

Pennsylvania LLC Documents – Corporate Model, Classes of Members and Family LLCs

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I. Corporate Model – Forms 22 and 23.

A. Certificate of Formation Provisions.

1. Perpetual existence, item 3, page 285.
  - Significant change from the default rule for dissolution of an LLC under §8971(a)(4), but is consistent with the default rule that corporations have perpetual existence under §1502(a)(10) and permitted by §8971(b).
2. Certificates of Membership, item 4, page 285.
  - Another analogy to a corporation is the issuance of certificates representing ownership in the entity.
  - §8924(b) permits an LLC to issue certificates of membership interest, but if the company intends to issue certificates of membership to its members, §8913(4) requires the Certificate of Organization to include a statement to that effect.
3. Central Management, item 5, page 286.
  - Like a board of directors for a corporation, an LLC may vest governance in one or more managers.
  - §8941(b) permits an LLC to provide for management by managers, but only if so provided in the certificate of organization. §8913(5) provides the certificate of organization may include a statement to that effect.
  - Under §8904(a)(2)(i), the managers of a manger-managed LLC are treated like general partners of a limited partnership, which means any one manager may act on behalf of and bind the LLC. To require the managers of a manager-managed LLC to act collectively it is prudent to add to the certificate of organization that the managers may only act collectively as a board and by resolution duly adopted, and have only such authority as the board of managers may delegate from time to time.

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- Issue of apparent authority. Under § 1506(a), any document executed or entered into between any business corporation and any other person, when signed by one or more officers or agents having actual or **apparent authority** to sign it, **or** by the president or vice president and secretary or assistant secretary or treasurer or assistant treasurer of the corporation, shall be held to have been properly executed for and in behalf of the corporation, binding the corporation. Because the certificate of organization is filed in the public records, all third parties are deemed to have **constructive notice** of the granting, or restricting, of the authority of members or managers set forth in it.
- Not necessary for the managers to be members. See §8941(c)(1).
- With the advent of “check-the-box” regulations, centralized management is no longer an issue for federal tax purposes. Member management was important before 1997 when the IRS used four factors to determine if an entity would be treated as a corporation for federal tax purposes: (1) limited liability, (2) centralized management, (3) continuity of life and (4) free transferability of interest. Three of four meant tax treatment as a corporation.

B. Operating Agreement Provisions.

1. Intended to operate as closely as possible to a corporation, so the terms are similar to those of bylaws.
2. Definition of “member” on page 292 is patterned on the definition of shareholder in 15 Pa.C.S. § 1103.
3. Ownership divided into units, similar to shares, and percentage interests are determined by dividing a member’s number of units by the number of all units. Pages 294, Section 3.02, and page 292, the definition of “percentage interest.”
4. Number of authorized units. Page 294, Section 3.02.
5. If included in the certificate of organization, ownership of membership interests can be evidenced by unit certificates. The information this form requires to be included on the unit certificate are described on page 299, Section 3.09(c) and is based on § 1528(c) of the BCL.
6. Like transfers of stock, unit certificates can be recorded on a unit transfer register, as described on page 298, Section 3.09(b).
7. LLCs permit use of profits interests, and Section 3.03, page 295, includes a provision for “profits interests” in prospective profits of the LLC.

8. LLC that contemplates an IPO should consider including Section 2.03 on page 293, as it will allow owners to tack their holding periods for purposes of Rule 144(d).
9. With respect to transfers of units, the default rule under the LLC Act, §8924(a), requires unanimous consent of the other members before a transferee of a membership interest can become a member (i.e., only an economic interest can be transferred without consent). This form permits free transferability, like shares in a corporation. See page 295, Section 3.05.
  - With the advent of “check-the-box” regulations, free transferability is no longer an issue for federal tax purposes. Member management was important before 1997 when the IRS used four factors to determine if an entity would be treated as a corporation for federal tax purposes: (1) limited liability, (2) centralized management, (3) continuity of life and (4) free transferability of interest. Three of four meant tax treatment as a corporation.
10. The general rule under the LLC Act, §8933, permits a member to disassociate and to receive the fair market value of their membership interest. This form, page 297-8, Section 3.08, reverses this rule reverses this rule, except for one limited circumstance, because the form permits free transferability.
  - The Act does not provide for dissenters’ rights upon a merger or other fundamental transaction. The form retains the default rule of §8933 as a substitute for dissenters’ rights in those situations. Page 297, Section 3.08(a)(2).
11. If included in the certificate of organization, an LLC may be manager-managed. The operative language regarding governance tracks the corresponding provisions of §1721(a) of the BCL. Page 305, Section 5.01(a), first sentence, and is reaffirmed by the final sentence of that Section.
12. Consistent with centralized management, and §8943(b)(2), the certificate of organization and this form of operating agreement explicitly state that member who is not a manager has no duties to the company or to the other members solely by reason of acting in the capacity of a member. Page 305, Section 5.01(a), second sentence.
13. Number of managers, election, removal, filling vacancies and resignation are consistent with the corresponding BCL provisions. Page 305, Section 5.02(b) (number), page 305, 5.02(a) (election), page 306, Section 5.04(b) (removal), page 306, Section 5.04(a), page 306, Section 5.04(c) (resignation).
14. The provisions regarding meetings of managers, notice, frequency and quorum are patterned on the corresponding BCL provisions. Page 307.

15. Remote participation and consent without a meeting also following the BCL. Page 308.
16. LLCs may have representatives corresponding to corporate officers, and this form endows such individuals with power customarily associated with a corporate office. Page 306, Section 5.03.
17. “Corporate opportunity doctrine” is disavowed in this operating agreement. Page 308, Section 5.08(a). See an alternative exclusion on page 127, Section 5.02(a).
18. The interested transactions provision borrows from §1728 of the BCL.
19. Exculpation, page 309, Section 5.10, as permitted by §8943(b)(1), and indemnity, page 313, Article VII, as permitted by §8945, are patterned on the corresponding BCL provisions.
20. Article VI, regarding members, follows the corresponding provisions of the BCL, as is the provision regarding reports, page 315, Section 8.02. Financial reports are required to be provided to shareholders of a Pennsylvania corporation under §1554, unless otherwise agreed between a business corporation and its shareholders.
21. Notices, page 319, Section 10.01, while patterned on §1702(a)(1), adopts the traditional “mail box” rule, which may work for larger, impersonal organizations, but may be inappropriate for a smaller organization.

## II. Classes of Members – Form 17.

- A. This form creates voting and non-voting/limited voting classes of members – class A members and class B members.
  1. Either class A members have all the voting rights, or a material advantage in voting rights. In this form, by a factor of ten (Alternative A) or eliminating voting for the class B members (Alternative B). Page 173, Section 6.01.
  2. Class A member elect the managers; class B members do not (or can easily be outvoted). See page 169, Section 5.02(a).
  3. Vacancies filled by the class A members only. Page 170, Section 5.04(a).
  4. Removal of managers, Alternative A, by the class A members only. Page 170, Section 5.04(b).
  5. Quorum requires class A members holding a majority of the percentage interest. Page 175, Section 6.03(a).
  6. Only class A members may call a special meeting. Page 175, Section 6.03(e).

7. Dissolution requires a vote of class a members. Page 181, Section 9.01.
- B. Only class A members may serve as a manager, and if a manager ceases to be a class A member, the manager must resign. Page 169, Section 5.02(d).
- C. Transfers of class A interests requires approval of class A members only (not B), while transfers of class B interest only requires the approval of the management committee. Page 160, Section 3.03(e). Only economic rights transfer if approval not given.

III. Family Limited Liability Companies – Form 21.

- A. Tends to be organized in the limited partnership model – sole manager with plenary authority to manage the affairs of the business and multiple members. Exclusive control by a single (“the”) manager. Page 258, Section 5.01(a).
- B. Transfers other than to permitted transferees require approval of the manager. Transfers without approval convey economic interests only. Page 250, Section 3.04(a)(1). Permits the founder of the entity, as long as he or she remains (or retains influence over) the manager, to designate additional members.
- C. See page 283, Exhibit 3.04, for a form of Notice of Gift/Assignment of Units.
- D. Likely to include classes of membership interests (voting and non-voting).
- E. Removal of manager for cause only, and typically by the voting class A members. Page 259, Section 5.03(a).