

Shedding Light on Recent Developments Affecting LLCs

Because limited liability companies are growing in popularity and now dominate all new Wisconsin business entity filings, attorneys need to remain up to date on developments affecting LLCs. Here, the authors highlight several cases and statutes they believe reflect the most important developments in the last few years.

by [Joseph W. Boucher, George R. Kamperschroer & Jennifer L. Knudson](#)

Sidebar:

- ▶ [State Bar CLE Books: Helping You Meet the Needs of Business Clients](#)

The limited liability company (LLC) legal entity remains the predominant entity choice for new business formations in Wisconsin. When the Wisconsin limited liability company law (WLLCL) went into effect on Jan. 1, 1994, its primary goal was to create a form of business entity that would provide limited liability to its owners, flow-through taxation, and simplicity. These benefits have led to the increasing popularity of the LLC form and its dominance of all new Wisconsin business formations. From Jan. 1, 2008 through May 31, 2008, LLCs made up approximately 86 percent of all new domestic entity filings, while corporations made up only around 13 percent¹ The remaining one percent were filings for domestic nonprofit organizations, limited liability partnerships, and limited partnerships. Today, there are approximately 193,000 Wisconsin domestic LLCs in existence, compared to only 128,000 domestic corporations.

In June 2005, more than 11 years after the WLLCL became effective, the Wisconsin Supreme Court issued its first opinion directly dealing with this law, *Gottsacker v. Monnier*² In *Gottsacker*, the court addressed two issues: whether certain members possessed the majority votes necessary to authorize the sale of a parcel of real estate (the LLC's sole asset) and whether a material conflict of interest prevented these two members from voting to transfer the sole asset. The court held that the two members did possess the necessary majority to authorize the transfer, and that a material conflict of interest did not prevent them from approving the transfer as long as they dealt fairly with the minority member and the LLC³

Since the supreme court issued its opinion in *Gottsacker*, several new developments have affected Wisconsin LLCs. This article highlights several cases and statutes relevant to all attorneys who work with LLCs. Although this article is not exhaustive as to all cases and regulations affecting LLCs, it emphasizes the most important developments in the last few years.

Cases

Decker v. Decker.⁴ In this case, the Wisconsin Court of Appeals dealt with a situation in which one member of an LLC acted oppressively and without good faith. The court held that the LLC's operating agreement provided no option other than dissolution and a resulting sale of assets.

Brothers Frederick and David Decker engaged in an investment real estate business, which they operated through multiple LLCs. In 1995, the brothers entered into an LLC operating agreement containing certain deadlock provisions that would apply if a dispute arose between them. If the members (that is, the brothers) could not resolve the dispute, then either member could make an offer specifying a price at which he would purchase the other member's entire interest in the LLC. The member who received the offer then had the option to either sell all his interest at the price set in the offer or purchase the other member's interest on the same terms, conditions, and price stated in the initial offer. The operating agreement anticipated that an accepted offer might not be consummated, but it failed to provide for penalty provisions if this were to occur. The operating agreement provided that if the sale of the interest never closed, then the LLC would be dissolved.

In 2001, Frederick and David began having business disputes, and David eventually sent Frederick a letter declaring a deadlock. Frederick, however, did not believe a deadlock existed and asked David to rescind the letter. David refused. Frederick then made an offer to buy David's *interest* in the business for \$7 million, which substantially exceeded the \$2.5 million estimated value of the business. Frederick made no efforts to close on the offer. He later hinted that he had no intention of closing on the excessive offer and instead wanted to use it as a preemptive strike to force dissolution.

Under the operating agreement's terms, dissolution of the company was the only option. The operating agreement provided as follows: "If, after the 150th day following the Statement Date (or such later date if agreed to by the Members), the dispute is not resolved, the Members shall take all necessary actions and use their best efforts to cause all directors elected by them to take all necessary actions to liquidate and dissolve the Company in accordance with the law."

In September 2002, David filed suit against Frederick based on Frederick's failure to purchase David's interest. In an oral order, the circuit court ordered the sale of the LLC's *assets* to David, presumably the proper order. However, the same court (but presided over by a different judge) then entered a *written* order requiring Frederick to sell his *interest* in the LLC to David at the value set by a receiver appointed by the court and denied David's motion for enforcement of Frederick's offer.

The court of appeals affirmed the circuit court's decision. The court first addressed the enforceability of Frederick's \$7 million offer. The court explained that since Frederick's offer was voluntary, it was unenforceable under the operating agreement terms. The court explained that "[w]hile it is true that the operating agreement obligated the members to 'use their best efforts to make available the assets of the Company to effect a buyout,' and while it would appear that Frederick's conduct could hardly be characterized as using his best efforts, this language does not automatically make his voluntary offer enforceable."⁵

The court also addressed Frederick's claim that the circuit court lacked authority to order the sale of his interest in the LLC to David. "[W]e conclude that in effect, what Frederick did ... was to sabotage the operating agreement's provisions for a buy-out by making an outrageous offer of \$7,000,000 for David's interest when it was worth only approximately \$2,500,000, and then making no effort to close on the offer. By doing so, he foreclosed the possibility that one of the two would buy out the other according to the terms of the operating agreement. This is so because while David was anxious to be the seller at \$7,000,000, he was not inclined to be the buyer at that figure. This left dissolution as the only remedy available under the operating agreement."⁶



Joseph W. Boucher, U.W. 1978, is a CPA and a shareholder in Neider & Boucher S.C., Madison, where he practices in business law, with an emphasis in emerging companies. He chaired the State Bar committee that originally drafted Wisconsin's LLC law. He also coauthored *LLCs and LLPs: A Wisconsin Handbook*, published by State Bar CLE Books. **George R. Kamperschroer**, U.W. 1975, is a CPA and shareholder in the firm, practicing in the area of business organizations, mergers and acquisitions, and other business transactions. **Jennifer**

L. Knudson, Marquette 1998, is an associate in the firm, practicing in the areas of business, employment, and health law.

David's offer to the receiver was for the purchase of all of the LLC's assets. While Frederick's position was that David no longer had the ability to buy him out under the operating agreement and that the properties owned by the LLC had to be sold on the open market, the court of appeals disagreed. "David's offer was no different from any other third-party offer, except that it was for all the property interests held by Frederick and it eliminated costly real estate commissions and other miscellaneous costs."⁷ Frederick's ownership interest was in the LLC, not in the real estate. It was the LLC that had the interests in the real estate (its assets).

As a side note, there was some confusion with respect to what was being sold: Frederick's ownership interest or the assets of the LLC. In an entity sale, a buyer purchases a seller's membership (or ownership) interest in the LLC. The buyer becomes the owner of the LLC, and all assets and liabilities of the LLC, including unknown liabilities, remain with the LLC. In an asset sale, the LLC sells its assets but the selling members keep their ownership interests in the LLC. The buyer becomes the owner of the assets, and generally no unknown liabilities are transferred. In addressing this issue, the court of appeals ordered that the circuit court's written order be corrected to reflect a sale of the assets.

Finally, the court of appeals also held that under Wis. Stat. section 183.0902, a court may order the dissolution of an LLC when one or more of the members in control of the LLC acts in a manner that is illegal, oppressive, or fraudulent. The court deemed Frederick's behavior oppressive. Accordingly, the court concluded that the circuit court had the authority under Wis. Stat. section 183.0902 and the operating agreement to order the dissolution of the LLC's assets.

Brew City Redevelopment Group LLC v. The Ferchill Group.⁸ In this case, the Wisconsin Supreme Court affirmed the general proposition that LLC managers or members may be liable for their conduct, despite the exculpatory language in Wis. Stat. section 183.0402, if they engage in conduct that falls outside the scope of their duties with the LLC.

The factual background for the case is quite complex. In 1996, Pabst Brewing Company closed its downtown Milwaukee brewery consisting of 27 buildings. Brew City Development Group LLC acquired the right to purchase the property, and on June 5, 2002, Brew City assigned that right to Wispark LLC. An entity related to Wispark, Juneau Avenue Partners, was the actual purchaser of the property from Pabst. The Ferchill Group also was a partner of Juneau. After the purchase, the parties to the transaction had a falling out. Brew City filed a lawsuit

against multiple defendants based on Juneau's alleged failure to perform certain obligations under the assignment agreement.

The circuit court dismissed all causes of action, including one for tortious interference with contract. This claim was against, among others, two individuals - Jerome Franke, the president of Wispark, and John Ferchill, a member of one of the LLCs affiliated with the Ferchill Group. The court of appeals affirmed the dismissal of the tortious interference claim but modified the dismissal to be without prejudice, to permit Brew City to replead its claims against Franke and Ferchill.

At issue was the application of Wis. Stat. section 183.0304, which provides as follows: "Liability of members to 3rd parties. (1) The debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company. Except as provided in ss. 183.0502 and 183.0608, a member or manager of a limited liability company is not personally liable for any debt, obligation or liability of the limited liability company, except that a member or manager may become personally liable by his or her acts or conduct other than as a member or manager."⁹

Franke and Ferchill argued that this exculpatory language protected them because they were not "independent from the legal entity." The court rejected this argument, pointing out the last clause in the statute: "... except that a member or manager may become personally liable by his or her acts or conduct other than as a member or manager." The court noted that this language clearly "preserves the liability of a member of an LLC for conduct `other than as a member or manager.'" [10](#)

The supreme court ultimately affirmed the decision of the court of appeals dismissing the cause of action without prejudice. Franke and Ferchill were not automatically immune from liability for intentional-interference-with-contract claims under Wis. Stat. section 183.0304. Brew City was allowed to replead facts that could lead to Franke's and Ferchill's personal liability, despite their status as members or managers.

The supreme court did not give any hints as to what these facts could be, but if this litigation continues and Brew City opts to replead its claims, perhaps light will be shed on the potential personal liability of members or managers and how the determination should be made as to whether they are acting other than as members or managers of an LLC.

Kasten v. Doral Dental USA LLC¹¹ This case concerns a member's request to inspect an LLC's records under Wis. Stat. section 183.0405. The supreme court held that a member has the right to inspect the LLC's information, particularly if the information affects a member's financial interest in the LLC, but the request cannot place an undue financial burden on the LLC and will be scrutinized as to its breadth, time, and form.

An LLC is required to keep certain business information at its principal place of business¹² Wisconsin Statute section 183.0405(2) additionally provides the following: "*Upon reasonable request*, a member may, at the member's own expense, inspect and copy during ordinary business hours *any limited liability company record* required to be kept under subsection (1) and, unless otherwise provided in an operating agreement, any other limited liability company record, wherever the record is located."¹³

Doral Dental USA LLC (Doral) was formed on April 29, 1996 by, among others, Craig and Marie Kasten. Craig and Marie were married at the time of the formation but they divorced in 2001, each taking a 23.13 percent interest in the business. Another company, MOA Investments, owned more than 51 percent of Doral.

Doral's primary business created and administered dental health programs for state governments and health maintenance organizations. In 2000, Doral had reported revenues of \$98.3 million. Marie asserted that Doral's success resulted in large part from the claims processing software developed by Craig.

In the beginning of 2003, Marie, as a nonmanaging member, sought to assert her rights under the operating agreement and Wis. Stat. section 183.0405(2) to inspect and copy Doral's records and documents. She asserted these rights, she said, because she began to "suspect that Doral's management was engaging in various actions adverse to her interests, such as the transfer, without adequate consideration of Doral's assets, including the [software] at the heart of the Company's success, to entities ... Craig Kasten/MOA [Investments] owned, but she did not."¹⁴

Throughout 2003, Marie made multiple requests to inspect Doral's records. Doral complied with some, but not all, of her requests. In November 2003, Marie filed a circuit court action seeking an order pursuant to Doral's operating agreement and Wis. Stat. section 183.0405(2) to compel Doral to produce all of the documents she requested and to respond to her request for information.

In July 2004, Marie filed a motion asking the court to compel production of documents and to require Doral to respond to her request for information. The

motion to compel sought some information and emails contained on computer equipment that had in the interim been sold to a third party. The circuit court ruled that the emails and draft documents were neither records under Wis. Stat. section 183.0405(2) nor company documents under the operating agreement. It further ruled that Doral was unable to make available the records because they were stored on equipment no longer in its control.

After additional litigation and motions, the circuit court granted Doral's motion for summary judgment, concluding that "Doral Dental had `complied with [all requests for record inspection] that they were supposed to comply with."¹⁵ Marie appealed to the court of appeals, which in turn certified the case to the supreme court to determine the scope of a member's right to inspect records of an LLC and whether this right included the right to review an LLC's email and document drafts.

The supreme court overruled the circuit court. It did not address whether informal stored information and emails were records for purposes of Wis. Stat. section 183.0405(2) because in fact Doral's operating agreement provided a greater right of inspection than section 183.0405(2). The supreme court held that the term "Company documents" in Doral's operating agreement is a broader category of information than the term "records" in the statute.

In its opinion, the court compared the record-inspection provisions of the corporation and partnership statutes and noted that an LLC is a hybrid of both of these entities. Although a partner in a limited partnership holds the right to inspect and copy records on reasonable request, the limited partnership statute limits inspection to those records enumerated in the statute, in contrast to the WLLCL, which provides for no such limitation. The corporation statute, in contrast, limits shareholder access to the records and requires that "the requests be made `in good faith and for a proper purpose,' and that the request identify `with reasonable particularity' the records sought and the purpose of the request."¹⁶ The corporation record-inspection statute contains several precise requirements not contained in the WLLCL.

The court noted that while chapter 183 does not define what constitutes an LLC "record," a "company document," or a "reasonable request," the scope of a member's right of inspection under Wis. Stat. section 183.0405(2) is broad. The member's right "hinges on what constitutes an LLC `record,' and the degree and kind of restrictions on access that `upon reasonable request' may impose."¹⁷ The court concluded that "the operating agreement provides member access to business-related company emails and document drafts. This right is subject to `upon reasonable request' language contained in Wis. Stats. § 183.0405(2) and the operating agreement...."¹⁸

The court next considered what effect Wis. Stat. section 183.0405(3) would have on a member's request to inspect LLC documents or records. This statute states that "[m]embers or, if the management of the limited liability company is vested in one or more managers, managers shall provide, to the extent that the circumstances render it just and reasonable, true and full information of all things affecting the members to any member or to the legal representative of any member upon reasonable request of the member or legal representative."¹⁹ The court construed the phrase "all things affecting the members" to mean all information affecting the member's financial interest in the company. "To the extent that the records and documents requested by Marie under Wis. Stats. § 183.0405(2) contain information affecting her financial interest in the company, subsection 3 requires that the information contained in the records or documents be furnished to Marie."²⁰

Finally, the court analyzed what constituted a "reasonable request" with respect to a member's inspection rights. Doral argued that the "upon reasonable request" language was intended to limit the types of records subject to inspection. Marie argued that Wis. Stat. section 183.0405(2) should be interpreted in the same manner as the partnership record-inspection statute. Neither argument convinced the court. The court said that Wis. Stat. chapter 183 does not address whether the "upon reasonable request" language encompasses the extent, timing, or form of the request. It concluded that "[t]he scope of items subject to inspection under Wis. Stats. § 183.0405(2) ... is so broad that to permit any inspection request, no matter its breadth, could impose unreasonable burdens upon the operations of the company. Because we do not believe that the drafters intended the inspection statute to threaten the financial well being of the company, we read 'upon reasonable request' to pertain to the breadth of an inspection request as well as the time and form of the inspection."²¹

The court stressed that the purpose of the language is to protect an LLC from member requests that are an unreasonable financial burden on the LLC. "Whether an inspection request is so burdensome as to be unreasonable requires balancing the statute's bias in favor of member access to records against the cost of inspection to the company. When applying this balancing test, a number of factors may be relevant, including, but not limited to: (1) whether the request is restricted by date or subject matter; (2) the reason given (if any) for the request and whether the request is related to that reason; (3) the importance of the information to the member's interest in the company; and (4) whether the information may be obtained from another source."²²

Marie was granted access under Doral's operating agreement to draft documents and emails. Additionally, the court concluded that the reasonableness test of Wis.

Stat. section 183.0405(2) balances the statute's bias in favor of a member's right of inspection against the burden the request places on the LLC.

Accordingly, LLC members now have affirmation that they may inspect the company's information, especially if it affects their financial interest in the LLC. Members must be aware, however, that the request will be scrutinized as to its financial burdens, timing, and form. Attorneys should review clients' LLC operating agreement forms, because if the agreement is not carefully drafted a member's inspection rights may be inadvertently expanded from what is allowed under Wis. Stat. section 183.0405.

Statutes

In addition to the recent case law developments, several statutory changes affect LLCs.

Mergers/Conversions. The Wisconsin Legislature enacted a new merger and conversion real estate report statute affecting LLCs in June 2006²³ If either an acquired business entity in a merger or a converted business entity in a conversion owned a fee simple interest in any Wisconsin real estate immediately before the merger or conversion, the surviving entity now must submit a report to the Wisconsin Department of Revenue (DOR)²⁴ The report must be submitted within 60 days of the effective date of the merger or conversion and must contain the following information: the effective date of the merger or conversion; the name, address, and federal employer identification number (FEIN) of any person or business entity that is a party to the merger or conversion; the name, address, and telephone number of a contact person at the surviving entity; the parcel identification number; a sworn statement that the ownership interests remain the same before and after the conversion; and a copy of the documentation showing the merger or conversion²⁵ This same act repealed the short-lived requirement to file real estate transfer documents and real estate transfer returns²⁶

Delinquent Annual Reports. Previously, LLCs that were administratively dissolved because they filed annual reports late could only apply for reinstatement within 30 days of their dissolution²⁷ According to the Department of Financial Institutions (DFI), the 30-day time limit was too burdensome for businesses and created unnecessary administrative burdens on the DFI²⁸ Accordingly, 2005 Wisconsin Act 132 removed the 30-day limit on seeking reinstatement²⁹ To seek reinstatement, an LLC now only need provide its name, the date on which it was administratively dissolved, a statement that each ground for dissolution either did not exist or has been cured, and a statement that its name satisfies Wis. Stat. section 183.0103³⁰

Tax Issues. IRS Notice 99-6³¹ which addresses whether a disregarded entity may either use its own FEIN or the FEIN of its owner for reporting and payment of employment taxes, becomes obsolete as of Jan. 1, 2009 for employment taxes and Jan. 1, 2008 for excise taxes³² After these dates, a disregarded entity for federal tax purposes is treated as a separate entity for employment tax and reporting purposes and must file separate employment and excise tax returns using its own FEIN.

Additionally, the DOR updated its LLC publication in February 2008³³

For tax years beginning on or after Jan. 1, 2006, an LLC nonresident member's share of income from a pass-through entity will be exempt from withholding if the nonresident member files an affidavit with the DOR on form PW-2³⁴ The nonresident must agree to file a Wisconsin earned income or franchise tax return.

Department of Financial Institutions. Except for delinquent LLC reports, an LLC's annual report now must be filed online. These reports must be filed through the DFI's Web site, www.wdfi.org/apps/corpar. Any changes to an LLC's registered office or agent and articles of merger also may be filed online.

Conclusion

Since the creation of the LLC legal entity in 1994, the popularity of this form of legal entity has grown each year. The cases decided since *Gottsacker* in 2005 have provided attorneys with some practical answers to questions unanswered in the WLLCL. Through these cases, attorneys have learned that courts hold the right to order an LLC's dissolution if a member in control acts in a manner that is illegal, oppressive, or fraudulent. Additionally, certain conduct of managers and members of an LLC may be outside the scope of their duties, and accordingly, they might not be immune from liability under Wis. Stat. section 183.0402 (although the nature of those type of activities has not yet been defined). Finally, attorneys have learned that an LLC member has the right to the LLC's information, particularly if the information affects a member's financial interest in the LLC. However, this request is subject to scrutiny with respect to its breadth, time, and form and cannot place an undue financial burden on the LLC. Additionally, attorneys should review their clients' operating agreements to confirm that the members' inspection rights provided by these documents do not unintentionally exceed the statutory inspection rights.

Statutorily, several things have changed with respect to LLCs. LLCs can apply at any time for reinstatement after an administrative dissolution based on delinquency. If real estate is acquired in a merger or conversion of an LLC, a report must be submitted to the DOR. Disregarded entities are now treated as a separate entity for employment tax and reporting purposes and will need to file

separate employment and excise taxes using their own employer identification number. Several LLC reports, with the exception of delinquent reports, presently may be filed online.

The continuing influence of LLCs in Wisconsin is evident by their growth in numbers and their more frequent treatment by cases and statutory changes. As the LLC entity form continues to grow in popularity, attorneys can anticipate further statutory and case law developments.

Endnotes

¹Statistics provided by the Wisconsin Department of Financial Institutions.

²*Gottsacker v. Monnier*, 2005 WI 69, 281 Wis. 2d 361, 697 N.W.2d 436.

³Joseph W. Boucher & George Kamperschroer, *The First LLC Case*, 78 Wis. Law. 9 (2005).

⁴*Decker v. Decker*, 2006 WI App 247, 298 Wis. 2d 141, 726 N.W.2d 664.

⁵*Id.* § 8.

⁶*Id.* § 13.

⁷*Id.* § 14.

⁸*Brew City Redev. Group LLC v. The Ferchill Group*, 2006 WI 128, 297 Wis. 2d 606, 724 N.W.2d 879.

⁹Wis. Stat. § 183.0304(1).

¹⁰*Brew City*, 2006 WI 128, ¶ 41, 297 Wis. 2d 606.

¹¹*Kasten v. Doral Dental USA LLC*, 2007 WI 76, 301 Wis. 2d 598, 733 N.W.2d 300.

¹²Wis. Stat. § 183.0405(1).

¹³Wis. Stat. § 183.0405(2) (emphasis added).

¹⁴*Kasten*, 2007 WI 76, ¶ 9, 301 Wis. 2d 598.

¹⁵*Id.* ¶ 17.

¹⁶*Id.* ¶ 34.

¹⁷*Id.* ¶ 38.

¹⁸*Id.* ¶ 50.

¹⁹Wis. Stat. § 183.0405(3).

²⁰*Kasten*, 2007 WI 76, ¶ 52, 301 Wis. 2d 598.

²¹*Id.* ¶ 67.

²²*Id.* ¶ 68.

²³Wis. Stat. § 73.14, *as created by* 2005 Wisconsin Act 476.

²⁴*Id.*

²⁵*Id.*

²⁶Wis. Stat. § 183.1205(2), *repealed by* 2005 Wisconsin Act 476.

²⁷2005 Wisconsin Act 132.

²⁸*Id.*

²⁹*Id.*

³⁰Wis. Stat. § 183.0902(4).

³¹IRS Notice 99-6 (Jan. 6, 1999).

³²T.D. 9356, IRS Bulletin 2007-39 (Sept. 24, 2007).

³³Wisconsin Department of Revenue, Pub. 119 (2/2008).

³⁴Wis. Stat. § 77.775(4)(d), *as amended by 2007 Wisconsin Act 20* .

Wisconsin Lawyer