

October 31, 2022

THE NORTH CAROLINA BUSINESS COURT CONSIDERS BUSINESS INTEREST DISPOSITION FOLLOWING AN OWNER'S DEATH

For the second time this year, the North Carolina Business Court considered the disposition of a business interest following an owner's death. On October 19, 2022, the Court issued its opinion in *Phe, Inc. v. Dolinsky*, 2022 NCBC 62. *Phe* involves the issue of whether a corporation could maintain claims against an executor where a shareholders' agreement required the redemption of shares upon a shareholder's death, but the executor nonetheless failed to move forward with the redemption.

The Court dismissed the claim for breach of fiduciary duty, holding that the issue was one of contract; thus, the claim was barred by North Carolina's economic loss rule—a rule which precludes monetary recovery in tort when a contract governing the same subject matter exists. In reaching this holding, the Court deferred to remedies sounding in contract—here, the shareholders' agreement. In doing so, the Court underscored the importance of the governing instrument.

The North Carolina Business Court considered a similar issue earlier this year in *Agarwal v. Estate of Agarwal*, 2022 NCBC 7 (N.C. Super. Ct. Feb. 9, 2022). *Agarwal* arose out of ownership of three Dunkin' Donuts franchise locations, each owned by a separate limited liability company. While the default rule in North Carolina is that a person's interest in an LLC turns into a non-economic voting interest at death, the rule can be supplanted by clear language to the contrary in an operating agreement. See N.C.G.S. § 57D-3-02.

In *Agarwal*, the Court held the language of the operating agreements was ambiguous and presented a question of fact as to whether the intent was for the deceased owner's interest to convert to a nonvoting economic interest. Accordingly, the Court ordered the case to proceed to discovery so the parties could develop evidence as to the intent of the parties at the time the operating agreements were entered.

How JAH Can Help

Phe and *Agarwal* highlight the importance of ensuring that a corporation's governing documents clearly provide for what happens upon an owner's death, as well as remedies which may be available after death. At Johnston, Allison & Hord, P.A., our **corporate practice group** can help with this on the front-end by preparing governing documents which address these issues. For those who find

themselves in disagreements relating to how an owner's death impacts ownership of a company, our **litigation team** is ready to assist.

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