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LIMITED LIABILITY COMPANIES

By James V. Irving

A valid limited liability company maybe formed in Virginia without the appropriate organizational documents, such as an Operating Agreement. However the failure to formalize the members' understanding of such critical issues as ownership stakes, management, and shares of the profits may result in differing recollections should a dispute arise. In such a case, it may be left to the court to separate truth from fiction, and to fashion a remedy that may seem unfair and unreasonable to both parties.

The case of *Clarke v. Newell* arose from the formation of a limited liability company for the purpose of purchasing and renting units in the River Place Apartment complex in Arlington, Virginia. While the specifics of the arrangement between the members was never reduced to written form, Clarke alleged that in January, 2002, he and Newell entered into an agreement to form a Virginia limited liability company called Joyce A. Newell, LLC. A limited liability company by this name was registered in the Commonwealth and Clarke opened an operating account at a local bank. It was Clarke's understanding that he and Newell were equal owners and would share in all the obligations, benefits, profits and losses. After Newell, LLC acquired seven units and six parking spaces at River Place, Clarke estimated the value of the LLC's assets at 1.5 million dollars.

According to Clarke, Newell approached him in the fall of 2004 and asked him to buy out her interest in the LLC. The parties negotiated, but were unable to reach an agreement. In November of 2004, Newell allegedly removed Clarke as a signatory on the LLC's account and left the area.

In August 2005, Clark filed suit in the Federal District Court in Alexandria relying on diversity jurisdiction. The six count complaint sought declaratory relief, injunctive relief, damages for breach of contract, damages for breach of the Virginia Limited Liability Company Act, unjust enrichment, and accounting. Newell filed a Motion to Dismiss on the basis of the statute of limitations.

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CONSENT TO CONTRACT

By James V. Irving

The case of *Giordano v. Atria Assisted Living Virginia Beach, LLC*, raises the issue of the consent necessary to form a binding contract within the context of an elderly resident of an assisted living facility.

In March of 2003, Ruth L. Brennan entered the Atria Assisted Living facility in Virginia Beach. To facilitate this arrangement, her daughter, Judith Giordano, signed her own name to the Residency Agreement ("Agreement") as the "Responsible Party" and signed her mother's name in the space marked "Resident". However, as Ms. Giordano later stated in an Affidavit, she had never discussed with her mother whether she had consent to sign her mother's name to the Agreement, or, for that matter, the terms of the Agreement at all. Ms. Brennan was not present when her daughter signed and the daughter did not have her mother's power of attorney. The Agreement at issue contained a binding arbitration clause, requiring that claims for injuries be arbitrated rather than tried in court.

Ms. Brennan was injured at the Atria facility on March 28, 2005, and died on July 30th of that year. Her daughter, on behalf of the estate, brought suit alleging that Ms. Brennan's injury and death were due to Atria's negligence. Atria filed a Motion to Compel Arbitration and Stay the action.

The questions before the Court were: had Atria and Ms. Giordano reached a meeting of the minds embodied in the Agreement; had Ms. Giordano acted as an agent for her mother when she signed the Agreement; and whether the combination of Ms. Giordano's signature on the Agreement combined with Ms. Brennan's two year residence at the facility in compliance with the Agreement established an apparent agency relationship under Virginia Law.

The Court noted that arbitration clauses are favored in Virginia as a matter of public policy and law, but that in order for a contract to be validly formed, a meeting of the minds must occur. In this case, there was no evidence that Ms. Brennan was ever aware of the terms, conditions, or requirements of the Residency Agreement in general or the arbitration clause in particular. Therefore, the Court found that there could be no mutual assent and that the arbitration clause could not be binding unless the Defendant could establish an agency or apparent agency relationship.

The Court concluded that Atria had not established Ms. Brennan's assent to allow her daughter to act for her or control her decision-making process. Atria had merely allowed Ms. Giordano to sign her mother's name and took no steps to investigate Ms. Brennan's understanding of the relationship. Ms. Giordano's statement that her mother had not consented, and the facts that Ms. Brennan was not present when the Agreement was signed and Ms. Giordano's lack of a power of attorney led to the conclusion that there was no agency.

The Court then considered the issue of apparent agency. An apparent agency is established when the principal's actions reasonably lead a third party to conclude that an agency exists. Atria's burden was to show that Ms. Brennan, through her actions or inactions, created a perception of agency and that Atria had reasonably relied upon it. However, as the Court noted, Ms. Brennan did not give her daughter extensive control over any element of her life, Ms. Giordano did regularly appear to act as agent for her mother, and Ms. Brennan did not generally confirm or adopt her daughter's actions. In essence, Atria allowed the daughter to sign her mother's name, but there was nothing to suggest this was at Ms. Brennan's request or reflected her intention. While Ms. Brennan did appear to comply with the terms of the Residence Agreement, the fact that Atria could not demonstrate that she had knowledge of what those terms were diminished this argument. In the final analysis, Atria had done nothing to determine Ms. Brennan's understanding of her daughter's role, and therefore the Court found that no apparent agency existed.

While *Giordano v. Atria Assisted Living* arises from an unusual circumstance, it reminds us of the danger of casually allowing one party to sign a contract on behalf of another. Custom, assumptions, or standard business practices are not sufficient to establish an agency relationship absent evidence of the principal's intent.

INDEMNIFICATION AGREEMENTS

By James V. Irving

Requiring personal liability to secure business obligations is a familiar business practice; so much so that many entrepreneurs - confident of their success and anxious to move forward - undertake wide-ranging obligation without carefully considering the ramifications of doing so. Indemnification agreements typically require an individual to promise to bear the responsibility for all loss occasioned by the default to the party he or she indemnifies. "All" loss usually means exactly that, as John V. Carmichael learned in the case of *Fidelity & Guarantee Insurance Company v. Specialty Mechanical Company, LLC*, decided in the Eastern District of Virginia, on March 10, 2006.

Conditioned on Carmichael's and several other individuals' agreement to indemnify, Fidelity issued payment and performance bonds on behalf of Specialty Mechanical Company, LLC, for construction services rendered as part of the Virginia Commonwealth University Parking Deck Project and the Chesterfield School Kitchen's Renovation Project, both in the Richmond area. Specialty defaulted on the projects. As required by the bond agreements, Fidelity, as surety, paid the resulting claims, leaving Fidelity to seek its recovery against Carmichael and the other indemnitors under the Indemnity Agreement. Fidelity's loses under the two projects totaled more than $240,000.00.

When Fidelity sought to collect against Specialty's indemnitors, all but Carmichael declared bankruptcy, leaving Carmichael faced with a claim for the full amount of the damages, plus related fees and costs.

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As the parties acknowledged, the ownership arrangement at issue had been established through an oral contract and the statute of limitations for enforcement of an oral contract in Virginia is three years. Newell asked for dismissal of the law suit based upon her theory that breach of contract (if any) occurred in January of 2002, when the limited liability company was formed, because the failure to create the required documentation at that time amounted to a breach of the oral agreement. Clarke argued that the breach did not occur until the breakdown of negotiations for the purchase of defendant's interests in late August of 2004, or when the Defendant took control of the limited liability company in November of the same year. Under Newell's interpretation the law suit would be barred in its entirety. Under Clarke's interpretation, the August, 2005 filing would have been timely if the claim arose under either of his theories of breach.

The Court agreed with Newell that the Limited Liability Company Act requires the maintenance of a written list naming each member of the company, but noted that Clarke was not seeking a remedy based upon the failure to keep this list, but upon Newell's subsequent affirmative actions designed to deprive him of the benefit of his investment. In ruling for Clarke, the Court stated that the statue of limitations runs from the date of the alleged breach that gives rise to the damages sought.

The parties are now at issue, and each of them will bear the burden of establishing their understanding of the agreement before any relief can be granted or Clarke's claims dismissed. This will be a far more difficult and costly exercise than if the parties had taken the time to memorialize the terms of their agreement at the outset.

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Faced with this debacle, Carmichael defended by arguing, among other things, that Fidelity had an obligation to provide the indemnitors with timely notice and an opportunity to defend the third party claims that Fidelity paid; and that Fidelity had certain obligations to protect the indemnitors' interests. Judge Henry Hudson of the United States District Court, sitting in Richmond, disagreed.

In pertinent part, the Indemnification Agreement stated that Carmichael was required to indemnify Plaintiff and "hold it harmless from and against all claims, damages, expenses, losses, costs, professional and consulting fees, disbursements, interests and expenses of every nature, … which the surety [Fidelity] may sustain, incur or become liable… by prosecuting or defending any action in connection with the bond or bonds."

As the Court pointed out, the indemnification language is "broad and expansive, encompassing almost every conceivable expense that Plaintiff could incur in establishing its right to indemnification." Fidelity owed no duty to protect the indemnitors from the result of Specialty's default. Accordingly, the Court awarded damages of $250,009.14, as well as attorney's fees in the amount of $40,500.00.

Security arrangements like personal guarantees and indemnification agreements will always be part of the landscape of sophisticated business transactions, and when they are required there will always be risk. The lesson of *Fidelity v. Specialty* is that the risk should be analyzed at the outset and accepted with eyes wide open.

This paper was prepared by Bean, Kinney & Korman, P.C. as a service to clients and friends of the firm. The purpose of this paper is to provide a general review of current issues. It is not intended as a source of specific legal advice. © Bean, Kinney & Korman, P.C. 2006.

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