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Recent Changes to Delaware's Alternative Entity Acts as a Result of Obeid v. Hogan

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Delaware has recently revised its Limited Liability Company Act (DLLCA), its Revised Uniform Partnership Act (DRUPA), and its Revised Uniform Limited Partnership Act (DRULPA) to address concerns raised by the Delaware Chancery Court opinion in *Obeid v. Hogan* CA No. 11900-VCL (Del. Ch. June 10, 2016). The amendments to all three alternative entity acts are effective as of Aug. 1, 2017.

The amendments all address the power of those governing alternative entities to delegate their power and authority, which was called into question in *Obeid* when the Delaware Chancery Court addressed the all too common use of a corporate-like "Board of Directors" for managing an LLC. Although LLCs are beloved for their contractual flexibility, the use of certain "corporate" aspects of governance in LLCs can become problematic, as the *Obeid* case demonstrated.

There were two cases in 2016, which addressed aspects of the "corporification" of LLCs, which raised concerns: *Obeid v. Hogan,* CA No. 11900-VCL (Del. Ch. June 10, 2016), and *Richardson v. Kellar*, 2016 WL 4165887 (Sup. Ct. N.C. Aug. 2, 2016). Since this article is focused on the recent Delaware amendments to its alternative entity statutes, it will examine the *Obeid* opinion and the resulting Delaware amendments to the LLC and partnership statutes. I recommend you also read the *Richardson* opinion by the North Carolina Supreme Court in yet another LLC member dispute.

Obeid involved a dispute among the three owners of two LLCs which owned and managed a successful portfolio of 11 hotel and 22 commercial properties. Both LLCs were owned by the same three members with equal 1/3 interests. All three members were also named as members of the "Board of Directors" of one LLC, and as "Managers" of the other LLC. In its opinion, the Court designated one of the LLCs as the "*Corporate LLC*" because it utilized a "board of directors" comprised of the three members for its governance. The second LLC was called the "*Manager-Managed LLC*" by the Court throughout its opinion because it was managed by the three members but in their capacity as "Managers" as provided in the LLC Agreement.

Prior to the dispute, William Obeid was tasked with managing the portfolio of hotel properties, and his other two co-members were charged with managing the portfolio of commercial properties. That is, until the other two co-members took action to remove Obeid from power.

The other two co-members took action by majority vote to remove Obeid as the President of the Manager-Managed LLC, replacing him with one of his co-members, and they also voted to remove him as a member of the Board of Directors of the Corporate LLC.

Obeid initiated litigation against his co-members in multiple state and federal courts challenging their actions. One of the actions was a derivative action in New York brought by Obeid on behalf of both LLCs. Consequently, the two LLCs acting through the other two co-members as directors in the Corporate LLC and as Managers in the Manager-Managed LLC, retained Michael Hogan, a retired Federal judge, to serve as the special litigation committee for both LLCs to evaluate the claims brought by Obeid in the derivative action. Importantly, Hogan was not named as a "director" of the Corporate LLC, nor was he named as a "Manager" of the Manager-Managed LLC.

Following the appointment of Hogan as the special litigation committee, Obeid filed the lawsuit in Delaware seeking a determination that Hogan was not properly appointed as the special litigation committee for either LLC, because he was not a director of the Corporate LLC, nor a manager of the Manager-Managed LLC. Obeid also contested the actions of his co-owners in removing him as the President of the Manager-Managed LLC.

The Chancery Court in a far reaching opinion by Vice-Chancellor J. Travis Laster, addressed the use of a "corporate-like governance structure" for a Delaware LLC. He acknowledged that Delaware approved of the contractual flexibility of LLCs which allowed the owners to create corporate-like governance structures; however, in so doing, he noted that members of an LLC should be aware that there could be unintended consequences. The Vice Chancellor concluded that if an LLC was set up to be governed like a corporation, the parties should expect that a court would draw on corporate law principles when addressing actions by the corporate styled governing body. The court declared that a "derivative suit is a corporate concept grafted onto the LLC form", and further that case law governing corporate derivative suits is generally applicable to derivative suits on behalf of an LLC.

So the court examined *Zapata Corp. v. Maldonado*, 43 A.2d 779 (Del. 1981), which held that a properly constituted corporate board committee could serve as a special litigation committee. Vice Chancellor Laster concluded that since a special litigation committee is not an 'ordinary course" action in the corporate context, it should be undertaken only by one or more members of the board of directors. The court ignored the fact that the board of directors of the Corporate LLC was comprised of named defendants, therefore they could not be independent and disinterested. The Chancery Court nonetheless ruled that former Judge Hogan could not function as a special litigation committee for either LLC because he was not a director of the Corporate LLC, nor a Manager of the Manager-Managed LLC.

Surprisingly, the Vice Chancellor concluded that a Manager-Managed LLC was sufficiently analogous to a board of directors-managed LLC, to allow the court to apply the same reasoning that it applied in the Corporate LLC context, i.e., that it was enough of a corporate-like governance structure to be controlled by the *Zapata* case, which would have required that an appointee to a special litigation committee be a member of the Board of Managers of the Manager-Managed LLC. This reasoning was surprising to say the least, and disturbing to many LLC watchers.

The result in *Obeid* was so disturbing that Delaware has now enacted amendments to its alternative entity statutes, all of which are intended to make it quite clear that managers, members, general partners or partners, as applicable, have the power and authority to delegate "any or all" of their rights, powers and duties to manage and control the business and affairs of the applicable entity, including core government functions, notwithstanding any other provision of the applicable act. See revised Section 18-407 of the DLLCA, Section 17-403(c) of the DRULPA and Section 15-401(l) of the DRUPA.

Florida lawyers should take note that the Florida Revised LLC Act, Section 605.04071, provides that members or managers of a Florida LLC have:

> "the *power and authority to delegate to one or more other persons the member's or manager's, as the case may be, rights and powers to manage and control the business and affairs of the limited liability company, including the power and authority to delegate to agents, boards of managers, members, or directors, officers and assistant officers, and employees of a member or manager of the limited liability company, and the power and authority to delegate by a management agreement or similar agreement with, or otherwise to other persons.*"

Although the broad statutory statement of delegation in the Florida Revised LLC Act should be sufficient to preclude a result like the one in *Obeid*, it may be prudent for Florida to consider a tweak to the statutory language to be doubly certain that anyone may be appropriately delegated "any or all" right or power to act, including serving as a special litigation committee, without the necessity of being a member, manager, or director (if a "board of directors" is utilized as the governing body of the LLC).

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