Drawing the Line: When Operating Agreements Govern the Relationships Between New York Limited Liability Companies and Their Members

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In this article, the authors discuss a recent New York court decision holding that a limited liability company organized under New York law that has not executed its own operating agreement is not a party to, and therefore cannot be bound by, that operating agreement.

Whether a New York limited liability company is a party to and bound by its own operating agreement has been examined in a recent decision by the New York Supreme Court, Appellate Division, First Judicial Department. The opinion distinguished New York's Limited Liability Company Act from the Revised Uniform Limited Liability Company Act (RULLCA), ultimately delineating a bright-line rule: An LLC organized under the laws of the State of New York that has not executed its own operating agreement is not a party to, and therefore cannot be bound by, such operating agreement.

BACKGROUND

In *Wythe Berry v. Goldman*,[1] a dispute arose between two real estate entrepreneurs, Yoel Goldman and Zelig Weiss, relating to the development of a hotel in New York. Pursuant to Section 11 of the Fifth Amendment to the operating agreement of the developers' primary operating company, Wythe Berry LLC, Goldman and Weiss agreed that any dispute arising under the operating agreement would be determined by the American Arbitration Association.

Significantly, the Fifth Amendment only refers to the members - including Goldman and Weiss, in their individual capacities as members - as parties to the agreement. Accordingly, the signature block of the Fifth Amendment made no reference to Wythe Berry.

When a dispute later arose in connection with financing the hotel development, Goldman commenced arbitration against Weiss and several of Weiss and Goldman's entities, including Wythe Berry, pursuant to the arbitration clause in the Fifth Amendment. In re-

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sponse, the petitioner entities, including Wythe Berry, filed a petition to stay the arbitration pursuant to N.Y. Civ. Prac. Law & Rules 7503(b), which allows courts to stay arbitration proceedings on the basis that a valid agreement does not exist.

In opposing the petition, Goldman presented a contract referred to as the "Side Agreement," wherein Weiss and Goldman agreed that the Fifth Amendment would be the governing agreement should any dispute arise between Goldman and Weiss in connection with the hotel development. Specifically, Goldman cited a provision in the Side Agreement that he argued expressed an intent to bind Weiss and Goldman, as well as certain entities registered under their names, such as Wythe Berry, to the Side Agreement.

As translated from Hebrew to English, the relevant provision in the side agreement provided that "Goldman and Weiss 'hereby acknowledge, both on our own behalf and on that of all the corporations registered under our names, whether in whole or in part, and that have any relevance or connection to the [hotel] land and building, without exception - fully acknowledge . . . everything that is written' in the Side Agreement. The Side Agreement further provide[d] that the 'main and principal agreement that shall be determinative and dispositive between us in any case of doubt, dispute, or . . . conflict that may perhaps arise between us . . . shall be . . . [the] [Fifth Amendment], which was signed by us on the said date.' "[2] Like the Fifth Amendment, however, the Side Agreement was not executed by Wythe Berry.

The lower court held that Wythe Berry had agreed to arbitrate, reasoning that the Side Agreement incorporated the Fifth Amendment's arbitration clause and that Weiss and Goldman had acted on behalf of Wythe Berry when they signed the Side Agreement.

LEGAL ANALYSIS ON APPEAL

The Appellate Division relied on a comparative analysis to illustrate how the New York LLC Act diverges from the RULLCA on the issue at hand. The appellate court explained that under the RULLCA, an LLC would be bound by its operating agreement, even if the LLC had not itself manifested assent to said agreement. Under Delaware law, for example, Section 18-101(9) of the Delaware Limited Liability Company Act explicitly provides that a "limited liability company . . . is bound by its limited liability company agreement whether or not the limited liability company . . . executes the limited liability company agreement." In sharp contrast to Delaware's law and the RULLCA, the court explained that under the New York LLC Act, an "operating agreement" is defined as a written agreement among the members of an LLC that concerns the business of the LLC and the conduct of its affairs.[3]

Moreover, because the LLC and its members exist as separate legal entities pursuant to N.Y. Ltd. Liab. Co. Law § 203(d), an LLC that does not execute its own operating agreement is not a party to such agreement. The court further explained that the New York LLC Act does not otherwise provide that operating agreements necessarily govern the relationship between an LLC and its members. Therefore, unlike Delaware and other states that have adopted the RULLCA, the operating agreement of an LLC organized under the New York LLC Act (1) can be exclusively among the members of the LLC, and (2) a nonsignatory LLC is a nonparty to any such operating agreement among members.[4]

The Appellate Division rejected the lower court's determination that Wythe Berry's acknowledgment of the Side Agreement manifested an intent for Wythe Berry company to be bound by the Fifth Amendment's arbitration clause. Rather, the appellate court determined that the more consistent interpretation of the Side Agreement is that Wythe Berry merely acknowledged that the Fifth Amendment would be the governing agreement between Goldman and Weiss, the signatories to the Side Agreement.

Because Wythe Berry did not sign the Fifth Amendment and because its mere acknowledgment of the side agreement did not constitute "a clear and unequivocal manifestation of an intent to arbitrate"[5] by Wythe Berry, the court determined that Wythe Berry was not bound by the arbitration provision under the Fifth Amendment.

A BRIGHT-LINE RULE EMERGES

In *Wythe Berry*, the Appellate Division made one thing very clear: Under the New York LLC Act, an LLC shall not be bound by its operating agreement unless it signs the agreement separately from the members themselves. Therefore, if it is the intent of the parties that an LLC formed in New York be bound by the same contractual rights and duties as the members under the operating agreement, then it is imperative that the LLC be a signatory to its operating agreement.

NOTES:

[1] https://www.nycourts.gov/courts/ad1/calendar/List_Word/2024/09_Sep/26/PDF/Wythe%20Berry%20%20v%20%20%20Goldman%20(2023-06011).pdf.

[2] Wythe Berry LLC v. Goldman, 230 A.D.3d 1081, 220 N.Y.S.3d 7 (1st Dep't 2024).

[3] N.Y. Ltd. Liab. Co. Law § 102(u).

[4] Wythe Berry LLC v. Goldman, 230 A.D.3d 1081, 220 N.Y.S.3d 7 (1st Dep't 2024).

[5] Wythe Berry LLC v. Goldman, 230 A.D.3d 1081, 220 N.Y.S.3d 7 (1st Dep't 2024).