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Model Company Agreements For Closely Held LLCs

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I. Introduction.

Records maintained by the Texas Secretary of State indicate that the limited liability company has become the entity of choice among Texas organizations. The office of the Texas Secretary of State reports that of the 222,112 certificates of formation filed for domestic for-profit entities in 2018, 192,284 (or approximately 87%) were limited liability companies, and of the 231,677 certificates of formation filed for domestic for-profit entities in 2019, 204,065 (or approximately 88%) were limited liability companies.[1]

It is often stated that one of the benefits of organizing an entity as a limited liability company is that this form of entity offers the owners and governing authority of the entity the flexibility to agree to provisions for the economic terms and governance that are more flexible than available with respect to a corporation. This is true, and indeed limited liability companies are sometimes used to create highly complex structures with multiple classes of ownership interests and highly customized provisions regarding management and governance of the entity, including complicated provisions for voting and management succession. However, given the large number of entities now being created as limited liability companies in Texas and other states, it is likely that many of these new entities are not entities with complex structures with multiple classes of ownership and complex bureaucracies for governance. Statistics compiled by the Internal Revenue Service show that for the tax years 2015 and 2016 (the most recent years for which statistics are currently available), approximately 65% of the S corporation returns are for single-shareholder S corporations and approximately 26% have only two shareholders.[2] The Internal Revenue Service does not publish similar statistics for limited liability companies, and of course single-member limited liability

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[1] The office of the Texas Secretary of State has provided to the authors the following information about numbers of certificates of formation and initial LLP registrations filed for domestic entities:

	2018	2019
For-Profit Corporations	24,135	22,122
Professional Corporations	686	580
Professional Associations	408	307
Limited Liability Companies	192,284	204,065
Limited Partnerships	4,599	4,603
Limited Liability Partnerships	417	364

[2] Table 9: Returns of Active Corporations, Form 1120S (2015) (2016), available at https://www.irs.gov/statistics/soi-tax-stats-corporation-complete-report

companies are typically disregarded entities that do not file tax returns. But if one assumes that most limited liability companies are closely held entities, then by analogy, it is likely that a large portion of limited liability companies have one or two owners. Therefore, it is much more likely that practitioners will find themselves needing to draft simple limited liability company agreements suitable for entities with one or two or a very few owners, rather than more complex documents.

The purpose of this paper is to present and discuss models for governing agreements for limited liability companies when a simple structure is needed.

II. Company Agreements Generally.

As with other filing entities under the Texas Business Organizations Code ("BOC"),[3] a Texas limited liability company is created by the filing of a certificate of formation meeting the requirements of BOC §3.005 and §3.010. The existence of the company commences when the filing of the certificate takes effect as provided in BOC Chapter 4.[4]

The BOC does not expressly require that a Texas limited liability company have a company agreement, but it is difficult to conceive of a situation in which there would not be some skeletal agreement of the members regarding the conduct and affairs of the limited liability company.[5] The statute expressly recognizes that a company agreement may be written or oral.[6] However, it is obviously advisable for a limited liability company to have a written company agreement to provide certainty and avoid ambiguity about the ownership and management of the entity.

It should be noted that in the event of a conflict between the language of the certificate of formation and the company agreement, the language of the certificate of formation will govern.[7] Most practitioners have moved away from the practice of including long substantive provisions in the certificate of formation, and indeed many are comfortable using the simple form of certificate promulgated by the Secretary of State.[8] In the past it was more common to address issues such as indemnification or written consents in lieu of meetings in the filing made with the Secretary of State. Since the owners of the entity do not need to sign the certificate and may not see or focus on substantive provisions in the certificate, care should be given that any such provisions do not unintentionally override the provisions of the company agreement.

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3 TEX. BUS. ORGS. CODE ANN. § 1.001 ET SEQ.

4 TEX. BUS. ORGS. CODE ANN. § 3.001(c).

5 Inasmuch as the BOC recognizes oral as well as written company agreements, a course of dealing may reflect the company agreement of the members on some matters. Furthermore, any provision that may be contained in the company agreement may be included in the certificate of formation. TEX. BUS. ORGS. CODE ANN. § 101.051(a). Even a very basic certificate of formation would seemingly constitute a company agreement as to certain items, such as the name of the company, the type of management (i.e., member-managed or manager-managed), and the identity of the initial members or managers.

6 TEX. BUS. ORGS. CODE ANN. § 101.001(1) (defining "company agreement" as "any agreement, written or oral, of the members concerning the affairs of a limited liability company").

7 TEX. BUS. ORGS. CODE ANN. § 101.052(d). See *Pinnacle Data Servs., Inc. v. Gillen*, 104 S.W.3d 188 (Tex. App.—Texarkana 2003, no pet.) (holding voting provision in limited liability company's articles of organization controlled over conflicting voting provision contained in the company's regulations). Because BOC § 101.052(d) is not listed among the provisions that cannot be waived or modified in the company agreement, the statute arguably permits the members to provide in the company agreement (or certificate of formation) that the company agreement controls over a conflicting provision in the certificate of formation. See TEX. BUS. ORGS. CODE ANN. § 101.051, 101.052, 101.054.

8 http://www.sos.state.tx.us/corp/forms_boc.shtml.

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