

*Know your rights! Would you know if your business partners were taking advantage of you?*

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## Membership Rights in a Limited Liability Company

In Arizona, management of an LLC is vested in all the members, unless the LLC's articles of organization or the LLC's operating agreement specify management procedures to the contrary.

For example, the articles of organization can be drafted to vest management power in only one or a select few LLC managers and an operating agreement can be drafted to enlarge or reduce management powers among LLC members.

### Member's Right to Split Profits and Losses

Unless otherwise provided in an operating agreement, LLC members will split profits and losses as follows:

- Profits will be allocated according to the share distributions that exceed the repayment of the member's capital contributions; and
- Losses shall be allocated according to the member's capital contributions.

### Arizona Revised Statutes: ARS: 29-709. Sharing of Profits and Losses:

The profits and losses of a limited liability company shall be allocated among the members and among classes of members in the manner provided in an operating agreement. If an operating

agreement does not so provide, profits shall be allocated among the members according to the manner in which they share in distributions that exceed the repayment of their capital contributions, and losses shall be allocated among the members according to the relative capital contributions that they have made or promised to make in the future.

### Membership Consent Requirements to Conduct Business:

Unless otherwise provided in the LLC's operating agreement, approval or consent of all LLC members is required to:

- Authorize a transaction on behalf of the LLC that is unrelated to the LLC's business purpose; or
- Authorize a transaction on behalf of the LLC to:
  - Violate the LLC's operating agreement;
  - Amend, revoke, or change the LLC's operating agreement;
  - Amend the articles of organization to change how the LLC is managed;
  - Issue an interest in the LLC to another individual;
  - Approve an action allowing the LLC to merge with another business entity; or

- Approve an action consolidating the LLC with another business entity.

Unless otherwise provided in the LLC's operating agreement, approval or consent of a majority of the members, or if management of the LLC is vested in one or more members, a majority of the members vested with management power, is required to:

- Resolve LLC business matters;
- Authorize LLC cash or property distributions to the LLC's members;
- Authorize the LLC's repurchase of an LLC member's interest in the LLC;
- Authorize the termination of the LLC by filing the articles of termination; or
- Authorize an amendment to the articles of organization.

### **Membership and Authority to Sign a Contract**

If an LLC owns real property such as a rental property (i.e. the title to the rental property is held in the name of the LLC) and a member signs a contract, places a mortgage on the property or deeds the property to a third party, such actions by the member will be valid if the documents were:

- Executed by one or more authorized managers of the LLC; or
- Executed by the member, if management of the LLC was reserved to the LLC members.

However, the above referenced or similar actions may be voided by the LLC if the acting member or manager did *not* have the authority to act according to limitations outlined in the operating agreement. Therefore, a member's action are not binding on the LLC if the action taken by a member, manager, employee or other agent is in

violation of a restriction on authority and does not bind the LLC to persons with the knowledge of the restriction.

### **Requirements for Joining LLC**

An LLC can add members at its formation or after its formation by conducting any of the following:

- Identifying the person as a member in the articles of organization;
- Identifying the person as a member in the operating agreement and having the individual sign the operating agreement at the time the articles of organization are filed; or
- Identifying the individual as a member in a written statement that is certified by each of the managers that were identified in the initial articles of organization.

A member can be added to an LLC after the LLC's initial articles of organization have been filed by any of the following:

- An individual acquires an interest in the LLC from the LLC so long as such action is in compliance with the terms of the LLC's operating agreement. If the LLC's operating agreement does not set forth guidelines for adding a member, all the members of the LLC must consent to adding a new member;
- A member can assign their membership interest to another person (called an assignee) so long as such assignment is allowed under the LLC's operating agreement. If the LLC's operating agreement does not cover assignments of a membership interests, all the members of the LLC must consent to the assignment adding the new member; or

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- If the LLC has no members, a new member can be added upon the consent of all of the LLC's assignees unless contrary to the LLC's operating agreement.

### **Withdrawing from an LLC**

A member may withdraw from an LLC by either mailing or delivering to the other members of the LLC, at their last known address on file with the LLC, a notice of withdrawal. A withdrawing member may be liable for damages for breach of the LLC's operating agreement. However, these damages may be offset by distributions owed to the withdrawing member by the LLC.

### **Expelling an LLC Member**

A member of an LLC who engages in the following activities will be expelled from the LLC, unless the operating agreement sets forth different rules. These activities include but are not limited to:

- Making an assignment for the benefit of creditors;
- Filing a voluntary petition in bankruptcy; or
- Is adjudicated as bankrupt or insolvent.

### **Assigning Membership Interest to a Third Party**

A member of an LLC can transfer their interest in an LLC, either in whole or in part, so long as the transfer is not prohibited by the LLC's operating agreement.

It is important to note that when a member transfers their interest in an LLC to another individual, their action will not dissolve the LLC or allow the third

party receiving the member's interest to have management powers within the LLC or the right to be a member of the LLC. Rather, the recipient of such an interest is only entitled to share in the LLC's distributions of profits, losses or return on capital investments that the member transferring their interest would have been eligible to receive.

Liability of Assigning Member - A member who has assigned all of their interest in an LLC is still liable to the LLC unless otherwise provided in the LLC's operating agreement. If no operating agreement exists, or it is silent on this topic, then the member who assigned all of their interest to the third party must obtain written consent from all the LLC members in order to be released from LLC liability.

New Member's Rights - In order for the new member of an LLC to have management rights, the consent of the existing members authorizing management rights to the new member is required. By becoming a new member, the new member only assumes the rights and powers, to the extent assigned, to participate in the management of the LLC. However, with such power also comes responsibility. These responsibilities include complying with the restrictions in the LLC's operating agreement and Arizona laws.

Unless otherwise provided in an operating agreement, a member who has assigned all or part of their interest in a limited liability company is not released from their liability to the limited liability company under this chapter without the written consent of all members whether or not the assignee becomes a member. A member who has assigned all of their interest in a

limited liability company remains a member until the admission of the assignee as a member unless otherwise provided in an operating agreement.

### **Rights to Inspect LLC Records**

Each member of an LLC is allowed to inspect and copy the financial records. Further, each member may inspect and copy any other information regarding the affairs of the LLC as is just and reasonable for any purpose reasonably related to the member's interest.

### **Records to be Kept; Inspection Rights of Members:**

The LLC shall keep at its known place of business the following:

1. A current list of the full name and last known business, residence or mailing address of each member.
2. A copy of the initial articles of organization and all amendments.
3. Copies of all written operating agreements and all amendments to the agreements, including any prior written operating agreements no longer in effect.
4. Copies of those writings and documents required by law.
5. Copies of the limited liability company's federal, state and local income tax returns and reports, if any, for the three most recent years.
6. Copies of any financial statements of the limited liability company for the three most recent years.

### **Capital Contributions**

A member's commitment to make a capital contribution to the LLC is enforceable if the commitment is set out in writing and signed by the member who is making the contribution. This commitment is binding on the member,

even if they can not perform for any reason, including death. Therefore, the LLC has the right to collect the deceased member's contribution from the member's estate. In addition, the LLC has the right to assign their interest in the capital contribution to a creditor of the LLC.

Except as provided in the LLC's operating agreement, an LLC member who commits to make a required capital contribution may only be released from that obligation with the written consent of all the LLC members.

### **About the Author** **Scott F. Burns, Esq.**

Scott F. Burns, Esq. is an Arizona attorney whose clientele include professional athletes, business owners, and families desirous of protecting their personal and professional legacies through the use of asset protection strategies, estate planning and business consulting.

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