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DISSOCIATION FROM ALABAMA LIMITED LIABILITY COMPANIES IN THE POST CHECK-THE-BOX ERA

*Laurel Wheeling Farrar**
*Susan Pace Hamill***

I. INTRODUCTION

The rise of the domestic limited liability company (LLC), the newest and fastest growing business form, occurred because it represented the first domestic business entity offering the corporate characteristic of limited liability combined with the favorable tax treatment afforded partnerships.[1] Only after the Inter-

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* B.A., Auburn University, 1981; J.D., The University of Alabama, December, 1996. This Article grew out of an independent study project Ms. Farrar completed for Professor Hamill during her third year of law school. Ms. Farrar is a member of the class of 1996-97.

** Associate Professor of Law, The University of Alabama. Professor Hamill thanks Dean Kenneth C. Randall and her faculty colleagues for all their support and gratefully acknowledges The University of Alabama Law School Foundation, the Edward Brett Randolph Fund and the William H. Sadler Fund. Professor Hamill specially recognizes the students in the Fall 1996 and Fall 1997 course on LLCs and LLPs, especially Carol Longshore, Mike Perrett, Fallany Stover, James Coomes and Wade Hartley, whose valuable classroom participation and outside research contributed greatly toward the understanding of the issues discussed in this Article.

1. *See* LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 1.03 (1996) (an excellent, exhaustive and extremely useful treatise and practitioners' manual). The articles written on LLCs are too numerous to cite completely. For some early articles exploring the ramification of the recently created LLC before it became apparent that the LLC would be an important business form, see Susan Pace Hamill, *The Limited Liability Company: A Possible Choice for Doing Business?*, 41 U. FLA. L. REV. 721 (1989) (early article, written shortly after the Internal Revenue Service recognized the LLC's ability to be taxed as a partnership, when only Wyoming and Florida had passed LLC legislation, predicts growth in the LLCs popularity in the future); Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375 (1992) (article written when only eight states had passed LLC legislation, predicting that all 50 states would pass statutes and discussing extensively the early tax and business issues that confronted LLCs). *See also* William J. Carney, *Close Corporations and the Wyoming Business Corporation Act: Time For a Change?* 12 LAND & WATER L. REV. 537, 581-82 (1977) (noting right after Wyoming passed the first LLC statutes, but long before the IRS allowed partnership taxation, that the LLC was

nal Revenue Service recognized the LLC's ability to meet the requirements under the partnership classification regulations did the states adopt LLC legislation.[2] In 1993 Alabama enacted an LLC statute.[3] In order to ensure that Alabama LLCs met the then-existing requirements to be taxed as a partnership,[4] the

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probably a poor substitute for a close corporation under most circumstances). By the mid 1990s the literature exploring LLCs and a related business entity, the limited liability partnership (LLP), which essentially operates as a general partnership while offering general partners limited liability, exploded. For example, in 1995 four law reviews dedicated entire issues to LLCs and LLPs. *See* 73 WASH. U. L. Q.; 66 U. COLO. L. REV.; 25 STETSON L. REV.; 51 BUS. LAW. As recent as the spring of 1997, three law reviews including the inaugural issue of THE JOURNAL OF SMALL AND EMERGING BUSINESS LAW, dedicated entire issues to LLCs and LLPs. *See* 32 of the WAKE FOREST L. REV.; 54 WASH. & LEE L. REV.; 1 THE JOURNAL OF SMALL AND EMERGING BUSINESS LAW. The differences between LLCs and LLPs and what business lawyers should consider when choosing between the two is beyond the scope of this Article and will be explored in a follow-up piece.

2. *See* Susan Pace Hamill, *The Limited Liability Company: A Catalyst Exposing the Corporate Integration Question*, 95 MICH. L. REV. 393 (1996) (documenting the rise of the limited liability company through state enactments and individual business filings; discussing the response of the Internal Revenue Service, other branches of government and the practicing bar; and concluding that the creation and proliferation of LLCs was completely tax driven). For an exhaustive discussion of the details on how the partnership tax rules work, see WILLIAM S. MCKEE ET AL., FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS (2d ed. 1990 & Supp. 1997).

3. ALA. CODE §§ 10-12-1 to -61 (1994). On May 17, 1993, the Alabama LLC Act passed both the Senate and the House. *See* 1993 H.J. Ala. Reg. Sess. 4141-42; 1993 S.J. Ala. Reg. Sess. 2845-46. Governor Jim Folsom signed the legislation on May 20, 1993, with an effective date of October 1, 1993. 1993 Ala. Acts 1425, 1460. For an excellent discussion of all the provisions in the Alabama LLC Act, see Bradley J. Sklar & W. Todd Carlisle, *The Alabama Limited Liability Company Act*, 45 ALA. L. REV. 145 (1993). The language in Alabama's statute came from previously enacted LLC statutes in other states, portions of the Alabama Business Corporation and Partnership Acts, the Prototype LLC Act (finished in 1992 by members of the ABA's subcommittee on LLCs to aid state drafters) and the then-current draft of the Uniform Limited Liability Company Act (the drafting process started in August of 1992 and National Conference of Commissioners on Uniform State Laws (NCCUSL) adopted the Uniform Act in August of 1994, with amendments issued in 1995 and 1996). *See* commentary to all provisions of the Alabama LLC Act . *See also* Mitchel Hampton Boles & Susan Pace Hamill, *Agency Powers and Fiduciary Duties Under the Alabama Limited Liability Company Act: Suggestions for Future Reform*, 48 ALA. L. REV. 143 (1996) (discussing extensively the agency powers and fiduciary duties of LLC members as compared to similar rights and duties of general partners, limited partners, and corporate shareholders).

4. Until recently, unincorporated organizations seeking partnership taxation had to defeat two out of four corporate characteristics—continuity of life, centralized management, free transferability of interests and limited liability—set out in detail in the partnership classification regulations finalized in 1960 in response to *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954); *infra* note 8 and accompanying text

statutory default provisions vested agency powers and management rights in all members, restricted the ability of all members to transfer their interest in the LLC and required the LLC to dissolve upon the death, retirement, withdrawal, bankruptcy or incompetence of any member unless all remaining members agreed to continue the business.[5] The need to trigger a possible dissolution every time a member withdrew from or otherwise became separated from the business, known as dissociation under partnership and many LLC statutes,[6] created a highly unstable

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discussing the recent regulations granting domestic unincorporated business organizations automatic partnership taxation. *See* Treas. Reg. § 301. 7701-2 (as amended in 1993); Susan Pace Hamill, *The Taxation of Domestic Limited Liability Companies and Limited Partnerships: A Case for Eliminating the Partnership Classification Regulations*, 73 WASH. U. L.Q. 565, 566-68 (1995) (describing in detail the historical evolution of the partnership classification regulations; documenting extensively partnership classification private letter rulings issued to limited partnerships and limited liability companies; and concluding that the partnership classification regulations serve no purpose other than to increase transaction costs). *See also* Patrick E. Hobbs, *Entity Classification: The One Hundred-Year Debate*, 44 CATH. U. L. REV. 437 (1995) (discussing the evolution of the criteria for corporation tax classification).

5. *See* ALA. CODE §§ 10-12-21, -22, -30, -32, -33, -36, and -37 (1994) (ensuring that all Alabama LLCs that form under the Alabama LLC statute without making substantive changes in the operating agreement lack centralized management, free transferability of interests and continuity of life). *See also* Rev. Rul. 94-6, 1994-1 C.B. 314 (recognizing that Alabama LLCs operating under the default provisions meet the Internal Revenue Service's partnership classification regulations). For explanations of Alabama LLC provisions within the primary context of a comprehensive and excellent treatise on Alabama corporate law, see RICHARD THIGPEN, ALA. CORP. LAW WITH FORMS, §§ 1-16 to -18 (1995).

On September 15, 1997, the Alabama Legislature amended the Alabama Limited Liability Company Act. Act of Sept. 23, 1997, No. 97-920, 1997 Ala. Advance Legis. Serv. 677. The amendments became effective on January 1, 1998. *Id.* The amendment changed the following sections of the Alabama Code of 1975: 10-12-2; 10-12-4; 10-12-5; 10-12-8; 10-12-9; 10-12-10; 10-12-12; 10-12-13; 10-12-14; 10-12-15; 10-12-16; 10-12-21; 10-12-22; 10-12-24; 10-12-29; 10-12-30; 10-12-34; 10-12-35; 10-12-36; 10-12-37; 10-12-45; 10-12-47; 10-12-51; and 10-12-55. *Id.*

6. REVISED UNIF. PARTNERSHIP ACT § 601 (1994) (hereinafter RUPA); UNIF. LTD. LIAB. CO. ACT § 601 (1994) (hereinafter ULLCA), *reprinted in* J. DENNIS HYNES AGENCY, PARTNERSHIP AND THE LLC: SELECTED STATUTES AND FORM AGREEMENT (1997). Under the RUPA and the ULLCA, dissociation refers to all situations where the partner or LLC member is no longer associated with the business. *See* RUPA § 601; ULLCA § 601. Clearly, dissociation occurs when a partner or member voluntarily withdraws or retires from the business. *See* RUPA § 601(1); ULLCA § 601(1). However, other involuntary situations such as death, bankruptcy, incapacity or expulsion also result in dissociation from the business. *See* RUPA § 601(4)-(5); ULLCA § 601(5)-(8). Depending on the circumstances, dissociations may or may not result in an actual dissolution. *See infra* notes 40-52 and accompanying text (discussing when dissolution or buyouts occur). Because the Uniform Partnership Act requires the

business environment. The LLC's dissolvability created the potential for individual members to abusively withdraw from the business.[7]

On December 18, 1996, the Internal Revenue Service issued the long-awaited final regulations, known as the check-the-box regulations, automatically taxing domestic LLCs and many other unincorporated entities as partnerships.[8] For the first time in the history of tax classification of unincorporated business organizations, partnership taxation can be achieved without regard to the business characteristics of the entity. The state legislatures are free to craft the LLC's provisions governing dissociation and dissolution in order to promote the best business policy. This could entail eliminating all dissolution triggers[9] and also could go as far as eliminating all dissociation rights, which would essentially render LLC members similar to shareholders of closely held corporations with no individual rights to withdraw from and be bought out by the company.[10]

Primarily in response to the check-the-box regulations, on September 23, 1997, Governor Fob James signed new legislation amending Alabama's LLC statute.[11] This legislation eliminates

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partnership to dissolve upon all separations from the business, the term dissociation does not appear in that statute. *See* RUPA § 601, cmt.

7. *See infra* note 27 and accompanying text. *See also infra* notes 53-56 and accompanying text (discussing wrongful dissolution under RUPA).

8. *See* Treas. Reg. §§ 301. 7701-1 to -4, 61 Fed. Reg. 66584 (1996). The final regulations treat domestic unincorporated business organizations as partnerships by default. *See* Treas. Reg. § 301.7701-3(b)(1). In other words, unincorporated business firms must affirmatively elect to be taxed as corporations. Although most unincorporated business firms will prefer partnership taxation, thus making any affirmative election unnecessary, these regulations acquired the label "check-the-box" during their development. *See also* Prop. Treas. Reg. §§ 301.7701-1 to -4, 61 Fed. Reg. 21,989 (1996) and I.R.S. Notice 95-14, 1995-1 C.B. 297 (Internal Revenue Service's development leading up to the final regulations); Hamill, *supra* note 4; and Daniel Shefter, *Check the Box Partnership Classification: A Legitimate Exercise in Tax Simplification*, 67 TAX NOTES 279 (1995) (supporting the regulations before they were finalized); Susan Kalinka, *The Louisiana Limited Liability Company Law After "Check-the-Box,"* 57 LA. L. REV. 715 (1997).

9. The tax necessity of triggering a possible dissolution of the firm when a member dissociates created negative business consequences. *See* Sklar & Carlisle, *supra* note 3, at 217-18.

10. *See* F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 7.03 (3d ed. 1996) [hereinafter CLOSE CORPORATIONS].

11. Act of Sept. 23, 1997, No. 97-920, 1997 Ala. Advance Legis. Serv., 1st Spec. Sess., 677, 723. The newly enacted provisions can be found at ALA. CODE § 10-12-8

all possibilities of dissolution and dissociation due to a member's withdrawal or other separation from the LLC. Consequently, Alabama LLC members no longer individually possess statutory rights to dissolve the company or withdraw their capital and have their interest purchased by the company. The new Alabama LLC legislation became effective on January 1, 1998.[12]

Part II of this Article explores the statutory provisions and legal precedents defining the rights of partners and corporate shareholders to recoup their investments through either a complete dissolution of the entity or a buy out of the particular ownership interest, emphasizing the evolutionary changes occurring over time.[13] Using a continuum model to outline the possible approaches at either extreme, at one end the Uniform Partnership Act allowed partners the absolute right to dissolve the partnership and withdraw their capital, while at the other end, traditional corporate law provided no rights of shareholders to sell their shares back to the corporation whose continued existence remains unaffected by the departure of shareholders.

This Part then explores the dissociation and dissolution rights of general partners and shareholders falling in between these two extremes on the continuum. In 1994, the Revised Uniform Partnership Act, approved by the National Conference of Commissioners on Uniform State Laws, substantially revised portions of the Uniform Partnership Act, including the dissolution provisions, rendering general partnerships far less susceptible to actual dissolutions.[14] Moreover, the corporate statutes and legal precedents developed a set of judicial and statutory exceptions to the traditional corporate law, allowing minority shareholders of closely held corporations to force a buy back of their shares, dissolve the corporation or otherwise receive damages when majority shareholders breach fiduciary duties or behave oppressively.[15] Finally, Part II concludes that the provisions of Alabama's LLC amendments eliminating all statutory dissolution triggers represent a positive improvement to the LLC

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et seq. (1994).

12. Act of Sept. 23, 1997, No. 97-920, § 3, 1997 Ala. Advance Legis. Serv., 1st Sp. Sess., 677, 723.

13. *See infra* Part II.

14. RUPA §§ 601-603, 701, 801.

15. *See infra* Part II(C).

law because no valid policy justification exists to retain dissolution powers in LLCs due to the limited liability protection.[16]

Part III first presents the pure business arguments for and against retaining provisions in the LLC statute providing members the right to withdraw or otherwise dissociate from the LLC, requiring the LLC to redeem the member's interest.[17] Many practitioners argue that dissociation rights in the partnership and LLC statutes should be totally eliminated because these rights increase transaction costs.[18] Faced with default provisions allowing partners and LLC members to withdraw their capital, attorneys are often asked by their business clients, who by definition are sophisticated enough to secure competent legal advice before proceeding, to restrict or eliminate these rights in a tailored operating agreement.[19]

Despite a possible increase in transaction costs for some business owners, Part III argues that the LLC statute should retain rights of members to dissociate and be redeemed by the company. Statutory default provisions for LLCs, as well as other business forms historically used by small business, should be written for the unsophisticated business participants who will rarely seek adequate legal advice in advance. Because unsophisticated members of LLCs more closely resemble simple general partners, dissociation provisions are needed to protect them from the oppression situations that have plagued close corporation shareholders. Moreover, the legal authorities addressing the oppression of minority shareholders in close corporations suggest that the presence of dissociation rights, effectively evening out the bargaining power between the minority and majority owners, help small business owners more easily settle their differences without resorting to litigation. Also, retaining traditional partnership style penalties for wrongful dissociation, resembling the wrongful dissolution remedies developed under general partnership law, should effectively curb members from exercis-

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16. *See infra* notes 57-58 and accompanying text.

17. *See infra* Part III(A).

18. *See, e.g.*, Franklin A. Gevurtz, *California's New Limited Liability Company Act: A Look at the Good, the Bad, and the Ambiguous*, 27 PAC. L.J. 261, 284-87 (1996).

19. *See* Kalinka, *supra*, note 8, at 767, 787.

ing their right to dissociate abusively.[20]

Part III then identifies the federal gift and estate tax valuation provisions as the new driving tax force dictating the substantive business provisions concerning dissociation rights in LLCs.[21] The rules governing eligibility for discounted valuation of gifts and bequests between family members conclusively deny any opportunity to discount the valuation if the relevant state statute provides for transfer or liquidation rights in the business interest gifted or bequeathed. In order to render the LLC suitable for family gift and estate tax planning, Alabama, and many other states have eliminated all dissociation rights in the statutory default provisions, causing closely held LLCs to be subject to the same perils currently faced by minority shareholders of close corporations.[22] By requiring the state law statutory default provisions to eliminate all dissociation rights in order to qualify for the discounted valuation, the gift and estate tax rules force state legislators to choose between preserving the interests of small unsophisticated business owners benefiting from statutory dissociation rights and legitimate family gift and estate tax plans using the LLC.[23]

II. RIGHTS TO WITHDRAW CAPITAL IN PARTNERSHIP AND CORPORATE FORMS

A. General Partnerships Governed by the Uniform Partnership Act

Even before the Uniform Partnership Act (UPA), completed in 1914,[24] became effective the common law recognized that all changes in the relationship among the partners resulted in a dissolution of that partnership.[25] The UPA codified the events

20. *See infra* notes 102-105 and accompanying text.
21. *See infra* notes 106-118 and accompanying text.
22. *See infra* notes 106-108 and accompanying text.
23. *See supra* notes 11-12, *infra* notes 106-116 and accompanying text.
24. UNIFORM PARTNERSHIP ACT [hereinafter UPA], reprinted in BROMBERG & RIBSTEIN ON PARTNERSHIP app. A (1988). For an exhaustive and excellent treatise on partnership law and practice see J. WILLIAM CALLISON, PARTNERSHIP LAW AND PRACTICE, GENERAL AND LIMITED PARTNERSHIPS (1992 & Supp. 1995).
25. *See* BROMBERG & RIBSTEIN, *supra* note 24, § 7.01. *See also* Smith v. Rosson,

triggering a dissolution—a partner's death, insanity, retirement, withdrawal or bankruptcy—causing the business to either be sold in a judicial sale and wound up, or continued in a successor partnership.[26] The right of every partner to unilaterally dissolve the partnership and demand a judicial sale of the assets created the opportunity for partners to abuse this power. A partner with limited economic resources could lose his share of the business at an unfairly low price. As long as a withdrawing partner with sufficient assets to purchase the entire business avoided being classified as a wrongful dissolver, such partner's bid conclusively set the fair market value of the entire business and each partner's rights in the liquidation. If the other partner lacked the economic resources to counterbid for the business, the withdrawing partner had no incentive to bid a fair price.[27]

A partner who dissolves the partnership wrongfully has no right to bid for the business and is liable for damages to the other partners. Moreover, the partners not responsible for the wrongful dissolution can avoid a judicial sale and continue the business in a new partnership after buying out the wrongful partner. In addition to subtracting damages from the buyout price, the wrongful partner receives no compensation for a share of good will in the continuing partnership.[28] In order to protect partners who bargained ahead of time for a definite term or particular undertaking from damages due to another partner's premature withdrawal, the Uniform Partnership Act conclusively deems a partner's withdrawal before the completion of a definite term or a particular undertaking as wrongful.[29]

However, because many partnerships operate informally

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171 So. 375 (Ala. 1936) (concluding that dissolution occurred three years after partner's stroke—the time of total incapacity); McKleroy v. Muskgrove, 84 So. 280 (Ala. 1919) (deeming the partnership dissolved due to partner's insanity); Didlake v. Roden Grocery Co., 49 So. 384 (Ala. 1909) (finding that death of a partner dissolved the firm); Butts v. Cooper, 44 So. 616 (Ala. 1907) (one partner's purchase of another partner's interest deemed to dissolve the partnership under pre-UPA Alabama law).

26. *See* UPA § 31.

27. *See* UPA §§ 29, 31, 38 (stating no explicit requirement that the partner bid a fair price); Cude v. Couch, 588 S.W.2d 554 (Tenn. 1979) (upholding a partner's withdrawal followed by a low bid for the assets). *See also* Franklin A. Gevurtz, *Preventing Partnership Freeze-outs*, 40 MERCER L. REV. 535 (1989).

28. UPA § 38(2)(c)(II).

29. UPA § 31(2); BROMBERG & RIBSTEIN, supra note 24, § 7.03.

and the facts and circumstances sometimes strongly suggest that the partners intended to remain partners for a term or specific undertaking, some courts were willing to imply a term or undertaking even when they have not explicitly so agreed. Consequently partners prematurely withdrawing before the end of an implied term or undertaking will also be treated as wrongful dissolvers.[30] Courts look for strong evidence that the partners manifested clear intent to stay partners for a period of time or to complete a separate project; courts refuse to imply a term solely because the partners entered a specific business.[31] Consequently, situations arose where the facts and circumstances could not support an implied term under circumstances where the facts strongly indicated that one partner had abused the power to dissolve the partnership.[32]

Even if the facts and circumstances could not imply a term or undertaking, some courts treated a withdrawing partner as a wrongful dissolver if the partner breached his fiduciary duty to the other partner by seeking to appropriate the entire business at an unfairly low price.[33] The determination of whether a withdrawal amounted to a breach of fiduciary duty was predict-

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30. *See* Rhue v. Dawson, 841 P.2d 215 (Ariz. Ct. App. 1992) (implying a term or undertaking for a partnership to purchase and develop a single shopping center); Zeibak v. Nasser, 82 P.2d 375 (Cal. 1938) (concluding that a period covering a lease of theaters implies a term); Bates v. McTammany, 76 P.2d 513 (Cal. 1938) (concluding that period covering a federal license to operate radio station implies a term); Girard Bank v. Haley, 332 A.2d 443 (Penn. 1975) (concluding that partnership was for an undertaking where partnership formed to develop and sell a specific tract of land); Williams v. Terebinski, 24 Ohio Misc. 53, 261 N.E.2d 920 (1970) (implying an undertaking for a partnership formed to purchase two cemeteries and sell plots).

31. *See* CALLISON, *supra* note 24, at 15-9, § 15.03.

32. *See* Page v. Page, 359 P.2d 41 (Cal. 1961) (refusing to imply term to cover period of time allowing the partnership to repay certain debts and make profits from the business; consequently, low bid for the assets by one partner upheld); Chandler Med. Bldg. Partners v. Chandler Dental Group, 855 P.2d 787 (Ariz. Ct. App. 1993) (refusing to imply a term for a partnership formed to own, develop, and lease property).

33. *See* Page v. Page, 359 P.2d 41 (Cal. 1961) (dictum) (suggesting that a withdrawing partner acting in bad faith, dissolving the partnership in order to acquire the other partners' share of the business at an unfairly low price, will be deemed wrongful); Wilensky v. Blalock, 414 S.E.2d 1 (Ga. 1992) (concluding that a partner wrongfully dissolved the partnership by freezing out plaintiff partner from further business opportunities). *See also* Zimmerman v. Harding, 227 U.S. 489 (1913) and Newman v. Pitman, 12 So. 412 (Ala. 1893) (pre-UPA cases involving wrongful dissolutions).

ably hard to determine. Ultimately the threat of wrongful status at best has served as a spotty and unpredictable deterrent to opportunistic withdrawals intended to appropriate the other partner's share of the business.[34]

B. *The Revised Uniform Partnership Act*

In response to an American Bar Association Committee report recommending extensive changes to the UPA,[35] the National Conference of Commissioners on Uniform State Laws promulgated the Revised Uniform Partnership Act (RUPA) in 1994 after many drafts and much discussion.[36] The Alabama Legislature recently adopted RUPA in 1996, effective January, 1997.[37] RUPA completely rewrites the dissolution provisions seeking to make partnerships somewhat less dissolvable while still preserving the individual partner's right to withdraw her capital.[38] Borrowing from the law of corporations, RUPA expressly views the partnership as an entity,[39] creating a theoretical basis for allowing the same partnership to remain legally intact even if a partner dies, withdraws, or otherwise becomes

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34. *See* Cude v. Couch, 588 S.W.2d 554 (Tenn. 1979) (rejecting plaintiff partner's assertion that the other partner wrongfully dissolved the partnership under facts and circumstances that strongly suggest the withdrawing partner, who successfully purchased the business through an undisclosed agent, intended to usurp the plaintiff partner's share of the goodwill). *See also* Robert W. Hillman, *Private Ordering Within Partnerships*, 41 U. MIAMI L. REV. 425, 468 (1987) (concluding that when dissolutions of partnerships without a term are wrongful is a major issue of partnership law).

35. *See also* Donald J. Weidner, *The Revised Uniform Partnership Act Midstream: Major Policy Decisions*, 21 U. TOL. L. REV. 825 (1990); Donald J. Weidner, *Three Policy Decisions Animate Revision of Uniform Partnership Act*, 46 BUS. LAW. 427 (Feb. 1991).

36. RUPA (1994). *See also* Donald J. Weidner & John W. Larson, *The Revised Uniform Partnership Act: The Reporters' Overview*, 49 BUS. LAW. 1 (Nov. 1993); BROMBERG AND RIBSTEIN ON PARTNERSHIP, SPECIAL RELEASE ON THE REVISED UNIFORM PARTNERSHIP ACT (1993). *But see* Larry E. Ribstein, *The Revised Uniform Partnership Act: Not Ready for Prime Time*, 49 BUS. LAW. 45 (Nov. 1993) (criticizing portions of RUPA).

37. ALA. CODE § 10-8A-101 to -1109 (Supp. 1996) (unless the text of footnotes clearly state otherwise, citations to RUPA also refer to Alabama's RUPA with no substantive variations).

38. RUPA §§ 601-603, 701, 801.

39. RUPA § 201.

separated from the partnership.[40]

Rather than always expressing the departure of a partner as a dissolution, RUPA defines a partner's death, retirement, bankruptcy, withdrawal or other separation from the partnership as a dissociation, not necessarily leading to a dissolution.[41] The new term dissociation essentially mirrors the dissolution triggering events found in the UPA. Because not all dissociations trigger dissolutions, RUPA sharply limits those circumstances where a partner has the accompanying right to demand a judicial sale and bid for the business. If a dissociation event does not cause a dissolution the dissociated partner has a right to be redeemed at fair market value,[42] leaving the legal existence of the partnership intact.

RUPA's paradigm distinguishing which dissociation events trigger buyouts and which only result in dissolution of the partnership essentially follows a modified two-pronged approach, hinging on whether the partnership agreement contains an express term or particular undertaking.[43] If the partnership agreement does not contain a term or particular undertaking, RUPA labels it as a partnership at will. If the partnership is at-will, all dissociation events, except a partner's voluntary withdrawal, result in no dissolution of the partnership thus triggering buy out rights only for the dissociated partner.[44] Consequently, the partnership continues to exist as the same legal entity after the buy out of the dissociated partner's interest much like a corporation that has redeemed a shareholder's stock.[45]

A partner's voluntary withdrawal from an at will partnership conclusively dissolves the partnership, allowing each part-

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40. *See* note 36 *supra*.

41. RUPA § 601 (1994).

42. RUPA § 701(b) & Alabama cmts. 1 & 3. RUPA requires the valuation to equal the greater of going concern or liquidation value. RUPA § 801 determines which dissociation events trigger absolute dissolutions, dissolution possibilities or buy out rights only.

43. RUPA § 601 (identifying dissociation events) and §§ 801(1) and (2) (concluding that which dissociation events cause dissolution, liquidation, and winding up of the partnership business hinge on whether the partnership is for a term or at-will).

44. RUPA § 801(1).

45. *Id.*

ner the absolute right to demand a judicial sale of the partnership's assets.[46] Even if the remaining partners settle the pay out for the withdrawing partner and continue the business in an uninterrupted fashion, the old partnership still technically ceases to exist with the business being continued in a new partnership.[47] The drafters of RUPA probably deemed it necessary to retain the right of at-will partners to dissolve the partnership in order to ensure a mechanism to cut off personal liability exposure.[48] As long as the same partnership remains legally intact, a partner remains personally liable for partnership debts arising before withdrawing from the partnership, even long after the withdrawal.[49] Thus, the only way for a partner to sever all possibilities of personal liability exposure is to dissolve the partnership. The personal liability exposure faced by all partners in general partnerships forced the RUPA drafters to preserve the absolute right to withdraw and dissolve an at-will partnership.

If the partnership is for a stated term or a particular undertaking, all wrongful dissociations trigger the possibility of a dissolution. Some examples of wrongful dissociations include voluntary withdrawal, bankruptcy or judicial expulsion before the completion of the term or undertaking. Certain other dissociations, such as death or incompetence before the end of the term or undertaking, also trigger the possibility of a dissolution.[50] Unlike the dissolution of an at-will partnership, which allows all partners the absolute right to demand a judicial sale, partners of term or undertaking partnerships do not enjoy an absolute right to a judicial sale. If a majority of the nondissociating partners want to continue the partnership the dissolution can effectively be thwarted.[51] If the nondissociating partners avoid the poten-

46. RUPA § 801(1) and cmt. 3.

47. *Id.*

48. *See* RIBSTEIN & KEATINGE, *supra* note 1, §§ 11.14, 11.16 (stating that partners must have some ability to dissolve in order to cut off lingering personal liability); PROTOTYPE LTD. LIAB. CO. ACT, commentary to § 802 (stating that historically, partnerships were concerned about indefinite personal liability).

49. RUPA § 806 (governing partners' liability to other partners after dissolution); RUPA § 703 (stating that without dissolution, a dissociated partner's liability lasts two years after dissociation).

50. RUPA §§ 801(2), 602(b), 601(6)-(10).

51. RUPA § 801(2). The Alabama language differs from RUPA, as enacted by NCCSUL, in one minor and in one major respect. The language of Alabama's

tial dissolution of the partnership, the dissociating partner and those partners who do not want to continue have the right to be bought out by the partnership.[52]

Although RUPA substantially increases the stability of partnerships by substituting partnership dissolution triggers with dissociations, allowing buy out rights only, RUPA leaves in place the one scenario under the UPA where many partners risked their share of the business being appropriated by a more powerful partner. Because under RUPA all withdrawals in an at-will partnership still always dissolve the partnership giving each partner the absolute right to demand a judicial sale, only a finding that the withdrawing partner has wrongfully dissolved the partnership can protect the less powerful partner.

Unlike the UPA, which left open the possibility of finding wrongful dissolutions through implied terms and fiduciary duty breaches, RUPA attempts to define "wrongful" more precisely by stating that a dissolution is wrongful only if "it is in breach of an express provision of the partnership agreement" or if a partner withdraws, suffers bankruptcy or judicial expulsion before the completion of a term or particular undertaking.[53] Arguably under RUPA, unlike the UPA, under no circumstance will the withdrawal from an at-will partnership amount to wrongful conduct.[54] On the other hand, because RUPA imposes an abso-

§ 801(2) speaks of at least half the partners affirmatively expressing a desire for the dissolution to go forward while RUPA's § 801(2) refers to a majority agreeing to continue. Either way, a "majority" threshold of the partners must want to continue the partnership to avoid a dissolution.

The major difference emphasizes how to measure majority consent. RUPA § 801(2), as promulgated by NCCSUL, requires a "majority in interest" measured in economic terms to continue the partnership, in order to satisfy the requirement for lacking continuing of life under the partnership classification rules that existed before the final check-the-box regulations. *See* RUPA § 801, cmt. 5. Alabama's § 801(2) contains no reference to economic interest, thus presumably the majority required to continue the partnership constitutes a majority of the number of partners (head count). Because lacking continuity of life is no longer relevant for partnership classification, Alabama's head count test carries no risk and will inevitably be simpler to administer.

52. RUPA § 701(a).

53. RUPA § 602(b).

54. RUPA § 602(b) enumerates wrongful withdrawal to include two types of withdrawals; withdrawals from a term partnership or a partnership for a particular undertaking and withdrawals in breach of an express provision of the partnership agreements. Express provision may be said to exclude any implied contracts, includ-

lute minimum level of fiduciary duty protection to all partners and requires all partners to act in good faith with fair dealing,[55] arguably RUPA leaves room to find wrongful withdrawals, even in partnerships with no explicit terms or undertakings, if the withdrawal violates the minimum fiduciary duties or clearly shows bad faith and unfair dealing.[56]

The elimination of all statutory dissolutions of Alabama LLCs by the new legislation represents sound business policy. The right to compel dissolution serves no meaningful goal and

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ing the contracts of good faith and fair dealing, or the fiduciary duties, which cannot be contractually eliminated. RUPA § 602(b). *See infra* note 56. *See also* Carter G. Bishop, *Treatment of Members Upon Their Death and Withdrawal from a Limited Liability Company: The Case for a Uniform Paradigm*, 25 STETSON L. REV. 255, 269 n.57 (1995) (LLC symposium article stating that ULLCA § 602(b)(1) provides that dissociation from an at-will LLC is wrongful only where "specifically made wrongful by the operating agreement").

55. RUPA § 103(b)(3) (stating that partners are unable to contractually eliminate entirely the basic duty of loyalty).

See also Donald J. Weidner, *Cadwalader, RUPA and Fiduciary Duty*, 54 WASH. & LEE L. REV. 877, 908 (1997); Gary W. Derrick, *Oklahoma Limited Liability Companies and Limited Liability Partnerships*, 22 OKLA. CITY U.L. REV. 643, 676 (1997); Michael K. Pierce, *Substantive Partnership Law: Special Problems of General and Limited Partnerships*, SB85 ALI-ABA Course of Study 1, 41 (May 1, 1997); Elisa Feldman, *Your Partner's Keeper: The Duty of Good Faith and Fair Dealing Under the RUPA*, 48 SMU L. REV. 1931, 1944 (1995).

56. *See* RUPA § 404 & cmts. The behavior of a partner dissociating from an at-will partnership with the clear intent of appropriating the entire business for herself should both violate the minimum fiduciary duties and amount to bad faith and unfair dealing. Because § 103(b)(3) of RUPA forbids the total elimination of fiduciary duties, and §§ 103(b)(4) and (b)(5) forbid the elimination of the duties of care and good faith, RUPA cannot possibly allow a partner to dissolve the partnership in a manner that clearly violates the minimum fiduciary duties.

Comment 4 of § 404 recognizes that the good faith obligation may create a duty for a partner to affirmatively disclose information beyond the duties established in the statute. This could operate to make an otherwise proper withdrawal wrongful in light of § 103(b)(3) requirements. Since no definition of "good faith and fair dealing" is provided, the courts will have to develop the meaning through case law (see cmt. 4), which, based on prior cases, could certainly declare a withdrawal wrongful even under an at-will agreement. *See, e.g.*, Wilensky v. Blalock, 414 S.E.2d 1 (Ga. 1992); Reid v. Bickel & Brewer, 1990 WL 129199 (S.D.N.Y. Sept. 4, 1990); Page v. Page, 359 P.2d 41 (Cal. 1961).

See also Robert W. Hillman, *RUPA and Former Partners: Cutting the Gordian Knot with Continuing Partnership Entities*, 58 LAW & CONTEMP. PROBS. 7 n.17 (1995) (stating that actions that violate the intent of the partnership agreement are still recognized by RUPA as breaches of the agreement thus raising the possibility that dissociation from an at-will partnership may be wrongful under some circumstances).

sets up the opportunity for an economically powerful member to purchase the entire business from the others at an unfairly low price. Unlike RUPA, which vests with each partner the absolute power to withdraw from and dissolve an at-will partnership, no policy justification exists to retain dissolution in LLCs. In a general partnership, the personal liability exposure of each general partner justifies allowing each partner the right to dissolve an at-will partnership.[57] Because only a dissolution eliminates the entity and any liabilities up to that time, a partner no longer wanting to associate with the others needs the ability to dissolve the entity in order to avoid being held personally liable for debts allegedly incurred before the partner's withdrawal. Because LLCs offer limited liability protection to all members, no reason exists to allow LLC members the absolute right to dissolve the LLC.[58]

C. Corporations

The corporation represents the business form that is the most difficult to dissolve.[59] Under traditional corporation law, a corporation may voluntarily dissolve by a recommendation by the board of directors followed by two-thirds of all votes entitled to be cast. The corporate statutes generally provide no rights for individual shareholders to dissolve the corporation or demand the corporation to redeem their shares.[60] In a widely held or publicly traded corporation, dissatisfied shareholders can simply sell their shares on the market and therefore generally do not need a comparable right to a partner's dissociation rights.[61]

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57. *See supra* notes 48-50, and accompanying text.

58. *See* PROTOTYPE LTD. LIAB. CO. ACT, commentary to § 802 (concluding that limited liability protection provided by LLCs provides a good reason for allowing LLCs to eliminate the right of dissolution under the statute).

59. ALA. CODE §§ 10-2B-1.01 to -17.03 (1994) (containing Alabama's law of corporations). For an excellent textbook on general corporations law, see ROBERT CHARLES CLARK, CORPORATE LAW (1986). For a comprehensive and excellent treatise on Alabama Corporate Law, see THIGPEN, *supra* note 5. For an excellent and useful treatise on corporations, see JAMES D. COX ET AL., CORPORATIONS (1995).

60. *See* REVISED MODEL BUS. CORP. ACT § 14.02, and ALA. CODE § 10-2B-14.02 (1994) (stating that corporation dissolves when two-thirds of shareholders vote, ratifying the board's recommendation to dissolve; the articles can reduce required vote to a majority; shareholders by unanimous vote can directly dissolve the corporation through written consent). For a full treatment of corporate dissolution, see COX, *supra* note 59, §§ 14, 26.

61. *See* CHARLES R. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND

However, shareholders of closely held corporations without a ready market for their shares often found themselves trapped in the corporation.[62] Problems typically arise when a particular shareholder has trouble getting along with the rest of the shareholders, who, as a group, have the power of the majority block to elect the entire board of directors and appoint the officers. The majority shareholders through their control of the board typically withhold all dividends, exclude the minority shareholder from the corporate payroll, while paying themselves large salaries as officers.[63]

Over time, both courts and legislatures[64] recognized a need to alter the traditional corporate law to provide relief for minority shareholders in closely held corporations. Leading the way, courts borrowed fiduciary duties from partnership law and provided equitable relief for a minority shareholder if the majority shareholders acted wrongfully by denying the shareholder any income from the company through salaries or dividends while attempting to force the shareholder to sell shares at an unfairly

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OTHER BUSINESS ORGANIZATIONS 499 (2d ed. 1996).

62. *See* Cookies Food Prod. Inc. v. Lakes Warehouse Distrib., Inc., 430 N.W.2d 437 (Iowa 1988) (allowing majority shareholders who received large salaries while minority shareholders received no salaries or dividends to successfully prove fairness to the corporation because the corporation was profitable); Jefferson County Truck Growers Ass'n v. Tanner, 341 So. 2d 485, 487 (Ala. 1977) (stating that unless corporation suffers actual injury no grounds for derivative suit exist); Ingalls Found. v. Ingalls Iron Works, 98 So. 2d 30, 39 (Ala. 1957); (concluding actions of directors are not sufficient to show unfairness to the corporation or bad faith). *See also* O'NEAL & THOMPSON, CLOSE CORPORATIONS, *supra* note 10. *See generally* F. HODGE O'NEAL & ROBERT B. THOMPSON, OPPRESSION OF MINORITY SHAREHOLDERS (1991-95) (Supp. 1996) [hereinafter MINORITY SHAREHOLDERS].

63. *See* O'NEAL & THOMPSON, MINORITY SHAREHOLDERS, *supra* note 62, ch. 3 (describing in detail the techniques used to squeeze out a minority shareholder); THIGPEN, *supra* note 5, ch. 9; Robert B. Thompson, *The Shareholder's Cause of Action For Oppression*, 48 BUS. LAW. 699 (1993).

64. In an attempt to address the inability of traditional corporate law to deal with the business problems of close corporations, state legislatures adopted close corporation supplements. Shareholders of closely held corporations could elect, if the corporation qualified, to be governed by the close corporation supplement instead of the general corporation law. Although the close corporation supplement tried to treat the corporation more like a partnership, the supplement failed to address the most significant problem faced by the shareholders, that of no liquidity of shares, because any dissolution or redemption rights had to be affirmatively provided for in the articles. Alabama had a close corporation supplement until it adopted the Revised Model Business Corporation Act in 1994. *See generally* THIGPEN, *supra* note 5, § 9-11.

low price.[65]

The Revised Model Business Corporation Act (RMBCA) continued this trend by allowing shareholders a statutory right to petition the court to dissolve the corporation if the majority shareholders through their control of the board are guilty of oppressive conduct. Alabama adopted the RMBCA in 1994, thus creating for the first time new statutory remedies for Alabama close corporation shareholders being squeezed out by majority shareholders.[66] Once a shareholder files a petition seeking an involuntary dissolution, the other shareholders have ninety days to purchase the shareholder's interest at fair market value. If the other shareholders refuse to buy out the complaining share-

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65. *See* Donahue v. Rodd Electrotype Co., 328 N.E.2d 505 (Mass. 1975); Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657 (Mass. 1976) (most frequently cited cases recognizing modified partnership fiduciary duties among close corporation shareholders). *See also* Rexford Rand Corp. v. Ancel, 58 F.3d 1215 (7th Cir. 1995) (recognizing fiduciary duties in close corporations under Illinois law); Alaska Plastics, Inc. v. Coppock, 621 P.2d 270 (Alaska 1980) (remanding for a factual determination of whether a close corporation remedy is appropriate); Van Schaack v. Van Schaack Holdings, Ltd., 856 P.2d 15 (Colo. Ct. App. 1992); Yackel v. Kay, 642 N.E.2d 1107 (Ohio 1994); Frank Lerner & Assocs. v. Vassy, 599 N.E.2d 734 (Ohio 1991); Crosby v. Beam, 548 N.E.2d 217 (Ohio 1989); Thompson v. Central Ohio Cellular Inc., 639 N.E.2d 462 (Ohio Ct. App. 1994); Koos v. Central Ohio Cellular, Inc., 641 N.E.2d 265 (Ohio Ct. App. 1994) (recognizing fiduciary duties in the close corporation context, but holding that defendants did not breach their fiduciary duties to minority shareholders under those specific facts); Gigax v. Repka, 615 N.E.2d 644 (Ohio Ct. App. 1992); Masinter v. WEBCO Co., 262 S.E.2d 433 (W. Va. 1980) (reversing summary judgment and remanding for factual findings to determine if majority shareholder conduct wrongful); O'NEAL & THOMPSON, MINORITY SHAREHOLDERS, *supra* note 62, §§ 7:03-:04.

66. 1994 Ala. Acts 343, effective Jan. 1, 1995. ALA. CODE § 10-2B-14.30(2)(ii) provides statutory remedy of judicial dissolution for oppressed minority shareholders, and under section 10-2B-14.34, as an alternative to dissolution, either the corporation or the remaining shareholders can elect a buyout of the complaining shareholder at fair value. *See* section 10-2B-14.34 comm. Although the buyout option has not been available as a statutory remedy before Jan. 1, 1995, Alabama courts have had equitable powers to order whatever remedies they deem appropriate upon a petitioner's showing of oppression under previous statutes since 1959. *See* Abel v. Forrest Realty, 484 So. 2d 1069, 1072 (Ala. 1986) (citing the authority of former Alabama corporate law); ALA. CODE § 10-2A-195(a)(1)(b); Belcher v. Birmingham Trust Nat'l Bank, 348 F. Supp. 61 (N.D. Ala. 1968) (citing ALA. CODE § 10-2A-76 and concluding controlling stockholders' fiduciary obligations and courts' jurisdiction to remedy oppression unimpaired by statute). Section 10-2A-76 is Alabama's predecessor to section 10-2B-8.31. ALA. CODE § 10-2B-8.31 cmt. 2. *See also* Fulton v. Callahan, 621 So. 2d 1235, 1251 (Ala. 1993) (fashioning a remedy using ALA. CODE §§ 10-2A-195 and 10-2A-76, ordering buyout of petitioner's shares, which later became available under section 10-2B-14.34).

holder, the court must decide if grounds exist to order an actual dissolution of the corporation or some other remedy, the most common being a buyout of the minority shares.[67] Regardless whether the relief sought is equitable or statutorily based, the complaining shareholder still must prove wrongful behavior by the majority.[68]

Even before the Alabama legislature adopted the RMBCA and the statutory remedies for oppression that came with it, the Alabama Supreme Court granted equitable remedies for minority shareholders showing that the majority group breached fiduciary duties.[69] Alabama commentators labeled this remedy as the "tort of oppression"[70] marked by behavior designed to deprive the minority shareholders of any return on their shares.[71] Under the facts, however, if the majority's conduct fails to reach a high level of wrongful behavior, the court will refuse to exercise its equitable powers,[72] even under circumstances where

67. REV. MODEL BUS. CORP. ACT §§ 14.30-.34 (1990); ALABAMA BUS. CORP. ACT §§ 14.30-14.34 (1994). *See generally* Joshua M. Henderson, *Buyout Remedy For Oppressed Minority Shareholders*, 47 S.C. L. REV. 195 (1995); Ian Ayres, *Judging Close Corporations in the Age of Statutes*, 70 WASH. U. L.Q. 365 (1992); Dennis S. Karjala, *An Analysis of Close Corporation Legislation in the United States*, 21 ARIZ. ST. L.J. 663 (1989).

68. REV. MODEL BUS. CORP. ACT §§ 14.30-.34

69. *See* sources cited at *infra* note 71.

70. *See* Andrew P. Campbell, *Litigating Minority Shareholder Rights and the New Tort of Oppression*, 53 ALA. LAW. 108 (1992); Michael E. DeBow, *"Oppression" of Minority Shareholders: Contract, Not Tort*, 54 ALA. LAW. 128 (1993). *See also* James Christopher McCool, Comment, Michaud v. Morris *and Minority Shareholder Oppression in Alabama: Attempting to Clarify an Ambiguous Cause of Action*, 44 ALA. L. REV. 621 (1993).

71. Gilliland v. USCO Power Equip. Corp., 631 So. 2d 938 (Ala. 1994) (holding that minority shareholder stated valid cause of action due to wrongful behavior of majority shareholder and remanding to lower court for findings of fact); *Ex parte* Brown, 562 So. 2d 485 (Ala. 1990) (ordering relief when majority shareholder used corporate assets to benefit another business that minority shareholder enjoyed no benefits from); Fulton v. Callahan, 621 So. 2d 1235 (Ala. 1993) (ordering relief when majority shareholders reduced minority shareholder's salary and attempted to value his shares too low during buyout negotiations). *See also* THIGPEN, *supra* note 5, § 9-2 (stating that Alabama courts are moving toward partnership-like fiduciary duties between close corporation shareholders, at least in cases of freeze-out of minority shareholders by the majority). *See also* Michaud v. Morris, 603 So. 2d 886 (Ala. 1992) (refusing to order relief under the facts, but strong dicta states that shareholders in close corporations have a right to share in corporation earnings, and a majority cannot frustrate these rights by failing to declare dividends or otherwise manipulate corporate earnings to squeeze out minority interests).

72. *See* Michaud v. Morris, 603 So. 2d 886 (Ala. 1992) (refusing to allow an

arguably the minority successfully showed some level of wrongful conduct.[73]

Courts and commentators dealing directly with statutory oppression remedies like the one offered by the Revised Model Business Corporation Act and the Alabama Business Corporation Law have struggled over the statutory definition of oppression.[74] Although to date there have been no cases in Alabama where the Alabama Supreme Court has directly defined oppression under the Alabama Business Corporation Law, no valid policy justifies an interpretation that materially differs from the level of wrongful conduct Alabama courts have historically required in order to grant equitable remedies under Alabama's common law remedy known as the tort of oppression.[75] Moreover, court decisions in other jurisdictions defining the threshold of majority wrongful conduct may prove helpful by analogy if

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equitable remedy when minority shareholder fired as manager of a restaurant due to business failure); Abel v. Forrest Realty, Inc., 484 So. 2d 1069 (Ala. 1986) (concluding minority shareholder unable to show wrongful conduct solely by demonstrating his lack of control); Stallworth v. AmSouth Bank of Alabama, 1997 WL 778838 (Ala. Dec. 19, 1997) (concluding that minority shareholder unable to show oppression/squeeze-out simply because rest of board voted against his wishes).

73. *See* Fisher v. Bankers' Fire & Marine Ins. Co., 155 So. 538 (Ala. 1934); Johnston v. Livingston Nursing Home, Inc., 211 So. 2d 151 (Ala. 1968) (concluding that mere quarrels between shareholders do not constitute wrongful behavior by majority).

74. *See In re* Topper, 433 N.Y.S.2d 359 (N.Y. Sup. Ct. 1980) (defining oppression as defeating minority shareholder's reasonable expectations at the time of the formation of the contract; court ordered corporation to buy out minority shareholder's interest); *In re* Kemp & Beatley, Inc., 473 N.E.2d 1173 (N.Y. Ct. App. 1984) (concluding oppression clearly present when dividends suspended only after the shareholder attained minority status; court ordered a buyout); Meiselman v. Meiselman, 307 S.E.2d 551 (N.C. 1983) (finding oppression where the majority shareholders diverted profits away from the minority shareholder, resulting in frustration of the shareholder's reasonable expectations). *See generally* Thompson, *supra* note 63; Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675 (1990) (concluding that oppression statutes are moving toward providing less protection than equitable remedies because often minority shareholder must demonstrate intentional wrongful conduct).

75. This assumes that the Alabama Supreme Court is generally satisfied with the standard of wrongful conduct that minority shareholders must prove to qualify for relief. If the Alabama Supreme Court later decides to change the standard (i.e., either require the minority shareholder to prove a lower or higher threshold of wrongful conduct in order to get relief), the new level of proof should apply in the same manner to minority shareholders seeking relief under the court's equitable powers or the involuntary dissolution statute.

those decisions are consistent with Alabama's general policy of articulating when majority shareholders' conduct reaches a level of wrongfulness justifying allowing a remedy for the minority shareholders.[76]

The problems associated with the breakup of a business focus on opposite perspectives when comparing close corporations and partnerships. In the partnership context the opportunity of the withdrawing partner to economically take advantage of other partners arises due to the liquid nature of the investment, in legal terms, the general right to dissolve an at-will partnership. Even if the partner's dissociation results in no dissolution, the withdrawing partner still has the right to be bought out by the partnership and these rights cannot be contractually eliminated.[77] Because partners have the right to recoup their investment, any abusive behavior more often comes from the withdrawing partner rather than those remaining in the business, especially in at-will partnerships where the withdrawing partner has the absolute right to dissolve the partnership and demand a judicial sale.

In the close corporation context the illiquid nature of the investment, legally the fact that corporate law provides no redemption rights for individual shareholders without an explicit contractual provision, provides the majority shareholders seeking to remain in the business an opportunity to squeeze out the minority shareholder. Consequently, statutory drafters considering changes to the dissociation provisions in LLC statutes must make a basic policy choice between the corporation and partnership models. A corporate based model favors eliminating, while a partnership based model favors retaining individual dissociation rights in the statutory default provisions.

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76. *See, e.g.*, Belcher v. Birmingham Trust, 348 F. Supp. 61 (N.D. Ala. 1968); Smith v. Flynn, 155 So. 2d 497 (Ala. 1963) (examples where Alabama courts used other states' authorities by analogy).

77. RUPA §§ 103(b)(6), 602(a).

III. POLICY ISSUES WHEN DRAFTING LLC STATUTORY DISSOCIATION PROVISIONS

A. *The Business Debate: Partnership or Corporate Model?*

The Internal Revenue Service's recent regulations, eliminating the need to make LLCs statutorily dissolvable upon a change in the members, frees all state legislatures, including Alabama's, to rewrite the default provisions governing member dissociations.[78] As already noted, no valid business reason exists to retain statutory default provisions allowing individual members to dissolve the LLC.[79] Consequently, the new Alabama legislation's elimination of dissolution rights, that were once but no longer needed to ensure that the LLC would meet the partnership classification regulations, represents a positive development in the law of LLCs.[80] Alabama LLC members with insufficient economic resources to purchase the entire business no longer risk losing their share at an unfair low price in the hands of a more powerful member dissolving the LLC.[81]

The other question, whether state LLC statutes should retain or eliminate statutory dissociation rights triggering a redemption by the company at a price determined by professional valuation standards, contains no simple answers. In making the decision the statutory drafters must make a fundamental policy decision to base the statutory provision on partnership or corporation law. Moreover, unlike dissolution triggers, dissociation with buyout rights do not carry the same potential for abuse that currently plagues partnership law.[82] Although strong arguments exist to the contrary, when viewing this issue only from the perspective of finding the best business policy, the partnership model probably works best for LLCs, tilting the

78. *See supra* notes 4-12 and accompanying text.
79. *See supra* notes 57-58 and accompanying text.
80. *See supra* notes 57-58 and accompanying text.
81. *See supra* notes 27, 56 and accompanying text.
82. *See supra* notes 77-78.

decision in favor of leaving dissociation rights in the statute.[83]

Long before LLCs rose into prominence, scholars debated whether or not close corporation shareholders should have individual rights to withdraw from the business and require the corporation to redeem the shares. Focusing on practical characteristics of the business, closely held corporations have been directly compared to partnerships thus supporting allowing close corporation shareholders partnership dissociation rights.[84] Others argue that because majority shareholders would not bargain for partnership dissociation rules, close corporations should not be analogized as partnerships.[85] Practitioners advising sophisticated business owners and joint venture participants undoubtedly can give many examples of clients insisting that the LLC operating agreement eliminate, as much as the tax law would permit, all dissociation and dissolution rights.[86] Representing the legitimate interests of these business participants to lower their transaction costs, this argument favors, for pure business reasons, eliminating all dissociation rights in the LLC statute in order to reflect what these parties would bargain for.[87]

Unfortunately statutory default provisions denying LLC members dissociation rights in order to legitimately save some business owners transaction costs comes at a heavy price for less sophisticated persons that either cannot or will not seek competent legal advice before proceeding. The vast amount of litigation and legislative activity struggling with the rights of minority

83. *See infra* notes 84-97 and accompanying text. Gevurtz, *supra* note 18, at 286 (concluding that California's LLC laws giving cash-out rights to LLC members provide best default rules). *See also* Larry E. Ribstein, *The Emergence of the Limited Liability Company*, 51 BUS. LAW. 1, 27 (1995); Franklin A. Gevurtz, *Squeeze-Outs and Freeze-outs in Limited Liability Companies*, 73 WASH. U. L.Q. 497, 516 (1995) (suggesting that LLC members should have rights to be cashed out in the absence of other agreement); Gevurtz, *supra* note 27, at 540-41.

84. *See* John A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VAND. L. REV. 1 (1977).

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

86. *See* RIBSTEIN & KEATINGE, *supra* note 1, § 1.03; *supra* note 5 and accompanying text (indicating the possibility of LLCs adopting more corporate features now that partnership business provisions are no longer necessary to ensure partnership taxation).

87. *See* Easterbrook & Fischel, *supra* note 85.

shareholders in close corporations illustrates the cost both to the shareholders and the legal system when the shareholders no longer get along and particular shareholders have no ability to separate from the business.[88] These shareholders did not and for the most part, due to their level of sophistication, will not, bargain ahead of time to address separations from the business. Consequently, if harmony among unsophisticated business owners using closely held corporations disappears, the minority shareholder is forced into litigation and must affirmatively prove a substantial level of wrongful conduct by the majority shareholders in order to secure a court ordered buyout of their shares.[89]

The recent elimination of dissociation rights in LLCs exposes unsophisticated business owners using LLCs to the same risk of oppression and squeeze out techniques that have been faced by similar business owners using close corporations.[90] On pure business policy grounds this represents a very negative development because LLCs have primarily developed as the small business owners' alternative to the general partnership.[91] Indeed the default provisions addressing the members' agency powers to bind and management powers over the LLC directly reflect the provisions of the UPA and the RUPA.[92] Although the members of the LLC possess the ability to override the general partnership style of management by centralizing management in the managers, the creation of managers clearly requires an affirmative agreement altering the default provisions.[93] Thus the LLC statute itself assumes that business owners desiring a management style closer to a traditional corporation possess the ability to tailor their own arrangement.[94]

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88. *See supra* notes 62-63 and accompanying text.

89. *See supra* notes 67-76 and accompanying text.

90. *See supra* notes 62-63 and accompanying text.

91. *See* RIBSTEIN & KEATINGE, *supra* note 1, § 2.02.

92. *See* ALA. CODE §§ 10-12-21 to -22; Boles & Hamill, *supra* note 3, at 148-51 (discussing general partnership origins of LLC default agency and management powers). *See also supra* note 12 and accompanying text (stating that recent LLC amendment does not change the default provisions addressing each member's agency powers to bind the LLC and management rights).

93. *See* ALA. CODE §§ 10-12-21 to -22; Boles & Hamill, *supra* note 3, at 151-60 (discussing the creation of managers in a LLC). *See also supra* note 11.

94. *Id.* By providing default management provisions that reflect general partner-

The policy behind drafting statutory default provisions should seek to provide a set of rules addressing the needs of the intended users of the business form who are least likely to plan ahead of time.[95] The law surrounding close corporations clearly did not develop in a logical fashion where the judicial and legislative responses collectively reflected a well thought out business policy for the business owners using the close corporations. Instead, close corporations developed as a reaction to vast problems experienced by small business owners using a business form, the corporation, with default provisions and legal doctrines totally unsuited for small business. The corporation was simply not created for small businesses; small businesses chose to use corporations in order to obtain limited liability under circumstances where as a business matter, they resembled partnerships in all other ways.[96]

Unlike close corporation law, which developed in a reactive fashion, the LLC business provisions were affirmatively modeled after partnership law.[97] Although the argument in favor of creating corporate-like rules concerning separation from the business in order to save transaction costs raises legitimate points, on balance, business policy would be better served if the LLC's default provisions remained largely partnership based, leaving in dissociation rights while eliminating dissolution rights. Leaving rights of all members to dissociate in the statute will allow unsophisticated members who have fallen out of favor with the majority group some bargaining power when negotiating a settlement, and should reduce the amount of litigation. Moreover,

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ships with a direct ability to appoint managers, the LLC effectively combines the corporate and partnership models, using the partnership model as the basis for the default provisions. *See* Hamill, *supra* note 4, at 594-95; Boles & Hamill, *supra* note 3, at 148-60.

95. *See* CHARLES R. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 47-50 (2d ed. 1996) (describing various policy approaches to drafting statutory default provisions).

96. *See* Lawrence E. Mitchell, *Close Corporations Reconsidered*, 63 TUL. L. REV. 1143 (1989) (describing the development of close corporation law).

97. *See* RIBSTEIN & KEATINGE, *supra* note 1, Ch. 16 (describing in detail the partnership tax classification rules and how the LLC's business provisions were crafted to fit within those rules). Because the partnership classification regulations initially developed to distinguish true business differences between partnerships and corporations, the LLC's default provisions started out adopting a general partnership model. *See* Hamill, *supra* note 4, at 571-81.

LLC business participants that wish to eliminate all dissociation rights can easily do so in the operating agreement, and by definition, normally these businesses seek adequate legal advice concerning their business affairs.[98]

Statutory dissociation rights can be tailored in a way to minimize the opportunities for the individual member to abuse the power to dissociate. Members of LLCs with actual or implied terms or undertakings should be required to wait until the term or undertaking expires before any redemption rights materialize.[99] In addition to the delay of payment until the end of the term or undertaking, members dissociating prematurely should be liable for damages under a statutory scheme similar to RUPA.[100]

Members of LLCs with no actual or implied term or undertaking may encounter an individual member using the power to dissociate in an abusive manner. For example, an LLC member may threaten dissociation and the economic hardships that may come with the buyout in order to gain a greater profit share or some other advantage not bargained for. As already noted, general partnership cases show many examples of individual partners dissolving the partnership under facts that suggest the dissolver may be trying to appropriate the other partner's share of the business.[101] Although questionable uses of dissociation powers undoubtedly will come up, the LLC statute can take at least two steps to substantially mitigate the abuse potential. First, eliminating statutory dissolution rights will stop most of the opportunity to appropriate the other member's share of the business.[102] Unlike dissolution rights, dissociation rights confer no rights to a judicial sale of the business and require an actual valuation of the business separate and apart from the amount any particular person would bid from the business.[103] Consequently, unlike general partners dissolving the partnership, dissociating members of LLCs will not have the opportunity to

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98. *See supra* note 84 and accompanying text.

99. *See supra* notes 28-31 and accompanying text.

100. *See* RUPA art. 7 (addressing partner's dissociation when business is not wound up).

101. *See supra* notes 27, 30-33 and accompanying text.

102. *See supra* notes 27, 57-58, 77 and accompanying text.

103. *See supra* note 42 and accompanying text.

set an unfairly low valuation to the business through the bidding process.[104] Any remaining abuses of the power to dissociate can be largely curtailed by retaining general concepts of wrongful dissociation if the power is used in a manner that breaches fiduciary duty to the other members.[105]

B. Effect of Estate and Gift Tax Valuation Rules on Dissociation Provisions

Although LLC state drafting committees are now able to craft provisions addressing statutory withdrawal rights from the business without conforming to the former partnership classification requirements for lacking continuity of life, ironically Alabama's legislature, and many others, have been strongly encouraged to, once again, put tax considerations at the forefront.[106] Now that the legislatures have full discretion over the dissociation provisions, for the first time the opportunity exists to draft the business exit provisions to meet requirements under the Estate and Gift Tax rules for discount valuations when persons give or bequeath LLC interests to family members.[107] Be-

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104. *See supra* note 27 and accompanying text.

105. *See supra* note 33 and accompanying text. *See also* Drashner v. Sorenson, 63 N.W.2d 255 (S.D. 1954) (finding a partner's threat of withdrawal in order to get more distribution rights to be wrongful).

106. Several states other than Alabama have recently passed legislation or have bills pending that do away with all dissociation rights, rendering LLC members indistinguishable from close corporation shareholders. For new legislation, see S. 266, 20th Leg., 1st Sess. (Alaska 1997); 1997 Ariz. Legis. Serv. 282 (West) (amending ARIZ. REV. STAT. ANN. § 29-707); 1997 Conn. Legis. Serv. 97-70 (S.S.B. 1193) (West) (amending CONNECTICUT GENERAL STAT. ANN. § 34-159); 1997 Ill. Legis. Serv. 90-424 (West) (adding ILL. COMP. STAT. §§ 180/35-50/35-55, & /35-60); 1997 Iowa Legis. Serv. Ch. 188 (West) (changing IOWA CODE ANN. § 490A.704); 1997 Md. Laws 659; 1997 Mich. Legis. Serv. 52 (West) (adding § 304 to MICH. COMP. LAWS ANN. § 450.4304); 1997 N.H. Laws ch. 120 (amending RSA 304-C:41); 1997 Ohio Laws 73 (amending OHIO REV. CODE ANN. § 1705.16(c) (1997)). For recently introduced legislation, see S.J. 154, 1998 Miss. Reg. Sess. and H. 928, 1998 Miss. Reg. Sess. (amending MISS. CODE ANN. § 79-29-307(3)); 1997 R.I. Pub. Laws Ch. 188, §§ 5-6 (amending R.I. GEN. LAWS § 7-16-29).

107. Limited partnerships have always been an effective tool for gift and estate tax planning. *See* Troy Renkemeyer, *The Family Limited Partnership: An Effective Estate Planning Tool*, DIGEST OF TAX ARTICLES, Nov. 1996, at 77; Louis A. Mezzullo, *Family Limited Partnerships and Limited Liability Companies*, SB05 ALI-ABA 35, 42-43 (July 18, 1996). Before the Internal Revenue Service issued the check-the-box regulations, LLCs were not suitable for family gift and estate tax planning because

cause the law concerning valuation of interests in business forms places a high degree of emphasis on the statutory provisions addressing the ability of the recipient to transfer or liquidate the interest, Alabama and many other states have been strongly encouraged to eliminate all statutory dissociation rights in LLCs without fully considering the impact on other businesses using LLCs outside the family gift and estate planning context.[108]

When valuing an ownership interest in a corporation, partnership or LLC for purposes of the estate and gift tax, generally the inability to transfer or liquidate the interest results in a valuation discount from the true fair market value which translates into less tax.[109] Section 2704(b) of the Internal Revenue Code, however, places substantial limitations on the ability to discount the value of gifts and bequests between family members even if the family members cannot transfer or liquidate the shares of stock or interest in the partnership or LLC. This provision conclusively assumes that any restrictions on transfer or liquidation rights are not real if the family as a unit controls the business even if these restrictions otherwise meet the general requirement for discounted valuation.[110]

Section 2704(b)(3)(B) provides an exception to the draconian rule denying discounted valuation to all transfers of business interests between family members. Under section 2704(b)(2)(B) gifts or bequests of corporate shares, partnership or LLC interests among family members can qualify for discounted valuation, if the relevant statute governing the business organization restricts the recipient's ability to transfer or liquidate the interest in the business organization.[111] In other words, the Internal

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of the necessity to lack continuity of life. *See* note 4 *supra*.

108. *See supra* notes 78-83 and accompanying text.

109. I.R.C. § 2703(b) (stating that restrictions on the right to sell or use property can be considered when valuing the property as long as the restriction is (1) a bona fide business arrangement, (2) not a device to make transfers among family members for less than adequate consideration, and (3) the terms are similar to comparable arms length transactions).

110. I.R.C. §§ 2704(b)(1) and (b)(2). For purposes of gift and estate valuation these provisions disregard applicable restrictions, generally the ability to liquidate the corporate or partnership interests, if the family unit controls the business.

111. I.R.C. § 2704(b)(3)(B) (providing exception to the rule disregarding applicable restrictions in IRC § 2704(b)(1), if the restriction is provided by Federal or State

Revenue Code when dictating which transfers of business interests among family members can qualify for discounted valuation makes a sharp distinction based on the state statutory default provisions governing the ability to dissociate and receive buyout rights. LLCs organized in states where the statutory default provisions provide dissociation rights can never qualify for discounted valuation if interests are gifted or bequeathed among family members. This is true even if the relevant LLC operating agreement eliminates the statutory dissociation rights, rendering the member legally in the same position as a close corporation shareholder or a member of a LLC that never had dissociation rights in the statute.

In order to use LLCs as gift and estate tax planning vehicles, practitioners are understandably lobbying their state legislatures to eliminate all dissociation rights in the statute.[112] Although no commentary exists, the elimination of all dissociation rights in Alabama LLCs was probably motivated by a desire to use LLCs in the gift and estate tax planning context. Unfortunately, the elimination of statutory dissociation rights will negatively affect many unsophisticated small business users of LLCs who are in no way engaging in complex gift and estate tax planning.[113] The overly formalistic emphasis in section 2704(b) on the source of the transfer and liquidation restrictions (restrictions originating in the statute can produce valid discounts while contractual restrictions cannot) has replaced the partnership classification requirements as the driving force dictating the provisions governing individual rights to withdraw from the business. Alabama and all other state legislatures that have revised or are revising their LLC statutes to eliminate the dissolution and dissociation provisions once again experience the tax rules dictating substantive business provisions that should be

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law; the exception takes it out of the disregarded applicable restrictions thus allowing the family member to discount the fair market value if all other requirements to qualify for discounted valuation are met). IRS Reg. § 25.2704-2(b) defines an applicable restriction as "a limitation on the *ability to liquidate* the entity (*in whole or in part*) that is more restrictive than the limitations that would apply under the State law generally applicable to the entity in the absence of the restriction" (emphasis added).

112. *See supra* notes 106-108 and accompanying text.

113. *See supra* notes 82-94 and accompanying text.

drafted to further larger business policy concerns.[114]

Ironically, the source of a restriction, in the statute or a contract, on the ability to transfer or liquidate an ownership interest in a business organization probably fails to distinguish between gifts and bequests that deserve discounted values from those that should be taxed at the full fair market value. Because LLC statutory dissociation rights can easily be eliminated by the operating agreement, arguably a state law imposed restricted interest carries no more assurance of being a bona fide restriction than a contractually based restriction. In both instances the real inquiry should focus on whether the recipient has received shares of stock or interests in a partnership or LLC that truly cannot be liquidated or disposed of, or if the statutory or contractual restrictions represent shams serving only to provide a basis to lower the gift or estate tax through discounted valuation.[115]

Although Congress' emphasis on the state law statutory default provisions will do little to further the gift and estate tax policy, this formalistic distinction will encourage legislators to eliminate statutory dissociation rights, thus exposing unsophisticated business participants to all of the risks minority shareholders of close corporations currently face.[116] In Alabama, this result has already occurred, and in the years to come the Alabama courts will probably see cases of Alabama LLC minority members with problems similar to those experienced by close corporation shareholders. Although the Alabama LLC statute has no statutory remedies for oppressed minority LLC members, the Alabama courts should, by analogy, allow these LLC mem-

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114. *See supra* notes 5, 106-107 and accompanying text.

115. *See generally* Mezzullo, *supra* note 107, at 107 (arguing that reliance on the restriction provided by state law not good if transferor or a family member of transferor is able to remove restriction immediately after transfer); Matthew McGuire, Note, *The Uncertain Future of the Limited Partnership in Estate Planning*, 10 CONN. PROB. L.J. 337, 365 (1996) (stating that Congress is likely to eventually take away § 2704(b) statutory restriction exception); William E. Sider, *Partnership Taxation—What's Hot and What's Not*, 74 MICH. B.J. 1034, 1038-39 (1995) (arguing that certain states' statutory defaults have not yet been tested to determine whether they qualify for maximum valuation discounts by eliminating the impact of § 2704(b); IRS/Congress will probably issue future rules to curb the growing use of vehicles such as the LLC to obtain valuation discounts).

116. *See supra* notes 62-63.

bers to invoke the current statutory oppression remedy available to corporate shareholders.[117] Moreover, Alabama LLC members victimized by squeeze-out techniques should also be able to invoke the common law tort of oppression remedies developed by the Alabama courts for close corporation shareholders.[118]

IV. CONCLUSION

Long before the LLC rose into prominence, partnership and close corporation law struggled with issues concerning the individual owners' rights to withdraw their capital from the business. By statutorily granting each partner the power to withdraw from the partnership, the partnership model favors the rights of the individual partners over the rest of partners. The corporate model, providing no statutory redemption rights thus requiring the shareholders to contractually bargain for a buy-sell agreement, favors the rights of the shareholders as a group over the rights of the individual shareholder. For solely tax reasons, until late 1996 the LLC statutory provisions had to provide the members the power to withdraw and trigger a possible dissolution of the company. After the Internal Revenue Service eliminated the partnership classification regulations by automatically taxing all LLCs as partnerships, LLCs for the first time possessed the freedom to adopt business provisions addressing dissociation without regard to the partnership classification regulations.

When analyzing only the business policy concerns, the LLC statute should eliminate the individual member's power to dissolve the LLC but retain rights to dissociate with redemption rights from the company. Although strong arguments can be made that statutory dissociation rights increase transaction costs for more sophisticated LLC business participants, these rights should nevertheless remain in the statute in order to help prevent the squeeze-out techniques so commonly experienced by minority shareholders of close corporations. Unsophisticated business participants that will not seek adequate legal advice before proceeding are especially vulnerable to oppressive behav-

117. *See supra* notes 66-68, 74-76.
118. *See supra* notes 69-73.

ior by the majority owners. Statutory dissociation rights will provide such members with enough bargaining power that should encourage the parties to settle rather than resort to litigation.

Although the debate addressing whether the corporate or partnership dissociation model offers superior statutory defaults is interesting and leaves a great deal of room for disagreement, it appears that another set of tax rules has replaced the partnership classification regulations as the driving force behind LLC legislation addressing dissociation rights. Because the gift and estate rules deny all opportunities to discount the value of LLC interests transferred by gift or bequest between family members if the statute allows dissociation rights, state legislatures, like Alabama's, will be strongly motivated to eliminate the dissociation rights for that reason alone, without carefully considering the business consequences. Thus, a large number of LLC members not engaged in estate and gift tax planning will become vulnerable to the close corporation squeeze-out tactics and will further crowd the courts seeking the equitable and statutory relief now available to close corporation shareholders.

Moreover, the elimination of dissociation rights in the state law statutory default provisions does little to distinguish those gifts and bequests that deserve discounted valuation from those that deserve to be taxed at full fair market value. Regardless how the state statute resolves the dissociation rights question in the default provision, the parties' operating agreement still provides the last word. In otherwords the operating agreement of a LLC in a state with statutory dissociation rights can eliminate those rights rendering that LLC indistinguishable from a LLC in a different state that contains no dissociation rights in the statute. Conversely, the operating agreement of a LLC in a state with no dissociation rights can provide for such rights in a buy-sell agreement.

As long as the gift and estate tax valuation rules artificially focus on the state law statutory default provision as the ironclad dividing line separating LLC interests that can and cannot qualify for discounted valuation, the trend to eliminate all dissociation rights in the LLC statutes will continue. Only Congress can stop this trend and allow the states to draft LLC dissociation rules for business policy reasons. Congress should re-exam-

ine the gift and estate tax valuation rules and move the emphasis away from the state law statutory default provisions addressing dissociation.