

Voting Rights in LLCs: Who Has a Voice?

On average, 4 million new businesses are started each year in the United States. Many of those businesses are organized as limited liability companies (LLCs). Combining the benefits of a corporation and a partnership, an LLC protects its members' personal assets from business liabilities, avoids double taxation, and provides flexibility regarding its operations, management, and financial and voting rights.

While state LLC laws establish default provisions, LLC members may adopt a written operating agreement that alters those rules, specifying how they want the business to be run. An operating agreement is not required, but without one, members are subject to statutory default provisions that may not align with their interests and goals. This includes the default rules on voting for LLC matters such as adding new members, disassociating members, dissolving the company, and amending the operating agreement.

The Most Common LLC Voting Rights

An operating agreement should be drafted at the time of LLC formation. You can amend the operating agreement by a vote of the members at any time, but this brings us back to our original topic: how are voting rights determined in an LLC?

The first consideration is whether the LLC is set up as **member-managed or manager-managed**.

- In a member-managed LLC, all members are active in managing and voting on the company's business affairs. This is the default structure and can work for LLCs with a small number of members who are not only investors, but are active in running the company.
- In a manager-managed LLC, the members/owners leave the management of the company to professional managers, similar to a board of directors in a corporation. Members of a manager-managed LLC can usually vote on major changes, such as amending the operating agreement and adding or removing a member, but they have limited authority to make business decisions, such as entering contracts, hiring employees, and borrowing money. The managers of the LLC are not required to be members.

The default rule in most LLC statutes is member management. However, in practice, most attorneys recommend the use of manager-managed LLCs for increased liability protection. For the company to operate as a manager-managed LLC, this management structure must be specified in the articles of organization or the operating agreement, depending on the state.

Voting in Member-Managed LLCs

Management authority is vested in the members of a member-managed LLC. Each member has a say in decision-making according to the voting structure outlined in the state LLC statute or the operating agreement. The following are the most common voting powers:

- Voting on a weighted, or proportionate, basis is decided by a member's ownership share. For example, if an LLC has four members, and one member owns 70 percent of the company while the other members own 10 percent, the owner holding a 70 percent share can outvote the other members (the way a majority shareholder can do in a corporation).

- Per capita voting is done on a “one person, one vote” basis. This means that there is no “majority shareholder” whose vote outweighs the votes of the other LLC members. Each member’s vote is counted equally, regardless of their investment share.

Voting in Manager-Managed LLCs

A manager-managed LLC requires an operating agreement that is customized for this structure. It should state that managers will make management decisions and detail the voting process (e.g., a majority or unanimous vote of managers). The operating agreement should also spell out a process for adding or removing managers, rules for meetings, and quorum requirements (how many managers must be present for a vote).

Unanimous versus Majority Votes

Whether an LLC is member-managed or manager-managed, the state’s default rules may require unanimous consent or majority consent for certain business decisions. Some states have default provisions requiring unanimity for amending articles of incorporation, adding members, expelling members, and permitting the sale of a member’s interest. Other states have default rules requiring a majority vote to amend the articles or operating agreement, approve the sale of LLC assets, wind up the LLC, and admit new members.

Again, these default rules can be modified by the operating agreement. If they are not, the LLC must follow rules that may not be ideal for its members. If your state has a unanimous consent rule to add members, for example, this may not be a problem in the LLC’s early stages. But this rule could make it more difficult to bring in new investors needed for the LLC to grow and expand.

LLCs should establish a management and voting structure that is tailored to the needs of its members. If these structures are not addressed in an operating agreement, the applicable rules could be altered whenever a state updates its LLC laws. If that happens, a state default rule that was initially fine with the members could suddenly become problematic.

Your LLC operating agreement should, at a minimum, include provisions addressing voting rights for the following matters:

- Admitting new members
- Terminating members
- Changing the operating agreement
- Allocating profits and losses
- Dissolving or winding down the company
- Binding the LLC to contracts
- Selling an entire membership interest to a third party
- Selling, mortgaging, or distributing LLC assets

Other important issues that the operating agreement should address are how votes are cast (by video call, email, in person, etc.), whether votes can be cast by proxy, and failure to object (i.e., whether failure to object or cast a vote is considered tacit agreement with the matter being voted on).

LLC Economic Interests with No Voting Rights

An advantage of a manager-managed LLC is that it is easier to add passive investors who do not participate in running the business. However, a passive investor retains some voting rights, because they are a member of the LLC despite not being actively involved in its daily operations.

There is also what is known as an “economic interest” in an LLC. This is an ownership share that allows the holder to receive distributions (i.e., profits and distribution of company assets) from the LLC, without any control or voting rights. This individual could be an investor who is a silent partner or the beneficiary of an economic interest in an LLC left by a relative. In the latter case, a business owner may have given their children and grandchildren economic interests entitling them to receive a share of the profits, while the business is run by professional managers.

It is possible to allow an economic interest holder to become a member through a vote of the LLC members, but—you guessed it—the process should be laid out in the operating agreement. For a family business, an operating agreement could even be drafted to specify that when a member passes away, their financial *and* membership rights are passed on to a chosen beneficiary. However, default state rules generally limit the transfer of interests to economic interests and do not allow full membership rights to be transferred without the consent of the remaining members.

Get Help Setting Up Your LLC

Choosing to structure your business as an LLC is just the beginning. The next decision is to decide on a management structure and to formalize it in the articles of incorporation and operating agreement. At a minimum, you need to understand state default LLC rules about financial rights, voting rights, and how voting works so you can ensure your LLC runs how the members want it to.

Flexibility is one of the best features of an LLC, but the number of options can make the decision-making process feel overwhelming. Because the choices you make when you create your operating agreement will have a significant impact on your business’s day-to-day functions, they should not be made lightly or without consulting an attorney. You should review your operating agreement on a regular basis to stay on top of legal changes and to make sure it remains in line with members’ goals and interests. To schedule an appointment to discuss your LLC, contact us at 954-862-1479.