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Medical Professional Limited Liability Companies (PLLC)

Michigan Supreme Court's Ruling Determines PLLC Member Rights and Valuation Calculations

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This legal alert is to provide healthcare, valuation, tax, and accounting professionals with an update on a recent Michigan Supreme Court ruling, issued on July 3, 2013, that determines member rights and valuation calculations and applies to all Michigan limited liability companies.

Two cardiothoracic surgeons formed a professional limited liability company (PLLC) to operate a vascular laboratory. When one member lost hospital privileges in 2004, the PLLC's operating agreement required that member to withdraw from the PLLC and provided that dissolution occurs "at any time that there are less than two remaining members." While the dissolution occurred under the operating agreement in 2004, the vascular laboratory continued to operate and generate profits until the company was sold in 2007.

The physician members litigated their respective rights under the PLLC's operating agreement and the Michigan Limited Liability Company Act (the "Act") between the date of dissolution and the sale of the company. Essentially, the questions before the Michigan Supreme Court were:

1. Does the PLLC's operating agreement trump a certain provision of the Act to prevent both members from sharing equally in the profits of the company between the date of dissolution and the date of the company's sale; and

2. Should the valuation of the company be determined on the date of dissolution with assessments of future earnings and goodwill excluded?

The withdrawing member argued that the Act entitles him to receive a portion of the payments from 2004 to 2007, under a statutory provision that requires a manager to account for profits received: "Except as otherwise provided in an operating agreement or by vote of the members … a manager shall account to the limited liability company and hold as trustee for it any profit or benefit derived by the manager from any transaction connected with the conduct or winding up of the limited liability company or from any personal use by the manager of its property." See MCL 450.4404(5).

For calculations as to amounts owed, the withdrawing member presented a valuation expert and argued that the laboratory's future earnings and goodwill should be included in determining the company's fair market value for purposes of distributing that value between the parties.

In rejecting both arguments, the Michigan Supreme Court held that "MCL 450.4404(5) is not applicable to this case. Instead, the division of the profits of the company are governed by the operating agreement, which provides that the PLLC "shall be dissolved" upon the occurrence of a withdrawal event. Thus, the PLLC was dissolved on January 13, 2004…The value of the PLLC should be assessed as of that date. The [withdrawing member] is not entitled to any profits derived from the [non-withdrawing member's] use of the laboratory between January 13, 2004 and the date that the laboratory was sold [in 2007]."

The Michigan Supreme Court also agreed that "the trial court should not consider defendant's expert's testimony regarding the value of the PLLC. The defendant's expert valued the PLLC as an on-going concern, taking into account future earnings and goodwill. While this type of valuation would be appropriate in a divorce or condemnation, it is not an appropriate way to value a dissolved business because future earnings and goodwill are not tangible assets that can be distributed by the dissolved company." Additionally, "the operating agreement does not provide for the distribution of goodwill or future earnings. Therefore, the defendant's valuation of the business should not be considered on remand."

This ruling is important because it sets precedent for the legal rights and valuation for all Michigan Limited Liability Companies, including Professional Limited Liability Companies. External events that trigger certain provisions in a company's operating agreement can establish withdrawal and dissolution dates as a matter of law. Although these dates may not be immediately recognized by the company's members or their advisors, the legal affect impacts valuation calculations for membership interests and member rights to post-dissolution profits. Every operating agreement is unique and should be evaluated in context of current case law.

For more information or legal questions regarding the formation, operation, management, sale, or purchase of Professional Limited Liability Companies, please contact Steven Stawski, Attorney and Counselor at Law, at (616) 458-4394 or sstawski@shrr.com.

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