for dissolution if a deadlock occurs and cannot be resolved within a reasonable period of time.

Another popular method of dealing with deadlocks without resorting to the dissolution of the LLC is a so-called Solomon's choice provision. Under such a provision, a member has the right to purchase the interests of all other members at a price and on terms specified by the member by making a written proposal to the other members. The other members then have the option to either purchase the proposing member's interest at the specified price and on the specified terms or to sell their interests to the proposing member at that price and on those terms. Either the proposing member or the other members will gain control of the LLC, which will resolve any deadlock between them.

As in the case of dissolution of an LLC by consent of the members, ULLCA §802(b) permits the members of an LLC dissolved under the provisions of its operating agreement to agree to waive their right to have the LLC's business wound up and to continue the business. But doing so requires the unanimous consent of the members.

Unlawful To Continue Business

An LLC is dissolved under ULLCA §801(a)(3) if it becomes unlawful for all or substantially all of its business to be continued. This is not a default rule, and ULLCA §103(b)(6) states that the statutory rule requiring dissolution of an LLC if its business cannot lawfully be continued is not subject to modification by the terms of an LLC's operating

agreement. An LLC dissolved because it is illegal to continue its business does, however, have a 90-day period to cure the illegality, in which case the LLC can continue its business as if no dissolution occurred.

Judicial Dissolution

Under ULLCA §801(a)(4), the dissolution of an LLC can be ordered in a judicial proceeding brought by a member or dissociated member if:

- The economic purpose of the LLC is likely to be unreasonably frustrated;
- A member other than the petitioner has engaged in conduct that makes it impractical to carry on the business of the LLC with the member;
- It is otherwise impractical to carry on the business of the LLC in conformance with its articles organization or operating agreement;
- The LLC has failed to purchase the interest of a dissociated member; or
- The managers or controlling members are acting in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the petitioner.

The transferee of an LLC member's interest can obtain a judicial dissolution of the LLC under ULLCA §801(a)(5) if a court determines that it is equitable to wind up its business. If the LLC had a specified term at the time the transferee obtained an interest in the LLC, the action may only be brought after the term of the LLC expires.

The rights of members and their transferees to obtain judicial dissolution cannot be varied by the terms of an LLC's operating agreement. A member has the right to seek judicial dissolution in an appropriate case regardless of the terms of the LLC's operating agreement under ULLCA §103(b)(6), and the statutory rights of transferees to seek dissolution of an LLC are protected by ULLCA §103(b)(7).