

ESSAY QUESTION NO. 6

Answer this question in booklet No. 6

Interior Inc. is an Alaska corporation that owns and operates a rock quarry in Alaska. Transporters LLC is an Alaska limited liability company that owns heavy construction equipment used in construction projects. Interior and Transporters form a new Alaska limited liability company in which each owns a 50% interest. They name their new company "InTrans LLC".

Interior and Transporters enter into a simple operating agreement that designates Transporters as the managing member, with no further guidance on the role of members in the management of the company. Neither the articles of organization nor the operating agreement have provisions that address the removal or replacement of the manager. The articles of organization state that the purpose of InTrans LLC is to do construction projects in Alaska for the next ten years, at which time InTrans LLC will be dissolved. The first project they will bid on is an Alaska road construction project.

Attached to the operating agreement is a separate contract between Interior and InTrans LLC which sets forth the pricing at which Interior has agreed it will sell rock to InTrans LLC. Also attached is a separate contract between Transporters and InTrans LLC setting forth the price at which Transporters agrees to provide heavy equipment and operators to InTrans LLC.

Transporters, as manager of InTrans LLC, drafts the proposal it will submit in response to the Request for Proposal for the road project using the pricing information the members have agreed upon. Interior reviews the draft proposal and voices its objection to the manner in which Transporters has structured the bid, stating that the proposal is not as competitive as it could be. Transporters ignores Interior's objection and submits the proposal as originally drafted.

The road construction project is awarded to a different company. Thereafter, Transporters notifies Interior that it is resigning as the manager of InTrans LLC effective immediately.

1. Discuss what, if any, legal obligations Transporters had to satisfy the concerns of Interior with regard to the InTrans LLC proposal structure before it was submitted.
2. Discuss what, if anything, Interior could have done at time of proposal preparation to remove Transporters as the manager of InTrans LLC because its concerns were being ignored.
3. Explain whether Transporters acted lawfully when it resigned as manager.
4. Discuss the possible different approaches that Interior might take to remove itself from any further involvement with Transporters and InTrans LLC, and the impediments, if any, to those approaches.

GRADERS' GUIDE
***** QUESTION NO. 6 *****
BUSINESS LAW

The rights and duties of the parties that form and operate limited liability companies in Alaska are governed by Alaska's Revised Limited Liability Company Act (AS 10.50.010 - .995).

Question 1- Discuss what, if any, legal obligations Transporter had to satisfy the concerns of Interior with regard to the InTrans LLC proposal structure before it was submitted. (20 points)

None. Under AS 10.50.110(b), if a limited liability company is managed by a manager, rather than the members, "the manager has the exclusive power to manage the affairs of the company to the extent authorized by the operating agreement." Under the facts, the parties adopted a "simple" operating agreement that merely appointed Transporters as the manager, and provided no additional guidance on what role the members could have in operations of the company. Therefore, since the operating agreement did not give Interior any authority over the management of the company, Transporter was left with the exclusive power to decide how to structure the proposal and was not obligated to take into account Interior's opinions and concerns.

A manager of an LLC does have a statutory duty of care that is owed to the LLC which requires that the manager perform the management duties "in good faith, in a manner the person reasonably believes to be in the best interests of the company." AS10.50.135(a). The facts only state that Interior believes the bid proposal could be "more competitive". It is unlikely the differences in views on proposal structure are more than a disagreement between reasonable strategy calls. More facts would be needed to reach conclusion that there was a probable breach of the statutory duty of care.

Question 2- Discuss what, if anything, Interior could have done at time of proposal preparation to remove Transporter as the manager of InTrans LLC because its concerns were being ignored. (20 Points)

Nothing. Because the operating agreement and articles of organization were silent on the issue of removal or replacement of the manager, the only way Transporter could have been removed from the position of manager would be with a vote of "more than one-half of all the members of the company." AS 10.50.115. The facts state that there are only two members and each owns 50%. The only way to gain "more than one-half" of the members' agreement to remove Transporter as manager, would be to gain Transporters' own vote. At the time of bid preparation, Transporter was not likely to provide this approval

given its willingness to proceed with the proposal process without honoring any of Interior's concerns.

Again, absent additional facts, there does not seem to be any support for Interior to be able to file an action to enjoin Transporter from submitting the proposal on the grounds of breach of the statutory duty of care.

Question 3- Explain whether Transporter acted lawfully when it resigned as manager. (10 Points)

Transporter did not act lawfully when it resigned as manager. Under AS 10.50.125(b), a manager may not resign "except at the time or upon the happening of events specified in the operating agreement of the company." Neither the articles of organization nor the "simple" operating agreement mentioned the conditions under which a manager could resign. The business of InTrans LLC was to continue for ten years. Those ten years have not passed and the business of InTrans LLC should continue. Therefore, Transporter can only lawfully resign if it obtains Interior's approval of its resignation as manager. Transporter also has the option to proceed with its unlawful resignation which would make it liable for breach of the operating agreement and make it liable for damages arising from that breach to the LLC. AS10.50.125(b).

Question 4- Discuss the possible different approaches that Interior might take to remove itself from any further involvement with Transporter and InTrans LLC, and the impediments, if any, to those approaches. (50 Points)

Like Transporters, Interior has limited options to unilaterally remove itself from involvement in InTrans LLC and its operations.

a) Termination of Interior's Rock Sale Agreement- Interior's primary problem is the fact that even if it successfully exits as a member of InTrans LLC, it still has the contractual obligation to provide rock at a set price to InTrans LLC for projects over the next 10 years. So any full removal and disengagement will necessarily need to involve the rescission or termination of this contract obligation. This can only be accomplished with dissolution and winding up of InTrans LLC or the agreement of InTrans LLC to release Interior from this contractual obligation.

b) Withdraw as a member- It is unclear from the facts if Interior can withdraw as a member. Under AS 10.50.185(a) "a member may not resign from a limited liability company except at the time or upon the happening of events specified in the operating agreement..." Because the operating agreement is "simple", it may not have provisions that address a member's withdrawal. If the operating agreement is silent on the matter, the only time the member can lawfully withdraw is at the time of dissolution and winding up. AS 10.50.185(b). To

resign lawfully, Interior would need the agreement of Transporter to its withdrawal or to the dissolution and winding up of the affairs of InTrans LLC. If Interior resigned as a member without the consent of Transporter, it would remain a member but have the rights of an assignee, and thus would participate financially in the ongoing affairs of InTrans LLC, but have no voting rights. AS 10.50.185(d).

c) Assignment of InTrans LLC's interest to other party- It is unclear from the facts if Interior can assign its member interest under the operating agreement. AS 10.50.165 states that unless the operating agreement provides otherwise, "an assignee of a limited liability company interest may not become a member unless all other members consent. Therefore, an assignment would fail to remove Interior as a member unless there was consent to the assignment by Transporters. Only with that consent could Interior fully cease to be a member of the InTrans LLC. AS10.50.180

d) Seek Dissolution of InTrans LLC- Interior could file an action with the Superior Court and seek a court-ordered dissolution of InTrans LLC. To get this result, Interior would have to prove to the court that "it is impossible for InTrans LLC to carry on the purposes of the company". AS 10.50.405. Had Transporters not attempted to resign as manager, this would have been difficult to prove. However, with the resignation after only the first job attempt, assuming that Transporter does not step back up and resume acting as manager, management of the company will fall upon the shoulders of the two members, who are 50-50 owners. AS 10.50.110(a). Therefore, the probability of becoming deadlocked in their voting over future operations is high. If that can be shown to be occurring, then Interior should be able to demonstrate that it will be impossible for InTrans LLC to conduct business in accordance with its intended purposes.

e) Dissolve and Wind up Interior Inc. - Interior could take a very drastic action to terminate membership in InTrans LLC by dissolving and winding up the affairs of Interior Inc. Under AS 10.50.220, unless otherwise provided in the operating agreement, the membership of a member that is a corporation "terminates when the corporation is dissolved and 90 days lapses without reinstatement." This "out" is analogous to the rule that the membership of a natural person ceases on his or her death or declared incompetency. AS 10.50.210.

f) Negotiate an Exit with Transporters- Under the facts, Transporters has attempted to resign as manager. They obviously have little interest in continuing the business of InTrans LLC. A smart move by Interior would be to point out the illegality of Transporter's attempt to resign and offer a compromise, in which the parties agree to simply dissolve and wind up the affairs of InTrans LLC. This would remove both the contractual obligation to

supply rock at the agreed prices, and enable Interior to entirely exit the business arrangement with Transporters.