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### The Ties That Bind: LLC Operating Agreements as Binding Commitments

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*University of Tennessee College of Law*

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#### Recommended Citation

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Citations:

Bluebook 21st ed.

Joan MacLeod Heminway, *The Ties That Bind: LLC Operating Agreements as Binding Commitments*, 68 S.M.U. L. REV. 811 (2015).

ALWD 7th ed.

Joan MacLeod Heminway, *The Ties That Bind: LLC Operating Agreements as Binding Commitments*, 68 S.M.U. L. Rev. 811 (2015).

APA 7th ed.

Heminway, J. (2015). *The ties that bind: llc operating agreements as binding commitments*. *SMU Law Review*, 68(3), 811-830.

Chicago 17th ed.

Joan MacLeod Heminway, "The Ties That Bind: LLC Operating Agreements as Binding Commitments," *SMU Law Review* 68, no. 3 (Summer 2015): 811-830

McGill Guide 9th ed.

Joan MacLeod Heminway, "The Ties That Bind: LLC Operating Agreements as Binding Commitments" (2015) 68:3 SMU L Rev 811.

AGLC 4th ed.

Joan MacLeod Heminway, 'The Ties That Bind: LLC Operating Agreements as Binding Commitments' (2015) 68(3) SMU Law Review 811

MLA 9th ed.

Heminway, Joan MacLeod. "The Ties That Bind: LLC Operating Agreements as Binding Commitments." *SMU Law Review*, vol. 68, no. 3, Summer 2015, pp. 811-830. HeinOnline.

OSCOLA 4th ed.

Joan MacLeod Heminway, 'The Ties That Bind: LLC Operating Agreements as Binding Commitments' (2015) 68 SMU L Rev 811

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# THE TIES THAT BIND: LLC OPERATING AGREEMENTS AS BINDING COMMITMENTS

*Joan MacLeod Heminway\**

SOMETIMES, a single sentence, clause, phrase, or word stimulates ideas or action. And so it was with a simple passage from a recent federal bankruptcy court opinion: “. . . LLC operating agreements are not *per se* executory contracts governed by § 365 of the Bankruptcy Code because of their unique elements and features under state law that are inconsistent with contract law.”<sup>1</sup> These few words galvanized two questions that had been circulating in my brain for quite some time. First: is a limited liability company (“LLC”) operating agreement (now known under Delaware law and in certain other circles as a limited liability company agreement<sup>2</sup>) a contract? And second: should we care either way?

These two questions offer insights into matters of immediate relevance to practitioners as well as legal scholars and law teachers. Specifically, the status of operating agreements as contracts may have implications under both LLC law and other laws involving the adjudication of rights under (or effects of) operating agreements that depend on the existence (or absence) of contractual relations. This essay highlights both issues.

LLC law—and especially current Delaware LLC law—has consistently been described by scholars and other commentators as highly contrac-

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\* W.P. Toms Distinguished Professor of Law, The University of Tennessee College of Law. New York University School of Law, J.D. 1985; Brown University, A.B. 1982. Thanks to Steve Bainbridge, Keith Bishop, and Tom Norris for supplying me with food for thought that laid the foundation for this essay, to Carter Bishop, Alex Davie, Josh Fershee, Ben Means, Tom Rutledge, and the audience members at a 2015 Law and Society Association session (at which the ideas underlying this essay were presented) for offering encouragement and comments on prior drafts, and to Matthew Sipf for providing valuable research assistance. Work on the essay was supported by a summer research grant from The University of Tennessee College of Law and is inspired by the lengthy and rich academic legacy left to us all by Professor Alan R. Bromberg. I owe Alan a personal debt of gratitude for the scholarship review letter he wrote for my tenure review a number of years ago, in which he helpfully concluded that I had “both substantial scholarly ability and substantial promise for further growth and achievement.” I can only hope that my work lives up to that kind assessment and, in some small measure, continues in the spirit of his scholarly endeavors.

1. *In re Denman*, 513 B.R. 720, 725 (Bankr. W.D. Tenn. 2014).

2. For ease of reference, this essay uses the term “operating agreement” throughout, except when quoting or referencing the analog under a legal regime that uses a different term.

tual.<sup>3</sup> This observation (really a characterization) manifests itself in distinct ways under the laws of various jurisdictions—in some states constituting a strong and express policy underpinning for LLC internal governance rules. Yet an operating agreement may not constitute a contract at common law, and state LLC laws do not expressly label an operating agreement a statutory contract. If an operating agreement is not a contract, LLC constituents may not be able to successfully make arguments grounded in contract law in seeking judicial interpretation or enforcement of an operating agreement.

In addition, it may be necessary or desirable in adjudicating controversies or otherwise determining legal rights under areas of law outside LLC law to ascertain whether an operating agreement is a contract. The *Denman* case provides an example of this phenomenon. The *Denman* court determined that the status of an operating agreement as an executory contract for federal bankruptcy law purposes depended in part on whether an operating agreement may be classified as a contract.<sup>4</sup>

This essay is designed to provide preliminary insights into the status of operating agreements as contracts and contextualize the significance of those insights. It proceeds in three principle substantive parts. I begin by defining and describing operating agreements to establish their basic attributes. Next, I identify the nature of operating agreements by reference to several relevant legal contexts: contract law, LLC law, partnership law, and corporate law. Finally, before briefly concluding, I make derivative observations about operating agreements as contracts.

## I. DEFINING AND DESCRIBING THE LLC OPERATING AGREEMENT

Operating agreements exist because of LLC law. The LLC is a creature of late 20th century state statutory law that marries the limited liability for which corporations became famous with flexible, partnership-like structural norms and (apart from single-member LLCs that enjoy disre-

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3. See, e.g., J. William Callison & Allan W. Vestal, *Contractarianism and Its Discontents: Reflections on Unincorporated Business Organization Law Reform*, 42 SUFFOLK U. L. REV. 493, 496 (2009) (“LLC law in the United States has become the contractarian test case, and one frequently hears that the LLC is a ‘creature of contract,’ a contractarian dream entity where any deal can be structured among the parties.”); Larry A. DiMatteo, *Policing Limited Liability Companies Under Contract Law*, 46 AM. BUS. L.J. 279, 280–81 (2009) (“An example of the freedom of contract approach to LLC governance is the Arkansas LLC statute. It states that “maximum effect” should be given to “the principle of freedom of contract [in the interpretation] and the enforceability of Operating Agreements. This is the approach taken by the Delaware Act.”); Mohsen Manesh, *Delaware and the Market for LLC Law: A Theory of Contractibility and Legal Indeterminacy*, 52 B.C. L. REV. 189, 193 (2011) (“Delaware LLC law, like the LLC law of several other states, affords parties an extraordinarily high degree of contractibility, allowing LLCs to contractually tailor virtually all matters of the firm’s internal governance in the terms of the LLC’s governing agreement.”).

4. *Denman* at 723 (“Contract rights arise upon an offer, acceptance, and transfer of adequate consideration between at least two assenting parties. If these elements do not exist, a contract right does not exist and, thereby, an executory contract cannot exist.” (citation omitted)).

garded entity status) default partnership taxation for federal income tax purposes.<sup>5</sup> LLC law comprises these statutes and the relevant decisional law that interprets and fills gaps in the statutory framework. Accordingly, in defining and describing the LLC and the operating agreement, one must look to both statutory law and decisional law.

#### A. PROTOTYPE AND UNIFORM LLC STATUTES

Like the statutory laws establishing other business entities, LLC statutes include basic rules on entity structure and governance. Although the applicable law varies (sometimes significantly) from state to state, most of these rules are default rules. Variation of those rules is invited through private ordering. The documentary locus for that private ordering is the operating agreement. LLC statutes expressly provide for the existence of the operating agreement and describe its function in LLC law.<sup>6</sup>

The development of LLC statutes has benefitted over the years from work done by a committee of the American Bar Association, which designed a Prototype Limited Liability Company Act in 1992,<sup>7</sup> and the National Conference of Commissioners on Uniform State Laws, which first created a Uniform Limited Liability Company Act in 1996.<sup>8</sup> The most recent versions of these two exemplar LLC statutes, the Revised Prototype Limited Liability Company Act (the “Prototype Act”)<sup>9</sup> and the Revised Uniform Limited Liability Company Act (the “RULLCA”),<sup>10</sup> were adopted in 2011 and 2006, respectively. They both reflect and shape the statutes adopted in individual states.<sup>11</sup>

5. See, e.g., *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 290 (Del. 1999) (“The LLC is an attractive form of business entity because it combines corporate-type limited liability with partnership-type flexibility and tax advantages.”).

6. As noted *infra* in this Part I, uniform, prototype, and state LLC statutes typically allow for written, oral, and implied operating agreements, at least under certain circumstances. However, some of the commentary on operating agreements—especially remarks relating to the validity, binding nature, and enforceability of operating agreements—envision a written document. For example, jurists, scholars, and other observers reference “drafting” or “entering into” an operating agreement and note the identity of the operating agreement “signatories.” In assessing the status of an operating agreement as a contract or agreement, and in positing possible clarifications of or changes to that status, it is important to take into account the possibility that some or all of the terms of an operating agreement may not be documented in a writing.

7. AM. BAR ASS’N COMM. ON LLCs, P’SHPs AND UNINCORP. ENTITIES, PROTOTYPE LTD. LIAB. CO. ACT (1992).

8. NAT’L CONF. OF COMM’RS ON UNIF. ST. LAWS, UNIFORM LIMITED LIABILITY COMPANY ACT (1996).

9. Am Bar Ass’n Comm. on LLCs, P’ships and Unincorp. Entities, *Revised Prototype Limited Liability Company Act*, 67 BUS. LAW. 117 (2011).

10. NAT’L CONF. OF COMM’RS ON UNIF. ST. LAWS, REVISED UNIFORM LIMITED LIABILITY COMPANY ACT (2006), available at [http://www.uniformlaws.org/shared/docs/limited%20liability%20company/ullca\\_final\\_06rev.pdf](http://www.uniformlaws.org/shared/docs/limited%20liability%20company/ullca_final_06rev.pdf).

11. The *Denman* case was decided under, and therefore cites to, Tennessee law in construing the legal nature of an LLC operating agreement. The most recent iteration of limited liability company law in Tennessee (two limited liability company acts currently are operative in Tennessee) is an outlier in certain key aspects. Most prominently, it codifies three, rather than two, different types of LLC—director-managed, manager-managed, and member-managed—and adopts related, distinct internal governance rules. See TENN.

The Prototype Act principally refers to the operating agreement for an LLC as a “limited liability company agreement.”<sup>12</sup> Under the Prototype Act:

[l]imited liability company agreement” means any agreement (whether referred to as a limited liability company agreement, operating agreement, or otherwise), written, oral, or implied, of the member or members as to the affairs and activities of a limited liability company and any series thereof. The limited liability company agreement of a limited liability company having only one member shall not be unenforceable by reason of there being only one person who is a party to the limited liability company agreement. The limited liability company agreement includes any amendments to the limited liability company agreement.<sup>13</sup>

Section 110(a) of the Prototype Act relatedly provides that “(1) the limited liability company agreement governs relations among the members as members and between the members and the limited liability company; and (2) to the extent the limited liability company agreement does not otherwise provide for a matter described in subsection (a)(1), this Act governs the matter.”<sup>14</sup> In addition, Section 110(c) lists LLC rules that cannot be eliminated, modified, restricted, or waived in the limited liability company agreement.<sup>15</sup>

The RULLCA supplies similar definitional content, defining an “operating agreement” as

the agreement, whether or not referred to as an operating agreement and whether oral, in a record, implied, or in any combination thereof, of all the members of a limited liability company, including a sole member, concerning the matters described in Section 110(a). The term includes the agreement as amended or restated.<sup>16</sup>

Section 110(a), referenced in that definition, provides that

[e]xcept as otherwise provided in subsections (b) and (c), the operating agreement governs:

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CODE ANN. §§ 48-249-101 to 48-249-1133 (Tennessee Revised Limited Liability Company Act). Nevertheless, Tennessee’s rules regarding the operating agreement are relatively normative.

12. The original *Prototype Limited Liability Company Act* used the term “operating agreement,” which still is in use in many states. The drafters explained that the motivation for the change in terminology represented “an effort to better signify the nature of the agreement among the members by referring to the agreement in a manner consistent with the general and limited partnership statutes (which refer to the agreement of the partners as the ‘partnership agreement’).” Am Bar Ass’n, Comm. on LLCs, P’ships and Unincorp. Entities, *supra* note 9, at 119; *see also id.* at 131 (“The change from ‘operating agreement’ to ‘limited liability company agreement’ reflects a combination of Colorado and Delaware law and conforms the agreement name to that used in other unincorporated entities—e.g., ‘partnership agreement’ and ‘limited partnership agreement.’”).

13. *Id.* at 129 (§ 101(14)).

14. *Id.* at 136.

15. *Id.* at 137–38.

16. NAT’L CONF. OF COMM’RS ON UNIF. ST. LAWS, *supra* note 10, § 102(13).

- (1) relations among the members as members and between the members and the limited liability company;
- (2) the rights and duties under this [act] of a person in the capacity of manager;
- (3) the activities of the company and the conduct of those activities; and
- (4) the means and conditions for amending the operating agreement.<sup>17</sup>

Subsection (b) notes that “[t]o the extent the operating agreement does not otherwise provide for a matter described in subsection (a), this [act] governs the matter.”<sup>18</sup> Finally, subsection (c) sets forth immutable legal principles—rules of the road for LLCs that cannot be modified in the operating agreement.<sup>19</sup>

The RULLCA is accompanied by commentary, and the comment on the operating agreement definition states that “[a]n operating agreement is a contract, and therefore all statutory language pertaining to the operating agreement must be understood in the context of the law of contracts.”<sup>20</sup> The comment also notes that, consistent with general principles of contract law, unanimous member assent is required to establish an operating agreement.<sup>21</sup> In addition, it clarifies the validity of an operating agreement in a single-member LLC, explaining that, “[b]ecause a key function of the operating agreement is to override statutory default rules, it was necessary to make clear that a sole member could make an operating agreement”<sup>22</sup> and that “the operating agreement binds the LLC.”<sup>23</sup> Finally, the commentary generally describes the operating agreement as a “foundational contract” that derives from the modern conception of a partnership agreement under the Revised Uniform Partnership Act.<sup>24</sup>

## B. STATE STATUTORY AND DECISIONAL LAW

The information about operating agreements offered by the Prototype Act and the RULLCA provides general information and guidance. State legislative efforts reflect and have contributed to the Prototype Act and the RULLCA, but they also innovate in unique ways. State decisional law fills gaps in and interprets state LLC statutes, including with respect to operating agreements.

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17. *Id.* § 110(a).

18. *Id.* § 110(b).

19. *Id.* § 110(c).

20. *Id.* § 102, cmt. ¶ 13.

21. *Id.* (noting, *e.g.*, that “[a]n agreement among less than all of the members might well be enforceable among those members as parties, but would not be part of the operating agreement”).

22. *Id.*

23. *Id.* (citing to RULLCA Section 111(a)).

24. *Id.* Prefatory Note.



Delaware law, for example, provides that an operating agreement is “any agreement (whether referred to as a limited liability company agreement, operating agreement or otherwise), written, oral or implied, of the member or members as to the affairs of a limited liability company and the conduct of its business.”<sup>25</sup> Colorado law similarly provides that “[o]perating agreement’ means any agreement of all of the members as to the affairs of a limited liability company and the conduct of its business”<sup>26</sup> and notes that, “[e]xcept as otherwise provided in this article or as otherwise required by a written operating agreement, the operating agreement need not be in writing.”<sup>27</sup> Under Texas law, an operating agreement is called a “company agreement” and is defined as “any agreement, written or oral, of the members concerning the affairs or the conduct of the business of a limited liability company.”<sup>28</sup> The definition also provides that “[a] company agreement of a limited liability company having only one member is not unenforceable because only one person is a party to the company agreement.”<sup>29</sup> Tennessee law, under its unique revised limited liability company act,<sup>30</sup> includes a relatively comprehensive description of the operating agreement.

Except as otherwise provided in § 48-249-205 [setting forth waivable and non-waivable LLC act rules], all members of an LLC may enter into an operating agreement to regulate the affairs of the LLC and the conduct of its business, and to govern relations between or among the members, holders, managers, directors, officers and the LLC, as applicable. Persons other than members, including holders of financial rights, may, but need not, also enter into the operating agreement. The LLC also may be a party to the operating agreement. An operating agreement may be entered into either before, after or at the time of filing of articles of organization, and, whether entered into before, after or at the time of such filing, may be made effective as of the formation of the LLC, or at a later time or date provided in the operating agreement. Except to the extent the articles of organization or a written provision of an operating agreement specifically require otherwise, an operating agreement need not be in writing. The written provisions of an operating agreement need not be set out in a single integrated document.<sup>31</sup>

State statutes may provide guidance on the interpretation of operating agreements. Delaware law includes detailed interpretive provisions, starting with a general policy “to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.”<sup>32</sup> “The basic approach of the Delaware Act is to provide

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25. See DEL. CODE ANN. tit. 6, § 18-101(7).

26. COLO. REV. STAT. § 7-80-102(11)(a).

27. *Id.*

28. TEX. BUS. ORGS. CODE ANN. § 101.001.

29. *Id.*

30. See *supra* note 11.

31. TENN. CODE ANN. § 48-249-203.

32. DEL. CODE ANN. tit. 6, § 18-1101(b); accord KY. REV. STAT. ANN. § 275.003(1).

members with broad discretion in drafting the Agreement . . . .”<sup>33</sup> Nevada law is similar, providing that “[a]n operating agreement . . . must be interpreted and construed to give the maximum effect to the principle of freedom of contract and enforceability.”<sup>34</sup>

One important operating agreement interpretive question addressed by state LLC statutes and cases is the extent to which the LLC or an LLC member may be bound by an operating agreement even if not a signatory to the operating agreement. In Delaware, decisional law addressing this question led to statutory changes. In *Elf Atochem North American, Inc. v. Jaffari*,<sup>35</sup> decided by the Delaware Supreme Court in 1999 under Delaware’s LLC act as then in existence, the court held that an LLC was bound by the terms of the operating agreement even though the LLC was not a signatory to the operating agreement.<sup>36</sup> The court reasoned that the members of the LLC were the true interested parties and that binding the LLC to the operating agreement served their interests (as established and embodied in the operating agreement).<sup>37</sup>

In 2002, the Delaware legislature incorporated this rule from *Elf Atochem* into its LLC act, which now provides that: “[a] limited liability company is not required to execute its limited liability company agreement. A limited liability company is bound by its limited liability company agreement whether or not the limited liability company executes the limited liability company agreement.”<sup>38</sup> In 2005, the statute was further amended to provide that “[a] member or manager of a limited liability company or an assignee of a limited liability company interest is bound by the limited liability company agreement whether or not the member or manager or assignee executes the limited liability company agreement.”<sup>39</sup> The 2005 amendment to the statute was recently cited in a Delaware Chancery Court opinion in which the court found that an LLC member was bound by a fee shifting provision in an operating agreement the member had not signed.<sup>40</sup>

Delaware has taken a distinctly different approach to operating agreement non-signatories than a federal trial court took in applying Wisconsin law just two years before *Elf Atochem* was decided. In *Bubbles & Bleach, LLC v. Becker*,<sup>41</sup> after canvassing the relevant LLC statute and applicable decisional law, the court held that a non-signatory LLC was not

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33. *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 291 (Del. 1999).

34. NEV. REV. STAT. § 86.286.4(b).

35. *Elf Atochem*, 727 A.2d 286.

36. *Id.* at 287.

37. *Id.* at 293; accord *Arfa v. Zamir*, 2008 N.Y. Misc. LEXIS 10110, \*3 (N.Y. Sup. Ct. Apr. 29, 2008) (holding that “a cause of action for breach of an operating agreement can be asserted by an LLC, irrespective of whether the LLC actually executed it”).

38. DEL. CODE ANN. tit. 6, § 18-101(7). Similar language is employed in Kentucky. See KY. REV. STAT. ANN. § 275.003(4).

39. *Id.*

40. See *Seaport Vill. Ltd. v. Seaport Vill. Operating Co., LLC*, No. CIV.A. 8841-VCL, 2014 WL 4782817 (Del. Ch. Sept. 24, 2014).

41. *Bubbles & Bleach, LLC v. Becker*, No. 97 C 1320, 1997 WL 285938 (N.D. Ill. May 23, 1997).

bound by arbitration provisions in an operating agreement (comprising two agreements).

A fair reading of the Agreements in their entirety leads to the conclusion that B & B was not a party thereto and is therefore not bound by the arbitration clauses therein. Thus, finding no contractual basis upon which to bind B & B to arbitration, and in light of the relevant portions of the Wisconsin Limited Liability Statute, this court denies defendants' motion.<sup>42</sup>

The court found nothing in the operating agreement or Wisconsin's LLC statute that could be construed as evidence of an intention to bind a non-signatory LLC to the operating agreement.

In a 2010 case under Illinois law,<sup>43</sup> a court declined to follow *Elf Atochem*, holding that non-signatory LLCs were not, based on the issue and applicable facts in that case, bound by their operating agreements. The court's holding relied expressly on "the statutory guidelines, as well as the fact that the operating agreements d[id] not reveal that the signatories were signing on behalf of or in the name of the LLCs."<sup>44</sup> In its reasoning, the court notes that LLCs are legal entities separate from their members that have the ability to be bound as independent legal actors through well-known processes—processes that were known to the LLC members and not invoked in connection with the matters at issue in the case.<sup>45</sup>

Perhaps the most significant, controversial operating agreement issue in recent years, however, has been the extent to which LLC participants can agree around fiduciary duties by making provision in the operating agreement. Delaware law provides a relatively clear answer.<sup>46</sup> The Delaware LLC act "allows an LLC agreement to alter common law fiduciary duty rules by restricting, expanding, or eliminating LLC members' or managers' fiduciary duties."<sup>47</sup> Many state LLC statutes, however, follow the rule in RULLCA § 110<sup>48</sup> (which limits the extent to which private ordering through operating agreements can alter fiduciary duties) or otherwise restrict the modification of fiduciary duties in the operating agreement in some way.<sup>49</sup>

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42. *Id.* at \*6.

43. *Trover v. 419 OCR, Inc.*, 921 N.E.2d 1249 (Ill. App. 2010).

44. *Id.* at 1255.

45. *See id.* at 1254–55.

46. *See* DEL. CODE ANN. tit. 6, § 18-1101(c).

47. *Marino v. Grupo Mundial Tenedora, S.A.*, 810 F. Supp. 2d 601, 607 (S.D.N.Y. 2011) (citing DEL. CODE ANN. tit. 6, § 18-1101(c)).

48. NAT'L CONF. OF COMM'RS ON UNIF. ST. LAWS, *supra* note 10, at § 110(c)(4) & (d)–(g).

49. *See, e.g.*, CAL. CORP. CODE § 17701.10(c)(4), (d)–(g); FLA. STAT. ANN. § 605.0105(3)(e), (4); MONT. CODE ANN. § 35-8-109(3)(b)–(c); TENN. CODE ANN. § 48-249-205(b)(13)–(14).

## II. CONTEXTUALIZING THE LLC OPERATING AGREEMENT

Given these definitions and descriptions of operating agreements, what is their legal nature? Are they contracts or something else? The legal nature of an operating agreement can be assessed from a number of different perspectives. This part locates operating agreements by reference to four important legal frameworks: contract law, LLC law, partnership law, and corporate law.

### A. CONTRACT LAW

At common law, a contract is a legally enforceable promise.<sup>50</sup> Under basic contract law principles, an agreement needs to meet certain formative requirements, known as elements, to be a contract. The baseline legal elements of a valid contract are well known and relatively simple (even if not straightforward in application): “the formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration.”<sup>51</sup> A contract has two or more parties<sup>52</sup> and, in its archetypal form, codifies bilateral transactions, obligations, or relationships.<sup>53</sup> Although much more could be said here about the nature of a contract, this unadorned summary is adequate for purposes of the limited points made in this essay.

Operating agreements do involve a form of mutual assent, although perhaps not in the classic sense in which there is a promisor and promisee. The finance and governance provisions (which may relate to management, fiduciary duties, and other obligations) typically comprising an operating agreement represent a bargained-for consensus as among the members and, as applicable, managers. Members and managers may contribute or agree to provide money capital or human capital and exchange mutual promises relating to the conduct of the business of the LLC. Some or all of this may be reflected in the operating agreement. Contract law contemplates that a bargain may consist of an exchange of promises between or among contracting parties and that promisors and promisees to

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50. See RESTATEMENT (SECOND) OF CONTRACTS § 1 (1981) (“A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.”); GEORGE W. KUNEY & ROBERT M. LLOYD, *CONTRACTS: TRANSACTIONS AND LITIGATION* 1 (3d ed. 2011) (“[A] contract is ‘a promise that the law will enforce.’”).

51. RESTATEMENT (SECOND) OF CONTRACTS § 17 (1981); *In re Denman*, 513 B.R. 720, 723 (Bankr. W.D. Tenn. 2014) (“Contract rights arise upon an offer, acceptance, and transfer of adequate consideration between at least two assenting parties. If these elements do not exist, a contract right does not exist . . . .” (citation omitted)).

52. See RESTATEMENT (SECOND) OF CONTRACTS § 9 (1981) (“There must be at least two parties to a contract, a promisor and a promisee, but there may be any greater number.”).

53. See, e.g., *In re Estate of ACN*, 509 N.Y.S.2d 966, 969 (N.Y. Sur. Ct. 1986) (“A contract is a bilateral transaction in which an exchange of benefits, either present or deferred, is exchanged.”); Amelia H. Boss, *Electronic Data Interchange Agreements: Private Contracting Toward a Global Environment*, 13 *Nw. J. INT’L L. & BUS.* 31, 67 (1992) (“The traditional concept of contract is a bilateral negotiated agreement between parties.”).

a contract may promise each other the same performance.<sup>54</sup> As a result, at least some operating agreements may be common law contracts. Yet, as the information provided *supra* Part I of this essay demonstrates, the nature of an operating agreement is not fixed, may address a broad scope of matters relating to the affairs and operations of the LLC and the conduct of its constituents, and may differ significantly from firm to firm and from state to state.

The *Denman* court, as indicated in the quote that introduces this essay, concludes that an operating agreement is not a common law contract. "Such operating agreements . . . may lack mutual assent, consideration, and privity amongst the parties. Furthermore, a member's failure to perform under an LLC operating agreement does not excuse the other members' performance under the LLC operating agreement . . ." <sup>55</sup> In its analysis, the court stresses two points. First, the court notes that "[a] single member LLC operating agreement does not have multiple members and, therefore, can satisfy neither the mutual assent element nor the exchange of consideration element of contract law."<sup>56</sup> Second, the court finds that "the enforceability of an LLC operating agreement against members that were not a party to the LLC operating agreement"<sup>57</sup> conflicts with contract law norms.<sup>58</sup> The *Denman* court's supporting rationale is transparent, but its conclusions are contestable.

Specifically, the court avers that "[a] single member LLC operating agreement does not have multiple members and, therefore, can satisfy neither the mutual assent element nor the exchange of consideration element of contract law."<sup>59</sup> Said another way, there is no contract if there is only one party. Yet, although the matter is not free from doubt,<sup>60</sup> the operating agreement for a single-member LLC still may be deemed to have two parties: the member and the LLC (which may be bound, even if not a signatory).<sup>61</sup> Tennessee law, which governed the operating agreement at issue in the *Denman* case, supports the view that the operating

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54. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS §§ 3 & 10 (1981).

55. *Denman*, 513 B.R. at 726.

56. *Id.* at 724.

57. *Id.* at 725.

58. *Id.* ("[U]nder contract law, parties cannot be deemed to be parties to a contract without their assent. Similarly, parties to contracts must mutually assent to amendments to existing contracts; whereas, LLC operating agreements may be amended without all members approving.").

59. *Id.* at 724.

60. Courts scrutinize single-member LLCs carefully in applying legal rules that invite inquiry into their separateness from their single member. See, e.g., Anthony Q. Fletcher, *Publish or Perish: The New York Limited Liability Company Law Publication Requirement the Fundamental Flaw of an Otherwise Flawless Law*, 1 N.Y.U. J. L. & Bus. 139, 195 (2004) (noting that "[f]ederal agencies and almost one-half of the states have adopted the view that the LLC is a legal 'person[ ]'" and that "[t]he predominant view in both federal and state law is that the LLC possesses all the attributes of legal personhood."); see also Daniel S. Kleinberger & Carter G. Bishop, *The Single-Member Limited Liability Company As Disregarded Entity Now You See It, Now You Don't*, BUS. L. TODAY, August 2010, at 1, 2-3.

61. See Larry A. DiMatteo, *supra* note 3, at 300 (2009) ("The operating agreement establishes the member-to-member relationship, but it does so in the context of the crea-

agreement of single-member LLC is an agreement between the member and the LLC.<sup>62</sup> Moreover, the LLC may be a signatory to the operating agreement.<sup>63</sup>

In addition, the *Denman* court ruled that enforcing an operating agreement against non-signatory members and amending an operating agreement without unanimous consent are inconsistent with contract law. For example, the Tennessee law applicable in *Denman* provides that “[a]n LLC is bound by the provisions of an operating agreement, even if the LLC is not a signatory to the agreement”<sup>64</sup> and further states that,

[t]he articles or the written provisions of an operating agreement . . . may provide that the written provisions of the LLC’s operating agreement shall be binding upon a person who thereafter becomes a member . . . , without executing an existing operating agreement, if the new member . . . otherwise complies with the conditions for becoming a member . . . , as set forth in the LLC documents of such LLC.<sup>65</sup>

“[U]nder contract law,” the court states, “parties cannot be deemed to be parties to a contract without their assent.”<sup>66</sup> The court adds, on the amendment issue, that “parties to contracts must mutually assent to amendments to existing contracts; whereas, LLC operating agreements may be amended without all members approving.”<sup>67</sup> From these observations, the court concludes that “[s]uch LLC provisions undermine the privity of contract and demonstrate that LLC operating agreements are unique instruments apart from executory contracts.”<sup>68</sup>

It seems fair to note, however, that an LLC or LLC member may assent to the terms of an operating agreement without being a signatory<sup>69</sup>

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tion of a separate legal entity. Thus, it also creates a relationship between the member and the LLC.”).

62. TENN. CODE ANN. § 48-249-203(c) (“An LLC with a single member may adopt, and, if so, shall be bound by, an operating agreement between the member and the LLC.”). However, some state LLC statutes describe an operating agreement for a single-member LLC as an agreement with only one party, even when the state law recognizes that the LLC is bound by the agreement as an entity separate from its owner. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-101 (“A limited liability company agreement of a limited liability company having only 1 member shall not be unenforceable by reason of there being only 1 person who is a party to the limited liability company agreement.”); MICH. COMP. LAWS ANN. § 450.4215 (“An operating agreement of a limited liability company that has 1 member is not unenforceable because only 1 person is a party to the operating agreement.”); TEX. BUS. ORGS. CODE ANN. § 101.001 (“A company agreement of a limited liability company having only one member is not unenforceable because only one person is a party to the company agreement.”).

63. *Id.* § 48-249-203 (“The LLC . . . may be a party to the operating agreement.”).

64. *Id.* § 48-249-203(d).

65. *Id.* § 48-249-203(e). *But see* TEX. BUS. ORGS. CODE ANN. § 101.053 (“The company agreement of a limited liability company may be amended only if each member of the company consents to the amendment.”).

66. *In re Denman*, 513 B.R. 720, 725 (Bankr. W.D. Tenn. 2014).

67. *Id.*

68. *Id.*

69. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 18 (1981) (“Manifestation of mutual assent to an exchange requires that each party either make a promise or begin or render a performance.”).

and, in so doing, may assent to a statutory rule or operating agreement provision that allows for amendment of the operating agreement with less than unanimous consent. The Tennessee law provision that binds new members to the operating agreement, for instance, requires compliance with the conditions for becoming a member,<sup>70</sup> which may be deemed to constitute assent to the terms of the operating agreement. In other words, under Tennessee law, acceptance by a member of the terms of membership constitutes acceptance of all of the terms and provisions of the operating agreement. Further, contract law does not require that the parties commit their agreement to writing<sup>71</sup> and may support enforcement of a valid and binding agreement that provides for amendment without the approval of all parties (absent an independent reason—*e.g.*, bad faith, unfair dealing, illegality, or violation of public policy—to find the provision unenforceable).<sup>72</sup>

### B. LLC LAW

Delaware LLC law implicitly characterizes limited liability company agreements as contracts and invokes contract law for their interpretation and enforcement.<sup>73</sup> Delaware courts cite to contract law principles in support of their opinions on LLCs and limited liability company agreements. For example, a 2014 unpublished opinion of the Court of Chancery cites to the Delaware LLC act for the proposition that an LLC is bound by the limited liability company agreement even if it is not a signatory, asserting that:

Basic principles of contract law support this reading. As a general matter, “only parties to a contract are bound by that contract.” Likewise, “only a party to a contract may be sued for breach of that contract.” By binding a Delaware LLC and its members to their operating agreement, Section 18–101(7) makes them parties to the operating agreement.<sup>74</sup>

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70. See *supra* note 65 and accompanying text.

71. See, *e.g.*, KUNEY & LLOYD, *supra* note 50, at v (“Contracts can be oral, in writing, or both.”). Under the Restatement (Second) of Contracts, a contract is a legally enforceable promise, and “[a] promise may be stated in words either oral or written, or may be inferred wholly or partly from conduct.” RESTATEMENT (SECOND) OF CONTRACTS §§ 1 & 4 (1981). See also *supra* note 6.

72. See, *e.g.*, *Abbey v. Fortune Drive Assocs.*, 2010 WL 1553616, \*8–9 (Cal. Dist. Ct. App. Apr. 20, 2010) (provision allowing for non-unanimous contract amendment may be enforceable; however, “amendment of a contract by less than all parties is subject to certain common law constraints. First and foremost . . . is the intent of the parties . . . . In addition, the requirement of definiteness and the obligation of parties to act in good faith and deal fairly limit the scope of amendments.”). *Abbey* involved the enforceability of a non-unanimous amendment to an operating agreement, authorized under the amendments provision of the operating agreement, that (among other things) added an arbitration provision to the operating agreement.

73. See, *e.g.*, 6 DEL. CODE ANN. § 1101(d); see also DiMatteo, *supra* note 3, at 286 (“Delaware’s freedom of contract approach results in the application of the entire common law of contracts to govern an otherwise statutorily controlled area of law.”).

74. *Seaport Vill. Ltd. v. Seaport Vill. Operating Co., LLC*, No. CIV.A. 8841-VCL, 2014 WL 4782817, at \*2 (Del. Ch. Sept. 24, 2014) (citations omitted).

Moreover, the Delaware LLC act provides that “[a] limited liability company agreement of a limited liability company having only 1 member shall not be unenforceable by reason of there being only 1 person who is a party to the limited liability company agreement.”<sup>75</sup>

Decisional law in other states also includes references to operating agreements as contracts or as being contractual in nature. A South Carolina case expressly classifies an operating agreement as a contract.<sup>76</sup> Similarly, under Colorado law:

An LLC’s operating agreement serves as a multilateral contract among the members, who agree that the exercise of their membership and management rights and duties will be bound by the terms set forth. This conclusion is consistent with the terms of the . . . operating agreement . . . Thus, the Operating Agreement itself is framed in terms of a multilateral agreement among the members and it is appropriate to interpret it in light of prevailing principles of contract law.<sup>77</sup>

Moreover, a number of Louisiana cases address the contractual nature of LLCs.<sup>78</sup> Although the opinions in these cases and others like them do not always label operating agreements “contracts,” they do conclude that the operating agreements at issue to be valid, binding, and enforceable obligations of the parties. These conclusions do not necessarily ensure that contract law will apply to other issues relating to those operating agreements, however.

### C. PARTNERSHIP AND CORPORATE LAW

LLC law combines attributes of partnership and corporate law.<sup>79</sup> The foundational relationship between LLC law and partnership law is manifest in the Prototype Act and the RULLCA<sup>80</sup> and has been acknowledged, including by reference to analogies between partnership agreements and operating agreements, in judicial opinions and legal scholarship.<sup>81</sup> *Elf Atochem*, the 1999 Delaware Supreme Court case cited

75. DEL. CODE ANN. tit. 6, § 18-101(7); accord KY REV. STAT. ANN. § 275.015(21).

76. See *Clary v. Borrell*, 727 S.E.2d 773, 778 (S.C. Ct. App. 2012) (“The operating agreement of a limited liability company is a binding contract that governs the relations among the members, managers, and the company.”).

77. *Condo v. Conners*, 266 P.3d 1110, 1115 (Colo. 2011) (citations omitted).

78. See, e.g., *Ark-La-Tex Safety Showers, LLC v. Jorio*, 132 So. 3d 986 (La. Ct. App. 2013); *Risk Mgmt. Servs., LLC v. Moss*, 40 So. 3d 176 (La. Ct. App. 2010); *Kinkle v. R.D.C., LLC*, 889 So. 2d 405 (La. App. Ct. 2004).

79. See, e.g., *Arfa v. Zamir*, 2008 N.Y. Misc. LEXIS 10110, \*3 (N.Y. Sup. Ct. Apr. 29, 2008) (“An LLC is a hybrid entity, combining elements of the corporate and partnership form.”); Alan R. Bromberg, *Texas Business Organization and Commercial Law—Two Centuries of Development*, 55 SMU L. REV. 83, 124 (2002) (“Limited Liability Companies (‘LLCs’) came into Texas law in 1991 by the passage of a complete statute patterned partly on the TBCA and otherwise on TRLPA’s limited partnership features designed to achieve taxation as a partnership rather than a corporation.” (footnote omitted)).

80. See *supra* note 24 and accompanying text.

81. See, e.g., *Feeley v. NHAOCG, LLC*, 62 A.3d 649, 669 (Del. Ch. 2012) (“Delaware alternative entity statutes, including the LLC Act . . . , are modeled on the LP Act . . . .” (footnote omitted)); *Wasserman v. Kay*, 197 Md. App. 586, 592 (Md. Ct. Spec. App. 2011)



*supra* Part I. B., expressly cites to guidance on limited partnership agreements as a foundation for its analysis.<sup>82</sup> Similar observations have been made about corporate law's relationship to LLC law and operating agreements.<sup>83</sup> The *Denman* court found that "[t]he rights and duties of an operating agreement function akin to corporate by-laws, establishing the structure and form of an entity and arising by adoption by its members or shareholders."<sup>84</sup>

Various observers acknowledge that operating agreements share characteristics with *both* partnership agreements and corporate bylaws.<sup>85</sup>

(describing an operating agreement as "much like a partnership agreement"); Scott Y. Barnes et al., *1996 Limited Liability Company Act*, 8 S. C. LAW. 33, 34 (1996) (describing an operating agreement as "essentially the same as a partnership agreement"); Peter D. Hutcheon, *The New Jersey Limited Liability Company Statute: Background and Concepts*, 18 SETON HALL LEGIS. J. 111, 136-37 (1993) ("The operating agreement for an LLC is intended to function for an LLC much like the limited partnership agreement functions for a limited partnership . . ."); Anthony J. Luppino, *Multidisciplinary Business Planning Firms: Expanding the Regulatory Tent Without Creating a Circus*, 35 SETON HALL L. REV. 109, 147 (2004) (describing an LLC operating agreement as "the LLC equivalent of a partnership agreement").

82. See *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 291 (Del. 1999).

83. See, e.g., Scott R. Anderson, *The Illinois Limited Liability Company: A Flexible Alternative for Business*, 25 LOY. U. CHI. L.J. 55, 87 (1993) (describing an operating agreement as "similar to corporate by-laws"); Michael A. Budin, *Prepare LLC Documents With Care—Issues to Consider to Achieve the Desired Results for Your Client*, 74 PA. B. A. Q. 27, 31 (2003) ("Under the PA LLC Act, the operating agreement is considered a counterpart to the bylaws of a corporation . . ."); David Groshoff, *Contrepreneurship? Examining Social Enterprise Legislation's Feel-Good Governance Giveaways*, 16 U. PA. J. BUS. L. 233, 247-48 (2013) ("Operating agreements typically govern an LLC's internal affairs in a similar manner to how bylaws govern a corporation."); Martha W. Jordan, *Pennsylvania's Limited Liability Company Act Raises Taxing Questions*, 69 TEMP. L. REV. 703, 705 n.10 (1996) ("The operating agreement is similar to corporate bylaws."); Carol J. Miller et al., *Limited Liability Companies Before and After the January 1997 IRS "Check-The-Box" Regulations: Choice of Entity and Taxation Considerations*, 25 N. KY. L. REV. 585, 589 (1998) (describing the operating agreement as "comparable to corporate by-laws").

84. *In re Denman*, 513 B.R. 720, 723 (Bankr. W.D. Tenn. 2014).

85. See, e.g., *Underground Grp., LLC v. Hali Power, Inc.*, 2012 N.Y. Misc. LEXIS 6323, \*13 (N.Y. Sup. Ct. Mar. 21, 2012) ("As with partnership agreements and corporate by-laws, an LLC operating agreement serves to fill in any gaps left by the statute or to vary the default rules as desired by the equity holders and as permitted by law."); Anderson, *supra* note 83, at 65 n.57 ("An LLC operating agreement is similar in form to a corporation's by-laws or a partnership agreement . . ."); Steven Aurlerith, *The ABCs Of LLCs (Limited Liability Companies): What Are They; Who Needs Them; And Is Vermont Ready for Them?*, 21 VER. B. J. & L. DIG. 11, 12 (1995) ("The operating agreement in the LLC is the counterpart of the corporate by-laws and the partnership agreement."); Howard M. Friedman, *The Silent LLC Revolution - The Social Cost Of Academic Neglect*, 38 CREIGHTON L. REV. 35, 75 (2004) ("The operating agreement resembles the partnership agreement in a general partnership; it also resembles corporate by-laws." (footnote omitted)); Ronald J. Kline et al., *The New Limited Liability Company in Florida*, 73 FLA. BAR J. 42, 44 (1999) (describing the LLC operating agreement as "a combination of a partnership agreement and corporate bylaws"); Robert G. Lang, *Utah's Limited Liability Company Act: Viable Alternative or Trap for the Unwary?*, 1993 UTAH L. REV. 941, 949 ("The LLC operating agreement is similar to corporate bylaws or a partnership agreement . . ."); Craig J. Langstraat & K. Dianne Jackson, *Choice of Business Tax Entity after the 1993 Tax Act*, 11 AKRON TAX J. 1, 6 (1995) ("[A]n operating agreement . . . resembles the by-laws of a corporation and the agreement in a partnership."); Kathleen King Parker, *The Limited Liability Company: An Introduction*, 39 B.B.J. 8, 9 (1995) ("An LLC operating agreement is roughly analogous to a partnership agreement or a corporation's articles of organization and by-laws.").

Many agree that operating agreements are more like partnership agreements—especially limited partnership agreements—because of their focus on provisions that interact with partnership tax rules.<sup>86</sup> Also, unlike corporate bylaws, operating agreements are optional in many states.<sup>87</sup>

Are these partnership and corporate law analogs contracts? Although partnership law varies from state to state, as a general matter, partners are not expressly required to contract to form a partnership,<sup>88</sup> and a partnership agreement is not defined in a manner that mandates adherence to the common law elements of a contract.<sup>89</sup> However, courts often view partnership agreements as enforceable contracts and routinely apply principles from contract law in interpreting and enforcing the terms and provisions in partnership agreements.<sup>90</sup> Even if a partnership agreement is not a contract, it may be enforceable among the partners in certain respects.<sup>91</sup> And, while corporate bylaws admittedly look less like an ar-

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86. See, e.g., Anderson, *supra* note 83, at 65 n.57 (“An LLC operating agreement . . . generally will be more analogous to a partnership agreement than to corporate by-laws in substance.”); *id.* at 87–88 (“Because LLCs are generally treated as partnerships for tax purposes, LLC operating agreements should generally be drafted in a manner similar to partnership agreements.” (footnote omitted)); *id.* at 88 n.203 (“In contrast to standard corporate by-laws, LLC operating agreements should contain provisions such as partnership-type tax allocations that address the requirements and tax consequences associated with subchapter K tax treatment.”); B. Todd Bailey & Rick D. Bailey, *The Idaho Limited Liability Company: In Search of the Perfect Entity*, 31 IDAHO L. REV. 1, 10 (1994) (“An operating agreement of an LLC is similar to corporate bylaws or a partnership agreement, more closely resembling the latter.”).

87. See *supra* notes 25–31 and accompanying text (illustrating the statutory use of “any agreement” and “may enter into”); see also Trippe S. Fried, *Minimizing Disputes and Maximizing Profits: Five Balancing Acts for New Business Owners*, 4 DEPAUL BUS. & COMM. L.J. 401, 408 (2006) (noting that “partnership agreements and LLC operating agreements are not always required by statute”).

88. Under the Revised Uniform Partnership Act, a partnership exists when two or more persons associate as co-owners to carry on a business for profit. REVISED UNIFORM PARTNERSHIP ACT § 101(6), 202(a) (1997).

89. See, e.g., *Sewing v. Bowman*, 371 S.W.3d 321, 332 (Tex. App.—Houston [1st Dist.] 2012, no pet.). The Revised Uniform Partnership Act provides the following definition for a partnership agreement: “the agreement, whether written, oral, or implied, among the partners concerning the partnership, including amendments to the partnership agreement.” REVISED UNIFORM PARTNERSHIP ACT § 101(7).

90. See, e.g., *In re Kinder Morgan, Inc.*, 2014 Del. Ch. LEXIS 225, \*8 (Del. Ch. Nov. 5, 2014) (“Principles of contract interpretation apply to limited partnership agreements.”); *Norton v. K-Sea Transp. Partners L.P.*, 67 A.3d 354, 360 (Del. 2013) (“Limited partnership agreements are a type of contract.”); *Schuss v. Penfield Partners, L.P.*, 2008 Del. Ch. LEXIS 73, \*18 (Del. Ch. June 13, 2008) (“Limited partnership agreements are contracts the courts construe like any other contract.”); *Knapp v. Neptune Towers Assocs.*, 72 Mass. App. Ct. 502, 508 n.9 (Mass. App. Ct. 2008) (“Courts interpret partnership agreements in accordance with general contract principles.”); *In re Midnight Star Enters., L.P.*, 2006 SD 98, P12 (S.D. 2006) (“The partnership agreement is a contract between the partners and effect will be given to the plain meaning of its words.”); *In re Waggoner Estate*, 163 S.W.3d 161, 165 (Tex. App.—Amarillo 2005, no pet.) (“The law applicable to construction of contracts has been applied to partnership agreements . . . .”); *Kuderewski v. Estate of Hobbs*, 2001 Tenn. App. LEXIS 561, \*10 (Tenn. Ct. App. July 30, 2001) (“General principles of contract law apply to partnership agreements . . . .”).

91. See generally *Grunstein v. Silva*, 2014 Del. Ch. LEXIS 167, \*71 (Del. Ch. Sept. 5, 2014) (“Some of the critical elements of an enforceable partnership agreement include profits and losses, control, and ownership.” (citing *Cochran v. Nagle*, 1995 WL 819054, at \*2 (Del. Ch. Feb. 27, 1996))).

chetyal contract than partnership agreements (e.g., because they are not styled as bilateral or multilateral agreements with signatures of the parties and words indicating mutual assent), many courts and commentators do characterize corporate bylaws as contracts or at least apply rules of contract interpretation in analyzing the validity, binding nature, and enforceability of bylaw provisions.<sup>92</sup> This characterization is not expressly or impliedly based on compliance with the common law elements of a contract.

Specifically, corporate bylaws are often described as a contract between or among corporate constituents.<sup>93</sup> Litigants and courts sometimes distinguish between contractual bylaw provisions, which vest property rights in the shareholders with respect to one another, and non-contractual provisions that merely regulate the conduct of the corporation's internal affairs.<sup>94</sup> The language of contract used by litigants and the courts should not mislead observers into believing that courts will actually treat bylaws exactly as they would a contract. First, bylaw provisions are subject to a large body of state law that applies specifically to them as elements of a mandatory corporate organizational document, and a court may not enforce a provision under contract law that runs contrary to established principles of corporate law without over-ruling that corporate law. Second, even where a provision is deemed contractual in nature, it may not be enforced against other shareholders unless a claimant relied on it and enforcement would not cause unreasonable hardship to the other shareholders.<sup>95</sup>

### III. CATEGORIZING THE LLC OPERATING AGREEMENT

The court in *Denman* characterizes an operating agreement as “a business formation and governance instrument”<sup>96</sup> and “a legal instrument that defines the membership interests and rights”<sup>97</sup> of LLC members rather than as a contract. Yet, as noted in *supra* Part II. A., the *Denman*

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92. See, e.g., *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990) (“Corporate charters and by-laws are contracts among the shareholders of a corporation and the general rules of contract interpretation are held to apply.”); *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010) (“Corporate charters and bylaws are contracts among a corporation’s shareholders; therefore, our rules of contract interpretation apply.”); Craig W. Dallan, *Understanding Judicial Review of Hospitals’ Physician Credentialing and Peer Review Decisions*, 73 TEMP. L. REV. 597, 643 (2000) (“[G]eneral corporate law . . . holds that corporate bylaws are contracts between the corporation and its shareholders.”).

93. *Id.*

94. See, e.g., *Galaviz v. Berg*, 763 F. Supp. 2d 1170, 1174–75 (N.D. Cal. 2011); *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 954–55 (Del. Ch. 2013), *judgment entered sub nom.*, *Boilermakers Local 154 Ret. Fund & Key W. Police & Fire Pension Fund v. Chevron Corp.* (Del. Ch. June 22, 2013); *Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 492–93 (Del. Ch.), *aff’d and remanded*, 670 A.2d 1338 (Del. 1995).

95. 8 WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS* § 4166 (2014) (footnotes omitted).

96. *In re Denman*, 513 B.R. 720, 726 (Bankr. W.D. Tenn. 2014).

97. *Id.*

court's contract law analysis is not unassailable.<sup>98</sup> Moreover, the court is careful to note that its analysis is based on the application of Tennessee law.<sup>99</sup> The *Denman* court's apparent restraint is appropriate under the circumstances. In the absence of a statutory provision classifying an operating agreement as a contract under applicable federal or state law,<sup>100</sup> a specific operating agreement may not be able to be classified as a contract because it may not meet the common law requirements for a contract.

Yet, judges, legal scholars, and other commentators with knowledge of the law often assume operating agreements are contracts or categorize them, without analysis, as contracts.<sup>101</sup> What of that? Does this classification reflect inadequate consideration or improper engagement of the relevant legal analysis? Unlikely. A more plausible explanation derives from the nature of the law of contracts and the context in which the classification is made.

The common law of contracts arose to give legal effect to people's bargained for and agreed to transactional relationships and to attach legally recognized consequences to noncompliance with their terms.<sup>102</sup> If one considers the categorization of an agreement as a contract to be, at its core, a proxy for a legally valid covenant that may bind and be enforcea-

98. See *supra* notes 61–62, 71–72 and accompanying text.

99. *Denman*, 513 B.R. at 725 (“Tennessee LLC operating agreements are not *per se* executory contracts governed by § 365 of the Bankruptcy Code because of their unique elements and features under state law that are inconsistent with contract law.”).

100. The common law of contracts may be supplemented or superseded by statutory law in specific contexts. For example, New York has a general obligations law that codifies many contract law rules. N.Y. GEN. OBLIG. LAW §§ 1-101-19-103. Also, the Uniform Commercial Code defines a contract as “the total legal obligation that results from the parties’ agreement as determined by [the Uniform Commercial Code] as supplemented by any other applicable laws.” NAT’L CONF. OF COMM’RS ON UNIF. ST. LAWS, UNIFORM COMMERCIAL CODE § 1-201(b)(11) (2001), available at [http://www.uniformlaws.org/shared/docs/ucc1/ucc1\\_am01.pdf](http://www.uniformlaws.org/shared/docs/ucc1/ucc1_am01.pdf).

101. See, e.g., *Showell v. Pusey*, 2011 Del. Ch. LEXIS 123, \*10 n.25 (Del. Ch. Sept. 1, 2011) (“LLC agreements are contracts . . .”); *Bluewater Logistics, LLC v. Williford*, 55 So. 3d 148, 159–60 (Miss. 2011) (“[A]n LLC operating agreement is a contract, subject to contract law[ ] . . .”); *TravelCenters of Am., LLC v. Brog*, 2008 Del. Ch. LEXIS 199, \*3 (Del. Ch. Apr. 3, 2008) (“[L]imited liability companies are creatures of contract[ ] . . .”); J. William Callison, *Venture Capital and Corporate Governance: Evolving the Limited Liability Company to Finance the Entrepreneurial Business*, 26 IOWA J. CORP. L. 97, 106 (2000) (describing an operating agreement as “a principal-agent contract”); DiMatteo, *supra* note 3, at 300 (“[T]he operating agreement begins a long-term, relational contract.”); Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 387, 416 n.1 (1991) (“LLC operating agreements are contracts.”); Patrick G. Goetzinger et al., *The South Dakota Limited Liability Company Act: The Next Generation Begins*, 44 S.D. L. REV. 207, 221 (1999) (“The operating agreement is the contract between members, managers and the company . . .”); Meghan Gruebner, *Delaware’s Answer to Management Deadlock in the Limited Liability Company: Judicial Dissolution*, 32 J. CORP. L. 641, 649 (2007) (“[A]n LLC agreement is a contract . . .”); Miller et al., *supra* note 83, at 589 (describing an operating agreement as “a contract between the members . . .”).

102. See KUNEY & LLOYD, *supra* note 50, at vi (“[C]ontract law is about putting relationships together and defining them, as well as taking them apart or trying to mend or break them.”).

ble against those who consent to its terms,<sup>103</sup> the references to operating agreements as contracts makes sense. Although an operating agreement may not always have all of the common law elements of a contract, LLC law typically affords it a contractual status, just as partnership agreements and corporate bylaws are afforded contractual status under partnership and corporate law, respectively.

Said another way, LLC law performs the same function for operating agreements that contract law provides for contracts—namely, it establishes the rules for determining when the terms of a consensual relationship resulting in the formation and maintenance of an LLC are valid, binding on the parties, and enforceable by one party against another as a matter of law. One might then observe that an operating agreement is a statutory form of contract, rather than a common law contract—one with its own legal rules. An operating agreement does not need to be a contract in any other sense in order for it to have the necessary legal effects as a valid, binding, and enforceable obligation.<sup>104</sup> Yet, in the absence of an express acknowledgement in LLC law that an operating agreement is a statutory contract, some uncertainty continues to exist about the application of the many aspects of contract law to operating agreements in both advisory and adjudicatory contexts.

#### IV. CONCLUDING

Ultimately, then, an operating agreement may or may not be a common law contract. But that legal categorization may not matter for purposes of simple legal conclusions regarding the force and effect of operating agreements under LLC law. A state's LLC law may establish the circumstances in which operating agreements are valid, binding, and enforceable and may provide that operating agreements are contracts or are to be treated as contracts in general or for specific purposes. This is, in essence, what the Delaware courts and legislature did in the *Elf Atochem* opinion and the resulting amendments to Delaware LLC law, respectively.<sup>105</sup>

However, the legal conclusion that an operating agreement is or is not a contract—and more specifically, a common law contract—may matter

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103. See, e.g., Jay M. Feinman, *Un-Making Law: The Classical Revival in the Common Law*, 28 SEATTLE U. L. REV. 1, 26 (2004) (noting that contract law decides “which promises to enforce, how to interpret and fill gaps in them, and what remedies to provide for breach”); Blake D. Morant, *The Teachings of Dr. Martin Luther King, Jr. and Contract Theory: An Intriguing Comparison*, 50 ALA. L. REV. 63, 93–94 (“The key to contract theory remains enforcement, where bargainers gain security through the use of contract rules and from the knowledge that any breach of a validly formed contract will result in a remedy.”).

104. See generally *Olson v. Halvorsen*, 986 A.2d 1150, 1161 (Del. 2009) (“[T]he LLC Act, like many other contracts, treats LLC agreements by permitting oral, written, or implied agreements.”); *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 292 (Del. 1999) (“In general, the commentators observe that only where the agreement is inconsistent with mandatory statutory provisions will the members’ agreement be invalidated.”).

105. See *supra* notes 35–39 and accompanying text.

in legal contexts that depend on the common law of contracts for their rules. This may include, for example, the application of the executory contracts definition in the *Denman* case. The *Denman* court states that the underlying legal issue as to the existence of an executory contract depends on the existence of a contract.<sup>106</sup> The *Denman* court relied heavily on the terms and provisions of Tennessee LLC law in rendering its decision that the operating agreement at issue was not a contract. Although the matter is not free from doubt, the *Denman* case may have been resolved differently if the court found clear evidence in or under Tennessee LLC law that an operating agreement was a contract.

Yet, before determining that a contract law conclusion or analysis answers a question in a legal regime outside contract law (or even outside a statutory law that labels a specific type of agreement as a contract), in the absence of clear statutory guidance under that legal regime, a decision-maker is best advised to look behind the “contract” label of an agreement to the dominant policy and theory relevant to the applicable legal regime. Where the objectives and philosophy of contract law and the non-contract law regime are consistent, a common law contract inquiry may well be appropriate. But where the policy and theory underlying contract law and the non-contract law regime diverge, an analysis based on the common law of contracts may be inapposite or even counterproductive.

As I believe Alan Bromberg, in whose honor and memory this essay was drafted,<sup>107</sup> would note, there is an opportunity here for legislative action that the specialty bar associations, the American Bar Association, and state bar associations can encourage.<sup>108</sup> If applicable policy makes it advisable for operating agreements to be contracts or to be consistently treated as contracts—or not be or be treated as contracts—in a specific situation, a statute (or at least explicit regulatory guidance) can and should be written for that purpose. Perhaps this essay will encourage closer attention to that issue and, in doing so, foster clearer advice. LLC

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106. *In re Denman*, 513 B.R. 720, 726 (Bankr. W.D. Tenn. 2014) (“Executory contracts are ‘contracts,’ and, therefore, must satisfy the elements and requirements of contract law.”). Interestingly, other cases addressing the question of whether an operating agreement is an executory contract under federal bankruptcy law (including cases cited in the *Denman* opinion) do not question the operating agreement’s classification as a contract. See, e.g., *In re Tsiaoushis*, 383 B.R. 616, 618–20 (Bankr. E.D. Va. 2007) *aff’d*, No. 1:07 CV 436, 2007 WL 2156162 (E.D. Va. July 19, 2007) (focusing on the existence of unperformed obligations); *in re Allentown Ambassadors, Inc.*, 361 B.R. 422, 444 (Bankr. E.D. Pa. 2007) (focusing on “ongoing, material, unperformed obligations” under the operating agreement); *In re DeLuca*, 194 B.R. 65, 77 (Bankr. E.D. Va. 1996) (“[T]he operating agreement . . . is an executory contract, since the object of the agreement . . . has not yet been accomplished and the parties have on-going duties and responsibilities to bring the project to a successful conclusion.”); *In re Daugherty Constr., Inc.*, 188 B.R. 607, 612 (Bankr. D. Neb. 1995) (focusing on the existence of unperformed obligations).

107. See *supra* \*.

108. See Alan R. Bromberg et al., *The Role of the Business Law Section and the Texas Business Law Foundation in the Development of Texas Business Law*, TEX. J. BUS. L. 41, 44, (2005) (telling “the proud story” of the role of the Section of Business Law of the State Bar of Texas and the Texas Business Law Foundation in developing the business law of the State of Texas).

operating agreements are contracts or otherwise constitute valid, binding, and enforceable legal commitments in a given context if the applicable statute says so. That much, we can count on.