It is not too broad a generalization to suggest that almost all LLC members fall within one of two categories: those who are members of the control group and those who are not members of the control group. Typically the control group dictates, through counsel that it selected, the terms of the operating agreement with potential minority participants then invited to accept those terms by joining the company as minority members or, in the alternative, by passing on the opportunity. Alternatively, the minority participants may be invited, and they are certainly always free to insist, upon modifications to the proposed terms. Following are a few thoughts on representing the potential minority in such a situation.

Unanimity or Supermajority for Amendment of Operating Agreement.

Many LLC acts permit, as a default rule, amendment of the operating agreement by a simple majority of the members. Absent a contractual modification of this threshold, irrespective of the negotiated agreement providing minority protections, such may be promptly lost if the majority determines they should be amended out of the agreement. In Shapiro v. Ettenson, three individuals came together and formed a member-managed LLC, equally owned by the three of them. They did not, however, adopt a written operating agreement. Nearly 2 years after the LLC’s organization, two of the members executed a written consent pursuant to which the articles of organization were amended to change the LLC from being member-managed to manager-managed and they also adopted a written operating agreement. In addition to addressing the management of the company, that operating agreement provided that a majority

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1 Likely the sole exception to this characterization is the instance of a true 50/50 deal in which instance each member, with respect to any decision that must be made by either a majority or by unanimous decision, has absolute blocking veto with respect to the other. Further, it should be recognized that at times the minority/majority issues will, vis-à-vis a particular member, be mixed. Consider, for example, the instance where the minority member, in terms of economic rights is granted managerial control by reason of designed appointments in the operating agreement on the disproportionate voting rights with respect to classes of membership units, or otherwise, but where certain decisions will also be made based upon capital. In that circumstance, each member is, with respect to certain issues, in a control position, while with respect to others in a minority position.


3 See generally Thomas E. Rutledge and Katharine M. Sagan (An Amendment Too Far?: Limits on the Ability of Less Than All Members to Amend the Operating Agreement, 16 Florida State University Business Review 1 (Spring 2017)).

of the members could determine to make a capital call upon all of the members and, upon a
member’s failure to satisfy a capital call, their interest in the company would be diluted. After a
capital call was made, one of the members, Shapiro, filed a lawsuit challenging the adoption of
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Cutting to the chase, Shapiro lost, primarily because the New York LLC Act provides a
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The same outcome can happen under Kentucky law. If the members never adopt an
operating agreement per se, then the articles of organization and the LLC Act are the operating
agreement.6 Initially, the Kentucky LLC Act provides a default rule that the members vote in
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While there are potential challenges to such an effort by the majority, including the
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5 See N.Y. LTD. LIAB. CO. LAW § 402(c)(3). This decision was reviewed by Peter Mahler on his (highly recommended) blog, New York Business Divorce, in a piece titled Can LLC Agreement Be Enforced Against Member Who Doesn’t Sign It? (Sept. 8, 2015). The affirming decision is reviewed in a posting titled Thinking About Becoming a Minority Member of a New York LLC Without an Operating Agreement? Think Again (Jan. 20, 2017).

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7 See KY. REV. STAT. ANN. § 275.175(1); id. § 275.175(2)(a).

8 KY. REV. STAT. ANN. § 275.200(1).

9 See KY. REV. STAT. ANN. §§ 275.003(2)(a)-(g).
Supermajority or Unanimity Requirement for Organic Transactions.

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For example, under Kentucky law, absent a contrary provision in a written operating agreement, a majority-in-interest of the members can approve a merger. Utilizing this provision (i) a majority of the members set up a new company and with it a new operating agreement and then (ii) cause the existing LLC to be merged with and into the new LLC with the new LLCs operating agreement binding all of its members. Upon the effective time and date of the merger, all of the members of the former LLC are bound by that new operating agreement. While members who vote against the merger may not be subject to capital contribution obligations to the new company, they may be subject to various penalties, detailed in the new LLCs operating agreement, if they do not participate in additional capital raises.

Dissenters’ Rights.

Only a minority of the LLC acts provide dissenter rights in the event of an organic transaction. The balance of the acts, many of which as well provide that a merger or similar organic transaction may be approved by a mere majority of the members, do not contain this

10 See, e.g., KY. REV. STAT. ANN. § 275.350(1); IOWA CODE § 490A.1203(1)(a), id. § 490A.701(2)(c). There are states that as a default require unanimity. See, e.g., MICH. CODE § 450.4702(1). The various approval thresholds required for the merger or conversion of an LLC are collected in 2 ROBERT R. KEATINGE, LARRY E. RIBSTEIN AND THOMAS E. RUTLEDGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES, appendix 14-15 (2nd Ed. July 2019).

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Other states are silent as to dissenter rights, while others (e.g., DEL. CODE ANN. tit. 18, § 210; KY. REV. STAT. ANN. § 275.030(6)) provide that dissenter rights exist only if provided for by contract.
protection. Obviously, if it can be negotiated that a merger or similar organic transaction may be undertaken only upon the unanimous approval of the member, dissenter rights are not necessary. 16 Note, however, that it is in no manner required that the dissenter rights provisions model those found in corporate acts such as the Model Business Corporation Act (“MBCA”) or even LLC acts, such as that of California, that provide dissenter rights. Rather, the procedures that are to be utilized, as well as the triggering events, will be a matter of contract. As an example of this flexibility, while under corporate law it is the corporation that initiates the judicial action seeking determination of share value, that obligation in an LLC may be reversed, it being the obligation then of the dissatisfied members to initiate the action. It could as well be provided that dissenter rights will not be available if some threshold of the disinterested members have approved the transaction. By way of example, imagine an LLC with ten members, one holding 55% and the balance of 45% spread among the remaining nine members, each holding a 5% interest. The operating agreement could provide that dissenter rights will exist in the event of a merger unless the merger transaction receives the approval of at least 89%, by percentage interests, of the members. In that instance, if two of the minority members withhold their vote, they representing 10% of the total interests in the company, dissenter rights will not be available, it being presumed that the overwhelming approval by a supermajority of the disinterested members confirms that the merger consideration is appropriate. Alternatively, if one-third of the disinterested members do not vote in favor of the transaction, dissenter rights would be available.

If dissenter rights are afforded by statute, it is incumbent upon the potential minority participant in the venture to understand what are those rights and to take steps to protect them. If there are not dissenter rights, or they are limited, the potential minority participant will want to negotiate for those protections.

Purpose.

An LLC may have a generic (“any lawful activity”) or a specific (“acquire, rehabilitate and lease the improved real property located at 123 Chestnut Street”) purpose. If the investors are joining the venture because of a specific purpose, they should insist upon a veto right with respect to amending that purpose. At the same time the promotors of the venture will often want flexibility to expand the venture beyond its initial purpose. 17 At the same time investors may have concern as to too narrow a purpose as it may limit the scope of the fiduciary obligations, especially as to opportunities, to which the majority may be subject. 18

Compensatory Payments.

Beware of any situation in which the control block has the power, whether by means of cash, by means of altering guaranteed payments, or by issuing profits interests, to alter the LLC’s

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16 At one time in the development of the corporation, a merger required the unanimous approval of the shareholders. Over time, as that threshold was reduced to a majority, dissenter rights were added as a mechanism for protecting the economic rights of the minority shareholders.

17 Berkshire-Hathaway was originally a textile company.

compensation structure. Obviously, such provisions provide a mechanism by which those in control may, even without running afoul of the conflict of interest transaction rules (unless written quite broadly into the operating agreement) benefit friends, family and business associates. A provision that allows the compensatory arrangement between the LLC and any manager to be approved by a majority of the managers disinterested with respect to that proposed transaction is, in effect, consent to the managers to, as a group, set their own compensation. Further, a requirement that changes in the compensatory arrangements between the LLC and the managers being subject to the approval of a majority of the members concedes to the control block the ability to sanction siphoning significant amounts of LLC cash for distribution other than to the minority member while at the same time maintaining the allocation of income in the same manner as is provided for in the operating agreement. Arrangements for compensation to be paid a minority participant in the capacity as a manager that are subject to termination by the majority come all too close to “at will” arrangements between the LLC and that minority member/manager. In that context, additional requirements prior to termination, such as a requirement of “for cause,” may be sought.

Define the Duty of Loyalty.

While there are LLC acts that define, and at a rather stringent level, the duty of loyalty that is imposed upon those acting on behalf of an LLC, other states take a more lenient standard, going so far, in the case of Delaware, as not defining the standard of loyalty in the statute, but leaving it to the common law. In the consideration of the duty of loyalty, should the threshold be set at conduct that generates for those in control a benefit for which they have not separately negotiated or, rather, a conduct that is disadvantageous to the minority? Put another way, identifying and clearly delineating what is the duty of loyalty, when does it not apply (is the business opportunity doctrine going to apply in the context of this LLC, and if so, what is the LLC’s purpose and scope?) and what should be the assumptions used in its application should all be considered? By defining what those in control may reasonably expect out of the business venture, it is possible to identify issues that are or are not subject to a duty to account.

Limits Upon Conflict of Interest Transactions.

Conflict of interest transactions are, of course, a subset of the duty of loyalty. It may important to put particular limitations upon related party transactions. For example, in an LLC with a number of managers, it may be possible for a majority of those managers to approve a transaction between the LLC and a business organization owned by one of the members. Alternatively, the operating agreement could provide that any transaction between the company and a party related to or affiliated with any member must receive the approval of all of the members. While such a limitation admittedly impacts upon the flexibility of management if for no other reason than a time delay in acquiring consent, if a transaction is truly at market terms

19 See, e.g., KY. REV. STAT. ANN. § 275.170(2); PROTOTYPE LLC ACT § 402(b); ULLCA § 409(b).

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and in the best interest of the company, assuming a member is not simply being cantankerous, it must be assumed that the members will approve it.\textsuperscript{21}

\textbf{Define the Duty of Care.}

The states have adopted a multitude of formula by which to describe the duty of care in LLCs.\textsuperscript{22} For example, while certain states utilize a prudent man standard, others use a standard of care that is probably more accurately characterized as a standard of culpability, namely wanton or reckless misconduct.\textsuperscript{23} Most recently, the Revised Uniform Limited Liability Company Act (2006) adopted a prudent man standard subject to the business judgment rule.\textsuperscript{24} The suggestion that the business judgment rule may be properly utilized in the contractual realm of the LLC has been criticized,\textsuperscript{25} and most recently criticized by the ABA Committee on LLCs, Partnerships and Unincorporated Business Organizations.\textsuperscript{26} Setting aside these debates with respect to what is the statutory duty of care, it must be recognized that, while there may be state specific limitations in the form of a “floor” on the duty of care, such may be defined by agreement. The minority participants may seek to negotiate for a standard of care imposed upon those in control of the venture that, while perhaps not holding them liable on the simple negligence threshold that is applicable to paid agents,\textsuperscript{27} will hold them to a standard that is not quite so lenient as one requiring wanton or willful misconduct before the managers will be culpable. Further, it should be specified that any standard of liability more relaxed than simple negligence will apply only in the context of discretionary management functions.\textsuperscript{28}

\textbf{Limit Indemnification.}

Indemnification provisions always require strict scrutiny. First, does the proposed provision provide for indemnification in a scope broader than the standard of culpability? The net effect of such a provision is to allow a breach of the standard of culpability with no actual exposure of the actor to the consequences of his or her own actions. Furthermore, the types of actions for which indemnification will be available should be carefully scrutinized. For example, while indemnification may be appropriate in cases where there is a non-culpable violation of a duty of care to the other members, it must be questioned whether indemnification is ever

\textsuperscript{21} Setting aside, with respect to this statement, the possibility that a particular member or subset of the members will be engaged in a “strike” against management.

\textsuperscript{22} For a survey of these formula and some of their implications, see, e.g., Sandra K. Miller, \textit{What Fiduciary Duties Should Apply to the LLC Manager After More Than a Decade of Experimentation?}, 35 J. CORP. L. 565 (Spring 2007).

\textsuperscript{23} See, e.g., KY. REV. STAT. ANN. § 275.170(1).

\textsuperscript{24} RULLCA § 409(c).


\textsuperscript{27} RESTATEMENT (3\textsuperscript{rd}) OF AGENCY § 8.08 (2006).

\textsuperscript{28} The Principles of Corporate Governance, § 4.01, utilized the term “business judgment” with respect to activities and decisions to which the relaxed culpability standard of the business judgment rule is available.
appropriate in the context of a duty of loyalty violation. With respect to claims by third parties, it will be appropriate to require a written (and even secured) undertaking to return all funds advanced in the defense of litigation where the actor is ultimately found liable.29

Information Rights and Delivery Obligations.

Most LLC acts recite a list of records that must be maintained by the company and provide that the members will have certain inspection rights of either those documents or the records of the LLC in general. However, these provisions are typically qualified by a requirement that the members’ request to review documents be “reasonable” or for a “proper purpose.” It will be the control bloc, or managers appointed by the control bloc, who will typically determine whether a minority member’s request to review LLC records is “reasonable.”30 These pressures may be remedied by provisions in the operating agreement detailing records that must either be made available or must be furnished to the minority members on a set schedule. Obvious examples of this information include financial statements in the form of profit and loss statements and a balance sheet, and a comparison of actual results against the budget. Should those mandatory delivery obligations not be satisfied, the minority members should be in a position to bring an action for breach of contract. But an action against whom? Is this a claim against the LLC, or a claim against a particular manager for failure to discharge his or her obligations.31 The minority member would rather it be the latter.

Further, in order to provide some additional “bite” to that right, the operating agreement should provide that the member/manager who has failed to satisfy that obligation should not be able to satisfy their legal fees out of LLC assets and may be subject to a penalty such as paying the legal fees of the minority members.

Admission of New and Substitute Members.

While a number of LLC Acts require the unanimous approval for the admission of a substitute member, being in this instance the assignee of a member,32 certain other states allow for the admission of an assignee as a full member upon the approval of a majority of the incumbent members.33 Most LLC Acts require, as a default rule, the unanimous approval of the

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29 Senior Tour Players 207 Management Company LLC v. Golftown 207 Holding Company LLC, 853 A.2d 124 (Del. Ch. 2004) (actor not required to submit an undertaking to repay advanced fees to limited liability company where not required by either the LLC Act in question or the operating agreement). Further, it is worth noting that a right of indemnification does not necessarily bring with it a right of advancement; they are distinct concepts with need to be distinctly addressed in the operating agreement. See Majkowski v. American Imaging Management Services, LLC, 913 A.2d 572 (Del. Ch. 2006).


31 See also Ross v. Institutional Longevity Assets LLC, Civ. Act. No. 2017-0186-TMR, 2019 WL 960212, *3 (Del. Ch. Feb. 26, 2019) (where operating agreement said the LLC was responsible for preparing and distributing financial statements to the members, one member could not bring a claim against another for failure to prepare and distribute financial statements.).

32 See, e.g., IOWA CODE § 490A.903.

33 KY. REV. STAT. ANN. § 275.265(1).
incumbent members for the admission of a new member,34 although there are certainly states that
do not require that such be a unanimous action.35 With respect to the admission of new
members, a minority may want to negotiate for a requirement of unanimous approval of among
the incumbent members for admission or some other mechanism that precludes dilution of their
percentage of the membership interest without the requirement of additional capital that would
be required in order to exercise preemptive rights. As to the admission of substitute members, a
similar requirement of unanimity or other at minimum super majority protection is justifiable on
a number of bases. For example, the minority participants may be placing particular reliance
upon either or both of the expertise or the reliability of the manager. Those characteristics being
specific to that manager and not mere commodities such as available capital, the minority
members will want a strong voice in determining whether and on what terms the majority
position may alter its economic interests in the venture, such as by selling all or a portion of its
economic interests, or the substitution of a third party for that controlling member who then has
managerial control.

Legal Fees to Minority Members.

The legal costs involved with soliciting and accepting the investment of the minority
members, in part, will be paid by the minority members who contribute capital. To that extent,
the minority members are underwriting legal expenses incurred on behalf of both the venture and
the control block. Simultaneously, the minority members are exclusively bearing the legal and
other professional costs incurred in connection with the planned investment. In order to equalize
this treatment, the minority members may argue that their expenses involved in joining the
venture should be satisfied out of company funds thereby, on a net basis, reducing the burden
that they would otherwise bear.

Conclusion

In any negotiating situation, the relative power of the two sides will dictate the degree to
which potential minority participants may modify the transaction as proposed to them. Every
transaction has a unique dynamic, and requires a unique approach. In any situation, it is doubtful
that all of the suggested lines of negotiation would be appropriate, and in any transaction there
are undoubtedly going to be other lines of negotiation that need to be explored. What is crucial
is that counsel for the minority participants understand the full implications of the transaction
that they are entering and that with that appreciation they as appropriate seek modification of the
transaction to make it as palpable as possible to the minority participants who then may make the
business decision of whether or not they will make the investment.

34 See, e.g., KAN. STAT. ANN. § 17-7686(b)(1); KY. REV. STAT. ANN. § 275.275(1)(a).
It is not too broad a generalization to suggest that almost all LLC members fall within one of two categories: those who are members of the control group and those who are not members of the control group.\(^1\) Typically the control group dictates, through counsel that it selected, the terms of the operating agreement with potential minority participants then invited to accept those terms by joining the company as minority members or, in the alternative, by passing on the opportunity. Alternatively, the minority participants may be invited, and they are certainly always free to insist, upon modifications to the proposed terms. Following are a few thoughts on representing the potential minority in such a situation.

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\(^*\) This article is substantially based upon Rutledge, *Minority Members and Operating Agreements*, J. PASSTHROUGH ENTITIES (Nov./Dec. 2007) 21.

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15 See, e.g., CALIF. CODE §§ 17600 through 17613; FLORIDA CODE § 608.4384; NEW HAMPSHIRE CODE § 304-C:22; OHIO CODE §§ 1705.40 et seq.; WIS. CODE § 183.1206; MICH CODE § 450.4702(2):

If an operating agreement of a constituent company provides for approval of a merger by less than unanimous vote of members entitled to vote and the merger is approved, a member that did not vote in favor of the merger may withdraw from the limited liability company and receive, within a reasonable time, the fair value of the member's interest in the limited liability company, based upon the member's share of distributions as determined under section 303.
organic transaction may be approved by a mere majority of the members, do not contain this protection. Obviously, if it can be negotiated that a merger or similar organic transaction may be undertaken only upon the unanimous approval of the member, dissenter rights are not necessary.\textsuperscript{16} Note, however, that it is in no manner required that the dissenter rights provisions model those found in corporate acts such as the Model Business Corporation Act (“MBCA”) or even LLC acts, such as that of California, that provide dissenter rights. Rather, the procedures that are to be utilized, as well as the triggering events, will be a matter of contract. As an example of this flexibility, while under corporate law it is the corporation that initiates the judicial action seeking determination of share value, that obligation in an LLC may be reversed, it being the obligation then of the dissatisfied members to initiate the action. It could as well be provided that dissenter rights will not be available if some threshold of the disinterested members have approved the transaction. By way of example, imagine an LLC with ten members, one holding 55% and the balance of 45% spread among the remaining nine members, each holding a 5% interest. The operating agreement could provide that dissenter rights will exist in the event of a merger unless the merger transaction receives the approval of at least 89%, by percentage interests, of the members. In that instance, if two of the minority members withhold their vote, they representing 10% of the total interests in the company, dissenter rights will not be available, it being presumed that the overwhelming approval by a supermajority of the disinterested members confirms that the merger consideration is appropriate. Alternatively, if one-third of the disinterested members do not vote in favor of the transaction, dissenter rights would be available.

If dissenter rights are afforded by statute, it is incumbent upon the potential minority participant in the venture to understand what are those rights and to take steps to protect them. If there are not dissenter rights, or they are limited, the potential minority participant will want to negotiate for those protections.

**Purpose.**

An LLC may have a generic (“any lawful activity”) or a specific (“acquire, rehabilitate and lease the improved real property located at 123 Chestnut Street”) purpose. If the investors are joining the venture because of a specific purpose, they should insist upon a veto right with respect to amending that purpose. At the same time the promotors of the venture will often want flexibility to expand the venture beyond its initial purpose.\textsuperscript{17} At the same time investors may have concern as to too narrow a purpose as it may limit the scope of the fiduciary obligations, especially as to opportunities, to which the majority may be subject.\textsuperscript{18}

\textsuperscript{16} At one time in the development of the corporation, a merger required the unanimous approval of the shareholders. Over time, as that threshold was reduced to a majority, dissenter rights were added as a mechanism for protecting the economic rights of the minority shareholders.

\textsuperscript{17} Berkshire-Hathaway was originally a textile company.

Compensatory Payments.

Beware of any situation in which the control block has the power, whether by means of cash, by means of altering guaranteed payments, or by issuing profits interests, to alter the LLC’s compensation structure. Obviously, such provisions provide a mechanism by which those in control may, even without running afoul of the conflict of interest transaction rules (unless written quite broadly into the operating agreement) benefit friends, family and business associates. A provision that allows the compensatory arrangement between the LLC and any manager to be approved by a majority of the managers disinterested with respect to that proposed transaction is, in effect, consent to the managers to, as a group, set their own compensation. Further, a requirement that changes in the compensatory arrangements between the LLC and the managers being subject to the approval of a majority of the members concedes to the control block the ability to sanction siphoning significant amounts of LLC cash for distribution other than to the minority member while at the same time maintaining the allocation of income in the same manner as is provided for in the operating agreement. Arrangements for compensation to be paid a minority participant in the capacity as a manager that are subject to termination by the majority come all too close to “at will” arrangements between the LLC and that minority member/manager. In that context, additional requirements prior to termination, such as a requirement of “for cause,” may be sought.

Define the Duty of Loyalty.

While there are LLC acts that define, and at a rather stringent level, the duty of loyalty that is imposed upon those acting on behalf of an LLC, other states take a more lenient standard, going so far, in the case of Delaware, as not defining the standard of loyalty in the statute, but leaving it to the common law. In the consideration of the duty of loyalty, should the threshold be set at conduct that generates for those in control a benefit for which they have not separately negotiated or, rather, a conduct that is disadvantageous to the minority? Put another way, identifying and clearly delineating what is the duty of loyalty, when does it not apply (is the business opportunity doctrine going to apply in the context of this LLC, and if so, what is the LLC’s purpose and scope?) and what should be the assumptions used in its application should all be considered? By defining what those in control may reasonably expect out of the business venture, it is possible to identify issues that are or are not subject to a duty to account.

Limits Upon Conflict of Interest Transactions.

Conflict of interest transactions are, of course, a subset of the duty of loyalty. It may important to put particular limitations upon related party transactions. For example, in an LLC with a number of managers, it may be possible for a majority of those managers to approve a transaction between the LLC and a business organization owned by one of the members. Alternatively, the operating agreement could provide that any transaction between the company and a party related to or affiliated with any member must receive the approval of all of the members. While such a limitation admittedly impacts upon the flexibility of management if for no other reason than a time delay in acquiring consent, if a transaction is truly at market terms

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19 See, e.g., KY. REV. STAT. ANN. § 275.170(2); PROTOTYPE LLC ACT § 402(b); ULLCA § 409(b).

20 See, e.g., KY. REV. STAT. ANN. § 275.170(2).
and in the best interest of the company, assuming a member is not simply being cantankerous, it must be assumed that the members will approve it.\footnote{Setting aside, with respect to this statement, the possibility that a particular member or subset of the members will be engaged in a “strike” against management.}

**Define the Duty of Care.**

The states have adopted a multitude of formula by which to describe the duty of care in LLCs.\footnote{For a survey of these formula and some of their implications, see, e.g., Sandra K. Miller, *What Fiduciary Duties Should Apply to the LLC Manager After More Than a Decade of Experimentation?*, 35 J. CORP. L. 565 (Spring 2007).} For example, while certain states utilize a prudent man standard, others use a standard of care that is probably more accurately characterized as a standard of culpability, namely wanton or reckless misconduct.\footnote{See, e.g., KY. REV. STAT. ANN. § 275.170(1).} Most recently, the Revised Uniform Limited Liability Company Act (2006) adopted a prudent man standard subject to the business judgment rule.\footnote{RULLCA § 409(c).} The suggestion that the business judgment rule may be properly utilized in the contractual realm of the LLC has been criticized,\footnote{Thomas E. Rutledge and Professor Elizabeth S. Miller, *The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations*, 30 DELAWARE JOURNAL OF CORPORATE LAW 343 (2005).} and most recently criticized by the ABA Committee on LLCs, Partnerships and Unincorporated Business Organizations.\footnote{See James J. Wheaton, *The Report of the RULLCA Review Task Force*, 24 PUBOGRAM 9 (July, 2007).} Setting aside these debates with respect to what is the statutory duty of care, it must be recognized that, while there may be state specific limitations in the form of a “floor” on the duty of care, such may be defined by agreement. The minority participants may seek to negotiate for a standard of care imposed upon those in control of the venture that, while perhaps not holding them liable on the simple negligence threshold that is applicable to paid agents,\footnote{RESTATEMENT (3rd) OF AGENCY § 8.08 (2006).} will hold them to a standard that is not quite so lenient as one requiring wanton or willful misconduct before the managers will be culpable. Further, it should be specified that any standard of liability more relaxed than simple negligence will apply only in the context of discretionary management functions.\footnote{The Principles of Corporate Governance, § 4.01, utilized the term “business judgment” with respect to activities and decisions to which the relaxed culpability standard of the business judgment rule is available.}

**Limit Indemnification.**

Indemnification provisions always require strict scrutiny. First, does the proposed provision provide for indemnification in a scope broader than the standard of culpability? The net effect of such a provision is to allow a breach of the standard of culpability with no actual exposure of the actor to the consequences of his or her own actions. Furthermore, the types of actions for which indemnification will be available should be carefully scrutinized. For example, while indemnification may be appropriate in cases where there is a non-culpable violation of a duty of care to the other members, it must be questioned whether indemnification is ever...
appropriate in the context of a duty of loyalty violation. With respect to claims by third parties, it will be appropriate to require a written (and even secured) undertaking to return all funds advanced in the defense of litigation where the actor is ultimately found liable.\textsuperscript{29}

**Information Rights and Delivery Obligations.**

Most LLC acts recite a list of records that must be maintained by the company and provide that the members will have certain inspection rights of either those documents or the records of the LLC in general. However, these provisions are typically qualified by a requirement that the members’ request to review documents be “reasonable” or for a “proper purpose.” It will be the control bloc, or managers appointed by the control bloc, who will typically determine whether a minority member’s request to review LLC records is “reasonable.”\textsuperscript{30} These pressures may be remedied by provisions in the operating agreement detailing records that must either be made available or must be furnished to the minority members on a set schedule. Obvious examples of this information include financial statements in the form of profit and loss statements and a balance sheet, and a comparison of actual results against the budget. Should those mandatory delivery obligations not be satisfied, the minority members should be in a position to bring an action for breach of contract. But an action against whom? Is this a claim against the LLC, or a claim against a particular manager for failure to discharge his or her obligations?\textsuperscript{31} The minority member would rather it be the latter.

Further, in order to provide some additional “bite” to that right, the operating agreement should provide that the member/manager who has failed to satisfy that obligation should not be able to satisfy their legal fees out of LLC assets and may be subject to a penalty such as paying the legal fees of the minority members.

**Admission of New and Substitute Members.**

While a number of LLC Acts require the unanimous approval for the admission of a substitute member, being in this instance the assignee of a member,\textsuperscript{32} certain other states allow for the admission of an assignee as a full member upon the approval of a majority of the incumbent members.\textsuperscript{33} Most LLC Acts require, as a default rule, the unanimous approval of the

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\textsuperscript{29} Senior Tour Players 207 Management Company LLC v. Golftown 207 Holding Company LLC, 853 A.2d 124 (Del. Ch. 2004) (actor not required to submit an undertaking to repay advanced fees to limited liability company where not required by either the LLC Act in question or the operating agreement). Further, it is worth noting that a right of indemnification does not necessarily bring with it a right of advancement; they are distinct concepts with need to be distinctly addressed in the operating agreement. See Majkowski v. American Imaging Management Services, LLC, 913 A.2d 572 (Del. Ch. 2006).


\textsuperscript{31} See also Ross v. Institutional Longevity Assets LLC, Civ. Act. No. 2017-0186-TMR, 2019 WL 960212, *3 (Del. Ch. Feb. 26, 2019) (where operating agreement said the LLC was responsible for preparing and distributing financial statements to the members, one member could not bring a claim against another for failure to prepare and distribute financial statements.).

\textsuperscript{32} See, e.g., IOWA CODE § 490A.903.

\textsuperscript{33} KY. REV. STAT. ANN. § 275.265(1).
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incumbent members for the admission of a new member, \textsuperscript{34} although there are certainly states that do not require that such be a unanimous action. \textsuperscript{35} With respect to the admission of new members, a minority may want to negotiate for a requirement of unanimous approval of among the incumbent members for admission or some other mechanism that precludes dilution of their percentage of the membership interest without the requirement of additional capital that would be required in order to exercise preemptive rights. As to the admission of substitute members, a similar requirement of unanimity or other at minimum super majority protection is justifiable on a number of bases. For example, the minority participants may be placing particular reliance upon either or both of the expertise or the reliability of the manager. Those characteristics being specific to that manager and not mere commodities such as available capital, the minority members will want a strong voice in determining whether and on what terms the majority position may alter its economic interests in the venture, such as by selling all or a portion of its economic interests, or the substitution of a third party for that controlling member who then has managerial control.

**Legal Fees to Minority Members.**

The legal costs involved with soliciting and accepting the investment of the minority members, in part, will be paid by the minority members who contribute capital. To that extent, the minority members are underwriting legal expenses incurred on behalf of both the venture and the control block. Simultaneously, the minority members are exclusively bearing the legal and other professional costs incurred in connection with the planned investment. In order to equalize this treatment, the minority members may argue that their expenses involved in joining the venture should be satisfied out of company funds thereby, on a net basis, reducing the burden that they would otherwise bear.

**Conclusion**

In any negotiating situation, the relative power of the two sides will dictate the degree to which potential minority participants may modify the transaction as proposed to them. Every transaction has a unique dynamic, and requires a unique approach. In any situation, it is doubtful that all of the suggested lines of negotiation would be appropriate, and in any transaction there are undoubtedly going to be other lines of negotiation that need to be explored. What is crucial is that counsel for the minority participants understand the full implications of the transaction that they are entering and that with that appreciation they as appropriate seek modification of the transaction to make it as palpable as possible to the minority participants who then may make the business decision of whether or not they will make the investment.

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\textsuperscript{34} See, e.g., KAN. STAT. ANN. § 17-7686(b)(1); KY. REV. STAT. ANN. § 275.275(1)(a).

\textsuperscript{35} See, e.g., VA. CODE ANN. § 13.1-1040.
Minority Veto Rights in an LLC and Their Practical Limitations

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Case Study

Blue Jay LLC is a manager-managed Florida limited liability company that manufactures whistles. The company has three owners. Paul and Linda are siblings who each own 35 percent of the company. George owns the remaining 30 percent. Each is a manager of the company. Paul and Linda want all company decisions to be made by a majority of managers, so they can control the operations of the company. All three have significant experience in the manufacturing sector.

Concerns of the Minority Owner

At the outset, understand that a Florida limited liability company can be managed by one or more elected managers (who need not be members of the LLC), or by all the members. The above example assumes this is a manager-managed company. But the issues will be similar in a member-managed company.

In Florida, most decision making for an LLC managed by one or more managers will, by default, be determined by the vote of a majority, by number, of the managers. A minority owner who desires to have a voice in the management of the business (rather than be a passive investor) is in a precarious situation because the majority, whether consisting of a single owner or a group of related owners, will, in the absence of a different agreement, be making virtually all decisions for the business. It is apparent in the above example that George is at a significant disadvantage because Paul and Linda are siblings and likely to vote together. So, George is concerned that his voice in making decisions for the LLC will not matter.

In the example above, Paul and Linda are siblings, but the issue can arise in other contexts. Perhaps Paul and Linda are husband and wife. Or maybe they do business in other ventures that are successful and believe their proven management track record in those enterprises render them fully capable to run the company.

A Solution: Supermajority Voting

To give the minority owner in the above example a voice in the management of the business, the minority owner can and should negotiate into the company’s operating agreement “supermajority” voting protections, also known as "veto powers." A supermajority voting provision can be written in many ways, but the general idea is that certain company decisions will require the approval not only of a majority of managers, but also owners who, in the aggregate, hold a certain percentage of ownership in the company that exceeds the combined ownership of the related or affiliated owners.

A particular company decision that requires supermajority approval essentially gives the minority owner veto power over that decision. Under the facts above, George, the minority owner, could be protected by requiring that certain actions be approved either by unanimous consent of the owners or by the approval of owners who, in an aggregate, own more than 70 percent of the company.

Actions that are subject to supermajority voting rights typically include modifying or expanding the company’s business purpose, admitting new members, requiring existing members to contribute capital to the company, dissolving the company, amending the articles of organization or operating agreement, and approving a merger, consolidation, or sale of the company. But almost any other action can be subject to a supermajority voting requirement.

The categories and scope of actions subject to supermajority voting will be determined by the circumstances, including each party’s expectations in the business arrangement. For example, Paul and Linda may have contributed to the company more capital than George, and George has agreed...
that he will have limited veto powers over company decisions.

Is Supermajority Voting Practical?

While supermajority voting power is important to the minority owner in the above example, it is not without its practical limitations. A company must have a management structure that permits business operations to run smoothly and without unwarranted and constant interruptions when it comes to decision making.

To illustrate the potential problems created by abusing supermajority voting rights, assume the company, by its nature, experiences significant turnover in its lower-level employees. The business would likely be disrupted if all owners had to agree on every lower-level hire. Or consider a situation in which every expenditure by the company required the approval of all owners. These would likely not be practical uses of a supermajority voting requirement.

The company may need to raise capital from passive investors in the future. Investors, even in a small business setting, will not want to invest in a company that does not have a sound management structure. They generally require a fluid management structure for making decisions.

A Compromise Approach

A lawyer experienced in negotiating and preparing LLC operating agreements can advise on and implement supermajority voting rights that protect the minority while allowing general business operations to continue unfettered by constant meetings. For example, the agreement could require that supermajority voting is required to approve hiring and firing personnel above a certain level of skill or above a certain salary or hourly rate. In the case of company expenditures, the agreement might require supermajority approval for expenditures exceeding a certain dollar amount. The beauty of the LLC form of doing business is its flexibility. An experienced practitioner can seize on this flexibility and assist the parties in crafting provisions that balance the owners’ relative needs and expectations.

This issues and discussion in this article are limited to LLCs governed by Florida law. Because laws can vary from state to state, a person seeking guidance on these matters with respect to an LLC governed by another state’s laws should consult an attorney admitted to practice in that state.