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District Court Underscores the Importance of Suing the Correct Party in Action for Recovery of Distributional Interest

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In *FW Associates LLC v. WM Associates LLC*, 2019 WL 354953 (No. 18 C 5081) (N.D. Ill. Jan. 28, 2019), the United States District Court for the Northern District of Illinois held that a dissociated LLC member may not sue another member to recover his distributional share in a company, but that the appropriate party for such a suit is the LLC itself. The court also dismissed the member’s conversion claim for his distributional interest because that interest was “intangible” and thus could not be converted.

This case arose out of a dispute between the owners of Smart Bar, a company that produces an automated cocktail dispenser known as the Smartender. In 2012, William Metropulos and FW Associates, LLC (“FWA”) formed Smart Bar, USA, LLC and Smart Bar International, LLC (together, Smart Bar). Before long, the parties began to experience friction in their relationship and, by 2013, found themselves in arbitration amid reciprocal claims of breach of the Smart Bar operating agreement and various acts of misconduct. In April 2015, the arbitrator ordered Metropulos dissociated from Smart Bar and required him to pay several hundred thousand dollars in attorneys’ fees and

expenses to FWA and Smart Bar. The Circuit Court of Cook County confirmed the arbitrator's award, and the Illinois Appellate Court affirmed.

Metropulos alleged that Smart Bar dissociated him on November 21, 2016. This normally would mean that he was still entitled to receive distributions from the entities, but could no longer participate in management of them. However, according to Metropulos, Smart Bar effectively extinguished his rights entirely by also purporting to take away his distributional interest in the company. In addition, Metropulos had already transferred his interest in Smart Bar to WM Associates, a new entity Metropulos established after he was dissociated.

In 2018, FWA brought suit against Metropulos and WM (collectively "Defendants"), claiming that Metropulos had wrongfully transferred his interest in the Smart Bar entities to WM in an effort to avoid paying the arbitration judgment. Defendants brought two counterclaims. The first asserted that FWA had violated section 35-60 of the Illinois Limited Liability Company Act (the "LLC Act"), by failing to buy out Metropulos' distributional interest in Smart Bar upon his dissociation. In addition, Defendants claimed that FWA had engaged in other conduct warranting their dissociation from the company.

FWA argued that Defendants' counterclaims should be dismissed because FWA was not the proper party for Metropulos to sue to obtain recovery of his distributional interest. Instead, Defendants should have sued Smart Bar itself. The court agreed, rejecting Defendants' three arguments to the contrary.

First, Defendants claimed that section 15-20(a) of the LLC Act permitted a "member [of an LLC] to maintain an action against....*another member*" (emphasis added) to enforce its rights under the Act. But the court pointed out that this provision no longer applied to Metropulos because he had ceased to be a member of Smart Bar upon his dissociation in 2016. (*See section 35-55(a)(1) of the LLC Act: "Upon a member's dissociation from the LLC, he ceases to be a member and is treated as a transferee."*)

Second, Defendants contended that, because they were seeking to dissolve Smart Bar due to FWA's harmful or oppressive conduct, section 35-1(b) of the LLC Act gave the court power to provide relief other than dissolution, "including....a buyout of the applicant's membership interest." Again, however, Defendants had to bring their claims against Smart Bar, not FWA, the member. In fact, the court suggested that Smart Bar was a necessary party to Defendants' action, because it had a present, substantial interest in the matter being litigated, which was its own potential dissolution.

Third, Defendants asserted that suing FWA was essentially the same as suing Smart Bar because FWA, as the purported 100% owner of the company, was Smart Bar's "alter ego." The court rejected this assertion because an "alter ego" exists between an owner and a company only if (1) there is a unity of interest and ownership that is so strong that the separate personalities of the corporation and the owner "no longer exist," or (2) treating the company and owner as separate entities would promote injustice or inequity. However, defendants failed to allege such circumstances.

In their second counterclaim, Defendants sought to have FWA dissociated from Smart Bar based upon various acts of oppressive or illegal conduct FWA allegedly perpetrated upon Metropulos, including attempting to take away his distributional interest in Smart Bar and moving the company's headquarters to Nevada without legal authority to do so. Defendants asked the court to find that WM Associates was the owner of Metropulos's distributional interest in Smart Bar or, alternatively, to award defendants damages for FWA's conversion of that interest.

The court denied Defendants' request to have WM declared the owner of Metropulos's distributional interest, reiterating that FWA was not the proper entity to sue for such relief. With regard to conversion, the court held that Illinois law does not recognize conversion claims based upon "intangible rights." Here, the distributional share allegedly converted by FWA was merely an intangible *right* of future payment, rather than a tangible or intangible thing that could be converted. Accordingly, Defendants' claim for conversion had to be dismissed as well.

FW Associates LLC v. WM Associates LLC makes it clear that any former LLC member seeking to recover his or her distributional interest must name the LLC itself as a party, not a fellow member and that a conversion claim may not be used a vehicle for recovery.

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