

## Question MEE 1 – July 2025 – Selected Answer 1

### 1. Prevailing Preference

Lin's preference will prevail. At issue is whether the decision to expand the business into other products is outside of the scope of business.

An LLC combines the limited liability rules of a corporation, while operating as if it were a partnership. Member-managed LLC are managed by the members who form a part of it. When making a business decision, decisions within the scope of business require a majority of members to agree on it. In some jurisdictions, if there are two members and one is in favor the decision will be considered approved. In other jurisdictions it would require both members to agree on it. On the other hand, a decision outside of the scope of business of the LLC requires unanimous agreement.

Here, the purpose behind the formation of the LLC was so that Lin and Bo could sell their new kind of antibacterial soap. For the last two years, the LLC has only been in the business of selling the soap. A decision to expand the scope of business will likely be outside of the scope of business of this LLC. Because of this, this decision would require unanimous agreement, which is not present in these circumstances.

Because there is a disagreement between Lin and Bo on a decision outside the scope of business, Lin's preference not to expand will prevail.

### 2. Distribution of Assets

If both parties agree to dissolve, the accounts between Lin and Bo would be divided. At issue is how the distribution would be calculated.

In a partnership, member accounts are kept for contributions and withdrawals by the members to/from the partnership. This account balance is used when an LLC dissolves and the LLC property is being liquidated. The money will go to the members after taking into consideration how much they contributed.

Here, the formula worth \$20,000 was contributed by the both of them and this contribution will be divided between the two. In the first two years, Bo contributed \$7,000 that will be added to his account. This is effectively a debt owed to Bo. The property owned by the LLC at the start of the third year was \$5,000 in cash, \$1,000 in supplies, and the formula now worth \$40,000. If this is all liquidated it would amount to \$46,000. This will be divided between Lin and Bo after taking into account the

previous contribution by Bo of \$7,000. After Bo is repaid the \$7,000, \$39,000 will be divided between the two.

After Bo receives the \$7,000 repayment, Bo receives \$19,500 and Lin receives \$19,500.

### 3. Likelihood of Dissolution

It is unlikely that a court will order a dissolution. At issue is whether a court will dissolve an LLC if one of the two members seeks to leave.

Unlike a partnership, an LLC does not require at least two persons to continue. As a result, if one member of an LLC decides to leave, the LLC will not automatically begin the process of dissolution. While the dissolution of the LLC will not occur, the member will have to be given what he is owed after the accounts are taken into consideration.

Here, there is an LLC with two members and one wishes to dissolve. The court will likely not order a dissolution, but if Lin leaves he must be paid what he is owed by the LLC after his contributions and the increase in property of the LLC are considered.

While the dissolution will not be ordered, Lin can leave with what he is owed.

## **Question MEE 1 – July 2025 – Selected Answer 2**

### Whose preferences will prevail

LLCs are limited liability companies made up of either members or member-managers. In a member-manager LLC, managers have the power to make decisions for the LLC. However, the LLC is only comprised of members, fundamental business decisions (decisions not made in the ordinary course of business) can only be made with approval of the majority of its members. Absent an operating agreement, the amount of money contributed does not dictate the decision power of an individual member of an LLC.

Additionally, changing the original purpose of an LLC is a fundamental business decision, requiring approval of a majority of the members.

Here, the LLC is likely a member only organization. There is nothing indicating that either Bo or Lin are managers. Thus, any fundamental business decision must be approved by both of them, since that would constitute a majority of the members.

Bo's preference to expand the business into other consumer products is a fundamental business change. Lin and Bo formed their LLC for the purpose of manufacturing, distributing and selling their antibacterial soap. Expanding to other consumer markets goes beyond the original scope of the LLC's purpose. Therefore, the expansion of the LLC's purpose requires approval from both Lin and Bo to be enforceable. Since Lin has made it clear to Bo that she does not wish to expand the LLC to other markets, her preference will take priority over Bo's. Bo does not have majority member approval in order to establish the fundamental business change.

#### How would the LLC distribute assets if dissolution occurred

When an LLC is dissolved, its assets are wound up and sold. The proceeds of dissolution are then distributed to several costs. The first distribution goes to all the LLC's debts. After the debts have been paid, the money members originally put in is recouped. Finally, absent an operating agreement, the profits are distributed equally among the members. Additionally, if the operating agreement is silent on losses, the losses are distributed however the profits are distributed.

Additionally, members are not entitled to yearly distributions. Distributions are at the discretion of the members, but cannot be unreasonably withheld. Here, the fact that neither Bo or Lin received distributions in the second year would not affect the distribution of assets upon dissolution.

Here, the LLC has no debts so no money will be paid towards that. There is no operating agreement so the profits are shared equally and the losses are shared equally. At the time of dissolution, the LLC had 5,000 in cash, the soap formula worth 40,000 and supplies worth 1,000. Upon dissolution, these assets would be liquidated and turned into the distribution property. The total amount would be 46,000.

Bo and Lin equally owned an interest in the soap formula at the time of contributing it to the LLC. The value of the soap formula was 20,000. Initially, Bo would be able to recoup the 17,000 he initially invested in the LLC. This 17,000 is his half from the 20,000 value of the soap formula at the time of contribution and the 7,000 Bo contributed later on to buy ingredients and advertise. Lin would also be able to recoup his 10,000 contribution via his half of the value of the soap formula at the time of contribution. This would leave \$19,000 of assets. Absent any kind of agreement, the members would split this remaining amount equally. Bo would get 9,500 and Lin would get 9,500.

#### If only one party seeks dissolution, is a court likely to order a dissolution

If only one party seeks dissolution the court will look at several things to determine whether to order a dissolution. Dissolution is a fundamental business change which would normally require a majority of the members to approve. However, in a close LLC with very few members, courts will look to determine if the LLC's purpose is hindered by an inability to work together. The court will look at the parties' willingness to continue to do business with a difference of opinion. However, if it seems as though the parties have irreconcilable differences that make it impossible for the business to operate, the court may order a dissolution.

Here, Lin and Bo likely do not rise to the level of disagreement allowing a court to order a dissolution. They have differences in opinion about where the LLC should expand, but they have not indicated an unwillingness to work with one another. In fact, their LLC has made profits every year so far. Their formula has doubled in value from 20,000 to 40,000. It seems they are able to work together, even though they have a difference of opinion regarding the LLC.

### **Question MEE 1 – July 2025 – Selected Answer 3**

1) Lin's preference not to expand the business will prevail. At issue here is the unanimity requirement among LLC members to make fundamental changes to the scope of business of an LLC.

LLCs are co-owned by members and must be formed through filing of a certificate of formation with the appropriate state authorities. A written operating agreement can be used to control the rules governing the operation of the LLC and the interactions of its members. However, an operating agreement is not required and in the absence of one, the default rules for limited liability companies apply. Furthermore, an LLC can either be member-managed or manager-managed. In the former, the members themselves manage the operations of the business. In the latter, third-party managers are appointed for that purpose. Under the default rules, regardless of whether member- or manager-managed, each member has equal voting rights. This is true regardless of each member's initial contributions to the entity. Moreover, decisions within the ordinary course of business on an LLC require majority vote, whereas decisions outside the ordinary course of business require unanimous agreement among the members. Importantly, expansion of the scope of business of an LLC constitutes one such change outside the ordinary course of business.

Here, Lin and Bo are the only two members of this member-managed LLC formed in State A. As stated, Lin and Bo did not enter into a written operating agreement nor discuss altering any of the default rules. In turn, the default rules under the RULLCA

govern this business. As the only two members, Lin and Bo each possess 50% of the voting rights of the business. This is true irrespective of their relevant contributions (for instance, Bo's contribution of \$5,000 to the LLC and subsequent contribution of \$2,000). Next, the decision whether to expand the business beyond soap into additional consumer products is a fundamental change outside the ordinary scope of business. While it's not clear whether the certificate of formation specified that their business was limited to soap, the facts make clear that Lin and Bo at least "agreed" to start a business to manufacture, distribute, and sell their proprietary soap that they co-invented. Therefore, at least implicitly this is a fundamental change to the operations of the business. However, this fact is ultimately moot because under either a majority or unanimous voting procedure, Bo's preference to expand the business will fail. Clearly there is no unanimous agreement given Lin's dissent. But even if this is subject to a majority vote, the equal voting rights would make this a deadlock favoring the status quo of non-expansion. Therefore, Lin's preference will prevail.

2) The issue here is how the assets of a LLC are distributed among members upon dissolution where members have made different initial capital contributions to the entity throughout its existence.

The general rule of disposition of assets upon dissolution of an LLC is to first compensate capital contributions of each member before divvying up any remaining profits or assets according to the agreed upon distribution formula. Absent a written operating agreement, the default rules of the RULLCA split assets of the business equally among members. In other words, where there are two members (as there are here--Lin and Bo), each member is entitled to 50% of the assets. Furthermore, because not all assets are liquid, an LLC must decide whether to partition the assets or to partition through contribution (in which one party is entitled to title of the assets and the other to compensation for their share of value through cash or other consideration).

Here, the appropriate starting point is the initial capital contributions of the members. First, both Lin and Bo contributed equally to the initial \$20,000 valuation of the soap formula. They worked together over the course of two years and shared ownership of the soap formula equally. However, Bo contributed an additional \$5,000 to the LLC to buy soap ingredients an advertising space, and made an additional contribution of \$2,000 in cash during the first year of operations. These are the only contributions either member made to the LLC. Therefore, in total, Bo's contributions totaled \$17,000 (half the value of the soap formula, \$10,000, plus the \$5,000 and \$2,000 contributions) and Lin's totaled \$10,000 (half the value of the soap formula). Neither party was compensated for their contributions through distributions of the first-year's \$5,000 profits.

At the proposed point of dissolution, the LLC had \$5,000 in cash, a soap formula worth \$40,000, and supplies worth \$1,000. There was no debt, therefore the asset value represents the total net worth of the LLC--\$46,000. Again, Bo is entitled to repayment of his \$17,000 contribution, and Lin for his \$10,000 contribution. This totals \$27,000, leaving another \$19,000 in value to split evenly between them (\$9,500 each). Given the differing contributions of each member and the difficulty in splitting ownership of the soap formula or ingredients to reflect the relative value each contributed and is owed, contribution is likely required. A court could, for instance, order the sale of all the assets (i.e., the soap formula and ingredients) and thereafter distribute the proceeds accordingly--\$26,500 to Bo (\$17,000 contribution plus \$9,500 in leftover distributions) and \$19,500 to Lin (\$10,000 contribution plus \$9,500 in leftover distributions).

3) A court is likely to order judicial dissolution. The issue here is whether there are adequate grounds for dissolution by operation of law, which is typically reserved for cases in which members are deadlocked on the operations of the LLC and one party seeks judicial dissolution.

Generally, a court will not order judicial dissolution due to mere disagreements among members. However, where there are fundamental disagreements about the essential operations of the LLC and the managing members are deadlocked on how to proceed, a court may order judicial dissolution to protect the contributions of the dissenting members.

Here, Lin and Bo are at an impasse about the company's direction. Bo wants to expand the business into other consumer products. Lin does not. While the voting rights discussed in question 1 favor Lin's position, they two members are at odds about the fundamental direction of the business. Given that both members have significant capital contributions tied up in the LLC, as discussed in question 2, a court is likely to order judicial dissolution upon request by one party. Otherwise, the operations of the entity will be frustrated and one of the parties' contributions will be put at risk in a business to which they do not wish to proceed.