

Chapman v. Regional Radiology Associates, PLLC: A Case Study in the Consequences of Resignation

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The decision of the Kentucky Court of Appeals in *Chapman v. Regional Radiology Associates, PLLC*¹ is a helpful, but still not complete, review of the implications of resigning from an LLC absent a binding agreement as to the consequences that will follow therefrom.

The Facts of the Case

Cyrus Chapman, a physician, was an employee of Regional Radiology Associates, PLLC, a Kentucky limited liability company (“RRA”). At that time, Rosemary Shibben was the sole member and manager of RRA. After a year’s employment there were discussions as to Chapman becoming a member of the LLC, but those discussions were never memorialized in a written operating agreement. While Chapman tendered \$10,000 as his initial capital contribution, those funds were returned on the basis that the terms of the buy-in were still under discussion. Still, beginning on January 1, 2003, Chapman was treated as a member. His prior salary was reduced and recharacterized as a guaranteed payment and the tax reports stated him to be a 40% member. For the full years that Chapman was a member, he received his guaranteed payment as well as a distribution of 40% of company earnings.

In January 2006, Chapman gave notice that he was leaving the practice, working only intermittently from that date through April 14, 2006 and thereafter entirely leaving RRA. Through April 14, Chapman continued to receive his guaranteed payment. He requested, coincident with his departure, an additional distribution from RRA based upon his status as a former member. No agreement was reached on that point. Eventually RRA filed a declaratory judgment action, in which Chapman counterclaimed seeking a determination as to the amount of net income and accounts receivable due to Chapman. For the period ended April 14, 2006, RRA allocated \$51,826 to Chapman.

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¹ 2011 Ky. App. Unpub. LEXIS 251 (Mar. 25, 2011). Chapman has applied to the Kentucky Supreme Court for discretionary review of this decision. As of this time, the Court has not ruled on that application.

Notwithstanding the absence of a written operating agreement identifying Chapman as a member of RRA during the period from January 1, 2003 through April 14, 2006, no party contested that characterization. Also, on a basis not explained by the Court of Appeals, RRA conceded that \$51,826, which was the amount of 2006 RRA income allocated to him, was owed to Chapman. Open to question were the proper offsets against that amount. For 2006, Chapman had as well been allocated RRA tax deductions in the amount of \$14,255, an amount calculated to offset the taxable income. Further, \$6,862 of state taxes were paid by RRA on Chapman's behalf. The trial court determined that \$20,709 was owed to Chapman as follows:

\$51,826	2006 Allocated Income
(\$10,000)	Capital Contribution Never Made
(\$ 6,862)	State Taxes Paid by RRA on Chapman's behalf
(\$14,255)	2006 Allocated Tax Deductions
\$20,709 ²	

RRA accepted this calculation. In contrast, Chapman asserted that he was entitled to 40% of RRA accounts receivable as of April 14, 2006, or in the alternative, a remand to the trial court to determine the fair value of RRA as of April 14, 2006 with Chapman to receive 40% thereof less \$10,000.³

The Court of Appeals affirmed the trial court, finding no basis for Chapman's claim to 40% of either RRA's accounts receivable or total value.

The Court of Appeals' Analysis

The question presented on appeal, as phrased by the Court of Appeals, is whether a member of a professional LLC, upon resignation, is entitled to an additional distribution when no written or oral agreement provides therefor.⁴ In other words, Chapman asserted that "his percentage of ownership was 40%, and, therefore, he is entitled to 40% of the value of the company on the date of withdrawal."⁵ Affirming the trial court, the Court of Appeals rejected Chapman's claims.

The Court's analysis began with consideration of whether Chapman was a member of RRA. Curiously, the Court framed this question "notwithstanding the lack of a written operating agreement or any written documentation" of his admission as a member.⁶ This statement was made notwithstanding earlier statements that Chapman was, as of January 1, 2003, treated as a member with a K-1 reflecting a 40% interest and

² *Id.* at *7.

³ *Id.* at *8.

⁴ *Id.*

⁵ *Id.* at *9.

⁶ *Id.* at *11.

being listed on the annual report as a member.⁷ Certainly tax and state law filings made under penalty of perjury must constitute “records” of the LLC sufficient to satisfy the statute.⁸

The Court then engaged in a somewhat undirected review of the statutory defaults for how allocations and distributions are made. While citing to the applicable statutes,⁹ it never made the connection between an established course of conduct memorialized in the Forms K-1 and an operating agreement between Chapman and Shiben as to how allocations and distributions would be shared between them.¹⁰ Ultimately, the Court reached the core question, namely, whether upon dissociation by resignation Chapman was entitled to additional compensation.¹¹ Here the Court’s confusion is most evident. First, the characterization of a liquidating distribution as “compensation” is misleading. More pernicious is the Court’s suggestion that as the LLC’s manager, Shiben could determine to make distributions to some but not all members. Rather, while a manager may determine that a distribution will be made and in what amount, the sharing ratios of the members in that distribution are determined by the member’s agreement or as the LLC Act dictates.¹²

Fortunately, the Court returned to the primary issue, namely, whether upon resignation a member is entitled to a liquidating distribution. The Court also examined the corollary question of whether the distribution proffered by RRA and approved by the trial court was appropriate. The Court correctly found that Chapman was not, by reason of his resignation, entitled to a liquidating distribution and that the trial court’s determination of the distribution to be made was correct.

A Few Additional Thoughts

Before going to the primary deficiency of the Chapman decision, which is the Court’s failure to consider the history of a right to a liquidating distribution upon resignation, a few additional thoughts are in order.

The Red Herring of a “Professional” LLC

It is unfortunate that the Court of Appeals referenced the “professional” character of RRA, thereby implying a differential in analysis between professional and non-professional LLCs. In fact, under Kentucky law, there are only three distinguishing

⁷ *Id.* at *3-*4. One may receive a K-1 from an LLC without being a member, but being rather an assignee, and for that reason receipt of a K-1 is not conclusive that one is a member. There was apparently no assertion of mere assignee status in this case.

⁸ *See* KY. REV. STAT. ANN. § 275.275(2)(b).

⁹ KY. REV. STAT. ANN. § 275.210 (distributions); *id.* § 275.205 (allocations).

¹⁰ *See also* KY. REV. STAT. ANN. § 275.015(20) (definition of “operating agreement”).

¹¹ 2011 Ky. App. Unpub. LEXIS 251 at *12.

¹² *See* KY. REV. STAT. ANN. § 275.205; *id.* § 275.210.

factors between professional and non-professional LLCs.¹³ As none of these factors implicate the rights of a resigning member, the Court’s focus on RRA’s “professional” nature did not aid the discussion.

A Flawed Appreciation of the LLC

An LLC is described as being “in essence ... a hybrid business entity that offers its members limited liability, as if they were the shareholders of a corporation, but treats the entity and its members as a partnership for tax purposes.”¹⁴ While such a characterization may in the early days of the LLC have been substantially correct,¹⁵ today this formula is so limiting as to be misleading. In a realm in which limited liability is available in not only the LLC but also in the general and limited partnerships,¹⁶ citing the corporation as the archetype for limited liability is misleading, especially as that characteristic is not intrinsic to the corporate form.¹⁷ As to tax classification, many LLCs are not taxed as partnerships, but rather as either associations taxable as corporations or as disregarded entities.¹⁸ In today’s environment, the LLC, like each other form of business organization, must be understood as a unique construct of formulas and characteristics that may or may not be shared with other organizational forms.¹⁹

The Ownership of Company Assets

Chapman sought, in effect, a declaration that as a 40% member, he had a title interest in 40% of the LLC’s assets. That assertion, however, is directly contrary to the controlling statute. The property of an LLC, whether real or personal, is that of the entity, and is not the property of the individual members.²⁰ Therefore, holding an interest

¹³ A professional LLC is subject to particular name requirements (*see* KY. REV. STAT. ANN. § 14A.3-010(3)), the requirement that the articles of organization list the profession(s) practiced through the LLC (*see id.* § 275.025(3)) and the extension from two years to five years of the period in which, after publication of notice of dissolution, a claim may be filed against the LLC. *See id.* § 275.325(3).

¹⁴ 2011 Ky. App. Unpub. LEXIS 251 at *9-*10.

¹⁵ Compare Thomas E. Rutledge and Lady E. Booth, *The Limited Liability Company Act: Understanding Kentucky’s New Organization Option*, 83 KY. L.J. 1, 6-8 (1994-95).

¹⁶ *See* KY. REV. STAT. ANN. § 362.1-306(3) (KyRUPA LLP); *id.* § 362.2-303 (limited partners in a KyULPA limited partnership) and *id.* § 362.2-404(3) (general partners in a KyULPA LLLP).

¹⁷ *See* BAYLESS MANNING, A CONCISE TEXTBOOK ON LEGAL CAPITAL 5-6 (2d ed. 1990) (“[T]he feature of limited liability ... played little or no part in the development of modern corporation law.”). Blackstone did not identify limited liability as a characteristic of a corporation. *See* 1 WILLIAM BLACKSTONE, COMMENTARIES 455 (1765); *see also* WILLIAM L. CLARK, JR., HANDBOOK OF THE LAW OF PRIVATE CORPORATIONS 16 (Francis B. Tiffany ed., 2d ed., 1907) (limited liability is “not an essential attribute” of the private corporation); and Wesley Newcomb Hohfeld, *Nature of Stockholders’ Individual Liability for Corporation Debts*, 9 COLUM. L. REV. 285 (1909).

¹⁸ *See* TREAS. REG. § 301.7701-3.

¹⁹ *See, e.g.,* Thomas E. Rutledge, *Vampires and the Law of Business Organizations: The Fruitless Search for Authenticity*, 14 J. PASSTHROUGH ENTITIES (Nov./Dec. 2011) (*forthcoming*).

²⁰ KY. REV. STAT. ANN. §§ 275.240(1), (2). *See also* *Baker v. Erpenbeck (In re Erpenbeck)*, 2004 Bankr. LEXIS 739 (Bankr. E.D. Ky. 2004) (property of LLC is not property of the members; members

only in the limited liability company interests,²¹ and not in the underlying property of the LLC, a member, absent a contrary provision in the operating agreement giving such a right, is unable to bring an action for partition of the LLC's property.²²

The \$10,000 Capital Contribution

In determining the amount due to Chapman from RRA, it received a credit of \$10,000 for the unpaid capital contribution of that same amount. The Court never explained how this amount was determined. While Chapman did at one point tender that amount,²³ it was not recited that there was agreement as to that amount. If it was based upon RRA somehow subsequently accepting that as the correct amount, that explanation would have been helpful.²⁴

The Straight-Line Offset of Tax Deductions Against Cash Distributions

The trial court determined, and the Court of Appeals agreed, that the claim for \$51,826 of 2006 allocated income would be partially offset by the allocation in 2006 of \$14,255 of deductions.²⁵ This offset was incorrect in that it mixed apples and oranges.

have no equitable interest in LLC's property). As stated in the commentary to § 701 of the Prototype LLC Act:

The first sentence of subsection (A) is from RUPA § 203. This section clarifies that, unlike a partnership under UPA, LLC property is owned by the firm itself rather than nominally or otherwise by the members. This ensures that the "tenancy in partnership" which has confused partnership law will not plague LLCs. It is implicit in this section that a member may use LLC property for LLC purposes provided the member is authorized to do so.

²¹ See KY. REV. STAT. ANN. § 275.250 ("A [LLC] interest shall be personal property.")

²² See also KY. REV. STAT. ANN. § 275.220(3); Thomas E. Rutledge, *The 2010 Amendments to Kentucky's Business Entity Laws*, 38 N. KY. L. REV. [REDACTED] (2011) (forthcoming), SSRN abstract 1705557, p. 47. In *Gattoni v. Zaccaro*, 1997 WL 139410 (Conn. Super., March 7, 1997), the court reviewed a situation in which the title owner to certain real property was an LLC. There was a falling out between the members of the LLC. In rejecting a claim for, *inter alia*, partition of the property, the Court cited the provisions parallel to KRS § 275.240 and held that the plaintiff had no interest in the real estate of the LLC which would entitle him to bring a partition action. See also *Zipp v. Florian*, 2006 WL 3719373 (Conn. Super. Nov. 13, 2006) (member of LLC lacked standing to bring suit based upon damage to property owned by LLC); *Finley v. Takisaki*, 2006 WL 1169794 (W.D. Wash. April 28, 2006) (members of LLC lacked standing to assert a claim for injury to LLC); *Carey v. Howard*, 950 So.2d 1131 (Ala. 2006) (members of LLC lacked standing to sue for declaratory relief with respect to option agreement between LLC and third-party); *Northeast Realty, L.L.C. v. Misty Bayou, L.L.C.*, 920 So.2d 938 (La. App. 2006) (members of LLC lacked standing to intervene in an action against LLC to quiet the tax title because claim of ownership of property in dispute belongs to LLC); *Cortelleso v. Town of Smithfield Zoning Board of Review*, 888 A.2d 979 (R.I. 2005) (sole member of LLC lacked standing to appeal zoning decision on property that the sole member had conveyed to LLC); and Thomas E. Rutledge, *Regarding the Disregarded Entity*, 14 J. PASSTHROUGH ENTITIES 39 (Mar./Apr. 2011).

²³ 2011 Ky. App. Unpub. LEXIS 251 at *3.

²⁴ For example, a partner's K-1 recites information on paid-in and allocated capital.

²⁵ See *supra* note 2.

The \$14,255 was, it appears, calculated to offset Chapman's personal tax liability on the \$51,826 he was to receive as a liquidating distribution. In effect, the \$51,826 was to have been after-tax dollars. The trial court, by reducing the \$51,826 by the \$14,255, caused Chapman to receive fewer actual dollars than was otherwise agreed to and confused funds expended (a distribution) and tax allocations.²⁶

Private Ordering Versus Legal Right

It is important that the *Chapman* decision not be read for the rule that, upon resignation, a member is entitled to a liquidating distribution of, at least initially, total company income allocated to them for the year of the resignation. For reasons not detailed by the Court of Appeals, RRA offered a liquidating distribution equal to the \$51,826 of allocations made to Chapman for 2006,²⁷ subject to certain credits. Chapman, of course, sought more. What is crucial is to appreciate that Chapman sought more than he was offered, not more than he was entitled to as a matter of law. As discussed below, at law he was not entitled to any liquidating distribution.

Choice of Entity Matters

Chapman's belief that upon resignation he was entitled to a liquidating interest in the venture was misplaced because that venture was an LLC organized under Kentucky law. Had the same LLC been organized in Delaware, then upon Shiben accepting his resignation, he would have been entitled to the fair value of his interest.²⁸ Had the venture been an at-will general partnership, Chapman could have withdrawn and received the value of his interest.²⁹ But RRA is not a Delaware LLC, and it was not a Kentucky

²⁶ In contrast, the offset for personal income tax liabilities satisfied by the LLC was entirely appropriate. On a dollar for dollar basis, RRA paid Chapman's debt.

²⁷ The description given by the Court of Appeals on this point is faulty. It wrote that "it was ascertained from his tax forms that he was credited with an additional \$51,826, which, in essence, was a cash distribution." 2011 Ky. App. Unpub. LEXIS 251 at *5. That Chapman was allocated 40% of company income for the portion of 2006 preceding his effective date of resignation (*see also* KRS § 275.205) does not of itself support the assertion that he was in any manner entitled to a distribution (*see also* KRS § 275.210) in like amount. An allocation is not, "in essence," a cash distribution.

²⁸ As adopted in 1992, the Delaware LLC Act afforded a member the unilateral right to withdraw upon six months prior written notice, whereupon the former member is/was to receive the fair value of their interest in the company. DEL. CODE ANN. tit. 6, §§ 18-603, 18-604 (both as prior to 1996 amendments). Although not retroactive to LLCs formed prior to the 1996 amendments (DEL. CODE ANN. tit. 6, § 18-603), the statute was amended to provide that a member has only such right to resign as is provided for in the operating agreement. DEL. CODE ANN. tit. 6, § 18-603. While presumably the operating agreement of a 1992 through July 31, 1996 organized LLC could eliminate or condition that right, a member of a Delaware LLC organized after July 31, 1996 does not have a right to resign unless so provided in the operating agreement. *Id.* If resignation is permitted, absent private ordering to the contrary, the member has a right to be redeemed by the company for fair value. DEL. CODE ANN. tit. 6, § 18-604.

²⁹ *See* KY. REV. STAT. ANN. § 362.355; *id.* § 362.1-701; *see also* THOMAS E. RUTLEDGE AND ALLAN W. VESTAL, RUTLEDGE & VESTAL ON KENTUCKY PARTNERSHIPS AND LIMITED PARTNERSHIPS 117-21. In his brief to the Court of Appeals, Chapman argued that general partnership law should serve as a gap filler for the LLC Act (Appellant's Brief at 15), pursuant to which he would have a right to a liquidating

general partnership. Rather, RRA is a Kentucky LLC governed by the default rules of the LLC Act, Chapman's rights are defined by that law, and it is the law that absent private ordering to the contrary, a member is not entitled, upon dissociation, to a liquidating distribution.³⁰ To expand on Professor Ribstein's refrain,³¹ "a corporation is not a partnership or an LLC, a partnership is not a corporation or an LLC, and an LLC is not a partnership or a corporation." That the rules applicable to a particular set of facts under one organizational form are different from the rules (yielding a different result) in another organizational form is not a deficiency in one form or the other.³² Rather, different rules and outcomes are the intended result of a robust menu of organizational forms.

Kentucky's Evolution of a Member's Right to Resign and Receive a Liquidating Distribution

Under the LLC Act as adopted in 1994, a member had the right to unilaterally resign from the LLC.³³ A member's resignation (a dissociation) effected the dissolution of the company,³⁴ an outcome consistent with the predecessor partnership law.³⁵ If the LLC was otherwise continued by the other members, the resigning member was entitled to a liquidating distribution of the fair value of the resigning member's interest in the LLC.³⁶ Had the LLC Act as adopted in 1994 governed RRA in 2006, and in the absence

distribution, and suggested that reference should be made to § 603(a)(1) of the Uniform Limited Liability Company Act, it likewise providing for a liquidating distribution. *Id.* at 16. As to the latter reference, and setting aside the fact that ULLCA has been superseded by the Revised Uniform Limited Liability Company Act (2006) (6B U.L.A. 407 (2008)), the fact that other organizational statutes give different rules and outcomes is exactly the intended point. As for the former, while partnership law can and should inform the interpretation of those provisions of the LLC Act that are based upon partnership law (*see also* Rutledge and Geu, *infra* note 52), such reference cannot overcome the words employed (or not) in the statute. *See infra* notes 31 to 44.

³⁰ *See also Midwest Mutual Ins. Co. v. Wireman*, 54 S.W.3d 177, 181-82 (Ky. App. 2001) ("It is axiomatic that all persons are presumed to know the law.") (citation omitted).

³¹ Larry E. Ribstein, *Truth on the Market*, "A corporation is not a partnership." (Aug. 2, 2010), <http://truthonthemarket.com/2010/08/02/a-corporation-is-not-a-partnership>.

³² *See also* Rutledge, *Vampires*, *supra* note 19.

³³ *See* KY. REV. STAT. ANN. § 275.280(3) (as adopted 1994 Ky. Acts, ch. 389, § 56 and prior to amendment by 1998 Ky. Acts, ch. 341, § 37); *see also* Rutledge & Booth, *The LLC Act*, *supra* note 15 at 36; PROTOTYPE LLC ACT § 802(C).

³⁴ *See* KY. REV. STAT. ANN. § 275.285(3) (as adopted by 1994 Ky. Acts, ch. 389, § 57 and prior to amendment by 1998 Ky. Acts, ch. 341, § 38); *see also* PROTOTYPE LLC ACT § 901(c).

³⁵ *See* UNIF. PART. ACT § 31, 6 (pt. II) U.L.A. 370 (2001); KRS § 362.300; *see also* ALAN R. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP §§ 74(b), 86(c). While the Kentucky LLC Act has been repeatedly amended since its adoption, the original 1994 Act was substantially based upon the Prototype LLC Act. *See* Rutledge & Booth, *The LLC Act*, *supra* note 15 at 9. The Prototype is reproduced at 3 LARRY E. RIBSTEIN AND ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES app. C (2d ed. June 2011).

³⁶ *See* KY. REV. STAT. ANN. § 275.215 as adopted by 1994 Ky. Acts, ch. 389, § 43 (repealed 1998 Ky. Acts, ch. 341, § 59); *see also* Rutledge & Booth, *The LLC Act*, *supra* note 15 at 36; PROTOTYPE LLC ACT § 602.

of a contrary provision in an operating agreement, the law would have been consistent with Chapman's claim that upon his resignation he was entitled to 40% of RRA's value.³⁷ Assuming that Chapman was relying upon this state of the law, he failed to recognize that these rules were materially amended in 1998.

In 1998, the provision allowing a member to unilaterally withdraw from an LLC was deleted from the Kentucky LLC Act, and replaced by the following provision:

Unless otherwise provided in a written operating agreement, a member has no right to withdraw from a [LLC]. If the written operating agreement does not specify a time a member may withdraw, a member shall not withdraw without the consent of all other members remaining at the time.³⁸

At the same time there was deleted the provision directing that upon dissociation a member would receive the fair value of the member's interest.³⁹ Accordingly, after 1998, a member does not have the right to withdraw from a Kentucky LLC unless such a right is set forth in a written operating agreement or, at the time resignation is desired, all of the other members consent.⁴⁰ Further, even if resignation is permitted, there is no right to a liquidating distribution of the former member's interest in the LLC.

In 2010,⁴¹ the statute addressing the right of resignation was again revised to provide that unless a contrary rule is set forth in a written operating agreement, a member in a member-managed LLC⁴² may resign on thirty days notice.⁴³ In a manager-managed

³⁷ See 2011 Ky. App. Unpub. LEXIS 251 at *8 (assertion by Chapman that he "is entitled to a 40% payment for the value of the company on the date of withdrawal").

³⁸ KY. REV. STAT. ANN. § 275.280(3).

³⁹ See 1998 Ky. Acts, ch. 341, § 59 (repealing KRS § 275.215).

⁴⁰ A written operating agreement may provide a threshold other than all of the members to approve, on a case-by-case basis, a resignation. These changes in the law caused LLCs organized in Kentucky to have, absent contrary private ordering, what has been described as "defensive asset partitioning" or "capital lock-in." See Henry Hausmann and Renier Krackman, *The Essential Role of Organizational Law*, 110 YALE L. J. 387, 394-95 (2000); Lynn Stout *On the Nature of Corporations*, 2005 U. ILL. L. REV. 253 (2005); see also Robert B. Thompson, *Exit, Liquidity, and Majority Rule, Appraisal's Role in Corporate Law*, 84 GEO. L. J. 1, 6 (1995-96) (citing Robert W. Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations*, 67 MINN. L. REV. 1, 74 (1982)):

The majoritarian character is reinforced by the corporation's potential for perpetual duration. Until the majority decides otherwise, the entity can keep a minority investor's money. This stability permits reliable planning in a way that is simply not possible if the enterprise must deploy its assets to insure that it is able to redeem the assets of an investor who wants to depart.

⁴¹ See also Rutledge, *The 2010 Amendments*, *supra* note 22 at [redacted], SSRN pp. 24-28.

⁴² Whether the LLC in question is member- or manager-managed is a question of positive law determined by reference to the statement made in the articles of organization. See KRS § 275.025(1)(d); see also PROTOTYPE LLC ACT § 401, comment.

LLC, such as RRA, the 1998 rule remains in place; there is no right of resignation except and unless set forth in a written operating agreement or unless the resignation is approved by all other members.⁴⁴ Upon resignation, absent contrary private ordering,⁴⁵ a member who has resigned is treated as his or her own assignee, having only the rights of an assignee, and there is no right upon resignation to a liquidating distribution.⁴⁶

**The Status of a Resigned Member, or
How Chapman Put the Cart Before the Horse**

Initially, Chapman had no right to unilaterally resign from RRA.⁴⁷ His resignation having been accepted by Shiben, there was the question of Chapman's economic interest in the LLC. Chapman could have tendered a resignation contingent upon conditions such as an agreement that there would be a liquidation of his LLC interest and how that distribution would be calculated. He did not do so. Having never insisted upon a written operating agreement detailing his economic rights upon dissociation (the horse), Chapman was left to the default rules of the LLC Act (the cart).⁴⁸ Chapman, it appears, believed that upon his resignation he was entitled to not only a distribution, but one equal to his 40% interest in the LLC. As has already been reviewed, the LLC Act does not so provide.⁴⁹ Chapman, in effect, walked away from his asset not knowing what, if anything, he would receive for it.

Upon his resignation, Chapman ceased to be a member and, as to his 40% interest in the LLC, became an assignee.⁵⁰ As an assignee, Chapman did not have inspection

⁴³ KY. REV. STAT. ANN. § 275.280(3)(a).

⁴⁴ KY. REV. STAT. ANN. § 275.280(3)(b).

⁴⁵ See also Thomas E. Rutledge, *You Just Resigned – Now What? Different Paradigms for Withdrawing From a Venture*, 12 J. PASSTHROUGH ENTITIES 43 (Nov./Dec. 2009); Rutledge, *Assigning Membership Interests: Consequences to the Assignor and Assignee*, 12 J. PASSTHROUGH ENTITIES 35 (July/Aug. 2009).

⁴⁶ See KY. REV. STAT. ANN. § 275.255(1)(b); *id.* § 275.255(1)(c); see also *id.* § 275.280(1)(c)3.

⁴⁷ See KY. REV. STAT. ANN. § 275.280(3) (prior to amendment by 2010 Acts, ch. 133, § 37); see also *supra* notes 37 through 39 and accompanying text.

⁴⁸ An LLC may exist without a formal written operating agreement, in which case it will be governed by the default rules of the LLC Act and, to the degree permitted, the oral and course of conduct agreement of the members. To the extent no contrary provision is set forth in the operating agreement, the terms of the LLC Act are incorporated into and become part of every operating agreement. See KY. REV. STAT. ANN. § 275.005 (“A [LLC] may be *organized under this chapter*”) (*emphasis added*); *Racing Investment Fund 2000, LLC v. Clay Ward Agency, Inc.*, 320 S.W.3d 654, 657 (Ky. 2010) (“If the members of a particular LLC do not adopt a written operating agreement or adopt one that is silent on certain matters, KRS Chapter 275 contains default provisions that will govern the conduct of the entity’s business and affairs.”).

⁴⁹ See *supra* notes 32 through 39 and accompanying text.

⁵⁰ See KY. REV. STAT. ANN. § 275.280(4); see also *id.* § 275.280(5). While these provisions were not in place in 2006, having been added to the LLC Act in 2010, they recite a treatment that is confirmatory of the prior analysis.

rights or other related information rights,⁵¹ nor a right to participate in management⁵² even with respect to modification of the underlying operating agreement.⁵³ Chapman, as an assignee, was not the beneficiary of either fiduciary obligations or an obligation of good faith and fair dealing.⁵⁴ At that point he was at risk of Shiben continuing to allocate to him RRA income, thereby creating a tax liability, but making no distributions from which he could satisfy that debt.⁵⁵ Shiben apparently elected to make a liquidating redemption to Chapman and to thereby terminate his assignee status.⁵⁶ Enjoying the right to unilaterally amend the operating agreement,⁵⁷ Shiben could unilaterally determine the formula for the redemption value.

Conclusion

Although the Court of Appeals' ruling is "less tight" than it might be, especially in failing to address the evolution of the right of resignation and the consequences thereof under the LLC Act, the decision is normatively correct in its outcome. Chapman, having received a liquidating distribution of \$20,709, took away more than that to which he was

⁵¹ See KY. REV. STAT. ANN. § 275.185(2) (inspection rights are available to "members"); *id.* § 275.185(3) (obligation to disclose information to "members"); *id.* § 275.255(1)(c) (assignee does not have the rights of a member).

⁵² See KY. REV. STAT. ANN. § 275.255(1)(c) (providing in part "An assignment of a [LLC] interest shall not . . . entitle the assignee to participate in the management and affairs of the [LLC] or to become or exercise any rights of a member other than the right to receive distributions pursuant to subsection (1)(b) of this section.")

⁵³ See KY. REV. STAT. ANN. § 275.015(20) (operating agreement is among the members); *id.* § 275.170(1) (duty of care is owed the LLC and the other members); *id.* § 275.170(2) (duty of loyalty is owed the LLC); and *id.* § 275.255(1)(c) (assignee may not exercise the rights of a member); see also *Bauer v. The Blomfield Co.*, 849 P.2d 1365 (Alaska 1993) (assignee of partnership interest not owed obligations of good faith and fair dealing); *Bayside Petroleum, Inc. v. Whitmar Exploration Co.*, 1997 WL 34690262 (D. Okla. 1997) ("no fiduciary duty" is owed the assignee of a partner); *Haynes v. B&B Realty Group, LLC*, 633 S.E.2d 691 (N.C. 2006) (no fiduciary duties owed to transferee of LLC interest); *Landskroner v. Landskroner*, 797 N.E.2d 1002, 1014 (Ohio Ct. App. 2003) (fiduciary duties are not owed to former member of LLC); 1 CARTER G. BISHOP AND DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES – TAX AND BUSINESS LAW ¶ 8.04.

⁵⁴ See *id.*; see also Thomas E. Rutledge, Carter G. Bishop & Thomas Earl Geu, *No Cause for Alarm: Foreclosure and Dissolution Rights of a Member's Creditor*, 21 PROBATE & PROPERTY 35 (May-June 2007). Chapman cited *Patmon v. Hobbs*, 280 S.W.3d 589 (Ky. App. 2007), for the proposition that he was owed a duty of good faith and to be treated fairly. 2011 Ky. App. Unpub. LEXIS 251 *20-*21. While this author has criticized the analysis of the *Patmon* decision (see Thomas E. Rutledge and Thomas Earl Geu, *The Analytic Protocol for the Duty of Loyalty Under the Prototype LLC Act*, 63 ARK. L. REV. 473 (2009)), in this instance the rejection of a *Patmon* based duty was entirely correct. See also *supra* note 51.

⁵⁵ While in that circumstance Shiben would as well have been at risk of phantom income, a Code § 707(a) guaranteed payment to her might, with proper planning, have minimized if not eliminated that risk. While beyond the scope of this review, a guaranteed payment likely would have been a distribution. See Thomas E. Rutledge and Sarah S. Wilson, *A Review of the Charging Order Under Kentucky's LLC and Partnership Acts* (Part I), 99 KY. L.J. ONLINE 85, 94-95 (2010-11).

⁵⁶ For a review of the issues incident to redeeming a member from an LLC, see *Model Limited Liability Company Membership Interest Redemption Agreement*, 61 BUS. LAW. 1197 (May 2006).

⁵⁷ See KY. REV. STAT. ANN. § 275.175(2)(a).

entitled, and for that he should be happy – he was not, under the LLC Act, entitled even to that amount.

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