No Operating Agreement? No Problem!: Transferring LLC Interests at Death Might be a Big Problem

Conflicts in Louisiana Law Regarding Transfers of Deceased Members’ LLC Interests

INTRODUCTION

The reasons for forming Limited Liability Companies (“LLCs”) are myriad. Whether to avoid ancillary, out-of-state probates, to operate a business or to protect property or for anonymity, LLCs have become common vehicles for individuals and families to own and manage significant assets. During life, LLCs provide an ownership structure that is advantageous to their members and managers; however, for those who die owning membership interests in a Louisiana LLC, the transfer of such LLC membership interests can create serious obstacles for a decedent’s executors, heirs and business partners, especially if the LLC has no operating agreement or the operating agreement fails to address effectively transfers on death.

THE LAW

Generally, unless the LLC’s articles of organization or operating agreement provide otherwise, the death of a member of an LLC causes such member’s membership interest to cease and the member’s executor to be treated as an assignee of the member’s membership interests.
La. R.S. 12:1333(A):

“Except as otherwise provided in the articles of organization or a written operating agreement, if a member who is an individual dies or a court of competent jurisdiction adjudges him to be incompetent to manage his person or his property, the member's membership ceases and the member's executor, administrator, guardian, conservator, or other legal representative shall be treated as an assignee of such member's interest in the limited liability company.”

This assignment on death of a decedent’s LLC membership interest to the executor of his or her estate is consistent with the general assignability of membership interests under Louisiana law; assignment is permitted, whether a membership interest is assigned voluntarily, involuntarily or by death:

La. R.S. 12:1330(A):

“Unless otherwise provided in the articles of organization or an operating agreement, a membership interest shall be assignable in whole or in part. An assignment of a membership interest shall not entitle the assignee to become or to exercise any rights or powers of a member until such time as he is admitted in accordance with the provisions of this Chapter. An assignment shall entitle the assignee only to receive such distribution or distributions, to share in such profits and losses, and to receive such allocation of income, gain, loss, deduction, credit, or similar item to which the assignor was entitled to the extent assigned.”

However, as noted in La. R.S. 12:1330(A), above, an assignee is not treated as a full member with all associated rights and privileges of membership.

Under La. R.S. 12:1332(A), an assignee of a membership interest is not entitled to become a member of such LLC and is granted limited rights with respect to such membership interest. Upon assignment of a membership interest, the assignee is allowed to receive “distributions,” “profits and losses” and “such allocation of income, gain, loss, deduction, credit” to which the assignor was entitled. Notably, however, under La. R.S. 12:1332(A)(2), until such time as the assignee is admitted as a member of the LLC, the assignor of such membership interests (i.e., the transferring member), “shall continue to be a member” of such LLC. Furthermore, under La. R.S. 12:1332(A)(1), an assignee is expressly prohibited from becoming a member and participating in the management of the LLC “unless the other members unanimously consent in writing.” La. R.S. 12:1332(A) reads:

La. R.S. 12:1332(A)

Except as otherwise provided in the articles of organization or a written operating agreement:
An assignee of an interest in a limited liability company shall not become a member or participate in the management of the limited liability company unless the other members unanimously consent in writing.

Until the assignee of an interest in a limited liability company becomes a member, the assignor shall continue to be a member.

These statutes (La. R.S. 12:1330-1333) effectively form two categories of membership rights, bifurcating, upon any assignment of a membership interest, the rights of membership until such time as the assignee is admitted as a full member. In bifurcating the rights of membership between assignee and assignor, Louisiana creates two kinds of LLC membership rights: management rights and financial rights. La. R.S. 12:1318 and La. R.S. 12:1319 describe the rights of management, which consist of (i) the right to vote “on all matters properly brought before the members” (including the right to vote on dissolution/ winding up, selling substantially all the assets, merging/consolidating, incurring debt, alienating,leasing/encumbering immovable property, or amending the articles of organization or operating agreement—see, La. R.S. 12:1318); and (ii) to inspect the records of the LLC (including to obtain complete financial information or tax returns or demand a formal accounting—see, La. R.S. 12:1319). Financial rights are those separate rights described in La. R.S. 12:1330 consisting of the right to receive “distributions,” “profits and losses” and “such allocation of income, gain, loss, deduction, credit,” which is described in the context of an assignee’s financial rights. For a deceased LLC member’s executor, including such member’s heirs or legatees and remaining members, these statutes can be a trap for the unwary.

THE PROBLEM

For a Louisiana LLC member who dies without any governing document in place that addresses the transfer of his or her membership interests (e.g., an operating agreement), the application of these rules can wreak havoc.

Upon the death of an LLC’s member, such member’s executor is not vested with the member’s management rights. The executor becomes an assignee entitled to receive distributions of profits, but any right to vote on matters, such as whether to make such distributions, is denied. Ordinarily, the assignor would retain management rights, but in the case of death, the assignor is deceased and, thus, no longer a member of the LLC capable of exercising managerial authority. The executor, as assignee, would be unable to control the decedent’s bequeathed LLC interests and would be required to seek the unanimous consent of the remaining members in order to obtain such managerial rights.

Consider the scenario where the deceased member was a majority (51% or greater) member: the remaining minority member(s) not only would assume sole determination of whether to admit the executor-assignee as a member—with no obligation to do so—but also would have the ability to control all aspects of the LLC’s operations, from voting on day-to-day operations to
whether to sell substantially all the assets, dissolve and wind up the LLC’s affairs, or amend the existing operating agreement. In addition, the executor-assignee would have no right to inspect the LLC’s records and books to obtain necessary information that is required to administer the estate or prepare an estate tax return.

Moreover, these rules potentially place any remaining members in the position either of (a) admitting an executor as a member (often a family member of the decedent)—and working with someone with whom those members did not choose to partner with in business—or (b) creating potential conflicts between the remaining members, executor and heirs.

This stripping away of managerial rights from an executor-assignee undoubtedly produces unjust and inequitable outcomes, which include denying the executor the ability to safeguard the decedent’s membership interests through the exercise of voting powers, to verify the LLC’s assets and liabilities, to determine the value of the decedent’s membership interest, or to demand an accounting. With the exception of receiving the estate’s fair share of profits or allocable losses, the executor can be shut out and deprived of vital information altogether. What is certain, however, is that these managerial limitations imposed on executors create insecurity, which allows for the deceased member’s heirs to harbor mistrust and fear regarding the decedent’s interests.

**THE SOLUTION**

The good news is that these scenarios described above, as well as the uncertainty and potential conflicts, can be avoided entirely. With proper planning—i.e., with either an operating agreement, buy-sell agreement or other properly drafted writing among the members—that specifies how a deceased member’s membership interests are to be transferred, many of the unknown variables can be eliminated. Having a succession plan among the members also assures the fellow members that the LLC’s business can continue uninterrupted despite the loss of one of its valuable members. We urge clients to review and consider whether their LLC’s governing documents effectively address the transfer of membership interests upon death. Of course, such LLC documents should be part of every comprehensive estate plan that addresses how property passes at one’s death.

If you believe that one or more of these issues apply to you, we recommend that you reach out to an estate planning attorney as soon as possible. If you have any questions for our firm regarding this matter, please contact Lukinovich, APLC at 504-818-0401.
DISCLAIMER
Lukinovich, a Professional Law Corporation, produces the information in this newsletter as a service to clients and friends of the firm. It should not be construed as legal or professional advice or as an opinion with regard to any particular factual scenario. Legal advice or consultation should be sought before taking action on the information presented in this newsletter.