

LLC Member Buyout Provision With Familiar Wording Held to Be Irrevocable

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On March 25, in *Walsh v. White House Post Productions, LLC*, C.A. No. 2019-0419-KSJM, the Delaware Court of Chancery held that a limited liability company's contractual right to repurchase a member's units upon the termination of that member's employment with the company (the Buyout Provision) became irrevocable once the company chose to exercise that right. The court's decision serves as a reminder to drafters of limited liability company agreements to be as explicit as possible when drafting provisions like the Buyout Provision to avoid unintended results and unwanted uncertainty. More specifically, if a limited liability company would like certain contractual rights to be revocable, the limited liability company should so specify in clear and explicit terms within the limited liability company agreement.

Background

In 2009, the plaintiffs entered into the limited liability company agreement (the LLC Agreement) of Carbon Visual Effects, LLC (the Company) as minority members. The LLC Agreement contained the Buyout Provision, which gave the Company the right to repurchase the plaintiffs' units in the Company in the event that the plaintiffs' employment with the Company ended. If the Company exercised this right, the Buyout Provision also specified a process by which the value of the plaintiffs' units would be determined. Under the provision, the Company would first retain a third-party appraiser to determine the value of the plaintiffs' units. If the plaintiffs did not agree with the initial appraisal, then the plaintiffs would be entitled to retain their own appraiser. If the value of the plaintiffs' units as determined by the plaintiffs' appraiser was more than 10 percent higher than the value specified in the initial appraisal, then the parties would jointly retain a third appraiser to determine the final value of the plaintiffs' units.

In 2018, the plaintiffs were given notice that their employment with the Company would end in the following months. The Company then exercised its right under the Buyout Provision, retained an appraiser to determine the value of the plaintiffs' units, and provided the plaintiffs with the results of the valuation. The plaintiffs then retained their own appraiser to conduct a valuation of the units. The Company subsequently informed the plaintiffs that it had decided not to purchase the plaintiffs' units. When the plaintiffs' appraisal later returned a valuation at more than 10 percent higher than the company's valuation, the plaintiffs requested that the parties engage a third appraiser in accordance with the terms of the LLC Agreement. The defendants did not respond. The plaintiffs subsequently filed suit, alleging, among other things, breach of the LLC Agreement and seeking specific performance of the Company's obligation under the Buyout Provision. The defendants moved to dismiss.

Analysis

The plaintiffs argued that the Company breached the Buyout Provision by withdrawing from, and failing to complete, the appraisal process, notwithstanding the fact that the LLC Agreement did not expressly prohibit the Company from doing so. According to the plaintiffs, the Buyout Provision was akin to an option contract under common law, which, upon its exercise, created an enforceable obligation to keep the offer to purchase the plaintiffs' units open. The defendants argued that the Company's exercise of the Buyout Provision was an offer that the Company had the right to withdraw before the plaintiffs accepted.

The court, siding with the plaintiffs, held that the Buyout Provision was properly construed as a type of option contract under the common law, noting that option contracts are an exception to the general rule that an offeror may revoke its offer before acceptance by the counterparty. Therefore, the court held that, once the Company exercised its right to purchase the plaintiffs' units under the Buyout Provision, the Company was bound to proceed with the appraisal process as outlined by the LLC Agreement and that the plaintiffs had accordingly stated claims for breach and specific performance of the Buyout Provision.

Takeaways

In *Walsh*, the court analyzed the basic terms of an option contract under the common law in the context of an LLC Agreement: (1) an offer to enter into an underlying agreement for the sale of property and (2) a promise to keep that offer open. This broad definition conceivably encompasses more than just repurchase provisions, and could be applied to other provisions commonly found in negotiated limited liability company agreements, such as rights of first refusal, co-sale rights and buy/sell provisions. Given the broad flexibility afforded to drafters under the Delaware Limited Liability Company Act, the takeaway from *Walsh* is clear — if the applicable right is intended to be revocable, the limited liability company agreement should say so in clear and explicit terms.

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