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editor's note

Dear Business Law Section Members:

This month's issue of *The Arizona Business Lawyer* contains an interesting article authored by Mike Widener entitled, *BEWARE THE SINGLE MEMBER, MEMBER-MANAGED, ARIZONA LLC: Haphazard Assignment of Economic Interests Leads to a Nice Conundrum.*

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Next month's issue of *The Arizona Business Lawyer* will have an article discussing the Internal Revenue Service's Rule 230 Tax Disclosure provisions as they apply to business law.

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STATE BAR OF ARIZONA

BEWARE THE SINGLE MEMBER, MEMBER-MANAGED, ARIZONA LLC:
Haphazard Assignment of Economic Interests Leads to a Nice Conundrum

By Mike Widener

Wandering minds have ruminated for more than a decade on the theoretical concept of a "no-member LLC" under the Arizona Limited Liability Company Act. My hunch is this isn't a theory, but genuinely a commonplace occurrence, arising in an environment of growing numbers of disregarded entities structured (initially) as single member LLCs. I believe this to be likely when the initial, sole member foregoes executing a thoughtfully prepared operating agreement. Here's your new client, Beaucephus. This no-nonsense fellow arrives in your law office and proclaims his desire to have "maximum protection" requiring the least amount of work to establish him as Acme Brands, LLC, a single member LLC. Your urging notwithstanding, Beaucephus snubs the idea of an operating agreement or of any management structure, so your paralegal prepares articles of organization, making him the sole member (but not Manager), and the application for a tax identification number.

Consider A.R.S. § 29-781(4) in the context of a single (initial) member LLC without a helpful operating agreement. Beaucephus is approached by Moe, a lover of the Acme Brands business model, who agrees to buy Acme. (But you can change the facts here, if you like. Suppose Beaucephus just decides to assign to Moe his company profits and equity interest while he takes an extended fishing vacation, or to avoid his soon-to-be former-wife's divorce attorney's scrutiny of his assets.)

In any case, the assigning document reads: "I hereby assign all my Member's Interest to Moe, for $10 and other consideration." Beaucephus disappears, seemingly never to be heard from again. Assignee Moe, the self-proclaimed sole member and Acme manager, continues doing business under the Acme label. But is there a company? § 29-781(4) says, in my view, unless there is "cover" under an operating agreement, only two outcomes are possible: Either § 29-731(B) (4) has been complied with – the requirement of written consent[1]; or the company dissolved 90 days after Beau went missing.

Wait – is that correct? A.R.S. § 29-732(C) suggests "no." The last sentence of that provision says that the erstwhile Beaucephus *remains* a member until the admission of the assignee as a member. A.R.S. §§ 29-732(C) and –733(2) together appears to be our legislature's effort to ensure that there will not be, unintentionally at least, a "no-member LLC." Of course, this intention fails, functionally, if the assigning lone Member is unaware of the house rules, there's no operating agreement, *and* the assigning Member is unavailable, refuses or is denied the right to manage in the post-assignment environment. So, Beaucephus leaves Acme no forwarding address, becoming a "member without portfolio," disengaged from the operation of Acme's business. Now what? Are all the post Beau-assignment contracts and actions under the Acme aegis voidable – or, gadzooks, void? Alternatively, are these Moe-driven acts those of a sole proprietor, that is, has Acme's company liability protection been lost?

Now, read A.R.S. § 29-781.01 – does it save Moe's bacon? Can he argue that even if Beau's disassociation was an "event of dissolution," Moe is the appointed agent of Acme to continue forward? I suppose the answer here is "yes", but *only* to the extent Moe acts motivated by the intention to liquidate the business and affairs of the company.

Or is that correct? A.R.S. § 29-782(A) affords a dissolved company a continued existence – assuming no one has sued for a decree terminating Acme's existence. But, while A.R.S. § 29-782(B) addresses the "unwinding" acts of a company's aware management, it dictates no end date for the liquidation process, although the newly-revised version of the section (Laws 2007, Chapter 4, Sec. 29) endeavors to "wrap it up" by discouraging new business endeavors.

Moe, acting in reliance of the "total transfer of Beaucephus' interest" ought to be protected, right? If you are approached with this dilemma, what advice will you give? Pragmatically, the best advice may be to track down Beau, the lingering member, and document his consent to Moe's admission as a new member. Even a simple oral declaration of Beau's intention constitutes an operating agreement, after December 31, 1996, anyway. *See* A.R.S. § 29-601(14)(b). (Don't forget to have Beau withdraw as a member immediately after the substitution.) Or, will you tell Moe to wind up the company and start up a new company with the Acme brand?

Counsel your legislator that when single member LLC's became permitted and common, the intent of the Act was subverted by ignoring aspects of certain statutes adopted in a multiple-member company environment. Unless I'm missing something, the Act's provisions now don't properly cover company operation in "de facto proprietorships," where a mere assignee continues using the entity form, expecting ongoing limited protection of his or her investment. Perhaps it's time for some commonsense amendments to the Act. Connecticut Public Act 97-70 (1997) amended Connecticut Limited Liability Act Section 34-172 to state that an assignee of an interest in a company may become a member when [(a)(3)], "if the limited liability company has only one member, the assignor gives the assignee the right to become a member." That's a start; at least in Connecticut, the assignor is empowered, if he chooses, to ratify the transfer of membership after the conveyance of his ownership rights.

ENDNOTES

1 One pragmatic bankruptcy judge in Colorado simply dismissed the notion that member consent is a requirement for assuming company control when a single member's interest has been transferred. See In re Ashley Albright, 2003 Bankr. Lexis 291 (Bank D. Colo. April 4, 2003) (citing Colo. Rev. Stat. § 7-80-702). The statutory citation does not, alas, support the court's pragmatism beyond the facts of that case, and especially is unavailing where a deemed transfer of control does not match the assignor's intent. What if the sole member's economic interest is transferred to more than one person? What if those transferees own unequal fractional interests? Note that Colorado does not have a counterpart to A.R.S. Section 29-732(C).