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**Transfers of LLC Membership Interests:  
Consequences to the Assignor, the Assignee and the LLC**

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## TRANSFERS OF LLC MEMBERSHIP INTERESTS: CONSEQUENCES TO THE ASSIGNOR, THE ASSIGNEE AND THE LLC

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Corporate stock is freely assignable. Absent a stock restriction agreement or similar private ordering to the contrary, a stockholder may unilaterally assign the stock to another. Upon assignment, the assignee succeeds to all of the rights of a stockholder. Those rights include the right to interim and liquidating dividends, to vote with respect to matters put to the shareholders both as to the election of directors and with respect to organic transactions such as a merger or an amendment of the articles of incorporation, to inspect corporate records, and to enjoy the benefit of the fiduciary obligations owed by the board of directors.

Partnerships, limited partnerships and limited liability companies<sup>1</sup> employ a paradigm wherein the ownership rights are bifurcated into those that are purely economic in nature, being specifically the right to receive interim and liquidating distributions (the “Economic Rights”) and those which involve participation in management of the venture, including the right to participate with respect to any vote of the owners, being in privity with the operating/partnership agreement, the right to inspect records and benefiting from such fiduciary obligations as are owed (the “Management Rights”). Absent private ordering to the contrary, while a member may unilaterally assign Economic Rights to a third party and by so doing fully vest in them the right to interim and liquidating distributions, it is not possible to unilaterally assign Management Rights. Rather, absent the necessary threshold of consent to that assignment, those Management Rights will either be retained by the assignor of the Economic Rights, or may simply cease to exist or be subject to redemption by either the entity or by the incumbent members.

A failure to fully appreciate the model utilized in the LLC as contrasted with that utilized in the corporation can yield results no doubt surprising to the person believing themselves to

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<sup>1</sup> This discussion is typically framed in the context and nomenclature of the LLC, but is intended to encompass the partnership as well. Further, “assignor/assignee” and “transferor/transferee” are utilized in various statutes; here they are considered to be interchangeable. Aspects of this paper are adapted from Rutledge, *Assigning Membership Interests: Consequences to the Assignor and Assignee*, 12 J. PASSTHROUGH ENTITIES 35 (July/Aug. 2009), Rutledge, *You Just Resigned – Now What? Different Paradigms for Withdrawing From a Venture*, 12 J. PASSTHROUGH ENTITIES 43 (Nov./Dec. 2009), and Rutledge, *In Delectus Personae and Proxies*, 14 J. PASSTHROUGH ENTITIES 43 (July/Aug. 2011). With respect to the Texas laws governing limited liability companies, see generally ELIZABETH S. MILLER AND ROBERT A. RAGAZZO, BUSINESS ORGANIZATIONS (3<sup>RD</sup>), vols. 19 & 20 of TEXAS PRACTICE SERIES.

have acquired a full participatory interest in an LLC and discovering they hold merely the Economic Rights.<sup>2</sup>

This presentation will begin with a general review of the treatment of the assignor, the assignee and the LLC through various steps of the assignment of an interest, comparing and contrasting the formula employed in various of the states. From there the focus will shift to how various states address the death of a member and the treatment, vis-à-vis the LLC, of the estate. The discussion will then turn to the question of a member's voluntary resignation from the venture. Next and last, there is considered how a proxy may impact upon the otherwise applicable rule of in *delectus personae*.

## **Distinguishing Economic and Management Rights**

The various organic statutes governing partnerships/limited partnerships/LLCs address the distinction between Management and Economic Rights in different ways. For example, the Revised Uniform Partnership Act (1997) ("RUPA") identifies the Economic Rights as being the "transferable interest" and further provides that it is freely transferable.<sup>3</sup> There is, in addition to the "transferable interest," the "interest in the partnership," a term broader than the "transferable interests" and encompassing as well the Management Rights with respect to the partnership.<sup>4</sup> In contrast, the Delaware LLC Act defines an "interest in an LLC" as being exclusively the Economic Rights.<sup>5</sup> The Kentucky LLC Act defines a "limited liability company interest" as

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<sup>2</sup> This discussion is focused upon an effort to voluntarily assign an interest in an LLC from an incumbent member to one who was previously a stranger to the venture. Although not reviewed in detail herein, there are at least two other scenarios in which the transfer of an interest in an LLC may take place. In the first, a new member is admitted to the venture by the direct acquisition of an LLC interest from the LLC. All else being equal (such as, it is assumed, there is not a coincident redemption of another member), the capital of the venture will be increased by the capital contribution obligation of the new member while the sharing ratios of the other members will be adjusted so as to account for the sharing ratio of the new member. The second possibility is a transfer of an LLC interest from an existing member to one who is already a member. In this scenario, the aggregate identities of the owners are not altered, but the sharing ratios of at least two of them, and in many if not most instances an alteration as well in their relative voting rights, will occur.

<sup>3</sup> REV. UNIF. PART. ACT § 502, 6 U.L.A. 156 (2001) ("The only transferable interest of a partner in the partnership is the partner's share of the profits and losses of the partnership and the partner's right to receive distributions. The interest is personal property.") See also UNIF. LTD. PART. ACT (2001) § 701, 6A U.L.A. 461 (2008) ("The only interest of a partner which is transferable is the partner's transferable interest. A transferable interest is personal property."); REV. UNIF. LTD. LIAB. CO. ACT (2006) § 102(21), 6B U.L.A. 430 (a "transferable interest" as "the right, as originally associated with a person's capacity as a member, to receive distributions from a [LLC] in accordance with the operating agreement, whether or not the person remains a member or continues to own any part of the right.")

<sup>4</sup> REV. UNIF. PART. ACT § 101(9), 6 U.P.A. 61 (2001) ("'Partnership interests' or 'Partner's interest in the partnership' means all of the partner's interests in the partnership, including the partner's transferrable interest and all management and other rights.") See also DEL CODE ANN. tit. 6, § 15-101(15) (substituting "economic interest" for "transferable interest").

<sup>5</sup> DEL. CODE ANN. tit. 6, § 18-101(8) (defining a "liability company interest" as "A member's share of the profits and losses of a [LLC] and a member's right to receive distributions of the [LLC]'s assets."). See also GA. CODE § 14-11-101(13) (defining a "limited liability company interest" as referring to only the economic interest in the company); VA. CODE § 13.1-1002 (defining a "membership interest" as referring to only the economic interest in the company).

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