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The Lost Distinction Between Agency and Decisional Authority: Unfortunate Consequences of the Member–Managed versus Manager–Managed Distinction in the Limited Liability Company

BY THOMAS E. RUTLEDGE*

I. INTRODUCTION

The universe of limited liability companies ("LLCs") is bifurcated into two species: LLCs that are member–managed and LLCs that are manager–managed. Under most statutory formulations, in a member–managed LLC each member, by reason of their member status, has statutory apparent agency authority to act on behalf of the LLC. In contrast, in a manager–managed LLC only those who are designated as managers have statutory apparent agency authority to act on behalf of the LLC, and members, as members, do not have such authority. Most statutes provide that either the member–managed or manager–managed paradigm must be designated in the articles of organization.

Furthermore, various LLC acts link the internal management structure to the apparent agency structure. In a member–managed LLC there is a default rule for internal management by the members, with the members voting pro–rata, in proportion to capital, or by some other method of determining relative voting authority. In contrast, in a

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1 As used herein, "apparent authority" has the meaning ascribed in the RESTATEMENT (SECOND) OF AGENCY, section 8 (1958) [hereinafter RESTATEMENT].

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manager–managed LLC the managers are afforded the authority to make decisions on behalf of the LLC. Ergo, the election made with respect to external apparent agency authority carries with it a default rule regarding the internal governance of the entity.

The linkage between default agency and default management structures in the LLC has existed since the inception of the structure, appears in nearly all of the extant statutes, and is derived from the general and limited partnership laws that combined to create the LLC, a hybrid of the two. However, that linkage need not be accepted as integral to the LLC, and in fact has unfortunate consequences in structuring LLC operating agreements. Recently the National Conference of Commissioners of Uniform State Laws ("NCCUSL"), which has undertaken a project to amend and update the Uniform Limited Liability Company Act ("ULLCA"), considered and rejected a proposal to fundamentally alter ULLCA by eliminating a designated default rule of statutory apparent agency and de-linking external agency from internal management structure. Under this proposal, 1) there would be no requirement that the articles of organization indicate a member versus manager structure, 2) the statutory designation of apparent authority would be eliminated, and 3) the internal management/decisional structure would no longer be tied, as a default rule, to apparent agency authority. If adopted, this

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4 Id. ULLCA has to date been adopted in eight states and the U.S. Virgin Islands. ULLCA was not submitted to any state legislation in 2004, 2005, or 2006. A significant reason for the relative lack of success of ULLCA was its release after most states had already adopted their own LLC acts. There seems to exist significant inertia against change of the newly adopted state acts which combined with the general impression that ULLCA was not a materially better product. In 2003, NCCUSL initiated a project to amend and update ULLCA, an effort oft referred to as ReULLCA. However, the "Re" understates the scope of the project, which is not simply the revision of ULLCA, but the drafting of an entirely new act based upon current knowledge and experience. The author is an American Bar Association Section of Business Law Advisor to the ReULLCA project. However, all views expressed herein are entirely the author's own, and in no manner reflect the views of the other American Bar Association Advisors, any of the NCCUSL Commissioners, or of the ReULLCA drafting committee as a whole.
proposal would result in ReULLCA moving forward significantly from virtually all current LLC statutes. But instead of adopting this proposal, the NCCUSL chose to continue with the historical and generally known distinction between the member-managed and the manager-managed LLC and the linkage of that characteristic with the internal decisional structure of the entity.\textsuperscript{5}

The objective of this article is to identify certain issues that have arisen from the linkage of statutory apparent agency and decisional structure, using the rejected ReULLCA proposal as a means of exploring a possible resolution of the matter. As there is little (if any) likelihood that the linkage between agency and decisional authority will be eliminated from LLC law any time soon (if ever), it is important to appreciate the issues that flow from the joinder of the two and some of the drafting challenges that are engendered thereby.

II. APPARENT AGENCY AUTHORITY IN THE MEMBER–MANAGED VERSUS MANAGER–MANAGED LLC

In the context of the LLC, “apparent agency” refers to the power to act on behalf of an LLC where that authority arises not from a specific delegation from the LLC (the principal) to an agent, but rather from the actions of the LLC toward the world at large. The two broad models of LLC structure are “member–managed” and “manager–managed,” and these models are based upon different paradigms of statutory apparent agency authority to act on behalf of an LLC.\textsuperscript{6} In the former, each

\textsuperscript{5} See infra notes 46–56 and accompanying text. General rules of agency as applied to apparent authority apply to the exercise of this authority, and the members can be subject to the liability of an agent that acts outside the appropriate limits of that authority.

\textsuperscript{6} Recall that in questions of apparent authority, it is the actions of the principal to the third party, and not the actions of the agent to the third party, that control. Restatement, supra note 1, at §§ 8 cmt. a, 27; see also id. § 49(a). It is possible for an agent to create the required manifestation of the principal’s desire that the agent act on its behalf. This situation arises where the agent accurately describes to a third party the existence and limits of the authority held. Id. § 27 cmt. c. In contrast, actual authority arises out of the conduct of the principal to the agent. Id. § 26. What activities do or do not fall within the “ordinary course of business” is a fact–dependent question for which the limited case law is of little benefit. See, e.g., In re Avalon Hotel Partners, L.L.C., 302 B.R. 377 (Bankr. D. Or. 2003) (filing bankruptcy is a “major decision” requiring consent of seventy–five percent of the members); J.M. Equip. & Transp., Inc. v. Gemstone, L.L.C., No. CV
member, as a member, has apparent agency to act on behalf of the LLC in the ordinary course of the LLC's business. In doing so, the LLC utilizes the agency rule that existed in partnerships formed under the Uniform Partnership Act of 1914, under which each partner, as a partner, had agency authority to act on behalf of the partnership within the ordinary course of business. Consequently, the member–managed LLC


Except as provided in subsection (2) of this section, every member shall be an agent of the limited liability company for the purpose of its business or affairs, and the act of any member, including, but not limited to, the execution in the name of the limited liability company of any instrument, for apparently carrying on in the usual way the business or affairs of the limited liability company of which he is a member, shall bind the limited liability company, unless the member so acting has, in fact, no authority to act for the limited liability company in the particular matter, and the person with whom the member is dealing has knowledge or has received notification of the fact that the member has no such authority.

Id.; OR. REV. STAT. § 63.140(1)(a) (2003); VA. CODE ANN. § 13.1-1021(A) (Michie 2004); PROTOTYPE LTD. LIAB. CO. ACT § 301(a) (1994) [hereinafter PROTOTYPE LLC ACT]; ULLCA, supra note 3, § 301(a)(1).

See UPA, supra note 2, at sections 9(1)–(2), which provide:

(1) Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.

(2) An act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by the other partners.

Id. The UPA has been revised and superseded by RUPA. The RUPA provision equivalent to UPA section 9 is section 301, which provides for the general apparent agency of all
is sometimes referred to as the “partnership model.” In contrast, in the manager–managed LLC, only those named as “managers” have apparent agency authority to act on behalf of the entity, and the members, as members, have no agency authority. As there is no requirement that the

partners, subject to the limitations permitted by the Statement of Authority as provided for in RUPA section 303, which states:

Subject to the effect of a statement of partnership authority under section 303:

(1) Each partner is an agent of the partnership for the purpose of its business. An act of a partner, including the execution of an instrument in the partnership name, for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership, unless the partner had no authority to act for the partnership in the particular matter and the person with whom the partner was dealing knew or had received a notification that the partner lacked authority.

(2) An act of a partner which is not apparently for carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership only if the act was authorized by the other partners.

RUPA, supra note 2, § 303.

9 See, e.g., K.R.S. § 275.135(2):

If the articles of organization provide that management of the limited liability company is vested in a manager or managers: (a) No member, solely by reason of being a member, shall be an agent of the limited liability company; and (b) Every manager shall be an agent of the limited liability company for the purpose of its business or affairs, and the act of any manager, including, but not limited to, the execution in the name of the limited liability company of any instrument, for apparently carrying on in the usual way the business or affairs of the limited liability company of which he is the manager shall bind the limited liability company, unless the manager so acting has, in fact, no authority to act for the limited liability company in the particular matter, and the person with whom the manager is dealing has knowledge or has received notification of the fact that the manager has no such authority.

Id.; ALA. CODE § 10-12-21 (2004); IOWA CODE § 490A.702.3 (2004); OR. REV. STAT. § 63.140(2); VA. CODE ANN. § 13.1-1021(B); PROTOTYPE LLC ACT, supra note 7, § 301; ULLCA, supra note 3, § 301. The Colorado LLC Act provides that only “managers” may incur debts or liabilities on behalf of the LLC while providing that “‘manager’ means any member” where the LLC is member–managed. COLO. REV. STAT. ANN. §§ 7-80-407, 7-80-102(8) (West 2004). If a member is named as a manager, that person will have agency authority, but only in the latter role and without respect to the former. A departure from this general statement is Delaware, which provides that absent a contrary provision in the operating agreement, “each member and [each] manager has the authority to bind the limited liability company.” DEL. CODE ANN. tit. 6, § 18-402 (2004). See also infra notes 66–69 and accompanying text (for a discussion of the Delaware approach to this issue).
managers be members, the manager–managed LLC affords the opportunity for the complete separation of ownership and agency authority. This model is sometimes referred to as the "corporate model" because ownership (member or shareholder) is entirely separated from agency authority (manager or officer).11

The distinction between the member–managed and the manager–managed LLC has existed since the inception of the form and exists for reasons that are in part based upon the then–applicable tax classification regulations. Prior to January 1, 1997, under the then–controlling "Kintner" tax classification regulations,12 the election of a manager–managed structure led to the LLC having "centralized management" and made it more difficult for the LLC to be classified as a partnership.12 The member–managed option and its retention of member agency authority made classification as a partnership, the desired outcome in the overwhelming majority of cases, far more likely. Effective January 1, 1997, the so–called "Check-the-Box" classification regulations were adopted,14 thus eliminating the impact of agency structure on the issue of tax classification.

10 See, e.g., ALA. CODE § 10-12-22(b)(2); K.R.S. § 275.165(2)(b); OR. REV. STAT. § 63.001(19); VA. CODE ANN. § 13.1-1024(B); PROTOTYPE LLC ACT, supra note 7, § 401(B)(2); ULLCA, supra note 3, § 101(10).

11 See 1 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 30 nn.8–9 (2004); 5 id., § 2098 nn.5, 8–12. It could also be said that the apparent agency authority of a member in a manager–managed LLC is equivalent to that of a limited partner in a limited partnership formed under the RULPA. See RULPA, supra note 2, § 303(a). However, this may overstate the case, as under RULPA sections 303(a) and (d) a limited partner who was held out as a general partner, such as by the exercise of agency authority, was subject to the loss of limited liability. No such loss of limited liability exists for an LLC member. It should be noted that the "corporate model" moniker is limited to describing the separation of ownership and apparent agency and does not suggest that a "corporate model" LLC is otherwise equivalent to a corporation.


The initial LLC Act, adopted in Wyoming in 1977, provided that each LLC must either be member–managed or manager–managed. Under this bulletproof statute, the default rule was that the LLC would be member–managed, and it was mandated that the articles of organization state whether the LLC was member– or manager–managed. In the next series of LLC acts, Colorado mandated that the LLC be manager–managed, and did not provide that the LLC could be member–managed, while the Minnesota LLC Act provided for a corporate structure including a board of directors and other governance mechanisms drawn from the Minnesota corporations statute. However, these statutes were atypical, nearly all other states have adopted acts

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16 Early LLC Acts were “bulletproof” in that they mandated structural points that would insure the federal tax classification of the entity as a partnership under the then prevailing “Kintner” classification regulations. See generally Charles W. Murdock, Limited Liability Companies in the Decade of the 1990s: Legislative and Case Law Developments and Their Implications for the Future, 56 BUS. LAW. 499 n.17–18 and accompanying text (Feb. 2001).

17 The second LLC Act, adopted by Florida in 1982, was likewise bulletproof and was patterned on the Wyoming Act. FLA. STAT. ch. 608.401-71 (effective Apr. 21, 1982).

18 See COLO. REV. STAT. ANN. § 7-80-401(1) (West Supp. 1993); see also Rev. Rul. 93–6, 1993-I C.B. 229; Robert Keatinge et al., Colorado Enacts Limited Liability Legislation, 19 COLO. LAW., No. 6, at 1029 (June 1990). Other exceptions are: Oklahoma, OKLA. STAT. ANN. tit. 18, §§ 2013, 2015 (West Supp. 1994); Texas, TEX. REV. CIV. STAT. ANN., art. 1582n, § 2.12 (Vernon 1994) (reversing the typical regime by vesting management in elected managers but allowing the articles of organization to transfer management to the members).


20 In 1994, the Colorado LLC Act was amended to provide that LLCs formed thereunder could be member–managed or manager–managed. COLO. REV. STAT. § 7-80-401 (2004), revised by SB 94-107, Chapter 139 of Laws of 1994; see also Risa Lynn
allowing both member- and manager-managed LLCs. Notice of the model selected is typically required to be recited in the articles of organization, thereby giving third parties at least the opportunity of discovering the apparent agency structure. However, states differ on the notice effect of the articles of organization. For example, the Kentucky LLC Act contains no express provision regarding the notice effect of the articles of organization. The Delaware LLC Act states that the filing of the certificate of formation is notice of both the organization of the LLC and the facts required to be set forth in the certificate under Delaware law. The Illinois LLC Act provides that “The fact that the articles of organization are on file in the Office of the Secretary of State is notice that the limited liability company is a limited liability company and is notice of all other facts set forth therein.” The Colorado LLC Act, prior to its amendment in 2004, provided that the articles were notice of all facts that were required or expressly permitted to be set forth therein; a similar provision appears in the Florida LLC Act as well. But, irrespective of formulation, it is all a legal fiction. Everyday transactions do not involve due diligence on the part of the apparent agent (or the one representing himself as the apparent agent).


See generally LARRY E. RIBSTEIN & ROBERT R. KEATINGE, 1 RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 8, Appendix 8–2 (2d ed. 2004).

See, e.g., K.R.S. § 275.025(1)(d) (Banks-Baldwin 2004); OR. REV. STAT. § 63.047(1)(d) (2003); PROTOTYPE LLC ACT, supra note 7, § 202(d); ULLCA, supra note 3, § 203(a)(6). By way of contrast, the Virginia LLC Act does not require the article of organization to set forth whether the LLC is member- or manager-managed. VA. CODE ANN. § 13.1-1011 (Michie 2004). The Delaware LLC Act does not require the certificate of formation (the Delaware nomenclature for articles of organization) to recite whether the LLC is member- or manager-managed or to otherwise make for public record any limitation on authority made in accordance with state law. DEL. CODE ANN. tit. 6, § 18-402 (2004).

Tit. 6, § 18-207. The Delaware LLC Act does not mandate that the certificate of formation recite whether the LLC is member- or manager-managed, and, as such, a statement as to that distinction in the certificate of formation is not deemed “notice.” Id.

805 ILL. COMP. STAT. ANN. § 180/5-70 (West 2004).

COLO. REV. STAT. § 7-80-208. As amended, section 7-80-208 provides that the articles of organization are notice of only the facts required to be set forth therein.


A further limitation on the utility of this declaration is that it is often not available on the Secretary of State websites. For example, while the websites of the Iowa, Utah, and South Dakota Secretaries of State provide information on the name, registered office,
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In either the member-managed or the manager-managed LLC, the entity may at any time designate a particular agent with actual authority irrespective of that agent’s position as either a member, a manager, or as neither. For example, in a member-managed LLC the members could adopt a resolution authorizing a non-member to execute a deed transferring the LLC’s real property and that agent, having been granted actual authority to act, may fully bind the LLC and properly transfer the property. Furthermore, assuming that the LLC act and the applicable operating agreement so allowed, that grant of authority from the members to the third-party agent would be effective even where the LLC is manager-managed. As such, grants of actual authority to act on behalf of the LLC are not constrained by the statutory apparent agency afforded by the member—versus manager—managed distinction.  

To date, this somewhat indefinite structure for apparent agency has been generally accepted by the constituencies that make use of the LLC form. Where apparent agency authority in each of the members is acceptable, as is often the case in a professional practice, the member-managed paradigm is selected. Where centralized agency is desired, such as where a real estate venture is structured as an LLC having an active promoter and a significant number of passive members, the manager-managed paradigm is chosen. When combined with the ability to appoint actual agents to supplement the statutory apparent authority, the system has at least been workable. But there are limitations; for instance, it is unclear whether the LLC can limit the apparent authority of a person within the class of those holding statutory apparent authority.  

While and date of formation of an LLC, none list whether it is member-managed or manager-managed. It was only in 2004 that the Kentucky Secretary of State’s website began noting whether the LLC is member- or manager-managed. A website which resembles that of the Oregon Secretary of State is most helpful; it lists whether the LLC is member- or manager-managed and lists the names and addresses of the members and, if any, the managers.  

28See, e.g., commentary to PROTOTYPE LLC ACT, supra note 7, § 301.  
29Section 303 of RUPA provides for a Statement of Authority that can serve to limit the apparent authority of a partner in a partnership. RUPA, supra note 2, § 303. To date, the various LLC acts have not adopted a filing mechanism by which the apparent authority of a member or manager otherwise having apparent authority may be limited or eliminated. A proposed amendment to the Florida LLC Act, pending as this article goes to press, would allow the articles of organization to “describe any limitations upon the authority of a manager or managing member.” S.B. 1056, § 3 (proposing to amend Fla.
such limitations may be imposed by private ordering, those limitations on authority are not binding on a third party who has not received notice. That said, it is clear that when a member acts outside the scope of his actual authority as limited by private ordering, but within the scope of his statutory apparent authority, the LLC, and in some instances the other members, will have a claim against the acting member. As such, if a manager is constrained in the operating agreement or another private ordering in such a way that his authority is limited to obligations having a value of $500 or less, even while agreements of a greater value would be in the ordinary course of business, the execution of an agreement binding the LLC in excess of $500 would still be enforceable against the LLC (assuming the third party did not have actual notice of the limitation on the manager’s authority). At the same time, the LLC (and in some cases the members) would have a claim for damages against that manager for the consequences of the agreement entered into outside of his authority.

III. THE DEFAULT DECISIONAL AUTHORITY STRUCTURE THAT FOLLOWS FROM THE MEMBER–MANAGED VERSUS MANAGER–MANAGED ELECTION

Flowing from the election of a default rule of apparent agency authority is the election of the internal governance structure of the LLC.
In most statutory formulations, the member–managed LLC is directly managed by the members, vesting in them the authority to direct the day–to–day and extraordinary activities of the business. In this circumstance, default rules vary regarding the relative voting power of the various members and the voting thresholds required to approve a particular action. In contrast, in the manager–managed LLC, the statutory default is that the managers have the authority to manage at least the ordinary, and in some instances the extraordinary, course of business of the LLC, with little if any decisional authority left to the members.

And here arise the problems. In some instances, poor statutory drafting has conveyed to the managers power and authority that was neither properly considered nor intended. Even where these language–specific problems are not present, there are ongoing debates regarding which activities fall within the purview of the managers and which

31 For example, members may vote per capita (one member, one vote). See, e.g., PROTOTYPE LLC ACT, supra note 7, § 403(a); ULLCA, supra note 3, § 404(a)(1). They may vote in proportion to their capital (per capital). See, e.g., K.R.S. § 275.175(3); VA. CODE ANN. § 13.1-1022(B). Or they may vote on some other basis. See, e.g., COLO. REV. STAT. ANN. § 7-80-706(1) (2004). The various LLC acts generally provide that the operating agreement may provide alternative means of allocating voting power, examples of which include non–voting interests in the LLC or units with veto power over ordinary or extraordinary transactions. See, e.g., K.R.S. § 275.175(1) (“Unless otherwise provided in the articles of organization, a written operating agreement, .... ”); VA. CODE ANN. § 13.1-1022(F) (“The articles of organization or an operating agreement may provide for classes or groups of members having such relative rights, powers, and duties as the articles of organization or an operating agreement may provide....”).

32 For example, an act may provide a default rule of a majority of the members (however measured) to approve ordinary course transactions and unanimous approval for extraordinary transactions.

33 See, e.g., K.R.S. § 275.175(1)–(2) (placing business affairs of LLC under control of the managers while reserving to the members the power to vote upon amendments to written operating agreement, approval of an action in contravention of a written operating agreement and certain amendments to the articles of organization).

34 As a result of poor drafting, under the Kentucky LLC Act there is the possibility that the managers could amend an oral operating agreement or adopt amendments to the articles of organization that do not deal with the member– or manager–managed options. See K.R.S. §§ 275.030, 275.175. Prior to its recent revision, the Colorado LLC Act, by means of addressing the removal of a manager, could be used to authorize the expulsion of a member by a vote of a majority of the members. COLO. REV. STAT. ANN. §§ 7-80-120(8), 7-80-401(2), 7-80-405.
Activities remain within the control of the members.\textsuperscript{35} Avoiding these ambiguities imposes costs in the form of greater detail in the drafting of the operating agreement, costs that are not avoidable by relying on the statute. The fact that some portion of the existing ambiguity can be ascribed to the "growing pains" of a relatively new business structure in no manner minimizes the actuality of the costs imposed on those suffering its consequences. Inter se allocations of authority will almost always involve a degree of private ordering. Increasing the required amount of private ordering by a confusing and poorly fitted statutory allocation only exacerbates the problem.

IV. The Real World of LLC Decisional Structures and Apparent Agency

A significant fact that is ignored in the member-managed versus manager-managed LLC paradigm is that decisional authority and agency authority are independent attributes that should not necessarily be linked together. Apparent agency authority need not involve a grant of authority to make managerial decisions on behalf of the principal; likewise, the authority to make managerial decisions on behalf of an entity need not be accompanied by a grant of apparent authority to carry out those decisions.\textsuperscript{36} The predominant paradigm for LLCs links the two. This linkage is without obvious benefit, yet it has obvious costs and limitations.

Consider the following typical example of the formation of an LLC. A group of six individuals with complimentary strengths in a particular type of consulting decide to join forces. Operating collectively, they can offer an integrated product and better compete for consulting contracts. They decide that the common vehicle through which they will offer this integrated suite of services will be an LLC. Each member will be responsible for the delivery of those services for which he or she has particular expertise. Once a contract is in place, each of the members,

\textsuperscript{35} See, e.g., Apple Glen Crossing, L.L.C. v. Trademark Retail, Inc., 784 N.E.2d 484, 486 (Ind. 2003) ("change orders," not "major decisions," requiring approval of all of the members); Chase Manhattan Bank v. Iridium African Corp., 197 F. Supp. 2d 120 (D. Del 2002) (attestation as to proper amendment of the operating agreement not an ordinary matter).

\textsuperscript{36} See supra note 11 (separation in corporation of agency authority from board's decisional authority).
when dealing with the client, will have agency authority on behalf of the LLC. However, all decisions regarding the operation of the LLC, including the decision on the terms of a bid for a contract, will be made by at least a majority of the members. One member, in addition to rendering services in the consultant capacity, will have responsibilities that include acting as the "business manager" for the LLC. For example, this business manager will bear the responsibility of dealing with the landlord for the LLC's offices.

In this instance, the LLC ("Typical LLC") is set up as a manager-managed LLC with the "business manager" member named as the manager. That member, identified as a manager for ease of dealing with third parties in the ordinary course of business, is thereby imbued with apparent agency on behalf of all company operations. At the same time, none of the other members has statutorily derived apparent authority to deal with any third parties, including those organizations to which the members are rendering services. Rather, the LLC operating agreement must provide that each member will have the actual authority to represent the LLC to clients, and each individual consulting agreement must specify, and thereby place the client on notice, that each member has actual agency authority. According to the operating agreement, consulting agreements may be entered into with clients only with the consent of a majority of the members. But third-party clients, unaware of this limitation upon the "manager's" apparent authority, may rely upon the manager's ability to bind Typical LLC to any agreement in the ordinary course.

Could the members have decided to structure Typical LLC as a member-managed entity? Certainly they had that option, with the consequence that each member would have the apparent agency authority described above for the manager. Another consequence is that every member would have the apparent authority to bind Typical LLC to third parties in its ordinary course of business; in that case, the consultants lose the centralization of authority that was a product of the decision to use a manager-managed structure.38

37 These facts are a slightly modified version of an operating agreement structured by another member of the ReULLCA drafting committee.
38 In the member-managed structure, the operating agreement could specify that the members would act by majority (or some other defined threshold), and that no member would have actual authority when acting without such consent, but such is not binding
A third option is available as well: use of a manager-managed structure in which every member is also a manager, investing in each a manager's apparent agency authority. This structure, however, simply duplicates the problems that exist in the member-managed option, but now under the guise of manager apparent agency rather than member apparent agency.

What is missing from the statute is a default paradigm that accommodates the expectations and desires of the persons forming Typical LLC. What exists is a pair of alternative default structures, neither of which is satisfactory to the members of Typical LLC, each of which imposes costs that could be avoided if LLC statutes were to 1) provide a different structure for the apparent agency authority to act on behalf of an LLC and 2) de-link apparent agency authority and decisional authority.

This is not the only problem with the current paradigm of statutory apparent agency. There is also the issue of changes in the managerial structure. Imagine a situation in which a third-party has done business with a member-managed LLC through a number of transactions. The LLC is organized in a state that requires a declaration of "member-managed" or "manager-managed" in its articles of organization, and state law also provides that the articles are notice of the facts set forth therein. The LLC then decides to alter its structure, elects to become manager-managed, and makes the necessary amendment to its articles of organization, which now provide:

The management of the limited liability company is reserved to managers elected and/or appointed in accordance with the operating agreement of the limited liability company. Only those elected or appointed as managers may bind the limited liability company, and no member, by reason of being a member, may bind the limited liability company. The authority of the managers shall be exercised in

upon third parties without notice. See supra note 27 and accompanying text.

This structure is equivalent, from the standpoint of apparent agency, to member-management, but perhaps has tax consequences for purposes of the passive activity rules, self-employment taxes, and other provisions of the tax code. See 26 U.S.C. §§ 467, 1402 (2004).

The third party has properly relied upon the authority of the member with whom it deals, as the transactions are "for apparently carrying on in the ordinary course the [LLC's] business." ULLCA, supra note 3, § 301(a)(1).
accordance with the operating agreement of the limited liability company.

There exists no obligation that the LLC, or the member who has previously represented it to the third party, deliver to the third party a copy of that amendment. Rather, at least within the confines of the LLC act, the accepted fiction is that filing the amendment to the articles of organization provides notice to the third party of the changed management structure. Further assume that the member with whom the third party has previously dealt is not elected a manager. That member no longer has statutory apparent agency authority to act on behalf of the LLC. Sometime thereafter, the non-manager member with whom that third party has always dealt purports to enter into a transaction with the third party on behalf of the LLC. However, as that member lacked both statutory apparent and actual agency authority to act on behalf of the LLC, the LLC has statutory authority for the position that it is not bound by that action even if it was in the ordinary course of the LLC's business.

This result follows from the fact that apparent agency exists based on the relation of the principal to the third party, and it is the articles of organization that are the manifestation of those actions in the member–or manager–managed (represented) designation. So the fact that the member did not tell the third party of the change in management structure does not alter the fact that the previously existing authority had been revoked. Admittedly, it may be possible for that third party to argue that there existed lingering apparent authority pursuant to which the LLC should be bound, but such a reference is outside the scope of the LLC's organizational law and the statutory basis by which the LLC designated who does (and does not) have agency authority to act on its behalf.

\[41\] See, e.g., K.R.S. § 275.165(2) (Banks-Baldwin 2004); VA. CODE ANN. § 13.1-1021.1(B)(1) (Michie 2004); PROTOTYPE LLC ACT, supra note 7, § 301(B)(1); ULLCA, supra note 3, § 301(b)(1).

\[42\] This result follows from the two-part effect on apparent agency of the manager–managed election: the "managers" are afforded statutory authority while the members, qua members, are denied authority. See supra note 9.

\[43\] See supra note 6.

\[44\] This problem of lingering apparent authority exists as well in the partnership and the limited partnership contexts. Under the prior RULPA, while there was a requirement that the general partners be named in the certificate of limited partnership, the fact that a
This is not to say that the members in a member-managed or the manager in a manager-managed LLC are the only persons who can be its apparent agents. Assume Bob's Bar is a single-member LLC with Bob as the sole member. Scott works at the bar but is neither a member nor a manager. One day he places an order with Beth, a liquor saleswoman, to deliver a case of fine Kentucky small-batch bourbon. After the delivery, Bob reprimands Scott, reminding him that only Bob should be ordering stock. Still, Bob pays the invoice and the bourbon is wildly popular with the customers. By paying the invoice, Bob ratified the initial transaction and, by paying the invoice without bringing Scott's lack of authority to Beth's attention, has indicated to Beth that Scott did have authority to act. This invests Scott with the apparent authority to place further orders with Beth in the future. An express revocation of that authority, delivered to Beth, is required to deprive Scott of the apparent, albeit not statutory, agency authority.

We are left in a most unsatisfactory position. The LLC act itself provides alternative default agency rules that have unsatisfactory consequences for management structure. The apparent agency rules are unsatisfactory for both the LLC and for third parties since they are likely ineffective at truly limiting apparent authority to those the LLC may from time to time choose as its agents. The LLC must be continually aware of the creeping designation of apparent agents arising in the ordinary course of business under generally applicable rules of agency law. And the possibility of confusing third parties who deal with LLCs continues unabated.

V. THE REJECTED REULLCA PROPOSAL

In 2003, the ReULLCA drafting committee conceived, considered, and, with the input of the entire NCCUSL, eventually rejected a proposal that would have provided that the new ULLCA would eliminate the person or entity was not named as a general partner did not constitute notice that they were not a general partner, and as such the limited partnership could have statutory apparent agents not named in the certificate of limited partnership. See RULPA, supra note 2, § 201(a)(3). Recent statutory efforts to address this issue include the RUPA section 704 Statement of Dissociation.

45 This is not a case of acquiescence giving rise to actual authority, as the agent has been told by the principal that he acted outside the scope of his authority. See, e.g., RESTATEMENT, supra note 1, § 33.
alternative member versus manager apparent agency structures, while at the same time eliminating the linkage between apparent agency and decisional authority. Currently, ULLCA addresses the alternative agency structures in section 301(a)–(b), which provide:

(a) Subject to subsections (b) and (c):

(1) Each member is an agent of the limited liability company for the purpose of its business, and an act of a member, including the signing of an instrument in the company’s name, for apparently carrying on in the ordinary course the company’s business or business of the kind carried on by the company binds the company, unless the member had no authority to act for the company in the particular matter and the person with whom the member was dealing knew or had notice that the member lacked authority.

(2) An act of a member which is not apparently for carrying on in the ordinary course the company’s business or business of the kind carried on by the company binds the company only if the act was authorized by the other members.

(b) Subject to subsection (c), in a manager–managed company:

(1) A member is not an agent of the company for the purpose of its business solely by reason of being a member. Each manager is an agent of the company for the purpose of its business, and an act of a manager, including the signing of an instrument in the company’s name, for apparently carrying on in the ordinary course the company’s business or business of the kind carried on by the company binds the company, unless the manager had no authority to act for the company in the particular matter and the person with whom the manager was dealing knew or had notice that the manager lacked authority.

(2) An act of a manager which is not apparently for carrying on in the ordinary course the company’s business or business of the kind carried on by the company binds the company only if the act was authorized under Section 404.46

46 ULLCA, supra note 3, § 301(a)–(b). The equivalent provision to ULLCA section
In the proposed ReULLCA formulation, the options of vesting apparent agency authority in either the members or the managers is abandoned, and members qua members would not have agency authority. Rather: "[a] member does not have the right or the power as a member to act for or bind the limited liability company."^47

At the same time, it was proposed that the requirement that the articles of organization reciting the management/agency be eliminated. No affirmative statement as to who would have apparent agency authority was substituted in place of this previously required declaration. Rather, the LLC, in its articles of organization, would be permitted, but not obligated, to make provision for persons with actual agency authority on behalf of the LLC.^49 The proposal then addressed the binding effect of such a declaration of agency authority.^50 Under this proposed formula, an

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301 in the Prototype LLC Act is section 301. See also K.R.S. § 275.135; VA. CODE ANN. § 13.1-1021.1(A), (B).


^48 See supra note 22 and accompanying text.

^49 See 2003 ULLCA Proposal, supra note 47, at 40, stating that the new section 203(b) would provide:
(b) The articles of organization may delineate the authority of any person to:
(1) transfer real property held in the name of the limited liability company;
(2) enter into other transactions on behalf of the limited liability company or to otherwise act for the limited liability company in interactions with persons who are not members or transferees.

Id. See also id. at 41, stating that new section 203(e) would provide:
(e) A delineation under subsection (b) may:
(1) identify a particular person or may refer to a position that exists in or with respect to the limited liability company; and
(2) state authority, limit authority or negate authority, or any do any combination.

Id. See id. at 40–41, stating that the new section 203(c) and (d) would provide:
(c) A delineation under subsection (b)(1):
(1) provides notice of its contents to all persons;
(2) is conclusive in favor of any person that gives value without knowledge to the contrary; and
(3) is conclusive against the limited liability company in favor of a person that has not given value if the person:
(i) is not a member or a transferee, and
(ii) relies on the delineation with knowledge to the contrary.
(d) A delineation under subsection (b)(2) does not by itself provide notice of its
LLC that made no provision for a specific grant of agency in its articles of organization would, as to the public record, be without an indicated agency structure. Actual and apparent agents would arise from time to time in accordance with general agency law.

Addressing decisional authority at section 404(a)–(b), ULLCA currently provides:

(a) In a member–managed company:

(1) each member has equal rights in the management and conduct of the company's business; and
(2) except as otherwise provided in subsection (c), any matter relating to the business of the company may be decided by a majority of the members.

(b) In a manager–managed company:

(1) each manager has equal rights in the management and conduct of the company's business;
(2) except as otherwise provided in subsection (c), any matter relating to the business of the company may be exclusively decided by the manager or, if there is more than one manager, by a majority of the managers; and
(3) a manager:
   (i) must be designated, appointed, elected, removed, or replaced by a vote, approval, or consent of a majority of the members; and
   (ii) holds office until a successor has been elected and qualified, unless the manager sooner resigns or is removed.  

The 2003 ReULLCA Proposal regarding management's decisional authority over the activities of an LCC provided:

contents but is conclusive against the limited liability company in favor of a person that:
(i) is not a member or a transferee, and
(ii) relies on the delineation without knowledge to the contrary.

Id.

51 ULLCA, supra note 3, § 404(a)–(b). The equivalent provision in the Prototype LLC Act, supra note 7, is section 401(b)(3). See also K.R.S. § 275.165(2)(c); ALA. CODE §§ 10-12-21(b)(2), 10-12-22(a)–(b) (2004); OR. REV. STAT. § 63.130(1)–(2) (2003).
(a) Except as provided in subsection (b):

(1) Each member has equal rights in the management and conduct of the affairs and activities of a limited liability company.

(2) A difference arising as to a matter in the ordinary course of the affairs and activities of a limited liability company may be decided by a majority of the members. An act outside the ordinary course of affairs and activities of a limited liability company may be undertaken only with the consent of all the members.

(b) In a manager-managed limited liability company:

(1) Each manager has equal rights in the management and conduct of the affairs and activities of a limited liability company.

(2) A difference arising as to a matter in the ordinary course of the affairs and activities of a limited liability company may be decided by a majority of the managers. An act outside the ordinary course of affairs and activities of a limited liability company may be undertaken only with the consent of all the members.\(^{52}\)

At the 2003 Annual Meeting of NCCUSL, this proposal was made to the floor of Conference. It was met with objections from a number of the commissioners. For example, one commissioner observed:

Two comments. I guess I don't understand or appreciate why you're abandoning the default rule. I have a great deal of faith and esteem for the committee. I will work on that issue myself, or try to understand that. But it seems to me, as you drafted this, however, you have left the potential for a void in power, because what you have done here is, you've taken away the default rule and then you said in the articles you may delineate power, but somebody may not in fact do that. It may be silent in the articles. And then earlier you've taken away the requirement of an operating agreement.\(^{53}\)

A member of the ReULLCA drafting committee observed:

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\(^{52}\) This language is patterned after RUPA, supra note 2, § 401(j). Departing from prior ULLCA § 404(c), the 2003 ReULLCA Proposal did not list particular items that are outside the ordinary course and reserved to the members.

This is one I think that is going to be very controversial, because I, for one, am very concerned along the lines of what Commissioner Nixon has said:

Putting something in a statute that says that nobody has any apparent authority and saying that that meets the expectations of the public is, to me, very foolish.\(^4\)

Among the comments made in response to these concerns, was one ReULLCA reporter's observations:

I want to make a couple of general points and then a specific comparison with the current law.

I think it is important to underscore that this is at the moment a very tentative view. We had one meeting. It was suggested that the reporters were told, go draft something to illustrate what it would look like. The committee has not—other than in a teleconference to say, yes, that's an adequate job of showing us sort of what it would look like—has not passed upon it.

Again, it would be a radical departure from two things. One, as has been indicated twice, the partnership law origins of LLC's. Because in partnership law, somebody by their status has, and under a statute, has the apparent authority to bind for ordinary matters a general partner, be it a limited or general partnership.\(^5\)

Concerns were also raised about the enactability of the new paradigms.

I am very concerned about whether the legislatures will understand this, accept the rationale for the change and be willing to accept it.\(^6\)

In response to this low level of criticism, at its next meeting after the 2003 Annual Meeting, the ReULLCA Drafting Committee decided to


\(^6\) Commissioner Nixon, \textit{supra} note 53.
revert to the traditional member versus manager–managed paradigm, even while acknowledging its problems.

VI. DEALING WITH (SEVERING?) THE LINKAGE BETWEEN APPARENT AGENCY AND DECISIONAL AUTHORITY AND PROVIDING LLC ORGANIZERS WITH STATUTORY STRUCTURES THAT MEET THEIR NEEDS

The preferable solution to the dual problems of linkage between apparent agency and decisional authority and the inadequacies of the alternative agency structures is modifying the organic LLC acts to separate agency and decisional issues and to provide agency and decisional options that meet the needs of those constituencies using the structure. But whether those modifications should follow the model proposed (and rejected) by NCCUSL or some other model remains in question. Currently, most LLC acts embody the alternative statutory apparent agency structures of member– or manager–managed. The 2003 ReULLCA Proposal would replace this bilateral situation with a system in which there is no statutory apparent agency. Rather, agency authority, either actual or apparent, would be determined without reference to the fact that the entity in question is an LLC, but instead with reference to actual business practices and otherwise applicable agency law. Another alternative would be to modify the LLC act in question to provide a range of options for agency structure, allowing those forming an LLC to choose from a menu of options a statutory agency structure that most closely meets their expectations. For example, such a statute could provide the prior options of member agency or manager agency, while adding an option for structuring the LLC in a corporate model with a board of directors having decisional authority, which could appoint managers with agency authority. Alternatively, there could be an option in which there is a board of managers with the members of that board having, on a collegial but not an individual basis, decisional authority.


In that situation, apparent agency authority could be restricted to that same collegial body without vesting agency in any individual manager.

But where should such a menu of options end? Should there be one in which the agency authority is vested in the members as a collegial body? Should there be one in which the agency authority is vested only in those members who hold more than a certain percentage of the membership interests in the LLC? Should there be one in which agency authority is vested in persons named in the articles of organization? Should there be one in which...?

The statutory drafter and the potential beneficiary of such a statute are thus faced with the problem of an abundance of riches—additional options impose their own costs in the preparation of the statutory language, practitioners must differentiate among them to determine which most closely conforms to the expectations of the organizers, and the public doing business with LLCs must be educated regarding the differences between the various options. Further, the cost issues that exist even with the dual options of member–managed versus manager–managed will continue to exist. While there will be situations in which one of the expanded menu of options for apparent agency will so closely match the expectations of the organizers that further customization will not be necessary, such situations will be fortuitous. The infinite range organizers’ expectations will guarantee that in most circumstances, regardless of whether the statute provides for two, three, four, five, or

59 Such an option does have statutory precedent, albeit in foreign law. Section 7 of the 1961 Malaysian Partnership Act contemplates a “silent partner” who is without apparent agency authority. See EL GAILY AHMED EL TAYEB, PRINCIPLES OF PARTNERSHIP LAW IN MALAYSIA 16, 17 (1998) (“[A]nd the person with whom [the partner] is dealing either knows that he has no authority or does not believe him to be a partner.”) (quoting MALAYSIAN P’SHIP ACT § 7.6 (1961)).

60 As observed by Abbi D’Allanival, “The more alternatives, the more difficult the choice.” See also Barry Schwartz, The Tyranny of Choice, 290 Scn. AM. 70, 70 (2004):

Americans today choose among more options in more parts of life than has ever been possible before. To an extent, the opportunity to choose enhances our lives. It is only logical to think that if some choice is good, more is better; people who care about having infinite options will benefit from them, and those who do not can always just ignore the 273 versions of cereal they have never tried. Yet recent research strongly suggests that, psychologically, this assumption is wrong. Although some choice is undoubtedly better than none, more is not always better than less.

Id.
even more reasonable options, further customization of the “closest fit” will be necessary. While a large number of options may minimize the amount of customization that may be required within the operating agreement in any particular instance (assuming a statutory option is relatively close to the desired structure), a large number of options will impose increased educational costs on the public to learn the various options and to differentiate among them. At some point such an educational effort will not be effective—in fact it is questionable whether the public is able to differentiate between the existing member- and manager-managed structures. Consequently, increasing the number of statutory options for apparent agency is not a solution to the problem of how to address apparent agency.

So is the “non-rule” of the rejected ULLCA proposal without problems? Some would suggest that such a non-rule of apparent agency will lead to uncertainty, that third parties doing business with an LLC will have no point of reference from which to determine who has apparent agency authority. Closer examination shows this to be an illusory concern. In fact, LLCs and those with whom they do business already operate in a realm of manifest uncertainty as to who has that authority. Clearly, the LLC that believes its indication of member- or manager-managed in its articles of organization has conclusively identified its agents is misinformed—Scott is still ordering bourbon from Beth for the LLC of which he is neither a member nor a manager. And it has been shown that the LLC cannot rely upon the alteration of its management structure to terminate a prior grant of agency authority. At the same time, the third parties doing business with the LLC must be concerned both with whether the LLC is member- or manager-managed and whether the person with whom they are dealing falls within the managing class. In addition, the determination of whether the person

61 Keeping in mind that inter se allocations of apparent agency must accommodate the perspective and expectations of the third parties to whom the manifestations will be made and who must interpret them.

62 See, e.g., supra notes 53–54 and accompanying text.

63 See supra note 45 and accompanying text.

64 As observed by Kleinberger, supra note 55 (discussing revision of section 301): That is the specific point I want to mention, that currently if someone comes up to you and says, I’m a member of Walker LLC and based on that commits the LLC to you, you do not have a claim against the LLC if the LLC’s articles say it is a manager-managed LLC. Because this switching provision cuts off members’ apparent authority to bind if the articles—which, of course, no
falls within the class having authority should not arise from a representation by that person but rather by the LLC. It would strain credibility to suggest that the immeasurable number of interactions that have and do take place between LLCs and third parties have been preceded by the due diligence that would, as of that point in time, assure the third party of the actuality of the apparent authority. LLCs are already operating primarily through generally applicable, and not statutory, agency law.

At the same time, severing the linkage between apparent agency and management structure allows the two to be addressed separately and in a manner that best comports with the expectations and desires of the organizers. Just as organizers can desire a multitude of models for agency (although they may not conceptualize it under that rubric), they may have a similar multitude of models for how they want to allocate decisional authority in the entity, some of which have been recited above.

Without linkage to agency, an LLC could be structured with a board of directors elected or appointed by some or all of the members and each of those board members could be designated a “manager,” all without vesting apparent agency authority in each individual. An LLC could be organized without “managers,” retaining in the members the authority to make collective decisions on behalf of the LLC but without retaining individual apparent agency authority. In that option, apparent agency authority could be restricted to that same collegial body with the authority to delegate its authority on a case–by–case basis. Or any number of other options could be provided.

At this point the question of statutory structure resurfaces. As with apparent agency, there is an issue regarding the number of necessary statutory options for management structure. Regardless of the number of options provided, the problems and costs of customization to match the expectations of the participants in each venture will not necessarily be

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Id.

65 Lawyered transactions that proceed on the basis of resolutions, certificates and opinion letters are typically accomplished pursuant to actual (as contrasted with apparent) authority, and fall into a different category than the type of transaction here contemplated.
lower if there are more options. While there will be instances in which a particular statutory option conforms precisely to the desires and expectations of the participants, such cases will again be fortuitous. In most circumstances, the actual management structure will need to be customized in the operating agreement to meet those expectations; as a result, the abundance of riches problem resurfaces again.

VII. RADICALISM RUNNING AMOK?

The proposal to sever the linkage between statutory apparent agency and decisional authority already exists in LLC law and, depending upon your viewpoint, has either been consciously embraced or unconsciously accepted. The Delaware LLC Act:

(1) affords each manager and each member the authority to bind the LLC; and
(2) allows private ordering, by means of the operating agreement, of the limitations upon that grant of authority.\(^{66}\)

Outside of organization in the home jurisdiction of the organizer(s), Delaware is the most likely jurisdiction of organization for an LLC.\(^{68}\) These LLCs, organized in Delaware but doing business throughout the

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\(^{66}\) This is not a publicly filed document. In fact, the operating agreement containing the limitation on apparent agency may be “in the bottom of a locked filing cabinet stuck in a disused lavatory with a sign on the door saying 'Beware of the Leopard.’” DOUGLAS ADAMS, HITCHHIKER’S GUIDE TO THE GALAXY 9 (2005). Neither Delaware nor Virginia requires that the Certificate of Formation/Articles of Organization recite whether the LLC is member- or manager-managed. See supra note 22.

\(^{67}\) The Delaware Code states: “Unless otherwise provided in a limited liability company agreement, each member and manager has the authority to bind the limited liability company.” DEL. CODE ANN. tit. 6, § 18-402 (2004).


For decades, corporate law scholars have been arguing about Delaware. Roughly half of the largest corporations in the U.S. choose to incorporate in Delaware. No other state comes even remotely close to this figure—Delaware dominates the competition among states in attracting businesses to incorporate. Delaware began its domination early in the twentieth century after New Jersey, the first leader in this competition, faltered. Delaware has never faltered. Id. (citations omitted).
nation, operate under a rule of expansive apparent agency authority and private ordering of limitations. While there is a distinction between a rule of no person having statutory apparent agency by reason of position, as set forth in the 2003 ReULLCA Proposal, and a rule of all persons having statutory apparent agency by reason of position subject to limitation by private ordering, that distinction does nothing to give a third party dealing with an LLC confidence that the person with whom they are dealing is actually empowered to act for the LLC. At the same time, while the LLC may have a manager, the manager is not afforded plenary authority over the management of the LLC; he only has authority over those matters entrusted to him in the operating agreement. So the Delaware LLC, in expressing its desired management structure in the operating agreement, is relieved of the need to address default statutory rules that do not meet its needs through private ordering.

VIII. CONCLUSION

The first generation of LLC acts were drafted under the shadow of the Kintner regulations, their influence upon agency, and the possible negative classification consequences if centralized management were determined to be present. Unfortunately, since the adoption of the “Check-the-Box” classification regulations, LLC acts have not fully thrown off the influence of the prior law. We bear the cost of that continuing influence through the member-managed versus manager-managed system, even though neither is an effective response to the needs of most persons seeking to organize an LLC. The 2003 ReULLCA Proposal was intended to address this problem by eliminating the member- versus manager-managed distinction and separating the issues of internal decisional authority and external apparent agency. For the time being, this will not be the means by which this problem is addressed. Thus, the unfortunate consequences of the linkage remain, and for now the operating agreement must address them as well as possible.

69 Delaware law provides: “if a limited liability company agreement provides for the management, in whole or in part, of a limited liability company by a manager, the management of the limited liability company, to the extent so provided, shall be vested in the manager . . . .” Del. Code Ann. tit. 6, § 18-402.