

Court Deems LLC Members Insiders for Bankruptcy Preference

by Joel R. Glucksman on April 13, 2012

In re Longview Aluminum, LLC, 657 F.3d 507 (7th Cir. 2011), the Seventh Circuit Court of Appeals recently ruled that limited liability company members are to be considered insiders for preferential transfer purposes when a business files for bankruptcy protection.

The decision stems from a case in which Longview Aluminum LLC member Dominic Forte, who held 12 percent of membership interests, was sued by the company's bankruptcy trustee for a \$200,000 settlement payment he received four months prior to the filing, according to the Real Estate Finance Journal. Earlier that year, Forte entered into a settlement agreement with the LLC after the members denied him access to the financial books and records of the company.

Forte argued that because he had no management or decision-making responsibilities in the company, and bankruptcy law has not established a clear definition of LLC members in the event of insolvency, he should be classified as a noninsider, in which distributions can only be recovered within 90 days of a bankruptcy filing. However, the court disagreed and ruled that LLC members are considered insiders despite a clear definition under Bankruptcy Code, and asserted that a corporation managed by directors is the same as an LLC managed by members.

However, Forte argued that responsibilities, authority and influence of LLC members can vary and be less far-reaching than the authority of a director. The court explained that corporate titles are not indicative of insider status, but rather the legal responsibilities they hold.

The outcome has significant implications for LLC members who have a small stake or limited authority in a company. Under current bankruptcy law, trustees are authorized to recover distributions to insiders that were paid within one year of the bankruptcy filing, as opposed to 90 days for noninsiders.