UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF KENTUCKY
AT LOUISVILLE

CIVIL ACTION NO. 3:99CV-287-H

FLYNN INVESTMENT PARTNERSHIP, LTD. PLAINTIFF

V.

GENESIS PLASTICS AND ENGINEERING, LLC DEFENDANT

MEMORANDUM OPINION

Flynn Investment Partnership, LTD (the "Partnership") seeks a declaration that it owns a portion of Genesis Plastics and Engineering, LLC ("Genesis"), an Indiana plastic injection molding company. The Partnership claims this membership interest based on a transfer of shares from Thomas Flynn, an original member of Genesis, and the alleged acquiescence of the other Genesis members to that transfer. Genesis claims the transfer is void because it violated express terms of the Shareholders Agreement giving the other members a right of first refusal. Both parties have filed motions for summary judgment. Deciding these motions involves difficult issues of statutory and contractual interpretation and the extent to which the parties' actions may constitute a waiver of those provisions.

I.

In 1995, four investors formed Genesis and executed two agreements: an Operating Agreement on September 1, 1995 and a Stock Option and Shareholders Agreement on November 30, 1995. The Operating Agreement does not limit the transfer of shares. However, in the Shareholders Agreement, the four founding members of Genesis all unambiguously agreed to

limit their rights to transfer their membership interests in Genesis. Each member and the company had a right of first refusal on any proposed transfer and the option to purchase a member's interest upon their death.

Thomas Flynn initially owned a 26.6% interest in Genesis which he assigned to the Partnership on December 18, 1996. The other individual members knew of the transfer, but say that they were unaware of its legal consequences. Genesis recognized this transfer at first by identifying the Partnership as the owner of record on their books, stock certificates, and disclosure forms filed with the Indiana and Federal governments. Almost two years after the transfer, Thomas Flynn died. Three weeks later the other three members sought to exercise their right in the Shareholders Agreement to purchase the shares originally owned by Flynn. After Flynn's death, Genesis no longer identified the Partnership as the owner of the disputed shares and listed Thomas Flynn's estate as the owner of record on disclosure forms and dividend checks. The other members of Genesis claimed that because Thomas Flynn had not followed the procedure for transferring shares outlined in the Shareholders Agreement that the transfer was void. The Partnership brought suit seeking a declaratory judgment that would force Genesis to recognize the Partnership as a member of Genesis.

II.

The Shareholders Agreement and the Operating Agreement both contain choice of law clauses that select Indiana law. This Court, sitting in diversity, must apply the choice of law rules of Kentucky, the state where it sits. *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941). Kentucky recognizes such choice of law provisions, so long as a vital element of contract is associated with the chosen state and the parties entered into the contract in good faith.

See Consolidated Jewelers, Inc., v. Standard Fin. Corp., 325 F.2d 31, 34 (6th Cir. 1963) (applying Kentucky law); *Big Four Mills v. Commercial Credit Co.,* 211 S.W.2d 831, 836-37 (Ky. 1948). The Court finds that these contracts relating to an Indiana plastics company have more than a vital element associated with Indiana and neither party claims that bad faith tainted the formation of the contracts. Therefore, this Court applies Indiana law.

III.

The threshold issue facing this Court is whether the other three members of Genesis relinquished their rights to enforce these clear provisions of the Shareholders Agreement.[1] The three members had a right of first refusal that they did not exercise prior to Thomas Flynn's death that they now seek to invoke. If they can still rely on these provisions, then Genesis is entitled to summary judgment as there is no genuine dispute that the transfer to the Partnership did not comport with the terms of the Shareholders Agreement.

Genesis first argues that under the Indiana Business Flexibility Act ("the Act"), the members can only amend or waive the Shareholders Agreement in writing. They argue that the Shareholders Agreement qualifies as an "Operating Agreement" under section 23-18-1-16 of the Act, and as such, can only be amended in writing. IND. CODE. § 23-18-4-6(c) (2000). This statutory provision applies only if the Shareholders Agreement qualifies as an "operating agreement" under Indiana law. The parties dispute whether the Shareholders Agreement constitutes an "operating agreement" as defined by Ind. Code § 23-18-1-16 (2000). As to this issue, the Court agrees with Genesis. The Shareholders Agreement does concern the affairs of

[1]The Court notes the Partnership's arguments that Thomas Flynn was not a shareholder as that term is defined in the Shareholders Agreement. Such a reading negates the very purpose of the agreement and therefore, for the purposes of this motion, the Court presumes that the Shareholders Agreement covers the conduct at issue.

the company and the conduct of its business and, specifically, "the rights of members to assign . . . their interests in the limited liability company." IND. CODE § 23-18-4-5(3). Nothing in the statute requires that an operating agreement be named such, only that it meet the statutory definition. Nor does the statute or any other principle of logic prohibit a company from having two or more agreements governed by the statute.

Both the Act and the Shareholders Agreement clearly bar oral amendment. However, for the following reasons, the Court concludes that neither bars the application of waiver. The Act specifically states that members may only amend an operating agreement in writing. The Act does not preempt or supplant Indiana's common law of contract interpretation. Rather, the Act establishes a new mechanism for creating business organizations and it does not mention waiver. In addition, the Court of Appeals of Indiana in the only published Indiana decision on point declined to interpret the Act to preclude a finding of waiver. *Mid-America Surgery, L.L.C., v. Schooler*, 719 N.E.2d 1267 (Ind. App. 1999) (finding waiver of arbitration clause in Operating Agreement). Moreover, no language in the Shareholders Agreement prevents the parties from waiving its writing requirements. Sections 13.8 and 13.9 of the Shareholders Agreement purport to limit the ability of parties to waive provisions of the Shareholders Agreement. Section 13.8, however, recognizes the possibility of waiver and merely cabins that waiver to that instance and affected provision. Section 13.9, which attempts to limit amendment or waiver, may itself be waived. *See Farm Equip. Store v. White Farm Equip.*, 596 N.E.2d 274 (Ind. App. 1992); Richard A. Lord, WILLISTON ON CONTRACTS § 39:36 (4th Ed. 2000) (stating that "the nonwaiver clause itself, like any other form of the contract, is subject to waiver").

The Court must next determine whether either the enforceable statutory or contractual

provisions voids the transfer of the shares. This question is answered by deciding whether the acts of the parties constitute an amendment or a waiver. The distinction is not an artificial one by any means. Amendment or modification differs significantly from waiver. Amendments to agreements can alter and expand the rights and obligations of every party. Waiver, on the other hand, is a unilateral revocation of rights that cannot impose additional obligations on other parties. As such, courts typically require less extrinsic proof of waiver than of other changes to the underlying obligation. *See, e.g., Bank v. Truck Ins. Exch.,* 51 F.3d 736, 739 (7th Cir. 1995); E. Allan Farnsworth, CONTRACTS § 8.5 (2d ed. 1990).

The Court concludes that Flynn simply ignored one of the Agreement's provisions, which required written approval of a stock transfer, and other members acquiesced to it. Their acquiescence affected only their rights as to Flynn's particular transfer. It did not affect the rights of others or impose different future obligations on themselves or others. Consequently, the Court finds that the members' acquiescence to the transfer was much more like a waiver than amendment. Because the Court finds that neither the Shareholder Agreement nor Indiana law bar waiver of the members' rights in these circumstances, Genesis is not entitled to summary judgment as a matter of law.

IV.

The Court must now consider whether this finding requires sustaining the Partnership's motion for summary judgment. Summary judgment is appropriate if no genuine issue of material fact exists and the moving party is entitled to a judgment as a matter of law. Fed. R.Civ.Pro. 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). A dispute is genuine

when "the evidence is such that a reasonable jury could return a verdict for the non-moving party." *Anderson v. Liberty Lobby*, *Inc.*, 477 U.S. 242, 248 (1986). The issue is whether the evidence submitted presents a sufficient disagreement about the material facts so that submission to a jury is necessary, or whether the evidence is so one-sided that a party must prevail as a matter of law. *Id.* at 251-52. To the extent the parties dispute the underlying facts, none seem material to the issue of waiver.

The three members initially acquiesced to the transfer to the Partnership by recognizing the transfer and not attempting to exercise their right of first refusal.[2] Even though they may have acted under mistaken assumptions regarding the purchase-upon-death provisions, the members waived their right to purchase the membership interest before it was transferred to the Partnership. If mistake of law was a defense to conduct otherwise constituting waiver, then summary judgment would be inappropriate. Genesis, however, cannot rely on the mistake of law defense. The common definition of waiver–intentional relinquishment of a known right–glosses over this important distinction. *See, e.g., Bank,* 51 F.3d at 739. Generally all that is required is knowledge of the right, not awareness of "the exact legal nature or scope of the right being relinquished or the legal effect of the right at issue." Richard A. Lord, WILLISTON ON CONTRACTS § 39:22 (7th ed. 2000) (citing RESTATEMENT (SECOND) OF CONTRACTS § 84, cmt. b (1981)). Indeed, the contrary rule would produce absurd results. Very few parties know the

[2] Defendants' primary factual argument is that they may have somehow qualified their waiver. Defendants refer to a conversation in which Thomas Flynn assures one of the other members that he will not "have to deal with" Flynn's son due to the transfer. No one disputes the existence of this conversation. Viewed most favorably to Defendant, however, this conversation does not alter the waiver. It does not change the fact that Defendants permitted the ownership transfer. The comment is not nearly specific enough to raise an inference that Defendants either sought to retract or condition their waiver. Defendants were reassured that Thomas Flynn would continue to deal with his partners. As the Court discusses later in this opinion, Defendants' lack of clairvoyance about Flynn's death does not void their waiver.

exact legal consequences of their acts and allowing such an excuse to defeat waiver would impose formal requirements that contract law has long since abandoned.

The members' efforts after Thomas Flynn's death came too late to successfully revoke the waiver. By the time the members sought to invoke their rights, Thomas Flynn had already passed away and he could not cure any deficiencies in the transfer. Indeed, the members could have only revoked the waiver if they had given Thomas Flynn "a reasonable time and opportunity to comply with the contract." *Baker v. Eades*, 169 N.E. 686 (Ind. App. 1930). Needless to say, Thomas Flynn did not have the time or the opportunity to comply with the contract after the other members sought to challenge the transfer.

The Court has carefully considered whether its analysis is faulty in view of the statutory and contractual provisions prohibiting oral amendment. Admittedly, the arguments to apply these provisions seem quite reasonable. However, they fail once one understands that waiver, not amendment is at issue here. The Court also carefully considered the potential unfairness resulting from the other three Genesis members never intending to waive their rights of purchase upon death. These arguments also have some facial appeal. However, as the Court discussed above, the members can waive the transfer provisions even though they were unaware that their acquiescence negated the legal significance of Thomas Flynn's death.

The material facts and the applicable law compel, therefore, the conclusion that the Partnership is the lawful owner of Genesis shares previously owned by Thomas Flynn. The Court will enter an order consistent with this Memorandum Opinion.

JOHN G. HEYBURN II
JUDGE, U.S. DISTRICT COURT

cc: Counsel of Record

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ORDER

Both parties have moved for summary judgment. The Court has set forth its views in a Memorandum Opinion. Consistent therewith and being otherwise sufficiently advised,

IT IS HEREBY ORDERED that the motion for summary judgment of Genesis is DENIED.

IT IS FURTHER ORDERED that the Partnership's motion for summary judgment is SUSTAINED and Flynn Investment Partnership, Ltd. is declared the owner of Genesis stock previously owned by Thomas Flynn.

This is a final and appealable order.

This _____ day of October, 2000.

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JOHN G. HEYBURN II
JUDGE, U.S. DISTRICT COURT

cc: Counsel of Record