

SQUEEZE-OUTS AND FREEZE-OUTS IN LIMITED LIABILITY COMPANIES

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I. INTRODUCTION

In only six years since the Internal Revenue Service gave its blessing to the limited liability company (LLC),¹ statutes providing for this new business entity have spread across the country. Presently, all but a few states have such laws.² With its combination of limited liability for the owners and partnership-style flow-through tax treatment, the LLC provides an attractive option for closely held businesses.³ Indeed, it is not beyond the realm of reality to suggest that before too long the LLC may largely render the partnership, limited partnership and closely held corporation obsolete.

While this new business form raises many questions, a most appropriate one for this symposium is to consider the prospects for squeeze-outs and freeze-outs in LLCs. After all, Professor O'Neal wrote the book (both literally and figuratively) on the subject of corporate squeeze-outs and freeze-outs.⁴ As Professor O'Neal's work detailed, these phenomena have plagued the world of closely held corporations. Will they do the same with LLCs?

Not much has been written in the literature to date to address squeeze-outs and freeze-outs in LLCs. What little exists has focused on after-the-fact litigation-oriented remedies: what fiduciary duty should members of an

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I am pleased to write in a symposium dedicated to the late F. Hodge O'Neal. While he was serving as a distinguished visiting professor at McGeorge, Hodge generously gave his time to review portions of my book on business planning and made many helpful suggestions.

1. Rev. Rul. 88-76, 1988-2 C.B. 360 (classifying a Wyoming LLC as a partnership for tax purposes).

2. Only Hawaii, Massachusetts, Pennsylvania and Vermont lack such statutes at the time this is written.

3. For a detailed discussion of why this combination is desirable, see FRANKLIN A. GEVURTZ, BUSINESS PLANNING 48-98 (1991 & Supp. 1994).

4. F. HODGE O'NEAL, OPPRESSION OF MINORITY SHAREHOLDERS (1975); F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS (2d ed. 1985).

LLC owe to each other, and what remedies should exist for oppressive conduct?⁵ Fiduciary duty litigation and the like, however, is the last refuge of failed planning—either by the participants or by the legislature. This Article, therefore, takes a different approach. It focuses on the planning, or perhaps the lack thereof, in the LLC statutes to prevent these problems. The question it addresses is this: structurally, to what extent do provisions in the LLC statutes facilitate or frustrate squeeze-outs and freeze-outs?⁶

Part II of this Article will consider squeeze-outs, and Part III will look at freeze-outs. While the terms are often used interchangeably, “squeeze-out” as used in this Article refers to the situation where majority owners in a business cut off the minority from any say in management, and, far more importantly, from any significant distribution of the business’ earnings. “Freeze-out” refers to the situation in which the majority uses legal compulsion (a sort of business eminent domain) to force an unwilling minority to sell out its interest. The discussion in each Part will proceed along similar lines. First, we will consider what provisions in corporate and partnership law have promoted or inhibited squeeze-outs or freeze-outs, respectively. Next, we will examine to what extent such provisions are, and to what extent such provisions should be, in the LLC statutes. Part IV will conclude this Article with several specific suggestions that will aid drafters of LLC legislation in minimizing squeeze-out and freeze-out problems.

II. SQUEEZE-OUTS

A. *The Danger of Squeeze-Outs in the Corporate Form*

One of the primary dangers facing the minority shareholder in a closely held corporation is that he or she will end up as the victim of what is often referred to as a squeeze-out. In a squeeze-out, the majority shareholders use their control to deprive the minority of any managerial control over, and, of more practical significance, any economic return from, the corporation. The classic case of *Wilkes v. Springside Nursing Home, Inc.*⁷ provides a

5. See, e.g., Steven C. Bahls, *Application of Corporate Common Law Doctrines to Limited Liability Companies*, 55 MONT. L. REV. 43 (1994); Sandra K. Miller, *What Standards of Conduct Should Apply to Members and Managers of Limited Liability Companies?*, 68 ST. JOHN'S L. REV. 21 (1994); S. Mark Curwin, Note, *Fiduciary Duty and the Minnesota Limited Liability Company: Sufficient Protection of Member Interests?*, 19 WM. MITCHELL L. REV. 989 (1993).

6. This Article leaves for another day the question of what planning participants in an LLC can do for themselves to prevent these phenomena.

7. 353 N.E.2d 657 (Mass. 1976).

typical example.

In *Wilkes*, four individuals set up a corporation to operate a nursing home. They became equal shareholders, elected themselves directors, and divided responsibilities for running the business among themselves. The corporation declared no dividends, but paid equal amounts to the owners as compensation for work performed.⁸ Years after the corporation's founding, a falling out occurred between its owners. As a result, three owners voted the fourth, Wilkes, off the board and, acting as directors, cut off his compensation.⁹ Without judicial relief, Wilkes' investment would have been virtually worthless.

It requires no further citation than to Professor O'Neal's seminal work¹⁰ to recognize that this pattern has repeated itself countless times among the owners of closely held corporations. While the causes of dissension vary,¹¹ the pattern of the resulting squeeze-out is remarkably uniform: The minority shareholder loses his or her employment with the corporation,¹² and the majority votes him or her off the board. The board votes to declare little or no dividends, while the majority continues to receive money from the corporation through salaries and perquisites.¹³ Ultimately, the minority shareholder may sell out at a bargain price to the majority.

As in *Wilkes*, a squeeze-out often ends up in litigation. The minority shareholder generally has two available claims.¹⁴ The first—that involved in *Wilkes*—is for breach of fiduciary duty. Traditionally, this claim required the complaining shareholder to convince the court that the majority's actions, particularly in their role as directors, fall outside the protections normally accorded by the so-called business judgment rule.¹⁵ This is a difficult row to hoe. The actions that most directly impact the minority shareholder—his or her termination and the failure to declare divi-

8. *Id.* at 659-70.

9. *Id.* at 660-61.

10. See *supra* note 4.

11. See O'NEAL & THOMPSON, *supra* note 4, §§ 2:01-20 (reviewing various causes of squeeze-outs).

12. Often, the loss of employment is a cause rather than a consequence of the squeeze-out (as, for example, when a shareholder-employee retires). *Id.* § 2:03.

13. Tax considerations prompt owners of closely held C corporations to channel distributions into the form of salaries (which can generate a deduction for the corporation) rather than dividends (which are not deductible). See GEVURTZ, *supra* note 3, at 360.

14. This assumes no breach of a shareholders agreement designed to prevent squeeze-outs.

15. *E.g.*, *Gay v. Gay's Super Markets, Inc.*, 343 A.2d 577, 580 (Me. 1975). For a critical discussion of the business judgment rule, see Franklin A. Gevurtz, *The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?*, 67 S. CAL. L. REV. 287 (1994).

dends—do not involve a conflict of interest transaction between the majority owners and the corporation. Hence, under the traditional rule, courts would apply a highly deferential level of review; for example, they might require the complaining shareholder to prove the board's decision was in bad faith or irrational.¹⁶ Of course, the majority owners' receipt of salaries and perquisites involves a conflict of interest and, hence, the majority bears the burden of proving what they received was fair.¹⁷ Still, courts find a substantial range of compensation to be fair¹⁸ and, at best, such a challenge will give the squeezed-out shareholder only limited leverage in obtaining some benefit from the corporation.

Wilkes applied an expanded concept of fiduciary duty based upon the notion that shareholders in a closely held corporation owe each other a fiduciary duty akin to that owed between partners.¹⁹ In the context of a squeeze-out, this duty requires the majority to show both a corporate purpose for actions detrimental to the minority and that they could not achieve this purpose in a less onerous manner.²⁰ Not all jurisdictions, however, subscribe to this notion of an expanded duty between shareholders in a closely held corporation. Indeed, only just recently, the Delaware Supreme Court rejected such a duty in *Nixon v. Blackwell*.²¹

The alternate claim the minority shareholder may pursue is to seek an involuntary dissolution pursuant to statutes allowing for such upon a showing of oppression or the like.²² Not all jurisdictions, however, have such provisions in their corporation laws.²³ Those having such provisions vary in terms of the precise requirements the plaintiff must show in order to obtain relief. Some apply a "reasonable expectations" test which questions whether the majority's actions are contrary to the expectations the minority had when originally entering the venture, whether the majority knew of those expectations at the inception, and whether the actions were

16. *E.g.*, *Gottfried v. Gottfried*, 73 N.Y.S.2d. 692 (Sup. Ct. 1947); *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919).

17. *E.g.*, *Ruetz v. Topping*, 453 S.W.2d 624 (Mo. Ct. App. 1970). *But see* *Miller v. Magline, Inc.*, 256 N.W.2d 761 (Mich. Ct. App. 1977) (shifting the burden of proof back to the plaintiff after a limited showing by the defendant majority).

18. *See, e.g.*, *Cookies Food Products, Inc. v. Lakes Warehouse Distrib., Inc.*, 430 N.W.2d 447 (Iowa 1988); *Jaffe Commercial Fin. Co. v. Harris*, 456 N.E.2d 224, 230 (Ill. Ct. App. 1983).

19. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 661-63 (Mass. 1976).

20. *Id.* at 663.

21. 626 A.2d 1366, 1379-81 (Del. 1993).

22. *See, e.g.*, CAL. CORP. CODE § 1800 (West 1990); N.Y. BUS. CORP. LAW § 1104-a (McKinney 1986 & Supp. 1995).

23. Delaware, for example, has no such provision.

the plaintiff's fault.²⁴ Other jurisdictions view oppression in terms of conduct that is wrongful or in bad faith,²⁵ suggesting perhaps a less contractual and more subjective and fault-oriented approach.

Of course, if the remedy of dissolution resulted in the actual destruction of a viable business, it might be analogous to cutting a baby in half if one cannot determine the real mother. Much like Solomon's judgment, however, the threat of dissolution normally produces a less drastic outcome. Typically, the parties agree upon a buyout of the complaining shareholder's interest, but presumably at a better price than what the minority would have received without the leverage of dissolution.²⁶ Some statutes have short circuited this process by simply allowing the court to order a buyout instead of dissolution.²⁷

In any event, attacking squeeze-outs through litigation under these theories is not the most desirable solution for minority shareholders. The viability of these theories is limited in some jurisdictions; their application, even where recognized, requires the court to accept the plaintiff's version of what are often highly contested issues of fact;²⁸ and, under the best of circumstances, pursuing these approaches embroils the plaintiff in costly litigation. Accordingly, minority shareholders often attempt to protect themselves through agreements intended to limit the majority's ability to squeeze them out.²⁹ Naturally, the need to draft such agreements adds to the transaction costs of forming a closely held corporation, and worse, this need is not always recognized by less-sophisticated parties.

In sum, corporate law norms are conducive to minority squeeze-outs in a closely held firm. This, in turn, leads to costly litigation or the need to engage in efforts to draft around the statutory norms. This is not an ideal situation. Is there a better model that limited liability company statutes can follow?

B. *The Partnership Contrast Case*

In contrast to the plethora of reported decisions involving squeeze-outs in closely held corporations, few cases involve such a phenomenon in

24. See, e.g., *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1179-80 (N.Y. 1984).

25. See, e.g., *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387, 392-93 (Or. 1973).

26. See, e.g., J.A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 30-34 (1977) (finding a buyout the most prevalent outcome of threatened dissolution).

27. E.g., CAL. CORP. CODE § 2000 (West 1990); N.Y. BUS. CORP. LAW § 1118 (Supp. 1995).

28. See, e.g., *Zidell v. Zidell, Inc.*, 560 P.2d 1086, 1089 (Or. 1977).

29. For discussion of such agreements, see GEVURTZ, *supra* note 3, at 386-415.

partnerships. Only rarely does one find litigation in which a partner complains about his or her exclusion from management decisions,³⁰ and rarer still are complaints that a partner has been cut off from the firm's earnings.³¹ Why should this be so? There are several possible reasons.

Most writers ascribe the lack of squeeze-outs in partnerships to the more ready availability of dissolution or a buyout for dissatisfied participants in this form.³² Barring other agreement, each partner in an ordinary partnership has the right to dissolve the firm at any time and demand liquidation of the business.³³ As with involuntary dissolution of a corporation, if dissolution of a partnership led to the destruction of a viable business, it would hardly seem the recommended solution. As with corporate dissolutions, however, it is a mistake to assume that partnership dissolution has the same effect on the partnership business as did pouring water on the "Wicked Witch of the West." Instead, if the business is viable, the participants who wish to continue it can do so either by purchasing the business in a liquidation sale or, more commonly, by buying the interest of the departing partner.³⁴

Of course, partners can, and often do, contract around the norm of liquidation at will. Specifically, they can agree to a term, to an expulsion clause, or explicitly to a buyout in lieu of liquidation, or to some combination of the three. In fact, all three of these options essentially substitute a buyout of the departing partner's interest for a liquidation sale of the business.³⁵ The differences lie in the events which trigger the buyout—wrongful departure prior to expiration of the term, expulsion pursuant to the agreement, or whatever dissolution events the buy-sell contract lists—the price of the buyout and the terms of the buyout.

The price and terms provided by the Uniform Partnership Act (UPA) for

30. The cases that do exist fall into two camps. Some involve blatantly illegal attempts to exclude a partner from participating in management. *E.g.*, *Hankin v. Hankin*, 420 A.2d 1090 (Pa. 1980). In other cases, the partnership agreement allowed for exclusion. *E.g.*, *McCallum v. Asbury*, 393 P.2d 774 (Or. 1964) (en banc).

31. *Drashner v. Sorenson*, 63 N.W.2d 255 (S.D. 1954), comes about as close as one can get to finding this sort of complaint in a case dealing with an ordinary partnership. More recently, this sort of problem has arisen in a few cases involving limited partnerships. *E.g.*, *Labovitz v. Dolan*, 545 N.E.2d 304 (Ill. Ct. App. 1989); *Brooke v. Mt. Hood Meadows Oregon, Ltd.*, 725 P.2d 925 (Or. Ct. App. 1986).

32. *See, e.g.*, *Hetherington & Dooley*, *supra* note 26, at 3; *see also* O'NEAL & THOMPSON, *supra* note 4, § 2:15 (contrasting the difficulty of selling a minority interest in a close corporation).

33. UNIF. PARTNERSHIP ACT §§ 31(1)(b), 38(1) (1914) [hereinafter UPA].

34. *GEVURTZ*, *supra* note 3, at 185-87.

35. *See* UPA § 38 (1914).

buying out a partner wrongfully departing prior to the end of a term are particularly harsh for the departing partner. The UPA price excludes the value of any goodwill of the business and is net of any damages caused by wrongful departure.³⁶ The continuing partners can also delay payment until expiration of the term by posting a bond.³⁷ As a result, partnership agreements providing for a term, without more seller-friendly price and payment provisions, seriously undercut—although they do not completely eliminate—the traditional easy exit advantage of partnerships versus closely held corporations. It is therefore not surprising that one of the few partnership cases involving a squabble over distribution of earnings, *Drashner v. Sorenson*,³⁸ concerned a partnership for a term.

In *Drashner*, the plaintiff, in response to the partnership's failure to distribute earnings on which he depended, sued to dissolve the partnership prior to expiration of its term. His partners used this as grounds to invoke the harsh buyout terms the UPA imposes upon a wrongfully dissolving partner.³⁹ To avoid this outcome, the plaintiff argued that he was entitled to judicial dissolution under section 32 of the UPA. This section—somewhat akin to the corporate statutory provisions allowing dissolution for deadlock, oppression and the like—allows the court to dissolve a partnership where a partner's persistent breach of the partnership agreement or other conduct renders continuation of the partnership impractical, or, in any event, if the court finds dissolution equitable.⁴⁰ In the end, based upon the trial court's resolution of heavily contested facts, the plaintiff in *Drashner* lost;⁴¹ a lesson perhaps for those who decide that obtaining a reasonable price upon a business divorce should depend upon a judicial resolution of fault.

The limited partnership scheme is somewhat different. A general partner's departure triggers dissolution and liquidation barring other agreement or consent of the partners.⁴² A limited partner's departure,

36. UPA § 38(2)(c)(II) (1914). The Revised Uniform Partnership Act (RUPA), however, would include the value of goodwill even in the case of wrongful dissolution. REVISED UNIF. PARTNERSHIP ACT § 701(b) (1993) [hereinafter RUPA].

37. UPA § 38(2)(b) (1914). The RUPA, however, calls for payment before expiration of the term if this will not cause undue hardship to the continuing partnership. RUPA § 701(h) (1993).

38. 63 N.W.2d 255 (S.D. 1954).

39. *Id.* at 258-59. They also claimed that the plaintiff was neglecting his partnership duties. *Id.*

40. UPA § 32 (1914).

41. *Drashner*, 63 N.W.2d at 261.

42. REVISED UNIF. LTD. PARTNERSHIP ACT § 801(4) (1985) [hereinafter RULPA].

however, does not.⁴³ In lieu of liquidation rights, the Revised Uniform Limited Partnership Act (RULPA) gives general partners the right to get the fair value of their interest when their departure does not result in dissolution and gives limited partners the right to withdraw and cash out at fair value upon six months' notice.⁴⁴ (This, of course, is subject to other agreement, which might provide departing partners more or less favorable price and terms.⁴⁵) Hence, while liquidation rights may not be as readily available in limited partnerships, partners still have the ability to cash out at a presumably fair value.

All told, the partner's ability to demand liquidation or a buyout prevents a squeeze-out from rendering a minority partnership interest worthless. Yet, easier exit may not be the only reason squeeze-outs appear to be less of a problem in the partnership setting than in the close corporation context. One must also consider the operating rules. In the corporate scheme, ultimate management power normally resides in a board of directors elected by a plurality of the shares voted.⁴⁶ Hence, a majority can exclude the minority from any involvement in decisionmaking.⁴⁷ By contrast, barring contrary agreement, all partners (and all general partners in a limited partnership⁴⁸) have equal rights to be involved in management.⁴⁹

Of course, of more practical impact is the question of whether the majority can cut off the minority's economic return from the business. In the corporate context, the majority of the board generally has the power to decide whether to distribute dividends,⁵⁰ who shall be the officers or even employees of the corporation,⁵¹ and what compensation officers and employees shall receive.⁵² It is this power which provides the ammunition for a squeeze-out. What about partnerships?

Interestingly enough, the UPA is silent regarding a partner's right to demand immediate distribution of the firm's earnings. Presumably, the issue then becomes whether the decision to retain rather than distribute earnings

43. *See id.* § 801.

44. *Id.* §§ 603, 604.

45. *Id.* § 603.

46. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 141(a), 216 (1991).

47. This assumes the minority does not have the right to use cumulative voting and the parties have employed no other prearranged devices to prevent squeeze-outs from management.

48. *See* RULPA § 403(a) (1985).

49. UPA § 18(e) (1914).

50. *See, e.g.*, *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919).

51. This assumes that the corporation's articles or bylaws do not call for election of officers by the shareholders. *See, e.g.*, DEL. CODE ANN. tit. 8, § 142(b) (1991).

52. *See, e.g., id.* § 141(h).

is one concerning an ordinary matter—making it subject to majority rule⁵³—and, if not, whether the failure to reach unanimity on the question results in requiring distribution or requiring retention. Section 601 of the RULPA makes the partnership agreement control the timing of prewithdrawal distributions from a limited partnership—leaving the question of what happens if the agreement is silent on the subject. Curiously, and in contrast to the ample number of decisions addressing the discretion available to a corporation's directors to refrain from declaring dividends,⁵⁴ there appears to be little judicial authority on these questions in the partnership or limited partnership context.⁵⁵ Perhaps, in some instances, this is because drafters of partnership agreements have responded to the void by specifying rules regarding distributions. Yet, given the informal nature of many partnerships, this could not be the only reason for the lack of litigation over these issues. Perhaps, as suggested earlier, easy exit from the partnership, or the threat thereof, preempts any litigation over distributions.⁵⁶ Still, there is one other important factor to consider.

Section 18(f) of the UPA precludes partners from receiving salaries from the firm without agreement of all the partners (with a narrow exception for a surviving partner who winds up the partnership).⁵⁷ At first glance, this prohibition—especially when contrasted with section 18(c) (which provides for interest on a partner's loans)⁵⁸—might strike one as reflecting a strange antipathy toward the value of labor. Yet, when viewed in the context of the squeeze-out problem, section 18(f) may deserve more appreciation than it sometimes gets. If a majority in the corporation pursues a starvation dividend policy, all other factors being equal, this will hurt the

53. See UPA § 18(h) (1914) (mandating that differences as to ordinary matters are decided by majority).

54. See, e.g., *Zidell v. Zidell, Inc.*, 560 P.2d 1086 (Or. 1977); *Miller v. Magline, Inc.*, 256 N.W. 2d 761 (Mich. Ct. App. 1977); *Gay v. Gay's Super Markets, Inc.*, 343 A.2d 577 (Me. 1975); *Gottfried v. Gottfried*, 73 N.Y.S.2d 692 (Sup. Ct. 1947); *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919).

55. In dealing with a limited partnership, one court has held that the general partner has the same discretion in making distributions as the directors of a corporation. *Brooke v. Mt. Hood Meadows Oregon, Ltd.*, 725 P.2d 925, 929 (Or. Ct. App. 1986).

56. This is especially the case under the traditional common law rule barring suits between partners except as part of an accounting following dissolution. See, e.g., *Lewis v. Firestone*, 338 P.2d 953 (Cal. Ct. App. 1959).

57. UPA § 18(f) (1914). The RUPA slightly expands this exception to include remuneration for a winding up in any circumstance. RUPA § 401(h) (1993). The prohibition against receiving remuneration without the unanimous consent of participants covers limited partnerships. See RULPA §§ 403, 1105 (1985) (applying general partnership rules in absence of explicit reference).

58. UPA § 18(c) (1914).

majority more than the minority. Yet, the majority may offset this result through its ability to obtain distributions from the corporation in other ways—primarily through salaries.⁵⁹ By taking away this ability from majorities in partnerships, section 18(f) creates a powerful impediment to squeeze-outs.

C. *Whither Limited Liability Companies?*

1. *Operating Rules*

The LLC statutes typically provide, barring other agreement, for management by all members⁶⁰—much as under the partnership law scheme. While the normal LLC default rule, unlike the UPA, calls for voting in proportion to profits or capital interest,⁶¹ this scheme does not

59. Other distribution techniques include payment on shareholder loans, repurchase of stock and sale or lease of property from the shareholders to the corporation. GEVURTZ, *supra* note 3, at 289-325, 354-68, 604. For reasons that may be psychological as much as anything else, *see* text accompanying *infra* note 78, these other distributional techniques appear not to have caused as many problems with squeeze-outs as have salaries.

60. ALA. CODE § 10-12-22(a) (1994); ALASKA STAT. § 10.50.110 (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-681 (Supp. 1994); ARK. CODE ANN. § 4-32-401 (Michie Supp. 1993); CAL. CORP. CODE § 17150 (West Supp. 1995); COLO. REV. STAT. ANN. § 7-80-401 (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 21 (West); DEL. CODE ANN. tit. 6, § 18-402 (Supp. 1994); FLA. STAT. ANN. § 608.422 (West Supp. 1994); GA. CODE ANN. § 14-11-304 (1994); IDAHO CODE § 53-621 (1994); ILL. ANN. STAT. ch. 805, para. 180/15-1 (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-4-1(a) (Burns Supp. 1994); IOWA CODE ANN. § 490A.702(1) (West Supp. 1994); KAN. STAT. ANN. § 17-7612 (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 33 (Baldwin); LA. REV. STAT. ANN. § 12:1311 (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 651(1) (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS § 4A-402 (1993); MICH. COMP. LAWS ANN. § 450.4401 (West Supp. 1994); MO. ANN. STAT. § 347.079(1) (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-401(1) (1993); NEB. REV. STAT. § 21-2615 (Supp. 1994); NEV. REV. STAT. § 86.291 (Supp. 1993); N.H. REV. STAT. ANN. § 304-C:31(II) (Supp. 1994); N.J. STAT. ANN. § 42:2B-27 (West Supp. 1994); N.M. STAT. ANN. § 53-19-15(A) (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 401 (McKinney Supp. 1995); N.C. GEN. STAT. § 57C-3-20(a) (Supp. 1993); OR. REV. STAT. § 63.130 (Supp. 1994); R.I. GEN. LAWS § 7-16-14 (1992); S.D. CODIFIED LAWS ANN. § 47-34-16 (Supp. 1994); UTAH CODE ANN. § 48-2b-125 (1994); VA. CODE ANN. § 13.1-1022A (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 401(1) (West); W. VA. CODE § 31-1A-18(a) (Supp. 1994); WIS. STAT. ANN. § 183.0401(1) (West Supp. 1994); WYO. STAT. § 17-15-116 (Supp. 1994). *But see* MINN. STAT. ANN. § 322B.606 (West Supp. 1995) (requiring use of managers); N.D. CENT. CODE § 10-32-69 (Supp. 1993) (same); OKLA. STAT. ANN. tit. 18, § 2015 (West Supp. 1995) (providing for the use of managers unless otherwise provided); TENN. CODE ANN. § 48-238-101 (Supp. 1994) (containing no default for member or management control); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 2.12 (West Supp. 1995) (providing for the use of managers unless otherwise provided).

61. *See, e.g.*, ALA. CODE § 10-12-28 (1994); CAL. CORP. CODE § 17103(a)(1) (West Supp. 1995); COLO. REV. STAT. ANN. § 7-80-503 (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 23 (West); DEL. CODE ANN. tit. 6, § 18-402 (Supp. 1994); FLA. STAT. ANN. § 608.422 (West Supp. 1994);

seem to increase the danger of squeeze-outs for minority interests (albeit, it may somewhat increase the incidence of there being a voting minority in a two-person firm). Hence, in most jurisdictions, the LLC scheme should avoid the incidence of the *unanticipated* exclusion of some owners from management that can occur in the corporate setting.⁶² (Of course, the LLC's operating agreement or articles may call for managers rather than members to run the firm.⁶³ The whole purpose of doing this, however, is to exclude some members from management.⁶⁴ Hence, in this case, all the owners should be on notice of their possible exclusion from a role in

IOWA CODE ANN. § 490A.701 (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS § 4A-403(1) (1993); MICH. COMP. LAWS ANN. § 450.4502 (West Supp. 1994); MINN. STAT. ANN. § 322B.356 (West Supp. 1995); MO. ANN. STAT. § 347.079(1) (Vernon Supp. 1994); NEB. REV. STAT. § 21-2615 (Supp. 1994); N.J. STAT. ANN. § 42:2B-27 (West Supp. 1994); N.M. STAT. ANN. § 53-19-17(A) (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 402 (McKinney Supp. 1995); OKLA. STAT. ANN. tit. 18, § 2020 (West Supp. 1995); R.I. GEN. LAWS § 7-16-21 (1992); S.D. CODIFIED LAWS ANN. § 47-34-16 (Supp. 1994); VA. CODE ANN. § 13.1-1022B (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 302 (West); W. VA. CODE § 31-1A-18(b) (Supp. 1994); WIS. STAT. ANN. § 183.0404(1)(a) (West Supp. 1994); WYO. STAT. § 17-15-116 (Supp. 1994). *But see* KAN. STAT. ANN. § 17-7612 (Supp. 1993) (per capita); LA. REV. STAT. ANN. § 12:1318(A) (West Supp. 1994) (same); ME. REV. STAT. ANN. tit. 31, § 653 (West Supp. 1994) (same); N.H. REV. STAT. ANN. § 304-C:24 (Supp. 1994) (same); OR. REV. STAT. § 63.150(2) (Supp. 1994) (same); TENN. CODE ANN. § 48-224-101 (Supp. 1994) (same).

62. See O'NEAL & THOMPSON, *supra* note 4, § 2:10 (arguing that one cause of squeeze-outs in closely held corporations is the parties' failure to recognize that in corporations, unlike partnerships, majorities can exclude minorities from participating in management).

63. ALA. CODE § 10-12-22(b) (1994); ALASKA STAT. § 10.50.110(b) (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-681(b) (Supp. 1994); ARK. CODE ANN. § 4-32-401 (Michie Supp. 1993); CAL. CORP. CODE § 17151 (West Supp. 1995); COLO. REV. STAT. ANN. § 7-80-401 (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 21(d) (West); DEL. CODE ANN. tit. 6, § 18-402 (Supp. 1994); FLA. STAT. ANN. § 608.422 (West Supp. 1994); GA. CODE ANN. § 14-11-304 (1994); IDAHO CODE § 53-621(2) (1994); ILL. ANN. STAT. ch. 805, para. 180/15-1 (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-4-1(b) (Burns Supp. 1994); IOWA CODE ANN. § 490A.705 (West Supp. 1994); KAN. STAT. ANN. § 17-7612 (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 33 (Baldwin); LA. REV. STAT. ANN. § 12-1312 (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 651(3) (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS § 4A-402(a)(1) (1993); MICH. COMP. LAWS ANN. § 450.4402 (West Supp. 1994); MO. ANN. STAT. § 347.079(2) (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-402(2) (1993); NEB. REV. STAT. § 21-2615 (Supp. 1994); NEV. REV. STAT. § 86.291 (Supp. 1993); N.H. REV. STAT. ANN. § 304-C:31(I) (Supp. 1994); N.J. STAT. ANN. § 42:2B-27 (West Supp. 1994); N.M. STAT. ANN. § 53-19-15(B) (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW ch. 576, § 408 (McKinney Supp. 1995); N.C. GEN. STAT. § 57C-3-24 (Supp. 1993); OR. REV. STAT. § 63.135 (Supp. 1994); R.I. GEN. LAWS § 7-16-15 (1992); S.D. CODIFIED LAWS ANN. § 47-34-16 (Supp. 1994); UTAH CODE ANN. § 48-2b-125 (1994); VA. CODE ANN. § 13.1-1024 (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 401(2) (West); W. VA. CODE § 31-1A-20 (Supp. 1994); WIS. STAT. ANN. § 183.0401(2) (West Supp. 1994); WYO. STAT. § 17-15-116 (Supp. 1994).

64. If all owners plan to participate in management, it would make little sense to provide for managers, because such a provision could make it more difficult to qualify for partnership tax treatment. See Rev. Rul. 93-6, 1993-1 C.B. 229; Rev. Proc. 95-10, 1995-3 I.R.B. 20.

governance.)

While the LLC statutes almost invariably establish limits on distributions for the protection of creditors,⁶⁵ they are less uniform on the question whether the majority has the power to deprive the minority of prewithdrawal distributions—at least in the absence of prior specific agreement on the subject. Some of the most prominent jurisdictions, such as California,⁶⁶ Delaware,⁶⁷ and New York,⁶⁸ follow the RULPA approach and make the timing and extent of distributions subject to the operating agreement—ignoring the question of what rights exist if there is no agreement on this issue.⁶⁹ Other acts fail even to address the timing and extent, as opposed to perhaps the allocation,⁷⁰ of distributions.

65. ALA. CODE § 10-12-29(c) (1994); ALASKA STAT. § 10.50.305 (Supp. 1994) (effective July 1, 1995); ARIZ. REV. STAT. ANN. § 29-706 (Supp. 1994); ARK. CODE ANN. § 4-32-905 (Michie Supp. 1993); CAL. CORP. CODE § 17254 (West Supp. 1995); COLO. REV. STAT. § 7-80-606 (West Supp. 1994); DEL. CODE ANN. tit. 6, § 18-607 (Supp. 1994); FLA. STAT. ANN. § 608.427 (West Supp. 1994); GA. CODE ANN. § 14-11-407 (1994); IDAHO CODE § 53-646 (1994); ILL. ANN. STAT. ch. 805, para. 180/25-25 (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-5-6 (Burns Supp. 1994); IOWA CODE ANN. § 490A.807 (West Supp. 1994); KAN. STAT. ANN. § 17-7616 (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 45 (Baldwin); LA. REV. STAT. ANN. § 12:1327 (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 675 (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS § 4A-503 (1993); MICH. COMP. LAWS ANN. § 450.4808 (West Supp. 1994); MINN. STAT. ANN. § 322B.54 (West Supp. 1995); MO. ANN. STAT. § 347.109 (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-604 (Supp. 1994); NEB. REV. STAT. § 21-2625 (Supp. 1994); NEV. REV. STAT. § 86-331 (Supp. 1993); N.H. REV. STAT. ANN. § 304-C:44 (Supp. 1994); N.J. STAT. ANN. § 42:2B-42 (West Supp. 1994); N.M. STAT. ANN. § 53-19-26 (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 508 (McKinney Supp. 1995); N.C. GEN. STAT. § 57C-4-06 (Supp. 1993); N.D. CENT. CODE § 10-32-64 (Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2030 (West Supp. 1995); OR. REV. STAT. § 63.229 (Supp. 1994); R.I. GEN. LAWS § 7-16-31 (1992); S.D. CODIFIED LAWS ANN. § 47-34-23 (Supp. 1994); TENN. CODE ANN. § 48-236-105 (1994); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 5.09 (West Supp. 1995); UTAH CODE ANN. § 48-2b-132 (1994); VA. CODE ANN. § 13.1-1035 (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 605 (West); W. VA. CODE § 31-1A-29 (Supp. 1994); WIS. STAT. ANN. § 183.0607 (West Supp. 1994); WYO. STAT. § 17-15-120(a) (Supp. 1994).

66. CAL. CORP. CODE § 17251 (West Supp. 1995).

67. DEL. CODE ANN. tit. 6, § 18-601 (Supp. 1994).

68. N.Y. LTD. LIAB. CO. LAW § 507 (McKinney Supp. 1995).

69. Also following this approach are COLO. REV. STAT. ANN. § 7-80-601 (West Supp. 1994); IOWA CODE ANN. § 490A.804 (West Supp. 1994); OKLA. STAT. ANN. tit. 18, § 2026 (West Supp. 1995); OR. REV. STAT. § 63.200 (Supp. 1994); MICH. COMP. LAWS ANN. § 450.4304 (West Supp. 1994); N.H. REV. STAT. ANN. § 304-C:40 (Supp. 1994); N.J. STAT. ANN. § 42:2B-36 (West Supp. 1994); R.I. GEN. LAWS § 7-16-28 (1992); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 5.04 (West Supp. 1995); VA. CODE ANN. § 13.1-1031 (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 601 (West); W. VA. CODE § 31-1A-26 (Supp. 1994).

70. Most LLC statutes have a provision governing the allocation of interim distributions barring other agreement. ALA. CODE § 10-12-29 (1994) (proportional); ALASKA STAT. § 10.50.300 (Supp. 1994) (equal); ARIZ. REV. STAT. ANN. § 29-703(B)(1) (Supp. 1994) (proportional); ARK. CODE ANN. § 4-32-601 (Michie Supp. 1993) (equal); CAL. CORP. CODE § 17250 (West Supp. 1995) (proportional); COLO.

Interestingly, the proposed Uniform Limited Liability Company Act (ULLCA) reflects a clearer, if perhaps impractical, approach, by prohibiting interim distributions unless provided for in the operating agreement.⁷¹ Many acts, however, provide for majority rule on this issue in the absence of other agreement.⁷² This, of course, provides the potential for a squeeze-out. Nevertheless, it is difficult to fault such statutes. As discussed earlier,⁷³ it is arguable that the majority has this power even in the partnership context. Moreover, given the numerous variables involved in deciding whether to distribute or reinvest a firm's earnings, it seems

REV. STAT. ANN. § 7-80-504 (West Supp. 1994) (proportional); 1993 Conn. Legis. Serv. ch. 267, § 29 (West) (proportional); DEL. CODE ANN. tit. 6, § 18-504 (Supp. 1994) (proportional); FLA. STAT. ANN. § 608.426(1) (West Supp. 1994) (proportional); GA. CODE ANN. § 14-11-404 (1994) (equal); IDAHO CODE § 53-629 (1994) (equal); ILL. ANN. STAT. ch. 805, para. 180/20-15 (Smith-Hurd Supp. 1994) (proportional); IND. CODE ANN. § 23-18-5-4 (Burns Supp. 1994) (proportional); IOWA CODE ANN. § 490A.803 (West Supp. 1994) (proportional); KAN. STAT. ANN. § 17-7615(b) (Supp. 1993) (equal); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 42 (Baldwin) (equal); LA. REV. STAT. ANN. § 12:1324(B) (West Supp. 1994) (equal); ME. REV. STAT. ANN. tit. 31, § 671 (West Supp. 1994) (equal); MD. CODE ANN., CORPS. & ASS'NS § 4A-505(2) (1993) (proportional); MICH. COMP. LAWS ANN. § 450.4303 (West 1994) (proportional); MINN. STAT. ANN. § 322B.50 (West Supp. 1994) (proportional); MO. ANN. STAT. § 347.101(2)(1) (Vernon Supp. 1994) (proportional); MONT. CODE ANN. § 35-8-601 (1993) (equal); NEB. REV. STAT. § 21-2618 (Supp. 1994) (proportional); NEV. REV. STAT. § 86-341 (Supp. 1993) (proportional); N.H. REV. STAT. ANN. § 304-C:39 (Supp. 1994) (proportional); N.J. STAT. ANN. § 42:2B-35 (West Supp. 1994) (proportional); N.M. STAT. ANN. § 53-19-23 (Michie Supp. 1993) (proportional); N.Y. LTD. LIAB. CO. LAW § 504 (McKinney Supp. 1995) (proportional); N.C. GEN. STAT. § 57C-4-04 (Supp. 1993) (proportional); N.D. CENT. CODE § 10-32-60 (Supp. 1993) (proportional); OKLA. STAT. ANN. tit. 18, § 2025(2) (West Supp. 1995) (proportional); OR. REV. STAT. § 63.195 (Supp. 1994) (proportional); R.I. GEN. LAWS § 7-16-27 (1992) (proportional); S.D. CODIFIED LAWS ANN. § 47-34-22 (Supp. 1994) (proportional); TENN. CODE ANN. § 48-236-101 (Supp. 1994) (equal); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 5.03 (West Supp. 1995) (proportional); UTAH CODE ANN. § 48-2b-129 (1994) (proportional); VA. CODE ANN. § 13.1-1030 (Michie 1993) (proportional); 1994 Wash. Legis. Serv. ch. 211, § 504 (West) (proportional); W. VA. CODE § 31-1A-25 (Supp. 1994) (proportional); WIS. STAT. ANN. § 183.0602 (West Supp. 1994) (proportional); WYO. STAT. § 17-15-119 (Supp. 1994) (proportional). These will preclude any squeeze-out by the majority simply giving itself distributions while depriving the minority of such.

71. UNIF. LTD. LIAB. CO. ACT § 406(b) (1995) [hereinafter ULLCA]; *see also* TENN. CODE ANN. § 48-236-101 (Supp. 1994) (following the same approach).

72. *See* ALASKA STAT. § 10.50.330 (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-703(A) (Supp. 1994); ARK. CODE ANN. § 4-32-601 (Michie Supp. 1993); 1993 Conn. Legis. Serv. P.A. 93-267, § 29 (West); IDAHO CODE § 53-629 (1994); ILL. ANN. STAT. ch. 805, para. 180/25-1 (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-5-4 (Burns Supp. 1994); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 42 (Baldwin); ME. REV. STAT. ANN. tit. 31, § 671 (West Supp. 1994); MO. ANN. STAT. § 347.101(1) (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-601 (1993); WIS. STAT. ANN. § 183.0601 (West Supp. 1993); *see also* MINN. STAT. ANN. § 322B.51 (West Supp. 1995) (board decides); N.C. GEN. STAT. § 57C-4-04 (Supp. 1993) (managers decide); N.D. CENT. CODE § 10-32-61 (Supp. 1993) (board decides).

73. *See supra* text accompanying note 53.

virtually impossible to construct a reasonable statutory formula for when and how much of earnings every firm should pay out. Accordingly, the prevention of squeeze-outs in LLCs must come from other provisions.

As the earlier discussion suggests, perhaps the most important operating rule to prevent squeeze-outs in partnerships is the general preclusion of salaries without agreement of all partners. The LLC statutes have gone off in different directions on this point. California⁷⁴ and the ULLCA⁷⁵ follow the partnership law scheme by denying salaries barring other agreement. While some statutes expressly empower managers to vote themselves salaries,⁷⁶ the vast bulk of the acts are silent, thereby leaving the issue open to inevitable litigation.⁷⁷

As a prescriptive matter, it appears California and the proposed uniform act have it right. Allowing the majority to set salaries provides critical ammunition for squeeze-outs. More importantly, it plays into a central psychological factor motivating the phenomenon—the common belief of those running the business that the profits are almost entirely the result of their efforts and not of the investments of the passive owners who, needless to say, see things differently.⁷⁸ This conflict between active and passive owners pervades much of the squeeze-out phenomenon.⁷⁹ If parties at the venture's inception contemplate unequal roles—some active, some passive—presumably they will take this into account from the outset, either through their profit sharing scheme or through specific salary agreements. The typical squeeze-out occurs after some ownership interests, which started as active, become passive—perhaps, as in *Wilkes*, involuntarily at the behest of the majority (whether or not justified), or often because of changing life circumstances (retirement, inheritance of shares by those unable or unwilling to participate, or the like).⁸⁰ These cases, unless anticipated at the outset, would seem to call for a renegotiation among the

74. CAL. CORP. CODE § 17004(b) (West Supp. 1995).

75. ULLCA § 403(d) (1995). The speed with which the states have enacted their own LLC statutes has prevented the just-completed ULLCA from exerting the level of influence obtained by the uniform partnership and limited partnership acts.

76. See MINN. STAT. ANN. § 322B.623 (West Supp. 1995); TENN. CODE ANN. § 48-239-105 (Supp. 1994) (with member approval).

77. Arguably, the absence of a prohibition makes salaries subject to the general majority rule provisions of the statute. This argument becomes stronger if the "powers" section of the LLC act mentions compensation. See, e.g., WYO. STAT. ANN. § 17-15-104(a)(ix) (Supp. 1994) (giving the LLC the power to fix its managers' compensation).

78. O'NEAL & THOMPSON, *supra* note 4, § 2:03.

79. *Id.*

80. *Id.*

parties—possibly leading to a buyout of the passive owners. That is what the partnership norm produces. The problem with the corporate norm is that it allows the active majority to dictate terms without such renegotiation.⁸¹

As the discussion so far makes clear, the rights of the members of an LLC—including the rights to a role in management and to distributions or other compensation—are generally subject to the operating agreement. Could a majority undertake a squeeze-out by amending the operating agreement to deprive the minority of valuable rights? In fact, amendments to articles or bylaws have sometimes been a part of squeeze-outs in the corporate context.⁸² By contrast, unless the agreement itself allows for alteration on less than universal consent,⁸³ partnership or limited partnership agreements cannot be altered except by unanimous vote.⁸⁴

Again, the LLC statutes vary on this question. Many, if not most, acts require unanimity to amend the operating agreement, unless the parties have otherwise agreed.⁸⁵ Numerous other acts, however, allow amendment on a majority (or, under some statutes, two-thirds) vote.⁸⁶ Still other acts fail

81. While the majority is subject to review for fairness when setting its own salaries, *see supra* note 17 and accompanying text, this does not guarantee the same result as an arms-length negotiation with the passive owners. *See supra* note 18 and accompanying text.

In rebuttal, one might ask whether the partnership norm does not give the passive owners too much power to veto salaries justified by changed circumstances. *See Levy v. Levitt*, 178 N.E. 758 (N.Y. 1931) (providing an example of changed circumstances that created a sympathetic, but legally unsustainable, claim for a salary). One might also note that partnerships have produced their fair share of litigation over salary claims. *See, e.g., Busick v. Stoetel*, 264 Cal. App. 2d 736 (1968); *Levy*, 178 N.E. 758. The mitigating factor is that the active owners are not without leverage in any renegotiation; rather they can always withdraw or dissolve.

82. *See, e.g., Blount v. Taft*, 246 S.E.2d 763 (N.C. 1978).

83. *See, e.g., Day v. Sidley & Austin*, 394 F. Supp. 986 (D.D.C. 1975) (partnership agreement allowed amendment by majority), *aff'd sub nom. Day v. Avery*, 548 F.2d 1018 (D.C. Cir. 1976), *cert. denied*, 431 U.S. 908 (1977).

84. *See* UPA § 18 (h) (1914); RULPA § 1105 (1985).

85. ALA. CODE § 10-12-24(b) (1994); ARIZ. REV. STAT. ANN. § 29-681(c)(1) (Supp. 1994); ARK. CODE ANN. § 4-32-403(b)(1) (Michie Supp. 1993); CAL. CORP. CODE § 17103(a)(2)(C) (West Supp. 1995); GA. CODE ANN. § 14-11-308(b)(5) (1994); IDAHO CODE § 53-623(2)(a) (1994); IND. CODE ANN. § 23-18-4-3(c)(1) (Burns Supp. 1994); IOWA CODE ANN. § 490A.701(3) (West Supp. 1994); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 35(2)(a) (Baldwin); ME. REV. STAT. ANN. tit. 31, § 653(2)(A) (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS § 4A-402(b)(2) (1993); MO. ANN. STAT. § 347.079(3)(1) (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-403(2)(a) (1993); N.H. REV. STAT. ANN. § 304-C:24(VI)(a) (Supp. 1994); N.C. GEN. STAT. § 57C-3-03(1) (Supp. 1993); VA. CODE ANN. § 13.1-1023(B)(1) (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 302(2)(a) (West); W. VA. CODE § 31-1A-19(b)(2) (Supp. 1994); WIS. STAT. ANN. § 183.0404(2)(a) (West Supp. 1994).

86. LA. REV. STAT. ANN. § 12:1318(B)(6) (West Supp. 1994); N.M. STAT. ANN. § 53-19-17(B)(1) (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 402(c)(3) (McKinney Supp. 1995); OKLA. STAT. ANN. tit. 18, § 2020(B)(4) (West Supp. 1995); OR. REV. STAT. § 63.150(3)(c) (Supp. 1994); R.I. GEN.

to address the question—leaving for litigation the issue of whether the statutes' general majority rule provisions trump the normal rule requiring the consent of all parties in order to modify a contract.⁸⁷

The obvious problem with amendment by majority vote is that it enables the majority to alter the fundamental division of power and profit in ways the parties would never have agreed to allow. For example, the abuse is evident if a party with fifty-one percent of the profits and voting power could simply amend the agreement to increase his or her profit share to ninety-nine percent (particularly if he or she made no added contributions). To address this problem, New York's statute will not allow a bare majority, barring other agreement, to remove a supermajority voting requirement in the agreement.⁸⁸ Nor will the New York statute allow the majority to alter agreed contributions, tax item allocations, or distributions over the opposition of prejudiced members.⁸⁹ Such provisions, however, are largely unique to New York. They also risk ambiguities and gaps. As an illustration, New York's statute only indirectly, if at all, prevents the alteration of profit shares in the abusive manner described above. Since the New York statute refers only to profit allocations for tax purposes,⁹⁰ the prejudiced minority member would need to argue that the act also prohibits changing the allocation of economic profits because this would render any unchanged allocation of profits for tax purposes of questionable validity under I.R.C. section 704(b)'s "substantial economic effect" requirement.⁹¹ Yet, what about the majority voting itself generous salaries? This could certainly upset the allocation of economic benefits from the firm. Nevertheless, it is unclear if New York's law would prevent such an amendment.

LAW § 7-16-21(b)(5) (1992); TENN. CODE ANN. §§ 48-206-102, 48-209-103(e) (Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 2.23(D)(1) (West Supp. 1995); ALASKA STAT. § 10.50.150(e) (Supp. 1994) (two-thirds supermajority); 1993 Conn. Legis. Serv. P.A. 93-267, § 23(b) (West) (same); *see also* DEL. CODE ANN. tit. 6, § 18-209(b), (f) (Supp. 1994) (allowing amendment by majority vote through merger); N.J. STAT. ANN. § 42:2B-27 (West Supp. 1994) (same); MINN. STAT. ANN. §§ 322.B.603, 605 (West Supp. 1994) (amendment by majority of board members); ILL. ANN. STAT. ch. 805, para. 180/5-20(c) (Smith-Hurd Supp. 1994) (two-thirds vote to amend articles, which can trump operating agreement).

87. *See, e.g.,* Angel v. Murray, 322 A.2d 630, 634-36 (R.I. 1974).

88. N.Y. LTD. LIAB. CO. LAW § 402(e) (McKinney Supp. 1995); *see also* N.M. STAT. ANN. § 53-19-17(C) (Michie Supp. 1993) (similar protective provision).

89. N.Y. LTD. LIAB. CO. LAW § 417(b) (McKinney Supp. 1995) (requiring consent of each affected member to implement the change).

90. *Id.* § 417(b)(ii)(B).

91. I.R.C. § 704(b) (1988). For an explanation of the substantial economic effect requirement, *see* GEVURTZ, *supra* note 3, at 151-52.

This discussion suggests that a unanimous vote requirement (barring other agreement) for amendment of the operating agreement is the better approach. Moreover, it is the approach which poses less danger of unfair surprise for the parties. Not only is it the rule for partnerships and limited partnerships, but it corresponds with the general notion of a contract as not something normally subject to unilateral alteration. By contrast, while corporate articles and bylaws are typically subject to amendment by less than universal consent,⁹² these corporate documents provide more of a general framework—commonly understood to be subject to change over objections—than a contract in the traditional sense between the participants. Indeed, in a corporation, the basic allocation of profits and power, to a great extent, is embodied in the stock distribution—which itself is commonly understood to be subject to change (as when the corporation issues new shares) with less than universal concurrence.

2. Exit Rules

For the most part, the LLC statutes' exit rules follow the pattern of the RULPA. As with the withdrawal of a general partner from a limited partnership,⁹³ departure of a member from an LLC will trigger dissolution under most LLC statutes unless otherwise agreed or all (or, under some statutes, a majority) of the remaining members consent to continue the company without dissolution.⁹⁴ Avoiding dissolution and liquidation,

92. See, e.g., DEL. CODE ANN. tit. 8, §§ 216, 242 (1991) (allowing a majority to amend, barring other arrangement).

93. See RULPA § 801(4) (1985).

94. ALA. CODE § 10-12-37(3)(b) (1994); ALASKA STAT. § 10.50.400(3)(A) (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-781(A)(3) (Supp. 1994); ARK. CODE ANN. § 4-32-901(c) (Michie Supp. 1993); CAL. CORP. CODE § 17350(d) (West Supp. 1995); COLO. REV. STAT. ANN. § 7-80-801(1)(c) (West Supp. 1994); DEL. CODE ANN. tit. 6, § 18-801(4) (Supp. 1994); FLA. STAT. ANN. § 608.441(1)(c) (West Supp. 1994); GA. CODE ANN. § 14-11-602(4) (1994); IDAHO CODE § 53-642(3)(a) (1994); ILL. ANN. STAT. ch. 805, para. 180/35-1(3) (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-9-1(3) (Burns Supp. 1994); IOWA CODE ANN. § 490A.1301(3) (West Supp. 1994); KAN. STAT. ANN. § 17-7622(a)(3) (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 57(3)(a) (Baldwin); LA. REV. STAT. ANN. § 12:1334(3) (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 701(3)(A) (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS § 4A-904 (1993); MO. ANN. STAT. § 347.137.1(3) (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-901(3) (1993); N.H. REV. STAT. ANN. § 304-C:50(IV)(a) (Supp. 1994); N.J. STAT. ANN. § 42:2B-48(d) (West Supp. 1994); N.M. STAT. ANN. § 53-19-39(A)(2) (Michie Supp. 1993); N.C. GEN. STAT. § 57C-6-01(4) (Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2037(A)(3) (West Supp. 1995); TENN. CODE ANN. § 48-245-101(b)(2) (Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 6.01(B) (West Supp. 1995); UTAH CODE ANN. § 48-2b-137(3)(b) (1994); VA. CODE ANN. § 13.1-1046(3) (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 801(4) (West); W. VA. CODE § 31-1A-35(3) (Supp. 1994); WIS. STAT. ANN. § 183.0901(4)(a) (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 42(3) (West) (majority consent); MICH. COMP. LAWS ANN. § 450.4801(d)(i) (West Supp.

however, does not render a member's interest illiquid. Instead, the LLC statutes generally follow the limited partnership model by allowing LLC members, in the absence of contrary agreement, to withdraw and cash out at any time or on thirty days', ninety days', or six months' notice (depending on the statute).⁹⁵

1994) (same); NEB. REV. STAT. § 21-2622(3) (Supp. 1994) (two-thirds supermajority); N.Y. LTD. LIAB. CO. LAW § 701(d)(2) (McKinney Supp. 1995) (majority consent). *But see* MINN. STAT. ANN. § 322B.80(1)(5) (West Supp. 1995) (unanimous consent can avoid dissolution only if stated in the articles of organization); NEV. REV. STAT. § 86-491(1)(c) (Supp. 1993) (same); N.D. CENT. CODE § 10-32-109(1) (Supp. 1993) (same); OR. REV. STAT. § 63.621(4) (Supp. 1994) (same); S.D. CODIFIED LAWS ANN. § 47-34-29(3) (Supp. 1994) (same); WYO. STAT. § 17-15-123(a)(iii) (Supp. 1994) (same); *see also* R.I. GEN. LAWS § 7-16-39(d) (1992) (dissolution unless otherwise agreed).

95. The statutes allowing withdrawal at any time are: ARIZ. REV. STAT. ANN. § 29-734 (1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 30 (West); ILL. ANN. STAT. ch. 805, para. 180/25-5 (Smith-Hurd Supp. 1994); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 43 (Baldwin); MO. ANN. STAT. § 347.103(2) (Vernon Supp. 1994); WIS. STAT. ANN. § 183.0802 (West Supp. 1994).

Those allowing withdrawal on 30 days' notice are: ALA. CODE § 10-12-36(d) (1994); ALASKA STAT. § 10.50.185(b) (Supp. 1994); ARK. CODE ANN. § 4-32-802(c) (Michie Supp. 1993); GA. CODE ANN. § 14-11-601(c) (1994); IDAHO CODE § 53-641(3) (1994); IND. CODE ANN. § 23-18-6-6 (Burns Supp. 1994); LA. REV. STAT. ANN. § 12:1325(A) (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 692(3) (West Supp. 1994); MONT. CODE ANN. § 35-8-802(3) (1993); N.H. REV. STAT. ANN. § 304-C:27(III) (Supp. 1994); N.M. STAT. ANN. § 53-19-37(A) (Michie Supp. 1993); 1994 Wash. Legis. Serv. ch. 211, § 304(3) (West).

The statutes allowing withdrawal on 90 days' notice are: MICH. COMP. LAWS ANN. § 450.4509 (West Supp. 1994); OKLA. STAT. ANN. tit. 18, § 2036(c) (West Supp. 1995).

Those statutes allowing withdrawal on six months' notice are: CAL. CORP. CODE § 17252(a)(1), (c) (West Supp. 1995); DEL. CODE ANN. tit. 6, §§ 18-603, 18-604 (Supp. 1994); FLA. STAT. ANN. § 608.427(1) (West Supp. 1994); IOWA CODE ANN. § 490A.704 (West Supp. 1994); KAN. STAT. ANN. § 17-7616(b)(3) (Supp. 1993); MD. CODE ANN., CORPS. & ASS'NS § 4A-605 (1993); NEB. REV. STAT. § 21-2619(b) (Supp. 1993); NEV. REV. STAT. § 86.331(2)(b) (Supp. 1993); N.J. STAT. ANN. § 42:2B-38 (West Supp. 1994); N.Y. LTD. LIAB. CO. LAW §§ 509, 606 (McKinney Supp. 1995); N.C. GEN. STAT. § 57C-5-06 (Supp. 1993); OR. REV. STAT. § 63.205(1)(b) (Supp. 1994); S.D. CODIFIED LAWS ANN. § 47-34-23 (Supp. 1994); VA. CODE ANN. § 13.1-1032 (Michie 1993); W. VA. CODE § 31-1A-27 (Supp. 1994); WYO. STAT. § 17-15-120(b)(ii) (Supp. 1994). A couple of states, Minnesota and North Dakota, have no cash-out right in their LLC acts.

The LLC statutes also vary with respect to what the withdrawing member will receive. ALA. CODE § 10-12-30(c) (1994) (liquidation value); ALASKA STAT. § 10.50.335(b) (Supp. 1994) (fair market value); ARK. CODE ANN. § 4-32-602 (Michie Supp. 1993) (fair market value); ARIZ. REV. STAT. ANN. § 29-734-707(B) (Supp. 1994) (fair market value); CAL. CORP. CODE § 17252(c) (West Supp. 1995) (fair market value); 1993 Conn. Legis. Serv. P.A. 93-267, § 30 (West) (fair market value); DEL. CODE ANN. tit. 6, § 18-604 (Supp. 1994) (fair market value); FLA. STAT. ANN. § 608.427 (West Supp. 1994) (balance of capital contribution); GA. CODE ANN. § 14-11-405 (1994) (fair market value); IDAHO CODE § 53-630 (1994) (fair market value); ILL. ANN. STAT. ch. 805, para. 180/25-10 (Smith-Hurd Supp. 1994) (fair market value); IND. CODE ANN. § 23-18-5-5 (Burns Supp. 1994) (fair market value); IOWA CODE ANN. § 490A.805 (West Supp. 1994) (fair market value); KAN. STAT. ANN. § 17-7616 (Supp. 1993) (capital contribution); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 43 (Baldwin) (fair market value); LA. REV. STAT. ANN. § 12:1325 (West Supp. 1994) (fair market value); ME. REV. STAT. ANN. tit. 31, § 672 (West Supp. 1994) (any distribution); MICH. COMP. LAWS ANN. § 450.4305 (West Supp. 1994) (fair

Tax ramifications have been the principal motivating factor behind the typical LLC statute's choice of a limited partnership rather than a corporate exit model. The drafters were trying to avoid the corporate characteristic of continuity of existence in order to obtain taxation as a partnership.⁹⁶ By happy coincidence, however, picking up the cash-out right from the limited partnership acts should make LLC members less susceptible to squeeze-outs. This also renders the involuntary dissolution provisions in many of the LLC statutes,⁹⁷ whether modeled on UPA section 32 or on corpora-

market value); MO. ANN. STAT. § 347.103 (Vernon Supp. 1994) (fair market value); MONT. CODE ANN. § 35-8-602(2) (1993) (fair market value); NEB. REV. STAT. § 21-2619 (Supp. 1994) (capital contribution); NEV. REV. STAT. § 86-331 (Supp. 1993) (capital contribution); N.H. REV. STAT. ANN. § 304-C:41(I) (Supp. 1994) (fair market value); N.J. STAT. ANN. § 42:2B-39 (West Supp. 1994) (fair market value); N.M. STAT. ANN. § 53-19-24 (Michie Supp. 1993) (fair market value); N.Y. LTD. LIAB. CO. LAW § 509 (McKinney Supp. 1995) (fair market value); OKLA. STAT. ANN. tit. 18, § 2027 (West Supp. 1995) (fair market value); OR. REV. STAT. § 63.215(1)(b) (Supp. 1994) (fair market value); R.I. GEN. LAWS § 7-16-29 (1992) (fair market value); S.D. CODIFIED LAWS ANN. § 47-34-23 (Supp. 1994) (member contribution); TENN. CODE ANN. § 48-216-101(6)(e) (Supp. 1994) (value as determined by operating agreement); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 5.06 (West Supp. 1995) (fair market value); UTAH CODE ANN. § 48-2b-132(2) (1994) (fair market value); VA. CODE ANN. § 13.1-1033 (Michie 1993) (fair market value); 1994 Wash. Legis. Serv. ch. 211, § 602 (West) (fair market value); WIS. STAT. ANN. § 183.0604 (West Supp. 1994) (fair market value); WYO. STAT. § 17-15-120 (Supp. 1994) (contribution). Providing for anything less than fair market value undercuts the protection these provisions give against squeeze-outs.

96. In order to obtain taxation as a partnership, an LLC can have no more than two of the following four corporate characteristics: (1) limited liability; (2) central management; (3) free transferability of interests; and (4) continuity of life. *See, e.g.*, Rev. Rul. 93-6, 1993-1 C.B. 229. By definition, an LLC's members have limited liability and, if run by managers rather than members, an LLC likely has central management. *Id.*; Rev. Proc. 95-10, 1995-3 I.R.B. 20. Hence, it is important to avoid the corporate characteristic of continuity of life.

97. ALA. CODE § 10-12-38 (1994); ALASKA STAT. § 10.50.405 (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-785 (Supp. 1994); ARK. CODE ANN. § 4-32-902 (Michie Supp. 1993); CAL. CORP. CODE § 17351 (West Supp. 1995); COLO. REV. STAT. ANN. § 7-80-802 (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 43 (West); DEL. CODE ANN. tit. 6, § 18-802(a) (Supp. 1994); FLA. STAT. ANN. § 608.441(2) (West Supp. 1994); GA. CODE ANN. § 14-11-603(a) (1994); IDAHO CODE § 53-643 (1994); ILL. ANN. STAT. ch. 805, para. 180/35-5 (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-9-2 (Burns Supp. 1994); IOWA CODE ANN. § 490A.1302 (West Supp. 1994); KAN. STAT. ANN. § 17-7629 (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 58 (Baldwin); LA. REV. STAT. ANN. § 12:1335 (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 702(1) (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS § 4A-903 (1993); MICH. COMP. LAWS ANN. § 450.4802 (West Supp. 1994); MINN. STAT. ANN. § 322B.833(1) (West Supp. 1995); MO. ANN. STAT. § 347.143(2) (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-902 (1993); NEB. REV. STAT. § 21-2622 (Supp. 1994); NEV. REV. STAT. § 86.331(4) (Supp. 1993); N.H. REV. STAT. ANN. § 304-C:51 (Supp. 1993); N.J. STAT. ANN. § 42.2B-49 (West Supp. 1994); N.M. STAT. ANN. § 53-19-40 (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 702 (McKinney Supp. 1995); N.C. GEN. STAT. § 57C-6-02(5) (Supp. 1993); N.D. CENT. CODE § 10-32-119 (Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2038 (West Supp. 1995); OR. REV. STAT. § 63.661 (Supp. 1994); R.I. GEN. LAWS § 7-16-40 (1992); S.D. CODIFIED LAWS ANN. § 47-34-30 (Supp. 1994); TENN. CODE ANN. § 48-245-902(a) (1994); TEX. REV. CIV. STAT. ANN. art. 1528n,

tions laws, relevant only when an operating agreement curbs the cash-out right.

As a prescriptive matter, one might challenge the choice of the limited partnership over the corporate exit model for LLCs. The put option for any member on six months' or less notice creates a continuing liquidity danger for a firm with limited access to ready cash.⁹⁸ Worse, a member might choose opportunistically to exploit a lack of liquidity by threatening withdrawal unless there is a renegotiation of terms.⁹⁹ Such a tactic might also be used to force a liquidation and allow a freeze-out of other members.¹⁰⁰ While these concerns are not without some force, on balance, easier exit remains the better default rule. To understand why, it is useful to step back and consider a fundamental planning choice confronting parties forming any business.

In any business, the parties must consider what happens when an owner departs the venture, either through death, personal bankruptcy or simply the desire to withdraw. There are, broadly speaking, two models one may follow. One is a buyout model, under which the remaining members of the firm must purchase the departing member's interest if they wish to continue the venture following such departure. The other is a free transfer model, under which departure does not impact the other owners' right to continue the business, but rather the departing owner conveys his or her interest to whoever he or she wishes (or can). In a closely held business, typical for an LLC,¹⁰¹ the owners generally prefer the buyout model. This is not only because such owners normally want control over who will be their associates in the venture,¹⁰² but also because free transfer does not provide a meaningful option when there are no outsiders interested in

art. 6.02 (West Supp. 1994); UTAH CODE ANN. § 48-2b-142 (1994); VA. CODE ANN. § 13.1-1047 (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 802 (West); W. VA. CODE § 31-1A-36 (Supp. 1994); WIS. STAT. ANN. § 183.0902 (West Supp. 1994); WYO. STAT. § 17-15-120(c) (Supp. 1994).

98. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 289 (1986).

99. *Id.* at 287. Tax considerations do not require such a cash-out right. Avoiding the characteristic of continuity of life requires the possibility of dissolution rather than individual withdrawal. Rev. Proc. 95-10, 1995-3 I.R.B. 20.

100. See *infra* text accompanying note 106.

101. Publicly traded firms cannot obtain partnership tax treatment, see I.R.C. § 7704 (1988), and hence will probably continue to use the corporate form. Thus, most LLCs will be closely held.

102. For example, it is common for shareholders in a closely held corporation to limit the transferability of their stock in order to keep out strangers. See GEVURTZ, *supra* note 3, at 421-22.

buying into the closely held business.¹⁰³ Hence, the partnership or limited partnership buyout model corresponds with the probable choice of more owners of closely held businesses than does the corporate free-transfer model.¹⁰⁴

At the other end of things, one might ask whether more of the LLC statutes should have followed the UPA, rather than the RULPA, default rule and given each member a liquidation, rather than just a cash-out, right (barring other agreement). As an overall matter, the wisdom of this choice leads one into the debate that occurred over whether the Revised Uniform Partnership Act should include such a liquidation right.¹⁰⁵ Suffice it to say for present purposes that none of the arguments in this debate suggested there would be a significant difference in terms of squeeze-outs. There may, however, be a difference in terms of freeze-out potential—a subject to which we now turn.

III. FREEZE-OUTS

Both partnership law and corporate law contain mechanisms through which some owners can involuntarily remove—or “freeze out” to use the pejorative term—others from the firm. These mechanisms have important differences, however, which may affect their suitability for limited liability companies.

A. *Freeze-Outs in Partnerships*

The very ease of exit that serves to curb squeeze-outs in partnerships provides the mechanism for some partners to freeze out others. In a partnership at will, any partner (or group of partners) seeking to kick out other partners might simply dissolve the firm and then attempt to acquire the business in the ensuing liquidation sale.¹⁰⁶ This tactic, however, is not without difficulties. Some rights of the firm may be nonassignable or terminate upon dissolution,¹⁰⁷ and the purchasing partners may need to line up new financing rather than simply assuming the partnership's debts.

103. See, e.g., O'NEAL & THOMPSON, *supra* note 4, § 2:15 (“Anything less than a controlling interest in a close corporation does not have a ready market . . .”).

104. Tax considerations compound this conclusion for an LLC. Restricting free transfer may be necessary in order to obtain partnership tax treatment. See *supra* note 96.

105. See, e.g., RUPA § 801 cmt. (1992 Draft).

106. See Franklin A. Gevurtz, *Preventing Partnership Freeze-Outs*, 40 MERCER L. REV. 535, 540-41 (1989).

107. See, e.g., *Fairway Dev. Co. v. Title Ins. Co.*, 621 F. Supp. 120 (N.D. Ohio 1985).

More significant is the self-defense available to the partner or partners who are the target of the freeze-out. Such partner or partners could also attempt to acquire the business in the liquidation sale, thereby turning the tables on those who would attempt such a freeze-out. At the very least, the ensuing bidding war might ensure the leaving partners receive a fair price.

Given the availability of such a self-defense mechanism, when do partners in a partnership at will (or, for that matter, in a term partnership subject to dissolution by majority vote) need to worry about freeze-outs? A review of the cases suggests two areas of concern. The first involves the well-heeled versus strapped-for-cash partner scenario. Simply, this situation is when the partner(s) causing dissolution possess the funds to buy the business, but the other partner(s) do not. The case of *Page v. Page*¹⁰⁸ provides an illustration and something of a variation on this theme. The Pages were partners in a linen supply business in Santa Maria, California. The plaintiff partner sued to establish his right to dissolve the firm at will.¹⁰⁹ The defendant partner responded by unsuccessfully claiming that the parties had agreed to a partnership for a term. In addition, he charged that the plaintiff intended to freeze him out of a business that had recently become profitable due to the establishment of Vandenberg Air Force Base nearby. Specifically, he asserted that the plaintiff had a superior financial position to obtain the business on liquidation, since the partnership owed a substantial sum of money to a company that the plaintiff owned, whereas a period of losses by the business had exhausted most of the defendant's capital investment.¹¹⁰ While not explicitly stated, the underlying thrust of these allegations appears to be that the defendant lacked the funds to compete with the plaintiff, who could credit bid against the debt the partnership owed his company.¹¹¹

The second area of concern involves the unaccounted-for intangibles problem. Here, the partners causing dissolution are able to appropriate some intangible values of the partnership's business (elements that often go under the rubric of goodwill) without having to purchase them in the liquidation. The tangible assets that the firm then sells may only represent a skeleton

108. 359 P.2d 41 (Cal. 1961) (en banc).

109. *Id.* at 42.

110. *Id.* at 43-44.

111. See also *Prentiss v. Sheffel*, 513 P.2d 949 (Ariz. Ct. App. 1973) (concerning defendant's assertion that the plaintiffs had an unfair advantage in bidding for the partnership's property since they could credit bid against their 85% interest in the firm); *Davis v. Davis*, 366 P.2d 857 (Colo. 1961) (describing how the husband, in a husband and wife partnership, was unable to obtain financing to buy partnership's assets after dissolution, while his wife could).

of the business. The purchase of these tangible assets would not allow the other partner(s) to continue the enterprise effectively, nor will their sale to the partner causing dissolution produce anything close to the fair market value of the business as a going concern. A vivid example of this type of freeze-out is found in *Cude v. Couch*.¹¹² Cude and Couch were partners operating a laundromat on premises which they rented from Couch on a month-to-month basis. Couch dissolved the firm and announced that he would no longer rent the premises to anyone else. Couch then purchased the partnership's equipment at auction for a fraction of the price that he and Cude originally spent to buy the laundromat as a going concern. He continued to operate the business with his son.¹¹³ Less vivid but more common examples of this phenomenon occur upon the breakup of professional firms, when the various partners scramble for the clients. Unless the ensuing struggle produces a roughly proportional division of the firm's business, there will be a freeze-out by those partners able to obtain the bulk of the clientele and thereby essentially the business.¹¹⁴

A number of possible defenses exist against freeze-outs even in these two situations. To begin with, one might challenge the dissolution and liquidation of the business as involving a breach of a partner's duty of good faith or fiduciary duty towards his or her fellow partner(s).¹¹⁵ Such a challenge involves difficult questions of defining good faith, as well as difficult issues of proof,¹¹⁶ and there is a serious split of authority on its availability.¹¹⁷ Alternatively, courts might refuse to allow any partner, in the absence of agreement, to bid for the firm's assets in a liquidation sale¹¹⁸—although this seems a bit like Solomon's famous bluff. At the

112. 588 S.W.2d 554 (Tenn. 1979).

113. *Id.*; see also *Salter v. Condon*, 236 Ill. App. 17 (1925). The defendant in *Salter* owned land on which the partnership operated a golf course. *Id.* at 19. After dissolution, the defendant retained the land and the golf course's goodwill which came with the land. *Id.*

114. See, e.g., *Smith v. Bull*, 325 P.2d 463 (Cal. 1958) (detailing how defendant partners took advertising agency's primary client following dissolution).

115. See, e.g., *Page v. Page*, 359 P.2d 41, 44 (Cal. 1961) (dicta) ("A partner may not . . . by use of adverse pressure 'freeze out' a co-partner and appropriate the business to his own use.").

116. For a discussion of these problems, see Gevurtz, *supra* note 106, at 555-58.

117. Compare *Page*, 359 P.2d 41 (allowing such a challenge) and *Howell v. Harvey*, 5 Ark. 270 (1843) (same) with *Salter*, 236 Ill. App. at 25-26 (disallowing the challenge) and *Johnson v. Kennedy*, 214 N.E.2d 276 (Mass. 1966) (same). The RUPA further muddies the waters. Compare RUPA § 404(d) (1993) (partners must exercise any rights in good faith) with RUPA § 602(b) (limiting the definition of wrongful dissociation).

118. See, e.g., *Rowell v. Rowell*, 99 N.W. 473 (Wis. 1904) (voiding a transfer in which the sole remaining partner obtained partnership property). But see *Prentiss v. Sheffel*, 513 P.2d 949 (Ariz. Ct. App. 1973) (allowing partners to purchase partnership property in a liquidation sale).

least, a court could refuse to approve a sale to a partner at what the court perceives to be an inadequate price.¹¹⁹ Courts might decide to award the business to the more deserving partner¹²⁰ (however, not only does this seem contrary to the UPA,¹²¹ but experience suggests that this is as likely to facilitate a freeze-out as to frustrate one¹²²). To deal with the second freeze-out scenario, courts might demand that partners pay for the goodwill value they are effectively appropriating.¹²³ This, however, often entails the difficult effort of disentangling the value of individual and firm reputations.¹²⁴ From a planning standpoint, partners might seek to avoid freeze-outs upon dissolution by agreeing to a partnership for a term. This, however, can lead to the problem found in the *Drashner* case, discussed earlier,¹²⁵ when the partners no longer get along. Perhaps a buy-sell contract could help; although this adds to the transaction costs of forming a partnership and may not be done by less sophisticated parties.¹²⁶ All told, there may be no perfect solutions.¹²⁷ Fortunately, the two situations outlined above (in which dissolution freeze-outs can pose a problem) do not, judging by the quantity of reported litigation, appear to occur often.¹²⁸

As explained earlier, partners often contract around the norm of liquidation at will. In this event, is there a way for a majority of partners to remove other partners involuntarily? The answer depends upon whether the partnership agreement contains an expulsion clause.¹²⁹ If it does, then

119. See *Mandell v. Centrum Frontier Corp.*, 407 N.E.2d 821, 832 (Ill. Ct. App. 1980) (approving of certain precautions taken to obtain a fair price at a judicial sale).

120. See, e.g., *Nicholes v. Hunt*, 541 P.2d 820, 828 (Or. 1975).

121. UPA § 38(1) (1914) (directing that proceeds from dissolution be "applied to pay in cash the net amount owing to the respective partners"); *Dreifuerst v. Dreifuerst*, 280 N.W.2d 335 (Wis. 1979); *Young v. Cooper*, 203 S.W.2d 376 (Tenn. Ct. App. 1947).

122. *Rinke v. Rinke*, 48 N.W.2d 201 (Mich. 1951), provides an example of a situation in which a court's decision to distribute the partnership's assets in kind, rather than to order a sale of assets, may have facilitated a freeze-out.

123. E.g., *Swann v. Mitchell*, 435 So. 2d 797 (Fla. 1983).

124. See, e.g., *In re Brown*, 150 N.E. 581 (N.Y. 1926).

125. See *supra* text accompanying notes 38-41.

126. For a discussion of partnership buy-sell contracts, see *GEVURTZ, supra* note 3, at 188-233.

127. See generally *Gevurtz, supra* note 106. In this sense, I confess that the title *Preventing Partnership Freeze-Outs* was perhaps misleading.

128. At least relative to the frequency of litigation involving corporate squeeze-outs.

129. One other way to expel partners from a partnership for a term is for some partners to convince a court to order dissolution under UPA § 32 because of wrongful conduct by other partners and thereupon to award the wronged partners the right to continue the business under § 38(2). See, e.g., *Vangel v. Vangel*, 254 P.2d 919 (Cal. Ct. App. 1953). Expulsion clauses can also give partners the ability to remove other partners without liquidation in a partnership otherwise dissolvable at will. See

the majority can kick partners out in accordance with the terms of the clause.¹³⁰ Agreements vary as to whether the majority may expel partners for any reason¹³¹ or whether the expulsion power is limited to specified grounds.¹³² In either event, the expelled partners are entitled to receive the value of their interest in the partnership.¹³³ There is uncertainty in the cases, however, about the extent to which the exercise of an expulsion power is subject to a good faith limit; both in terms of whether such a limit exists¹³⁴ and, if so, in terms of what sort of conduct it would take to establish bad faith.¹³⁵ Overall, the critical point to note about the freeze-out of partners pursuant to an expulsion clause is that this power only exists when partners expressly agree to it. Hence, while partners may be upset to find themselves expelled under such a clause, they generally should not be unfairly surprised by the very possibility.

B. Freeze-Outs in Corporations

As just explained, unless partners expressly agree to give a majority the right to expel members, the majority of partners have no power, simply by virtue of being the majority, to freeze other partners out of the firm. True, the majority (or even a minority) might dissolve a partnership which is at will and attempt to acquire the business in the ensuing liquidation. But majority status does not dictate who succeeds to the business in this event; rather, the willingness and ability to pay more does.¹³⁶ Corporate law has evolved in a different direction. Significantly, this evolution has not occurred by virtue of provisions in the corporations statutes that have as their explicit objective allowing majority shareholders to expel the minority.¹³⁷ Instead, majority shareholders have discovered ways to use

UPA § 38(1) (1914).

130. UPA §§ 31(1)(d), 38(1) (1914).

131. *See, e.g.,* *Holman v. Coie*, 522 P.2d 515, 521 (Wash. Ct. App. 1974).

132. *See, e.g.,* *Millet v. Slocum*, 167 N.Y.S.2d 136, 140 (App. Div. 1957) (limiting the grounds to "incompatibility").

133. UPA § 38(1) (1914).

134. *See, e.g.,* *Gill v. Mallory*, 80 N.Y.S.2d 155, 158 (App. Div. 1948) ("It does not appear that defendants acted in bad faith [by expelling partners] (if that were to be the test) . . .").

135. *See, e.g.,* *Gelder Medical Group v. Webber*, 363 N.E.2d 573 (N.Y. 1977) (framing good faith as lacking any "undue penalty" or "unjust forfeiture").

136. Alternatively, in a professional firm, the ability to attract and retain clients dictates who effectively takes over the business.

137. An exception is for freeze-outs of small minorities through the use of short-form mergers. *See, e.g.,* *Stauffer v. Standard Brands, Inc.*, 187 A.2d 78, 80 (Del. 1962) ("[T]he very purpose of the [short form merger] statute is to provide the parent corporation with a means of eliminating the minority

provisions directed toward other ends in order to achieve this power. Historically, this began with a method familiar to partnerships: dissolution.

While corporations statutes, unlike the UPA, do not provide for dissolution at the will of any owner, they typically do allow for voluntary dissolution by majority votes of the directors and shareholders.¹³⁸ Hence, the majority might vote to dissolve under a plan whereby a new corporation owned solely by the majority acquires the operating assets in the ensuing liquidation. Interestingly enough, courts generally have been hostile to this freeze-out technique. In part, this reflects the majorities' attempts in these cases to short circuit the sort of self-defense to liquidation freeze-outs discussed earlier in dealing with partnerships—namely the minority's ability to bid for the business.¹³⁹ Rather than put up the business for bids, the majority in the corporate dissolution cases often simply transferred the operating assets to the majority's new corporation and gave the minority cash. A number of courts have held this to be impermissible.¹⁴⁰ More broadly, however, some decisions have held that a transaction whereby the business continues in a new corporation, unchanged except for the exclusion of the minority, is simply not a dissolution within the meaning of the corporation statute authorizing voluntary dissolution.¹⁴¹

This judicial reaction (coupled with other factors¹⁴²) has shifted corporate freeze-outs to two other techniques.¹⁴³ One is to undertake a reverse stock split in a sufficiently large ratio so that none of the minority

shareholder's interest in the enterprise.”).

138. See, e.g., DEL. CODE ANN. tit. 8, § 275 (1991); see also CAL. CORP. CODE § 1900(a) (West 1990) (allowing voluntary dissolution upon a vote of only 50% of the shareholders and without the requirement of director approval); N.Y. BUS. CORP. LAW § 1001 (McKinney 1986) (requiring a vote of two-thirds of the shareholders).

139. See *supra* text accompanying notes 106-07.

140. See, e.g., *Kellogg v. Georgia-Pacific Paper Corp.*, 227 F. Supp. 719 (W.D. Ark. 1964); *Zimmerman v. Tide Water Assocs. Oil Co.*, 143 P.2d 409 (Cal. Ct. App. 1943).

141. See, e.g., *Lebold v. Inland Steel Co.*, 125 F.2d 369, 373 (7th Cir. 1941) (“The so called [sic] dissolution was a mere device by means of which defendant appropriated for itself [the corporation] . . .”), *cert. denied*, 316 U.S. 675 (1942); *Theis v. Spokane Falls Gaslight Co.*, 74 P. 1004, 1007 (Wash. 1904) (holding that with such a transaction “there was no attempt at a bona fide dissolution of the corporation, such as is contemplated by the statute”).

142. For example, a dissolution might require the corporation to pay off existing creditors unless they are willing to have the new company assume the debts. *Darcey v. Brooklyn N.Y. Ferry Co.*, 89 N.E. 461 (N.Y. Ct. App. 1909). Also, appraisal rights, which might prevent a challenge for breach of fiduciary duty, see *infra* notes 154-56 and accompanying text, do not apply to dissolutions. See, e.g., DEL. CODE ANN. tit. 8, § 262(b) (1991).

143. This assumes one is not dealing with stock that the corporation has a contractual right to redeem. See, e.g., *Zahn v. Transamerica*, 162 F.2d 36 (3d Cir. 1947).

stockholders ends up entitled to more than a fraction of a share.¹⁴⁴ Then, the corporation pays cash to the minority in lieu of issuing fractional shares under statutory provisions allowing such an action.¹⁴⁵ The most popular freeze-out technique, however, is through a cash-out merger. *Coggins v. New England Patriots Football Club, Inc.*¹⁴⁶ provides a good illustration. Sullivan obtained ownership or control of all the voting shares of the corporation which operated the New England Patriots football team. He borrowed the funds for this acquisition and needed to use all the corporation's earnings to pay off this loan. In order to prevent challenges by holders of nonvoting shares, he cashed them out through a merger. Specifically, he transferred his voting shares to a shell corporation set up for the transaction in exchange for all the shell corporation's stock. He then had the boards of both corporations (who he, of course, controlled) and the shares of both corporations vote to approve a merger between the two corporations in which all the nonvoting shares of the Patriots corporation were cancelled and their owners received cash.¹⁴⁷

It is quite evident that these techniques involve the use of corporate law provisions to accomplish an objective foreign to their purposes. The reverse stock split depends upon the power of the majority to amend the articles¹⁴⁸—not something which at first glance would seem to encompass the power of expulsion—and the statutory ability to issue cash in lieu of fractional shares. The purpose of allowing the company to cash out fractional shares, however, is to avoid the inconvenience for both corporation and shareholder of holding fractional shares when, as inevitable, mergers and recapitalizations do not always involve one-to-one exchange ratios.¹⁴⁹ Merger provisions, like those used in *Coggins*, allow a convenient method for structuring acquisitions or combinations between different businesses or the simplification of corporate structures.¹⁵⁰ Allowing cash or other nonequity consideration in a merger recognizes that many acquisitions are for cash or debt rather than for stock in the buying

144. See, e.g., *Teschner v. Chicago Title & Trust Co.*, 322 N.E.2d 54 (Ill. 1974).

145. See, e.g., DEL. CODE ANN. tit. 8, § 155 (1991); N.Y. BUS. CORP. LAW § 509(b) (McKinney 1986).

146. 492 N.E.2d 1112 (Mass. 1986).

147. *Id.* at 1114-15.

148. See, e.g., *Lerner v. Lerner*, 511 A.2d 501 (Md. 1986).

149. See GEVURTZ, *supra* note 3, at 804.

150. As, for example, when a subsidiary merges with its parent corporation in order to allow operation completely within one corporate entity.

firm.¹⁵¹ The idea of using the merger provisions to allow the majority to kick out the minority in a transaction in which the only combination is with a short-lived shell corporation set up solely for the merger, however, is not something that appears contemplated on the face of the merger statutes. Nevertheless, and in contrast to the earlier dissolution cases, courts generally have rejected arguments that reverse stock split or merger freeze-outs simply are not authorized by the corporation laws.¹⁵²

Given this result, the only option left to expelled minority shareholders¹⁵³ is to challenge the specific freeze-out maneuver as a breach of the majority's fiduciary duty. Such an attack raises several issues. To begin with, state corporations statutes typically provide a right of appraisal for stockholders dissenting from a merger.¹⁵⁴ Do these statutes establish an exclusive remedy? If so, the minority stockholders may be able to demand that the corporation pay them more, and pay them cash (rather than debt instruments, for example). Minority stockholders, however, will not be able to halt their forced removal on the ground that it constitutes a breach of fiduciary duty. Both the language of appraisal provisions and judicial interpretations vary between the states. At one extreme lie opinions holding that the appraisal provisions preclude almost any challenge to the merger.¹⁵⁵ Short of this extreme lie a host of exceptions to exclusivity.¹⁵⁶

Assuming the challenging stockholders get past the appraisal statutes, the question becomes upon what grounds will the court upset the transaction. Here, one confronts a basic division between those jurisdictions that require

151. See GEVURTZ, *supra* note 3, at 804-22.

152. See, e.g., *Matteson v. Ziebarth*, 242 P.2d 1025 (Wash. 1952); *Teschner*, 322 N.E.2d 54. But see *Jutkowitz v. Bourns*, No. CA 000268 (Cal. Super. Nov. 19, 1975).

153. This assumes no misrepresentation or omission that might set up a fraud claim. See, e.g., *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977).

154. CAL. CORP. CODE §§ 1300-1312 (West 1990 & Supp. 1995); DEL. CODE ANN. tit. 8, § 262 (1991 & Supp. 1994).

155. See, e.g., *Yannow v. Teal Indus. Inc.*, 422 A.2d 311, 318-19 (Conn. 1979). Presumably, these courts still would allow challenges for failure to comply with statutory requirements; for example, insufficient votes cast in favor of the merger, or for misrepresentations in inducing the shareholder vote.

156. See, e.g., *Steinberg v. Amplica, Inc.*, 729 P.2d 683 (Cal. 1986) (holding that appraisal is the exclusive remedy except in a transaction with a controlling shareholder); *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983) (holding that, ordinarily, any monetary remedy should come from appraisal, but appraisal may not be adequate in cases of fraud, self-dealing, waste or gross overreaching); *Walter J. Schloss Assoc. v. Arkwin Indus., Inc.*, 460 N.E.2d 1090 (N.Y. 1984) (holding that the New York appraisal statute bars an action unless it seeks primarily an equitable remedy rather than money damages).

a business purpose for removal of the minority,¹⁵⁷ and those, most notably Delaware, that do not.¹⁵⁸ Even within the two camps, however, there exists uncertainty and variation. For example, in those jurisdictions that require a business purpose, what exactly constitutes a sufficient business purpose to freeze out minority shareholders? The New York Court of Appeals has held that the freeze-out must further an "independent corporate purpose."¹⁵⁹ Prior to abandoning the business purpose limit in *Weinberger v. UOP, Inc.*,¹⁶⁰ the Delaware Supreme Court had held that the majority's own business purpose could suffice.¹⁶¹ In the jurisdictions that do not require a business purpose to freeze out the minority, what else can the court review? In *Weinberger*, the Delaware Supreme Court required "fair dealing and fair price."¹⁶² In other words, the majority generally has the right to expel the minority without showing any particular justification so long as they are candid and pay the minority a fair value for the minority's shares.

C. *Whither Limited Liability Companies, Again?*

1. *Dissolution and Liquidation Freeze-Outs*

LLCs present somewhat different prospects for dissolution and liquidation freeze-outs than those found in partnerships. To begin with, the LLC statutes normally do not follow the UPA in giving each member of the firm a right to dissolve and demand a liquidation at will. Instead, following the pattern of the limited partnership acts, the remaining members of the firm (assuming no other agreement) may generally avoid dissolution and liquidation upon a member's withdrawal by unanimous (or, under some statutes, majority) consent to continue.¹⁶³ There are some potentially important exceptions. For example, most acts require (either explicitly, or implicitly through the definition of the entity) that there be more than one member left in order to continue the LLC,¹⁶⁴ which, of course, could be

157. See, e.g., *Alpert v. 28 Williams St. Corp.*, 473 N.E.2d 19, 25 (N.Y. 1984).

158. See *Weinberger*, 457 A.2d 701.

159. *Alpert*, 473 N.E.2d at 28.

160. 457 A.2d 701.

161. *Tanzer v. International Gen. Indus.*, 379 A.2d 1121 (Del. 1977).

162. 457 A.2d at 711.

163. See *supra* note 94.

164. See ALA. CODE § 10-12-37(3)(a) (1994); ALASKA STAT. § 10.50.070 (Supp. 1994); ARIZ. REV. STAT ANN. § 29-781(A)(5) (Supp. 1994); CAL. CORP. CODE § 17001(t) (West Supp. 1995); 1993 Conn. Legis. Serv. P.A. 93-267, § 2(9) (West); DEL. CODE ANN. tit. 6, § 18-101(6) (Supp. 1994); FLA. STAT.

critical in a two-member firm.¹⁶⁵ Also, a few states only allow the remaining members the power to continue without dissolution if so provided in the LLC's articles.¹⁶⁶

When more than one member of the LLC wishes to pull off a freeze-out through dissolution and liquidation, these members might be able to force liquidation in a jurisdiction requiring unanimity to continue. One member could resign and the other(s) could refuse to consent to the firm's continuing without dissolution. Whether such a tactic would work is unclear. Perhaps a court would find this breaches the nonconsenting members' duty of good faith. Or perhaps the court would deem the entire group of members involved to have effectively withdrawn from the LLC (which seems a reasonable interpretation of the events).

Alternatively, the member(s) seeking a freeze-out through dissolution might have a majority interest in the LLC. If so, they may have sufficient votes to force a dissolution. Many states allow the majority to dissolve an LLC (in the absence of other agreement).¹⁶⁷ Most states, however, only

ANN. § 608.405 (West Supp. 1994); ILL. ANN. STAT. ch. 805, para. 180/35-1 (Smith-Hurd Supp. 1994); IOWA CODE ANN. § 490A.102(13) (West Supp. 1994); KAN. STAT. ANN. § 17-7605 (Supp. 1993); LA. REV. STAT. ANN. § 12:1301(10) (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS § 4A-101(l) (1993); MICH. COMP. LAWS ANN. § 450.4102(i) (West Supp. 1994); MINN. STAT. ANN. § 322B.11 (West Supp. 1994); NEB. REV. STAT. § 21-2605 (Supp. 1994); NEV. REV. STAT. § 86.151 (Supp. 1993); N.H. REV. STAT. ANN. § 304-C:50(V) (Supp. 1994); N.J. STAT. ANN. § 42:2B-2 (West Supp. 1994); N.C. GEN. STAT. § 57C-2-20(a) (Supp. 1993); N.D. CENT. CODE § 10-32-06 (Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2001(12) (West Supp. 1995); OR. REV. STAT. § 63.001(12) (Supp. 1994); R.I. GEN. LAWS § 7-16-2(m) (1992); S.D. CODIFIED LAWS ANN. § 47-34-29(4) (Supp. 1994); TENN. CODE ANN. § 48-203-103 (Supp. 1994); UTAH CODE ANN. § 48-2b-103 (1994); VA. CODE ANN. § 13.1-1002 (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 801(6) (West); W. VA. CODE § 31-1A-2(8) (Supp. 1994); WIS. STAT. ANN. § 183.0201 (West Supp. 1994); WYO. STAT. § 17-15-106 (Supp. 1994). The rationale for requiring at least two members is to ensure partnership classification for tax purposes. See, e.g., Rev. Proc. 95-10, 1995-3 I.R.B. 20.

However, several state statutes do allow an individual to form an LLC. See ARK. CODE ANN. § 4-32-201 (Michie Supp. 1993); COLO. REV. STAT. ANN. § 7-80-203 (West Supp. 1994); GA. CODE ANN. § 14-11-203 (1994); IDAHO CODE § 53-607 (1994); IND. CODE ANN. § 23-18-2-4 (Burns Supp. 1994); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 4 (Baldwin); ME. REV. STAT. ANN. tit. 31, § 621 (West Supp. 1994); MO. ANN. STAT. § 347.037(1) (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-201 (1993); N.M. STAT. ANN. § 53-19-7 (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 102(m) (McKinney Supp. 1995); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 4.01 (West Supp. 1995).

165. Hence, use of an LLC would not have avoided, in most jurisdictions, dissolution in the situation in *Page v. Page*, 359 P.2d 41 (Cal. 1961). See *supra* text accompanying notes 108-11.

166. MINN. STAT. ANN. § 322B.80(1)(5) (West Supp. 1995); NEV. REV. STAT. § 86-491(1)(c) (Supp. 1993); N.D. CENT. CODE § 10-32-109(1) (Supp. 1993); OR. REV. STAT. § 63.621(4) (1993); S.D. CODIFIED LAWS ANN. § 47-34-29(3) (Supp. 1994); WYO. STAT. § 17-15-123(a)(iii) (1989).

167. CAL. CORP. CODE § 17350(c) (West Supp. 1995); 1993 Conn. Legis. Serv. P.A. 93-267, § 42 (West); LA. REV. STAT. ANN. § 12:1318(B)(1) (West Supp. 1994); MINN. STAT. ANN. § 322B.806(2)(b)

allow dissolution (barring other agreement) with the consent of all members.¹⁶⁸

All told, in most jurisdictions no members of an LLC can force liquidation as long as at least two other members wish to continue the firm. This, of course, precludes freeze-outs through dissolution and liquidation, at least as long as the firm has the liquidity to buy out the withdrawing members. On the other hand, it is difficult to criticize those statutes that allow the majority (or even any member) to force liquidation barring other agreement or provision in the articles. After all, if the parties do not get along, determining who gets the business through competitive bidding may be at least as reasonable as a contest over who withdraws from the firm last.

In any event, the liquidation of LLC assets after dissolution should be no different from the practice with partnerships.¹⁶⁹ The LLC statutes certain-

(West Supp. 1995); N.M. STAT. ANN. § 53-19-39(A)(2) (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 402(d)(1) (McKinney Supp. 1995) (two-thirds supermajority); N.D. CENT. CODE § 10-32-111 (Supp. 1993); R.I. GEN. LAWS § 7-16-21(b) (1992); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 2.23(D)(5) (West Supp. 1995); UTAH CODE ANN. § 48-2b-137(3)(b) (1994).

168 ALA. CODE § 10-12-37(2) (1994); ALASKA STAT. § 10.50.400(2) (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-781(A)(2) (Supp. 1994); ARK. CODE ANN. § 4-32-901(b) (Michie Supp. 1993); COLO. REV. STAT. ANN. § 7-80-801(b) (West Supp. 1994); DEL. CODE ANN. tit. 6, § 18-801(3) (1993); FLA. STAT. ANN. § 608.441(1)(b) (West Supp. 1994); GA. CODE ANN. § 14-11-602(3) (1994); IDAHO CODE § 53-642(2) (1994); ILL. ANN. STAT. ch. 805, para. 180/35-1 (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-9-1(2) (Burns Supp. 1994); IOWA CODE ANN. § 490A.1301(2) (West Supp. 1994); KAN. STAT. ANN. § 17-7622(2) (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 57(2) (Baldwin); MD CODE ANN., CORPS. & ASS'NS § 4A-902(2) (1993); ME. REV. STAT. ANN. tit. 31, § 701(2) (West Supp. 1994); MICH. COMP. LAWS ANN. § 450.4801(c) (West Supp. 1994); MO. ANN. STAT. § 347.137(2) (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-901(2) (1993); NEB. REV. STAT. § 21-2622(2) (Supp. 1994); NEV. REV. STAT. § 86-491(1)(b) (Supp. 1993); N.H. REV. STAT. ANN. § 304-C:50(III) (Supp. 1994); N.J. STAT. ANN. § 42:2B-48(c) (West Supp. 1994); N.C. GEN. STAT. § 57C-6-01(3) (Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2037(A)(2) (West Supp. 1995); OR. REV. STAT. § 63.621(3) (Supp. 1994); S.D. CODIFIED LAWS ANN. § 47-34-29(2) (Supp. 1994); TENN. CODE ANN. § 245-101(b)(2) (Supp. 1994); VA. CODE ANN. § 13.1-1046(2) (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 801(3) (West); W. VA. CODE § 31-1A-35(2) (Supp. 1994); WIS. STAT. ANN. § 183.0901(2) (West 1994); WYO. STAT. § 17-15-123(a)(ii) (1989). Two states' laws contain internal inconsistencies on this issue: IOWA CODE ANN. §§ 490A.701(2)(a) (requiring majority vote), 490A.1301(2) (requiring unanimous consent); OKLA. STAT. ANN. tit. 18, §§ 2020(B)(1) (requiring majority vote), 2037(A)(2) (requiring unanimous consent).

169 See ALA. CODE § 10-12-41 (1994); ALASKA STAT. § 10.50.425 (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-708 (Supp. 1994); ARK. CODE ANN. § 4-32-905 (Michie Supp. 1993); CAL. CORP. CODE §§ 17352, 17353 (West Supp. 1995); COLO. REV. STAT. ANN. § 7-80-805 (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-262, § 46 (West); DEL. CODE ANN. tit. 6, §§ 18-803, 18-804 (1993 & Supp. 1994); FLA. STAT. ANN. § 608.444 (West Supp. 1994); GA. CODE ANN. § 14-11-605 (1994); IDAHO CODE § 53-646 (1994); ILL. ANN. STAT. ch. 805, para. 180/35-10 (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-9-6 (Burns Supp. 1994); IOWA CODE ANN. § 490A.1304 (West Supp. 1994); KAN.

ly do not allow the majority to appropriate the business and cash out the minority through an in-kind liquidation of the assets.¹⁷⁰ Presumably, therefore, LLC members will have the same self-defense against a dissolution and liquidation freeze-out—bidding for the business—available to partners.

A variation on the dissolution and liquidation freeze-out is to reverse the order of the transaction. The majority could vote to sell the LLC's operating assets for cash to another entity owned only by themselves and then dissolve the LLC. Partnership law would preclude this because a transaction outside the ordinary course of business, such as the sale of

STAT. ANN. § 17-7625 (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 62 (Baldwin); LA. REV. STAT. ANN. § 12:1337 (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 705 (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS § 4A-908 (1993); MICH. COMP. LAWS ANN. § 450.4808 (West Supp. 1994); MINN. STAT. ANN. § 322B.873 (West Supp. 1995); MO. ANN. STAT. § 347.101 (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-905 (1994); NEB. REV. STAT. § 21-2625 (Supp. 1994); NEV. REV. STAT. § 86.521 (Supp. 1993); N.H. REV. STAT. ANN. § 304-C:58 (Supp. 1994); N.J. STAT. ANN. § 42:2B-51 (West Supp. 1994); N.M. STAT. ANN. § 53-19-44 (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW §§ 703, 704 (McKinney Supp. 1995); N.C. GEN. STAT. § 57C-6-05 (Supp. 1993); N.D. CENT. CODE § 10-32-131 (Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2040 (West Supp. 1995); OR. REV. STAT. § 63.625 (Supp. 1994); R.I. GEN. LAWS § 7-16-46 (1992); S.D. CODIFIED LAWS ANN. § 47-34-32 (Supp. 1994); TENN. CODE ANN. § 48-245-1101 (Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 6.04 (West Supp. 1994); UTAH CODE ANN. § 48-2b-138 (1994); VA. CODE ANN. § 13.1-1049 (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 807 (West); W. VA. CODE § 31-1A-38 (Supp. 1994); WIS. STAT. ANN. § 183.0905 (West Supp. 1994); WYO. STAT. § 17-15-126 (1989).

170. ALA. CODE § 10-12-29(d) (1994); ALASKA STAT. § 10.50.340 (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-704 (Supp. 1994); ARK. CODE ANN. § 4-32-603 (Michie Supp. 1993); CAL. CORP. CODE § 17253 (West Supp. 1995); COLO. REV. STAT. ANN. § 7-80-604 (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 31 (West); DEL. CODE ANN. tit. 6, § 18-605 (Supp. 1994); FLA. STAT. ANN. § 608.427(4) (West Supp. 1994); GA. CODE ANN. § 14-11-406 (1994); IDAHO CODE § 53-631 (1994); ILL. ANN. STAT. ch. 805, para. 180/25-15 (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-5-8(a) (Burns Supp. 1994); IOWA CODE ANN. § 490A.806 (West Supp. 1994); KAN. STAT. ANN. § 17-7615(b) (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 44 (Baldwin); LA. REV. STAT. ANN. § 12:1326 (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 673(1) (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS § 4A-506 (1993); MICH. COMP. LAWS ANN. § 450.4306 (West Supp. 1994); MINN. STAT. ANN. § 322B.52 (West Supp. 1995); MO. ANN. STAT. § 347.105 (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-603 (1993); NEB. REV. STAT. § 21-2619(3) (Supp. 1994); NEV. REV. STAT. § 86.331(3) (Supp. 1993); N.H. REV. STAT. ANN. § 304-C:42 (Supp. 1994); N.J. STAT. ANN. § 42:2B-40 (West Supp. 1994); N.M. STAT. ANN. § 53-19-25(B) (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 505 (McKinney Supp. 1995); N.C. GEN. STAT. § 57C-4-05 (Supp. 1993); N.D. CENT. CODE § 10-32-62 (Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2028 (West Supp. 1995); OR. REV. STAT. § 63.219 (Supp. 1994); R.I. GEN. LAWS § 7-16-30 (1992); S.D. CODIFIED LAWS ANN. § 47-34-27 (Supp. 1994); TENN. CODE ANN. § 48-236-103 (Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 5.07 (West Supp. 1994); UTAH CODE ANN. § 48-2b-132(3) (1994); VA. CODE ANN. § 13.1-1034 (Michie 1993 & Supp. 1994); 1994 Wash. Legis. Serv. ch. 211, § 603 (West); W. VA. CODE § 31-1A-28 (Supp. 1994); WIS. STAT. ANN. § 183.0605 (West Supp. 1994); WYO. STAT. § 17-15-120(c) (Supp. 1994).

substantially all assets, requires a unanimous vote.¹⁷¹ LLC statutes differ on this requirement. A few follow the partnership law rule and require a unanimous vote.¹⁷² Many, however, explicitly allow a sale of substantially all assets on less than unanimous vote.¹⁷³ Still others do not specifically address the issue—which may leave the matter open to majority rule by default.¹⁷⁴ One could easily debate whether a majority in an LLC should be able to force the sale of a business to a third party over the objections of the minority—a subject perhaps for another article. The fact that the partnership norm is to the contrary at least raises a question as to what the normal expectation of participants is in the sort of closely held venture most likely to use the LLC form. Be this as it may, there seems little policy reason to allow the majority to avoid the protection of a liquidation sale open to bids from all when it is the majority (directly or indirectly) who is the buyer.¹⁷⁵ On a broader level, whether asset sales should be a vehicle for LLC freeze-outs raises the same prescriptive issues as would an effort

171. See UPA §§ 9(3) (1914) (requiring unanimity for certain major transactions), 18(h) (allowing “differences arising as to ordinary matters” to be decided by a majority); RULPA §§ 403(a), 1105 (1985) (giving general partners of a limited partnership the same powers as partners in an ordinary partnership).

172. GA. CODE ANN. § 14-11-308(b)(3) (1994); MO. ANN. STAT. § 347.079(3)(5) (Vernon Supp. 1994); N.C. GEN. STAT. § 57C-3-03 (Supp. 1993).

173. IOWA CODE ANN. § 490A.701(2)(b) (West Supp. 1994); LA. REV. STAT. ANN. § 12:1318(B)(2) (West Supp. 1994); MICH. COMP. LAWS ANN. § 450.4502(3) (West Supp. 1994); MINN. STAT. ANN. § 322B.77 (West Supp. 1995); N.H. REV. STAT. ANN. § 304-C:24(V) (Supp. 1994); N.J. STAT. ANN. § 42:2B-27 (West Supp. 1994); N.M. STAT. ANN. § 53-19-17(B)(1) (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 402(d)(2) (McKinney Supp. 1995) (two-thirds supermajority); N.D. CENT. CODE § 10-32-108(1) (Supp. 1993) (majority of board); OKLA. STAT. ANN. tit. 18, § 2020(B)(3) (West Supp. 1995); OR. REV. STAT. § 63.150(3)(a) (Supp. 1993); R.I. GEN. LAWS § 7-16-21(b)(2) (1992); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 2.23(D)(7) (West Supp. 1995); 1994 Wash. Legis. Serv. ch. 211, § 404 (West) (majority of managers); W. VA. CODE § 31-1A-18(c) (Supp. 1994); WIS. STAT. ANN. § 183.0404(1)(a) (West Supp. 1994).

174. See ALA. CODE § 10-12-41 (1994); ALASKA STAT. § 10.50.150 (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-681(D) (Supp. 1994); ARK. CODE ANN. § 4-32-403 (Michie Supp. 1993); CAL. CORP. CODE § 17103(a)(3) (West Supp. 1995); COLO. REV. STAT. ANN. § 7-80-708 (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 23 (West); DEL. CODE ANN. tit. 6, § 18-402 (Supp. 1994); FLA. STAT. ANN. § 608.4231 (West Supp. 1994); IDAHO CODE § 53-623 (1994); ILL. ANN. STAT. ch. 805, para. 180/10-5 (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-4-3 (Burns Supp. 1994); KAN. STAT. ANN. § 17-7613 (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 34 (Baldwin); ME. REV. STAT. ANN. tit. 31, § 652 (West Supp. 1994); MD. CODE ANN., CORPS. & ASS’NS § 4A-403 (1993); MONT. CODE ANN. § 35-8-403 (1993); NEB. REV. STAT. § 21-2615 (Supp. 1994); NEV. REV. STAT. § 86.291 (Supp. 1993); S.D. CODIFIED LAWS ANN. § 47-34-16 (Supp. 1994); TENN. CODE ANN. § 48-206-101 (Supp. 1994); UTAH CODE ANN. § 48-2b-125 (1994); VA. CODE ANN. § 13.1-1022 (Michie 1993); WYO. STAT. § 17-15-116 (Supp. 1994).

175. *But see* *Abelow v. Midstates Oil Corp.*, 189 A.2d 675 (Del. 1963) (allowing such a sale in the corporate context).

to use LLC merger provisions toward that end—the subject to which we next turn.

2. Freeze-Out Mergers

Wyoming's ground-breaking LLC statute originally lacked any provision allowing the merger of LLCs with other LLCs or with other business entities.¹⁷⁶ As LLC statutes spread to other jurisdictions, drafters began to include merger provisions in the acts. Now, such provisions are common.¹⁷⁷ Two aspects of these provisions are critical to the potential for freeze-out mergers: (1) What vote do they require to approve a merger?; and (2) Can the merger agreement force members of a merged LLC to take consideration other than an ownership interest in the surviving entity?

The LLC statutes vary in terms of the vote required for a merger (at least in the absence of other agreement). A couple are silent¹⁷⁸—preferring perhaps to leave the question to litigation. Some require unanimity.¹⁷⁹

176. Wyoming's merger provision was added in 1993. *See* WYO. STAT. ANN. §§ 17-15-139 to 143 (Supp. 1994).

177. ALA. CODE § 10-12-54 (1994); ALASKA STAT. § 10.50.500 (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-752 (Supp. 1994); ARK. CODE ANN. § 4-32-1201 (Michie Supp. 1993); CAL. CORP. CODE § 17550 (West Supp. 1994); COLO. REV. STAT. ANN. § 7-80-1003 (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 64 (West); DEL. CODE ANN. tit. 6, § 18-209 (1993 & Supp. 1994); GA. CODE ANN. § 14-11-901 (1994); IDAHO CODE § 53-661 (1994); IND. CODE ANN. § 23-18-7-1 (Burns Supp. 1994); IOWA CODE ANN. § 490A.1201 (West Supp. 1994); KAN. STAT. ANN. § 17-7650 (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 69(1) (Baldwin); LA. REV. STAT. ANN. § 12:1357 (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 741(1) (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS § 4A-701 (1993); MICH. COMP. LAWS ANN. § 450.4701 (West Supp. 1994); MINN. STAT. ANN. § 322B.70(1) (West Supp. 1994); MO. ANN. STAT. § 347.127 (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-1201 (1994); N.H. REV. STAT. ANN. § 304-C:18 (Supp. 1994); N.J. STAT. ANN. § 42:2B-20 (West Supp. 1994); N.M. STAT. ANN. § 53-19-59 (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 1001 (McKinney Supp. 1995); N.C. GEN. STAT. § 57C-9-01 (Supp. 1993); N.D. CENT. CODE § 10-32-100 (Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2054 (West Supp. 1995); OR. REV. STAT. § 63.481 (Supp. 1994); R.I. GEN. LAWS § 7-16-59 (1992); S.D. CODIFIED LAWS ANN. § 47-34-38 (Supp. 1994); TENN. CODE ANN. § 48-244-101 (Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 10.01 (West Supp. 1995); UTAH CODE ANN. § 48-2b-149 (1994 & Supp. 1994); VA. CODE ANN. § 13.1-1070 (Michie Supp. 1994); 1994 Wash. Legis. Serv. ch. 211, § 1101 (West); W. VA. CODE § 31-1A-41 (Supp. 1994); WIS. STAT. ANN. § 183.1201 (West Supp. 1994); WYO. STAT. § 17-15-139 (Supp. 1994).

178. KAN. STAT. ANN. § 17-7650 (Supp. 1993); MONT. CODE ANN. § 35-8-1201 (1993).

179. ALA. CODE § 10-12-54(1) (1994); ALASKA STAT. § 10.50.510(a) (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-681(c) (Supp. 1994); COLO. REV. STAT. ANN. § 7-80-1003(3)(b) (West Supp. 1994); GA. CODE ANN. § 14-11-903(c)(1) (1994); IND. CODE ANN. § 23-18-7-3 (Burns Supp. 1994); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 70(1) (Baldwin); MD. CODE ANN., CORPS. & ASS'NS § 4A-702(a) (1993); MICH. COMP. LAWS ANN. § 450.4702(1) (West Supp. 1994); MO. ANN. STAT. § 347.079(3)(3) (Vernon Supp. 1994); N.C. GEN. STAT. § 57C-3-03(4) (Supp. 1993); R.I. GEN. LAWS § 7-16-21(b)(3) (1992); S.D. CODIFIED LAWS ANN. § 47-34-40(1) (Supp. 1994); VA. CODE ANN. § 13.1-1071(A)

This requirement, of course, will prevent freeze-out mergers for LLCs formed under the laws of those jurisdictions. Many others, however, including such important jurisdictions as Delaware,¹⁸⁰ New York,¹⁸¹ and California,¹⁸² call for majority (or at least less than unanimous) approval.¹⁸³

Still, if consideration in a merger must consist of an ownership interest in the new LLC, then even a majority vote could not turn the key for a freeze-out merger.¹⁸⁴ Yet, most of the jurisdictions that allow majority approval of mergers also allow nonequity consideration.¹⁸⁵ Other acts are

(Michie 1993); WYO. STAT. § 17-15-140(a) (Supp. 1994).

180. DEL. CODE ANN. tit. 6, § 18-209 (1993).

181. N.Y. LTD. LIAB. CO. LAW § 1002(c) (McKinney Supp. 1995) (requiring two-thirds approval).

182. CAL. CORP. CODE § 17551(a) (West Supp. 1995).

183. See ARK. CODE ANN. § 4-32-1202(a) (Michie Supp. 1993); IDAHO CODE § 53-662(1) (1994); IOWA CODE ANN. § 490A.701(2)(c) (West Supp. 1994); LA. REV. STAT. ANN. § 12:1318(B)(3) (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 742 (West Supp. 1994); MINN. STAT. ANN. § 322B.72(1) (West Supp. 1995); N.H. REV. STAT. ANN. § 304-C:19(I) (Supp. 1994); N.J. STAT. ANN. § 42:2B-20(b) (West Supp. 1994); N.M. STAT. ANN. § 53-19-17(B)(1) (Michie Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2020(B)(3) (West Supp. 1995); OR. REV. STAT. § 63.150(3)(b) (Supp. 1994); R.I. GEN. LAWS § 7-16-21(b)(3) (1992); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 2.23(D)(4) (West Supp. 1995); UTAH CODE ANN. § 48-2b-149(1) (1994); 1994 Wash. Legis. Serv. ch. 211, § 1102(1) (West); W. VA. CODE § 31-1A-42 (Supp. 1994); WIS. STAT. ANN. § 183.1202 (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 65(a) (West) (two-thirds supermajority); TENN. CODE ANN. § 48-244-102(a)(2) (Supp. 1994) (same); N.D. CENT. CODE § 10-32-102(1) (Supp. 1993) (same). Rhode Island has an internal inconsistency in its statute on this issue. See R.I. GEN. LAWS §§ 7-16-21(b)(3) (requiring majority vote), 7-16-61(a)(1) (requiring unanimous consent).

184. An exception could exist if the LLC had the option to redeem the new interest. Issuing a new redeemable interest in the merger appears equivalent to, or would seem to require amending the operating agreement to add, an expulsion clause—a subject for later discussion.

185. ALASKA STAT. § 10.50.505 (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-752(D) (Supp. 1994); ARK. CODE ANN. § 4-32-1201(b) (Michie Supp. 1993); CAL. CORP. CODE § 17551(a)(3) (West Supp. 1995); COLO. REV. STAT. ANN. § 7-80-1003(1)(e) (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 66(b)(3) (West); DEL. CODE ANN. tit. 6, § 18-209(b) (1993); GA. CODE ANN. § 14-11-902(b)(3) (1994); IDAHO CODE § 53-661(2) (1994); IND. CODE ANN. § 23-18-7-1(b) (Burns Supp. 1994); IOWA CODE ANN. § 490A.1202(2)(c) (West Supp. 1994); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 69(2) (Baldwin); LA. REV. STAT. ANN. § 12:1358(B)(3) (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 741(2) (West Supp. 1994); MICH. COMP. LAWS ANN. § 450.4701(2)(b) (West Supp. 1994); MINN. STAT. ANN. § 322B.71(1)(3)(i) (West Supp. 1994); N.H. REV. STAT. ANN. § 304-C:18(II) (Supp. 1994); N.J. STAT. ANN. § 42:2B-20(b) (West Supp. 1994); N.Y. LTD. LIAB. CO. LAW § 1002(a) (McKinney Supp. 1995); N.C. GEN. STAT. § 57C-9-02(b)(3) (Supp. 1993); N.D. CENT. CODE § 10-32-101(1)(c) (Supp. 1993); OR. REV. STAT. § 63.481(2)(c) (Supp. 1994); R.I. GEN. LAWS § 7-16-60(b)(3) (1992); S.D. CODIFIED LAWS ANN. § 47-34-39(3) (Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 10.02(5) (West Supp. 1995); VA. CODE ANN. § 13.1-1070(B)(4) (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 1101(2)(c) (West); W. VA. CODE § 31-1A-41(c) (Supp. 1994); WIS. STAT. ANN. § 183.1201(3) (West Supp. 1994).

silent or ambiguous, thereby inviting litigation.¹⁸⁶ At least one important jurisdiction, California, recognizing that the combination of majority vote and nonequity consideration allows for freeze-out mergers, limits the use of such consideration (unless all members consent) when an LLC merges with an entity owned by the majority of ownership in the LLC.¹⁸⁷

As a prescriptive matter, one must question the justification of those jurisdictions whose statutes contain the necessary ingredients for freeze-out mergers. Perhaps the drafters of these acts felt that the better gap-filling or "default" rule is for the majority (unless otherwise agreed) to have the power to expel the minority from the firm. If so, this reflects a questionable judgment.

In deciding upon a default rule, presumably one is attempting to codify the approach that most parties who form an LLC, and who do not cover this contingency in their own agreement, would have agreed to if they thought about it in advance.¹⁸⁸ In determining what most parties in LLCs would have agreed to, it is useful to start by noting a rather curious feature in the approaches of partnership and corporate law to this question. Ask yourself, in which form, partnership or corporation, would there appear to be a greater need for majorities to be able to expel minorities? The answer should be in partnerships, where each partner (barring other agreement) has the right to participate in management¹⁸⁹ and, even worse, each partner can create personal liability for his or her fellow partners.¹⁹⁰ By contrast, the majority rule and passive shareholder norms inherent in corporate law allow the majority essentially to ignore the minority.¹⁹¹ Yet, the default rules are the opposite of the result suggested by this logic. The majority of

186. ALA. CODE § 10-12-54 (1994); KAN. STAT. ANN. § 17-7650 (Supp. 1993); MD. CODE ANN., CORPS. & ASS'NS § 4A-701 to 710 (1993); MO. ANN. STAT. § 347.127 (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-1201 (1993); N.M. STAT. ANN. § 53-19-62(G) (Michie Supp. 1993) (allowing receipt of property); OKLA. STAT. ANN. tit. 18, § 2054 (West Supp. 1995); TENN. CODE ANN. § 48-244-101 (Supp. 1994); UTAH CODE ANN. § 48-2b-149 (1994).

187. CAL. CORP. CODE § 17551(b) (West Supp. 1995). California has exceptions, however, if the minority has less than a ten percent ownership or if the state's Corporations Commissioner approves the fairness of the transaction. *Id.* § 407. These provisions track California's corporations statute. *Id.* §§ 1101, 1101-1.

188. See, e.g., CHARLES R. O'KELLEY, JR. & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS, CASES AND MATERIALS 48 (1992). But see Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989) (arguing that legislatures should sometimes set "penalty defaults" that would induce parties to bargain, rather than relying on the legislature).

189. UPA § 18(e) (1914).

190. *Id.* §§ 9(1), 13, 15.

191. This was seen earlier in the discussion of squeeze-outs. See *supra* text accompanying notes 46-47.

partners lack the power to expel others and take the firm without express agreement; by contrast, courts have interpreted corporations statutes to allow such expulsion by majority shareholders.

Perhaps this simply reflects a poor choice of default rules in the UPA. If so, one would expect to find that most partnership agreements contract around the rule by including an expulsion clause. This is an interesting empirical question which the drafters of LLC statutes could investigate. Anecdotal evidence, however, suggests that expulsion clauses, while common (especially in professional firms), are not clearly predominant.¹⁹² This, in turn, may suggest that most owners in the sort of closely held businesses likely to become LLCs will not expect the majority to have the right to expel a minority.

At any event, even if majority expulsion is the better default rule, it should be explicit in the statute rather than hidden in merger provisions. There are a couple of reasons for this. The most obvious is to provide a warning to parties, who, if they knew about the rule, would wish to contract around it. In this regard, one might divide parties who will form LLCs into three groups. There are unsophisticated parties who will form the company without legal advice or much thought about contingencies like freeze-outs. Obviously, for this group, clarity in the statute about the default rule will not make any difference. On the other hand, given that formation of an LLC requires compliance with statutory formalities¹⁹³—in contrast

192. See, e.g., Alan R. Bromberg, *Partnership Dissolution—Causes, Consequences, and Cures*, 43 TEX. L. REV. 631, 653 (1965) (stating expulsion clauses are “quite rare” in the author’s experience).

193. ALA. CODE § 10-12-12 (1994); ALASKA STAT. § 10.50.070 (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-634 (Supp. 1994); ARK. CODE ANN. § 4-32-201 (Michie Supp. 1993); CAL. CORP. CODE § 17050 (West Supp. 1995); COLO. REV. STAT. ANN. § 7-80-205 (West Supp. 1994); 1993 Conn. Legis. Serv. P.A. 93-267, § 14 (West); DEL. CODE ANN. tit. 6, § 18-201 (1993 & Supp. 1994); FLA. STAT. ANN. § 608.4081 (West Supp. 1994); GA. CODE ANN. § 14-11-206 (1994); IDAHO CODE § 53-611 (1994); ILL. ANN. STAT. ch. 805, para. 180/5-1 (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-2-4 (Burns Supp. 1994); IOWA CODE ANN. § 490A.120 (West Supp. 1994); KAN. STAT. ANN. § 17-7605 (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 4 (Baldwin); LA. REV. STAT. ANN. § 12:1304 (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 621 (West Supp. 1994); MD. CODE ANN., CORPS. & ASS’NS § 4A-202 (1993); MICH. COMP. LAWS ANN. § 450.4104 (West Supp. 1994); MINN. STAT. ANN. § 322B.105 (West Supp. 1994); MO. ANN. STAT. § 347.037 (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-201 (1993); NEB. REV. STAT. § 21-2605 (Supp. 1994); NEV. REV. STAT. § 86.151 (Supp. 1993); N.H. REV. STAT. ANN. § 304-C:2 (Supp. 1994); N.J. STAT. ANN. § 42:2B-11 (West Supp. 1994); N.M. STAT. ANN. § 53-19-9 (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 203 (McKinney Supp. 1995); N.C. GEN. STAT. § 57C-1-20 (Supp. 1993); N.D. CENT. CODE § 10-32-08 (Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2004 (West Supp. 1995); OR. REV. STAT. § 63.004 (Supp. 1994); R.I. GEN. LAWS § 7-16-5 (1992); S.D. CODIFIED LAWS ANN. § 47-34-4 (Supp. 1994); TENN. CODE ANN. § 48-203-102 (Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 3.01 (West Supp. 1995); UTAH CODE ANN. § 48-2b-103 (1994); VA. CODE ANN. § 13.1-1003 (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 201 (West); W. VA. CODE § 31-1A-7 (Supp. 1994); WIS. STAT. ANN. § 183.0108 (West Supp. 1994);

to an ordinary partnership¹⁹⁴—this group is not likely to be that large. At the other extreme, participants may have the assistance of highly sophisticated legal counsel. Such counsel should be aware of the potential use of merger provisions to force minority owners out and could explore alternatives in the operating agreement. The problem lies, however, with the middle group; parties who seek assistance of counsel, but whose counsel does not realize the hidden significance of merger provisions in the LLC statute. Is this likely to be a large group? Given the fact that a review of many of the articles to date discussing the LLC statutes,¹⁹⁵ as well as the available treatise on the acts,¹⁹⁶ found no mention of the possibility of freeze-out mergers, the answer must be yes.¹⁹⁷

A second problem with a hidden statutory expulsion rule is that it fails to consider a variety of questions which an explicit rule normally would cover. For example, what, if any, grounds must the majority have to expel the minority? A well-drafted contract would address this.¹⁹⁸ The default expulsion provisions in the RUPA do as well.¹⁹⁹ Small wonder that one of the basic divisions of authority involving freeze-out mergers in corporate law is whether there must be a corporate purpose for the transaction.²⁰⁰

A more likely rationale for the merger provisions in the LLC statutes is simply to facilitate the combination and sale of businesses; one suspects the drafters probably never focused on mergers whose sole function is to freeze-out a minority. Actually, one could question whether LLC merger provisions are necessary or even appropriate for the goal of facilitating business combinations and sales. Partners have bought, sold and combined businesses for decades under the UPA without any statutory merger

WYO. STAT. § 17-15-106 (Supp. 1994).

194. See UPA § 6(1) (1914).

195. E.g., Scott R. Anderson, *The Illinois Limited Liability Company: A Flexible Alternative for Business*, 25 LOY. U. CHI. L.J. 55 (1993); Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 387 (1991); Peter D. Hutcheon, *The New Jersey Limited Liability Company Statute: Background and Concepts*, 18 SETON HALL LEGIS. J. 111 (1993); James W. Lovely, *Agency Costs, Liquidity, and the Limited Liability Company as an Alternative to the Close Corporation*, 21 STETSON L. REV. 377 (1992); *Symposium on Oregon's Limited Liability Company Act*, 73 OR. L. REV. 1 (1994); Ann Maxey, *West Virginia's Limited Liability Company Act: Problems with the Act*, 96 W. VA. L. REV. 905 (1994); see also articles cited in *supra* note 5.

196. LARRY E. RIBSTEIN & ROBERT R. KEATINGE, *RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES* (1992).

197. At the risk of resurrecting law faculty debates over curriculum, one wonders, given the reduced hours devoted to the basic business associations courses in most law schools, just how many students graduate law school without ever having heard of a freeze-out merger, even in the corporate context.

198. See GEVURTZ, *supra* note 3, at 192.

199. RUPA § 601(4) (1993).

200. See *supra* text accompanying notes 157-61.

provisions.²⁰¹ Partners can structure the transaction as a sale of assets or a sale of partnership interests, an assumption of liabilities, and an admission of new partners.²⁰² While the existence of statutory merger provisions might allow some aspects of such a transaction to be handled in a more convenient way,²⁰³ corporate planners, who have the merger option, have nevertheless frequently structured business acquisitions or combinations as asset or stock purchases rather than as statutory mergers.²⁰⁴ Indeed, this fact has led to repeated litigation over whether courts should deem asset or stock deals to be de facto mergers.²⁰⁵

Moreover, for LLC statutes to allow mergers based upon majority vote departs from long-established partnership norms. Barring contrary agreement, admission of new members to a partnership or a limited partnership, or a transaction outside the ordinary course of a partnership's or limited partnership's business, requires a unanimous vote.²⁰⁶ This, at least, raises the question of which norm matches the expectations of most parties entering the sort of closely held businesses likely to become an LLC. Worse, LLC statutes usually follow the partnership norm with respect to admission of new members; explicitly requiring unanimous consent in the absence of other agreement.²⁰⁷ For the same statute to allow LLC

201. The RUPA introduced such provisions. RUPA §§ 905, 906, 907 (1993).

202. See GEVURTZ, *supra* note 3, at 42-43 (Supp. 1994).

203. For example, it avoids the need for extensive paperwork to transfer title for each piece of property. *Id.* at 893.

204. *Id.* at 872-89.

205. See, e.g., *Hariton v. Arco Elec., Inc.*, 188 A.2d 123 (Del. 1963); *Applestein v. United Bd. & Carton Corp.*, 159 A.2d 146 (N.J. Ch.), *aff'd*, 161 A.2d 474 (N.J. 1960).

206. UPA § 18(g), (h) (1914); RULPA §§ 301 (b)(1), 401, 403(a), 1105 (1985).

207. ALA. CODE § 10-12-31(a)(1) (1994); ALASKA STAT. § 10.50.155(1)(B) (Supp. 1994); ARIZ. REV. STAT. ANN. § 29-731(B) (Supp. 1994); ARK. CODE ANN. § 4-32-801(a)(1) (Michie Supp. 1993); CAL. CORP. CODE § 17100(a)(1) (West Supp. 1995); COLO. REV. STAT. ANN. § 7-80-701 (West Supp. 1994); DEL. CODE ANN. tit. 6, § 18-301(b)(1) (Supp. 1994); FLA. STAT. ANN. § 608.4232 (West Supp. 1994); GA. CODE ANN. § 14-11-505(b) (1994); IDAHO CODE § 53-640(a) (1994); ILL. ANN. STAT. ch. 805, para. 180/10-1 (Smith-Hurd Supp. 1994); IND. CODE ANN. § 23-18-6-1(1) (Burns Supp. 1994); IOWA CODE ANN. § 490A.903(1) (West Supp. 1994); KAN. STAT. ANN. § 17-7618 (Supp. 1993); 1994 Ky. Rev. Stat. & R. Serv. ch. 275, § 53(1) (Baldwin); LA. REV. STAT. ANN. § 12:1332(A)(1) (West Supp. 1994); ME. REV. STAT. ANN. tit. 31, § 691(1)(A) (West Supp. 1994); MD. CODE ANN., CORPS & ASS'NS § 4A-601(b)(1) (1993); MICH. COMP. LAWS ANN. § 450.4506(1) (West Supp. 1994); MO. ANN. STAT. § 347.079(3)(2) (Vernon Supp. 1994); MONT. CODE ANN. § 35-8-801(1)(a) (1994); N.H. REV. STAT. ANN. § 304-C:23(II)(a) (Supp. 1994); N.J. STAT. ANN. § 42:2B-21(b)(1) (West Supp. 1994); N.M. STAT. ANN. § 53-19-36(A)(1) (Michie Supp. 1993); N.C. GEN. STAT. § 57C-3-01(b)(1) (Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2035(A)(2) (West Supp. 1995); OR. REV. STAT. § 63.245(2)(a) (Supp. 1994); R.I. GEN. LAWS § 7-16-36(a) (1992); TENN. CODE ANN. § 48-232-102 (Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 4.01(B)(1) (West Supp. 1995); UTAH CODE ANN. § 48-2b-122 (1994); VA. CODE ANN. § 13.1-1038.1(1) (Michie 1993); 1994 Wash. Legis. Serv. ch. 211, § 301(2)(a) (West); W. VA. CODE § 31-1A-34(c)(1) (Supp. 1994); WIS. STAT. ANN. § 183.0404(2)(b)

mergers—which can certainly serve to introduce new members—based upon majority vote is rather anomalous.

These comments, however, are getting beyond the focus of the present Article and can provide the subject for another. If the purpose of the merger provisions is simply to facilitate business combinations and sales, then legislatures, by drafting appropriate statutory language, should be able to prevent use of merger provisions to force owners out of an LLC otherwise unchanged by the transaction. California's LLC statute, as discussed above,²⁰⁸ takes a step in this direction by prohibiting nonequity consideration in mergers with entities owned by the LLC's majority. California, however, allows exclusion of minorities smaller than ten percent, or of any minority if the state's Corporations Commissioner finds the transaction fair.²⁰⁹ Why ownership interests of less than ten percent should exist at the suffrage of the majority is unclear. Moreover, what standards will the Commissioner apply to determine if a freeze-out is "fair": A fair price? A business purpose? This brings one back to the same questions raised in fiduciary duty litigation over freeze-out mergers.²¹⁰

3. *Reverse Stock Split Freeze-Outs*

LLC statutes lack anything that would allow for the equivalent of a reverse stock split and cash out of fractional shares sometimes used in corporations as a freeze-out device. Specifically, nothing in the acts allows a forced cash out of fractional interests—a concept that does not make any sense in an LLC, since it does not normally issue stock.

4. *Expulsion Clauses*

A number of LLC statutes sanction provisions in the operating agreement (or, under some acts, the articles) that allow members to expel fellow members from the firm.²¹¹ To the extent this creates the prospect for

(West Supp. 1994); WYO. STAT. § 17-15-122 (1989). *But see* 1993 Conn. Legis. Serv. P.A. 93-267, § 40(a) (West) (majority); N.Y. LTD. LIAB. CO. LAW § 602(b)(1) (McKinney Supp. 1995) (majority).

208. *See supra* note 187 and accompanying text.

209. CAL. CORP. CODE § 17551(b) (West Supp. 1995).

210. *See supra* notes 157-62 and accompanying text.

211. ALASKA STAT. § 10.50.205(c) (1994); ARK. CODE ANN. § 4-32-802 (Michie Supp. 1993); CAL. CORP. CODE § 17100(c) (West Supp. 1995) (holding such provisions enforceable unless found to be "unreasonable"); MD. CODE ANN., CORPS. & ASS'NS § 4A-606(2) (1993); MINN. STAT. ANN. § 322B.306(2) (West Supp. 1995); MO. ANN. STAT. § 347.123(3) (Vernon Supp. 1994); N.H. REV. STAT. ANN. § 304-C:27(I)(c) (Supp. 1994); N.C. GEN. STAT. § 57C-3-02(3) (Supp. 1993); N.D. CENT. CODE § 10-32-07(f) (Supp. 1993); OKLA. STAT. ANN. tit. 18, § 2036(A)(3)(a) (West Supp. 1995); OR. REV. STAT. § 63.209(1)(a) (Supp. 1994); TENN. CODE ANN. § 48-216-101(b) (Supp. 1994) (if provided for in articles of organization); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 5.05 (West Supp. 1995);

freeze-outs when the parties have agreed to this possibility, such provisions seem unexceptional. A problem exists, however, when one views such powers in conjunction with the ability, under many acts, of a majority in an LLC to amend the operating agreement.²¹² Could the majority amend the operating agreement to allow for expulsion and then kick out the minority? This seems to be the literal result, which again illustrates that statutes should require a unanimous vote (barring other agreement) to amend the operating agreement.

IV. CONCLUSION

Given the speed with which LLC statutes have spread across the country, especially without the guidance of a uniform act, one can expect a period of flux as states modify their provisions. In making those modifications, states would do well to structure their LLC acts in such a way as to minimize problems from squeeze-outs and freeze-outs. This Article leads to several specific suggestions:

(1) LLC acts should generally prohibit salaries to LLC members barring other agreement.

(2) LLC acts should not allow (unless otherwise agreed) for amendment of the operating agreement (or the articles to the extent they contain provisions that go beyond mere formalities) by less than unanimous vote.

(3) LLC statutes should follow a limited partnership model giving members a cash-out right in the absence of other agreement.

(4) LLC acts should either not allow (barring other agreement) a majority of the membership to sell substantially all the firm's assets over the objection of the minority or, at least, not allow such a sale to the majority.

(5) LLC statutes should either not contain provisions that allow (barring other agreement) mergers based upon less than unanimous vote and with nonequity consideration, or, at least, not allow such mergers with an entity owned by the majority interest.

(6) If drafters decide to create a default rule giving the majority in an LLC the power to expel the minority, this should be made explicit in the statute.

UTAH CODE ANN. § 48-2b-126(4) (1994); 1994 Wash. Legis. Serv. ch. 211, § 304(1)(c) (West); WIS. STAT. ANN. § 183.0802(1)(c) (West Supp. 1994).

212. See *supra* text accompanying note 86.

