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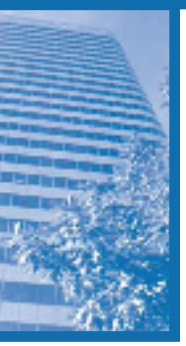

Business Law Newsletter

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Finality of Orders

By James V. Irving, Esquire

Under Virginia Supreme Court Rule 1:1, all "final judgments, orders, and decrees" remain under the jurisdiction of the trial court for 21 days after entry. After the expiration of the 21 day period, the order becomes final and no longer subject to modification. As Judge Jonathan C. Thacher of the Fairfax Circuit Court wrote in *Reston Homeowners Association v. Ramirez*, this Rule is intended to "assure the certainty and stability that the finality of judgments brings."

Occasionally, final judgments and orders do contain errors, and there are narrow and specific exceptions that allow the court to take corrective action outside the 21 day period. These include clerical mistakes which arise from "oversight or inadvertent omission" and Orders that were void at the time they were entered. However, these exceptions are narrow and are not liberally employed, as counsel for the Reston Homeowners Association ("RHA") recently learned.

The case arose from RHA's complaint against Eduardo Ramirez, alleging that Ramirez had failed to maintain his property as required by the RHA's governing documents. The Complaint sought corrective action, fees and costs, and the right to enter the property if Ramirez failed to correct the deficiency within a timely manner.

On June 18, 2010, a default judgment Order was entered in favor of RHA and against Ramirez. The Final Order contained the following statement: "the violating condition has been corrected and Defendant's lot is now in compliance."

On February 25, 2011, RHA again appeared before the court, seeking a second default judgment, because "the violating conditions… set forth in the Association's complaint remain uncorrected." As the Court noted, RHA was "requesting the Court to enter a second default order that grants an injunction and reverses the previous finding that Ramirez's lot is in compliance." The Court refused to do this.

RHA's raised two points in support of its second application: 1) that language

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in the Final Order stating that Ramirez "is now in compliance" was "included by accident," and 2) in any event, the Court retained jurisdiction because not all matters raised in the Complaint had been decided by the June 18 Order.

As Judge Thacher pointed out, clerical mistakes resulting from oversight or inadvertent omission may be corrected at any time, "however, to invoke such authority, the evidence must clearly support the conclusion that an error or inadvertence had been made." The only evidence of oversight was the "bare assertion" of RHA's counsel.

An Order is not final "if its terms retain jurisdiction for the trial court to reconsider the judgment or to address other matters still pending in the action." RHA argued that since their allegation that Ramirez was "illegally maintaining his property in violation of several building restrictions" was still undecided, the Order was not final.

RHA sought three forms of relief in its Complaint: an injunction ordering Ramirez to correct the violations, attorney's fees and costs. Costs and fees had been awarded. Since the purpose of the requested injunction was to correct violations, and since RHA acknowledged that the violating conditions had been addressed, Judge Thacher found that nothing remained before the Court and, therefore, the Court did not retain jurisdiction.

Under Code of Virginia Section 8.01-428, in addition to clerical mistakes, default judgments may be set aside by the defendant upon the grounds of fraud upon the court; a void judgment; failure to provide proper notice of judgment; proof of accord and satisfaction; or proof that the defendant was, at the time of service or entry of judgment, in the United States military. Each of these exceptions is subject to proof. In section B of this statute, the clerical error exception is separately set out and is perhaps distinguishable because the sufficiency of proof is somewhat subjective. While Judge Thacher provides no guidance on what would constitute sufficient proof a "bare assertion" is clearly not enough.

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Virginia Supreme Court Limits Transfers of LLC Membership Interest

By James V. Irving, Esquire and
David C. Canfield, Esquire

In Virginia, the elements of ownership of a limited liability company include "control interest," which is the right to participate in the LLC's administration, and "financial interest," which is the right to share in the LLC's profits and losses. A decision handed down by the Virginia Supreme Court on November 4, 2011, highlighted the legal distinctions between the two elements, before digressing into an analysis of transferability of control, which now calls into question the ability to provide in operating agreements for unrestricted transfers of control interest.

Ott v. Monroe arose from the formation of L&J Holdings by Dewey Monroe and his wife Lou Ann. As originally structured, Dewey owned 80 percent of the entity, Lou Ann 20 percent and Lou Ann was the managing member. Paragraph 2 of the Operating Agreement stated that except as otherwise provided in the agreement, "no Member shall transfer his membership ... to any non-Member... without the written consent of all other members, except by death, intestacy, devise or otherwise by operation of law."

Dewey died in 2004 and his will bequeathed his entire estate to his daughter Janet. Janet, asserting the authority to control the LLC through the bequest of her father's 80 percent interest, terminated Lou Ann as managing member and elected herself in Lou Ann's place. Lou Ann contested Janet's actions, arguing that Janet had inherited only her father's financial interest. Janet filed suit for a judicial declaration that she inherited both the financial and control interest.

The Circuit Court of Stafford County concluded

that under the Virginia Limited Liability Act, all of Dewey's right and authority to control the company terminated by operation of law upon his death (a "dissociation" under the LLC Act), leaving only his financial interest to be transferred by will. Therefore Janet did not become a member of the LLC, did not have authority to exercise control over the LLC, and could not remove Lou Ann as managing member.

Janet appealed, arguing that paragraph 2 of the Operating Agreement (cited above) superseded the default dissociation provisions of Section 13.1-1040.1(7)(a) of the LLC Act, by virtue of the statute containing the qualification language "except as otherwise provided in the articles of organization or an operating agreement." The Supreme Court disagreed and affirmed the trial court's decision.

In disagreeing with Janet, the high court found that all paragraph 2 of the Operating Agreement did was prohibit a member from transferring any part of his interest except "upon death" (among the other enumerated events), and did not specifically state an intention to supersede the statutory dissociation provision. Therefore the statutory qualification language was not applicable (i.e., paragraph 2 did not otherwise provide for a transfer of interest that differed from the statutory terms), and only the financial interest passed to Janet under Dewey's will in accordance with the Operating Agreement.

That might have been the end of the opinion and the case, as this reasoning fully decided the legal issues presented. Instead, the Court embarked on a review of the statutory and tax regulatory history underlying restrictions on partnership (and LLC) ownership transfers (since made obsolete by the 1997 "check the box" regulations), leading it to an additional conclusion which was not only unnecessary to the determination of the case, but likely to cause controversy and future uncertainty in the Virginia business community, announcing that "[u]nder the statute, only the financial interest in an LLC is alienable" and the control interest *cannot* be bestowed on another by the transferor's unilateral act.

The Court observed that even if the L&J Holdings operating agreement was construed to supersede the statutory consequences of dissociation under Section 13.1-1040.1 of the LLC Act, "it is *not possible* for a member unilaterally to alienate his personal control interest in a limited liability company." And then the Court summed up: "Thus it was not within Dewey's power under the Agreement unilaterally to convey to Janet his control interest and make her a member of the Company upon his death because *the Agreement could not confer* that power upon him." (emphasis added).

The problem with the Court's gratuitous observations? Section 13.1-1038.1 of the LLC Act provides that an assignee of interest may become a member as provided in Section 13.1-1040, which in turn states that "[e]xcept as otherwise provided in... an operating agreement," an assignee may become a member only as provided in the statute, and that "[a]n assignee who has become a member has ...the rights and powers... of a member..."

The Court acknowledged Section 13.1-1040 as providing the means by which the assignee of a financial interest could become a member, but failed to recognize that the operating agreement could provide that an assignee of interest might become a member automatically, or by a process far less restrictive than that set out in the statute.

Unless the Court is taking the position that an operating agreement cannot permit admission of an assignee as a member in a manner that is unrestricted or less restrictive than as provided in Section 13.1-1040, its bald pronouncement that control interest *cannot* be alienated by a member unilaterally simply fails to account for the right to provide in an operating agreement for the free transferability of control interest. While the L&J Holdings operating agreement may not have provided for an assignor's right to have its assignee admitted as a member without any consent or approval of other members or managers, under the contract flexibility afforded by Section 13.1-1040, it *could* have. The Court's

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statements indicate otherwise, however.

In suggesting that the transfer of control interest cannot be accomplished by admission of an assignee as a member except by the means specifically prescribed in Section 13.1-1040 (or on more restrictive terms), the Court lost sight of the overarching rule of construction for the LLC Act set forth in Section 13.1-1001.1: "This chapter shall be construed in furtherance of the policies of giving maximum effect to the principle of freedom of contract and of enforcing operating agreements."

On this issue, the *Ott* decision seems destined to unsettle far more LLC operating agreement drafting issues than it resolved – an unnecessary and unfortunate consequence.

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