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# A Limited Liability Company And A Quick Flip



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*I write about commercial real estate negotiations, deals and legal issues.*



What happens if an LLC manager buys out an investor and then scores a home run in selling the property? [-] RANJAN SAMARAKONE

Once in a while the manager of a limited liability company that owns commercial real estate buys out the interests of an investor member of the

company, and then, soon after, sells the LLC's real estate at a price far higher than anyone expected. The investor that sold its interest then regrets it sold its interest in the company and sues, claiming the manager violated its fiduciary obligations to the selling member, the investor.

These litigations tend to be nasty and complicated, very dependent on their particular facts, and expensive. But these buyouts happen, and so do the litigations that sometimes follow. They raise important issues about the rights and obligations within a limited liability company, and whether they still apply in the context of a buyout of an investor member.

New York's limited liability company law says a manager must act "in good faith and with that degree of care that an ordinarily prudent person in a like position would use under similar circumstances." The reference to "good faith" certainly suggests the manager should have disclosed to the bought-out investor member the details of the company's opportunity to execute a profitable sale of its property.

In the context of a manager's buyout of an investor member, though, maybe it's not that simple. Is it reasonable for the selling investor member to rely on information from the manager about the value of the company's assets? Is "value" something that is fixed, immutable, and objectively determinable, or merely a judgment call at a particular moment?

Before selling, should an investor member demand full disclosure about the company's affairs and possible opportunities, and representations and warranties about any possible sales that might be pending? Should the seller do enough homework to figure out its own view of the value of the company's property? Do the answers to these questions change if the relationships within the company have been unsatisfactory and tense? What if the selling investor member is highly sophisticated and knowledgeable about market conditions and commercial real estate generally? Should the selling investor member, as a condition to being bought out, demand a right to participate in a later profitable sale of the company's property?

These are fascinating questions, of course. The New York courts have answered them in somewhat inconsistent ways over the years.

Some cases suggested that the manager's obligations of good faith required full disclosure, and that obligation could not be waived. Many sections of New York's limited liability company law do say the parties can agree to something other than what the law states. But the section on good faith doesn't expressly provide for that flexibility.

Other cases, including some more recent ones, take a more "Wild West" view of the relationship. They recognize that if the relationship between the manager and the investor member has degenerated, maybe it's not reasonable for the investor member, when selling, to rely on the manager. Maybe once it's obvious the manager and the selling member have an adversarial relationship, the selling member should no longer expect full disclosure. That's especially true for something as vague and judgment-based as a determination of the "value" of the company's property.

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From the perspective of the manager, the buyer, it helps if the buyout documents include a full waiver and release of claims, and an acknowledgment that the selling investor member isn't relying on the buying manager for any disclosures at all. Particularly in the context of language like that, courts have sometimes displayed impatience with a selling investor member's claim that it was entitled to blindly rely on whatever information the buyer (manager) provided, or didn't provide, about the company's affairs.

On the other hand, a quick flip by the manager can look quite bad, especially if it turns out the manager's profitable sale of the property was well underway at the time of the buyout and the closing occurs very soon after the buyout.

If a selling member would be upset if the manager made a quick profit on the transaction, perhaps it's up to the selling member to raise the issue.

Conversely, if the manager/buyer sees any possibility of a quick sale on the horizon, the manager/buyer ought to proceed with great care. At a minimum, the manager/buyer ought to obtain as many waivers and releases as great legal minds can create.

The manager/buyer might even want to disclose the pending discussions, and thus perhaps avoid the issue entirely. If the selling member still wants to sell in the face of those disclosures, their claims become much less sympathetic.

Of course, the manager might hesitate to make those disclosures. It may represent another demonstration of the principle that if someone feels

uncomfortable about making disclosures, those are precisely the disclosures that ought to be made. Making those disclosures might mean the manager will miss out on a great opportunity. The manager will also miss out on a really interesting litigation.



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I help buyers, sellers, borrowers, lenders, tenants, property owners, and other commercial real estate market participants identify and achieve their business goals. To do that, I need to understand risk, security, numbers, value, financeability, flexibility, and exit strategy. Some legal issues matter a lot and many don't. It's important to know the difference. I write extensively on commercial real estate law and practice – over 300 articles and five books on leasing, lending, and other areas, with some emphasis on ground leases. I occasionally serve as an arbitrator or expert witness in complex real estate disputes. That lets me see how transactions go wrong. Often, the problems could have been avoided by keeping it simple and following the money, but everyone got sidetracked. As a Forbes contributor, I try to tell stories that teach worthwhile lessons for real estate deals. **Read Less**

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