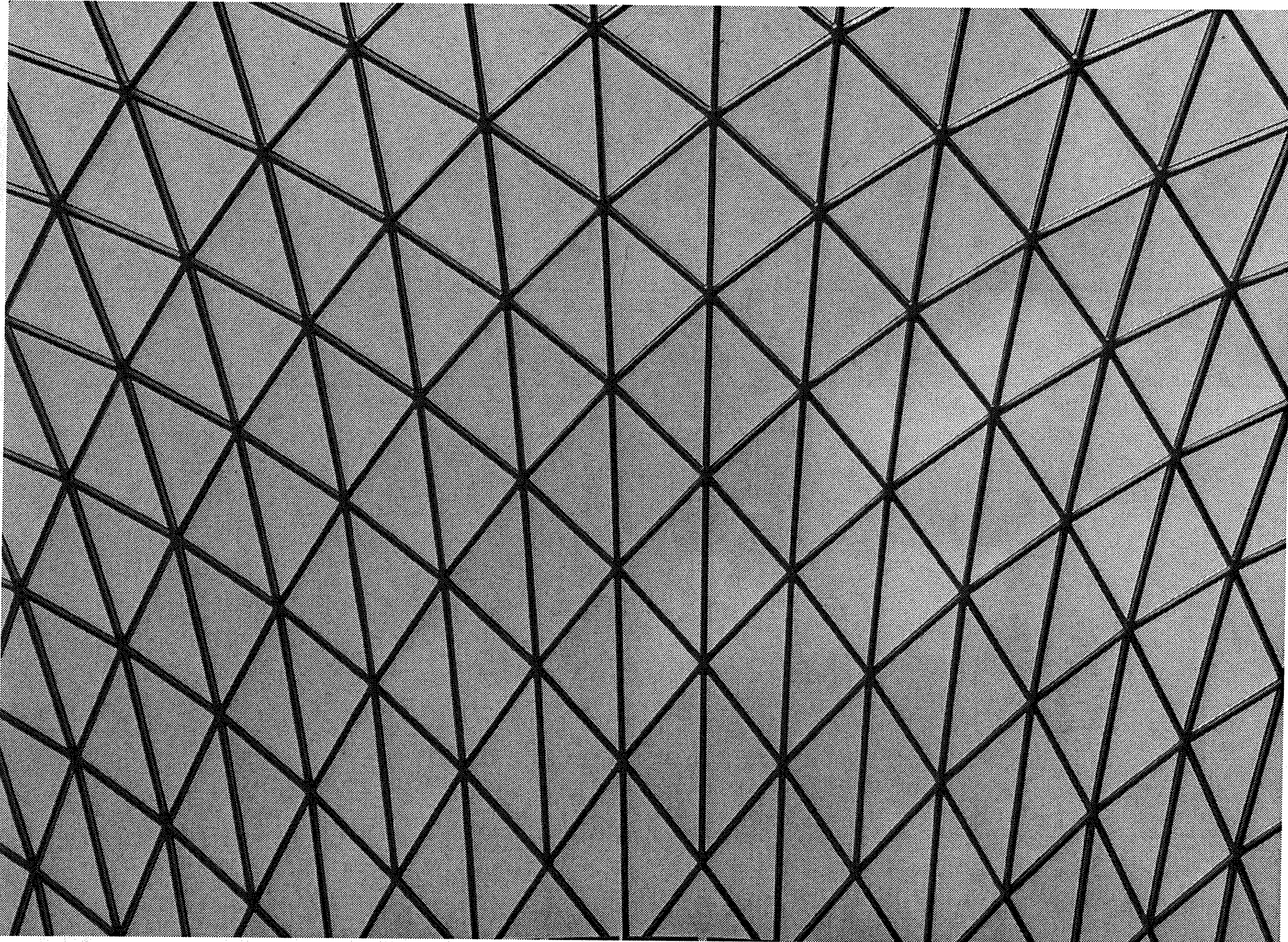
Robl Construction, Inc. vs. Homoly

A LESSON IN PROPER LLC GOVERNANCE



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Robl Construction, Inc. vs. Homoly
A LESSON IN PROPER LLC GOVERNANCE

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LLCs are indeed flexible business structures, but LLC members and managers must be careful not to confuse "flexibility" with "informality." A recent case out of the U.S. Court of Appeals for the 8th Circuit illustrates the danger in loosely documenting transactions and failing to maintain adequate records in the context of a two-member LLC. Practitioners representing LLCs must ensure that clients understand that proper LLC governance is an ongoing responsibility, and one that is not mitigated simply by virtue of an entity's size or the pre-existing relationship of its owners. Additionally, an LLC's operating agreement (and standalone buy-sell agreement if it has one) is the governing instrument not to be ignored or forgotten about post-signing. Practitioners should consider highlighting the key points from an LLC's governing documents for their clients to continuously refer to throughout the life of the entity.

Robl Construction, Inc. v. Homoly, No. 13-3607 (8th Cir. April 1, 2015)

Robl Construction was an appeal to the 8th Circuit following a grant of summary judgment in the lower court in favor of Andrew Homoly. The case was in federal court on the basis of diversity – Robl Construction ("Robl") is a Kansas corporation and Andrew Homoly ("Homoly") is a Missouri citizen.

FACTS

Robl (owned by Steve Robl and his wife, Vera) and Homoly formed Homoly and Robl, L.L.C., a Kansas limited liability company (the "Company"), in 2002, with Robl and Homoly owning 60% and 40%, respectively. The Company began to have financial problems in 2004 and operated at a loss from 2006 through 2011. During this time, Robl periodically advanced a total of $431,544 to the Company. Such advances are the subject of the parties' dispute, as Robl contended that the advances were a loan to the Company that Homoly personally guaranteed pursuant to the terms of the parties' Buy-Sell, Option and Financing Agreement (the "Buy-Sell Agreement"). As such, Robl claimed that Homoly breached the terms of the Buy-Sell Agreement by failing to repay his 40% share of the loan.

~ *Email Correspondence*

In support of its claim, Robl pointed to email correspondence between Vera Robl, the Company's accountant, and Homoly. In mid-2006, Vera emailed Homoly to notify him that the Company needed "to make a capital call or increase loans on existing inventory" and told Homoly that Robl had "put in $71,500 so if you go the route of capital call, your share to get caught up would be $47,666." Vera asked Homoly to "let [her] know what to do." Homoly responded asking whether the

[1] *Robl Construction, Inc. v. Andrew G. Homoly,* No. 5:11-CV-00995-SOW (W.D. Mo July 9, 2013).

$47,666 included $34,900 he previously contributed. In her next email, Vera explained to Homoly:

"No, the 71,000 is new money we've put in to cover all the carrying costs of the inventory. To match it, you would need to put in 47,666. . . . I've been treating the 71,000 like a loan from Robl Const, but I need to known what the plans are – will it be capital and you will match it, or will it be a loan and be repaid?"

A few days later, Homoly responded to Vera by email letting her know that contributing the requested $47,666 "would be a good sized hit for [his] liquidity" and that he "would prefer the money from Robl to be considered a loan and then [Robl] get[s] repaid with interest." Homoly concluded his email by saying, "If Steve would rather me put in a capital call, however, I will go ahead and write the check."

Vera's email reply stated that there was no money in the Company so she advanced money from Robl Construction, thinking they'll "get caught up" later. She then told Homoly she would not make any journal entries until Homoly and Steve talked it over. Robl claimed the parties later agreed to treat the advances as a loan personally guaranteed by Homoly, while Homoly argued that the advances may have been a loan, but that Homoly never personally guaranteed to repay it. In March, 2011, Robl formally demanded that Homoly repay his share of the unpaid loan, and when Homoly refused, Robl sued for breach of contract.

~ *Contractual Language*

In addition to the email correspondence, the parties' dispute also turns on the interpretation of their written agreements. The Operating Agreement provided that no member is authorized to create "any obligation or commitment of the Company, including the borrowing of funds, in excess of $10,000.00" or to commit "any act which would cause a Member, absent such Member's written consent, to become personally liable for any debt or obligation of the Company." The Buy-Sell Agreement provided that if the "Company actively seeks and needs a loan (otherwise a personal guarantee is irrelevant and not necessary)," then prior to making any loan, "both the lender and borrower make separate requests that the respective LLC members personally guaranty the Company's debt."

ISSUE

On appeal following the lower court's summary judgment ruling in favor of Homoly, the issue before the 8th Circuit was whether the evidence is such that a reasonable jury *could* return a verdict for Robl on its breach of contract claim or whether it is so one-sided that Homoly *must* prevail as a matter of law.

Analysis and Conclusion

The 8th Circuit reversed and remanded for further proceedings, holding that a reasonable jury could find that Homoly not only consented to the Robl loan, but also agreed to be personally liable for 40% of the debt.

~ Consent

The Court gave the following facts in support of the notion that Homoly consented to the loan and personal guarantee:

(a) Homoly's 2006 email indicated that he would prefer the money be construed as a loan;
(b) Steve and Homoly "constantly communicated" about the loan and the amount Homoly owed;
(c) Homoly agreed to Robl charging interest on the loan and agreed that the interest rate was fair;
(d) the Company's financial statements treated the advances as a loan and attributed 40% of the debt to Homoly, yet in 4 years of receiving the financial statements, Homoly never objected or denied liability, but he did "panic" about his growing losses;
(e) Homoly benefited from the loan by avoiding a capital call while maintaining a 40% interest in the Company, and also by offsetting the Company's losses against ordinary income on his tax return; and
(f) Most of Robl's advances to the Company occurred after the 2006 email exchange.

With respect to Homoly's claim that "his intent in agreeing and consenting to personal liability in the buy-sell agreement was limited to a specific loan from a bank," the Court held that questions of intent are factual disputes for a jury to decide. The Court also dismissed Homoly's argument that the conditions precedent to a personal guarantee under the Buy-Sell Agreement were not satisfied (namely, there was no pre-loan request for Homoly to provide a personal guarantee). The Court cited Kansas law in stating that Homoly could not avoid contractual liability "merely by claiming the conditions [precedent] have not been met"; rather, Homoly must show that the condition precedent actually failed and that because of such failure, the contract will not be performed.

~ Writing and Timing Requirements

The Court also questioned Homoly's contention that (a) the Operating Agreement required "signed written consent" for loans greater than $10,000 and (b) the parties could not designate Robl's advances as a loan or request a guarantee after the receipt of funds. The Court held that the contractual language was open to interpretation and that a "reasonable jury could find that there was no such binding obligation or commitment from the Company unless and until the parties decided to treat the advances as a loan." The Court also indicated that, under Robl's characterization of the multiple advances as a single revolving loan, "we would not expect a separate consent before each advance." On the other hand, if the multiple advances were intended to be a series of smaller loans, the Court found that some of the advances were below the Operating Agreement's $10,000 threshold; thus, they would not have required Homoly's consent.

~ Ratification

The Court further supported its decision by stating that the "facts also suggest Homoly may have ratified at least part of the loan to the Company by knowingly accepting the benefit." According to the Court, Homoly understood that Robl's advances "allowed the Company to operate without selling assets or making a capital call," and Homoly never asked Robl to stop loaning money to the Company.

~ Separate Guarantee Not Required

The Court disagreed with Homoly's claim that the Buy-Sell Agreement required a separate "written consensual personal guarantee" before Homoly could be subject to personal liability by its terms. The Court stated that the language of the Buy-Sell Agreement did not unambiguously require a separately documented personal guarantee, and Homoly failed to produce competent evidence that the parties' intended separate documentation of guarantees for every loan.

~ Statute of Frauds

Homoly raised the claim that Robl did not satisfy the statute of frauds with respect to Homoly's purported guarantee. The Court cited Kansas law which provides that a guarantee falls outside the statute of frauds in cases in which the guarantor's main purpose and object of providing the guarantee was to "subserve some purpose of his own." Since Homoly admitted in the 2006 emails that treating the advances as a loan would be better for his personal liquidity, the Court held that the intent behind Homoly's guarantee was a question of fact for a jury to decide.

TAKEAWAYS

Although nothing in the 8th Circuit's or the lower court's opinions confirms this, I suspect that Steve Robl and Andrew Homoly may have been buddies looking to join forces, leverage their talents, and operate a profitable real estate development company indefinitely. Steve's wife managed the books, and the three operated the Company harmoniously until the economy started to crumble and the Company could no longer make ends meet. Steve had been keeping the Company afloat through periodic, uncharacterized infusions of cash (no need for formalities here since we're all friends, right?). After many years of operating at a loss, they all started losing patience with each other. Unmet expectations resulted in frustration and resentment, and the parties found themselves in court fighting over money. Rarely do parties enter into a business relationship expecting this outcome, but unfortunately this scenario is far too common. As counsel for any newly formed or existing LLC, a practitioner would be wise to offer his or her client the following advice:

- Document all transactions in advance and keep detailed business records. Do not take an action and assume the business partners will "work it out" later.
- Keep in mind that email is discoverable and may be relied upon to determine the parties' intent should a dispute arise.
- Read and understand agreements before signing them and realize that ignorance of the law (or the terms of the contract) is no defense.
- Comply with the terms of an entity's governing documents at all stages of a proposed action or transaction.
- Consider amending the terms of an entity's governing documents if they no longer meet the needs of the entity or serve the intent of its owners.
- Resist the temptation to make "gentleman's agreements" with business partners for the sake of time or convenience; formalize and document all understandings and agreements now to potentially save the time and inconvenience of a lawsuit in the future.

For more information: information@wealthcounsel.com **or call us:** (888) 659-4069 #819