The Great Uncertainty: Rights of Minority Limited Liability Company Owners in New York

by Seth Marcus, Esq.

Question:
What are the rights of minority owners in a New York Limited Liability Company?

Answer: Whatever the Operating Agreement says they are, and if the Operating Agreement is unclear, then so are the rights of the minority.

Since the passage of Limited Liability Company statutes in the early to mid 1990's, the number of small businesses choosing to operate as LLCs has increased exponentially. Among the reasons for the explosive growth in the use of these entities is the flexibility they offer, both with regard to tax planning, and planning business management structure. However, the flip side of this flexibility is that if individuals who chose to become members of an LLC fail to pay careful attention to those provisions of the Operating Agreement dealing with disputes among the members, then they may be in for some very unpleasant surprises should such a dispute arise.

The legal rights of minority members of an LLC are less well defined than minority rights in other types of business entities. For example, among the rights that minority owners of New York privately held corporations enjoy are the right to bring derivate lawsuits in the name of the corporation against directors and/or managers; the right to seek judicial dissolution of the corporation if they are wrongfully denied meaningful participation in the entity; and the right to participate along with other shareholders in business opportunities within the company's business that may arise in the future. The conditions triggering these rights as well as their enforcement have been developed by applicable case-law over a long period of time.

The Limited Liability Company, however, is an entity of relatively recent vintage and consequently, case law is still developing leaving many areas unclear. For example, it was only in February of 2008 that the New York Court of Appeals decided that --even in the absence of statutory authorization-- members of Limited Liability Companies have the rights to bring derivative claims in the name of the entity. Having clarified this far reaching and fundamental proposition, the Court of Appeals left for another day the question of what triggers a member's right to bring a derivative action and how that right is properly invoked. Case law addressing other provisions of the Limited Liability Company Law have left the courts with a high degree of discretion in determining the rights of the parties as well as crafting appropriate remedies.

Problems in understanding the rights of minority members are further compounded when the members have failed to sign an Operating Agreement. The Limited Liability Company Law is clear on at least one important point, which is that a high level of deference will be given the express written agreement of the members in all aspects of operating and dissolving the entity. Paying careful attention to the provisions governing disputes among the members (including ensuring that such provisions actually exist) could save expensive legal bills down the line for litigating arcane points of law, should such a dispute arise.

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