

# Hey! That's My LLC!: The Importance of Looking to Facts, Not Initial Reports, to Resolve Membership Disputes in Louisiana Member-Managed LLCs

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# Hey! That's My LLC!: The Importance of Looking to Facts, Not Initial Reports, to Resolve Membership Disputes in Louisiana Member-Managed LLCs

## INTRODUCTION

Brad and Jennifer, a long-term couple, decided to co-own a business together. Jennifer formed the business as a limited liability company (LLC) by completing the necessary forms on the Louisiana Secretary of State's website.<sup>1</sup> She listed Brad and herself as the sole owners of the LLC. After several profitable years, Brad and Jennifer separated, and Jennifer, out of spite, sought to damage Brad financially and retain the business for herself. She filed an additional document with which she was able to remove Brad's name from the organizational documents filed with the secretary of state.<sup>2</sup> She informed Brad that according to the official documents on record with the secretary of state, she was the sole owner of the LLC, and therefore, he could no longer access the company's funds or records. With the simple filing of a document, she had divested Brad of his ownership interest in their co-owned business.

In light of recent decisions by Louisiana courts addressing similar issues, Brad's situation is as dire as it appears.<sup>3</sup> Mystified by the officiality and formality of LLC organizational documents filed with the secretary of state, courts have confused their probative value and considered them determinative of ownership in LLC ownership disputes.<sup>4</sup> LLC organizational documents have no effect on ownership rights and are merely intended to apprise third parties of who has management authority in the business and upon whom

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1. LOUISIANA SECRETARY OF STATE, <http://www.sos.la.gov> (last visited Feb. 23, 2014) [<http://perma.cc/WN7Q-QZM5>] (archived Feb. 24, 2014).

2. Such removal can be accomplished by filing an annual report, LA. REV. STAT. ANN. § 12:1308.1(A) (2010); *infra* Part I.C.2.a, a Notice of Change of Members and/or Managers of a Limited Liability Company form, Tom Schedler, Sec'y of State, #983A Notice of Change of Members and/or Managers of a Limited Liability Company, <http://www.sos.la.gov/BusinessServices/PublishedDocuments/983AChangeofMemberManagerLouisianaLimitedLiabilityCompany.pdf> (last modified Sept. 2011) [<http://perma.cc/4QDE-KWZ2>] (archived Feb. 24, 2014); *infra* Part I.C.2.b, or a certificate of correction, LA. REV. STAT. ANN. § 12:1310(F) (2010); *infra* Part I.C.2.c.

3. See *Settles v. Paul*, 61 So. 3d 854 (La. Ct. App. 2011); *Moise v. Moise*, 956 So. 2d 9 (La. Ct. App. 2007); *infra* Part II.C.

4. See *Settles*, 61 So. 3d at 858–59 (using an inappropriate legal theory to circumvent the fact that plaintiff was not listed in the LLC's initial report); *Moise*, 956 So. 2d at 11 (referring to a member or manager list in an initial report as a "definitive designation"); *infra* Part II.C.

process can be served.<sup>5</sup> Unfortunately for Brad, some Louisiana courts have been unable to resist the temptation to treat these documents as determinative of ownership.<sup>6</sup>

This judicial confusion is particularly unfortunate in light of the emergence of a new type of crime known as “business identity theft,” which includes the fraudulent alteration of organizational documents filed with the secretary of state.<sup>7</sup> In 2012, the Louisiana Legislature addressed some of the ramifications of this crime and in doing so compounded confusion over the probative value of LLC organizational documents by giving courts the false impression that the inclusion of an owner’s name on one of these documents is of great significance.<sup>8</sup>

In light of this misleading legislation and recent court decisions,<sup>9</sup> one owner is currently capable of divesting another owner of an ownership interest in an LLC by merely removing his or her name from an organizational document filed with the secretary of state. This Comment argues that to remedy this unfortunate reality, courts must explicitly acknowledge that these documents are not determinative of ownership and must, instead, consider the totality of the facts and circumstances when determining an LLC’s true owners.<sup>10</sup>

In reaching this conclusion, Part I of this Comment discusses the organizational documents that can be filed with the secretary of state in the formation and operation of an LLC. Next, Part II examines the unique initial report of the member-managed LLC and the courts’ confusion of its probative value. Finally, Part III suggests that LLC membership disputes are properly resolved by analyzing each situation’s facts and circumstances and analogizing to the resolution

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5. See *infra* Part I.C.1.

6. See *Settles*, 61 So. 3d at 859 (using an inappropriate legal theory to circumvent the fact that the plaintiff was not listed in the LLC’s initial report); *Moise*, 956 So. 2d at 11 (referring to a member or manager list in an initial report as a “definitive designation”); *infra* Part II.C.

7. See NAT’L ASSOC. OF SEC’YS OF STATE, DEVELOPING STATE SOLUTIONS TO BUSINESS IDENTITY THEFT: ASSISTANCE, PREVENTION, AND DETECTION EFFORTS BY SECRETARY OF STATE OFFICES 5–8 (2012), available at <http://sdsos.gov/content/html/corporations/corporationpdfs/white-paper-business-id-theft-012612.pdf> [<http://perma.cc/5K9U-QSJZ>] (archived Feb. 24, 2014); Yuki Noguchi, *Identity Theft a Growing Concern For Businesses*, NAT’L PUB. RADIO (Feb. 29, 2012, 3:31 AM), <http://www.npr.org/2012/02/29/147582287/identity-theft-a-growing-concern-for-businesses> [<http://perma.cc/ZT3B-C9Q2>] (archived Feb. 24, 2014); *infra* Part II.B.

8. See LA. REV. STAT. ANN. §§ 12:2.2 (creating an electronic notification system when a member’s name is removed from an organizational document with the secretary of state), :1701 (creating a cause of action for a member who has been fraudulently removed from these documents) (Supp. 2013); *infra* Part II.B.

9. See *Settles*, 61 So. 3d 854; *Moise*, 956 So. 2d 9; *infra* Part II.C.

10. See *infra* Part III.A–C.

of ownership disputes in closely held corporations. It also argues that the Legislature should take action to clarify that LLC organizational documents do not determine ownership in an LLC. Because the Legislature and courts have failed to recognize this truth, every member in a member-managed LLC is at risk.

#### I. THE DOCUMENTS: FORMING AND OPERATING A LIMITED LIABILITY COMPANY

Many small, closely held businesses prefer the LLC model because it offers the limited liability of a corporation with the pass-through taxation and flexible, informal governance of a partnership.<sup>11</sup> Louisiana passed LLC legislation in 1992,<sup>12</sup> which was based largely on a draft of the ABA Prototype Limited Liability Act and Louisiana's existing corporation and partnership law.<sup>13</sup> Specifically, the laws regarding LLC formation were adopted nearly wholesale from corporation law.<sup>14</sup>

The essential documents necessary to form an LLC in Louisiana are the articles of organization,<sup>15</sup> the initial report,<sup>16</sup> and sometimes the operating agreement.<sup>17</sup> The rules governing these formation documents and their adoption from corporation law are the sources of the problems addressed by this Comment.<sup>18</sup>

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11. GLENN MORRIS & WENDELL HOLMES, BUSINESS ORGANIZATIONS § 44.01, *in* 8 LOUISIANA CIVIL LAW TREATISE 482–83 (1999); ROBERT W. HAMILTON ET AL., CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES 1182 (11th ed. 2010).

12. Limited Liability Company Law, LA. REV. STAT. ANN. §§ 12:1301–1369 (2010).

13. MORRIS & HOLMES, *supra* note 11, § 44.01, at 483.

14. *Id.* at 484. See Deborah A. Wisnowski, *The Louisiana Limited Liability Company Law: A Gumbo of Previously Existing Business Entities*, 39 LOY. L. REV. 185, 194 (1993).

15. LA. REV. STAT. ANN. § 12:1304(A) (2010). See *infra* Part I.A.

16. § 12:1304(A). See *infra* Part I.C. If the secretary of state finds that these documents comply with the formation provisions set forth in Chapter 12, then he must record them and issue a certificate of organization, which serves as conclusive evidence that the LLC has been duly organized “except that in any proceeding brought by the state to annul, forfeit, or vacate a limited liability company’s articles of organization, the certificate of organization shall be only prima facie evidence of due organization.” LA. REV. STAT. ANN. § 12:1304(B) (2010).

17. LA. REV. STAT. ANN. § 12:1301(A)(16) (2010). See *infra* Part I.B.

18. See discussion *infra* Part II.A.

*A. The Articles of Organization*

First, a person must file articles of organization with the secretary of state to form an LLC.<sup>19</sup> An LLC's articles of organization must, at a minimum, state the name of the LLC and the purpose for which it is formed.<sup>20</sup> The hallmark of the LLC, though, is flexibility,<sup>21</sup> and the members or organizers of an LLC may include additional information in the articles of organization if they desire.<sup>22</sup> This additional information may include any provision not inconsistent with law,<sup>23</sup> and Louisiana Revised Statutes section 12:1305(C) sets forth specific examples that an LLC "may" include in its articles of organization.<sup>24</sup> Each of these optional provisions is aimed at assisting third parties in determining who has the authority to manage and bind the LLC.<sup>25</sup>

The statute suggests that an LLC's articles of organization may state "whether and to what extent" managers will direct the LLC.<sup>26</sup> An LLC may be managed by its members or by managers selected by its members.<sup>27</sup> This option essentially allows the members of an

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19. § 12:1304(A). "The articles of organization shall be acknowledged by the person or one of the persons who signed the articles of organization or may be executed by authentic act." *Id.* § 12:1305(A). Note that the term "filing" throughout this Comment encompasses electronic filing. *Id.* § 12:2(A)(1).

20. *Id.* § 12:1305(B). An LLC must also acknowledge whether it is a low-profit LLC. *Id.* The secretary of state website, however, provides two separate articles-of-organization forms depending on whether or not an LLC intends to operate as a low-profit LLC. See Tom Schedler, Sec'y of State, #365 *Articles of Organization-Domestic Limited Liability Company*, <http://www.sos.la.gov/BusinessServices/PublishedDocuments/365ArticlesofOrganizationLouisianaLimitedLiabilityCompany.pdf> (last modified Sept. 2011) [<http://perma.cc/7X7Q-PTXD>] (archived Feb. 24, 2014); Tom Schedler, Sec'y of State, #1L3 *Articles of Organization-Domestic Low-Profit Limited Liability Company*, <http://www.sos.la.gov/BusinessServices/PublishedDocuments/1L3ArticlesofOrganizationLouisianaLowProfitLimitedLiabilityCompany.pdf> (last modified Aug. 2013) [<http://perma.cc/N5JB-G4MQ>] (archived Feb. 24, 2014). Thus, it seems as though this is only required *if* an LLC intends to operate as a low-profit LLC. In addition, if an LLC intends to operate only for a term, it must state its duration. LA. REV. STAT. ANN. § 12:1303(B) (2010). If no duration is stated, the duration of the LLC will be deemed perpetual. *Id.* If an LLC intends to have classes of membership, it must also include that information in the articles of organization or a written operating agreement. SUSAN KALINKA, LLC & PARTNERSHIP BUSINESS AND TAX PLAN § 1.4, in 9 LOUISIANA CIVIL LAW TREATISE 9 (3d ed. 2011).

21. Wisnowski, *supra* note 14, at 194.

22. LA. REV. STAT. ANN. § 12:1305(C) (2010).

23. *Id.* § 12:1305(C)(6).

24. *Id.* § 12:1305(C)(1)–(5).

25. See *id.*; MORRIS & HOLMES, *supra* note 11, § 44.08, at 500–08.

26. § 12:1305(C)(2).

27. *Id.* §§ 12:1311, :1312. Whether management is vested in members or managers, these persons have essentially the same management powers. This

LLC to decide if they want their LLC to be governed more like a partnership or a corporation.<sup>28</sup> Unless the LLC includes a provision in the articles of organization stating that it wishes to be managed by managers,<sup>29</sup> the default position is that members will manage the LLC.<sup>30</sup>

The provision delineating management authority, and any other provision contained in the articles of organization, may be amended by a majority vote of the LLC's members.<sup>31</sup> When the members approve a change, a manager or member–manager must file articles of amendment with the secretary of state.<sup>32</sup> Members of an LLC may prefer, however, that some of the operating provisions of the company be more easily amended; these provisions can be included in the operating agreement, which need not be filed.<sup>33</sup>

### *B. The Operating Agreement*

Many of the provisions that an LLC may want to include in its articles of organization could optionally be included in a written operating agreement,<sup>34</sup> but this document is not required for the

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includes the power to act as an agent for the LLC in the ordinary course of its business, *id.* § 12:1317, and the power to vote in decisions regarding the management of the LLC, *id.* §§ 12:1316, :1318(B).

28. HAMILTON ET AL., *supra* note 11, at 1184. Partnerships are run informally by the owners in the business, MORRIS & HOLMES, *supra* note 11, § 2.14, at 87 (“The underlying assumption of the law’s rules on partnership management is that partners are essentially co-proprietors who ought to have normal proprietary powers to make decisions and enter into transactions on behalf of their businesses.”), while corporations are managed by a board of directors and owners take a more passive role, LA. REV. STAT. ANN. § 12:81(A) (2010); MORRIS & HOLMES, *supra* note 11, § 14.01, at 419.

29. §§ 12:1305(C)(2), :1312(A). These managers may be, but need not also be, members of the LLC. *Id.* § 12:1312(A).

30. *Id.* § 12:1311. These members with management authority will be referred to as “member–managers” throughout this Comment.

31. *Id.* § 12:1318(B)(6). Although an alternative provision can be provided for in the articles of organization or written operating agreement, the term “majority” means a majority of the members, not a majority in financial interest. *Id.* § 12:1318(A); KALINKA, *supra* note 20, § 1.4, at 11.

32. LA. REV. STAT. ANN. § 12:1309 (2010).

33. KALINKA, *supra* note 20, § 1.5, at 17. See LA. REV. STAT. ANN. §§ 12:1304(A), :1319(A)(5) (2010); *infra* note 34.

34. An LLC may choose to include some of its operating provisions in the operating agreement, rather than the articles of organization, for two reasons: First, the operating agreement is private because it need not be filed. § 12:1319(A)(5); CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW § 5.06(1)(b), at 5-165 (1994) (“Most, if not all, matters disclosed in an operating agreement can also be stated in the articles of

formation of an LLC.<sup>35</sup> An operating agreement is any oral or written agreement among the members memorializing the affairs and conduct of the company.<sup>36</sup> Unlike articles of organization, an LLC need not file its written operating agreement with the secretary of state, but a copy must be kept at the LLC's registered office.<sup>37</sup> Likewise, any amendments made to the document need only be approved by majority vote,<sup>38</sup> drafted, and kept at the LLC's registered office.<sup>39</sup>

### C. The Initial Report

In addition to the operating provisions contained in the operating agreement and articles of organization, an LLC must provide the secretary of state with contact information in its initial report.<sup>40</sup> An initial report must be filed with the secretary of state at the time the LLC is formed<sup>41</sup> and contain a list of the names and addresses of each of its managers or member-managers if its members plan to manage the LLC.<sup>42</sup> It must also provide the location and address of the LLC's registered office, the name and address of each of its registered agents, and a notarized affidavit of

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organization, but, since the operating agreement has the advantage of privacy, it will ordinarily be the location of choice.”). *Cf.* NAT'L ASSOC. OF SEC'YS OF STATE, *supra* note 7, at 9 (stating that a secretary of state has “no authority to control who can view or gain access to state business filings, which are public record”). Second, the operating agreement is more easily and inexpensively amended than the articles of organization. KALINKA, *supra* note 20, § 1.5, at 17 (stating that if the company wants the provisions to be amended more easily and without a filing fee, it will put them in the operating agreement, or if it wants a provision to be more difficult to amend, in the articles of organization). *Compare* § 12:1319(A)(5), with § 12:1309.

35. *Advanced Orthopedics, L.L.C. v. Moon*, 656 So. 2d 1103, 1105–06 (La. Ct. App. 1995) (“[W]e are aware of no requirement in the law that an L.L.C. have an operating agreement to be viable.”); KALINKA, *supra* note 20, § 1.5, at 14–18.

36. LA. REV. STAT. ANN. § 12:1301(A)(16) (2010). “An operating agreement is contractual in nature; thus, it binds the members of the LLC as written and is interpreted pursuant to contract law.” *E.g.*, *Risk Mgmt. Servs., L.L.C. v. Moss*, 40 So. 3d 176, 180 (La. Ct. App. 2010). An operating agreement is much like a corporation's bylaws. KALINKA, *supra* note 20, § 1.5, at 14.

37. § 12:1319(A)(5).

38. *Id.* § 12:1318(B)(6).

39. *Id.* § 12:1319(A)(5).

40. *See id.* § 12:1305(E).

41. *Id.* § 12:1304(A).

42. *Id.* § 12:1305(E)(4). If the first managers or member-managers were not selected at the filing of the initial report, a supplementary report must be filed setting forth their names and addresses as soon as they have been selected. *Id.* In each situation, the address provided must be a municipal address, not a post office box. *Id.* § 12:1305(E)(1), (2), (4).

acknowledgement signed by each of its agents.<sup>43</sup> The initial report is the primary focus of this Comment, and many of its facets will be explored including: its importance,<sup>44</sup> the ease at which it is amended,<sup>45</sup> and the problems it has caused in LLC law.<sup>46</sup>

*1. Importance: The Initial Report Informs Third Parties of an LLC's Managers and Agents for Process*

The initial report is an important document because it allows third parties to determine who has management authority in an LLC and upon whom process can be served.<sup>47</sup> Third parties may seek to determine who has management authority in an LLC to ensure, for example, that they are dealing with an authorized person prior to making a loan<sup>48</sup> or entering into a real estate transaction.<sup>49</sup> A third party may also use the initial report to determine who can receive process on behalf of the LLC.<sup>50</sup> In varying situations, service of process may be made on an LLC by personal service on one of its registered agents, managers, or member-managers.<sup>51</sup> If none of

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43. *Id.* § 12:1305(E). Each person, or an agent who is authorized by a document attached to the report, who signed the articles of organization must sign the initial report. *Id.* § 12:1305(E)(4).

44. *See infra* Part I.C.1.

45. *See infra* Part I.C.2.

46. *See infra* Part II.

47. KALINKA, *supra* note 20, § 1.4, at 11–12. *See* MORRIS & HOLMES, *supra* note 11, § 8.02, at 286 (“This initial report [in corporation law] essentially tells the public who initially has the power to manage the corporation and who in the state has authority to receive service of process on its behalf.”); James H. Brown, *Corporations and Partnerships: Administrative and Legislative Developments*, 28 LA. B. J. 127, 127 (1980) (“Without this current information it is also impossible, in many cases, for state agencies to know the individuals with whom they were contracting on behalf of the state.”). All documents filed with the secretary of state are public records and subject to examination by third parties. *See* LA. REV. STAT. ANN. § 44:31 (2010); NAT’L ASSOC. OF SEC’YS OF STATE, *supra* note 7, at 9 (stating that a secretary of state has “no authority to control who can view or gain access to state business filings, which are public record”).

48. DAVID S. WILLENZIK, LOUISIANA SECURED TRANSACTIONS § 10:46, *in* LOUISIANA PRACTICE SERIES 534 (2011–2012 ed.) (instructing lenders to review the LLC’s organizational documents to determine who has authority to sign loan documents).

49. *See* PETER S. TITLE, LOUISIANA REAL ESTATE TRANSACTIONS § 6:76, *in* LOUISIANA PRACTICE SERIES 313 (2011–2012 ed.) (instructing attorneys to review an LLC’s initial report).

50. KALINKA, *supra* note 20, § 1.4, at 11–12. *See* MORRIS & HOLMES, *supra* note 11, § 8.02, at 286.

51. LA. CODE CIV. PROC. art. 1266 (2014). Service of process must first be attempted on the LLC’s registered agent. *Id.* If no agent has been designated, the agent has died, the agent has resigned or been removed, or if after due diligence a



these alternative methods of service can be satisfied, a litigant may serve process on the secretary of state, who must then forward notice of the pending litigation to the LLC's last known address.<sup>52</sup> The initial report facilitates the service of process by providing the names and addresses of the LLC's registered agent, the names and addresses of those persons with management power, and the address of the LLC's registered office.<sup>53</sup> If an LLC does not have this information current with the secretary of state, it may not receive notice of pending litigation in time to prepare a defense and may risk having a default judgment brought against it.<sup>54</sup> Thus, it is important to both the LLC and third parties that the secretary of state has this information on file because it aids in both business transactions and litigation.

## 2. Amendment: The Initial Report's Flexibility

Public access to an LLC's current information is so critical that the Legislature intentionally made the initial report easy to amend so that an LLC's information could be regularly updated.<sup>55</sup> The Legislature chose to divide the corporate formation requirements, which were then adopted into LLC law, into the initial report and articles of incorporation in order to clarify that while the articles of incorporation require a vote of approval to amend, the initial report does not.<sup>56</sup> To amend its initial report, an LLC need only file an annual report,<sup>57</sup> a "Notice of Change of Members and/or Managers of a Limited Liability Company" form,<sup>58</sup> or a certificate of correction.<sup>59</sup>

### a. The Annual Report

An LLC must file an annual report that sets forth essentially the same information as the initial report.<sup>60</sup> The annual report simply requires the LLC to perform the administrative task of

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person attempting to make service is unable to serve the designated agent, service may be made on any manager or member-manager. *Id.*

52. *Id.* art. 1267.

53. LA. REV. STAT. ANN. § 12:1305(E) (2010). *See* art. 1266.

54. KALINKA, *supra* note 20, § 1.4, at 11–12.

55. MORRIS & HOLMES, *supra* note 11, § 8.01, at 286 n.1.

56. *Id.* *See supra* Part I.A. *Compare* § 12:1305(E), *with id.* § 12:24, *and id.* § 12:101.

57. LA. REV. STAT. ANN. § 12:1308.1(A) (2010). *See infra* Part I.C.2.a.

58. Schedler, *supra* note 2. *See infra* Part I.C.2.b.

59. LA. REV. STAT. ANN. § 12:1310(F) (2010). *See infra* Part I.C.2.c.

60. *Compare* § 12:1308.1(A), *with id.* § 12:1305(E).

keeping the contact information it has filed with the secretary of state up-to-date.<sup>61</sup> The annual report must state the address of the LLC's registered office, the name and address of its registered agents, and the names and addresses of parties with managerial power in the LLC, regardless of whether management is vested in managers or members.<sup>62</sup> An annual report, therefore, gives an LLC the opportunity to amend its initial report on a yearly basis if any of the substantive information has changed. The annual report is so easily filed that only one manager or member-manager is needed to sign and file it, and there is no requirement of member or manager approval.<sup>63</sup> In fact to make the process even easier, in 2009, the Louisiana Secretary of State digitized annual report filing.<sup>64</sup> Now, a member or member-manager need only edit and update the information currently on file with the secretary of state through a website he or she can access using the company's charter number and a unique user identification number.<sup>65</sup>

If an annual report is not timely filed, the LLC is considered to be "not in good standing" and is prohibited from entering into contracts with the State or its entities.<sup>66</sup> In addition, the secretary of state *must* revoke the LLC's articles of organization if an LLC has not filed an annual report for more than three years.<sup>67</sup> This revocation effectively terminates the limited liability enjoyed by the company.<sup>68</sup> These strict filing requirements again indicate the importance of updating the information contained in the initial report, which is vital to apprise third parties of who in the LLC has management authority and who can accept service of process for the company.<sup>69</sup>

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61. See Brown, *supra* note 47, at 127 (stating that annual reports furnish "the public with . . . necessary current corporate information").

62. § 12:1308.1(A).

63. *Id.*

64. Jay Dardenne, *Secretary of State's Office Offering New Services to Aid Entrepreneurs, Businesses*, 57 LA. B. J. 174, 175 (2009).

65. *Id.*

66. LA. REV. STAT. ANN. § 12:1308.2(E)(2) (2010). See Brown, *supra* note 47, at 127.

67. LA. REV. STAT. ANN. § 12:1308.2(A) (2010). See Brown, *supra* note 47, at 127.

68. KALINKA, *supra* note 20, § 1.4, at 12. Without articles of organization on file with the secretary of state, the company will be treated as a sole proprietorship or general partnership, which do not enjoy limited liability. *Id.* The company can avoid this treatment only if it can prove it is a *de facto* limited liability entity or that limited liability exists by estoppel. *Id.*

69. *Id.*

*b. The “Notice of Change of Members and/or Managers of a Limited Liability Company” Form*

The importance of the information provided in an LLC’s initial report is echoed by the opportunities the LLC is given to update its information more frequently than is required by the annual report.<sup>70</sup> An LLC may file both the “Notice of Change of Members and/or Managers of a Limited Liability Company” form (notice of change form)<sup>71</sup> and the certificate of correction *at will*.<sup>72</sup> The notice of change form allows an LLC to change the members or managers listed on the secretary of state’s records at any time.<sup>73</sup> One manager or member–manager may unilaterally sign and file this form, and the form makes no mention of a member vote requirement prior to filing.<sup>74</sup> Though there is no statutory authorization for the notice of change form, the Louisiana Secretary of State’s website offers the form to the public to facilitate the revision of its records.<sup>75</sup>

*c. The Certificate of Correction*

In addition to a notice of change form, an LLC may file a certificate of correction to remedy any erroneous information contained in the initial report.<sup>76</sup> These certificates may be used when any of the documents filed with the secretary of state contain an “inaccurate record of the action therein referred to or [have] been defectively executed.”<sup>77</sup> Like the annual report and notice of change form, only one manager or member–manager is needed to execute, sign, and file the certificate of correction with the secretary of state.<sup>78</sup> The certificate of correction, though, must either be acknowledged by one of the persons who signed it or be in the form of an authentic act.<sup>79</sup> This heightened formality is due

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70. See LA. REV. STAT. ANN. § 12:1310(A) (2010); Schedler, *supra* note 2.

71. Schedler, *supra* note 2.

72. § 12:1310(A).

73. See Schedler, *supra* note 2.

74. See *id.*

75. See *id.* This form may be an analogy to Louisiana Revised Statutes sections 12:1308(C) and 12:1350(B), which authorize an LLC or foreign LLC, respectively, to change its registered agent “by filing for record with the secretary of state.” LA. REV. STAT. ANN. §§ 12:1308(C), :1350(B) (2010).

76. § 12:1310(A).

77. *Id.*

78. *Id.* § 12:1310(F).

79. *Id.* § 12:1310(G). An authentic act is a writing executed before a notary public or other officer authorized to perform that function, in the presence of two witnesses, and signed by each party who executed it, by each witness, and by each notary public before whom it was executed. LA. CIV. CODE art. 1833(A) (2014).

to the fact that the certificate of correction can amend any document filed with the secretary of state; thus, its filing requirements match those of the document with the highest level of formality, the articles of organization.<sup>80</sup>

As the preceding overview indicates, amending an initial report filed with the secretary of state is not a particularly formal or arduous process.<sup>81</sup> The annual report, notice of change form, and certificate of correction each require the signature of only one manager or member-manager to be filed with the secretary of state.<sup>82</sup> The law does not require that any sort of vote be held among the members or managers prior to the filing of these documents.<sup>83</sup> The lack of a vote requirement means that the information included in an LLC's initial report—such as a list of its members—can be easily and unilaterally amended. Although these provisions may seem surprising, they are intentional.<sup>84</sup> They ensure that the information found in the initial report remains up-to-date so that third parties dealing with an LLC can determine who has management authority in the company and who is an agent for service of process.<sup>85</sup>

## II. THE PROBLEMS: MEMBER-MANAGED LLCs HAVE UNIQUE INITIAL REPORTS WITH UNIQUE PROBLEMS

Although the initial report is an important document for the secretary of state to have in its records for each LLC, it is problematic for member-managed LLCs. Because of the adoption of corporate formation law into LLC formation law,<sup>86</sup> the initial report of a member-managed LLC creates a unique, formal, and public list of owners in the entity. Courts have been unable to resist the temptation to treat these lists as determinative of ownership in the resolution of membership disputes.<sup>87</sup> This problem is

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80. § 12:1310(A). The filing requirements match those of the articles of organization. *See id.* § 12:1305(A).

81. *See supra* Part I.C.2.

82. *See* LA. REV. STAT. ANN. §§ 12:1308.1(A), :1310(A) (2010) (requiring certificate of correction to also be either acknowledged by one of the persons who signed it or be in the form of an authentic act); Schedler, *supra* note 2.

83. *See* §§ 12:1308.1(A), :1310(A); Schedler, *supra* note 2.

84. MORRIS & HOLMES, *supra* note 11, § 8.01, at 286 n.1 (stating that the Legislature divided corporate formation requirements into the initial report and articles of incorporation to clarify that the initial report does not require a vote to amend). *See supra* Part I.C.2.

85. *See supra* Part I.C.1.

86. MORRIS & HOLMES, *supra* note 11, § 44.01, at 484. *See* Wisnowski, *supra* note 14, at 193–94.

87. *See* Settles v. Paul, 61 So. 3d 854 (La. Ct. App. 2011); Moise v. Moise, 956 So. 2d 9 (La. Ct. App. 2007); *infra* Part II.C.

compounded by an increase in incidences of business identity theft,<sup>88</sup> and recent legislation aimed at addressing this criminal activity has only furthered the confusion regarding the probative value of LLC organizational documents.<sup>89</sup>

*A. The Adoption of Corporation Law into LLC Law Creates a Unique and Tempting Member List in Member-Managed LLCs*

An LLC is required to include a list of those with management authority in the entity in its initial report.<sup>90</sup> Thus, a member-managed LLC is required to list its members.<sup>91</sup> This requirement creates a public list of owners of the entity that is unique to the member-managed LLC.<sup>92</sup> The member list of a member-managed LLC is a convenient, official, and public document that tempts courts to treat it as determinative of ownership in the resolution of membership disputes.<sup>93</sup>

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88. See NAT'L ASSOC. OF SEC'YS OF STATE, *supra* note 7, at 5–8; *infra* Part II.B.

89. LA. REV. STAT. ANN. §§ 12:2.2 (creating an electronic notification system when a member's name is removed from an organizational document with the secretary of state), :1701 (creating a cause of action for a member who has been fraudulently removed from these documents) (Supp. 2013). See *infra* Part II.B.

90. LA. REV. STAT. ANN. § 12:1305(E)(4) (2010).

91. *Id.*

92. Manager-managed LLCs need only list managers, not members. *Id.* The requirement that an entity lists its owners as having management authority in the entity is, however, also seen in a partnership, which requires that a contract of partnership be filed with the secretary of state if the partnership's ownership of property is to be effective against third persons. LA. CIV. CODE art. 2806(B) (2014). The contract of partnership is required, among other things, to state the name and address of each partner. LA. REV. STAT. ANN. § 9:3403 (2010). These partner lists, however, are beyond the scope of this Comment.

93. See *Settles v. Paul*, 61 So. 3d 854 (La. Ct. App. 2011); *Moise v. Moise*, 956 So. 2d 9 (La. Ct. App. 2007); *infra* Parts II.A, C. There are two other situations in LLC law in which a list of members is created that could mislead courts when resolving membership disputes. See LA. REV. STAT. ANN. § 12:1319(A)(1), (D) (2010). Although courts have not yet been misled by these lists like the ones contained in the initial reports of member-managed LLCs, these lists present a danger because of their incompatibility with LLC law, as they were adapted from similar provisions in corporation law. Compare *id.* § 12:1319(A)(1), with *id.* § 12:103(B); compare *id.* § 12:1319(D), with *id.* § 12:79. The first list is created by the requirement that an LLC keep a current list of the name and address of each of its members at its registered office to apprise other members of who has voting power in the LLC. *Id.* § 12:1319(A)(1). The second list is created by the requirement that an LLC keep a record of its owners in accordance with the registered ownership rule, which states that an LLC may treat those on its record as an owner for all purposes, regardless of knowledge to the contrary. *Id.* § 12:1319(D). See generally WILLIAM D. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE 877 (1964). Both of these lists seek to inform the LLC or its members of the other members in the entity. These lists are

The requirement that an LLC list those with management authority in the entity in its initial report comes from corporation law.<sup>94</sup> In corporation law, a corporation must only list its directors, who need not be owners in the entity.<sup>95</sup> In addition, there is no provision in Louisiana corporation law that would allow a corporation to be managed directly by its owners,<sup>96</sup> known as “shareholders.”<sup>97</sup> Because shareholders do not have management authority, they are not listed as those with management authority in the corporation’s initial report.<sup>98</sup> Thus, the provision that requires a corporation to list the entity’s directors in its initial report does not create a public list of shareholders filed with the secretary of state.<sup>99</sup>

Upon adopting this provision into LLC law, however, the result is quite different.<sup>100</sup> When a member-managed LLC lists those who have management authority in the entity, a public list of owners will always be created, and courts have treated these lists as

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incompatible with LLC law because under LLC law, unlike the corporation law from which these rules were adopted, there is no situation in which a member can be admitted without unanimous consent of the other members. *See* LA. REV. STAT. ANN. § 12:1332(A)(1) (2010); KALINKA, *supra* note 20, § 1.41, at 119–20. Therefore, a list that appraises the LLC and its members of the other members in the company is unnecessary because each of the members will have had a hand in admitting each of the other members. *See* § 12:1332(A)(1); KALINKA, *supra* note 20, § 1.41, at 119–20. Because these lists serve no valuable purpose in LLC law, they only stand to confuse courts as to their probative value concerning ownership and, thus, should be repealed.

94. MORRIS & HOLMES, *supra* note 11, § 44.01, at 484.

95. LA. REV. STAT. ANN. §§ 12:101(3), :81(A) (2010). Directors are much like managers in an LLC because they are vested with managerial authority in the entity. *Id.* § 12:81(A); MORRIS & HOLMES, *supra* note 11, § 44.02, at 484–85.

96. MORRIS & HOLMES, *supra* note 11, § 14.03, at 422 (“While a number of states have enacted statutes permitting direct shareholder management of such corporations without the necessity of a formal board of directors, Louisiana has yet to do so.”). Corporation law was intentionally drafted this way because shareholders are meant to be passive contributors of capital and ownership interests in a corporation may be transferred frequently. *Id.* § 14.02, at 421–22. These rules, however, were created with large corporations in mind and are antithetical to the way that most closely held corporations actually operate. *Id.* § 28.01, at 688.

97. LA. REV. STAT. ANN. § 12:1(R) (2010); MORRIS & HOLMES, *supra* note 11, § 14.02, at 421.

98. *See* §§ 12:101(3), :81(A).

99. A corporation need only publish the names of its shareholders if it contracts with the State and even then only the names of shareholders who own more than a 5% interest in the company. *Id.* § 12:25(E)(2). In addition, this does not apply to agreements entered into between the State and corporations for electric or gas service, publicly traded corporations, or state-chartered banks. *Id.*

100. *Id.* § 12:1305(E)(4).

determinative of ownership in the resolution of membership disputes.<sup>101</sup> Courts and lawyers may be tempted to look to these lists as determinative of ownership because they are accustomed to referring to written documentation of ownership—such as corporate stock certificates—in resolving business ownership disputes.<sup>102</sup>

There are several reasons why the treatment of these member lists as determinative of ownership is illogical and inappropriate. First, the use of a member list in this way goes beyond the purpose of the initial report, which is to assist third parties in determining who has management authority in the LLC and who can accept service of process on behalf of the LLC.<sup>103</sup> Although its inclusion in the initial report is important for these purposes, it does not relate to ownership and certainly does not create an ownership right that a person does not already possess.<sup>104</sup>

Second, this treatment is inappropriate because any person may form an LLC by filing the required documents, regardless of whether he or she is a member of that LLC.<sup>105</sup> Thus, there is no guarantee that the person who formed an LLC was apprised of every member of that LLC prior to filing the company's initial report.

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101. See *Settles v. Paul*, 61 So. 3d 854 (La. Ct. App. 2011); *Moise v. Moise*, 956 So. 2d 9 (La. Ct. App. 2007); see *infra* Part II.C.

102. See LA. REV. STAT. ANN. § 12:1(F) (2010) (“‘Certificate of stock’ means a properly executed instrument evidencing the fact that the person therein named is the registered owner of the shares therein described.”). Courts treat stock certificates as *prima facie* evidence of corporate ownership. *E.g.*, *Ackel v. Ackel*, 595 So. 2d 739, 741 (La. Ct. App. 1992); *Int’l Stevedores, Inc. v. Hanlon*, 499 So. 2d 1183, 1188 (La. Ct. App. 1986); *Fireplace Shop, Inc. v. Fireplace Shop of Lafayette, Inc.*, 400 So. 2d 702, 703 (La. Ct. App. 1981).

103. See *supra* Part I.C.1.

104. Secretary of State Tom Schedler acknowledged that there is “no correlation” between organizational documents and ownership. Recording: Hearing on S.B. 595 Before the Senate and Governmental Affairs Committee, 2012 Regular Session Louisiana Senate (March 20, 2012) [hereinafter Committee Hearing], available at <http://senate.legis.state.la.us/video/2012/March/032012S&GA.aspx> [<http://perma.cc/LL9M-GMXV>] (archived Feb. 24, 2014) (statement of Secretary of State Tom Schedler). The Louisiana Public Records Doctrine is a helpful analogy to this idea. Under Louisiana law, the transfer of ownership is effective between the buyer and seller upon agreement, but it is not effective against third parties until the transfer has been recorded in parish conveyance records. LA. CIV. CODE art. 517 (2014). The fact that a transfer is recorded, however, does not mean that it is necessarily valid or that the person with the record title is the owner. *Id.* art. 3341; TITLE, *supra* note 49, § 8:16, at 476–77. “The public records doctrine . . . does not create rights in the positive sense.” *Id.* Likewise, the fact that a person is listed in an LLC’s initial report does not create an ownership right. A third person may rely on this list in determining who in the LLC has management power, but it does not affect existing ownership rights as between the members of the LLC.

105. LA. REV. STAT. ANN. § 12:1305(A) (2010).

Third, by regarding these member lists as determinative of ownership, courts arbitrarily treat the determination of ownership in a member-managed LLC differently from that of a manager-managed LLC merely because the entities have different management structures. Because the initial report of a manager-managed LLC lists only managers, and not the LLC's members, there is no public member list that a court might use to determine ownership in a manager-managed LLC.<sup>106</sup> Thus, using such a list in the determination of membership in a member-managed LLC treats the determination of ownership in the two types of LLCs differently.

Fourth, it is illogical to treat these lists as controlling of membership because they are so easily amended.<sup>107</sup> Because any member-manager can unilaterally amend the list of members contained in an initial report, there is no guarantee that such a list is accurate or all-inclusive.<sup>108</sup> In light of the recent increase in the crime of business identity theft,<sup>109</sup> there is also no guarantee that these lists are not fraudulent, and thus, it would be particularly unfortunate to treat these lists as determinative of ownership.

*B. The Business Identity Theft Act Increases Confusion Surrounding LLC Member Lists*

The National Association of Secretaries of State (NASS) recently recognized business identity theft as a real and growing problem.<sup>110</sup> Business identity theft encompasses a wide variety of crimes involving the fraudulent use of a company's identity.<sup>111</sup> Specifically, the term includes the unauthorized alteration of organizational documents filed with the secretary of state.<sup>112</sup> As NASS explained in its comprehensive assessment of the problem, "State trends make it very clear that criminals are looking to exploit state filing systems and business registration websites for financial gain."<sup>113</sup> Typically, these criminals change the entity's officers, registered agents, or registered business address on file with the secretary of state and then utilize those altered records to allege to third parties, such as credit card companies or retailers, that they

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106. *See id.* § 12:1305(E)(4).

107. *See supra* Part I.C.2.

108. *See supra* Part I.C.2.

109. NAT'L ASSOC. OF SEC'YS OF STATE, *supra* note 7, at 5–8. *See also* Noguchi, *supra* note 7.

110. NAT'L ASSOC. OF SECY'S OF STATE, *supra* note 7, at 5–8.

111. *Id.* at 5.

112. *Id.* at 6.

113. *Id.*



have authority in the victim entity.<sup>114</sup> In light of incidents of this crime in Louisiana, the Louisiana Legislature took steps to address some, but not all, of the ramifications of this type of crime.<sup>115</sup>

During the 2012 Regular Session, the Louisiana State Legislature reacted to the instances of fraudulent amendment of business records filed with the Louisiana Secretary of State by passing two companion bills.<sup>116</sup> The first law gives the secretary of state the authority to use electronic communications to notify any person who subscribes to the secretary of state's electronic mail service and is a member or manager of an LLC if a filing occurs "that may have removed that person's name from documents and records of that entity held by the secretary of state."<sup>117</sup> This step serves to at least alert a member that his or her name has been removed from the initial report of an LLC.<sup>118</sup>

The second law passed by the Legislature to address the issue of business identity theft created a cause of action for a member or manager whose name has been "removed from any document or record filed with the secretary of state in violation of state law or in contravention of any document of creation, organization or management of such business entity."<sup>119</sup> The law provides that the secretary of state shall be made a party to the suit, and if the court finds that the name removal was improper or fraudulent, then it must order the secretary of state to replace the name on appropriate

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114. *Id.*

115. Committee Hearing, *supra* note 104 (statement of Secretary of State Tom Schedler). See LA. REV. STAT. ANN. §§ 12:2.2, :1701 (Supp. 2013).

116. See §§ 12:2.2, :1701. At a senate committee hearing regarding this legislation, Secretary of State Tom Schedler acknowledged "several" situations of business identity theft in Louisiana. Committee Hearing, *supra* note 104 (statement of Secretary of State Tom Schedler). In particular, the impetus for this bill involved an individual who was removed from LLC organizational documents filed with the secretary of state by her business partner. *Id.* The partner then used those fraudulent documents "to prove or to allege that that person had no more ownership in the company." *Id.*

117. § 12:2.2. This law was passed as part of the Business Identity Theft Act in conjunction with Louisiana Revised Statutes section 12:2.1, which states that "[a]ny electronic mail address or short message service number submitted to or captured by the secretary of state pursuant to the provisions of this Title shall be confidential and shall not be disclosed by the secretary of state or any employee or official of the Department of State." *Id.* § 12:2.1. It was adopted unanimously by the House of Representatives and with only one "nay" in the Senate. S.B. 595, Leg. Reg. Sess. (La. 2012). It was signed by Governor Bobby Jindal and became effective January 1, 2013. *Id.*

118. Committee Hearing, *supra* note 104 (statement of Secretary of State Tom Schedler).

119. § 12:1701. The bill was adopted unanimously by both houses, signed by Governor Bobby Jindal, and became effective August 1, 2012. S.B. 516, Leg. Reg. Sess. (La. 2012).

documents.<sup>120</sup> The law also requires that an expedited hearing be held on the issue within ten days of service of process on all parties so that no business will be unduly prevented from continuing with daily business activity.<sup>121</sup>

This duo of new laws sufficiently addresses one risk of business identity theft: that an ill-intentioned person could alter business records and then use those records to prove to third parties that he or she is an owner, or that someone else is not an owner, in the business. By providing notification to an LLC member if his or her name is removed from an organizational document, the Legislature has given the member the opportunity to bring a cause of action for an expedited hearing to have his or her name reinstated.<sup>122</sup> The combination of these two laws has reduced or eliminated the opportunity for criminals to use the altered secretary of state documents as proof of ownership to third parties.

The new laws do not, however, address a second, equally serious problem: that courts have treated these organizational documents filed with the secretary of state as determinative of ownership in an LLC.<sup>123</sup> Although this problem exists whether or not the organizational documents at issue have been falsified, the increase in the incidence of this type of fraud makes the problem particularly troubling. The risk that a court might treat an organizational document as determinative of ownership is much more disconcerting when the document is fraudulent, rather than merely incorrect.

Not only do these new laws fail to address this serious problem, but they also *compound* the problem by adding to the confusion surrounding the probative value of these documents. Because these statutes provide both a means of notification of and retribution for the removal of a name from a document filed with the secretary of state,<sup>124</sup> they endorse a false idea: that the inclusion or exclusion of a member from an LLC's initial report is of great significance, or is so significant as to affect ownership rights. A member list in an LLC's initial report does not affect a member's existing ownership rights in the LLC. It merely intends to serve as notice of who has management authority in the entity and who can

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120. § 12:1701(C), (E).

121. *Id.* § 12:1701(D); Recording: Hearing of S.B. 516 Before the Commerce, Consumer Protection, S. and Int'l Affairs Comm., 2012 Regular Session Louisiana Senate (Mar. 28, 2012), available at <http://senate.legis.state.la.us/video/2012/March/032812COM.aspx> [<http://perma.cc/TTG2-LPR9>] (archived Feb. 24, 2014) (statement of Senator A.G. Crowe).

122. See §§ 12:2.2, :1701.

123. See *infra* Part II.C.

124. §§ 12:2.2, :1701.

receive service of process.<sup>125</sup> Courts and attorneys, however, accustomed to referring to other written documentation of ownership, such as stock certificates,<sup>126</sup> are tempted to rely on them as such.<sup>127</sup> In doing so, courts risk committing their own version of business identity theft on members of member-managed LLCs.

*C. Courts Treat Member Lists in Initial Reports as Controlling of Ownership in an LLC*

In two recent cases, Louisiana courts have treated member lists contained in an LLC's initial report as determinative of ownership in a membership dispute.<sup>128</sup> Each of these courts assumed, without question, that these lists were determinative of ownership and allowed this assumption to cloud their analyses.<sup>129</sup> In one instance, the court in *Settles v. Paul* assumed the disputed LLC's initial report was determinative and used an inappropriate legal theory to circumvent that fact.<sup>130</sup> In another instance, the court in *Moise v. Moise* assumed an initial report was determinative—calling it a “definitive designation”—and used its ambiguity to circumvent that fact.<sup>131</sup> Both of these courts reached equitable solutions by using creative analyses, but neither acknowledged that these member lists are not controlling.<sup>132</sup>

*1. The Court in Settles v. Paul Assumes LLC Member List Is Controlling*

In *Settles v. Paul*, a couple, Mr. Settles and Ms. Paul, formed a construction business, Landmark Construction Company of Coushatta, LLC (Landmark).<sup>133</sup> The couple discussed the creation of the company and intended it to be equally owned but listed only

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125. See KALINKA, *supra* note 20, § 1.4, at 11–12.

126. See LA. REV. STAT. ANN. § 12:1(F) (2010). Courts treat stock certificates as *prima facie* evidence of corporate ownership. *Ackel v. Ackel*, 595 So. 2d 739, 741 (La. Ct. App. 1992); *Int'l Stevedores, Inc. v. Hanlon*, 499 So. 2d 1183, 1188 (La. Ct. App. 1986); *Fireplace Shop, Inc. v. Fireplace Shop of Lafayette, Inc.*, 400 So. 2d 702, 703 (La. Ct. App. 1981).

127. See *Settles v. Paul*, 61 So. 3d 854 (La. Ct. App. 2011); *Moise v. Moise*, 956 So. 2d 9 (La. Ct. App. 2007); *infra* Part II.C.

128. See *Settles*, 61 So. 3d 854; *Moise*, 956 So. 2d 9.

129. See *Settles*, 61 So. 3d 854; *Moise*, 956 So. 2d 9.

130. *Settles*, 61 So. 3d at 858–59.

131. *Moise*, 956 So. 2d at 11.

132. See *Settles*, 61 So. 3d 854; *Moise*, 956 So. 2d 9.

133. *Settles*, 61 So. 3d at 856.

Paul as a member on the LLC's organizational documents.<sup>134</sup> Paul was involved in recordkeeping, while Settles was considered the project manager for Landmark and was responsible for all work done by the LLC.<sup>135</sup> The couple shared profits and paid living expenses and home improvement costs out of Landmark's funds.<sup>136</sup> Eventually, the couple ended their relationship, and Paul took the position that she was the sole member and manager of the LLC based on the organizational documents.<sup>137</sup> She denied Settles access to the LLC's records and funds.<sup>138</sup> Settles then brought suit to have his ownership interest in the LLC recognized.<sup>139</sup>

The Louisiana Second Circuit Court of Appeal, in its attempt to find a legal doctrine that would allow it to reach an equitable solution, used the inadvertent partnership theory of partnership law to resolve the issue.<sup>140</sup> This doctrine should not have been applied to the facts of *Settles* for two reasons: First, the business operated by Settles and Paul was an LLC, not a partnership. Partnership law should be utilized only to distinguish the affairs of a business from that of its owners when a business is co-owned and has not been set up as a separate business entity, such as an LLC.<sup>141</sup> Thus, the court did not need to use partnership law in this instance because the entity in question was an LLC.<sup>142</sup>

Second, in using partnership law to resolve the dispute in *Settles*, the court inappropriately applied the inadvertent partnership theory.<sup>143</sup> This theory is based on the idea that because a partnership may be formed by oral contract, parties can form a partnership without intent or without even being aware that they are doing so.<sup>144</sup> In applying this theory, the court found that Settles and Paul, by operation of the construction business, had inadvertently formed a partnership.<sup>145</sup> This partnership was the sole member of the Landmark LLC.<sup>146</sup> It is clear from the facts of the case, though, that the couple intended to form an LLC, not a

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134. *Id.* This was done primarily to protect the LLC from consideration in Settles's child support proceedings with his former wife. *Id.*

135. *Id.*

136. *Id.* at 858–59.

137. *Id.* at 857.

138. *Id.* at 856.

139. *Id.*

140. *Id.* at 859.

141. MORRIS & HOLMES, *supra* note 11, § 1.13, at 30; GLENN MORRIS, BUSINESS ASSOCIATIONS I SUPPLEMENT 161 (2005).

142. *Settles*, 61 So. 3d at 856.

143. *Id.* at 859.

144. MORRIS & HOLMES, *supra* note 11, § 1.01, at 2.

145. *Settles*, 61 So. 3d at 859.

146. *Id.*

partnership.<sup>147</sup> Under the court's analysis, it reached a bizarre solution in which the couple was deemed to have unintentionally created a separate partnership that acted as the parent company of the LLC that they had intended to own equally and directly.<sup>148</sup>

Although unnecessarily complicated and confusing, this theory allowed the court to come to an equitable solution: the reversal of the trial court's granting of Paul's Motion for Involuntary Dismissal.<sup>149</sup> It appears, though, that in coming to this solution, the court felt bound by the fact that Paul was the only member listed in the company's organizational documents and thus applied an inappropriate legal theory to circumvent this fact.<sup>150</sup> Although the court's instinct to look to the facts of the situation was correct, it should have done so more directly. The court likely would have applied a more direct LLC analysis had it understood that the list of members in Landmark's initial report was not controlling of membership in the LLC.

## 2. *Moise v. Moise Declares LLC Member List a "Definitive Designation"*

In another case, *Moise v. Moise*, the Louisiana Fifth Circuit Court of Appeal referred to a member list in an LLC's initial report as a "definitive designation" of the roles of those involved in the LLC.<sup>151</sup> In this partition of community property case, the former wife asserted that she owned part of an LLC with her former husband.<sup>152</sup> Both the former husband and wife were listed in the initial report, as equal owners on the LLC's tax return, and as owners on the LLC's lease agreement.<sup>153</sup> The LLC's only capital was a piece of property that, prior to its transfer to the LLC, was separately owned by Mr. Moise.<sup>154</sup> In arguing that she owned part of the LLC, Mrs. Moise noted that she had contributed services to the LLC by cutting the grass on the transferred property, meeting with the lessee of the transferred property, paying corporate fees, and opening the LLC's bank account.<sup>155</sup> The court ruled that, pursuant to the property transfer, Mr. Moise was the sole member of the LLC.<sup>156</sup> In finding that Mrs. Moise was not a member of the

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147. *Id.* at 856.

148. *See id.* at 859.

149. *See id.* at 860.

150. *See id.* at 858–59.

151. *Moise v. Moise*, 956 So. 2d 9, 11 (La. Ct. App. 2007).

152. *Id.* at 10.

153. *Id.* at 10–11.

154. *Id.* at 11.

155. *Id.* at 10.

156. *Id.* at 11.

LLC, the court relied on the fact that the initial report did not specify whether Mr. and Mrs. Moise were listed as member-managers or merely as managers.<sup>157</sup> The court stated that “while the documents creating the LLC are silent with respect to Mrs. Moise’s *definitive designation* as either a member or manager,” the duties she performed were consistent with those of a manager.<sup>158</sup>

The court only considered Mrs. Moise’s contributions to the LLC because of the ambiguity as to whether the initial report listed member-managers or managers.<sup>159</sup> It is disturbing that the court described the member-manager or manager list in the initial report as a “definitive designation” because doing so assumes that this listing is conclusive as to the roles being asserted.<sup>160</sup> The fact that the initial report was not explicit in this designation is consistent with the idea that this list merely shows who has managerial power; whether those people are member-managers or managers is irrelevant to third parties utilizing this document.<sup>161</sup> This list is in no way intended to be a definitive designation of whether a party is an owner in an LLC.

These two cases are examples of the kinds of dangerous traps into which a court can fall if it is tempted to consider a member list filed by a member-managed LLC with the secretary of state as determinative of ownership. The court in *Settles v. Paul* assumed that the LLC’s member list was determinative and used an inappropriate legal theory to circumvent that fact.<sup>162</sup> In *Moise v. Moise*, the court assumed the list was determinative as to the party’s roles in the LLC and used its ambiguity to circumvent that fact.<sup>163</sup> Both of these courts found ways around deciding these cases based solely on who was listed as a member in the LLCs’ initial reports, but neither understood that these member lists were not controlling. The fact that neither court acknowledged this fundamental point and instead used creative theories to avoid honoring these lists indicates to future courts that these lists really *are* determinative. When these misleading decisions are combined with the new legislation addressing business identity theft, the false impression that inclusion in an LLC’s member list is of great significance is magnified.<sup>164</sup> To combat this confusion, courts need affirmative guidance on the probative value of member lists

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157. *Id.*

158. *Id.* at 10 (emphasis added).

159. *See id.* at 11.

160. *See id.*

161. *See supra* Part I.C.1.

162. *Settles v. Paul*, 61 So. 3d 854, 858–59 (La. Ct. App. 2011).

163. *Moise*, 956 So. 2d at 11.

164. *See supra* Part II.B.

contained in initial reports filed with the secretary of state and direction as to the proper considerations in resolving future membership disputes.<sup>165</sup>

### III. THE SOLUTION: A FACT-BASED ANALYSIS SHOULD RESOLVE LLC MEMBERSHIP DISPUTES

The proper resolution of an LLC membership dispute should take into account the facts and circumstances of each situation and consider the member list in an initial report as merely one piece of evidence in the totality of evidence. The courts in *Settles v. Paul* and *Moise v. Moise* were, in fact, on the right track in resolving the membership disputes that arose in these cases because they ultimately considered the facts of each situation before ruling.<sup>166</sup> Although both courts treated the member lists in the initial reports of the disputed LLCs as determinative of ownership, both courts also recognized that mechanically honoring those lists is not always equitable.<sup>167</sup> Courts should explicitly acknowledge that member lists in the initial reports of member-managed LLCs are not determinative of ownership. To properly resolve LLC membership disputes, courts should look to the facts and circumstances of each situation by analogy to an analysis that is already used to resolve ownership disputes in closely held corporations.<sup>168</sup>

In ownership disputes involving closely held corporations, courts apply a fact-based analysis to resolve issues in which a shareholder, or purported shareholder, seeks to have his or her ownership interest recognized.<sup>169</sup> This same analysis should also be used to resolve membership disputes in LLCs. This application is appropriate because courts frequently analogize to existing corporate doctrines to resolve LLC issues because corporation law heavily influenced the drafting of LLC law.<sup>170</sup> Further, LLCs are markedly similar to closely held corporations. Thus, analogizing an

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165. See *infra* Part III.

166. See *Settles*, 61 So. 3d at 859; *Moise*, 956 So. 2d at 11.

167. See *Settles*, 61 So. 3d 854; *Moise*, 956 So. 2d 9.

168. See *infra* Part III.A.

169. See, e.g., *Ackel v. Ackel*, 595 So. 2d 739, 741–42 (La. Ct. App. 1992); *Int'l Stevedores, Inc. v. Hanlon*, 499 So. 2d 1183, 1188 (La. Ct. App. 1986); *Fireplace Shop, Inc. v. Fireplace Shop of Lafayette, Inc.*, 400 So. 2d 702, 703–04 (La. Ct. App. 1981); *Dardeau v. Fontenot*, 326 So. 2d 521, 524–25 (La. Ct. App. 1976); *Scobee v. Cont'l Hotel Corp.*, 242 So. 2d 610, 612 (La. Ct. App. 1970); see also *MORRIS & HOLMES*, *supra* note 11, § 10.11, at 359–61; *infra* Part III.A.

170. *HAMILTON ET AL.*, *supra* note 11, at 1186. See *MORRIS & HOLMES*, *supra* note 11, § 44.01, at 484 (stating that Louisiana's LLC formation requirements were adopted from existing Louisiana corporate law).

issue involving LLCs to an issue involving closely held corporations is fitting.

A closely held corporation is a term of art used to distinguish a corporation that possesses at least some of these characteristics:

- (1) A relatively small number of shareholders;
- (2) No public market for, nor active trading in its shares;
- (3) Close identity between shareholders (owners) and management;
- (4) A desire to operate the business in an informal manner akin to the general partnership; and
- (5) A desire by the shareholders to control the identity of their business associates.<sup>171</sup>

Noticeably, each of these characteristics could be used to describe an LLC as well.<sup>172</sup> In fact, commentators believe that the LLC will likely replace the closely held corporation and “emerge as the dominant form of business for non-publicly traded entities.”<sup>173</sup> Thus, it is logical to apply an analysis used to resolve disputes in closely held corporations to the same type of disputes in the similarly constructed LLC.

#### *A. A Fact-Based Analysis Resolves Ownership Disputes in Closely Held Corporations*

The analysis used to resolve ownership disputes in closely held corporations looks to the facts and circumstances of each dispute.<sup>174</sup> Traditionally, stock certificates are issued to prove ownership in a

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171. MORRIS & HOLMES, *supra* note 11, § 28.01, at 668.

172. In LLC law, the assignment rules prohibit public trading of ownership in an LLC and allow members to have control over with whom they wish to operate the business. LA. REV. STAT. ANN. §§ 12:1330, :1332 (2010); KALINKA, *supra* note 20, § 1.38, at 103–04. Management is left to the LLC’s owners by default, which is similar to the informal management of a partnership. LA. REV. STAT. ANN. § 12:1311 (2010); HAMILTON ET AL., *supra* note 11, at 1184.

173. HAMILTON ET AL., *supra* note 11, at 1184. See MORRIS & HOLMES, *supra* note 11, § 28.01, at 668 (“One of the great paradoxes of corporate law is that, to a large extent, these attributes of the close[ly held] corporation are antithetical to the ordinary statutory corporate model. Of the four classic distinguishing features of corporations—limited liability of shareholders; centralized management; continuity of existence; and free transferability of shares—most shareholders of close[ly held] corporations would aspire primarily to achieve [only] limited liability.”).

174. See, e.g., *Ackel*, 595 So. 2d at 741–42; *Int’l Stevedores, Inc.*, 499 So. 2d at 1188; *Fireplace Shop, Inc.*, 400 So. 2d at 703–04; *Dardeau*, 326 So. 2d at 524–25; *Scobee*, 242 So. 2d at 612; see also MORRIS & HOLMES, *supra* note 11, § 10.11, at 359–61.



corporation.<sup>175</sup> In ownership disputes involving closely held corporations, however, courts have held that these certificates merely evidence ownership of a share of stock but do not *determine* ownership as between the purported shareholders.<sup>176</sup> This treatment of stock certificates allows courts to utilize a fact-based analysis and consider other factors in the determination of the closely held corporation's true owners.<sup>177</sup> This analysis, which should be applied in LLC membership disputes, generally looks to two broad considerations: (1) the relative importance of the ambiguous shareholder's contributions to the business and (2) any acts or statements made by the corporation or other shareholders that would have caused the ambiguous shareholder to believe that he was an owner, even without the formal issuance of stock certificates.<sup>178</sup>

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175. LA. REV. STAT. ANN. § 12:1(F) (2010) (“Certificate of stock’ means a properly executed instrument evidencing the fact that the person therein named is the registered owner of the shares therein described.”).

176. Courts treat stock certificates as only *prima facie* evidence of corporate ownership and distinguish them from actual ownership. *E.g.*, *Ackel*, 595 So. 2d at 741; *Int’l Stevedores, Inc.*, 499 So. 2d at 1188; *Fireplace Shop, Inc.*, 400 So. 2d at 703. *See also Scobee*, 242 So. 2d at 613 (“From the foregoing it is very plain that a certificate of stock is merely a paper evidence created for convenience, of the ownership of the share of stock; That it is not the thing which is in reality the subject of the ownership; that the thing which is in reality the subject of the ownership is the share of stock itself.” (quoting *Succession of McGuire*, 92 So. 40 (La. 1922))); *MORRIS & HOLMES, supra* note 11, § 10.11, at 360 (“The formal statutory rules concerning share issuance transactions play a very small part in these decisions [involving ownership disputes brought by ambiguous shareholders in closely held corporations]. Indeed, the one legal rule that is most frequently applied in these cases is a rejection, not an affirmation, of formalism. It holds that as between the parties to a transaction, share certificates simply evidence ownership, they do not determine it.”). This treatment allows for the logical application of this analysis to LLC law because LLCs do not typically issue stock certificates. *See* JAMES S. HOLLIDAY, JR. & RICK J. NORMAN, *LOUISIANA CORPORATIONS* § 21:22, in 2 *LOUISIANA PRACTICE SERIES* 301 (2011–2012 ed.) (“Unlike the corporate shareholder whose ownership is evidenced by a stock certificate, the member of an LLC does not generally have any certificate of ownership. However, frequent transfers of ownership in an LLC are not expected.”).

177. *See, e.g.*, *Ackel*, 595 So. 2d at 741–42; *Int’l Stevedores, Inc.*, 499 So. 2d at 1188; *Fireplace Shop, Inc.*, 400 So. 2d at 703–04; *Dardeau*, 326 So. 2d at 524–25; *Scobee*, 242 So. 2d at 612.

178. *MORRIS & HOLMES, supra* note 11, § 10.11, at 359. In corporation law, this analysis has been used in three types of situations involving the payment for and issuance of stock certificates. First, the analysis has been applied when stock certificates are promised but never issued. *See, e.g.*, *Int’l Stevedores, Inc.*, 499 So. 2d at 1188; *Fireplace Shop, Inc.*, 400 So. 2d at 702–03; *Redemer v. Hollis*, 347 So. 2d 48, 50 (La. Ct. App. 1977); *Dardeau*, 326 So. 2d at 524–25 (stating that plaintiff’s “failure to take possession of the executed and endorsed stock certificate does not affect” his interest in the corporation); *Chapman v. Hamer’s Welding & Equip. Corp.*, 241 So. 2d 289, 291 (La. Ct. App. 1970) (stating that plaintiff, who

This fact-based approach focuses more on considerations of fairness rather than on statutory provisions.<sup>179</sup>

### *1. Relative Contributions of the Ambiguous Shareholder*

The first factor that courts consider in resolving ownership disputes in closely held corporations is the relative contributions of the ambiguous shareholder to the corporation.<sup>180</sup> Courts look not only to financial contributions but also to whether the shareholder performed the sorts of acts consistent with that of an owner of the corporation.<sup>181</sup> For example, in *Ackel v. Ackel*, a father and son were involved in a pharmaceutical corporation.<sup>182</sup> The father contributed all of the corporation's capital and assets, and the son managed the drugstore but made no financial contributions.<sup>183</sup> The stock certificates, which were defective because they lacked the father's signature, issued 100% of the corporation's stock to the son.<sup>184</sup>

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was promised stock in payment for services, was entitled to issuance of stock certificate when corporate records showed he was a subscriber to 12 shares and those shares had been paid for, regardless of who paid for the stock). Second, the analysis has been applied when no issuance price was paid for shares of stock but stock certificates were issued. *See e.g.*, *Hotard v. Diabetes Self Mgmt. Center, Inc.*, 838 So. 2d 94, 97–98 (La. Ct. App. 2003); *Ackerman Tool & Const. Co. v. McArthur*, 73 So. 2d 507, 508–09 (La. Ct. App. 1954) (holding that corporation had no cause of action for return of issued stock because employer gave his own stock in corporation to employee without consideration). Third, the analysis has been applied when the issuance price for stock was promised but not paid and stock certificates were not issued. *See, e.g.*, *Prejean v. Commonwealth for Cmty. Change, Inc.*, 503 So. 2d 661, 666 (La. Ct. App. 1987); *Scobee*, 242 So. 2d at 612–13 (holding that plaintiff was entitled to delivery of stock certificates upon payment of amount owed to corporation under subscription because corporation did not comply with statutory provisions before disposing of his subscribed interest); *Ingraos & Co. v. Eastman*, 179 La. 305, 307–08 (La. 1934) (stating that plaintiff could not bring suit on behalf of corporation because he was not a stockholder, he never paid for the stock to which he was subscribed despite a demand, and the court found there was no agreement between plaintiff and defendant that plaintiff could pay in good will). This latter situation ordinarily arises in the context of a subscription contract. Although subscription contracts are seldom used today, they often occurred when the plaintiff and corporation entered into a pre-incorporation agreement in which the plaintiff agreed to provide some contribution in exchange for a certain share in the corporation's stock. MORRIS & HOLMES, *supra* note 11, § 9.02, at 317–18. Subscription contracts are analogous to the idea that a member of an LLC may make a contribution to the LLC in the form of a promissory note. *See* LA. REV. STAT. ANN. § 12:1321 (2010).

179. MORRIS & HOLMES, *supra* note 11, § 10.11, at 360–61.

180. *Id.* § 10.11, at 359.

181. *See Ackel*, 595 So. 2d at 741.

182. *Id.*

183. *Id.* at 740.

184. *Id.* at 741.

Following the father's death, the mother brought suit to claim ownership in the corporation from her son, who claimed the stock certificates made him the corporation's sole owner.<sup>185</sup> The Louisiana Fifth Circuit Court of Appeal ruled that the father-decedent had been the owner of the corporation, despite being issued no shares of stock, based on the fact that he had contributed 100% of the capital.<sup>186</sup> The court also noted that he had generally "vested himself with the indicia of ownership of the corporation" by representing to the newspaper, the IRS, and his CPA that he was the owner and controlling all of the corporation's assets.<sup>187</sup> The court rested its holding on the fact that the father did the "innumerable things that the owner of a corporation would do," while the son did only one or two things that an owner in a corporation would do.<sup>188</sup> This case illustrates the sort of factors that courts consider to determine the relative weight of contributions to the corporation between the disputed shareholders in the resolution of ownership disputes.<sup>189</sup> In recognizing the ownership interest of the ambiguous shareholder, other cases have considered factors of contribution such as: the fact that the plaintiff considered and conducted himself as an equal owner,<sup>190</sup> the fact that the plaintiff personally secured a loan for the corporation,<sup>191</sup> and the fact that the plaintiffs had contributed capital in the corporation from their accounts in a prior corporation.<sup>192</sup>

The notion of considering a person's financial and material contributions to a corporation in determining whether he or she is an owner translates well into LLC law. In LLC law, a contribution

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185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.* The son managed the pharmacy and applied for licenses and permits that were required to operate the pharmacy. *Id.* at 740. The father, on the other hand,

filed an application for subchapter S status with the Internal Revenue Service and his personal tax returns thereafter reflected losses from the corporation . . . he placed ads in the Times-Picayne [sic] newspaper with a declaration that he, as owner, was responsible for the corporate debts. He applied for an employer identification number and performed administrative services for the corporation. His 1987 federal income tax return listed loans of \$287,000.00 to the corporation. He visited the drugstore on a regular basis.

*Id.*

189. *See id.*

190. *Fireplace Shop, Inc. v. Fireplace Shop of Lafayette, Inc.*, 400 So. 2d 702, 704 (La. Ct. App. 1981).

191. *Id.* at 703.

192. *Int'l Stevedores, Inc. v. Hanlon*, 499 So. 2d 1183, 1188 (La. Ct. App. 1986).

must take the form of cash, property, services rendered, or a written promissory note or other binding obligation to contribute; therefore, a court can determine whether the purported member made either a contribution or a written promise to contribute.<sup>193</sup> Because members are vested with managerial power in member-managed LLCs, a court can also consider whether a person has acted with authority in the business or voted in business decisions.<sup>194</sup> A trusted employee, however, might also act with considerable authority in an LLC, so courts must consider an ambiguous member's managerial acts and contributions in the context of the totality of circumstances.

## 2. Misleading Statements and Acts

In resolving ownership disputes in closely held corporations, courts next look for any statements or acts that the corporation, or its shareholders, made to the ambiguous shareholder to create the belief that he or she was a shareholder.<sup>195</sup> For example, in *Fireplace Shop Inc. v. Fireplace Shop of Lafayette, Inc.*, the Louisiana First Circuit Court of Appeal acknowledged the plaintiff's one-half interest in a corporation despite the fact that the defendant issued all of the stock to himself at the time of incorporation.<sup>196</sup> The court came to this conclusion by considering the following: the defendant's statements to third parties that he and the plaintiff were 50/50 owners in the corporation, the fact that it was "common knowledge" that the corporation was equally

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193. LA. REV. STAT. ANN. §§ 12:1321, :1322 (2010). See also MORRIS & HOLMES, *supra* note 11, § 44.13, at 518 ("The LLC statute never actually states that a person . . . must make, or agree to make, a contribution of some kind to an LLC to become a member in that LLC. However, the statute does state requirements concerning the permissible forms that such contributions may take, thus suggesting that a contribution is indeed required.").

194. LA. REV. STAT. ANN. § 12:1311 (2010).

If an LLC is managed by its members, then each member ordinarily possesses three kinds of managerial power: (1) to act as agent for the LLC in the ordinary course of its business, (2) to block two types of actions that require the unanimous approval of members (i.e., the admission of an assignee as a member of the LLC and the compromise of any obligation of a member to make a contribution or return distributions to the LLC), and (3) to cast one vote each in the majority-of-members-controlled decisions that govern all other aspects of the management of the LLC, including amendments of the LLC's articles or operating agreement.

MORRIS & HOLMES, *supra* note 11, § 44.07, at 496–97 (internal footnotes omitted).

195. MORRIS & HOLMES, *supra* note 11, § 10.11, at 359.

196. *Fireplace Shop, Inc.*, 400 So. 2d at 703–04.

owned, and the fact that the plaintiff and defendant were listed as equal owners on tax returns.<sup>197</sup> Likewise in *Hotard v. Diabetes Self Management Center, Inc.*, the Louisiana Third Circuit Court of Appeal deemed the defendant to be a shareholder in the corporation despite the fact that she did not pay for her shares.<sup>198</sup> The court decided the case for the defendant because none of the other purported shareholders had made a payment, the original shareholder had offered the shares to her, and she was involved in the formation of the corporation.<sup>199</sup> In addition, other courts have considered similar factors in determining whether an ambiguous shareholder was led to believe that he or she was an owner, such as: the fact that the business was a co-owned partnership prior to incorporation,<sup>200</sup> the understanding of employees and family members as to the corporation's ownership,<sup>201</sup> past business dealings between the plaintiff and defendant,<sup>202</sup> the plaintiff's reliance on the defendant to issue his or her stock,<sup>203</sup> and statements in the corporation's articles of incorporation allocating shares to the plaintiff.<sup>204</sup>

In evaluating this second consideration, courts look at the individual facts of each situation that might indicate that the ambiguous shareholder was led to believe that he or she was a shareholder in the corporation. This consideration would work to resolve ownership disputes in LLCs as well because, like closely held corporations, they are informally managed and susceptible to operating without regard to proper discussion or documentation of the allocation of ownership.<sup>205</sup> The words or actions that might have led a person to believe that he or she is an owner should be evaluated in conjunction with the first consideration, the member's

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197. *Id.*

198. *Hotard v. Diabetes Self Mgmt. Center, Inc.*, 838 So. 2d 94, 96–97 (La. Ct. App. 2003).

199. *Id.*

200. *Dardeau v. Fontenot*, 326 So. 2d 521, 524–25 (La. Ct. App. 1976).

201. *Id.* at 525.

202. *Scobee v. Cont'l Hotel Corp.*, 242 So. 2d 610, 612 (La. Ct. App. 1970) (assuming that corporation in dispute was intended to be formed under the same arrangements as a prior corporation owned by the plaintiff and defendant).

203. *Int'l Stevedores, Inc. v. Hanlon*, 499 So. 2d 1183, 1188 (La. Ct. App. 1986).

204. *Scobee*, 242 So. 2d at 611.

205. See *MORRIS & HOLMES*, *supra* note 11, § 44.07, at 499 (“[T]he LLC statute does not impose corporate-style formality requirements on decision-making by the members and managers of the LLC.”); *id.* § 21.04, at 543 (stating that closely held corporations “tend in practice to be operated directly and informally by their shareholders—much as a proprietorship, partnership or LLC might be—without all the procedural complexities and formalities that are contemplated by the corporate statute”).

relative contributions, to determine whether that person is an owner in the LLC. This fact-based analysis works to resolve ownership disputes in closely held corporations, and there are many reasons it would function to resolve LLC membership disputes as well.

*B. The Corporate Fact-Based Analysis Is Applicable to LLC Law*

In addition to the similar ownership and management structures of a closely held corporation and a traditional LLC,<sup>206</sup> there are additional reasons why the fact-based analysis used in corporation law is applicable to LLC law. First, because courts are willing to look beyond stock certificates—which are intended to prove ownership—in the resolution of corporation ownership disputes,<sup>207</sup> courts should also be willing to look beyond member lists in LLC initial reports—which are not intended to prove ownership—in resolving LLC membership disputes.<sup>208</sup> Second, the fact-based analysis works well in LLC law because it is consistent with the idea that an LLC can have an oral operating agreement that can override a written record of owners.<sup>209</sup>

To the first point, courts, which are willing to distinguish stock certificates from actual ownership in a corporation,<sup>210</sup> should likewise be willing to distinguish a list of members in an initial report from actual ownership in an LLC. Under the fact-based analysis discussed above, courts give the facts and circumstances surrounding the operation of a corporation more weight in an ownership dispute than the name listed on a stock certificate,<sup>211</sup> which is intended to show ownership.<sup>212</sup> By comparison, courts have considered a list of members in an LLC's initial report—which is *not* intended to show ownership<sup>213</sup>—determinative of ownership.<sup>214</sup> It is illogical that a court will set aside a stock

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206. See *supra* Part III.

207. See, e.g., *Ackel v. Ackel*, 595 So. 2d 739, 741 (La. Ct. App. 1992); *Int'l Stevedores*, 499 So. 2d at 1188; *Fireplace Shop, Inc. v. Fireplace Shop of Lafayette, Inc.*, 400 So. 2d 702, 703 (La. Ct. App. 1981).

208. See *supra* Part I.C.1.

209. See LA. REV. STAT. ANN. § 12:1301(A)(16) (2010).

210. See *supra* note 176.

211. See *supra* Part III.A.

212. LA. REV. STAT. ANN. § 12:1(F) (2010) (“‘Certificate of stock’ means a properly executed instrument evidencing the fact that the person therein named is the registered owner of the shares therein described.”).

213. See *supra* Part I.C.1.

214. See *Settles v. Paul*, 61 So. 3d 854 (La. Ct. App. 2011); *Moise v. Moise*, 956 So. 2d 9, 10 (La. Ct. App. 2007); *supra* Part II.C.

certificate, which is intended to evidence ownership,<sup>215</sup> but will feel compelled to honor a list of members in an initial report, which is merely intended to show management authority.<sup>216</sup> If facts and circumstances can be used to overcome evidence offered by a document intended to prove ownership, then logically, they should also be used to overcome a document that is not intended to prove ownership. The fact-based analysis used to resolve ownership disputes in corporation law is even more sensible when applied to LLC law.

Second, the fact-based analysis is applicable to LLC law because this treatment is consistent with the idea that an LLC can have an unwritten operating agreement that can override a written record of owners.<sup>217</sup> Operating agreements can be either written or oral.<sup>218</sup> If an LLC does not have a written operating agreement, a court can interpret the manner in which the company “conducts its affairs or structures [its] business relations” as an oral operating agreement.<sup>219</sup> A court could then find that this unwritten operating agreement overrides the registered ownership rule.<sup>220</sup> The registered ownership rule states that an LLC is permitted to treat those members registered in its records as members despite constructive or actual notice otherwise.<sup>221</sup> Because a contrary rule may be contained in an oral operating agreement, “a pattern of behavior under which non-registered ownership came to be recognized by members . . . of an LLC might be sufficient to create an operating agreement that would override the suppletive registered ownership rule.”<sup>222</sup> Thus, an ambiguous LLC member could prove his or her membership through evidence of the operations of the LLC, despite not being listed as a member on the

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215. § 12:1(F).

216. See *supra* Parts II.C, I.C.1.

217. See MORRIS & HOLMES, *supra* note 11, § 44.12, at 518.

218. LA. REV. STAT. ANN. § 12:1301(A)(16) (2010).

219. KALINKA, *supra* note 20, § 1.5, at 15. The court may have to choose whether an unwritten operating agreement or the default provisions of LLC law should apply to a particular dispute. *Id.* To prevent this potential for confusion, LLCs are encouraged to have written operating agreements. *Id.* In addition, a written operating agreement is necessary to alter certain default rules if they are not addressed in the articles of organization. *Id.* See LA. REV. STAT. ANN. §§ 12:1305(C)(3), :1317(B), :1334, :1336 (2010). Further, there are some default provisions that can only be altered in a written operating agreement. KALINKA, *supra* note 20, § 1.5, at 15–16. See LA. REV. STAT. ANN. §§ 12:1322(B), (C), :1323, :1324(A), (B), :1325(B), (C), :1326, :1330(C) (2010).

220. MORRIS & HOLMES, *supra* note 11, § 44.12, at 518.

221. LA. REV. STAT. ANN. § 12:1318(B) (2010). See *supra* note 93 for more on the registered ownership rule.

222. MORRIS & HOLMES, *supra* note 11, § 44.12, at 518.

company's records.<sup>223</sup> The evidence of the operations of an LLC in which an ambiguous member might come to be recognized as a member is likely the same evidence that would be considered in the fact-based analysis discussed in relation to corporation law: contributions and the misleading acts of other members.<sup>224</sup> The ambiguous member who proves his or her membership through the operations of the LLC despite not being listed on the LLC's records can be compared to an ambiguous shareholder who proves his or her ownership through the fact-based analysis despite not being issued stock certificates.<sup>225</sup> This comparison makes it clear that the corporate fact-based analysis is fitting in its application to LLC law.

The above considerations indicate that an application of the fact-based resolution of ownership disputes in closely held corporations is logical in its application to LLC law, and the following analysis indicates that it is not only logical in theory but practical in application.

### *C. The Corporate Fact-Based Analysis Is Easily Applied to LLC Law*

In the application of the corporate fact-based analysis to LLC law, courts should look at (1) the relative contributions of the ambiguous member to the LLC and (2) any acts or statements made by the LLC or other members that would have caused the ambiguous member to believe that he or she was a member of the LLC.<sup>226</sup> Instead of being treated as determinative of ownership, the initial report should be one factor considered in the context of the second, broad consideration. The explicit use of this fact-based analysis in LLC membership disputes would deter courts from treating member lists as determinative of ownership and provide a guide for the proper resolution of these disputes. The benefits of using this fact-based analysis in an LLC membership dispute can be seen by applying the analysis to the facts in *Settles v. Paul and Moise v. Moise*.<sup>227</sup> A third case, *Destiny Services, L.L.C. v. Cost Containment Services, L.L.C.*, reveals that at least one court has already resolved an LLC membership dispute in contradiction of

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223. *Id.*

224. *See supra* Part III.A.

225. *See supra* Part III.A.

226. *See* MORRIS & HOLMES, *supra* note 11, § 10.11, at 349.

227. *See supra* Parts II.C.1, .2.



the initial report by considering the facts and circumstances surrounding the dispute.<sup>228</sup>

*1. The Fact-Based Analysis as Applied to the Facts of Settles v. Paul*

A court applying the fact-based analysis to the facts of *Settles v. Paul* would first consider *Settle's* relative contributions to the construction LLC.<sup>229</sup> *Settles* performed the substantive construction work, which brought in the LLC's profits, while *Paul* handled the recordkeeping.<sup>230</sup> *Settle's* contribution to the company could potentially be seen as greater than that of *Paul's* because without *Settle's* special skills, there would likely be no construction business.<sup>231</sup>

The court would then look to acts or statements by *Paul* that would have led *Settles* to believe that he was a member of the LLC.<sup>232</sup> This consideration would likely include the couple's discussions about forming an equally owned business,<sup>233</sup> the fact that the business was operated as a partnership prior to the formation of the LLC,<sup>234</sup> and the fact that others viewed the business as an equally owned venture.<sup>235</sup> The combination of these factors could reasonably have led *Settles* to believe that he was a member of the LLC. In applying the fact-based analysis to the facts of *Settles*, a court might still have concluded that *Settles* was a

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228. *Destiny Servs., L.L.C. v. Cost Containment Servs., L.L.C.*, No. 2010-1895, 2011 WL 4375318 (La. Ct. App. Sept. 20, 2011).

229. *Settles v. Paul*, 61 So. 3d 854, 856 (La. Ct. App. 2011). See *supra* Part II.C.1 for background of case and *supra* Part III.A for discussion of analysis.

230. *Settles*, 61 So. 3d at 856.

231. Compare *id.*, with *Ackel v. Ackel*, 595 So. 2d 739, 741 (La. Ct. App. 1992) (finding decedent full owner of the corporation because he provided 100% of the capital despite his son's management contributions and possession of stock certificates). See *supra* Part III.A.1 for more background of *Ackel v. Ackel*.

232. See *supra* Part III.A.2.

233. *Settles*, 61 So. 3d at 856.

234. Compare *id.*, with *Dardeau v. Fontenot*, 326 So. 2d 521, 525 (La. Ct. App. 1976) (finding plaintiff one-half owner despite possessing no stock certificates, in part, because plaintiff and defendant began the enterprise as partners and intended to exchange partnership interest for interest in corporation).

235. Compare *Settles*, 61 So. 3d at 856 (acknowledging that both the plaintiff's mother and a former employer and business adviser of the couple understood the company to be equally owned), with *Dardeau*, 326 So. 2d at 525 (deciding that plaintiff was one-half owner, in part, because employees and family members understood the plaintiff and defendant to be co-owners in the corporation), and *Fireplace Shop, Inc. v. Fireplace Shop of Lafayette, Inc.*, 400 So. 2d 702, 703-04 (La. Ct. App. 1981) (holding that plaintiff was one-half owner, in part, because "employees felt it was common knowledge" that the corporation was equally owned).

member.<sup>236</sup> In fact, based on the disparity between the contributions offered by each member, the court may have found that Settles was the owner of a larger membership share than Paul or, perhaps, was the sole owner.<sup>237</sup>

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236. The preceding application of the fact-based corporate analysis to the facts of *Settles v. Paul* is analogous to the analysis actually applied by the court in that case. 61 So. 3d at 856. The court in *Settles v. Paul* used an inadvertent partnership theory to find that the couple, through their operation of the construction business, had unintentionally formed a partnership that was the sole member of the LLC. *Id.* The court's instinct to look for a doctrine that allowed it to base its decision on the facts and circumstances surrounding the operation of the LLC was correct. Inadvertent partnership theory looks to the facts and conduct between the purported partners to determine the true intention of their relationship. JAMES D. COX & THOMAS LEE HAZEN, BUSINESS ORGANIZATIONS LAW § 1:7, at 11 (3d ed. 2011) ("The determination of whether a particular business arrangement is a partnership is a highly factual inquiry and is dependent upon not only the written or oral understandings and agreements between the parties but also upon the conduct of the parties and the surrounding circumstances . . . . The determination depends not upon the form of the agreement but rather on the nature of relationship that the parties intended and how the law classifies such a relationship."). This often includes considering whether the parties have shared in the profits and losses of the business or created a community of goods in which each partner has an interest. MORRIS & HOLMES, *supra* note 11, § 1.06, at 15–16; *Darden v. Cox*, 123 So. 2d 68 (La. 1960). Therefore, like the fact-based analysis used to resolve closely held corporate ownership disputes, *see supra* Part III.A, the inadvertent partnership theory also requires an examination of the facts and circumstances of the operation of the business. COX & HAZEN, *supra*, § 1:7, at 11. So while the inadvertent partnership theory is meant to resolve issues involving unincorporated entities and is not an appropriate theory to apply to issues involving LLCs, *see supra* Part II.C.2; MORRIS & HOLMES, *supra* note 11, § 1.13, at 30–31, the fact-based analysis it requires is consistent with the fact-based analysis used in corporation law. The essence of both of these theories is the same: looking to the facts of the operation of a business to determine who is an owner in that business. *See* COX & HAZEN, *supra*, § 1:7, at 11; *Ackel*, 595 So. 2d at 741; *Int'l Stevedores, Inc. v. Hanlon*, 499 So. 2d 1183, 1188 (La. Ct. App. 1986); *Fireplace Shop, Inc.*, 400 So. 2d at 703.

237. One should note here, though, that without a contrary provision in a written operating agreement, the profits and losses of the LLC would still be shared equally. LA. REV. STAT. ANN. § 12:1323 (2010). In addition, without a provision in the articles of organization or operating agreement, each member would only be entitled to cast one vote, regardless of financial contribution. *Id.* § 12:1318. This factor complicates the corporate analysis's application to LLC law because, while a contribution to a corporation is proportional to the percentage of ownership in the corporation, contributions to an LLC could be minor but still allow equal ownership.

2. *The Fact-Based Analysis as Applied to the Facts of* *Moise v. Moise*

An application of the fact-based analysis to the facts of *Moise v. Moise*<sup>238</sup> first requires a consideration of the relative contributions of the husband and wife.<sup>239</sup> Mrs. Moise provided services to the LLC, including managing the company's property, while her husband provided 100% of the LLC's capital.<sup>240</sup> This case could be compared to the corporate case of *Ackel v. Ackel* in which the decedent was deemed the sole owner of the corporation, in part, because he contributed 100% of the company's capital, while his son, the holder of the stock certificates, contributed only management services.<sup>241</sup> Here too, the husband's contributions may outweigh his wife's contribution so significantly as to cast doubt on her membership.

The fact-based analysis next requires consideration of the words and actions that could reasonably have lead Mrs. Moise to believe that she was a member of the LLC.<sup>242</sup> It is clear from the case that Mrs. Moise *thought* she was a member,<sup>243</sup> but it is not clear who listed her as a member in the initial report, lease agreement, or tax return.<sup>244</sup> If her former husband listed her, then those acts would have reasonably caused her to believe that she was a member of the LLC. This belief, though, when weighed against the disparity in contributions, may not have been enough to deem Mrs. Moise an owner in the LLC. Therefore, using the fact-based analysis, the court may have reached the same conclusion in declaring Mr. Moise the sole owner.<sup>245</sup>

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238. *Moise v. Moise*, 956 So. 2d 9, 10–11 (La. Ct. App. 2007). See *supra* Part II.C.2 for background of case.

239. See discussion of fact-based analysis *supra* Part III.A.1.

240. *Moise*, 956 So. 2d at 10.

241. Compare *id.*, with *Ackel*, 595 So. 2d at 740. See *supra* Part III.A.1.

242. See *supra* Part III.A.2.

243. See *Moise*, 956 So. 2d at 10–11.

244. *Id.*; cf. *Fireplace Shop, Inc. v. Fireplace Shop of Lafayette, Inc.*, 400 So. 2d 702, 703 (La. Ct. App. 1981) (considering listing of both plaintiff and defendant as corporate owners on tax return).

245. *Moise*, 956 So. 2d at 11. The court in *Moise v. Moise*, like the one in *Settles v. Paul*, 61 So. 3d 854 (La. Ct. App. 2011), was on the right path in its analysis of this LLC membership dispute because it considered the facts and circumstances of the operation of the LLC. See *Moise*, 956 So. 2d at 11. The court's analysis would have been consistent with the fact-based analysis used in corporation law if it had taken the explicit stance that Mrs. Moise's name in the initial report did not control her designation as either a member or manager in the LLC. *Id.*

3. *Destiny Services, L.L.C. v. Cost Containment Services, L.L.C. Applies Fact-Based Analysis to LLC Membership Dispute*

In one recent LLC membership dispute case, the Louisiana First Circuit Court of Appeal applied an analysis that was consistent with the fact-based, closely held corporation analysis, and unlike *Settles* and *Moise*, it did not treat the LLC's organizational documents as determinative of ownership.<sup>246</sup> In *Destiny Services, L.L.C. v. Cost Containment Services, L.L.C.*, a three-member, member-managed LLC submitted a proposal to the two plaintiffs inviting them to participate in the LLC in a maximum 20% "equity" position.<sup>247</sup> Both plaintiffs agreed to the proposal and submitted payments totaling about 5% of the outstanding equity.<sup>248</sup> Following a dispute involving a request by the plaintiffs to inspect the LLC's records, the plaintiffs brought suit alleging breach of fiduciary duty and claimed the LLC had failed to pay them their share of the profits, draws, or capital.<sup>249</sup> The LLC claimed that the plaintiffs were not entitled to these remedies because they were not yet members and submitted the member list in its annual report, which listed only the original three members, as proof.<sup>250</sup> The court, however, rejected this argument and instead found that the plaintiffs were members because they had contributed capital to the LLC, were listed in the LLC's general ledger and tax returns as members, were given notice of member meetings, and were permitted to vote.<sup>251</sup> Although the court did not explicitly apply the fact-based analysis used in the resolution of ownership disputes in closely held corporations, the facts it considered in reaching its ruling are consistent with this analysis.<sup>252</sup> In determining membership, the court considered the ambiguous owners' contributions to the LLC, such as the paid-in capital, and the acts of other members that may have led the ambiguous owners to believe that they were members in the LLC, such as the choice to allow the plaintiffs to vote in member

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246. See *Destiny Servs., L.L.C. v. Cost Containment Servs., L.L.C.*, No. 2010-1895, 2011 WL 4375318 (La. Ct. App. Sept. 20, 2011).

247. *Id.* at \*1.

248. *Id.* at \*7.

249. *Id.* at \*2.

250. *Id.* at \*4.

251. *Id.* at \*5. The court further ruled that the proposal to the plaintiffs inviting them to participate in the LLC constituted a written operating agreement under which the plaintiffs agreed to participate as non-managing members and were entitled to disbursements of profits equal to their percentage share of equity ownership interest. *Id.* at \*7.

252. See *id.* at \*5; *supra* Part III.A.

decisions.<sup>253</sup> The court, however, should have gone one step further and both expressly acknowledged that an initial report is not determinative of ownership and analogized to the fact-based analysis used in closely held corporation law.

This fact-based analysis works to resolve LLC membership disputes both in theory and in application, as evidenced by *Destiny Services, L.L.C. v. Cost Containment Services, L.L.C.* The ease of application<sup>254</sup> and logical congruence<sup>255</sup> make the fact-based analysis applied by courts to resolve the ownership disputes of closely held corporations the perfect, common-sense solution to resolve these disputes in LLCs. Using this analysis, courts are able to reach equitable conclusions by considering the unique issues, facts, and circumstances presented in each case. To properly resolve LLC membership disputes, courts must expound an explicit application of this fact-based analysis and expressly recognize that member lists in LLC initial reports do not determine ownership in an LLC. Rather, they are merely one piece of evidence among many. The Legislature must also take steps to clarify the fact that these lists are not controlling of ownership because the recent legislation it passed aimed at addressing business identity theft has further muddled the problem.<sup>256</sup>

*D. The Legislature Should Clarify that LLC Member Lists Do Not Determine Ownership*

The Legislature should enact a statute that expounds to courts that a document filed by a member-managed LLC with the secretary of state that lists or amends its members does not determine ownership in that LLC. These documents seek to publicize who has management authority in an LLC, and thus there is no remedy that would prevent a member-managed LLC from being required to list its members.<sup>257</sup> Such a remedy would not be desirable either, as it is important that this information be available to facilitate service of process on an LLC and ensure that third parties can determine who has authority in the LLC.<sup>258</sup> Because these lists must exist, the only remedy is to warn the public, the courts, and the LLC itself that the list it provides to the secretary of state does not determine membership in the LLC. Such a statute might read:

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253. *Destiny Servs., L.L.C.*, No. 2010-1895, at \*5.

254. *See supra* Part III.C.

255. *See supra* Part III.B.

256. *See supra* Part II.B.

257. *See supra* Part I.C.1.

258. KALINKA, *supra* note 20, § 1.4, at 11–12. *See supra* Part I.C.1.

Any document filed with the secretary of state that lists members in a limited liability company does not affect ownership in that company as between its members.

A statute like this would accomplish the goal of ensuring that member lists in LLC organizational documents are not treated as controlling of ownership and point courts in the right direction when deciding membership disputes.<sup>259</sup> In addition, it would remedy the false impression that inclusion on a member list for an LLC is of great significance, which was created by the legislation addressing business identity theft.<sup>260</sup>

#### CONCLUSION

If courts continue to treat member lists in the initial reports of member-managed LLCs as determinative of ownership and the Legislature fails to remedy the false impression that the Business Identity Theft Act sent to courts regarding the probative value of member lists in initial reports, then every member in a member-managed LLC risks losing his or her ownership interest. These lists can be easily and unilaterally amended, and incidence of their fraudulent manipulation is on the rise. To avoid committing their own form of business identity theft in the resolution of LLC membership disputes, courts must view member lists in initial reports as only one piece of evidence in the totality of facts and circumstances. This remedy is the most common-sense solution for preventing business owners like Brad from being divested of their LLC ownership by disgruntled business partners and criminals alike.<sup>261</sup>

*Emily J. Gill\**

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259. Another legislative act that is suggested by this Comment is the repeal of Louisiana Revised Statutes sections 12:1319(A)(1) and (D). *See supra* note 93.

260. *See supra* Part II.B.

261. *See supra* Introduction.

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