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Recent Developments: MAS Associates, LLC v. Korotki

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RECENT DEVELOPMENT

MAS ASSOCIATES, LLC V. KOROTKI: TO FORM A PARTNERSHIP IN MARYLAND THERE MUST BE SUFFICIENT EVIDENCE AND FACTS TO CONCLUSIVELY DEMONSTRATE THAT THE PARTIES INTENDED TO FORM THE PARTNERSHIP THROUGH THEIR MANAGEMENT AND CONTROL, CAPITAL CONTRIBUTIONS, AND SHARING OF PROFITS AND LOSSES.

By: Christopher Ruyter

The Court of Appeals of Maryland held that evidence of equal control and decision making was not sufficient to support a conclusion of partnership, and any presumption of profit sharing was outweighed by the parties expressed intent to become members of MAS Associates, LLC (“MAS”) and their treatment of the payments as wages. *MAS Assocs., LLC v. Korotki*, 465 Md. 457, 494, 214 A.3d 1076, 1097 (2019). Therefore, there was insufficient material evidence to demonstrate that the parties intended to form a partnership. *Id.*

Harry Korotki (“Harry”) was the owner of Savings First Mortgage. In 2009, the business faced losses in profit as it became more difficult for loan officers to sell loans. Around the same time, Joel Wax (“Joel”), the sole owner of Greentree Mortgage, began to experience similar economic difficulties. In August of 2009, Harry and Joel engaged in negotiations with an intent to merge their companies. This merger was put on hold when Mark, CEO of MAS Associates, expressed interest in getting involved in the merger. The parties agreed to merge to Equity Mortgage Lending, a registered tradename for MAS Associates, LLC.

In October 2009, the parties held a meeting to discuss their business structure at which time an attorney drafted a document that represented the intent of the parties to become members of MAS. Pursuant to the agreement, before becoming members, Harry and Joel were to be employees of the company and were entitled to receive W-2 compensation. As part of their agreement, each party was to make \$150,000 and another \$125,000 contribution payment to Saralee, a 91% shareholder in the MAS, who then contributed the money to MAS. Additionally, the parties took out lines of credit throughout the year for new warehouses; however, Harry expressed discomfort with signing jointly and severally with Joel and Mark each time.

As of November 22, 2010, the parties had no agreement but still expressed their intent to become members of MAS. In March of 2011, Harry resigned from his position and requested \$275,000 for repayment of the loans made to Saralee.

On October 28, 2011, in the Circuit Court for Baltimore County, Harry filed a complaint for breach of contract and a requested declaratory judgment against Mark and Joel, asking for a determination of the buyout price of his partnership interest. On his first claim for breach of contract, the trial court held that because there was no signed contract, there could be no breach. Notwithstanding, the trial court found that the parties made management decisions jointly and contributed money equally, which was behavior consistent with a partnership. Mark and Joel appealed the decision to the Court of Special Appeals of Maryland. The court affirmed the trial court's ruling, holding that Harry, Mark, and Joel entered into a partnership for a short period of time. Joel and Mark petitioned for *certiorari*, and the Court of Appeals of Maryland granted their petition.

The issue before the court was whether the parties intended to create a partnership. *Korotki*, 465 Md. at 463, 214 A.3d at 1079. A partnership is defined as “the unincorporated association of two or more persons to carry on as co-owners of a business for profit” and does not carry with it the formal requirements of an LLC. *Id.* at 476, 214 A.3d at 1087 (quoting MD. CODE ANN., CORPS. AND ASS'NS §9A-202(a)). In order to form a partnership, there must be an expressed intention of individuals to form a partnership. *Korotki*, 465 Md. at 476, 214 A.3d at 1087.

This court had to determine whether there was sufficient material evidence outside of a written agreement to conclude that the parties intended to form a general partnership. *Korotki*, 465 at 478, 214 A.3d at 1088. The Court of Appeals of Maryland began its analysis by reviewing the negotiations between the parties. *Id.* Joel and Mark contended that due to their ongoing negotiations to form an LLC, they could not have also intended to form a partnership. *Id.* at 479, 214 A.3d at 1088. Several courts have examined this issue and have held that “it would be inequitable to construe arms-length negotiations . . . to form an LLC concurrently as intent to form a partnership when those negotiations fail.” *Id.* at 480, 214 A.3d at 1089 (citations omitted).

Here, Joel and Mark argue that throughout their relationship with Harry, they maintain the goal of becoming members of MAS and therefore had no intention of forming a partnership. *Korotki*, 465 Md. at 479, 214 A.3d at 1088. During the interim period, the parties never terminated their intention of becoming members. *Id.* at 482, 214 A.3d at 1090. In such circumstances, the party's intent controls, therefore the parties could not simultaneously form a partnership while continuing ongoing negotiations to form an LLC. *Id.*

In determining whether a partnership is formed, the court considered three factors, 1) the management and control over the entity, 2) capital contributions, and 3) the sharing of profits and losses. *Korotki*, 465 Md. at

482-493, 214 A.3d at 1091-1097. First, the Court of Appeals looked at the management and control of MAS and determined that the parties made joint business decisions together. *Id.* at 483-87, 214 A.3d at 1091-1093. However, making joint business decisions is only one factor that the court will consider when determining whether a partnership has been formed. *Id.* at 484, 214 A.3d at 1091. Additionally, these behaviors are also frequently seen as the usual duties of LLC managers. *Id.* at 484, 214 A.3d at 1091. Therefore, the court determined that none of the actions of the parties supported a finding of an intent to form a partnership. *Id.*

Next, the court looked at whether any of the parties made capital contributions to the entity. *Korotki*, 465 Md. at 486, 214 A.3d at 1093. As noted by the court, capital contributions are “generally understood to be a more permanent contribution to the partnership than a debt contribution.” *Id.* (quoting Christine Hurt et al., *Bromberg & Ribstein on Partnership* § 2.06[E], at 2-98 (2d ed. 2019)). Here, the alleged partners never made any payments directly into a partnership account or directly to MAS. *Korotki*, 465 Md. at 487, 214 A.3d at 1093. All contributions first went to Saralee, who would then distribute the money to MAS. *Id.* The parties would only need to do this if their intent was to contribute to MAS and not the formation of a partnership. *Id.* at 488, 214 A.3d at 1093-94. Thus, the evidence shows that the payments were loans made in order to make them members of MAS rather than capital contributions. *Id.* at 488, 214 A.3d at 1094.

Finally, the court looked at whether the parties agreed to share the profits and losses equally. *Korotki*, 465 Md. at 489, 214 A.3d at 1094. The court explained, “that a ‘person who receives a share of the profits of a business is presumed to be a partner in the business,’ unless the profits can be alternatively characterized.” *Id.* at 490, 214 A.3d at 1095 (quoting MD. CODE. ANN., CORPS & ASS’NS §202(d)(3)). One such alternative is when an individual receives shares “as wages or other compensation. . . .” *Korotki*, 465 Md. at 490, 214 A.3d at 1095 (emphasis omitted) (quoting MD. CODE. ANN., CORPS & ASS’NS §202(d)(3)(ii)). The court held that Harry’s income was a form of compensation because the payments made to him as a salary, therefore he did not satisfy the presumption of being a partner. *Korotki*, 465 Md. at 491-492, 214 A.3d at 1095. The court concluded that the evidence was insufficient to support the notion that Harry’s payments were shares of profits rather than wages. *Id.* at 493, 214 A.3d at 1097. Therefore, the court determined that Harry failed to produce enough competent material evidence to demonstrate a partnership existed. *Id.*

In *MAS Assocs.*, the Court of Appeals held that there was insufficient evidence to conclude that the parties intended to form a partnership. Although there are no formal requirements to forming a partnership in Maryland, this ruling will make it more challenging for individuals to create

partnerships. Now individuals must show sufficient evidence that they each have management and control over the entity, have provided capital contributions, and that they are sharing both the profits and losses of the entity.