

BUSINESS LAW TODAY

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When Deciding Whether to Judicially Dissolve an LLC, the Court May Find the “Purpose” of the LLC to Be Different Than What Is Stated in the LLC Agreement

By [Jason C. Jowers](#)

Pursuant to 6 Del. C. § 18-802, if a member or manager of a Delaware LLC petitions for a decree of dissolution, the Delaware Court of Chancery may dissolve the LLC “when-ever it is not reasonably practicable to carry on the business *in conformity with a limited liability company agreement*.” (Emphasis added). Judicial dissolution of an LLC is a discretionary remedy that the court grants sparingly. It is well settled in Delaware that the court may judicially dissolve an LLC in the event of a deadlock among the members. *See, e.g., In re Silver Leaf, L.L.C.*, 2005 WL 2045641, at *11 (Del. Ch. Aug. 18, 2005) (ordering dissolution where “[t]he vote of the members is deadlocked”); *Haley v. Talcott*, 864 A.2d 86, 89 (Del. Ch. 2004) (ordering dissolution where there was “indisputable deadlock between the two 50% members of the LLC”). Although it occurs less often than dissolutions based on deadlock, the court may also dissolve an LLC “where the defined purpose of the entity was fulfilled or impossible to carry out.” *In re Seneca Invs. LLC*, 970 A.2d 259, 263 (Del. Ch. 2008). This second basis for judicial dissolution begs the question: how is the “purpose” of the entity defined?

In the recent case of *Meyer Natural Foods LLC v. Duff*, 2015 WL 3746283 (Del. Ch. June 4, 2015), the court of chancery found that its analysis of an LLC’s purpose should not, necessarily, be limited

to what the LLC agreement identified as the purpose. Although the court acknowledged that a purpose clause is of “primary importance,” it went on to determine that the purpose clause is not the *only* evidence the court may consider, even where the purpose clause is unambiguous and the LLC agreement contains an integration clause. In particular, the court considered other agreements executed by the members of the LLC around the same time as the LLC agreement in determining the purpose of the LLC.

Given prior court of chancery opinions in which the court limited its analysis of an LLC’s purpose to that defined in an unambiguous purpose clause, the decision in *Meyer* marks a change in Delaware LLC law important for both drafters of LLC agreements and litigators bringing or defending against petitions for dissolution of LLCs. Despite the stated policy of the Delaware Limited Liability Company Act to give the maximum effect to freedom of contract, *Meyer* suggests that the court of chancery may consider material outside the four corners of an LLC agreement to determine the purpose of the LLC. This article examines: (1) the pre-*Meyer* case law examining the purpose of an LLC, (2) the facts and holdings of *Meyer*, and (3) the lessons taught and questions raised after *Meyer*.

Pre-*Meyer*, the Court of Chancery Limited its Analysis of an LLC’s Purpose to the Purpose Clause

Prior to the *Meyer* decision, opinions by the court of chancery looked to the text of the purpose clause in the LLC’s governing documents to determine an entity’s purpose when considering whether that purpose had been satisfied or was impossible to carry out. Given that the test of judicial dissolution under Section 18-802 is whether it is “reasonably practicable to carry on the business *in conformity with a limited liability company agreement*,” it is not surprising that the court would focus on the language of the LLC agreement. (Emphasis added).

For example, in *In re Arrow Investment Advisors, LLC*, 2009 WL 1101682 (Del. Ch. Apr. 23, 2009), a member and cofounder of Arrow sought dissolution based on the alleged failure of management to carry out Arrow’s original business plan. According to its purpose clause, Arrow was formed “for the purpose of acting as an investment adviser to certain investment funds *and for such other lawful business as the Management Committee chooses to pursue*.” (Emphasis in court’s opinion). According to the petitioner, the original business plan anticipated Arrow being profitable by the time it had a certain amount of assets under management, but it still lost money. The petitioner also alleged that management was

expanding the services offered by the company beyond that envisioned by the original business plan. Chief Justice Strine, then writing as a vice chancellor, focused on the text of the LLC agreement, stating that the petitioner “asks the court to ignore the entire clause of the Arrow LLC Agreement that authorizes Arrow to engage in ‘such other lawful business as the Management Committee chooses to pursue.’” Rejecting the petitioner’s argument that the purpose of the entity for dissolution purposes should be limited to the original business plan, the court stated:

[A]n important reason for parties to include a broad purpose clause in an entity’s governing instrument is to ensure that the entity has flexibility to adapt in the face of changing circumstances. Having agreed to such a clause in the Arrow LLC Agreement, and therefore having contemplated that Arrow may one day be something other than an investment advisor, [the petitioner] cannot now seek to prematurely end Arrow’s existence because he is unhappy with how Arrow’s management chose to exercise its discretion.

The court went on to explain that the court “must look to the operating agreement of the LLC to determine the purpose for which it was formed, and not to an initial business plan that any rational businessperson would expect to evolve over time.”

Similarly, in *In re Seneca Investments LLC*, 970 A.2d 259 (Del. Ch. 2008), the petitioner sought dissolution because the company was “functioning only as a passive investment vehicle and has conducted limited active business over the past several years.” Somewhat unusually, at the time of formation, the founders of Seneca agreed that the entity would be governed by the Delaware General Corporation Law despite the fact that it was an LLC. Therefore, Seneca had both an LLC agreement and a charter. Seneca’s charter stated that “the purpose of the Company is to engage in any lawful act or activity for which corporations may be organized under the Delaware General Corporation Law.” Given that

a Delaware corporation may exist as a passive investment entity, the court concluded that the LLC’s purpose under the purpose clause had not been frustrated. Moreover, limiting itself strictly to the purpose clause when deciding the question of purpose, the court stated that it would “not attempt to divine some other business purpose by interpreting provisions of the governing documents other than the purpose clause.”

The Meyer Court Considered Information Outside the LLC Agreement to Determine the LLC’s Purpose

In *Meyer*, the court of chancery was again asked to dissolve an entity because its purpose could not be met. Meyer Natural Foods LLC, owned 51 percent of Premium Natural Beef LLC (PNB) and served as PNB’s managing member. Kirk Duff, Todd Duff (together the Duffs) and C.R. Freeman owned the balance of PNB. Meyer sought dissolution, claiming that PNB’s purpose could not be fulfilled.

“[T]he LLC Agreement stated that ‘[t]he purpose and business of the Company shall be limited to engaging in the PNB Business and related activities,’ which in turn ‘mean[t] the business of marketing, distributing and selling natural Angus beef and beef products under the ‘Premium Natural Beef’ brand name to the Existing PNB Customers . . . and to new customers of the Company from time to time.’” The court found this language to be unambiguous. Contemporaneously with entering into PNB’s LLC agreement, Meyer also entered into an output and supply agreement with two entities controlled by the minority owners. “[U]nder the Output and Supply Agreement, Power Plus Feeders, LLC (‘PPF’), owned by the Duffs, and Premium Beef Feeders, LLC (‘PBF’), owned by Freeman, were to supply qualifying cattle to Meyer and its subsidiaries to sell.” Pursuant to the output and supply agreement, Meyer had the exclusive right to purchase such cattle. Furthermore, under the purchase agreement by which Meyer acquired its membership interest in PNB, the Duffs and Freeman could not own or operate a business that competed with PNB. How-

ever, the non-compete covenant in the purchase agreement terminated upon termination of the output and supply agreement.

In July 2012, the Duffs and Freeman and their entities purported to terminate the output and supply agreement, and in August 2012 they sued Meyer in Oklahoma state court for breach of contract and breach of fiduciary duties. The Oklahoma court terminated the exclusive purchase and supply obligations under the output and supply agreement as of March 31, 2013. On May 28, 2014, Meyer sought judicial dissolution in Delaware, arguing that PNB’s continuation was not reasonably practicable because its purpose had been frustrated.

When Meyer moved for summary judgment on its claim for dissolution, the minority owners argued that the motion should be denied because, among other reasons, the purpose of PNB, under PNB’s broad purpose clause, was to “market, distribute, and sell natural beef.” Acknowledging the *Arrow* and *Seneca* decisions, but finding that language in *Cincinnati Bell Cellular Systems Company v. Ameritech Mobile Phone Service of Cincinnati, Inc.*, 1996 WL 506906 (Del. Ch. Sept. 3, 1996), *aff’d*, 692 A.2d 411 (Del. 1997) gave the court discretion to look beyond an unambiguous purpose clause, the court stated:

There is authority that limits analysis of an LLC’s purpose to the purpose clause in an organizational document, but other authority suggests that additional evidence might inform the analysis. In *Cincinnati Bell Cellular Systems Co. v. Ameritech Mobile Phone Service of Cincinnati, Inc.*, for example, the Court rejected an argument that the purpose of the limited partnership was to provide services that did not compete with its limited partners’ businesses, noting that the plaintiff “executed the Partnership Agreement that does not contain a non-compete clause; nor did it ever seek an amendment to the Partnership Agreement.”

It would appear that the court believed *Cincinnati Bell* implied the ability of the court to look beyond the purpose clause. Attempting to harmonize its interpretation

of *Cincinnati Bell* with *Arrow* and *Seneca*, the vice chancellor in *Meyer* stated: “A sensible interpretation of precedent is that the purpose clause is of primary importance, *but other evidence of purpose may be helpful as long as the Court is not asked to engage in speculation.*” (Emphasis added.)

Meyer argued that the purpose of the LLC was narrower than the purpose stated in the LLC agreement given the mutual obligations and restrictive covenants under the various agreements. Specifically, Meyer advocated the court read “the parties’ agreements together to conclude that PNB’s purpose was not only to sell natural beef but also to partner exclusively with Respondents in a ‘joint venture business’” Agreeing with Meyer, the court found that “[l]imiting the analysis to the purpose clause of the LLC Agreement would resolve the dispute on a technicality.” Accordingly, the court found that the purpose of PNB was to market and sell beef that had been supplied by PPF and PBF. Given that PPF and PBF refused to supply PNB with cattle, the court found that it was no longer reasonably practical for the business to continue. Significantly, the court ordered the dissolution of PNB even though no deadlock existed (meaning Meyer still controlled the entity’s day-to-day operations) and PNB was profitable.

Conclusion

Meyer teaches several important lessons, but also leads to a question with which future decisions will grapple. First, litigators handling dissolution cases should no longer assume that the purpose of the LLC is necessarily what the LLC agreement identifies it to be. Particularly where there are contemporaneously executed documents

suggesting a purpose more narrow than the purpose in the LLC agreement, there may be grounds for judicial dissolution even if no deadlock exists and the business satisfies an unambiguous purpose clause. Second, to the extent a party wishes to limit the purpose to that stated in the purpose clause, drafters should be cautious in referencing other agreements in the LLC agreement or vice versa. In *Meyer*, the court repeatedly noted that the output and supply agreement provided that it was made “in connection with, and as a condition to” the LLC agreement. Third, under *Meyer*, the purpose clause remains of “primary importance” to the court’s decision as to purpose. Therefore, drafters should continue to carefully craft purpose clauses and consider whether the broader clauses similar to those chosen by the drafters in *Arrow* and *Seneca* should be used to make it easier for the company’s purpose to change from that envisioned at the time of formation. Finally, both drafters and litigators should continue to monitor developments in the case law to see how broadly (or narrowly) *Meyer* is interpreted. Although the court broadly stated that “other evidence of purpose may be helpful as long as the Court is not asked to engage in speculation,” the court limited its reliance to other contemporaneous agreements to narrow the meaning of the entity’s purpose. It is yet unclear whether the court of chancery will permit “other evidence” to include material beyond contract documents that formed the parties’ overall deal.

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ADDITIONAL RESOURCES

For other materials related to this topic, please refer to the following.

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By Peter B. Ladig and
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Presented by: LLCs, Partnerships and Unincorporated Entities

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What Is An Operating Agreement and Why Do We Care? (PDF) (Audio)

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