DELAWARE BUSINESS COURT INSIDER

May 29, 2020

An ALM Website

Chancery Holds Buyout Provision in LLC Agreement to Be a 'Call Option' and Irrevocable Following Exercise

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In *Walsh v. White House Post Productions*, Del. Ch., C.A. No. 2019-0419-KSJM, McCormick, V.C. (Mar. 25, 2020) (Mem. Op.), the Delaware Court of Chancery held that a buyout provision in the operating agreement of a Delaware limited liability company was a "call option" and that the company could not withdraw from the buyout process following the company's exercise of the option. The Court of Chancery's opinion offers valuable guidance to Delaware limited liability companies when drafting the buyout provision of their operating agreements, as well as when Delaware limited liability companies are considering exercising a buyout right in accordance with the terms of their operating agreements.

As background, Carbon Visual Effects, LLC (the company) is a Delaware limited liability company. The company is majority owned by White House Post Productions, LLC (White House), and Kieran Walsh and Francis Devlin are minority owners and employees. In January 2014, White House, Walsh and Devlin entered into an amended and restated limited liability company agreement (the LLC agreement). The LLC agreement provided that if a member ceased to be employed by the company for any reason, the Company would have the right to buy the member's units at fair market value, and the member would be obligated to sell his units to the company. The mechanism for determining fair market value can be summarized as follows: the company first obtains an appraisal and delivers it to the departing member(s), who can accept the results of the appraisal or dispute the results of the appraisal by obtaining a second appraisal. If the departing member(s) elects to obtain a second appraisal and the results of the second appraisal are within ten percent of the results of the first appraisal, then the fair market value of the units will be determined by averaging the results of the two appraisals. If the results of the second appraisal are more than 10% higher than the results of the first appraisal, then the two appraisers will jointly select a third appraiser, and the determination of the third appraiser will be binding on the company and the departing member(s).

From left: Robert B. Little and Louis J. Matthews of Gibson Dunn & Crutcher

In November 2018, Walsh and Devlin were notified that the company would not be renewing their service agreements. In December 2018, the company obtained the first appraisal contemplated by the buyout provision and delivered it to Walsh and Devlin. In February 2019, Walsh and Devlin informed the company that they would be obtaining the second appraisal and subsequently retained an appraiser. However, in March 2019,

the company communicated to Walsh and Devlin that it no longer desired to exercise its buyout right. Nevertheless, in April 2019, the second appraiser hired by Walsh and Devlin completed its appraisal and valued the units for an amount more than ten percent higher than the results of the first appraisal. Walsh and Devlin consequently requested the company engage a third appraiser pursuant to the terms of the LLC agreement. However, the company did not respond. Then, in June 2019, Walsh and Devlin initiated litigation claiming that the company breached the express or implied terms of the LLC agreement by withdrawing from the price-determination process (including refusing to engage a third appraiser) and sought specific performance to effectuate the buyout process.

In the Court of Chancery, the company argued that the company's December 2019 notice was an "offer" that, pursuant to common law principles, the company had the right to withdraw before it was accepted. The company further argued that because Walsh and Devlin never accepted the offer, the company's withdrawal was timely, and no binding contract was formed. Walsh and Devlin argued, on the other hand, that the buyout provision is a "call option," or a form of option contract. The court agreed with Walsh and Devlin that the buyout provision was a "call option" because it contained both elements of an option contract: an offer to enter into an underlying agreement for the sale of property (i.e., the members' offer to sell their units to the company for fair market value in connection with their termination of employment) and a promise to keep that offer open (i.e., the obligation of the members to sell their units to the Company pursuant to the preagreed process). In other words, the departing members were the offerors of the buyout right to the company (the offeree), and in exercising the buyout right, the company accepted the offer and created an enforceable agreement with the departing members. Therefore, once the company delivered the results of the first appraisal to Walsh and Devlin, the company exercised the option and could not withdraw the exercise or withdraw from the price-determination process.

The *White House Post Productions* decision serves as a helpful reminder to members and their counsel to be as clear as possible when drafting the buyout provision in the operating agreement of a Delaware limited liability company. Specifically, if the company would like the exercise of the buyout right to be revocable, the applicable terms of the operating agreement should be explicit on this point. The Court of Chancery was unconvinced by the company's argument that the exercise of the buyout right was revocable based on the company's theory that the buyout provision did not expressly prohibit the company from withdrawing from the price-determination process at any time.

In addition, the *White House Post Productions* decision serves as a helpful reminder to Delaware limited liability companies with similar provisions in their operating agreements that once they commence the buyout process, they must be prepared to complete the process in accordance with the terms of the operating agreement, even if the ultimate purchase price is higher than initially proposed.

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