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LIVE & RECORDED WEBCASTS | LEGAL | TAX | FINANCE | RISK | COMPLIANCE & HR

## Best Practices in Dealing with Disputes and Litigation in a Limited Liability Company (LLC) in 2015

### Presented By:

#### THE KNOWLEDGE GROUP

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### Partner Firms:



Founded 1910



Willamette Management Associates

McELROY, DEUTSCH, MULVANEY  
& CARPENTER LLP

### Speaker Firms and Organization:

**Shutts & Bowen LLP**  
Alette DelPozo Rodz  
*Partner*

**Willamette Management Associates**  
Shawn Fox, CPA/ABV, CFA, ASA  
*Managing Director*

**McElroy, Deutsch, Mulvaney &  
Carpenter, LLP**  
Margaret L. Watson  
*Of Counsel*

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### Partner Firms:



*Founded 1910*

Shutts & Bowen is a Florida-based law firm with approximately 250 attorneys in seven offices in the State of Florida. Founded in 1910, Shutts & Bowen is one of the oldest law firms in Florida. Shutts & Bowen is proud of its history and commitment to providing up-to-date technology services to its clients and staff.

The firm offers its clients, whether local, state, national or international, a diverse and complete range of high quality and responsive legal services. Shutts & Bowen represents major industrial corporations and life insurance companies, utilities companies, securities brokerage firms, transportation concerns, national and international financial institutions, local banking firms, major foreign companies, health care organizations, local municipalities, local corporations, and individuals and smaller enterprises of every nature.



Willamette Management Associates

Willamette Management Associates is focused on three areas, including (1) forensic analysis and expert testimony; (2) valuations of businesses, ownership interests, and intellectual property assets; and (3) fairness opinions. Willamette's leadership team has testified on hundreds of different litigation matters involving damages and valuation issues in federal and state courts.

Willamette's professional services include: business valuation, intellectual property valuation and royalty rate analysis, forensic accounting investigations, transaction fairness opinions and solvency opinions, lost profits and economic damages analysis, unjust enrichment, insurance claims, not-for-profit entity valuation and private investment opinions, transaction financial adviser and due diligence services, and ESOP valuation and adequate consideration opinions.

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## Best Practices in Dealing with Disputes and Litigation in a Limited Liability Company (LLC) in 2015

### Partner Firm:

McELROY, DEUTSCH, MULVANEY  
CARPENTER LLP

McElroy, Deutsch, Mulvaney & Carpenter, LLP ("MDMC") is a full service law firm, offering legal service across many practice areas, including litigation, labor and employment, healthcare, bankruptcy/restructuring, real estate, insurance, environmental law, fidelity and surety, construction, corporate transactions, white collar crime, municipal and local government law and corporate compliance. The Firm has more than 300 lawyers in twelve offices in seven states. It is the Firm's mission to provide clients with the critical edge they need to achieve their legal and business objectives. MDMC places the client first. Clients who seek the assistance of MDMC will discover lawyers dedicated to providing superior service and personal attention to clients' needs. The Firm has developed a national reputation and regional expertise without abandoning the focus on efficiency and client satisfaction that is oftentimes the hallmark of the best small firms.

## Brief Speaker Bios:



### **Alette DelPozo Rodz**

Alette DelPozo Rodz counsels businesses facing legal challenges to compete in the global economy. Whether in court or through alternative resolutions, she aggressively advocates for companies and institutions in U.S. and international disputes.

Ms. DelPozo Rodz is a shareholder in the Business Litigation Group in the Miami office. She works with U.S. and foreign-based businesses on commercial claims.

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### **Shawn Fox, CPA/ABV, CFA, ASA**

Shawn Fox is a managing director with Willamette Management Associates. He has nearly 20 years of accounting and consulting experience. As a certified public accountant, Shawn provides dispute advisory and litigation services, fraud and forensic accounting investigative services, and valuation services to organizations and their counsel. He directs forensic investigations and analysis across a wide range of areas, including complex damages, lost profits, intellectual property infringement, and bankruptcy litigation, as well as valuation and insurance coverage disputes. Shawn also leads investigations on financial restatements and financial reporting fraud, regulatory investigations, assessing fraud risk, corporate investigations, employee misconduct, and whistleblower matters.

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### **Margaret L. Watson**

MARGARET L. WATSON is Of Counsel to McElroy, Deutsch, Mulvaney & Carpenter, LLP and serves as the Firm's Labor and Employment lawyer in its New York City office. Ms. Watson has more than 20 years litigation experience in employment law, primarily in the areas of discrimination and retaliation claims. Her practice includes representing large corporations and start-up businesses, as well as individual managers, who are named as defendants in employment litigation. She also counsels employers on how to proactively prevent employment claims and deliver on best-in-class workplace policies, including diversity initiatives, as well as performance management programs.

## Best Practices in Dealing with Disputes and Litigation in a Limited Liability Company (LLC) in 2015

### Summary

The Limited Liability Company (LLC) is a legal entity that combines the advantages of a partnership and a corporation. However, in contrast to members of a partnership, those of a LLC normally are not liable for business debts, and unlike a corporation, they avoid 'double taxation' – taxation of profits of the business and of personal income of owners.

However, disputes often ensue among owners of LLCs. Operating agreements address member's rights, responsibilities, and any remedies. But, in their absence, members are governed by Uniform Limited Liability Company Acts of states. Alternative dispute resolution may be a good option to resolve certain disputes; as is mediation or arbitration. However and ideally, such dispute resolution methods should be stipulated and specifically addressed in an operating agreement.

LLC litigation is among the most complex and can have such far reaching consequences. Often, these cases require highly skilled attorneys undertaking assessment of business valuations, forensic accounting, and extensive document discovery and depositions. Therefore, it is important that owners have a well-drafted operating agreement and shareholder's agreements for corporations and partnership agreements for partnerships.

## Best Practices in Dealing with Disputes and Litigation in a Limited Liability Company (LLC) in 2015

### Summary

In this two hour, live webcast, a panel of key thought leaders organized by The Knowledge Group will provide an overview of the latest trends and Best Practices in Dealing with Disputes and Litigation in a Limited Liability Company. Speakers will also offer in-depth discussions of risk and compliance issues surrounding this topic.

Some of the major topics that will be covered in this course are:

- Limited Liability Company – An Overview
- Limited Liability Company Operating Agreements
- Limited Liability Company Disputes and Litigation
- Alternative Dispute Resolution (ADR)
- Common Limited Liability Company Violations
- Tax Requirements and Regulations
- Liabilities and Obligations of Limited Liability Company Members
- Best Compliance Practices
- Compliance and Litigation Risks
- Importance of Addressing Deadlock Scenarios and Dissolution



**SEGMENT 2:**

**Shawn Fox, CPA/ABV, CFA, ASA**  
*Managing Director*  
**Willamette Management Associates**



## Agenda

- Types of LLC litigation matters requiring forensic accounting and business valuation expertise
- Financial data considerations
- Calculating damages in member disputes involving breach of fiduciary duty
- Calculating damages for unjust enrichment and benefit of the bargain
- Valuation issues
  - Complexity on standard of value issues
  - Pass-through entity premium



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## LLC Litigation Matters

These types of LLC matters general require forensic accounting and business valuation expertise:

- Breach of fiduciary duties of members and managers
- Breach of contract
- Fraudulent inducement
- LLC veil piercing
- Involuntary dissolution
- Minority oppression and dissenting rights
- Right to an accounting
- Deceptive business practices





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## Damages Areas

- Improper management fees and expense reimbursement
- Distributions to preferential economic rights holders
- Valuation on a forced buyout situation
- Valuation of member interest in connection with “triggering event” defined in the operating agreement (such as member death, disability, bankruptcy, withdrawal, failure to make a capital contribution, etc.)
- Calculation of Capital Accounts
- Valuation of member units and/or member percentage
- Methodology for buyout price
  - Premise of value (going concern or liquidation value)
  - Application of discounts for lack of control and lack of marketability)



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## Types of LLCs

- Single Member LLC
- Multi Member LLC
- Non Profit LLC
- Professional Limited Liability Company (PLLC)
- Series LLCs (master LLC and separate subunit divisions)
  - Hedge funds
  - Venture capital funds
  - Real estate funds



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**LLC Tax Returns (1 of 2)**

- Single Member LLC
  - Treated as a “disregarded entity” for tax purposes
  - Individual owner reports the LLC’s income (loss) on Schedule C of Form 1040
- Multi Member LLC and PLLC
  - Files a partnership tax form (Form 1065)
  - Each member receives a Schedule Form K-1 reporting the member’s share of the LLC’s income (loss) on individual tax return
- Non Profit LLC
  - Files Form 990 Return of Organization Exempt from Income Tax



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**LLC Tax Returns (2 of 2)**

- Series LLC
  - Each series and series organization may file a partnership tax form (Form 1065) or it may file as a single entity
  - Each member receives a Schedule Form K-1 reporting the member's share of the LLC's income (loss) on individual tax return



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**Key Financial Documents (1 of 2)**

- Audited Financial Statements
- Tax Returns
  - Schedule M-1 – Reconciliation of Income (Loss) Per Books with Tax Return
  - Schedule K-1 – Member’s Share of Income, Deductions, Credits, Capital Account Percentages and Balances, Withdrawals and Distributions, etc.
- Internally Prepared Financial Statements
- Business Plans, Marketing Plans, Projections, Budgets and/or Forecasts
- Quarterly and/or Annual Statements to Members
  - Capital Account Balances
  - Distributions to Members
  - Management Fees



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**Key Financial Documents (2 of 2)**

- General Ledger and Subsidiary Ledgers (Cash Disbursements, Cash Receipts, etc.)
- Brokerage Statements
- Asset Valuations (securities, real estate, personal property, intellectual property, etc.)
- Prior valuations of businesses and business ownership interest(s)
- Portfolio Management System Reports
- Detailed Asset Schedules
- Operating and Member Agreements
- Offering Memorandum
- Prior Member Transactions
- M&A Transactions



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## Calculating Damages in Breach of Fiduciary Duty Claim

- Out of pocket loss
  - Excessive management fees
  - Personal expenses paid by LLC
  - Preferential distributions or non-payment of distributions
  - Return of fees
- Accounting
- Economic damages
  - Lost profits
  - Diminution of value
  - Lost business opportunities
- Punitive or exemplary damages
- Prejudgment interest



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## Calculating Damages Related to Unjust Enrichment

- Profits obtained by defendant for the alleged wrongful conduct - disgorgement
- Value of misappropriation of assets, services, or business opportunities
  - Measuring the benefit(s) conferred upon a defendant by the plaintiff
  - Use value
  - Increased market share
- Plaintiff's losses – lost profits
- Value of plaintiff's research and development
- Accounting in equity
- Fraud





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## Calculating Damages Related to Benefit of the Bargain

- Difference between the actual value of the LLC and the represented value of the LLC
- Plaintiff's lost profits and/or out of pocket expenses if the agreement had been fully performed – expectancy damages
- Puts both parties in the same economic position if both parties had performed
- Used for fraudulent misrepresentation



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## Valuation Guidelines

- Scope
- Professional standards
- Understanding from counsel on interpretation of Operating Agreement
- Relevant state statute
- Relevant case law
- Appropriate standard of value
- Appropriate premise of value
- Specific ownership interest to be valued
- Relevant valuation date(s)
- Other factors



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## Complexity on Standard of Value Issues (1 of 3)

- Fair Market Value
  - American Society of Appraisers (ASA) defines FMV to be “The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm’s length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.”
  - Used for tax purposes
- Investment Value
  - ASA defines investment value to be “The value to a particular investor based on individual investment requirements and expectations.”
  - Used for transaction purposes

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## Complexity on Standard of Value Issues (2 of 3)

- Fair value for dissenting and oppression cases defined by state statutes
  - Differences between fair market value and fair value
  - States vary widely on whether appraisers can apply a discount for lack of control or lack of marketability
  - The 1984 Model Business Corporation Act defines ‘fair value’ “with respect to dissenter’s shares, means the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects, excluding the appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable”
- Fair value measurements for financial reporting purposes defined by ASC 820 as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”



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## Complexity on Standard of Value Issues (3 of 3)

- Buy-sale agreement (contractual) value
  - Formula, agreed-upon value, or guidelines for using a third-party appraiser
  - Valuation premise and valuation discounts
  - Terms of buy-out (lump sum, monthly payment, interest)
  - Consistency in process
  - Update to reflect changes



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**Valuation Issue:**  
**Pass-Through Entity Premium (1 of 2)**

- Most valuation methods used by appraisers determine a C Corporation equivalent value
- C Corporations are subject to corporate income taxes at the entity level.
  - Conversely, the members of LLCs recognize a pro rata share of their reported net income of the LLC on their personal income tax returns from Schedule K-1
  - LLC members avoid such taxes
- Equity investment rates of return, equity security prices, and price/earnings multiples of publicly traded C corporations inherently reflect the income tax treatment of C corporations and their respective shareholders
  - Discounted future cash flow method
  - Guideline publicly traded company method



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**Valuation Issue:**  
**Pass-Through Entity Premium (2 of 2)**

- There are income tax differences between LLCs, C corporations, and their respective owners
- There is generally a net tax benefit in many situations for being a member in a LLC compared to being a shareholder in a C Corporation
- Many a times a “premium” is added to the valuation based on C Corporation equivalent based on tax advantages of LLC