

LLC MEMBERSHIP INTEREST IN VIRGINIA

In *Ott v. Monroe*, the Virginia Supreme Court has been called to decide whether a provision in an Operating Agreement can trump Va. Code § 13.1-1038, allowing a person to become a member in an LLC without being voted in by a majority of the company's members.

When Admiral Dewey Monroe passed away in 2004, he left all his property to his daughter, Janet M. Ott, including his membership interest in L&J Holdings, LLC.¹ As the result of a carefully construed provision in the operating agreement, Ms. Ott should have received not only her father's membership interest—his share of profits and losses—but also his influence as a member in the day-to-day operations of the company.² In an opinion spanning only a few short paragraphs, the Stafford County Circuit Court held that Ms. Ott was not a member of the company because Mr. Monroe could only transfer his membership interest, not his rights to participate in the operation of the company.³

The court arrived at its decision through a two-step process.⁴ First, the court acknowledged that upon his death, Mr. Monroe dissociated from L&J Holdings.⁵ Along with his dissociation, Mr. Monroe's rights to manage the company were rescinded.⁶ Second, the court stated that the only rights remaining after Mr. Monroe's dissociation were his ownership rights—his share of the profits and losses.⁷ Furthermore, the court cited Va. Code §13.1-1038, which

¹ See *Ott v. L&J Holdings, LLC*, 654 S.E.2d 902, 904 (Va. 2008).

² See *Ott v. Monroe*, No. CL08-1269 (Va. Cir. Ct. June 10, 2010).

³ See *id.*

⁴ See *id.*

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

states that the “only transferable interest of a member in the limited liability company is the member’s share of the profits and losses.”⁸ Ms. Ott appealed the decision.

In accordance with the company’s Operating Agreement, Ms. Ott claimed full membership rights in the company.⁹ In general, courts widely support freedom of contract; however, the occasional public policy concern may trump a well-drafted agreement.¹⁰ Clear public policy reasons support the goals behind Va. Code § 13.1-1038. If membership rights to manage the company were easily transferable, LLC members could find themselves in conflict with members with whom they had not intended to manage a company. Perhaps this is why a person who wishes to become a member of an LLC must be voted in by a majority of the company’s members.¹¹ Furthermore, the idea that only a member’s ownership interest is transferable has been bolstered by recent revisions to the Virginia Code.¹² The second sentence of Va. Code § 13.1-1038—stating that a member’s profits, losses, and rights to receive distributions is that member’s *only transferable interest*—was added in a recent 2006 revision.¹³

The conflict between Va. Code § 13.1-1038 and the concept of freedom of contract when drafting and negotiating a company’s Operating Agreement has driven *Janet M. Ott v. Lou Ann Monroe, et al.* to Virginia’s highest court; the Virginia Courts Case website shows that the Virginia Supreme Court granted the appeal and received appellate briefs in December of 2010. Virginia attorneys should keep an eye on this case to see how the Commonwealth rules. A decision in favor of the plaintiff could validate similar provisions in operating agreements, allowing members to join LLCs without majority member approval. Continued holdings in favor

⁸ VA. CODE ANN. §13.1-1038 (West 2010).

⁹ See *Monroe*, No. CL08-1269.

¹⁰ RESTATEMENT (SECOND) OF CONTRACTS intro. note (1981).

¹¹ VA. CODE ANN. § 13.1-1038.1(A)(1) (West 2010).

¹² VA. CODE ANN. §13.1-1038.

¹³ *Id.*

of the defendant will serve to strengthen the current policy that members can only transfer their share of profits and losses, protecting the control of current members. Either way, Virginia attorneys should be aware of the potential impact a law-altering decision could have on their client's businesses.