

## **Achaian — Lessons For Drafting LLC Agreements**

Law360, New York (September 2, 2011) -- The Delaware Chancery Court has issued a decision that has significant implications for drafting and interpreting limited liability company agreements.

In *Achaian Inc. v. Leemon Family LLC*, the Chancery Court held that (1) parties to an LLC agreement have considerable latitude to determine how to govern an LLC's affairs and that provisions in LLC agreements generally will trump contrary provisions in Delaware's Limited Liability Company Act (a reaffirmation of past Delaware decisions), (2) although the act provides that an assignment of limited liability company interests ("membership interests") entitles the assignee to economic interests associated with membership (but not to membership itself), assignment also will confer membership on the assignee where an LLC agreement defines "membership interest" as the "entire ownership interest" of a member, and (3) where an LLC agreement provides that membership interests may not be assigned without the consent of existing members, membership interests may be transferred to existing members without first obtaining such consent, i.e., assignees who are existing members need not be admitted again to acquire additional membership interests.

The Achaian case arises out of the LLC agreement of Omniglow LLC, a Delaware limited liability company that manufactures glowsticks. Omniglow was founded in 2005 by its parent and sole member, Omniglow Corporation. In 2006, the parent sold its membership interests in Omniglow as follows: 50 percent to Leemon Family LLC, 30 percent to the Randy Holland and the Stanley M. Holland Trust (collectively, "Holland"), and 20 percent to Achaian Inc, the plaintiff.

In 2008, Leemon allegedly took control of Omniglow in contravention of the LLC agreement. Holland thereafter assigned its 30-percent membership interest to Achaian. Achaian immediately claimed a 50/50 deadlock and asked the Chancery Court to dissolve the company, claiming that it was no longer possible to carry on Omniglow's business in conformance with the agreement. Leemon countered by arguing that the assignment of Holland's membership interests to Achaian gave Achaian an additional 30-percent economic interest, but not an additional 30-percent voting interest, because Leemon did not consent to a transfer of the voting interest as required by the agreement.

The court began its analysis by reaffirming that the act is an "enabling statute" whose primary purpose is to fill gaps concerning matters not addressed by an LLC agreement. The court makes clear that the parties to an LLC agreement have substantial authority to shape their own affairs and contract freely so long as they do not contravene mandatory provisions of the act. Thus, the act serves as a set of default rules that govern solely in areas where the LLC agreement is silent.

In the case of the members of Omniglow, the court ruled that the question of what rights would transfer in the event of an assignment was clear based on the text of the agreement. The court stated that, while the default rule in the act is that an assignment of a membership interest, by itself, does not entitle the assignee to be a member of the LLC, if there is a contradiction between

the act and a company's LLC agreement, the LLC agreement will control. The agreement defines a member's interest as "the entire ownership interest of the member in Omniglow."

The agreement, originally drafted for a single-member LLC, provides that "a member may transfer all or any portion of its interest to any person at any time" and "no person shall be admitted as a member of Omniglow after the date of this LLC Agreement without the written consent of the member." The agreement also states that, if any members other than Omniglow's parent were to be admitted, the agreement should be amended. It was not amended when the company became a multimember LLC, but the parties to the lawsuit agreed that "consent of the member" means "consent of the other members."

On the basis of these provisions, the court held that all of the rights accompanying a membership interest — including voting rights — were transferrable by a member of Omniglow without the consent of the other members. Consent would be required for a transfer to a person who is not already a member. Because Achaian was already a member, nothing in the agreement required Achaian's re-admission as a member for the purpose of taking assignment of an additional interest.

Furthermore, the court concluded that the word "entire" (in relationship to "membership interest") is not statutorily defined; thus, it is reasonable to infer that "entire," in this context, takes on its plain meaning, and that Holland had the power to transfer its membership interest in its entirety, meaning all of its rights whatsoever. Finally, the court found that the consent requirement serves mainly as a check against admitting an unwanted business partner. To that end, the court noted that Leemon already assented to having Achaian as a business partner, and that it would be improper to read the agreement so that it required the members' consent to the increased voting power of an existing member.

This case imparts several lessons. First, single-member LLC agreements will rarely address the complexities of the relationships among members of multiple-member LLCs. As a result, when a single-member LLC admits a new member or members, the LLC agreement should be amended to create certainty regarding the rights, obligations and interplay of the various interests of the members. Second, when drafting an LLC agreement, practitioners should pay close attention to the terminology used in describing restrictions on transfer and should make clear exactly what is transferred when a membership interest is transferred: the economic benefits of membership interests, membership status, or both.

Finally, if a client desires to have not only veto power over the identity of its business partners, but also over the size of such partners' membership interests, consent provisions should be drafted accordingly.

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