UNIFORM LIMITED LIABILITY COMPANY ACT (2006)

(Last Amended 2013)

Drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS ONE-HUNDRED-AND-TWENTY-SECOND YEAR
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WITH PREFATORY NOTE AND COMMENTS

August 19, 2015

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UNIFORM LIMITED LIABILITY COMPANY ACT (2006)
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PREFATORY NOTE TO ULLCA (2006)

Background to this Act:
Developments since the Conference Considered and Approved the Original Uniform Limited Liability Company Act (ULLCA)

The Uniform Limited Liability Company Act ("ULLCA") was conceived in 1992 and first adopted by the Conference in 1994. By that time nearly every state had adopted an LLC statute, and those statutes varied considerably in both form and substance. Many of those early statutes were based on the first version of the ABA Model Prototype LLC Act.

ULLCA's drafting relied substantially on the then recently adopted Revised Uniform Partnership Act ("RUPA"), and this reliance was especially heavy with regard to member-managed LLCs. ULLCA's provisions for manager-managed LLCs comprised an amalgam fashioned from the 1985 Revised Uniform Limited Partnership Act ("RULPA") and the Model Business Corporation Act ("MBCA"). ULLCA's provisions were also significantly influenced by the then-applicable federal tax classification regulations, which classified an unincorporated organization as a corporation if the organization more nearly resembled a corporation than a partnership. Those same regulations also made the tax classification of single-member LLCs problematic.

Much has changed. All states and the District of Columbia have adopted LLC statutes, and many LLC statutes have been substantially amended several times. LLC filings are significant in every U.S. jurisdiction, and in many states new LLC filings approach or even outnumber new corporate filings on an annual basis. Manager-managed LLCs have become a significant factor in non-publicly traded capital markets, and increasing numbers of states provide for mergers and conversions involving LLCs and other unincorporated entities.

In 1997 the tax classification context changed radically, when the IRS' "check-the-box" regulations became effective. Under these regulations, an "unincorporated" business entity is taxed either as a partnership or disregarded entity (depending upon the number of owners) unless it elects to be taxed as a corporation. Exceptions exist (*e.g.*, entities whose interests are publicly traded), but, in general, tax classification concerns no longer constrain the structure of LLCs and the content of LLC statutes. Single-member LLCs, once suspect because of novel and uncertain tax status, are now popular both for sole proprietorships and as corporate subsidiaries.

In 1995 the Conference amended RUPA to add "full-shield" LLP provisions, and today every state has some form of LLP legislation (either through a RUPA adoption or shield-related revisions to a UPA-based statute). While some states still provide only a "partial shield" for LLPs, many states have adopted "full shield" LLP provisions. In full-shield jurisdictions, LLPs and member-managed LLCs offer entrepreneurs very similar attributes and, in the case of professional service organizations, LLPs may dominate the field.

ULLCA was revised in 1996 in anticipation of the "check the box" regulations and has been adopted in a number of states. In many non-ULLCA states, the LLC statute includes RUPA-like provisions. However, state LLC laws are far from uniform.

Eighteen years have passed since the IRS issued its gate-opening Revenue Ruling 88-76, declaring that a Wyoming LLC would be taxed as a partnership despite the entity's corporate-like liability shield. More than eight years have passed since the IRS opened the gate still further with the "check the box" regulations. It is an opportune moment to identify the best elements of the myriad "first generation" LLC statutes and to infuse those elements into a new, "second generation" uniform act.

Noteworthy Provisions of the 2006 Act

The Revised Uniform Limited Company Act is drafted to replace a state's current LLC statute, whether or not that statute is based on ULLCA. The new Act's noteworthy provisions concern:

- the operating agreement
- fiduciary duty
- the ability to "pre-file" a certificate of organization without having a member at the time of the filing
- the power of a member or manager to bind the limited liability company
- default rules on management structure
- charging orders
- a remedy for oppressive conduct
- derivative claims and special litigation committees
- organic transactions—mergers, conversions, and domestications

<u>The Operating Agreement</u>: Like the partnership agreement in a general or limited partnership, an LLC's operating agreement serves as the foundational contract among the entity's owners. RUPA pioneered the notion of centralizing all statutory provisions pertaining to the foundational contract, and—like ULLCA and ULPA (2001)—the new Act continues that approach. However, because an operating agreement raises issues too numerous and complex to include easily in a single section, the new Act uses three related sections to address the operating agreement:

- Section 110—scope, function, and limitations;
- Section 111—effect on limited liability company and persons becoming members; preformation agreement; and
- Section 112—effect on third parties and relationship to records effective on behalf of limited liability company.

The new Act also contains a number of substantive innovations concerning the operating agreement, including:

- better delineating the extent to which the operating agreement can define, alter, or even eliminate aspects of fiduciary duty;
- expressly authorizing the operating agreement to relieve members and managers from liability for money damages arising from breach of duty, subject to specific limitations; and
- stating specific rules for applying the statutory phrase "manifestly unreasonable" and thereby providing clear guidance for courts considering whether to invalidate operating agreement provisions that address fiduciary duty and other sensitive matters.

Fiduciary Duty: RUPA also pioneered the idea of codifying partners' fiduciary duties in order to protect the partnership agreement from judicial second-guessing. This approach—to "cabin in" (or corral) fiduciary duty—was followed in ULLCA and ULPA (2001). In contrast, the new Act recognizes that, at least in the realm of limited liability companies:

- the "cabin in" approach creates more problems than it solves (*e.g.*, by putting inordinate pressure on the concept of "good faith and fair dealing"); and
- the better way to protect the operating agreement from judicial second-guessing is to:
  - increase and clarify the power of the operating agreement to define or re-shape fiduciary duties (including the power to eliminate aspects of fiduciary duties); and
  - provide some guidance to courts when a person seeks to escape an agreement by claiming its provisions are "manifestly unreasonable."

Accordingly, the new Act codifies major fiduciary duties but does not purport to do so exhaustively. *See* Section 409.

The Ability to "Pre-File" a Certificate of Organization: The Comments to Section 201 explain in detail how the new Act resolves the difficult question of the "shelf LLC" (*i.e.,* an LLC formed without having at least one member upon formation). In short, the Act: (i) permits an organizer to file a certificate of organization without a person "waiting in the wings" to become a member upon formation; but (ii) provides that the LLC is not formed until and unless at least one person becomes a member and the organizer makes a second filing stating that the LLC has at least one member.

The Power of a Member or Manager to Bind the Limited Liability Company: In 1914 the original Uniform Partnership Act codified a particular type of apparent authority by position, providing that "[t]he act of every partner . . . for apparently carrying on in the usual way the business of the partnership binds the partnership . . . ." This concept of "statutory apparent authority" applies by linkage in the 1916 Uniform Limited Partnership Act and the 1976/85 Revised Uniform Limited Partnership Act and appears in RUPA, ULLCA, ULPA (2001), and almost every LLC statute in the United States.

The concept makes good sense for general and limited partnerships. A third party dealing with either type of partnership can know by the formal name of the entity and by a person's status as general or limited partner whether the person has the power to bind the entity.

The concept does not make sense for modern LLC law, because: (i) an LLC's status as member-managed or manager-managed is not apparent from the LLC's name (creating traps for unwary third parties); and (ii) although most LLC statutes provide templates for member-management and manager-management, variability of management structure is a key strength of the LLC as a form of business organization.

The new Act recognizes that "statutory apparent authority" is an attribute of partnership formality that does not belong in an LLC statute. Section 301(a) provides that "a member is not an agent of the limited liability company solely by reason of being a member." Other law—most especially the law of agency—will handle power-to-bind questions.

Although conceptually innovative, this approach will not significantly alter the commercial reality that exists between limited liability companies and third parties, because:

1. The vast majority of interactions between limited liability companies and "third parties" are quotidian and transpire without agency law issues being recognized by the parties, let alone disputed.
2. When a limited liability company enters into a major transaction with a sophisticated third party, the third party never relies on statutory apparent authority to determine that the person purporting to act for the limited liability company has the authority to do so;
3. Most LLCs use employees to carry out most of the LLC's dealings with third parties. In that context, the agency power of members and managers is usually irrelevant (if an employee's authority is contested and the employee "reports to" a member or manager, the member's or manager's authority will be relevant to determining the employee's authority. However, in that situation, agency law principles will suffice to delineate the manager or member's supervisory authority);
4. Very few current LLC statutes contain rules for attributing to an LLC the wrongful acts of the LLC's members or managers. *Compare* RUPA § 305. In this realm, this Act merely acknowledges pre-existing reality;
5. As explained in detail in the Comments to Sections 301 and 407(c), agency law principles are well-suited to the tasks resulting from the "de-codification" of apparent authority by position.

The moment is opportune for this reform. The newly issued Restatement (Third) of Agency gives substantial attention to the power of an enterprise's participants to bind the enterprise. In addition, the new Act has "souped up" RUPA's statement of authority to permit an LLC to publicly file a statement of authority for a position (not merely a particular person). Statements of authority will enable LLCs to provide reliable documentation of authority to enter into transactions without having to disclose to third parties the entirety of the operating agreement. (The new Act also has eliminated prolix provisions that sought to restate agency law rules on notice and knowledge.)

<u>Default Rules on Management Structure</u>: The new Act retains the manager-managed and member-managed constructs as options for members to use in configuring their *inter se*

relationship, and the operating agreement is the vehicle by which the members make and state their choice of management structure. Given the elimination of statutory apparent authority, it is unnecessary and could be confusing to require the articles of organization to state the members' determination on this point.

Charging Orders: The charging order mechanism: (i) dates back to the 1914 Uniform Partnership Act and the English Partnership Act of 1890, and (ii) is an essential part of the "pick your partner" approach that is fundamental to the law of unincorporated businesses. The new Act continues the charging order mechanism, but modernizes the statutory language so that the language (and its protections against outside interference in an LLC's activities) can be readily understood.

A Remedy for Oppressive Conduct: Reflecting case law developments around the country, the new Act permits a member (but not a transferee) to seek a court order "dissolving the company on the grounds that the managers or those members in control of the company . . . have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the [member]." Section 701(5)(B). This provision is necessary given the perpetual duration of an LLC formed under this Act, Section 104(c), and this Act's elimination of the "put right" provided by ULLCA § 701.

Derivative Claims and Special Litigation Committees: The new Act contains modern provisions addressing derivative litigation, including a provision authorizing special litigation committees, and subjecting their composition and conduct to judicial review.

Organic Transactions—Mergers, Conversions, and Domestications: The new Act has comprehensive, self-contained provisions for these transactions, including "inter-species" transactions.

PREFATORY NOTE TO 2011 AND 2013 HARMONIZATION AMENDMENTS

From 2009 to 2013, the Uniform Law Conference undertook an intensive effort to harmonize, to the extent possible, all uniform acts pertaining to unincorporated organizations. As part of that effort, the Uniform Limited Liability Company Act ("ULLCA") underwent four types of changes: substantive; major improvements in language; minor revisions in language for the sake of harmonization; and relocation within this particular "spoke" of provisions that are part of the "HUB" in the new Uniform Business Organizations Code ("UBOC").

Substantive Changes

The three most significant substantive changes are:

- eliminating the possibility of a shelf LLC (with the attendant, complex provision requiring two filings with the filing office) and providing instead that "[a] limited liability company is formed when the company's certificate of organization becomes effective and at least one person becomes a member," Section 201(d);

- replacing the "ordinary care/business judgment rule" standard with the duty to "refrain from engaging in grossly negligent or reckless conduct, willful or intentional misconduct, or knowing violation of law," Section 409(c);
- recognizing that, when an LLC has only one member, the "pick your partner" concept is inapposite and providing that, in that situation, the foreclosure of a charging order pertains to the entire ownership interest, not just the economic rights, Section 503(f).

Other substantive changes include: (i) providing a narrow exception to the rule that the amendments to the operating agreement control the rights of person dissociated as a members and of persons that had previously become transferees, Section 107(b)(2); (ii) eliminating the requirement that a domestic LLC designate and maintain an in-state office, Section 201; (iii) requiring that the annual report list the name of at least one member if the LLC is member-managed and one manager if the LLC is manger-managed, Section 212(a)(4) and (5); and (iv) expressly authorizing a limited liability company to provide advancements to a person entitled to indemnification, Section 408(c).

Substantial Improvements to Language

The most significant improvements in language appear in Section 105 (formerly Section 110), the first of three sections addressing the operating agreement. The structure of Section 105 is far less complicated than the structure of former Section 110.

Harmonization-Based Language Changes

Minor changes in language for the sake of harmonization appear throughout the act. For example, Section 202(b) is revised as follows:

> (b) To amend its certificate of organization, a limited liability company must deliver to the [Secretary of State] for filing an amendment stating:
>
> (1) the name of the company;
>
> (2) the date of filing of its initial certificate of organization; and
>
> (3) ~~the changes~~ <u>the text of</u> the amendment ~~makes to the certificate as most recently amended or restated~~.

Relocation and Renumbering of HUB-Based Provisions

The Harmonization Project included both the harmonization of various stand-alone acts and the compilation of UBOC, which comprises a "HUB" (somewhat analogous to Article 1 of the Uniform Commercial Code) and various spokes. Each spoke pertains to a different type of organization (*e.g.*, limited liability company, statutory trust entity). Naturally, spokes in UBOC do not repeat the provisions from the HUB. In contrast, each stand-alone act includes provisions that appear in the HUB in the Code.

So that the section numbers of this "spoke" correspond with the spoke provisions in the Code, "HUB"-based provisions of this Act have been renumbered to appear at the end of articles. *See, e.g.*, Sections 112–21.

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EXPLANATORY NOTE ON THE REVISED COMMENTS

As part of the Harmonization Project, the Conference substantially revised the Comments to the Uniform Limited Liability Company Act. Professor Daniel S. Kleinberger was the principal drafter of the revised comments.

To distinguish among the current and prior versions of uniform business organization acts, the Harmonization comments use the following references.

The phrase "this act" refers to the Harmonized act – *i.e.*, the Uniform Limited Liability Company Act (2006) (Last Amended 2013).

"ULLCA (2006)" refers to the Revised Uniform Limited Liability Company Act as promulgated in 2006.

"ULLCA (1996)" refers to the original Uniform Limited Liability Company Act as promulgated in 1996.

"ULPA (2001) (Last Amended 2013)" refers to the Uniform Limited Partnership Act (2001) as harmonized.

"ULPA (2001) refers to the Uniform Limited Partnership Act as promulgated in 2001.

"ULPA (1976/1985)" refers to the Revised Uniform Limited Partnership Act as promulgated in 1976 and substantially revised in 1985.

"ULPA (1976)" refers to the Revised Uniform Limited Partnership Act as promulgated in 1976.

"ULPA (1916)" refers to the Uniform Limited Partnership Act as promulgated in 1916.

“UPA (1997) (Last Amended 2013)” refers to the Uniform Partnership Act (1997) as harmonized.

“UPA (1997)” refers to the version of the Uniform Partnership Act originally promulgated in 1994, with all amendments through 1997.

“UPA (1914)” refers to the original Uniform Partnership Act as promulgated in 1914.

“MBCA” refers to the Model Business Corporation Act.

UNIFORM LIMITED LIABILITY COMPANY ACT (2006)
(Last Amended 2013)

[ARTICLE] 1

GENERAL PROVISIONS

SECTION 101. SHORT TITLE. This [act] may be cited as the Uniform Limited Liability Company Act.

Comment

This Act is drafted to replace a state's current limited liability company statute, regardless of whether that statute is based on ULLCA (1996), ULLCA (2006), or other source. Section 110 contains transition provisions.

SECTION 102. DEFINITIONS. In this [act]:

(1) "Certificate of organization" means the certificate required by Section 201. The term includes the certificate as amended or restated.

(2) "Contribution", except in the phrase "right of contribution", means property or a benefit described in Section 402 which is provided by a person to a limited liability company to become a member or in the person's capacity as a member.

(3) "Debtor in bankruptcy" means a person that is the subject of:

(A) an order for relief under Title 11 of the United States Code or a comparable order under a successor statute of general application; or

(B) a comparable order under federal, state, or foreign law governing insolvency.

(4) "Distribution" means a transfer of money or other property from a limited liability company to a person on account of a transferable interest or in the person's capacity as a member. The term:

(A) includes:

(i) a redemption or other purchase by a limited liability company of a transferable interest; and

(ii) a transfer to a member in return for the member's relinquishment of any right to participate as a member in the management or conduct of the company's activities and affairs or to have access to records or other information concerning the company's activities and affairs; and

(B) does not include amounts constituting reasonable compensation for present or past service or payments made in the ordinary course of business under a bona fide retirement plan or other bona fide benefits program.

(5) "Foreign limited liability company" means an unincorporated entity formed under the law of a jurisdiction other than this state which would be a limited liability company if formed under the law of this state.

(6) "Jurisdiction", used to refer to a political entity, means the United States, a state, a foreign county, or a political subdivision of a foreign country.

(7) "Jurisdiction of formation" means the jurisdiction whose law governs the internal affairs of an entity.

(8) "Limited liability company", except in the phrase "foreign limited liability company" and in [Article] 10, means an entity formed under this [act] or which becomes subject to this [act] under [Article] 10 or Section 110.

(9) "Manager" means a person that under the operating agreement of a manager-managed limited liability company is responsible, alone or in concert with others, for performing the management functions stated in Section 407(c).

(10) "Manager-managed limited liability company" means a limited liability company that qualifies under Section 407(a).

(11) "Member" means a person that:

(A) has become a member of a limited liability company under Section 401 or was a member in a company when the company became subject to this [act] under Section 110; and

(B) has not dissociated under Section 602.

(12) "Member-managed limited liability company" means a limited liability company that is not a manager-managed limited liability company.

(13) "Operating agreement" means the agreement, whether or not referred to as an operating agreement and whether oral, implied, in a record, or in any combination thereof, of all the members of a limited liability company, including a sole member, concerning the matters described in Section 105(a). The term includes the agreement as amended or restated.

(14) "Organizer" means a person that acts under Section 201 to form a limited liability company.

(15) "Person" means an individual, business corporation, nonprofit corporation, partnership, limited partnership, limited liability company, [general cooperative association,] limited cooperative association, unincorporated nonprofit association, statutory trust, business trust, common-law business trust, estate, trust, association, joint venture, public corporation, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

(16) "Principal office" means the principal executive office of a limited liability company or foreign limited liability company, whether or not the office is located in this state.

(17) "Property" means all property, whether real, personal, or mixed or tangible or intangible, or any right or interest therein.

(18) "Record", used as a noun, means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(19) "Registered agent" means an agent of a limited liability company or foreign limited

liability company which is authorized to receive service of any process, notice, or demand required or permitted by law to be served on the company.

(20) "Registered foreign limited liability company" means a foreign limited liability company that is registered to do business in this state pursuant to a statement of registration filed by the [Secretary of State].

(21) "Sign" means, with present intent to authenticate or adopt a record:

(A) to execute or adopt a tangible symbol; or

(B) to attach to or logically associate with the record an electronic symbol, sound, or process.

(22) "State" means a state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(23) "Transfer" includes:

(A) an assignment;

(B) a conveyance;

(C) a sale;

(D) a lease;

(E) an encumbrance, including a mortgage or security interest;

(F) a gift; and

(G) a transfer by operation of law.

(24) "Transferable interest" means the right, as initially owned by a person in the person's capacity as a member, to receive distributions from a limited liability company, whether or not the person remains a member or continues to own any part of the right. The term applies to any fraction of the interest, by whomever owned.

(25) "Transferee" means a person to which all or part of a transferable interest has been transferred, whether or not the transferor is a member. The term includes a person that owns a transferable interest under Section 603(a)(3).

Comment

This Section contains definitions for terms used throughout the act, while Section 1001 contains definitions specific to Article 10's provisions on mergers, conversions, interest exchanges, and domestications.

"Certificate of organization" [(1)]—The original ULLCA and most other LLC statutes use "articles of organization" rather than "certificate of organization." This act purposely uses the latter term to signal that the certificate: (i) merely reflects the existence of an LLC (rather than being the locus for important governance rules); and (ii) is significantly different from articles of *incorporation*, which have a substantially greater power to affect *inter se* rules for the corporate entity and its owners. For the relationship between the certificate of organization and the operating agreement, see Section 107(d).

"Contribution" [(2)]—This definition serves to distinguish capital contributions from other circumstances under which a member or would-be member might provide benefits to a limited liability company (*e.g.*, providing services to the LLC as an employee or independent contractor, leasing property to the LLC).

This definition also distinguishes "contributions" from capital raised from transferees who invest; to be a contribution, the property or benefit must be "provided by a person … to become a partner or in the person's capacity as a partner." This distinction is ubiquitous in the law of unincorporated business organizations. *See, e.g.*, N.Y. LTD. LIAB. CO. LAW § 102(f) (McKinney 2013) ("'Contribution' means any cash, property, services rendered, or a promissory note or other binding obligation to contribute cash or property or to render services that a member contributes to a limited liability company in his or her capacity as a member."); DEL. CODE ANN. tit. 6, § 17-101(2) (West 2013) ("'Contribution' means any cash, property, services rendered or a promissory note or other obligation to contribute cash or property or to perform services, which a person contributes to a limited liability company in the person's capacity as a partner.").

In contrast, operating agreements sometimes provide for contributions from transferees. In such circumstances, the default rules for liquidating distributions should be altered accordingly. *See* Section 707(b)(1) (referring to distributions to be made "to each person owning a transferable interest that reflects *contributions* made and not previously returned") (emphasis added).

"Distribution" [(4)(A)—redemptions included]—This provision specifically refers to transactions between a limited liability company and one of its members, which in the corporate context would be labeled a "redemption." The paragraph has subparts because ownership interests in an LLC are conceptually bifurcated into economic rights ("transferable interest") and governance and information rights.

Under Section 404(a), "[a]ny distribution made by a limited liability company before its dissolution and winding up must be in equal shares among members and persons dissociated as members . . . ." Since a redemption is a distribution, absent authorization in the operating agreement an LLC may not redeem the interest of one member or transferee without redeeming (or at least offering to redeem) the interests of all other members and transferees to a comparable extent.

The law of close corporations has flirted with a similar notion. *See, e.g.*, *Donahue v. Rodd Electrotype Co. of New England, Inc.*, 367 Mass. 578, 598, 328 N.E.2d 505, 518 (1975) (stating, with regard to closely held corporations, "if the stockholder whose shares were purchased was a member of the controlling group, the controlling stockholders must cause the corporation to offer each stockholder an equal opportunity to sell a ratable number of his shares to the corporation at an identical price"); *Toner v. Baltimore Envelope Co.*, 304 Md. 256, 273, 498 A.2d 642, 650 (1985) (rejecting the "per se breach of duty" approach); *Wilkes v. Springside Nursing Home, Inc.*, 370 Mass. 842, 850, 353 N.E.2d 657, 663 (1976) (stating that "untempered application of the strict good faith standard enunciated in *Donahue* to . . . will result in the imposition of limitations on legitimate action by the controlling group in a close corporation which will unduly hamper its effectiveness in managing the corporation in the best interests of all concerned").

An operating agreement can override Section 404(a)'s equal treatment requirement without specifically mentioning redemptions.

> EXAMPLE**:** Ryan, LLC is a manager-managed limited liability company whose operating agreement: (i) includes a list (the "protected list") of decisions or actions that may be taken only with the consent of all members; and (ii) provides that all other decisions and acts may be taken as the manager determines. The protected list does not include redemptions. The operating agreement overrides the Section 404(a)'s equal treatment requirement.

[**(4)(B)—exclusion]**—This exclusion affects the reach of: (i) the charging order remedy under Section 503; and (ii) Section 405's clawback provision. The effect on the clawback provision reflects the law in several states, *see, e.g.*, DEL. CODE ANN., tit. 6, § 18-607(b) (2012) and VA. CODE ANN. § 13.1-1036 (2012), and makes sense conceptually and as a matter of policy. *See In re Tri-River Trading, LLC*, 329 B.R. 252, 266 (B.A.P. 8th Cir. 2005), *aff'd,* 452 F.3d 756 (8th Cir. 2006) ("We know of no principle of law which suggests that a manager of a company is required to give up agreed upon salary to pay creditors when business turns bad.").

"Foreign limited liability company" [(5)]—Some statutes have elaborate definitions addressing the question of whether an entity organized under the law of another jurisdiction is a "foreign limited liability company." The New York statute, for example, defines a "foreign limited liability company" as:

> an unincorporated organization formed under the laws of any jurisdiction, including any foreign country, other than the laws of this state (i) that is not authorized to do business in this state under any other law of this state and (ii) of which some or all of the persons who are entitled (A) to receive a distribution of the assets thereof upon the dissolution of the organization or otherwise or (B) to exercise voting rights with respect to an interest in the organization have, or are

entitled or authorized to have, under the laws of such other jurisdiction, limited liability for the contractual obligations or other liabilities of the organization.

N.Y. LTD. LIAB. CO. LAW § 102(k) (McKinney 2012). In contrast, Delaware takes a succinct and entirely formalistic approach. DEL. CODE ANN. tit. 6, § 18-101(4) (2012) (stating that the foreign limited liability company is one that is "denominated as such").

This definition, in contrast, intends a flexible, comparative approach. If a particular type of foreign entity has key legal characteristics that approximate the essential legal characteristics of a domestic limited liability company, that particular type of foreign entity is a foreign limited liability company under this act.

"Jurisdiction of formation" [(7)]—This definition is not limited to United States jurisdictions.

"Limited liability company" [(8)]—This definition makes no reference to a limited liability company having members upon formation, but Section 201(d) does.

"Manager" [(9)]—The act uses "manager" as a term of art, whose applicability under this act is confined to manager-managed LLCs. The phrase "manager-managed" is itself a term of art, referring only to an LLC whose operating agreement refers to the LLC as such. *See* Paragraph 10 (defining "manager-managed limited liability company"). Thus, for purposes of this act, if the members of a *member*-managed LLC delegate plenipotentiary management authority to one person (whether or not a member), this act's references to "manager" do not apply to that person, even if the members or their operating agreement refers to the person as a "manager."

This approach has the potential for confusion, but confusion around the term "manager" is common to all LLC statutes. The confusion stems from the choice to define "manager" as a term of art in a way that can be at odds with other, common usages of the word. For example, a member-managed LLC might well have an "office manager" or a "property manager." Moreover, in a manager-managed LLC, the "property manager" is not likely to be a manager as the term is used in many LLC statutes. For this nomenclature problem, the best solution is to have the operating agreement carefully delineate who is and is not a manager as this act uses that label.

For cases exemplifying the complexity and problems, *see, e.g.*, *In re Weddle*, 353 BR 892, 895 n.2 (Bankr. D. Idaho 2006) ("Plaintiff appears to argue that Debtors were managers of the LLC. However, Plaintiff's use of the term 'managers' to describe Debtors' duties under their employment agreement is not synonymous with 'manager' of the LLC within the use of that term in the operating agreement, the articles of incorporation, or chapter 6 of title 53 of the Idaho Code. The court views Debtors' 'management' role in the daily operation of the lodge as separate and distinct from management of the LLC."); *Brown v. MR Group, LLC*, 693 N.W.2d 138, 143 (Wis. App. 2005) (declining to use the dictionary definition of "manager" in determining coverage of a policy applicable to a limited liability company and its "managers" and relying instead on the meaning of the term under the Wisconsin LLC act); *Old Nat'l Villages, LLC v. Lenox Pine,' LLC*, 659 S.E. 2d 891, 893 (Ga. Ct. App. 2008) (treating the label "general manager" as a manager "under Georgia's LLC statute").

Under this act, the category of "person" is not limited to individuals. Therefore, a "manager" need not be a natural person. For example, one limited liability company can serve as the manager of another limited liability company.

After a person ceases to be a manager, the term "manager" continues to apply to the person's conduct while a manager. *See* Section 407(c)(6).

"Manager-managed limited liability company" [(10)]—This act authorizes a private agreement (the operating agreement) rather than a public document (certificate or articles of organization) to establish an LLC's status as a manager-managed limited liability company, thereby departing from most existing LLC statutes. Using the operating agreement makes sense, because under this act managerial structure creates no statutory power to bind the entity. *See* Section 301 (eliminating statutory apparent authority).

The only direct consequences of manager-managed status are *inter se*—principally the triggering of a set of rules concerning management structure, fiduciary duty, and information rights. *See* Sections 407–410. The rules on management structure are entirely default provisions—subject to change in whole or in part by the operating agreement. The operating agreement can also significantly affect the provisions on fiduciary duty and information rights. *See* Section 105.

An LLC that is "manager-managed" under this definition does not change its management structure simply because the members fail to designate anyone to act as a manager. In that situation, absent additional facts, the LLC is manager-managed and the manager position is vacant. Non-manager members who exercise managerial functions during the vacancy (or at any other time) will have duties as determined by other law, most particularly the law of agency.

"Member" [(11)]—After a person has been dissociated as a member under Section 602, the term "member" continues to apply to the person's conduct while a member. *See* Section 603(b).

"Member-managed limited liability company" [(12)]—Under this act, member-management is the default mode. *See* Section 407(a).

Some member-managed LLCs give important managerial responsibilities to one or more members. Because "manager" is a term of art under this act and applies only to manager-managed LLC, referring to such members as "managers" risks confusion. *See* the comment to Paragraph 9 (Manager). In contrast, "managing member" or some other designation such as Chief Executive Officer avoids the defined term of "manager" and thereby avoids confusion.

"Operating agreement" [(13)]—This definition must be read in conjunction with Sections 105 through 107, which further describe the operating agreement. In particular, although this definition refers to "the agreement . . . of all the members," the limited liability company itself is bound by and may enforce the agreement. Section 106(a).

An 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.

The definition in Paragraph 13 is very broad and recognizes a wide scope of authority for the operating agreement: "the matters described in Section 105(a)." Those matters include not only all relations *inter se* the members and the limited liability company but also all "activities and affairs of the company and the conduct of those activities and affairs." Section 105(a)(3). Moreover, the definition puts no limits on the form of the operating agreement. To the contrary, the definition contains the phrase "whether oral, implied, in a record, or in any combination thereof."

Unless the operating agreement itself provides otherwise:

- an operating agreement may comprise a number of separate documents (or records), however denominated; and
- subject to Section 106(b) (deeming new members to assent to the then-existing operating agreement), a document, record, understanding, etc. can be part of the operating agreement only with the assent of all persons then members.

An agreement among less than all members might well be enforceable among those members as parties, but would not be part of the operating agreement. However, under Section 105(a)(4), an amendment to an operating agreement can be made with less than unanimous consent if the operating agreement itself so provides.

An agreement to form an LLC is not itself an operating agreement. The term "operating agreement" presupposes at least one "member," and a person cannot be a member of an LLC before the LLC exists. However, as soon as a limited liability company has any members, the limited liability company perforce has an operating agreement. For example, suppose: (i) two persons orally and informally agree to join their activities in some way through the mechanism of an LLC; (ii) they form the LLC or cause it to be formed; and (iii) without further ado or agreement, they become the LLC's initial members. An operating agreement exists. In the words of Paragraph 13, "all the members" have agreed on who the members are, and that agreement—no matter how informal or rudimentary—is an agreement "concerning the matters described in Section 105(a)." To the extent the agreement does not provide the *inter se* "rules of the game," this act "fills in the gaps." Section 105(b).

The result is the same when a person becomes the sole initial member of an LLC, so long as the person has any understanding or intention with regard to the LLC. Any such understanding or intention constitutes an "agreement of all the members of the limited liability company, including a sole member." Paragraph 13.

It may seem oxymoronic to refer an "agreement of . . . a sole member," but this approach is common in LLC statutes. *See, e.g.*, ARIZ. REV. STAT. ANN. § 29-601 (14)(b) (2012) (defining operating agreement to mean "[i]n the case of a limited liability company that has a single member, any written or oral statement of the member made in good faith purporting to govern the affairs of a limited liability company or the conduct of its business as of the effective time of the statement"); WASH. REV. CODE ANN. § 25.15.005 (5) (2012) (defining limited liability company agreement to include "any written statement of the sole member").

This re-definition of "agreement" is a function of "path dependence." LLC statutes initially required an LLC to have at least two members, and almost all LLC statutes contemplated an agreement among members as an LLC's key organic document. Because LLC statutes make the operating agreement the principal way to override statutory default rules, the advent of single member LLCs made it necessary to provide that a sole member could make an operating agreement.

This act states no rule as to whether the statute of frauds applies to operating agreements. Case law suggests that the answer is yes. *Olson v. Halvorsen*, 986 A.2d 1150, 1161 (Del. 2009) ("The legislative history of the LLC Act does not demonstrate the General Assembly's intent to place LLC agreements outside of the statute of frauds.") (applying the one-year provision to an alleged oral buy-out agreement), *negated by* 2010 DEL. LAWS, ch. 287 (H.B. 372), §§ 1, 31 (pertaining to statutes of fraud generally).

The Delaware court decision is consistent with partnership cases.

> Partnership agreements, like other contracts, are subject to the Statute of Frauds. A contract of partnership for a term exceeding one year is within the Statute of Frauds and is void unless it is in writing [and signed by the party to be bound]; however, a contract establishing a partnership terminable at the will of any partner is generally held to be capable of performance by its terms within one year of its making and, therefore, to be outside the Statute of Frauds.

Abbott v. Hurst, 643 So. 2d 589, 592 (Ala. 1994) (citations omitted).

Likewise, the land provision of the statute of frauds:

> applies to an oral contract to transfer or convey partnership real property, and the interest of the other partners therein, to one partner as an individual, as well as to a parol contract by one of the parties to convey certain land owned by him individually to the partnership, or to another partner, or to put it into the partnership stock.

Froiseth v. Nowlin, 156 Wash. 314, 316, 287 P. 55, 56 (Wash. 1930) (quoting 27 C.J.S. § 220); *see also E. Piedmont 120 Associates, L.P. v. Sheppard*, 209 Ga. App. 664, 665, 434 S.E.2d 101, 102 (1993) (same, stating that "the fact that promises covered by the Statute of Frauds are made in the context of a partnership or joint venture agreement does not render the statute inapplicable"); *Filippi v. Filippi*, 818 A.2d 608, 618 (R.I. 2003) (applying the statute of frauds to an alleged oral agreement to transfer land owned by a limited partnership to one of its partners).

In contrast, the land provision does not apply to a member's ownership interest in an LLC, no matter how much the LLC owns or deals in real property. Interests in a limited liability company are personal property and reflect no direct interest in the entity's assets. *See* Sections 102(24), 501. Thus, the real property issues pertaining to the LLC's ownership of land do not "flow through" to the members and membership interests. *See, e.g.*, *Wooten v. Marshall*, 153 F. Supp. 759, 763–64 (S.D. N.Y. 1957) (involving an "oral agreement for a joint venture concerning the purchase, exploitation and eventual disposition of this 160 acre tract" and stating "[t]he real property acquired and dealt with by the venturers takes on the character of personal property as between the partners in the enterprise, and hence is not covered by [the Statute of Frauds]"); *see also Wade v. DeHart*, 1926 WL 2944 (Ohio Com. Pl. 1926), *aff'd sub nom., Wade v. De Hart*, 26

Ohio App. 177, 159 N.E. 838 (1927) (same).

On the question of how far a written (or "in a record") operating agreement can go to prevent oral or implied-in-fact terms, see Section 105(a)(4), comment. For the effect of a pre-formation agreement, see Section 106(c). For the limited liability company's status viz-a-viz the operating agreement, see Section 106(a).

"Organizer" [(14)]—An organizer need not be a prospective member of the limited liability company. Unless the organizer will be the sole initial member of the limited liability company, as a matter of agency law and Section 401(a) and (b), the organizer is acting on behalf of the person or persons who have agreed to become the initial member or members of the limited liability company. The organizer does not act on behalf of the limited liability company, because a person cannot be an agent of an organization that does not yet exist. RESTATEMENT (THIRD) OF AGENCY § 4.04, cmt. c (2006) (Nonexistent Principals).

"Property" [(16)]—This definition encompasses every form of property.

"Transfer" [(23)]—The term "transfer" is broadly defined to include all types of conveyances of interests in property. The reference to "transfer by operation of law" is significant in connection with Section 502 (Transfer of Transferable Interest). That section severely restricts a transferee's rights (absent the consent of the members), and this definition makes those restrictions applicable, for example, to transfers ordered by a family court as part of a divorce proceeding and transfers resulting from the death of a member. The restrictions also apply to transfers in the context of a member's bankruptcy, except to the extent that bankruptcy law supersedes this act.

"Transferable interest" [(24)]—Absent a contrary provision in the operating agreement or the consent of the members, a "transferable interest" is the only interest in an LLC which can be transferred to a non-member. *See* the comment to Section 502.

This paragraph defines "transferable interest" as an interest "initially owned by a person in the person's capacity as a member," because this act does not contemplate an LLC directly creating interests that comprise only economic rights. *See* Sections 401 (addressing how a person becomes a member), 502 (addressing how a person becomes a transferee).

"Transferee" [(25)]—This definition should be read in light of Section 603(a)(3), which subject to limited exceptions provides that "any transferable interest owned by the person in the person's capacity as a member immediately before dissociation as a member is owned by the person solely as a transferee."

SECTION 103. KNOWLEDGE; NOTICE.

(a) A person knows a fact if the person:

(1) has actual knowledge of it; or

(2) is deemed to know it under subsection (d)(1) or law other than this [act].

(b) A person has notice of a fact if the person:

(1) has reason to know the fact from all the facts known to the person at the time in question; or

(2) is deemed to have notice of the fact under subsection (d)(2).

(c) Subject to Section 210(f), a person notifies another person of a fact by taking steps reasonably required to inform the other person in ordinary course, whether or not those steps cause the other person to know the fact.

(d) A person not a member is deemed:

(1) to know of a limitation on authority to transfer real property as provided in Section 302(g); and

(2) to have notice of a limited liability company's:

(A) dissolution 90 days after a statement of dissolution under Section 702(b)(2)(A) becomes effective;

(B) termination 90 days after a statement of termination under Section 702(b)(2)(F) becomes effective; and

(C) participation in a merger, interest exchange, conversion, or domestication, 90 days after articles of merger, interest exchange, conversion, or domestication under [Article] 10 become effective.

Comment

This section is substantially slimmer than the corresponding provisions of previous uniform acts pertaining to business organizations: UPA (1997), ULLCA (1996), and ULPA (2001). Each of those acts borrowed heavily from the comparable Uniform Commercial Code provision. This act relies instead on generally applicable principles of agency law, *see* Section 111; therefore, this section is confined mostly to rules specifically tailored to this act.

Several facets of this section warrant particular note. First, and most fundamentally, because this act does not provide for "statutory apparent authority," Section 301, this section contains no special rules for attributing to an LLC information possessed, communicated to, or communicated by a member or manager.

Second, the section contains no generally applicable provisions determining when an organization is charged with knowledge or notice, because those imputation rules: (i) comprise core topics within the law of agency; (ii) are very complicated; (iii) should not have any different content under this act than in other circumstances; and (iv) are the subject of considerable attention in the Restatement (Third) of Agency (2006).

Third, this act does not define "notice" to include "knowledge." Although conceptualizing the latter as giving the former makes logical sense and has a long pedigree, that conceptualization is counter-intuitive for the uninitiated. In ordinary usage, notice has a meaning separate from knowledge. This act follows ordinary usage and therefore contains some references to "knowledge or notice."

Subsection (a)(2)—In this context, the most important source of "law other than this [act]" is the common law of agency.

Subsection (b)(1)—The "facts known to the person at the time in question" include facts the person is deemed to know under Subsection (a)(2).

Subsection (c)—If a person "notifies" another person of a fact, the other person has "reason to know" the fact and therefore has notice under Subsection (b)(1). However, a person can have "notice" of a fact without having been "notifie[d]" of the fact.

Section 210(f) pertains to delivery of records *by* the filing office.

Subsection (d)—This subsection provides constructive notice of facts stated in specified filed public records.

Subsection (d)(2)—Under this act, the power to bind a limited liability company to a third party is primarily a matter of agency law. Section 301, cmt. The constructive notice provided under this paragraph will be relevant if a third party makes a claim under agency law that someone who purported to act on behalf of a limited liability company had the apparent authority to do so.

SECTION 104. GOVERNING LAW. The law of this state governs:

(1) the internal affairs of a limited liability company; and

(2) the liability of a member as member and a manager as manager for a debt, obligation, or other liability of a limited liability company.

Comment

Paragraph (1)—Like any other legal concept, "internal affairs" may be indeterminate at its edges. However, the concept certainly includes interpretation and enforcement of the operating agreement, relations among the members as members, relations between the limited liability company and a member as a member, relations between a manager-managed limited liability company and a manager, and relations between a manager of a manager-managed limited liability company and the members as members. *Compare* Paragraph 1, *with* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302, cmt. a (1971) (defining "internal affairs" with reference to a corporation as "the relations inter se of the corporation, its shareholders, directors, officers or agents").

"Internal affairs" do not encompass the power *vel non* of a person to bind a limited liability company. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 292(2) (1971) ("The principal will be held bound by the agent's action if he would so be bound under the local law of the state where the agent dealt with the third person, provided at least that the principal had authorized the agent to act on his behalf in that state or had led the third person reasonably to believe that the agent had such authority."); *Id.* § 295(1) ("Whether a partnership is bound by action taken on its behalf by an agent in dealing with a third person is determined by the local law of the state selected by application of the rule of § 292."); RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 345, cmt. c (1934) (Law Governing Effect of Act of Agent or Partner) ("If… the principal or partner sends the agent or other partner into a state to act on his behalf, he assumes the risk of liability not only for authorized but for unauthorized conduct of the agent or partner in accordance with the law of that state."). *See also Farm & Ranch Services, Ltd. v. LT Farm & Ranch, L.L.C.*, 779 F. Supp. 2d 949, 960 (S.D. Iowa 2011).

The operating agreement cannot alter this section. *See* Section 105(c)(1). This approach comports with the law of other businesses entities whose formation or legal status depends at least in part on a publicly-filed record. *See, e.g.,* ULPA (2001) (Last Amended 2013) § 104 (stating that the law of the state of formation is the domestic entity's governing law) and ULLCA (2006) (Last Amended 2013) § 104 (same).

However, an operating agreement may lawfully incorporate by reference the provisions of another state's LLC statute. If done correctly, this incorporation makes the foreign statutory language part of the operating agreement, and the incorporated terms (together with the rest of the operating agreement) then govern the members (and those claiming through the members) to the extent not prohibited by this act. *See* Section 105. This approach: (i) does *not* switch the limited liability company's governing law to that of another state; (ii) instead takes the provisions of another state's law and incorporates them by reference into the contract among the members; (iii) raises complex drafting issues – *e.g.*, how to address subsequent changes to the incorporated law (whether occurring by statutory amendment or court decision); and (iv) thus is rarely, if ever, a good idea.

Paragraph (2)—This paragraph obviously encompasses Section 304 (the liability shield) but does not necessarily encompass a claim that a member or manager is liable to a third party for: (i) having purported inaccurately to have the actual authority to bind a limited liability company to the third party; or (ii) having committed a tort against the third party while acting on the limited liability company's behalf or in the course of the company's business. That liability is not by status (*i.e.,* not "as member . . . [or] as manager") but rather results from function or conduct. *Compare* Paragraph 2, *with* Section 301(b) (stating that, although this act does not make a member as member the agent of a limited liability company, other law may make an LLC liable for the conduct of a member).

"Internal affairs" and the "liability of a member as a member" are mentioned separately because it can be argued that the liability of members and managers to third parties is not an internal affair. *See, e.g.*, RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 307 (1971) (treating shareholders' liability separately from the internal affairs doctrine). A few cases subsume owner/manager liability into internal affairs, but many do not. *See, e.g.*, *Kalb, Voorhis & Co. v. Am. Fin. Corp.,* 8 F.3d 130, 132 (2nd Cir. 1993) (holding that the corporation's "primary purpose is to insulate shareholders from legal liability" and therefore "the state of incorporation has the greater interest in determining when and if that insulation is to be stripped away") (quoting *Soviet Pan Am Travel Effort v. Travel Comm., Inc.*, 756 F. Supp. 126, 131 (S.D.N.Y. 1991) (internal quotation marks omitted).

In any event, most (if not all) LLC statutes follow the rule stated in this paragraph. *See, e.g.,* ARIZ. REV. STAT. ANN. § 29-801(A)(1) (2013) (stating that "[t]he laws of the state or another jurisdiction under which a foreign limited liability company is organized govern its organization and internal affairs and the liability of its members"); GA. CODE ANN. § 14-11-701 (West 2013)(a) (stating that "[t]he laws of the jurisdiction under which a foreign limited liability company is organized govern its organization and internal affairs and the liability of its managers, members, and other owners"); N.Y. LTD. LIAB. CO. LAW § 801(a) (McKinney 2013) (stating that "[t]he laws of the jurisdiction under which a foreign limited liability company is formed govern its organization and internal affairs and the liability of its members and managers").

Moreover, in the case law, "[t]he general rule is that a plaintiff's alter ego theory is governed by the law of the state in which the business at issue is organized." *Rual Trade Ltd. v. Viva Trade L.L.C.*, 549 F. Supp. 2d 1067, 1077 (E.D. Wis. 2008); *see also In re Gulf Fleet Holdings, Inc*., 491 B.R. 747, 787 (Bankr. W.D. La. 2013) (stating both conceptual and policy rationales for choosing the law of the state of formation); *In re Saba Enterprises, Inc.*, 421 B.R. 626, 648–51 (Bankr. S.D.N.Y. 2009) (examining the issue in detail and applying the state of formation rule).

SECTION 105. OPERATING AGREEMENT; SCOPE, FUNCTION, AND LIMITATIONS.

(a) Except as otherwise provided in subsections (c) and (d), the operating agreement governs:

(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 and affairs of the company and the conduct of those activities and affairs; and

(4) the means and conditions for amending the operating agreement.

(b) To the extent the operating agreement does not provide for a matter described in subsection (a), this [act] governs the matter.

(c) An operating agreement may not:

(1) vary the law applicable under Section 104;

(2) vary a limited liability company's capacity under Section 109 to sue and be sued in its own name;

(3) vary any requirement, procedure, or other provision of this [act] pertaining to:

(A) registered agents; or

(B) the [Secretary of State], including provisions pertaining to records authorized or required to be delivered to the [Secretary of State] for filing under this [act];

(4) vary the provisions of Section 204;

(5) alter or eliminate the duty of loyalty or the duty of care, except as otherwise provided in subsection (d);

(6) eliminate the contractual obligation of good faith and fair dealing under Section 409(d), but the operating agreement may prescribe the standards, if not manifestly unreasonable, by which the performance of the obligation is to be measured;

(7) relieve or exonerate a person from liability for conduct involving bad faith, willful or intentional misconduct, or knowing violation of law;

(8) unreasonably restrict the duties and rights under Section 410, but the operating agreement may impose reasonable restrictions on the availability and use of information obtained under that section and may define appropriate remedies, including liquidated damages, for a breach of any reasonable restriction on use;

(9) vary the causes of dissolution specified in Section 701(a)(4);

(10) vary the requirement to wind up the company's activities and affairs as

specified in Section 702(a), (b)(1), and (e);

(11) unreasonably restrict the right of a member to maintain an action under [Article] 8;

(12) vary the provisions of Section 805, but the operating agreement may provide that the company may not have a special litigation committee;

(13) vary the right of a member to approve a merger, interest exchange, conversion, or domestication under Section 1023(a)(2), 1033(a)(2), 1043(a)(2), or 1053(a)(2);

(14) vary the required contents of a plan of merger under Section 1022(a), plan of interest exchange under Section 1032(a), plan of conversion under Section 1042(a), or plan of domestication under Section 1052(a); or

(15) except as otherwise provided in Sections 106 and 107(b), restrict the rights under this [act] of a person other than a member or manager.

(d) Subject to subsection (c)(7), without limiting other terms that may be included in an operating agreement, the following rules apply:

(1) The operating agreement may:

(A) specify the method by which a specific act or transaction that would otherwise violate the duty of loyalty may be authorized or ratified by one or more disinterested and independent persons after full disclosure of all material facts; and

(B) alter the prohibition in Section 405(a)(2) so that the prohibition requires only that the company's total assets not be less than the sum of its total liabilities.

(2) To the extent the operating agreement of a member-managed limited liability company expressly relieves a member of a responsibility that the member otherwise would have under this [act] and imposes the responsibility on one or more other members, the agreement also may eliminate or limit any fiduciary duty of the member relieved of the responsibility which

would have pertained to the responsibility.

(3) If not manifestly unreasonable, the operating agreement may:

(A) alter or eliminate the aspects of the duty of loyalty stated in Section 409(b) and (i);

(B) identify specific types or categories of activities that do not violate the duty of loyalty;

(C) alter the duty of care, but may not authorize conduct involving bad faith, willful or intentional misconduct, or knowing violation of law; and

(D) alter or eliminate any other fiduciary duty.

(e) The court shall decide as a matter of law whether a term of an operating agreement is manifestly unreasonable under subsection (c)(6) or (d)(3). The court:

(1) shall make its determination as of the time the challenged term became part of the operating agreement and by considering only circumstances existing at that time; and

(2) may invalidate the term only if, in light of the purposes, activities, and affairs of the limited liability company, it is readily apparent that:

(A) the objective of the term is unreasonable; or

(B) the term is an unreasonable means to achieve the term's objective.

Comment

Principal Provisions of the Act Concerning the Operating Agreement

The operating agreement is pivotal to a limited liability company, and Sections 105 through 107 are pivotal to this act. They must be read together, along with Section 102(13) (defining the operating agreement).

This section performs five essential functions. Subsection (a) establishes the primacy of the operating agreement in establishing relations *inter se* the limited liability company, its member or members, and any manager. Subsection (b) recognizes this act as comprising mostly default rules— *i.e.,* gap fillers for issues as to which the operating agreement provides no rule. Subsection (c) lists the few mandatory provisions of the act. Subsection (d) lists some provisions frequently found in operating agreements, authorizing some unconditionally and others so long as “not manifestly unreasonable.” Subsection (e) delineates in detail both the meaning of “not manifestly unreasonable” and the information relevant to a determining a claim that a provision of an operating agreement is manifestly unreasonable.

Section 106 details the effect of an operating agreement on the limited liability company and on persons becoming members of an LLC. Section 107 concerns the effect of an operating agreement on third parties.

Role and Inevitability of Operating Agreement

A limited liability company is as much a creature of contract as of statute, *TravelCenters of Am., L.L.C. v. Brog*, CIV.A. 3516-CC, 2008 WL 1746987, at *1 (Del. Ch. Apr. 3, 2008) (stating that “limited liability companies are creatures of contract”); *Gottsacker v. Monnier*, 281 Wis. 2d 361, 370, 697 N.W.2d 436, 440 (2005) (stating that “from the partnership form, the LLC borrows . . . internal governance by contract”), and Section 102(13) delineates a very broad scope for “operating agreement.” As a result, once an LLC comes into existence and has a member, the LLC necessarily has an operating agreement. *See* the comment to Section 102(13). Accordingly, this act refers to “the operating agreement” rather than “an operating agreement.” This phrasing should not, however, be read to require a limited liability company or its members to take any formal action to adopt an operating agreement.

The operating agreement is the exclusive consensual process for modifying this act’s various default rules pertaining to relationships *inter se* the members and between the members and the limited liability company. Section 105(b). The operating agreement also has power over “the rights and duties under this [act] of a person in the capacity of manager,” Subsection (a)(2), and “the obligations of a limited liability company and its members to a person in the person’s capacity as a transferee or person dissociated as a member,” Section 107(b). For the relationship between the operating agreement and certificate of formation, see Section 107(d).

The Operating Agreement and the Fiduciary and Other Duties of Those Who Manage

One of the most complex questions in the law of unincorporated business organizations is the extent to which an agreement among the organization’s owners can affect the fiduciary and other duties of those who manage the organization (*e.g.,* members in a member-managed LLC; managers in a manager-managed LLC). As explained in detail in the comment to Subsection (d)(3), this act rejects the notion that a contract can completely transform an inherently fiduciary relationship into a merely arm’s length association. Within that limitation, however, this section provides substantial power to the operating agreement to reshape, limit, and eliminate fiduciary and other managerial duties.

Subsection (a) recognizes that the operating agreement is the map to the parties’ deal and that any claim by a member of managerial misconduct must be assessed first under the relevant terms of the operating agreement. Subsection (d) specifically validates arrangements commonly used to reshape managerial duties and limit the consequences of breaching those duties. Subsection (c) contains relevant limitations, but those limitations: (i) must be read together with subsection (d); and (ii) do not preclude the operating agreement fundamentally redesigning the duties applicable to those who manage the organization. For the act’s design of those duties, see Sections 409 and 410.

Subsection (a)—This section describes the very broad scope of a limited liability company's operating agreement, which includes all matters constituting "internal affairs." *Compare* Subsection (a), *with* Section 104(1) (using the phrase "internal affairs" in stating a choice of law rule). This broad grant of authority is subject to the restrictions stated in Subsection (c), including the broad restriction stated in Paragraph (c)(15) (concerning the rights of third parties under this act).

Subsection (a)(1)—This paragraph encompasses all the rights and duties of each member, including rights and duties pertaining to transactions under Article 10.

Subsection (a)(2)—Under this paragraph, the operating agreement has the power to affect the rights and duties of managers (including non-member managers). Because the term "[o]perating agreement . . . includes the agreement as amended or restated," Section 102(13), this paragraph gives the members the ongoing power to define the role of an LLC's managers. Power is not the same as right, however, and exercising the power provided by this paragraph might constitute a breach of a separate contract between the LLC and the manager. A non-member manager might also have rights under Section 107(a).

Subsection (a)(4)—Under this provision, the operating agreement can control both the quantum of consent required (*e.g.,* majority of members) and the means by which the consent is manifested (*e.g.*, prohibiting modifications except when consented to in writing). *See* the comment to Section 107(a).

If the operating agreement does not address the issue, this act provides the rule. Section 407(b)(4)(C) and 407(c)(3)(C) each require the affirmative vote or consent of all the members. Under Section 111 (supplemental principles of law), the parol evidence rule will apply to a written operating agreement when appropriate under contract law.

Subsection (b)—To the extent the operating agreement does not determine an *inter se* matter, this act determines the matter. The operating agreement may vary any provision of this act pertaining to *inter se* matters, except as provided in Subsections (c) and (d).

Sometimes—but not always—the Comments to this act refer to a variable provision as a "default rule" and a non-waivable provision as "mandatory." These references are merely to draw attention to the default/mandatory distinction in particular contexts and have neither the intent nor the power to affect the default/mandatory status of provisions of this act whose comments lack a comparable reference.

Subsection (c)—This subsection lists provisions of this act whose respective effects cannot be varied or may be varied subject to a stated limitation. For historical reasons, this subsection uses the words "vary" and "alter" interchangeably. No difference in meaning is intended.

If a person claims that a term of the operating agreement violates this subsection, as a matter of ordinary procedural law the burden of proof is on the person making the claim.

Subsection (c)(1)—Section 104 states that this act provides the law applicable to: (i) the internal affairs of an LLC formed under this act; and (ii) the liability of members and managers for obligations of the LLC. The organizers of an LLC make this choice of law by choosing to form an LLC under this act. Domestication to another jurisdiction will re-set the choice of law, *see* Sections 1051–56, but the operating agreement cannot*, see* the comment to Section 104(1).

Subsection (c) contains no parallel prohibition on varying Section 901 (stating the governing law for foreign limited liability companies), because a prohibition is unnecessary. As a matter of fundamental contract law, an agreement among members of one limited liability company is powerless to govern the affairs of another limited liability company.

Subsection (c)(2)—Under this act, a limited liability company is emphatically an entity, and the members lack the power to alter that characteristic.

Subsection (c)(3)—This prohibition is arguably implicit in Subsection (c)(15) (affecting rights of third parties under this act) but is specifically noted to avoid doubt.

Subsection (c)(4)—This provision means that the operating agreement cannot affect the right of an "aggrieved" person to seek the court's help when "a person required by this [act] to sign a record or deliver a record to the [Secretary of State] for filing under this [act] does not do so." Section 204(a).

Subsection (c)(5)—This limitation is less powerful than might first appear, because Subsection (d) specifically authorizes substantial alterations to the duties of loyalty and care, including restricting and substantially eliminating those duties.

Subsection (c)(6)—Section 409(d) refers to the "contractual obligation of good faith and fair dealing," which contract law implies in every contract. The operating agreement cannot eliminate this obligation, neither in whole (*i.e.,* generally) nor in part (*i.e.,* as applicable to specified situations).

However, an operating agreement may "prescribe the standards . . . by which the performance of the obligation is to be measured."

> EXAMPLE: The operating agreement of a manager-managed LLC gives the manager the discretion to cause the LLC to enter into contracts with affiliates of the manager (so-called "Conflict Transactions"). The agreement further provides: "When causing the Company to enter into a Conflict Transaction, the manager complies with Section 409(d) of [this act] if a disinterested person, knowledgeable in the subject matter, states in writing that the terms and conditions of the Conflict Transaction are equivalent to the terms and conditions that would be agreed to by persons at arm's length in comparable circumstances." This provision "prescribe[s] the standards by which the performance of the [Section 409(d)] obligation is to be measured."

> EXAMPLE: Same facts as the previous example, except that, during the performance of a Conflict Transaction, the manager causes the LLC to waive material protections under the applicable contract. The standard stated in the previous example is inapposite to this conduct. Section 409(d) therefore applies to the conduct without any direct contractual delineation. (However, other terms of the agreement may be relevant to determining whether the conduct violates Section 409(d). *See* the comment to Section 409(d).)

EXAMPLE: The operating agreement of a manager-managed LLC gives the manager "sole discretion" to make various decisions. The agreement further provides: "Whenever this agreement requires or permits a manager to make a decision that has the potential to benefit one class of members to the detriment of another class, the manager complies with Section 409(d) of [this act] if the manager makes the decision with:

a. the honest belief that the decision:
    i. serves the best interests of the LLC; or
    ii. at least does not injure or otherwise disserve those interests; and
b. the reasonable belief that the decision breaches no member's rights under this agreement."

This provision "prescribe[s] the standards by which the performance of the [Section 409(d)] obligation is to be measured." *Compare* Section 105(c)(6), *with Nemec v. Shrader*, 991 A.2d 1120 (Del. 2010) (considering such a situation in the context of the right to call preferred stock and deciding by a 3-2 vote that exercising the call did not breach the implied covenant of good faith and fair dealing).

An operating agreement that seeks to prescribe standards for measuring the contractual obligation of good faith and fair dealing under Section 409(d) should expressly refer to the obligation. *See Gerber v. Enter. Prods. Hldgs., L.L.C.*, 67 A.3d 400, 418 (Del. 2013) (distinguishing between the implied contractual covenant and an express contractual obligation of "good faith" as stated in a limited partnership agreement).

For an explanation of the function and role of the covenant of good faith and fair dealing, see Section 409(d), comment. For the rules delimiting the "not manifestly unreasonable" requirement, see Subsection (e).

Subsection (c)(7)—These restrictions are ubiquitous in the law of business entities and, in conjunction with other provisions of this section, control the otherwise very broad power of an operating agreement to affect fiduciary and other duties. The restrictions are central to the raft of exculpatory provisions that sprung up in corporate statutes in response to *Smith v. Van Gorkum*, 488 A.2d 858 (Del. 1985), *overruled on other grounds by Gantler v. Stephens*, 965 A.2d 695 (Del. 2009). Delaware led the response with DEL. CODE ANN. tit. 8, § 102(b)(7), and a number of LLC statutes have similar provisions. *E.g.*, GA. CODE ANN. § 14-11-305(4)(A) (2011). For an extreme example, *see* VA. CODE ANN. § 13.1-1025 (B) (2012). In this context, "conduct" includes both acts and omissions. BLACK'S LAW DICTIONARY (9th ed. 2009) (defining conduct as "[p]ersonal behavior, whether by action or inaction").

The term "bad faith" has multiple meanings, and the context determines which meaning applies. In the context of the duty of loyalty, "bad faith" includes conduct motivated by ill will or other intent purposely to harm another person. The concept also includes conduct from which a person derives an improper personal benefit. *See, e.g., Mroz v. Hoaloha Na Eha, Inc.*, 410 F. Supp. 2d 919, 936–37 (D. Haw. 2005) (denying a motion to dismiss a claim that "the Majority Partners" were personally liable for the partnership's wrongful termination of the plaintiff; quoting the complaint as alleging that "the Majority Partners, individually and as a group, acted with malice and/or ill will, and/or with an intent to serve their own personal interests and/or without an intent to serve company interests, and/or outside of the scope of their authority and/or without justification"); *BOGNC, L.L.C. v. Cornelius NC Self-Storage L.L.C.*, 10 CVS 19072, 2013 WL 1867065, at *9 (N.C. Super. [Business Court] May 1, 2013) (noting that "no . . . [exculpatory] provision may limit a manager's liability for acts known to be in conflict with the interests of the limited liability company, or for acts from which the manager derived an improper personal benefit") (citing N.C. GEN. STAT. § 57C–3–32(b)); *Lasica v. Savers Grp. of Minn., L.L.C.*, A12-0092, 2012 WL 3553246, at *2 (Minn. Ct. App. Aug. 20, 2012) (noting that an "individual seeking indemnification [under statute providing for indemnification)] must have acted in good faith and must not have received an improper personal benefit") (citing MINN. STAT. § 322B.699, subdivs. 2(a)(2), (3) (2010)).

In the context of the duty of care, the concept of bad faith comes primarily from corporate law and means an extreme breach of the duty (*i.e.*, "the failure to exercise "*honest judgment* in the lawful and legitimate furtherance of corporate purposes." *Deblinger v. Sani-Pine Products Co., Inc.*, 107 A.D.3d 659, 661, 967 N.Y.S.2d 394 (2013) (quoting Auerbach v. Bennett, 47 N.Y.2d 619, 629, 393 N.E.2d 994 (1979) (emphasis added) (internal quotation marks omitted).

Thus, when a plaintiff alleges bad faith as pertaining to the duty of care, "[t]he burden . . . is to show irrationality: a plaintiff must demonstrate that no reasonable business person could possibly authorize the action in good faith. Put positively, the decision must go so far beyond the bounds of reasonable business judgment that its only explanation is bad faith." *In re Tower Air, Inc.*, 416 F.3d 229, 238 (3d Cir. 2005) (discussing then prevailing Delaware law) (citation omited); *see also KDW Restructuring & Liquidation Servs. LLC v. Greenfield*, 874 F. Supp. 2d 213, 226 (S.D.N.Y. 2012) (referring to a lack of "a rationale corporate purpose" and "a disregard for the duty to examine all available information—*information that was readily at hand*") (emphasis added).

With regard to both the duty of loyalty and the duty of care, "bad faith" is entirely distinct from the meaning of "good faith" in the contractual covenant of good faith and fair dealing. *See* the comment to Section 409(d).

Subsection (c)(7) pertains to indirect as well as direct efforts to "relieve or exonerate" and thus limits how far an operating agreement can go in providing for indemnification. *See* Section 408(b) (stating a default rule for indemnification). Also, in accordance with this paragraph, an exculpatory provision cannot shield against a member's claim of oppression. *See* Section 701(a)(4)(C).

Although this paragraph does not expressly address contracts between an LLC and a member or manager, the stated constraints must also apply to such contracts. If not, those constraints are effectively meaningless.

> EXAMPLE: A manager-managed LLC enters into a management contract with its sole manager, and the contract provides the manager exoneration for liability to the LLC even for willful and intentional misconduct. Most likely, contract law will treat the provision as against public policy and therefore unenforceable. RESTATEMENT (SECOND) OF CONTRACTS § 195(1) (1981) ("A term exempting a party from tort liability for harm caused intentionally or recklessly is unenforceable on grounds of public policy."). If not, a court should hold the provision unenforceable to avoid evisceration of Subsection (c)(7). (Or, the court could invoke the policy expressed in Subsection (c)(7) as grounds

for holding the provision unenforceable under contract law.)

Subsection (c)(8)—Although phrased as a restriction, this provision grants substantial power to the operating agreement.

> EXAMPLE: A law firm operates as a limited liability company, and the operating agreement provides that a "Compensation Committee" periodically decides each member's compensation. The agreement also states that only members who are on the Compensation Committee may have access to the Committee's compensation decisions pertaining to other members. This restriction is reasonable.

The act also empowers the LLC "as a matter within the ordinary course of its activities and affairs [to] impose reasonable restrictions and conditions on access to and use of information" obtained under Section 410. *See* Section 410(h).

In determining whether a restriction is reasonable, a court might consider: (i) the danger or other problem the restriction seeks to avoid; (ii) the purpose for which the information is sought; and (iii) whether, in light of both the problem and the purpose, the restriction is reasonably tailored. In addition, a restriction that is reasonable viz-a-viz a non-managing member in a manager-managed LLC might be unreasonable viz-a-viz a managing member or in the context of a member-managed LLC.

Subsection (c)(9)—The operating agreement may not change the stated grounds for judicial dissolution but may determine the forum in which a claim for dissolution under Section 701(a)(4) is determined. For example, arbitration and forum selection clauses are commonplace in business relationships in general and in operating agreements in particular.

The approach of this paragraph differs from the law of Delaware. *Huatuco v. Satellite Healthcare*, CV 8465-VCG, 2013 WL 6460898, at *1, n.2 (Del. Ch. Dec. 9, 2013) (stating that "the right to judicial dissolution is a default right which the parties may eschew by contract" but reserving the question of "[w]hether the parties may, by contract, divest this Court of its authority to order a dissolution in all circumstances, even where it appears manifest that equity so requires—leaving, for instance, irreconcilable members locked away together forever like some alternative entity version of Sartre's *Huis Clos*").

Subsection (c)(10)—The cited provisions comprise the non-waivable aspects of winding up a dissolved limited liability company. The other provisions of Section 702 are default rules.

Subsection (c)(11)—Article 8 delineates a member's rights to bring direct and derivative actions. It would be unreasonable to frustrate these rights but not unreasonable to channel their exercise. For example, the operating agreement might select a forum, require pre-suit mediation, provide for arbitration of both direct and derivative claims, or override Section 802 and require "universal demand" in all derivative cases. Similarly, it is not unreasonable to provide for liquidated damages consonant with the law of contracts. In contrast, it would be unreasonable for an operating agreement to both: (i) require a would-be derivative plaintiff to make demand regardless of futility; and (ii) bar taking the claim to court no matter how long the management group ponders the demand.

Subsection (c)(12)—An operating agreement may not alter the act's rules for a special litigation committee but may preclude entirely the use of such a committee.

Subsection (c)(13)—Section 1023(a)(1), 1033(a)(1), 1043(a)(1), and 1053(a)(1) each requires the consent or the affirmative vote of all members. The operating agreement may modify these requirements. In contrast, under the sections stated in this subsection:

- each member is protected from being merged, exchanged, converted, or domesticated "into" the status of a partner in a general partnership that is not a limited liability partnership (or a comparable "unshielded" position in some other organization) without the member having *directly* consented to either:
    - the merger, interest exchange, conversion, or domestication; or
    - an operating agreement provision that permits such transactions to occur with less than unanimous consent of the members; and
- merely consenting to an operating agreement provision that permits amendment of the agreement with less than unanimous consent of the members does not qualify as the requisite direct consent.

Subsection (c)(14)—Because these plans are the basic "deal documents" for each of the organic transactions contemplated in Article 10, the operating agreement may not vary the contents of these plans.

Subsection (c)(15)—This limitation pertains only to "the rights under this [act] of" third parties other than members and managers. Moreover, the limitation is subject to two substantial exceptions: Section 106 (pertaining to the operating agreement's relationship to the limited liability company itself and to persons becoming members) and Section 107(b) (pertaining to the operating agreement's power over the rights of transferees).

Subsection (d)—The operating agreement has plenipotentiary power over the matters described in Subsection (a), except as specifically limited by Subsections (c) and (d)(3). However, for the convenience of practitioners and the courts. Paragraphs 1 and 2 list various terms often found in operating agreements. No negative inference should be drawn about terms not listed; the listing is provided "without limiting other terms that may be included in an operating agreement."

Paragraph 3 lists terms subject to the "not manifestly unreasonable" standard. Subsection (e) delineates that standard. The same standard applies to terms of an operating agreement which seek to "prescribe the standards . . . by which the performance of the [Section 409(d)] obligation [of good faith and fair dealing] is to be measured." Subsection (c)(6).

Subsection (d)(1)(A)—An arrangement *not* involving "one or more disinterested and independent persons" acting "after full disclosure of all material facts" would "alter . . . the aspects of the duty of loyalty stated in Section 409(b) and (i)" and would therefore be subject to the "not manifestly unreasonable standard" of Subsection (d)(3)(A).

For the meaning of "material" as applied to information, see Section 409(f), comment.

Subsection (d)(1)(B)—Section 405(a)(2) prohibits distributions:

- *not merely* when, after the distribution, "the company's total assets would be less than the sum of its total liabilities,"
- *but also* when, after the distribution, the assets would less than the total liabilities "plus the amount that would be needed, if the company were to be dissolved and wound up at the time of the distribution, to satisfy the preferential rights upon dissolution and winding up of members and transferees whose preferential rights are superior to those of persons receiving the distribution."

The second part of the solvency test pertains to preferential rights to distributions, is thus a matter *inter se* the members and any transferees, and is therefore subject to change in the operating agreement.

In contrast, the first part of the solvency test protects third parties—creditors of the LLC—and therefore cannot be changed by the operating agreement. Subsection (c)(15). Likewise, the operating agreement cannot change the solvency test stated in Section 405(a)(1) (providing that "the company would not be able to pay its debts as they become due in the ordinary course of the company's activities and affairs").

Subsection (d)(2)—This provision is limited to member-managed limited liability companies on the premise that: (i) managers are collectively responsible; and (ii) managers may properly delegate a duty but the delegation does not discharge the duty. However, in a manager-managed LLC (as well as in a member-managed LLC), subject to Subsection (d)(3) the operating agreement may alter or even eliminate fiduciary duties.

> EXAMPLE: ABC LLC ("ABC") is a member-managed LLC. ABC has two entirely separate lines of business, the Alpha business and the Beta business. Under ABC's operating agreement:
>
> - Member 1's responsibilities pertain exclusively to the Alpha business, while responsibility for:
>   - the Beta business is allocated exclusively to Member 2; and
>   - ABC's overall operations is allocated exclusively to Member 3.
> - Member 2's responsibilities pertain exclusively to the Beta business, while responsibility for:
>   - the Alpha business is allocated exclusively to Member 1; and
>   - ABC's overall operations is allocated exclusively to Member 3.
> - Member 1 has no fiduciary duties pertaining to the Beta business.
> - Member 2 has no fiduciary duties pertaining to the Alpha business.
>
> The elimination of Member 1's fiduciary duties with regard to the Beta business and Member 2's fiduciary duties with regard to the Alpha business are enforceable, without regard to the "manifestly unreasonable" standard of Subsection (d)(3).

Subsection (d)(3)—This act rejects the ultra-contractarian notion that fiduciary duty within a business organization is merely a set of default rules and seeks instead to balance the virtues of "freedom of contract" against the dangers that inescapably exist when some persons have power over the interests of others. *Cf.* Leo E. Strine, Jr. J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, ELGAR HANDBOOK ON ALTERNATIVE ENTITIES (Eds. Mark

Lowenstein and Robert Hillman), forthcoming 2014,, Edward Elgar Publishing 2014) (noting that an "argument often made in favor of [Delaware] alternative entity statutes is that they allow for the elimination of fiduciary duties and the establishment of a purely contractual relationship between entity managers and investors" and stating that "[a]s judges who have seen our fair share of alternative entity disputes, we do not immediately grasp why this would be seen as a compelling advantage"); available at SSRN: http://ssrn.com/abstract=2481039, at 9-10 (footnote omitted).

Under this act, a properly drafted operating agreement may substantially alter and even eliminate fiduciary duties. However, two important limitations exist.

First, arrangements subject to this subsection may not be "manifestly unreasonable." *See* Subsection (e) (delineating this standard).

Second, the operating agreement may not transform the relationship *inter se* members, managers, and the LLC into an entirely arm's length arrangement. For example, displacement of fiduciary duties is effective only to the extent that the displacement is stated clearly and with particularity. This rule is fundamental in the jurisprudence of fiduciary duty. *See, e.g.*, *Paige Capital Mgmt, L.L.C. v. Lerner Master Fund, L.L.C.*, Civ. A. No. 5502-CS, 2011 WL 3505355, at *31 (Del. Ch. Aug. 8, 2011) (Del. Ch. 2011) (stating that, even under a statute that "permits the waiver of fiduciary duties . . . such waivers must be set forth clearly"); *Kelly v. Blum*, Civ. A. No. 4516-VCP, 2010 WL 629850, at *10, n.70 (Del. Ch. Feb. 24, 2010) ("Having been granted great contractual freedom by the LLC Act, drafters of or parties to an LLC agreement should be expected to provide . . . clear and unambiguous provisions when they desire to expand, restrict or eliminate the operation of traditional fiduciary duties"). It would therefore be manifestly unreasonable for an operating agreement to negate this rule.

Although Subsection (d)(3) does not expressly address contracts between an LLC and a member or manager, the stated constraints must also apply to such contracts. If not, those constraints are effectively meaningless.

> EXAMPLE: A manager-managed LLC enters into a management contract with its sole manager, and the contract provides that the duties of loyalty stated in Section 409(b) and (i) are entirely eliminated. If the operating agreement were to so provide, the provision would be subject to the "manifestly unreasonable standard." Section 105(d)(3)(A). Absent the authorization provided by Section 105(d)(3)(A), the management contract's attempt to waive fiduciary duties may be unenforceable as a matter of public policy and contract law. *See Neubauer v. Goldfarb*, 108 Cal. App. 4th 47, 57, 133 Cal. Rptr. 2d 218 (2003) (stating that "waiver of corporate directors' and majority shareholders' fiduciary duties to minority shareholders in private close corporations is against public policy and a contract provision in a buy-sell agreement purporting to effect such a waiver is void"). If not, a court should hold the provision unenforceable nonetheless so as to avoid eviscerating Subsection (d)(3).

Subsection (d)(3)(A)—Subject to the "not manifestly unreasonable" standard, this paragraph empowers the operating agreement to eliminate *all* aspects of the duty of loyalty listed in Section 409(b). The obligation of good faith and fair dealing, Section 409(d), would remain. See Subsection (c)(6). As to any other, uncodified aspects of the duty of loyalty, see Subsection (d)(3)(D) (empowering the operating agreement to "alter or eliminate any other fiduciary duty").

EXAMPLE: Joint Venture LLC ("JV") is a manager-managed limited liability company, with two members, Kappa, Inc. ("Kappa") and Lambda, LLC ("Lambda"). The operating agreement provides that:

- JV is managed by a "board of managers" consisting of one person appointed by Kappa and one person appointed by Lambda;
- each appointee:
  - owes fiduciary and any other duties exclusively to the member that made the appointment; and
  - owes no duties to the other member and the limited liability company.

The "not manifestly unreasonable" standard applies to these provisions under Subsection (d)(3)(A) and (D), and the provisions are not manifestly unreasonable. Note that the provisions do not affect the duties of Kappa and Lambda to:

- the limited liability company, under applicable case law (pertaining to the obligations of owners of an entity who control the entity indirectly); and
- each other, under applicable case law and Section 701(a)(4)(C)(ii) (providing for judicial dissolution when "the managers or those members in control of the company . . . have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the [member seeking dissolution").

EXAMPLE: ABC LLC ("ABC") is a manager-managed limited liability company with three managers and two entirely separate lines of business, the Alpha business and the Beta business. Under ABC's operating agreement:

- Manager 1's responsibilities pertain exclusively to the Alpha business; responsibility for:
  - the Beta business is allocated exclusively to Manager 2; and
  - ABC's overall operations is allocated exclusively to Manager 3.
- Manager 2's responsibilities pertain exclusively to the Beta business; responsibility for:
  - the Alpha business is allocated exclusively to Manager 1; and
  - ABC's overall operations is allocated exclusively to Manager 3.
- Manager 1 has no fiduciary duties pertaining to the Beta business.
- Manager 2 has no fiduciary duties pertaining to the Alpha business.

The "not manifestly unreasonable" standard applies to these provisions under Subsection (d)(3)(A) and (D), and the provisions are not manifestly unreasonable.

Subsection (d)(3)(B)—Under this paragraph, an operating agreement might provide that an affiliate of a manager of a manager-managed LLC will provide compensated services to the LLC at a price not exceeding market price, or that the manager may pursue opportunities that otherwise would be company opportunities. Such arrangements are commonplace and permissible.

Subsection (d)(3)(C)—In this context, "conduct" includes both acts and omissions. BLACK'S LAW DICTIONARY (9th ed. 2009) (defining conduct as "[p]ersonal behavior, whether by action or inaction"). Subject to the "not manifestly unreasonable" standard and the bedrock requirements stated here and in Subsection (c)(7), the operating agreement can reduce the duty of care substantially. In particular, the operating agreement can eliminate the aspects of the duty of care pertaining to gross negligence and recklessness.

This provision replicates in a particular context the general rule stated in Subsection (c)(7). For the meaning of "bad faith" in the context of the duty of care, see Subsection (c)(7), comment.

Subsection (e)—The "not manifestly unreasonable" concept became part of uniform business entity statutes when UPA (1997) imported the concept from the Uniform Commercial Code. (In the current version of the Uniform Commercial Code, the concept appears in Section 1-302(b).)

This subsection provides rules for applying the concept, specifying:

- who decides the issue of "manifestly unreasonable"
  - "the court . . . as a matter of law," Subsection (e);
- the framework for determining the issue
  - determination to be made "in light of the purposes, activities, and affairs of the limited liability company," Subsection (e)(2);
- the temporal setting for determining the issue
  - "determination [to be made] as of the time the challenged term became part of the operating agreement," Subsection (e)(1); and
- what information is admissible for determining the issue
  - "only circumstances existing" when "the challenged term became part of the operating agreement," Subsection (e)(1).

The subsection also provides a very demanding standard for persons claiming that a term of an operating agreement is "manifestly unreasonable." "The court . . . may invalidate the term only if, in light of the purposes, activities, and affairs of the limited liability company, it is *readily apparent* that: (A) the objective of the term is unreasonable; or (B) the term is an unreasonable means to achieve the term's objective." Subsection (e)(2) (emphasis added).

Subsection (e) is fundamental to this act, because: (i) this act generally defers to the agreement among the members; and (ii) Subsection (e) safeguards the operating agreement in at least four ways:

- Determining manifest unreasonableness *inter se* owners of an organization is a different task than doing so in a commercial context, where concepts like "usages of trade" are available to inform the analysis. Each business organization must be understood in its own terms and context.
- If loosely applied, the concept of "manifestly unreasonable" would permit a court to rewrite the members' agreement, which would destroy the balance this act seeks to establish between freedom of contract and fiduciary duty.
- Case law has not adequately delineated the concept. *See, e.g.*, *In re Brobeck, Phleger & Harrison L.L.P.*, 408 B.R. 318, 335 (Bankr. N.D. Cal. 2009) ("RUPA [UPA (1997)] does not define what is 'manifestly unreasonable' and the parties have not cited, nor can the court locate, a decision that defines the term. Absent case law or even a dictionary

definition, the court must rely on its common sense to recognize something as manifestly unreasonable.").

- In the context of statutes permitting stock transfer restrictions unless "manifestly unreasonable," courts have often ignored the word "manifestly." *See, e.g.*, *Brandt v. Somerville*, 692 N.W.2d 144, 152 (N.D. 2005) (stating that "in close corporations, a majority of courts have sustained restrictions that are determined to be reasonable in light of the relevant circumstances"); *Roof Depot, Inc. v. Ohman*, 638 N.W.2d 782, 786 (Minn. Ct. App. 2002) (stating that "the restrictions [on share transfer] are not 'manifestly unreasonable' because they are reasonable means to ensure that the management and control of the business remains in the group of investors or with people well known to them"); *Castriota v. Castriota*, 633 A.2d 1024, 1027–28 (App. Div. 1993) ("We are obliged to apply the statute in a manner consonant with its essential purpose to permit reasonable restrictions upon alienation.").

Subsection (e)(1)—The significance of the phrase "as of the time the term as challenged became part of the operating agreement" is best shown by example.

> EXAMPLE: When a particular manager-managed LLC comes into existence, its business plan is quite unusual and its success depends on the willingness of a particular individual to serve as the LLC's sole manager. This individual has a rare combination of skills, experiences, and contacts, which are particularly appropriate for the LLC's start-up. In order to induce the individual to accept the position of sole manager, the members are willing to have the operating agreement significantly limit the manager's fiduciary duties. Several years later, when the LLC's operations have turned prosaic and the manager's talents and background are not nearly so crucial, a member challenges the fiduciary duty limitations as manifestly unreasonable. The relevant time under Subsection (e)(1) is when the LLC began. Subsequent developments are not relevant, except as they might inferentially bear on the circumstances in existence at the relevant time.

> EXAMPLE: As initially adopted, an operating agreement identifies a category of decisions ordinarily subject to the duty of loyalty and provides that "the manager's sole, reasonable discretion" satisfies the duty. A year later, the agreement is amended to delete the word "reasonable." Later, a member claims that, without the word "reasonable," the provision is manifestly unreasonable. The relevant time under Subsection (e)(1) is when the agreement was amended, not when the agreement was initially adopted.

Subsection (e)(2)—If a person claims that a term of the operating agreement is manifestly unreasonable under Subsections (c)(6) or (d)(3), as a matter of ordinary procedural law the person making the claim has the burden of proof.

SECTION 106. OPERATING AGREEMENT; EFFECT ON LIMITED LIABILITY COMPANY AND PERSON BECOMING MEMBER; PREFORMATION AGREEMENT.

(a) A limited liability company is bound by and may enforce the operating agreement, whether or not the company has itself manifested assent to the operating agreement.

(b) A person that becomes a member is deemed to assent to the operating agreement.

(c) Two or more persons intending to become the initial members of a limited liability company may make an agreement providing that upon the formation of the company the agreement will become the operating agreement. One person intending to become the initial member of a limited liability company may assent to terms providing that upon the formation of the company the terms will become the operating agreement.

Comment

Subsection (a)—This subsection resolves twin questions that have troubled some courts – namely, whether an unincorporated entity that has not signed its foundational agreement nonetheless is bound by and may enforce the agreement. The questions have been particularly troubling in the context of agreements to arbitrate. *See, e.g., Elkjer v. Scheef & Stone, L.L.P.*, 3:13-CV-1655-K, --- F. Supp.2d ----, 2014 WL 1255844 at *5-6 (N.D. Tex. Mar. 27, 2014) (concluding that a limited liability partnership "is a party to the Partnership Agreement," even though the partnership itself never signed or otherwise assented to the agreement; enforcing arbitration provision to the benefit of the LLP). *Contra Trover v. 419 OCR, Inc.*, 397 Ill. App. 3d 403, 409, 921 N.E.2d 1249, 1255 (2010) (finding that "neither FODG [an LLC] nor the Golf Club [a related LLC] was a party to the operating agreements and that they are therefore not bound by the arbitration clauses therein").

Developments pertaining to the Virginia LLC Act further illustrate the difficulties. In *Mission Residential, L.L.C. v. Triple Net Properties, L.L.C.*, 654 S.E.2d 888, 891 (2008), the Virginia Supreme Court held that a member's derivative claim was not subject to the arbitration provision in the operating agreement, because: (i) the LLC was "the real party in interest"; (ii) the LLC had not signed the operating agreement; and (iii) requiring the claim to be arbitrated would "ignore[] the separate existence of Holdings [the LLC]." The Virginia legislature promptly disagreed and amended the LLC act to state: "A limited liability company is bound by its operating agreement whether or not the limited liability company executes the operating agreement." VA. CODE ANN. § 13.1–1023.A.1 (2012). The legislature left open the question of a limited liability company's power to enforce an operating agreement that the company has not executed.

This subsection answers the twin questions, categorically and in the affirmative.

This subsection does not consider whether a limited liability company is an indispensable party to a suit concerning the operating agreement. That question is one of procedural law, and the answer can determine whether federal diversity jurisdiction exists.

Subsection (b)—Given the possibility of oral and implied-in-fact terms in the operating agreement, a person becoming a member of an existing limited liability company should take precautions to ascertain fully the contents of the operating agreement. *See* the comment to Section 105(a)(4).

Subsection (c)—The second sentence refers to "assent to terms" rather than "make an agreement" because, under venerable principles of contract law, an agreement presupposes at least two parties, and Section 102(13) specifically contemplates an operating agreement in a single member LLC.

A pre-formation arrangement is not an operating agreement. An operating agreement presupposes at least one member, and, under this act, the earliest a person can become a member is upon the formation of the limited liability company. *See* Section 401.

SECTION 107. OPERATING AGREEMENT; EFFECT ON THIRD PARTIES AND RELATIONSHIP TO RECORDS EFFECTIVE ON BEHALF OF LIMITED LIABILITY COMPANY.

(a) An operating agreement may specify that its amendment requires the approval of a person that is not a party to the agreement or the satisfaction of a condition. An amendment is ineffective if its adoption does not include the required approval or satisfy the specified condition.

(b) The obligations of a limited liability company and its members to a person in the person's capacity as a transferee or a person dissociated as a member are governed by the operating agreement. Subject only to a court order issued under Section 503(b)(2) to effectuate a charging order, an amendment to the operating agreement made after a person becomes a transferee or is dissociated as a member:

(1) is effective with regard to any debt, obligation, or other liability of the limited liability company or its members to the person in the person's capacity as a transferee or person dissociated as a member; and

(2) is not effective to the extent the amendment imposes a new debt, obligation, or other liability on the transferee or person dissociated as a member.

(c) If a record delivered by a limited liability company to the [Secretary of State] for filing becomes effective and contains a provision that would be ineffective under Section 105(c) or (d)(3) if contained in the operating agreement, the provision is ineffective in the record.

(d) Subject to subsection (c), if a record delivered by a limited liability company to the [Secretary of State] for filing becomes effective and conflicts with a provision of the operating agreement:

(1) the agreement prevails as to members, persons dissociated as members, transferees, and managers; and

(2) the record prevails as to other persons to the extent they reasonably rely on the record.

Comment

Subsection (a)—This subsection, derived from DEL. CODE ANN. tit. 6, § 18-302(e), permits the operating agreement to: (i) accord a non-member veto rights over amendments to the agreement; and (ii) establish other preconditions for amendments. An amendment made in derogation of a veto right or precondition is ineffective.

Veto rights are likely to be sought by lenders but may also be attractive to non-member managers.

> EXAMPLE: A non-member manager enters into a management contract with an LLC, and that agreement provides in part that the LLC may remove the manager without cause only with the consent of members holding 2/3 of the profits interests. The operating agreement contains a parallel provision (the "operating agreement's quantum provision"), but the non-member manager is not a party to the operating agreement. Later, the LLC members amend the operating agreement's quantum provision to reduce the quantum to a simple majority of profits interests and thereafter purport to remove the manager without cause. Although the LLC has undoubtedly breached its contract with the manager and subjected itself to a damage claim, the LLC has the *power* under Section 105(a)(2) to effect the removal—unless the operating agreement provides the manager a veto right over changes in the operating agreement's quantum provision.

This subsection does not refer to member veto rights because, unless otherwise provided in the operating agreement, the consent of each member is necessary to effect an amendment. *See* Section 407(b)(4)(B), (c)(3)(B).

Because "[a]n operating agreement may specify that its amendment requires . . . the satisfaction of a condition," an operating agreement can require that any amendment be made through a writing or a record signed by each member. *See* Section 105(a)(4) (empowering the operating agreement to determine "the means and conditions for amending the operating agreement”).

Subsection (b)—The law of unincorporated business organizations is only beginning to grapple in a modern way with the tension between the rights of an organization’s owners to carry on their activities as they see fit (or have agreed) and the rights of transferees of the organization’s economic interests. Such transferees can include the heirs of business founders as well as former owners who are “locked in” as transferees of their own interests. *See* Section 603(a)(3).

If the law categorically favors the owners, there is a serious risk of expropriation and other abuse. On the other hand, if the law grants former owners and other transferees the right to seek judicial protection, that specter can “freeze the deal” as of the moment an owner leaves the enterprise or a third party obtains an economic interest.

There is little case law in this area, and almost all of it pertains to limited partnerships rather than LLCs. The partnership case law clearly favors the remaining owners over former owners and other transferees. *See, e.g.*, *Bauer v. Blomfield Co./Holden Joint Venture*, 849 P.2d 1365, 1367, n.2 (Alaska 1993) (holding that a mere assignee “was not entitled to complain about a decision made with the consent of all the partners” and stating “[w]e are unwilling to hold that partners owe a duty of good faith and fair dealing to assignees of a partner's interest”); *Bynum v. Frisby*, 73 Nev. 145, 149-50, 311 P.2d 972, 975 (1957) (“[A]n assignment of a partnership interest from one partner to a stranger does not bring that stranger into fiduciary relationship with the remaining partners nor require them to resort to dissolution in order to prevent such a relationship from arising. The stranger remains a stranger entitled only to share in the partnership's worth and to demand an accounting upon dissolution.”) (applying UPA (1914) § 27, pertaining to rights of an assignee). *See generally* Daniel S. Kleinberger, *The Plight of the Bare Naked Assignee*, 42 SUFFOLK L. REV. 587 (2009).

This subsection follows *Bauer* and other cases by expressly subjecting transferees (including a person dissociated as a member) to operating agreement amendments made after the transfer or dissociation, except amendments that increase obligations on transferees. For example, an amendment might extend the duration of a limited liability company but may not institute a new capital call obligation on transferees.

The question of whether, in extreme and sufficiently harsh circumstances, transferees might be able to claim some type of duty or obligation to protect against expropriation awaits development in the case law. An unreported LLC case suggests the answer might be yes, but the decision rests primarily on the wording of the LLC’s operating agreement. In *Kohannim v. Katoli*, 08-11-00155-CV, 2013 WL 3943078, at *10-11 (Tex. App. July 24, 2013), the court: (i) noted that the LLC’s “Regulations provide[] for the distribution of ‘available cash’ to members quarterly provided that the available cash is not needed for a reasonable working capital reserve”; (ii) also noted that “Jacob [the defendant member] paid himself $100,000 for management services that were not performed and failed to make any profit distributions to Mike [former member and ex-spouse of the plaintiff Parvaneh] or Parvaneh [ex-spouse of Mike, who became Mike’s transferee as part of their divorce proceeding] even though more than $250,000 in undistributed profit had accumulated in the company's accounts since the mortgage on the property had been paid off in February 2007”; and (iii) concluded that “more than a scintilla of evidence supports the trial court’s finding that Jacob failed to make profit distributions to

Parvaneh." In essence, the court upheld a finding that Jacob had breached (or caused the LLC to breach) a contractual obligation to make distributions. But the court went further: "We also agree with the trial court's conclusion that the established facts demonstrated Jacob engaged in wrongful conduct and exhibited a lack of fair dealing in the company's affairs to the prejudice of Parvaneh." *Id.* at *11.

For the very limited rights of transferees, see Section 502.

Subsection (b)(1)—This provision is inapposite when "a member or transferee becomes entitled to receive a distribution." Section 404(d). In that circumstance:

- "the member or transferee has the status of . . . a creditor of the limited liability company with respect to the distribution," *Id.*; and
- the relevant obligation is not owed to "a person in the person's capacity as a transferee or person dissociated as a member," Subsection (b), but rather to the person in the person's capacity as a creditor.

Subsection (c)—This provision precludes using the certificate of organization to make an end run around the strictures of Section 105(c) and (d)(3).

Subsection (d)—It will be possible, albeit improvident, for a limited liability company's operating agreement to be inconsistent with the certificate of organization or other public filings pertaining to the company. For those circumstances, this subsection provides rules for determining which source of information prevails:

- For members, managers and transferees, the operating agreement is paramount.
- Third parties may invoke the public record upon a showing of reasonable reliance, which presupposes actual knowledge – *i.e.*, deemed knowledge under Section 103(d) does not suffice.

The mere fact that a term is present in a publicly filed record and not in the operating agreement, or *vice versa*, does not automatically establish a conflict. This subsection does not expressly cover a situation in which: (i) one of the specified filed records contains information in addition to, but not inconsistent with, the operating agreement; and (ii) a person, other than a member or transferee, reasonably relies on the additional information. However, the policy reflected in this subsection seems equally applicable to that situation. Moreover, to argue that the operating agreement prevails over the filed record is to argue that the additional term does conflict with the operating agreement, at least in effect.

Section 105(a)(4) might also be relevant to the subject matter of this subsection. Absent a contrary provision in the operating agreement, language in an LLC's certificate of organization or other record delivered to the filing office for filing on behalf of the LLC might be evidence of the members' agreement and might thereby constitute or at least imply a term of the operating agreement.

This subsection does not apply to records delivered to the filing office for filing on behalf of a person other than a limited liability company.

SECTION 108. NATURE, PURPOSE, AND DURATION OF LIMITED LIABILITY COMPANY.

(a) A limited liability company is an entity distinct from its member or members.

(b) A limited liability company may have any lawful purpose, regardless of whether for profit.

(c) A limited liability company has perpetual duration.

Comment

Subsection (a)—The "separate entity" characteristic is fundamental to a limited liability company and is inextricably connected to both the liability shield, Section 304, and the inability of creditors of a member or transferee to reach the assets of the limited liability company absent a "reverse pierce" or a claim of fraudulent transfer. *See, e.g.*, *Litchfield Asset Mgmt Corp. v. Howell*, 799 A2d 298 (Conn. Ct. App. 2002) (applying an "outside reverse pierce" to allow judgment creditor of member to reach assets of LLC) (overruled on other grounds by *Robinson v. Coughlin*, 830 A2d 1114 (Conn. 2003)); *Egle v. Egle*, 817 So. 2d 136, 140 (La. Ct. App. 2002) (allowing plaintiff to proceed with claims that transfers made by her ex-spouse inter alia to an LLC were sham transactions).

Subsection (b)—Although some LLC statutes continue to require a business purpose, this act follows the current trend and takes a more expansive approach. The phrase "any lawful purpose, regardless of whether for profit" encompasses even charitable activities, but this act does not include any comprehensive protections pertaining to charitable assets and purposes. Section 1004(b) does contain a "nondiversion" provision, but the provision applies only to the organic transactions contemplated by Article 10. Comprehensive protections must be (and typically are) found in other law, although sometimes that "other law" appears within a state's non-profit corporation statute. *See, e.g.,* MINN. STAT. § 317A.811 (2012) (providing restrictions on charitable organizations that seek to "dissolve, merge, or consolidate, or to transfer all or substantially all of their assets" but imposing those restrictions only on "corporations," which are elsewhere defined as corporations incorporated under the non-profit corporation act).

Subsection (c)—The word "perpetual" is a misnomer, albeit one commonplace in LLC statutes. In this context, "perpetual" means merely that the act: (i) does not require a definite term; and (ii) creates no nexus between the dissociation of a member and the dissolution of the entity.

Moreover, the public record pertaining to a limited liability company will not necessarily reveal whether the company actually has a perpetual duration or has in fact dissolved, because: (i) this act, like all LLC statutes, provides several consent-based methods to dissolve a limited liability company; and (ii) none of those methods involve a public filing. For example, dissolution and winding up of a limited liability company may result from a term specified in the operating agreement or the affirmative vote or consent of all members. *See* Sections 701 (events causing dissolution) and 702 (winding up required upon dissolution). An operating agreement is not a publicly filed document, and a member vote to dissolve a limited liability company is not a public event. A dissolved limited partnership may deliver to the filing office for filing a statement of dissolution, Section 702(b)(2)(A), and later a statement of termination, Section 702(b)(2)(F), or both, but the filing of such statements is permissive rather than mandatory, *id*.

Likewise, the public record will not reveal when (or even whether) a limited liability company has come into existence. *See* Section 201(d) ("A limited liability company is formed when the company's certificate of becomes effective and at least one person becomes a member.").

SECTION 109. POWERS. A limited liability company has the capacity to sue and be sued in its own name and the power to do all things necessary or convenient to carry on its activities and affairs.

Comment

Continuing the approach initiated in ULPA (2001) § 105, this act omits as unnecessary any detailed list of specific powers.

The operating agreement cannot vary a limited liability company's capacity to sue and be sued. Section 105(c)(2). An LLC's standing to enforce the operating agreement is a separate matter, which is covered by Section 106(a) (stating, as a default rule, that the limited liability company "may enforce the operating agreement").

SECTION 110. APPLICATION TO EXISTING RELATIONSHIPS.

(a) Before [all-inclusive date], this [act] governs only:

(1) a limited liability company formed on or after [the effective date of this [act]]; and

(2) except as otherwise provided in subsection (c), a limited liability company formed before [the effective date of this [act]] which elects, in the manner provided in its operating agreement or by law for amending the operating agreement, to be subject to this [act].

(b) Except as otherwise provided in subsection (c), on and after [all-inclusive date] this [act] governs all limited liability companies.

(c) For purposes of applying this [act] to a limited liability company formed before [the effective date of this [act]]:

(1) the company's articles of organization are deemed to be the company's certificate of organization; and

(2) for purposes of applying Section 102(10) and subject to Section 107(d), language in the company's articles of organization designating the company's management structure operates as if that language were in the operating agreement.

Legislative Note:

For states that have previously enacted ULLCA (2006): *For these states this section is unnecessary. There is no need for a delayed effective date, even with regard to pre-existing limited liability companies.*

For states that have not previously enacted ULLCA (2006)*:*

Each enacting jurisdiction should consider whether: (i) this act makes material changes to the "default" (or "gap filler") rules of a predecessor statute; and (ii) if so, whether Subsection (c) should carry forward any of those rules for pre-existing limited liability companies. In this assessment, the focus is on pre-existing limited liability companies that have left default rules in place, whether advisedly or not. The central question is whether, for such limited liability companies, expanding Subsection (c) is necessary to prevent material changes to the members' "deal."

Section 301 (de-codifying statutory apparent authority) does not require any special transition provisions, because: (i) applying the law of agency, as explained in the Comments to Sections 301 and 407, will produce appropriate results; and (ii) the notion of "lingering apparent authority" will protect any third party that has previously relied on the statutory apparent authority of a member of a particular member-managed LLC or a manager of a particular manager-managed LLC. RESTATEMENT (THIRD) OF AGENCY § 3.11, cmt. c (2006).

It is recommended that the "all-inclusive" date should be at least one year after the effective date of this act, Section 1106, but no more than two years.

Comment

Subsection (c)—When a pre-existing limited liability company becomes subject to this act, the company ceases to be governed by the predecessor act, including whatever requirements that act might have imposed for the contents of the articles of organization.

SECTION 111. SUPPLEMENTAL PRINCIPLES OF LAW. Unless displaced by particular provisions of this [act], the principles of law and equity supplement this [act].

Comment

For this act, the common law rules of contract and agency are among the most important supplemental "principles of law." With regard to transactions under Article 10, noteworthy principles include the rights of creditors following leveraged buyouts, spinoffs, asset purchases, or other similar transactions; and creditors' rights under other laws.

SECTION 112. PERMITTED NAMES.

(a) The name of a limited liability company must contain the phrase “limited liability company” or “limited company” or the abbreviation “L.L.C.”, “LLC”, “L.C.”, or “LC”. “Limited” may be abbreviated as “Ltd.”, and “company” may be abbreviated as “Co.”.

(b) Except as otherwise provided in subsection (d), the name of a limited liability company, and the name under which a foreign limited liability company may register to do business in this state, must be distinguishable on the records of the [Secretary of State] from any:

(1) name of an existing person whose formation required the filing of a record by the [Secretary of State] and which is not at the time administratively dissolved;

(2) name of a limited liability partnership whose statement of qualification is in effect;

(3) name under which a person is registered to do business in this state by the filing of a record by the [Secretary of State];

(4) name reserved under Section 113 or other law of this state providing for the reservation of a name by the filing of a record by the [Secretary of State];

(5) name registered under Section 114 or other law of this state providing for the registration of a name by the filing of a record by the [Secretary of State]; and

(6) name registered under [this state’s assumed or fictitious name statute].

(c) If a person consents in a record to the use of its name and submits an undertaking in a form satisfactory to the [Secretary of State] to change its name to a name that is distinguishable on the records of the [Secretary of State] from any name in any category of names in subsection (b), the name of the consenting person may be used by the person to which the consent was given.

(d) Except as otherwise provided in subsection (e), in determining whether a name is the same as or not distinguishable on the records of the [Secretary of State] from the name of another person, words, phrases, or abbreviations indicating a type of person, such as “corporation”, “corp.”, “incorporated”, “Inc.”, “professional corporation”, “P.C.”, “PC”, “professional association”, “P.A.”, “PA”, “Limited”, “Ltd.”, “limited partnership”, “L.P.”, “LP”, “limited liability partnership”, “L.L.P.”, “LLP”, “registered limited liability partnership”, “R.L.L.P.”, “RLLP”, “limited liability limited partnership”, “L.L.L.P.”, “LLLP”, “registered limited liability limited partnership”, “R.L.L.L.P.”, “RLLLP”, “limited liability company”, “L.L.C.”, “LLC”, “limited cooperative association”, “limited cooperative”, or “L.C.A.”, or “LCA” may not be taken into account.

(e) A person may consent in a record to the use of a name that is not distinguishable on the records of the [Secretary of State] from its name except for the addition of a word, phrase, or abbreviation indicating the type of person as provided in subsection (d). In such a case, the person need not change its name pursuant to subsection (c).

(f) The name of a limited liability company or foreign limited liability company may not contain the words [insert prohibited word or words that may be used only with approval by an appropriate state agency].

(g) A limited liability company or foreign limited liability company may use a name that is not distinguishable from a name described in subsection (b)(1) through (6) if the company delivers to the [Secretary of State] a certified copy of a final judgment of a court of competent jurisdiction establishing the right of the company to use the name in this state.

Comment

This section adopts the “distinguishable on the records” test for name availability and rejects the “deceptively similar” test widely used in the past.

For name requirements for foreign limited liability companies, see Section 906.

SECTION 113. RESERVATION OF NAME.

(a) A person may reserve the exclusive use of a name that complies with Section 112 by delivering an application to the [Secretary of State] for filing. The application must state the name and address of the applicant and the name to be reserved. If the [Secretary of State] finds that the name is available, the [Secretary of State] shall reserve the name for the applicant's exclusive use for [120] days.

(b) The owner of a reserved name may transfer the reservation to another person by delivering to the [Secretary of State] a signed notice in a record of the transfer which states the name and address of the person to which the reservation is being transferred.

Comment

This section does not provide for the renewal of a name reservation for successive 120-day periods. A new reservation may be filed upon the expiration of a reservation, but by requiring a new filing this section creates the possibility that another party may timely submit a reservation for the same name. It was considered appropriate to allow for that possibility so that the procedure in this section cannot be used to block a name indefinitely. *Compare* Section 113, *with* Section 114(d) (authorizing a renewable registration of certain names).

SECTION 114. REGISTRATION OF NAME.

(a) A foreign limited liability company not registered to do business in this state under [Article] 9 may register its name, or an alternate name adopted pursuant to Section 906, if the name is distinguishable on the records of the [Secretary of State] from the names that are not available under Section 112.

(b) To register its name or an alternate name adopted pursuant to Section 906, a foreign limited liability company must deliver to the [Secretary of State] for filing an application stating the company's name, the jurisdiction and date of its formation, and any alternate name adopted pursuant to Section 906. If the [Secretary of State] finds that the name applied for is available, the [Secretary of State] shall register the name for the applicant's exclusive use.

(c) The registration of a name under this section is effective for [one year] after the date of registration.

(d) A foreign limited liability company whose name registration is effective may renew the registration for successive [one-year] periods by delivering, not earlier than [three months] before the expiration of the registration, to the [Secretary of State] for filing a renewal application that complies with this section. When filed, the renewal application renews the registration for a succeeding [one-year] period.

(e) A foreign limited liability company whose name registration is effective may register as a foreign limited liability company under the registered name or consent in a signed record to the use of that name by another person that is not an individual.

Comment

Unlike the reservation of a name under Section 113, a registration of a name under this section may be renewed for successive periods thus permitting a name to be protected for a period longer than the initial registration period. Use of the procedure in this section is limited, however, to the names of foreign limited liability companies that are not registered to do business in the state. The purpose of this section is to permit a foreign entity to make sure its name will be available if the entity should choose to register in the state in the future.

SECTION 115. REGISTERED AGENT.

(a) Each limited liability company and each registered foreign limited liability company shall designate and maintain a registered agent in this state. The designation of a registered agent is an affirmation of fact by the limited liability company or registered foreign limited liability company that the agent has consented to serve.

(b) A registered agent for a limited liability company or registered foreign limited liability company must have a place of business in this state.

(c) The only duties under this [act] of a registered agent that has complied with this [act] are:

(1) to forward to the limited liability company or registered foreign limited liability company at the address most recently supplied to the agent by the company or foreign

company any process, notice, or demand pertaining to the company or foreign company which is served on or received by the agent;

(2) if the registered agent resigns, to provide the notice required by Section 117(c) to the company or foreign company at the address most recently supplied to the agent by the company or foreign company; and

(3) to keep current the information with respect to the agent in the certificate of organization or foreign registration statement.

Comment

This section is limited to prescribing the duties of a registered agent under this act. The operating agreement cannot vary this section. Section 105(c)(3)(A). However, an agent may undertake other responsibilities to a represented limited liability company or foreign limited liability company, such as by contract or course of dealing, but those duties will be determined under other law.

SECTION 116. CHANGE OF REGISTERED AGENT OR ADDRESS FOR REGISTERED AGENT BY LIMITED LIABILITY COMPANY.

(a) A limited liability company or registered foreign limited liability company may change its registered agent or the address of its registered agent by delivering to the [Secretary of State] for filing a statement of change that states:

(1) the name of the company or foreign company; and

(2) the information that is to be in effect as a result of the filing of the statement of change.

(b) The members or managers of a limited liability company need not approve the delivery to the [Secretary of State] filing of:

(1) a statement of change under this section; or

(2) a similar filing changing the registered agent or registered office, if any, of the company in any other jurisdiction.

(c) A statement of change under this section designating a new registered agent is an affirmation of fact by the limited liability company or registered foreign limited liability company that the agent has consented to serve.

(d) As an alternative to using the procedure in this section, a limited liability company may amend its certificate of organization.

Comment

A change in the identity of the registered agent of a LLC or foreign LLC or a change of the office address of a company's registered agent are usually routine matters that do not affect the rights of the members of the represented LLC. This section permits those changes to be made without: (i) amendment of an LLC's certificate of organization; (ii) formal approval by an LLC's managers (if any); and (iii) any approval by an LLC's members. For the registered agent's power to resign, see Section 117. For the registered agent's power to change its name, address, or both, see Section 118.

Subsection (c)—This subsection avoids the need to file with a statement of change consent of the new registered agent being designated.

Subsection (d)—This subsection makes clear that the procedures in this section are not exclusive. A common way in which a limited liability company changes its registered agent is to include the change in an amendment of its certificate of organization or in its annual/biennial report. *See* Section 212(e).

SECTION 117. RESIGNATION OF REGISTERED AGENT.

(a) A registered agent may resign as an agent for a limited liability company or registered foreign limited liability company by delivering to the [Secretary of State] for filing a statement of resignation that states:

(1) the name of the company or foreign company;

(2) the name of the agent;

(3) that the agent resigns from serving as registered agent for the company or foreign company; and

(4) the address of the company or foreign company to which the agent will send the notice required by subsection (c).

(b) A statement of resignation takes effect on the earlier of:

(1) the 31st day after the day on which it is filed by the [Secretary of State]; or

(2) the designation of a new registered agent for the limited liability company or registered foreign limited liability company.

(c) A registered agent promptly shall furnish to the limited liability company or registered foreign limited liability company notice in a record of the date on which a statement of resignation was filed.

(d) When a statement of resignation takes effect, the registered agent ceases to have responsibility under this [act] for any matter thereafter tendered to it as agent for the limited liability company or registered foreign limited liability company. The resignation does not affect any contractual rights the company or foreign company has against the agent or that the agent has against the company or foreign company.

(e) A registered agent may resign with respect to a limited liability company or registered foreign limited liability company whether or not the company or foreign company is in good standing.

Comment

Resignation under this section may be accomplished solely by action of the registered agent and does not require the cooperation or consent of the represented LLC or foreign LLC. Whether a resignation violates a contract between the registered agent and the company is beyond the scope of this act, and Subsection (d) preserves whatever claims a represented LLC may have against its registered agent for a wrongful termination. Even if a resignation were to violate such a contract, the resignation would still be effective if the provisions of this section were followed.

Subsection (b)—This subsection delays the effectiveness of a statement of resignation for thirty-one days to allow the notice of the resignation that must be sent under Subsection (c) to reach the represented LLC or registered foreign LLC and to allow the represented LLC to arrange for a substitute registered agent.

Subsection (e)—This subsection makes clear that a registered agent may resign with respect to LLC or registered foreign LLC that is not in good standing and supersedes the contrary administrative practice in some states of refusing to accept any filings with respect to an entity that is not in good standing until the problem with the entity's standing is cured.

SECTION 118. CHANGE OF NAME OR ADDRESS BY REGISTERED AGENT.

(a) If a registered agent changes its name or address, the agent may deliver to the [Secretary of State] for filing a statement of change that states:

(1) the name of the limited liability company or registered foreign limited liability company represented by the registered agent;

(2) the name of the agent as currently shown in the records of the [Secretary of State] for the company or foreign company;

(3) if the name of the agent has changed, its new name; and

(4) if the address of the agent has changed, its new address.

(b) A registered agent promptly shall furnish notice to the represented limited liability company or registered foreign limited liability company of the filing by the [Secretary of State] of the statement of change and the changes made by the statement.

Legislative Note: *Many registered agents act in that capacity for many entities, and the Model Registered Agents Act (2006) (Last Amended 2013) provides a streamlined method through which a commercial registered agent can make a single filing to change its information for all represented entities. The single filing does not prevent an enacting state from assessing filing fees on the basis of the number of entity records affected. Alternatively the fees can be set on an incremental sliding fee or capitated amount based upon potential economies of costs for a bulk filing.*

Comment

This section permits a registered agent to change the name and address of the agent that appears in the registered agent filing of an LLC or foreign LLC represented by the agent. This act does not provide for commercial registered agents. *Cf.* UBOC (2011) (Last Amended 2013) §§ 1-405, 1-406, 1-409. As a result, a registered agent will need to make a separate filing under this section for each LLC and foreign LLC represented by the agent, unless, if authorized by rule or administrative policy, the filing office establishes procedures for a bulk filing with one filing listing the names of all the registered agent's represented entities.

SECTION 119. SERVICE OF PROCESS, NOTICE, OR DEMAND.

(a) A limited liability company or registered foreign limited liability company may be served with any process, notice, or demand required or permitted by law by serving its registered agent.

(b) If a limited liability company or registered foreign limited liability company ceases to have a registered agent, or if its registered agent cannot with reasonable diligence be served, the company or foreign company may be served by registered or certified mail, return receipt requested, or by similar commercial delivery service, addressed to the company or foreign company at its principal office. The address of the principal office must be as shown on the company's or foreign company's most recent [annual] [biennial] report filed by the [Secretary of State]. Service is effected under this subsection on the earliest of:

(1) the date the company or foreign company receives the mail or delivery by the commercial delivery service;

(2) the date shown on the return receipt, if signed by the company or foreign company; or

(3) five days after its deposit with the United States Postal Service, or with the commercial delivery service, if correctly addressed and with sufficient postage or payment.

(c) If process, notice, or demand cannot be served on a limited liability company or registered foreign limited liability company pursuant to subsection (a) or (b), service may be made by handing a copy to the individual in charge of any regular place of business or activity of the company or foreign company if the individual served is not a plaintiff in the action.

(d) Service of process, notice, or demand on a registered agent must be in a written record.

(e) Service of process, notice, or demand may be made by other means under law other than this [act].

Comment

Subsection (b)—This subsection offers three alternative methods for establishing the date service is effected, a date important for determining the time within which an LLC or registered foreign LLC must respond to the process, notice, or demand served. Under Subsection (b)(1), service is effected on the date of receipt by the company of the mail or commercial delivery. Under Subsection (b)(2), service is effected on the date shown on the return receipt, if signed on behalf of the company. Under Subsection (b)(3), service is effected five days after it is deposited with the Postal Service or with a similar commercial delivery service, if correctly addressed and with correct postage or payment. Service is effective at the earliest of the three listed circumstances.

However, for the party effecting service there are difficulties of proof under the first two circumstances. Under Subsection (b)(1) the exact date of the receipt by the LLC or foreign LLC of mail or commercial delivery is peculiarly within the knowledge of the company. Under Subsection (b)(2) the return receipt must be signed on behalf of the company. That requirement is designed to assure that the service is actually received by the company, but the signature on the return receipt may not always show unambiguously that the signer was acting for the company and was authorized to do so. As a practical matter, therefore, parties effecting service under Subsection (b) may find it most convenient to rely on subsection (3) and to maintain their own records so that the date of deposit in the mails or with a commercial delivery service can easily be established.

Subsection (c)—This subsection provides a means for serving process on an LLC or foreign LLC that cannot be served under Subsection (a) or (b). Some LLC statutes require or permit service of process in that circumstance be made on the filing office

Subsection (e)—*See, e.g.*, Fed. R. Civ. P. 4(h)(1)(B) (authorizing service on "a domestic or foreign corporation, or a partnership or other unincorporated association that is subject to suit under a common name" to be made on "an officer, a managing or general agent, or any other agent authorized by appointment or by law to receive service of process").

SECTION 120. DELIVERY OF RECORD.

(a) Except as otherwise provided in this [act], permissible means of delivery of a record include delivery by hand, mail, conventional commercial practice, and electronic transmission.

(b) Delivery to the [Secretary of State] is effective only when a record is received by the [Secretary of State].

Comment

Subsection (a)—Permissible means of delivery are not limited to those listed in this subsection, because this subsection by its terms is a non-exclusive list. Conventional commercial practice includes the use of private delivery or courier services. What constitutes conventional commercial practice may change over time.

Subsection (b)—This section lists permissible means of delivery but, except for delivery to the filing office, does not determine when delivery occurs. Delivery to the filing office is effective only upon actual receipt.

SECTION 121. RESERVATION OF POWER TO AMEND OR REPEAL. The [legislature of this state] has power to amend or repeal all or part of this [act] at any time, and all limited liability companies and foreign limited liability companies subject to this [act] are governed by the amendment or repeal.

Comment

Provisions similar to this section have their genesis in *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat) 518 (1819), which held that the United States Constitution prohibited the application of newly enacted statutes to existing corporations while suggesting the efficacy of a reservation of power similar to this section. This section is a generalized form of the type of provision found in many entity organic laws, the purpose of which is to avoid any possible argument that an entity has contractual or vested rights in any specific statutory provision of its organic law and to ensure that the state may in the future modify its entity statutes as it deems appropriate and require existing entities to comply with the statutes as modified.

This section applies to changes in mandatory provisions of this act; the section does not pertain to changes in default rules.

> EXAMPLE: Having enacted this act, State A later amends Section 401(c)(3) (affirmative vote or consent of all members required for a person for a person to become a member) to reduce, as a default rule, the necessary quantum of consent to consent from members owning in the aggregate at least two-third of the interests in current profits owned by members at the time of the consent. XYZ, LLC is a limited liability company formed under State A's act before the amendment. XYZ's operating agreement is silent on this issue, leaving in place the act's default rule. Whether the act's amended default rule applies depends on whether the members initially: (i) agreed (whether expressly or implicitly) to accept the then-applicable default rule requiring unanimous consent; (ii) agreed (whether expressly or implicitly) to adopt whatever rule the act provided; or (iii) never considered the issue. In short, the change in a default rule occasions an inquiry into the members' express or implied agreement as to the role of the default rule in their mutual understanding. In the first instance, the old rule would continue in effect. In the second and third instances, the new rule would apply.

[ARTICLE] 2

FORMATION; CERTIFICATE OF ORGANIZATION AND OTHER FILINGS

SECTION 201. FORMATION OF LIMITED LIABILITY COMPANY; CERTIFICATE OF ORGANIZATION.

(a) One or more persons may act as organizers to form a limited liability company by delivering to the [Secretary of State] for filing a certificate of organization.

(b) A certificate of organization must state:

(1) the name of the limited liability company, which must comply with Section 112;

(2) the street and mailing addresses of the company's principal office; and

(3) the name and street and mailing addresses in this state of the company's registered agent.

(c) A certificate of organization may contain statements as to matters other than those required by subsection (b), but may not vary or otherwise affect the provisions specified in Section 105(c) and (d) in a manner inconsistent with that section. However, a statement in a certificate of organization is not effective as a statement of authority.

(d) A limited liability company is formed when the certificate of organization becomes effective and at least one person has become a member.

Comment

For a limited liability company to be formed (*i.e.*, to come into existence), two conditions must be met: (i) a certificate of organization must become effective; and (ii) at least one person must become a member.

By definition, the earliest a person can become a member is when the certificate of organization takes effect. *See* Section 102(11) (defining "member" as a person that "has become a member of a limited liability company"). However, a certificate of organization can take effect long before any person becomes a member, and the act does not require any public filing to indicate that a person has become a member. Therefore, the public record will not reflect when (and even whether) a limited liability company has come into existence. *See also* the comment to Section 211.

Subsection (b) – Consistent with the modern trend, this act requires only the most "bare bones" of disclosure.

Unlike many LLC statutes, this act does not require that the certificate of organization state whether the limited liability company is manager-managed or member-managed. Placing that information in a public record pertains primarily to "statutory apparent authority," which this act has eschewed. *See* the comment to Section 301(a). Under this act, the manager-managed and member-managed characterizations pertain principally to *inter se* relations, and the act therefore looks to the operating agreement to make the characterization. *See* Sections 102(10) and (12); Section 407(a).

Subsection (c) – This provision permits the certificate of organization to contain information beyond that required in Subsection (b). An LLC should have good reason, however, before choosing to include additional information. Such information: (i) is available to the public (including competitors); (ii) increases the chances of a conflict between the certificate of organization and the operating agreement, *see* Section 107(d); (iii) permits the argument that the additional information is part of the operating agreement, *see* the comment to Section 102(13) (stating that "[u]nless the operating agreement itself provides otherwise . . . an operating agreement may comprise a number of separate documents (or records), however denominated"); and (iv) can be confusing to the extent the information appears to delineate the power of persons to act for the LLC. (Subsection (c) states explicitly that information in a certificate of formation "is not effective as a statement of authority."). In any event, placing additional information in the certificate of formation does not enable an LLC to "end run" the provisions of Section 105(c) (limiting the power of the operating agreement to vary specified provisions of this act).

Subsection (d) – ULLCA (2006) flirted with the concept of a "shelf" LLC – *i.e.*, a limited liability company duly formed without having at least one member upon formation. As the Prefatory Note to ULLCA (2006) explains:

> [T]he Act: (i) permits an organizer to file a certificate of organization without a person "waiting in the wings" to become a member upon formation; but (ii) provides that the LLC is not formed until and unless at least one person becomes a member and the organizer makes a second filing stating that the LLC has at least one member.

Prefatory Note, *The Ability to "Pre-File" a Certificate of Organization*.

Subsection (d) clearly precludes a "shelf" LLC, which is consistent with ULPA (2001) (Last Amended 2013) Section 201(d) (providing that a limited partnership is formed when the certificate of limited partnership becomes effective, at least two persons have become partners, at least one person has become a general partner, and at least one person has become a limited partner).

SECTION 202. AMENDMENT OR RESTATEMENT OF CERTIFICATE OF ORGANIZATION.

(a) A certificate of organization may be amended or restated at any time.

(b) To amend its certificate of organization, a limited liability company must deliver to the [Secretary of State] for filing an amendment stating:

(1) the name of the company;

(2) the date of filing of its initial certificate; and

(3) the text of the amendment.

(c) To restate its certificate of organization, a limited liability company must deliver to the [Secretary of State] for filing a restatement, designated as such in its heading.

(d) If a member of a member-managed limited liability company, or a manager of a manager-managed limited liability company, knows that any information in a filed certificate of organization was inaccurate when the certificate was filed or has become inaccurate due to changed circumstances, the member or manager shall promptly:

(1) cause the certificate to be amended; or

(2) if appropriate, deliver to the [Secretary of State] for filing a statement of change under Section 116 or a statement of correction under Section 209.

Comment

Like other provisions of the act requiring records to be delivered to the filing officer for filing, this section is not subject to change by the operating agreement. See Section 105(c)(3). Except for Subsection (d), this section is essentially mechanical.

Subsection (d) – This subsection imposes an obligation directly on the members and managers rather than on the limited liability company. A member's or manager's failure to meet the obligation exposes the member or manager to liability to third parties under Section 205(a)(2) and might constitute a breach of the member or manager's duties under Section 409(c) and (i). In addition, an aggrieved person may seek a remedy under Sections 204 (Signing and Filing Pursuant to Judicial Order) and 205 (Liability for Inaccurate Information in Filed Record).

Like other provisions of the act requiring records to be delivered to the filing officer for filing, this section is not subject to change by the operating agreement. *See* Section 105(c)(3).

SECTION 203. SIGNING OF RECORDS TO BE DELIVERED FOR FILING TO [SECRETARY OF STATE].

(a) A record delivered to the [Secretary of State] for filing pursuant to this [act] must be signed as follows:

(1) Except as otherwise provided in paragraphs (2) and (3), a record signed by a limited liability company must be signed by a person authorized by the company.

(2) A company's initial certificate of organization must be signed by at least one person acting as an organizer.

(3) A record delivered on behalf of a dissolved company that has no member must be signed by the person winding up the company's activities and affairs under Section 702(c) or a person appointed under Section 702(d) to wind up the activities and affairs.

(4) A statement of denial by a person under Section 303 must be signed by that person.

(5) Any other record delivered on behalf of a person to the [Secretary of State] for filing must be signed by that person.

(b) A record delivered for filing under this [act] may be signed by an agent. Whenever this [act] requires a particular individual to sign a record and the individual is deceased or incompetent, the record may be signed by a legal representative of the individual.

(c) A person that signs a record as an agent or legal representative affirms as a fact that the person is authorized to sign the record.

Comment

Subsection (a) – Section 102(21) defines "sign" broadly, including "an electronic symbol, sound, or process."

Subsection (a)(1) – From the perspective of the filing office, it is not necessary that a record delivered for filing on behalf of a limited liability company be signed by a member or, in the case of a manager-managed LLC, a manager. The operating agreement can impose such a requirement as an *inter se* matter, but the requirement would not affect this provision. See Section 105(c)(3)(B) (stating that the operating agreement may not "vary any requirement, procedure, or other provision of this [act] pertaining to … the [Secretary of State], including provisions pertaining to records authorized or required to be delivered to the [Secretary of State] for filing under this [act]").

The filing office will not check whether a person who purports to be authorized to sign a record on behalf of an LLC actually has that authority, even if a statement of authority pertaining to the matter is in effect. Indeed, even if the filing office somehow "knows" of a statement limiting authority, the office lacks the authority to reject a record on that basis. *See* the comment to Section 206(a) (stating the requirements for filing and noting that the filing office's review is ministerial and limited to information pertaining to the stated requirements) and the comment to Section 302(c) (explaining why such a statement of authority does not affect the filing office).

Subsection (b) – The filing office will not check the bona fides of a person purporting to have signed a record in a representative capacity. This subsection expressly authorizes taking action through an agent so as to provide context for Subsection (c) and for the avoidance of doubt. No negative inference should be drawn about using agents to take other action under this act.

Subsection (c) – As a matter of agency law, a person who signs in a representative capacity gives a "warranty of authority." RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006) (Agent's Implied Warranty of Authority). This subsection has criminal law implications.

SECTION 204. SIGNING AND FILING PURSUANT TO JUDICIAL ORDER.

(a) If a person required by this [act] to sign a record or deliver a record to the [Secretary of State] for filing under this [act] does not do so, any other person that is aggrieved may petition [the appropriate court] to order:

(1) the person to sign the record;

(2) the person to deliver the record to the [Secretary of State] for filing; or

(3) the [Secretary of State] to file the record unsigned.

(b) If a petitioner under subsection (a) is not the limited liability company or foreign limited liability company to which the record pertains, the petitioner shall make the company or foreign company a party to the action.

(c) A record filed under subsection (a)(3) is effective without being signed.

Comment

This section gives the court the flexibility to order either that a record be signed or that the record be filed by the filing office unsigned. The latter circumstance may arise, for example, in a situation where the person who should sign the record is not subject to the jurisdiction of the court. This section also makes clear that the court may order a person with control over a record that has been signed to deliver the record to the filing office for filing.

SECTION 205. LIABILITY FOR INACCURATE INFORMATION IN FILED RECORD.

(a) If a record delivered to the [Secretary of State] for filing under this [act] and filed by the [Secretary of State] contains inaccurate information, a person that suffers loss by reliance on the information may recover damages for the loss from:

(1) a person that signed the record, or caused another to sign it on the person's behalf, and knew the information to be inaccurate at the time the record was signed; and

(2) subject to subsection (b), a member of a member-managed limited liability company or a manager of a manager-managed limited liability company if:

(A) the record was delivered for filing on behalf of the company; and

(B) the member or manager knew or had notice of the inaccuracy for a reasonably sufficient time before the information was relied upon so that, before the reliance, the member or manager reasonably could have:

(i) effected an amendment under Section 202;

(ii) filed a petition under Section 204; or

(iii) delivered to the [Secretary of State] for filing a statement of change under Section 116 or a statement of correction under Section 209.

(b) To the extent the operating agreement of a member-managed limited liability company expressly relieves a member of responsibility for maintaining the accuracy of information contained in records delivered on behalf of the company to the [Secretary of State] for filing under this [act] and imposes that responsibility on one or more other members, the liability stated in subsection (a)(2) applies to those other members and not to the member that the operating agreement relieves of the responsibility.

(c) An individual who signs a record authorized or required to be filed under this [act] affirms under penalty of perjury that the information stated in the record is accurate.

Comment

Subsection (a) – This subsection relates to liability to third parties for inaccurate information in a filed record. Paragraph 1 requires actual knowledge because the paragraph can inculpate a person who is neither a member of a member-managed limited liability company nor a manager of a manager-managed limited liability company. Under Paragraph 2(B), notice suffices, because: (i) the provision applies only to members of a member-managed LLC and managers of a manager-managed LLC; (ii) by status these persons have overall management authority; and (iii) therefore it is reasonable to impose liability when a person either knows or "has reason to know … from all the facts known to the person at the time in question." Section 103(b)(1) (defining notice). For the same reason, Paragraph 1 applies only to "information [known] to be inaccurate at the time the record was signed," while Paragraph 2 applies whenever a "member or manager knew or had notice of the inaccuracy for a reasonably sufficient time before the information was relied upon so that, before the reliance, the member or manager reasonably could have [taken corrective action]." Paragraph (2)(B).

Subsection (a)(2) – Although this act establishes the avoidance of gross negligence as the standard of care for those who manage a limited liability company, this provision encompasses liability to third parties. Accordingly, the standard here is more demanding. The phrases "reasonably sufficient time" and "reasonably could have" indicate a standard of ordinary care. "[N]otice of the inaccuracy" involves "reason to know." Section 103(b)(1)

Subsection (b) – Section 105(d)(2) authorizes the operating agreement to establish an analogous rule *inter se* the members. This subsection goes where the operating agreement cannot reach and affects the rights of third parties.

Subsection (c) – This subsection provides criminal liability. The elements of perjury are a matter for the criminal law of the jurisdiction.

SECTION 206. FILING REQUIREMENTS.

(a) To be filed by the [Secretary of State] pursuant to this [act], a record must be received by the [Secretary of State], comply with this [act], and satisfy the following:

(1) The filing of the record must be required or permitted by this [act].

(2) The record must be physically delivered in written form unless and to the

extent the [Secretary of State] permits electronic delivery of records.

(3) The words in the record must be in English, and numbers must be in Arabic or Roman numerals, but the name of an entity need not be in English if written in English letters or Arabic or Roman numerals.

(4) The record must be signed by a person authorized or required under this [act] to sign the record.

(5) The record must state the name and capacity, if any, of each individual who signed it, either on behalf of the individual or the person authorized or required to sign the record, but need not contain a seal, attestation, acknowledgment, or verification.

(b) If law other than this [act] prohibits the disclosure by the [Secretary of State] of information contained in a record delivered to the [Secretary of State] for filing, the [Secretary of State] shall file the record if the record otherwise complies with this [act] but may redact the information.

(c) When a record is delivered to the [Secretary of State] for filing, any fee required under this [act] and any fee, tax, interest, or penalty required to be paid under this [act] or law other than this [act] must be paid in a manner permitted by the [Secretary of State] or by that law.

(d) The [Secretary of State] may require that a record delivered in written form be accompanied by an identical or conformed copy.

(e) The [Secretary of State] may provide forms for filings required or permitted to be made by this [act], but, except as otherwise provided in subsection (f), their use is not required.

(f) The [Secretary of State] may require that a cover sheet for a filing be on a form prescribed by the [Secretary of State].

Comment

The filing office’s duty under this section is ministerial, Section 210(a), and the office’s assessment of a record delivered for filing is limited to conformity with this section. The filing office *must* file a record delivered for filing if the record contains the information required by this act and is accompanied by the required filing fee. The filing office is authorized to provide forms but not require their use, and, as a result, may not reject records delivered for filing on the basis of form (except to the very limited extent permitted by Subsections (d) and (f)).

In view of the very limited discretion granted to the filing office under this section and Section 210(a), "[t]he filing of … a record does not create a presumption that the information contained in the record is correct… ." Section 210(e).

Subsection (a) – The first requisite for having a record filed is to cause the record actually to be received by the filing office. Section 120(b) reiterates this point.

Subsection (a)(2) – A record delivered for filing must be in typewritten or printed form unless the filing office permits delivery by electronic transmission. The types of electronic transmission that may be used will be determined by the filing office and is intended to include the evolving methods of electronic delivery, including facsimile transmissions, electronic transmissions between computers, and filings through delivery of storage media.

Subsection (a)(3) – The text of an entity filing must be in the English language, except to the limited extent permitted by this paragraph.

Subsection (a)(4) – To be filed a record must be signed by the appropriate person. *See* Section 102(21) (defining "sign" and manner in which a record may be "signed"). Who is an appropriate person is determined under Section 203, but the filing office will not check to determine whether a person purportedly authorized to sign is in fact authorized. *See* the comment to Section 203(a)–(c).

The requirement in some state statutes that records delivered for filing on behalf of an entity must be acknowledged or verified as a condition for filing has been rejected. These requirements serve little purpose in connection with entity filings. On the other hand, many organizations, like lenders or title companies, may desire that specific records include acknowledgements, verifications, or seals; Subsection (a)(4) does not prohibit the addition of these forms of execution and their use does not affect the eligibility of the record for filing.

Subsection (b) – Under this subsection, a confidentiality obligation does not affect the filing office's duty to file, and the filing office is authorized but not required to redact. This act does not affect any confidentiality-related obligations the filing office may have under other law.

SECTION 207. EFFECTIVE DATE AND TIME. Except as otherwise provided in Section 208 and subject to Section 209(d), a record filed under this [act] is effective:

(1) on the date and at the time of its filing by the [Secretary of State], as provided in Section 210(b);

(2) on the date of filing and at the time specified in the record as its effective time, if later

than the time under paragraph (1);

(3) at a specified delayed effective date and time, which may not be more than 90 days after the date of filing; or

(4) if a delayed effective date is specified, but no time is specified, at 12:01 a.m. on the date specified, which may not be more than 90 days after the date of filing.

Comment

Records accepted for filing become effective at the date and time of filing as recorded by the filing office, or at another specified time on that date, unless a permissible delayed effective date is stated in the record.

Section 210(b) requires the filing office to maintain some means of recording the date and time of delivery of a record and requires that office to record that date and time as the date and time of filing. That provision gives express statutory authority to the common practice of most filing offices of ignoring processing time and treating a record as filed as of the date and time it is delivered for filing even though it may not be reviewed and accepted for filing until several days after delivery. That section contemplates that time of delivery, as well as the date, will be routinely recorded.

Paragraph (1) – In the absence of provision for a delayed effective date, a record delivered for filing becomes effective on the date and time of filing by the filing office. Since under 210(b) the date and time of filing is the recorded date and time of delivery of the record to the filing office (which under Section 210(b) is the date and time of actual receipt), together these provisions eliminate any doubt about situations involving same-day transactions in which a record, for example, a statement of merger, is delivered for filing on the morning of the day the merger is to become effective.

Paragraph (3) – This paragraph does not authorize or contemplate the retroactive establishment of an effective date before the date of filing.

Paragraphs (3) and (4) – A record that states an effective date beyond the 90-day limit is not a record that "satisfies this [act]," Section 210(a), and will properly be rejected by the filing office.

SECTION 208. WITHDRAWAL OF FILED RECORD BEFORE EFFECTIVENESS.

(a) Except as otherwise provided in Sections 1024, 1034, 1044, and 1054, a record delivered to the [Secretary of State] for filing may be withdrawn before it takes effect by delivering to the [Secretary of State] for filing a statement of withdrawal.

(b) A statement of withdrawal must:

(1) be signed by each person that signed the record being withdrawn, except as otherwise agreed by those persons;

(2) identify the record to be withdrawn; and

(3) if signed by fewer than all the persons that signed the record being withdrawn, state that the record is withdrawn in accordance with the agreement of all the persons that signed the record.

(c) On filing by the [Secretary of State] of a statement of withdrawal, the action or transaction evidenced by the original record does not take effect.

Comment

Only records that have not yet taken effect may be withdrawn under this section. If a record has taken effect, it may be corrected under Section 209 if the requirements of that section are satisfied. Otherwise, the record must be amended in accordance with this act or, if the record is a certificate of organization, the resulting limited liability company may be dissolved and terminated in accordance with Article 7.

Subsection (b)(1) – This provision is subject to Section 203(b) ("Whenever this [act] requires a particular individual to sign a record and the individual is deceased or incompetent, the record may be signed by a legal representative of the individual.").

SECTION 209. CORRECTING FILED RECORD.

(a) A person on whose behalf a filed record was delivered to the [Secretary of State] for filing may correct the record if:

(1) the record at the time of filing was inaccurate;

(2) the record was defectively signed; or

(3) the electronic transmission of the record to the [Secretary of State] was defective.

(b) To correct a filed record, a person on whose behalf the record was delivered to the [Secretary of State] must deliver to the [Secretary of State] for filing a statement of correction.

(c) A statement of correction:

(1) may not state a delayed effective date;

(2) must be signed by the person correcting the filed record;

(3) must identify the filed record to be corrected;

(4) must specify the inaccuracy or defect to be corrected; and

(5) must correct the inaccuracy or defect.

(d) A statement of correction is effective as of the effective date of the filed record that it corrects except for purposes of Section 103(d) and as to persons relying on the uncorrected filed record and adversely affected by the correction. For those purposes and as to those persons, the statement of correction is effective when filed.

Comment

This section permits making corrections in filed records without re-submitting the entire record.

Subsection (a)(1) and (2) – A filed record may be corrected because it contains an inaccuracy or because it was defectively signed (including defects in optional forms of execution that do not affect the eligibility of the original record for filing).

Subsection (a)(3) – In addition, a filed record may be corrected if its electronic transmission was defective – *i.e.*, where an electronic delivery is made but, due to a defect in transmission, the filed record is later discovered to be inconsistent with the record intended to be filed. If no delivery is made because of a defect in transmission, a statement of correction may not be used to effect a retroactive filing. Therefore, a limited liability company making an electronic delivery should take steps to confirm that the transmission was received by the filing office.

Subsection (c) – A provision in a filed record setting an effective date may be corrected under this section, but the corrected effective date must comply with Section 207, which limits delayed effective dates to within ninety days after filing. A corrected effective date is thus measured from the date of the original filing of the record being corrected, *i.e.*, it cannot be before the date of filing of the record or more than ninety days thereafter.

Subsection (d) – The correction relates back to the original effective date of the record being corrected, except as to persons relying on the original entity filing and adversely affected by the correction. As to these persons, the effective date of the statement of correction is the date the statement is filed.

SECTION 210. DUTY OF [SECRETARY OF STATE] TO FILE; REVIEW OF REFUSAL TO FILE; DELIVERY OF RECORD BY [SECRETARY OF STATE].

(a) The [Secretary of State] shall file a record delivered to the [Secretary of State] for filing which satisfies this [act]. The duty of the [Secretary of State] under this section is ministerial.

(b) When the [Secretary of State] files a record, the [Secretary of State] shall record it as filed on the date and at the time of its delivery. After filing a record, the [Secretary of State] shall deliver to the person that submitted the record a copy of the record with an acknowledgment of the date and time of filing and, in the case of a statement of denial, also to the limited liability company to which the statement pertains.

(c) If the [Secretary of State] refuses to file a record, the [Secretary of State] shall, not later than [15] business days after the record is delivered:

(1) return the record or notify the person that submitted the record of the refusal; and

(2) provide a brief explanation in a record of the reason for the refusal.

(d) If the [Secretary of State] refuses to file a record, the person that submitted the record may petition [the appropriate court] to compel filing of the record. The record and the explanation of the [Secretary of State] of the refusal to file must be attached to the petition. The court may decide the matter in a summary proceeding.

(e) The filing of or refusal to file a record does not:

(1) affect the validity or invalidity of the record in whole or in part; or

(2) create a presumption that the information contained in the record is correct or incorrect.

(f) Except as otherwise provided by Section 119 or by law other than this [act], the

[Secretary of State] may deliver any record to a person by delivering it:

(1) in person to the person that submitted it;

(2) to the address of the person's registered agent;

(3) to the principal office of the person; or

(4) to another address the person provides to the [Secretary of State] for delivery.

Comment

Subsection (a) – Under this subsection the filing office is required to file a record if it "satisfies this [act]." The purpose of this language is to limit the discretion of the filing office to a ministerial role in reviewing the contents of records. If the record submitted is in the form prescribed, contains the information required by this act, and the appropriate filing fee is tendered, the filing office must file the record. Consistent with this approach, this subsection states explicitly that the filing duty of the filing office is ministerial. *See also* Subsection (e) (pertaining to presumptions not created).

Subsection (b) – This subsection provides that when the filing office files a record, the filing office records it as filed on the date and time of delivery to the filing office, retains the original record for the office's records, and delivers a copy of the record to the person who delivered the record for filing with an acknowledgement of the date and time of filing. In the case of a statement of denial, Section 303, the filing office will also send a copy of the record and acknowledgment to the limited liability company.

In the case of a record transmitted electronically to the filing office, that office may make delivery by electronic transmission. The copy returned will be the exact or conformed copy if one has been required by the filing office, or will be a copy made by the filing office if an exact or conformed copy was not required.

Under this subsection the acceptance of a filing is evidenced merely by the filing office's delivery of a copy of the record with an acknowledgment of the date and time of filing. The act does not provide for the filing office to issue a formal certificate of filing. A copy of the filed record together with an acknowledgment of the date and time of filing should sufficiently indicate that the filing has been accepted for filing and been filed.

Subsection (c) – Because of the simplification of formal filing requirements and the limited discretion granted to the filing office by this act, it is probable that rejection of records delivered to the filing office for filing will occur only rarely. This subsection provides that if the filing office does reject a record delivered for filing, the filing office must return the record to the person that submitted the filing within fifteen days together with a brief written explanation of the reason for rejection. In the case of a record delivered by electronic transmission, rejection of the record may be made electronically by the filing office or by a mailing to the person that submitted the record.

Subsection (e) – This subsection provides that the filing of a record by the filing office does not affect the validity or invalidity of any provision contained in the record and does not create any presumption with respect to any information in the record. Likewise, the refusal of the filing office to file a record creates no presumption that any of the information in the record is incorrect. Persons adversely affected by a statement in a filed record may contest the statement in a proceeding appropriate for that purpose, including a damage action under Section 205.

SECTION 211. CERTIFICATE OF GOOD STANDING OR REGISTRATION.

(a) On request of any person, the [Secretary of State] shall issue a certificate of good standing for a limited liability company or a certificate of registration for a registered foreign limited liability company.

(b) A certificate under subsection (a) must state:

(1) the limited liability company's name or the registered foreign limited liability company's name used in this state;

(2) in the case of a limited liability company:

(A) that a certificate of organization has been filed and has taken effect;

(B) the date the certificate became effective;

(C) the period of the company's duration if the records of the [Secretary of State] reflect that its period of duration is less than perpetual; and

(D) that:

(i) no statement of dissolution, statement of administrative dissolution, or statement of termination has been filed;

(ii) the records of the [Secretary to State] do not otherwise reflect that the company has been dissolved or terminated; and

(iii) a proceeding is not pending under Section 708;

(3) in the case of a registered foreign limited liability company, that it is registered to do business in this state;

(4) that all fees, taxes, interest, and penalties owed to this state by the limited

liability company or foreign limited liability company and collected through the [Secretary of State] have been paid, if:

(A) payment is reflected in the records of the [Secretary of State]; and

(B) nonpayment affects the good standing or registration of the company or foreign company;

(5) that the most recent [annual] [biennial] report required by Section 212 has been delivered to the [Secretary of State] for filing; and

(6) other facts reflected in the records of the [Secretary of State] pertaining to the limited liability company or foreign limited liability company which the person requesting the certificate reasonably requests.

(c) Subject to any qualification stated in the certificate, a certificate issued by the [Secretary of State] under subsection (a) may be relied on as conclusive evidence of the facts stated in the certificate.

Comment

This section establishes a procedure by which anyone may obtain a conclusive certificate from the filing office that, among other things, the records of the filing office either (i) do not indicate that a particular domestic limited liability company has ceased to exist; or (ii) indicate that a particular foreign limited liability company is registered to do business in the state. The certificate will probably be a standardized form. The filing office is to make those determinations from public records only and is neither expected nor permitted to make a more extensive investigation.

Thus, the certificate of good standing will state whether a certificate has been filed and become effective but not that the limited liability company has been formed. For two reasons, a certificate concerning a domestic limited liability company can never conclusively indicate whether the LLC has actually been formed and, if formed, whether the LLC has been dissolved. Formation depends in part on the occurrence of an act "not of record." *See* Section 201(d) ("A limited liability company is formed when the company's certificate of organization becomes effective and at least one person becomes a member."). Similarly, causes of dissolution are typically "not of record." *See* Section 701. A dissolved limited liability company may deliver for filing a statement of dissolution, Section 702(b)(2)(A), and the filing of such a statement would preclude the issuance of a certificate of good standing, Subsection (b)(2)(D)(i). However a statement of dissolution is permissive; so too is a statement of termination. *See* Section 702(b)(2)(F).

Subsection (b)(4)(B) – This provision refers only to fees, taxes, interest, and penalties collected by the filing office. In some states other agencies may report to the filing office that franchise or other taxes have been paid; in those states, this information may be included in the certificate. In states where this procedure does not unduly delay the issuance of certificates, this section may be revised appropriately. Subsection (b)(4)(B) limits the scope of the statement in the certificate that all fees, taxes, interest, and penalties have been paid to those where nonpayment affects the existence or authorization to do business of the entity.

SECTION 212. [ANNUAL] [BIENNIAL] REPORT FOR [SECRETARY OF STATE].

(a) A limited liability company or registered foreign limited liability company shall deliver to the [Secretary of State] for filing [an annual] [a biennial] report that states:

(1) the name of the company or foreign company;

(2) the name and street and mailing addresses of its registered agent in this state;

(3) the street and mailing addresses of its principal office;

(4) if the company is member managed, the name of at least one member;

(5) if the company is manager managed, the name of at least one manager; and

(6) in the case of a foreign company, its jurisdiction of formation and any alternate name adopted under Section 906(a).

(b) Information in the [annual] [biennial] report must be current as of the date the report is signed by the limited liability company or registered foreign limited liability company.

(c) The first [annual] [biennial] report must be delivered to the [Secretary of State] for filing after [January 1] and before [April 1] of the year following the calendar year in which the limited liability company's certificate of organization became effective or the registered foreign limited liability company registered to do business in this state. Subsequent [annual] [biennial] reports must be delivered to the [Secretary of State] for filing after [January 1] and before [April 1] of each [second] calendar year thereafter.

(d) If [an annual] [a biennial] report does not contain the information required by this section, the [Secretary of State] promptly shall notify the reporting limited liability company or registered foreign limited liability company in a record and return the report for correction.

(e) If [an annual] [a biennial] report contains the name or address of a registered agent which differs from the information shown in the records of the [Secretary of State] immediately before the report becomes effective, the differing information in the report is considered a statement of change under Section 116.

Comment

In some states, an annual or biennial report by a limited liability company or registered foreign limited liability company will be a new requirement.

Subsection (a)(4) and (5) – The requirement that the report include the name of at least one member of a member-managed LLC and one manager of a manager-managed LLC will be a new requirement in some states. There has been increasing pressure from law enforcement agencies for access to more information about the ownership and control of legal entities. This requirement will enable law enforcement to contact a person with some knowledge about the affairs of the limited liability company. Members of the public will also have that ability.

[ARTICLE] 3

RELATIONS OF MEMBERS AND MANAGERS TO PERSONS DEALING WITH LIMITED LIABILITY COMPANY

SECTION 301. NO AGENCY POWER OF MEMBER AS MEMBER.

(a) A member is not an agent of a limited liability company solely by reason of being a member.

(b) A person's status as a member does not prevent or restrict law other than this [act] from imposing liability on a limited liability company because of the person's conduct.

Comment

Subsection (a) – Most LLC statutes, including the original ULLCA (1996), provide for what might be termed "statutory apparent authority" for members in a member-managed limited liability company and managers in a manager-managed limited liability company. This approach codifies the common law notion of apparent authority by position and dates back at least to the original Uniform Partnership Act. UPA (1914) § 9 provided that "the act of every partner … for apparently carrying on in the usual way the business of the partnership … binds the partnership," and that formulation has been essentially followed by UPA (1997) § 301, ULLCA (1996) § 301, ULPA (2001) § 402, and myriad state LLC statutes.

This act rejects the statutory apparent authority approach, for reasons summarized in a "Progress Report on the Revised Uniform Limited Liability Company Act," published in the March 2006 issue of the newsletter of the ABA Committee on Partnerships and Unincorporated Business Organizations:

> The concept [of statutory apparent authority] still makes sense both for general and limited partnerships. A third party dealing with either type of partnership can know by the formal name of the entity and by a person's status as general or limited partner whether the person has the power to bind the entity.
>
> Most LLC statutes have attempted to use the same approach but with a fundamentally important (and problematic) distinction. An LLC's status as member-managed or manager-managed determines whether members or managers have the statutory power to bind. But an LLC's status as member- or manager-managed is not apparent from the LLC's name. A third party must check the public record, which may reveal that the LLC is manager-managed, which in turn means a member as member has no power to bind the LLC. As a result, a provision that originated in 1914 as a protection for third parties can, in the LLC context, easily function as a trap for the unwary. The problem is exacerbated by the almost infinite variety of management structures permissible in and used by LLCs.
>
> The new Act cuts through this problem by simply eliminating statutory apparent authority.

PUBOGRAM, Vol. XXIII, no. 2 at 9-10.

Codifying power to bind according to position makes sense only for organizations that have well-defined, well-known, and almost paradigmatic management structures. Because:

- flexibility of management structure is a hallmark of the limited liability company; and
- an LLC's name gives no signal as to the organization's structure,

it makes no sense to:

- require each LLC to publicly select between two statutorily preordained structures (*i.e.,* manager-managed/member-managed); and then
- link a "statutory power to bind" to each of those two structures.

Under this act, other law – most especially the law of agency – will handle power-to-bind questions. Thus, LLCs formed under this act and corporations are subject to the same principles for attributing to the entity the conduct of those who act or purport to act on the entity's behalf. *See* RESTATEMENT (THIRD) AGENCY §§ 1.03, cmt. c (manifestations of authority by organizations); 2.01, cmt. e (actual authority); 2.03, cmts. (c) – (e) (apparent authority) (2006). Section 407 provides the default rules on the actual authority of those who manage an LLC.

This subsection does not address the power to bind of a manager in a manager-managed LLC, although this act does consider a manager's management responsibilities. *See* Section 407(c) (allocating management authority, subject to the operating agreement). For a discussion of how agency law will approach the actual and apparent authority of managers, see Section 407(c), comment.

Subsection (b) – As the "flip side" to Subsection (a), this subsection expressly preserves the power of other law to hold an LLC directly or vicariously liable on account of conduct by a person who happens to be a member. For example, given the proper set of circumstances: (i) a member might have actual or apparent authority to bind an LLC to a contract; (ii) the doctrine of *respondeat superior* might make an LLC liable for the tortious conduct of a member (*i.e.*, in some circumstances a member acts analogously to a "servant" or "employee" of the LLC); and (iii) an LLC might be liable for negligently supervising a member who is acting on behalf of the LLC. A person's status as a member does not weigh against these or any other relevant theories of law.

Moreover, subsection (a) does not prevent member status from being relevant to one or more elements of an "other law" theory. *See* Section 111. The most likely "other law" theory is the agency doctrine of apparent authority. Of course, if a member lacking actual authority binds an LLC through conduct within the member's apparent authority, the LLC has a claim against the member. RESTATEMENT (THIRD) OF AGENCY § 8.09 (2006) (Duty to Act Only Within Scope of Actual Authority and to Comply with Principal's Lawful Instructions). In contrast, if the member lacked even the power to bind the LLC, the member him, her, or itself will be liable to the vendor as a matter of agency law. RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006) (Agent's Implied Warranty of Authority).

For example, the common law of agency will determine the apparent authority of a member to bind a member-managed LLC. In that analysis what the particular third party knows or has reason to know about the management structure and business practices of the particular LLC will always be relevant. RESTATEMENT (THIRD) OF AGENCY § 3.03, cmt. b (2006) ("A principal may also make a manifestation by placing an agent in a defined position in an organization … . Third parties who interact with the principal through the agent will naturally and reasonably assume that the agent has authority to do acts consistent with the agent's position … unless they have notice of facts suggesting that this may not be so.")

Under Section 301(a), however, the mere fact that a person is a member of a member-managed limited liability company cannot *by itself* establish apparent authority by position. A course of dealing, however, may easily change the analysis:

> EXAMPLE: David is a one of two members of DS, LLC, a member-managed LLC. David orders paper clips on behalf of the LLC, signing the purchase agreement, "David, as a member of DS, LLC." Absent further facts, David has no apparent authority to bind the LLC.
>
> However, the vendor accepts the order, sends an invoice to the LLC's address, and in due course receives a check drawn on the LLC's bank account. When David next places an order with the vendor, the LLC's payment of the first order is a manifestation that the vendor may use in asserting that David had apparent authority to place the second order. A successful apparent authority claim also presupposes that: (i) the vendor

believed that David was authorized; and (ii) the belief was reasonable. RESTATEMENT (THIRD) OF AGENCY § 3.03 (2006) (Creation of Apparent Authority).

In general, a member's actual authority to act for an LLC will depend fundamentally on the operating agreement. *See* the comment to Section 407(b).

SECTION 302. STATEMENT OF LIMITED LIABILITY COMPANY AUTHORITY.

(a) A limited liability company may deliver to the [Secretary of State] for filing a statement of authority. The statement:

(1) must include the name of the company and the name and street and mailing addresses of its registered agent;

(2) with respect to any position that exists in or with respect to the company, may state the authority, or limitations on the authority, of all persons holding the position to:

(A) sign an instrument transferring real property held in the name of the company; or

(B) enter into other transactions on behalf of, or otherwise act for or bind, the company; and

(3) may state the authority, or limitations on the authority, of a specific person to:

(A) sign an instrument transferring real property held in the name of the company; or

(B) enter into other transactions on behalf of, or otherwise act for or bind, the company.

(b) To amend or cancel a statement of authority filed by the [Secretary of State], a limited liability company must deliver to the [Secretary of State] for filing an amendment or cancellation stating:

(1) the name of the company;

(2) the name and street and mailing addresses of the company's registered agent;

(3) the date the statement being affected became effective; and

(4) the contents of the amendment or a declaration that the statement is canceled.

(c) A statement of authority affects only the power of a person to bind a limited liability company to persons that are not members.

(d) Subject to subsection (c) and Section 103(d), and except as otherwise provided in subsections (f), (g), and (h), a limitation on the authority of a person or a position contained in an effective statement of authority is not by itself evidence of any person's knowledge or notice of the limitation.

(e) Subject to subsection (c), a grant of authority not pertaining to transfers of real property and contained in an effective statement of authority is conclusive in favor of a person that gives value in reliance on the grant, except to the extent that when the person gives value:

(1) the person has knowledge to the contrary;

(2) the statement has been canceled or restrictively amended under subsection (b); or

(3) a limitation on the grant is contained in another statement of authority that became effective after the statement containing the grant became effective.

(f) Subject to subsection (c), an effective statement of authority that grants authority to transfer real property held in the name of the limited liability company, a certified copy of which statement is recorded in the office for recording transfers of the real property, is conclusive in favor of a person that gives value in reliance on the grant without knowledge to the contrary, except to the extent that when the person gives value:

(1) the statement has been canceled or restrictively amended under subsection (b), and a certified copy of the cancellation or restrictive amendment has been recorded in the office

for recording transfers of the real property; or

(2) a limitation on the grant is contained in another statement of authority that became effective after the statement containing the grant became effective, and a certified copy of the later-effective statement is recorded in the office for recording transfers of the real property.

(g) Subject to subsection (c), if a certified copy of an effective statement containing a limitation on the authority to transfer real property held in the name of a limited liability company is recorded in the office for recording transfers of that real property, all persons are deemed to know of the limitation.

(h) Subject to subsection (i), an effective statement of dissolution or termination is a cancellation of any filed statement of authority for the purposes of subsection (f) and is a limitation on authority for the purposes of subsection (g).

(i) After a statement of dissolution becomes effective, a limited liability company may deliver to the [Secretary of State] for filing and, if appropriate, may record a statement of authority that is designated as a post-dissolution statement of authority. The statement operates as provided in subsections (f) and (g).

(j) Unless earlier canceled, an effective statement of authority is canceled by operation of law five years after the date on which the statement, or its most recent amendment, becomes effective. This cancellation operates without need for any recording under subsection (f) or (g).

(k) An effective statement of denial operates as a restrictive amendment under this section and may be recorded by certified copy for purposes of subsection (f)(1).

Comment

This section is derived from and builds on UPA (1997) § 303, which was refined in ULLCA (2006) and further refined in the Harmonization Project. This section is conceptually divided into two realms: statements pertaining to the power to transfer interests in the LLC's real property and statements pertaining to other matters. In the latter realm, statements are filed only in the records of the filing office and operate only to the extent the statements are actually known and relied on by a third party. Section 302(d) and (e).

As to interests in real property, in contrast, this section: (i) requires double-filing – with the filing office and in the appropriate land records; and (ii) provides for constructive knowledge of statements limiting authority. Thus, a properly filed and recorded statement can protect the limited liability company, Section 302(g), and, in order for a statement pertaining to real property to be a sword in the hands of a third party, the statement must have been both filed and properly recorded. Section 302(f). Experience suggests that statements of authority will most often be used in connection with transactions in real estate.

By its terms, this section applies only to domestic limited liability companies. A foreign LLC cannot make use of this section even as to real property located in this state. The section refers throughout to "limited liability company," which this act defines as a domestic limited liability company. *See* Section 102(8) ("'Limited liability company'… means an entity formed under this [act] or which becomes subject to this [act]"). *Cf. Fannie Mae v. Heather Apartments Ltd. P'ship*, A13-0562, 2013 WL 6223564 at *6 (Minn. Ct. App. Dec. 2, 2013) (considering the remedies available to a judgment creditor with respect to the judgment debtor's interest in a Cook Islands LLC; rejecting the debtor's argument that the creditor's "only remedy is to obtain a charging order under" [the Minnesota LLC statute]; explaining that "this argument fails because that statute only applies to Minnesota limited liability companies" which the Minnesota LLC statute "defines … as 'a limited liability company, other than a foreign limited liability company, *organized or governed by this chapter*'") (emphasis added; statutory citations omitted).

Subsection (a)(2) – This paragraph permits a statement to designate authority by position (or office) rather than by specific person, thus avoiding the need to file anew whenever a new person assumes the position or the office. This type of a statement will enable LLCs to provide evidence of ongoing power to enter into transactions without having to disclose to third parties the entirety of the operating agreement.

Subsection (a)(2)(A) and (a)(3)(A) – The authority to "sign" an instrument includes the authority to commit the partnership to the transfer reflected in the agreement. *See* Subsection (f) (referring not merely to signing but also to "an effective statement of authority that grants authority to transfer real property").

Here and elsewhere in the section, the phrase "real property" includes all interests in real property, such as mortgages, easements, etc.

Subsection (c) – This subsection expresses a very important limitation – *i.e.*, that this section's rules do not operate viz-a-viz members. For members, the operating agreement is controlling. Section 107(d). However, like any other record delivered for filing on behalf of an LLC, a statement of authority might be some evidence of the contents of the operating agreement. *See* the comment to Section 107(d).

Another important limitation exists. The filing office is not affected by a statement of authority that purports to delineate the authority of persons to sign documents to be delivered for filing of behalf of a limited liability company. The act does define "[p]erson" to include a "government or governmental subdivision, agency, or instrumentality," Section 102(15), but "a limitation on the authority of a person or a position contained in an effective statement of authority is not by itself evidence of knowledge or notice of the limitation by any person." Subsection (d).

Moreover, even if an employee of the filing office happened to see that a statement of authority purported to delineate the authority of persons to sign records to be delivered on behalf of an LLC, that information would not pertain to a "fact [that] is material to the agent's duties to the principal" and therefore would not be attributed to the filing office. RESTATEMENT (THIRD) OF AGENCY § 5.03 (2006).

Subsection (d) – The phrase "by itself" is important, because the existence of a limitation of authority could be evidence if, for example, the person in question reviewed the public record at a time when the limitation was of record.

Subsection (e)(1) – What happens if a statement of authority conflicts with the contents of an LLC's certificate of organization? The contents of the certificate are not statements of authority, Section 201(c), so the information in the certificate does not directly figure into the operation of this section. However, if the person claiming to rely on a statement of authority had read the certificate's conflicting information before giving value, that fact might be evidence that person gave value with "knowledge to the contrary" of the statement.

Subsection (e)(2) – This paragraph by its terms does not affect a claim of lingering apparent authority. A person could: (i) assert knowledge of a statement of authority as the statement existed before a cancellation or restrictive amendment; and (ii) characterize the original statement as a manifestation of authority traceable to the limited liability company. RESTATEMENT (THIRD) OF AGENCY § 3.03, cmt. b (2006) ("Apparent authority is present only when a third party's belief is traceable to manifestations of the principal.").

However, for apparent authority to exist, the purported agent must *reasonably* appear to be authorized. RESTATEMENT (THIRD) OF AGENCY § 2.03 (2006) (stating that apparent authority can only exist when "a third party reasonably believes the actor has authority to act on behalf of the principal"). Given the possibility of cancellation or restrictive amendment, it might not be reasonable for a person to know of a statement of authority, let time pass, and then rely on the statement without re-checking the public record.

Subsections (f) through (h) – These subsections: (i) pertain to transactions in real property; (ii) provide a mechanism by which authority to transfer an LLC's real property can be made to appear in the real estate records; and (iii) thus address the principal concerns (raised by real estate lawyers) that led the drafters of UPA (1997) to provide for statements of authority.

Subsection (f) – This subsection provides a sword for a vendee of real property. If the vendee has "give[n] value in reliance on the grant without knowledge to the contrary," the statement of authority protects the vendee against claims that contradict the grant.

Subsection (f)(1) and (2) – As a claim of lingering apparent authority, see the comment to Section (e)(2). The analysis stated there applies even more strongly in the context of customary practices involving land transfers.

Subsection (g) – This subsection provides a shield for the limited liability company as alleged vendor. If a vendee's claim contradicts the stated limitation, constructive knowledge ("deemed to know") defeats the claim even if the vendee gave value and lacked actual knowledge.

Subsection (h) – This subsection integrates statements of dissolution and termination, Section 702, into the operation of this section.

The effect of a statement of dissolution depends on the circumstances.

> EXAMPLE: ABC, LLC has in effect a properly filed and recorded statement of authority authorizing ABC's CEO to transfer real estate owned by the LLC. The proper filing and recording by ABC of a statement of dissolution cancels the statement of authority. Subsequently, Buyer gives value in return for a deed signed by the CEO on behalf of ABC. Due to Subsections (h) and (f)(1), Subsection (f) does not protect Buyer. Moreover, under Subsections (g) and (h), Buyer is "deemed to know" of the dissolution. Whether that deemed knowledge functions to deprive the CEO of authority to bind ABC depends on agency law and additional facts. For example, the CEO might have had actual or apparent authority to transfer the real estate despite the dissolution of the LLC.

If properly filed with the filing office and properly recorded in the office for land records, a statement of termination eliminates the power of any person to transfer real property owned in the name of the LLC. No one can have the authority to act for a non-existent entity. *Cf.* RESTATEMENT (THIRD) OF AGENCY § 4.04(1)(a) (2006) (precluding ratification by a principal that did not exist at the time of the unauthorized act).

Subsection (i) – This provision permits an LLC to use statements of authority during winding up. As an additional protection for third parties, a statement must be "designated as a post-dissolution statement of authority" to be effective under this provision.

Subsection (k) – Presumably, when real property is involved, a person who obtains the filing of a statement of denial under Section 303 will cause a certified copy of the statement to be "recorded by certified copy for purposes of subsection (f)(1)" [undercutting constructive notice as to authority to transfer real property]. However, nothing in this subsection prevents the limited liability company from causing a certified copy to appear in the land records; due the section's use of the passive voice ("may be recorded"), the act does not delimit who has the authority to act under this subsection.

SECTION 303. STATEMENT OF DENIAL. A person named in a filed statement of authority granting that person authority may deliver to the [Secretary of State] for filing a statement of denial that:

(1) provides the name of the limited liability company and the caption of the statement of authority to which the statement of denial pertains; and

(2) denies the grant of authority.

Comment

A person whose powers are delineated in the public record by another person should have the right to dissent from that delineation. This section takes an "all or nothing" approach; a person may not deny in part and confirm in part. For the effect of a statement of denial, see Section 302(k).

SECTION 304. LIABILITY OF MEMBERS AND MANAGERS.

(a) A debt, obligation, or other liability of a limited liability company is solely the debt, obligation, or other liability of the company. A member or manager is not personally liable, directly or indirectly, by way of contribution or otherwise, for a debt, obligation, or other liability of the company solely by reason of being or acting as a member or manager. This subsection applies regardless of the dissolution of the company.

(b) The failure of a limited liability company to observe formalities relating to the exercise of its powers or management of its activities and affairs is not a ground for imposing liability on a member or manager for a debt, obligation, or other liability of the company.

Comment

Derivation – ULLCA (2006) derived this section from UPA (1997) § 306, which was also the source for ULPA (2001) § 404. The Harmonization Project brought the two partnership acts and the limited liability company act into accord to the extent the three acts overlap.

Subsection (a) – This subsection provides a corporate-like liability shield to members and managers, protecting them against (and only against) the debts, obligations and liabilities of the limited liability company – *i.e.*, against a member's or manager's alleged vicarious liability for the obligations of the entity. The shield "applies regardless of the dissolution of the company" and thus continues in effect through the completion of winding up (*i.e.*, termination). The shield applies regardless of the law giving rise to a claim against a limited liability company.

Shield Applicable Regardless of the Identity of the Plaintiff

What makes the shield relevant is the nature of the claim. If the complaint seeks to hold a member vicariously liability for the LLC's obligations, the shield applies. If not, not. Thus, there is no distinction between a claim arising from an LLC's debt to a commercial creditor, a member's claim that the LLC has failed to return a contribution as required by the operating agreement, and a claim by a former member that the LLC has failed to follow through on a buy-out agreement. *See Rappaport v. Gelfand*, 197 Cal. App.4th 1213, 1230-1232, 129 Cal. Rptr. 3d

670, 682-84 (Cal. App. 2 Dist. 2011) (involving a claim by a former partner). *Accord Ederer v. Gursky*, 9 N.Y.3d 514, 526, 881 N.E.2d 204, 212-213 (N.Y. 2007) (Smith, J., dissenting).

Shield Inapposite for Claims Arising from a Member's or Manager's Own Conduct

Because the member or manager liability at issue is solely vicarious, the shield is irrelevant to claims seeking to hold a member or manager directly liable on account of the member's or manager's own conduct. Put another way, "[t]here is no question" that "the member-manager of a limited liability company who causes his business to breach common law and statutory duties may be held independently liable for his personal torts." *Dep't of Agric. v. Appletree Mktg., L.L.C.*, 485 Mich. 1, 4, 18, 779 N.W.2d 237, 239, 247 (2010).

A few judges have failed to understand this point. *See Puleo v. Topel*, 368 Ill. App. 3d 63, 68-69, 856 N.E.2d 1152, 1157 (Ill. App. Ct. 2006) (basing its holding on a legislative amendment that "removed … language which explicitly provided that a member or manager of an LLC could be held personally liable for his or her own actions or for the actions of the LLC to the same extent as a shareholder or director of a corporation could be held personally liable").

This mistaken view: (i) ignores the actual words of LLC shield provisions (which protect members and managers only against liability for obligations *of* an LLC and make no reference to direct obligations of a member or manager); and (ii) flouts public policy (which recoils from the idea of immunizing a person's misconduct solely because the person acts on behalf of an organization). Moreover, the mistaken view is contrary to the overwhelming weight of the case law. *See, e.g., Mbahaba v. Morgan*, 163 N.H. 561, 565, 44 A.3d 472, 476 (2012) ("When … a member or manager commits or participates in the commission of a tort, whether or not he acts on behalf of his LLC, he is liable to third persons injured thereby."); *Sturm v. Harb Dev., LLC*, 298 Conn. 124, 138, 2 A.3d 859, 870 (2010) (holding that the liability shield of an LLC is subject to "the common-law tort exception … [for] individual claims against LLC members); *Allen v. Dackman*, 413 Md. 132, 154, 991 A.2d 1216, 1229 (2010) ("An LLC member is liable for torts he or she personally commits, inspires, or participates in because he or she personally committed a wrong, not 'solely' because he or she is a member of the LLC."); *Weber v. U.S. Sterling Sec., Inc.*, 282 Conn. 722, 732–34, 924 A2d 816, 824–25 (2007) (stating that the Delaware LLC Act "does not preclude individual liability for members of a limited liability company if that liability is not based simply on the member's affiliation with the company" and holding, in particular, that the Act "does not bar the defendants' liability for tortious conduct").

> EXAMPLE: A manager personally guarantees a debt of a limited liability company. Subsection (a) is irrelevant to the manager's liability as guarantor.

> EXAMPLE: A member purports to bind a limited liability company while lacking any agency law power to do so. The limited liability company is not bound, but the member is liable for having breached the "warranty of authority" (an agency law doctrine). Subsection (a) does not apply. The liability is not *for* a debt, obligation, or other liability of the [limited liability] company, but rather is the member's own, direct liability. Indeed, the liability exists because the limited liability company is *not* indebted, obligated or liable. RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006).

> EXAMPLE: A manager of a limited liability company defames a third party in

circumstances that render the limited liability company vicariously liable under agency law. Under Subsection (a), the third party cannot hold the manager accountable for the *company's* liability, but that protection is immaterial. The manager is the tortfeasor and in that role is directly liable to the third party.

EXAMPLE: A limited liability company provides professional services, and one of its members commits malpractice. The liability shield is irrelevant to the member's direct liability in tort. However, if the member's malpractice liability is attributed to the LLC under agency law principles, the liability shield will protect the other members of the LLC against a claim that they must make good on the LLC's liability.

EXAMPLE: A single member limited liability company enters into a contract to build a home, and the member performs substantial amounts of the work. The homeowner sues both the LLC and the member for allegedly defective work, but the complaint sounds in contract rather than in tort. The LLC may be liable, but the member is not. *See Ogea v. Merritt* --- So.3d ----, 2013 WL 6439355 at *24-25 (La. 2013).

Subsection (a) pertains only to claims based on the LLC's liability and is irrelevant to claims by a limited liability company against a member or manager and *vice versa*. *E.g.*, Sections 408 (pertaining to a limited liability company's obligation to indemnify a member or manager), 409 (pertaining to management duties) and 801 (pertaining to a member's rights to bring a direct claim against a limited liability company).

Shield Inapposite to Role Liability Claims

Provisions of regulatory law may impose liability on a member or manager due to a role the person plays in the LLC. *See, e.g., Food Team Intern., Ltd. v. Unilink, LLC*, 872 F. Supp. 2d 405, 424 (E.D Pa. 2012) (holding several individuals "subject to secondary individual liability under PACA [Perishable Agricultural Commodities Act]" because their roles within the LLC enabled them to control the relevant assets) (citing *Bear Mountain Orchards, Inc. v. Mich–Kim, Inc.*, 623 F.3d 163, 172 (3d Cir. 2010)).

The Shield and Dissolution.

The rule stated here is inherent in the nature of LLC dissolution. "[D]issolution does not end a limited liability company's existence but rather changes the purpose of that existence." Section 701, cmt. "A dissolved limited liability company shall wind up its activities and affairs and … continues after dissolution … for the purpose of winding up." Section 702(a). Put another way: dissolution and winding up are part of the life cycle of a limited liability company – sometimes the most complicated part. There is no logical reason to remove the shield during the last part of an LLC's life cycle.

This subsection makes this point expressly, because it is possible to misinterpret some outlying LLP cases as holding to the contrary. *See, e.g., Carolina Cas. Ins. Co. v. L.M. Ross Law Grp., LLP*, 151 Cal. Rptr. 3d 628, 635 (2012) (affirming the trial court's decision to hold an LLP's named partner liable for a judgment against his limited ability partnership; noting that "[c]entral to the decision to amend the judgment to add Ross [the named partner] as a judgment debtor … is the trial court's finding that Ross Law Group dissolved"; recognizing, however, that, before the partnership incurred the liability, Ross had signed and filed with the California

Secretary of State a form stating that the law firm had "cease[d] to be a registered limited liability partnership and is hereby filing this notice with the California Secretary of State that [it] is no longer a registered limited partnership") (quotation marks omitted).

The Shield and Termination

This subsection does not expressly provide that, when a limited liability company's existence terminates, the liability shield remains in place as to any debt, obligation, or other liability of the LLC incurred before the termination. However, the point follows ineluctably from Subsection 304(a), which provides that the shield applies to any "debt, obligation, or other liability of a limited liability company." A debt, obligation or other liability of an LLC does not disappear merely because the LLC has terminated.

Moreover, any other result would: (i) create huge holes in the shield; (ii) put the law of unincorporated businesses at odds with the law of corporations; (iii) render surplus this act's distribution recapture provision, Section 406; and (iv) render nonsensical the otherwise logical extension of the equitable trust fund theory to limited liability companies. *Cf. Velasquez v. Franz*, 589 A.2d 143, 146 (N.J. 1991) (explaining that "the trust-fund doctrine… renders shareholders who receive distributed assets of the corporation liable as 'trustees' for claims of the corporation's creditors").

Dangers of Indemnification Provisions Inter Se the Members

Despite the phrase "by way of contribution or otherwise," the LLC shield has no effect on contribution or indemnification requirements running directly from member to member or from members to a manager. These obligations are not obligations of the LLC but rather personal to each member. Indirectly they pose a risk to the shield as to liability arising from the misconduct of a member or manager.

> EXAMPLE: A law firm operates as a professional limited liability company. One practice area (the "Practice Area") brings in large fees but also exposes its practitioners (the "Practitioners") to liability risks substantially higher than the risks faced by other lawyers in the firm. Fees in the Practice Area are episodic, so it makes sense for the Practitioners to share profits with the rest of the firm, where returns are lower but more regular.
>
> The firm carries liability insurance, and the operating agreement provides broad indemnification rights to all the firm's lawyers. However, the Practitioners are mindful that the LLC liability shield sets a practical limit to the firm's indemnification obligations and that policies of insurance have limits. The Practitioners obtain a provision in the operating agreement by which each member of the LLC makes a personal promise of indemnification (subject to a cap).
>
> The tortious conduct of one of the Practitioners (the "Tortfeasor") results in a substantial judgment against the Tortfeasor and, per Section 305(a), against the LLC. For unrelated reasons, the LLC has become insolvent and its liability coverage is "maxed out." The Tortfeasor's right to indemnification from fellow members is an asset of the Tortfeasor. The judgment creditor can levy on that asset, thereby defeating the liability shield in effect if not in form.

Subsection (b) – This subsection pertains to the equitable doctrine of "piercing the veil"

– *i.e.*, conflating an entity and its owners to hold one liable for the obligations of the other. The doctrine of "piercing the corporate veil" is well-established, and courts regularly (and sometimes almost reflexively) apply that doctrine to limited liability companies. In the corporate realm, "disregard of corporate formalities" is a key factor in the piercing analysis. In the realm of LLCs, that factor is inappropriate, because informality of organization and operation is both common and desired. *See, e.g., In re Packer*, Bankruptcy No. 13–41304, 2014 WL 5100095 (Bankr. E.D. Tex. Oct. 10, 2014) (noting the informality of LLC governance, recognizing that "the disregard of corporate formalities … [is] one of the key factors in [corporate] veil-piercing determinations"; but holding that "'it makes no sense to imperil the shield simply because the members do not undergo meaningless formalities such as formal meetings'") (citing Carter G. Bishop & Daniel S. Kleinberger, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 6.03 at *3 (Thomson Reuters Tax and Accounting 2014)).

The formalities at issue are the process formalities of governance – both those few created by this act and however few or many might be created by the operating agreement.

> EXAMPLE: The operating agreement of a three-member, member-managed limited liability company requires formal monthly meetings of the members. Each of the members works in the LLC's business, and they consult each other regularly. They have forgotten or ignore the requirement of monthly meetings. Under Subsection (b), that fact is irrelevant to a piercing claim.

In contrast, this subsection is inapposite to another key piercing factor – disregard of the separateness between entity and owner. *E.g., Vanderford Co. v. Knudson*, 165 P.3d 261, 271 (Idaho 2007) (noting that managing member and "his accountant testified that the LLC's checking account was so confusing that the accountant could not be sure whose money was in the account at what times"); *Utzler v. Braca*, 972 A.2d 743 (Conn. App. 2009) (holding that veil piercing was appropriate under alter-ego theory when owner deposited LLC funds into a commingled bank account from which he made withdrawals for personal needs and unrelated projects).

> EXAMPLE: The sole owner of a limited liability company uses a car titled in the company's name for personal purposes and writes checks on the company's account to pay for personal expenses. These facts are relevant to a piercing claim; they pertain to economic separateness, not Subsection (b) formalities.

This subsection also is inapposite to a member's claim of oppression under Section 701(a)(4)(C)(ii). In some circumstances, disregard of agreed-upon formalities can be a "freeze out" mechanism. Likewise, this subsection has no relevance to a member's claim that the disregard of agreed-upon formalities is a breach of the operating agreement.

This subsection addresses claims to "impos[e] liability on a member or manager for a debt, obligation, or other liability of the company" – *i.e.*, for what is sometimes termed a "direct pierce." Whether the same approach should apply to claims for a "reverse pierce" is a question for the courts. *See Comm'r of Envtl. Prot. v. State Five Indus. Park, Inc.*, 304 Conn. 128, 140, 37 A.3d 724, 732-33 (2012) (stating that "[a]lthough some courts have adopted reverse veil piercing with little distinction as a logical corollary of traditional veil piercing, because the two share the same equitable goals, others wisely have recognized important differences between them").

[ARTICLE] 4

RELATIONS OF MEMBERS TO EACH OTHER AND TO LIMITED LIABILITY COMPANY

SECTION 401. BECOMING MEMBER.

(a) If a limited liability company is to have only one member upon formation, the person becomes a member as agreed by that person and the organizer of the company. That person and the organizer may be, but need not be, different persons. If different, the organizer acts on behalf of the initial member.

(b) If a limited liability company is to have more than one member upon formation, those persons become members as agreed by the persons before the formation of the company. The organizer acts on behalf of the persons in forming the company and may be, but need not be, one of the persons.

(c) After formation of a limited liability company, a person becomes a member:

(1) as provided in the operating agreement;

(2) as the result of a transaction effective under [Article] 10;

(3) with the affirmative vote or consent of all the members; or

(4) as provided in Section 701(a)(3).

(d) A person may become a member without:

(1) acquiring a transferable interest; or

(2) making or being obligated to make a contribution to the limited liability company.

Comment

Most LLC statutes address in separate provisions: (i) how an LLC obtains its initial member or members; and (ii) how additional persons might later become members. This act follows that approach.

Subsections (a) and (b) – These subsections make explicit the agency relationship between the person acting as organizer and the initial member or members.

Subsection (c)(3) – A limited liability company being in part a creature of contract, consent is determined on an objective basis (*i.e.,* contract law's "reasonable person" standard). Depending on the terms of an LLC's operating agreement, the members' manifestation of consent might involve detailed formalities, entirely informal activities, or anything in between. Moreover, the operating agreement might reduce the quantum of consent necessary or shift the consent right to a manager.

A limited liability company being a voluntary association, a person cannot become a member without manifesting consent to do so. That consent also is judged objectively.

Under Section 106(b), "[a] person that becomes a member of a limited liability company is deemed to assent to the operating agreement," and the agreement binds the member regardless of whether the member has actually indicated assent in any way.

Subsection (d)(1) – To accommodate business practices and also because a limited liability company need not have a business purpose, this provision permits so-called "non-economic members."

SECTION 402. FORM OF CONTRIBUTION. A contribution may consist of property transferred to, services performed for, or another benefit provided to the limited liability company or an agreement to transfer property to, perform services for, or provide another benefit to the company.

Comment

This section is intentionally quite broad, encompassing past, present, and promised benefits. Comparable language exists in most, if not all, LLC statutes, and case law recognizes the intended broadness of this approach. *See, e.g.*, *Belgard v. Manchac Technologies, LLC*, 92 So.3d 660, 664 (La.App. 3 Cir. 2012) (stating that "the creation of an obligation to establish a $1.8 million line of credit was valid consideration for the transfer of 24% of the membership interest in Manchac"); *In re Eight of Swords, LLC*, 96 A.D.3d 839, 840, 946 N.Y.S.2d 248, 249 (N.Y.A.D. 2 Dept. 2012) (referring to "the petitioner's contributions to the LLC, which overwhelmingly consisted of services rendered to the LLC in the form of preparing and filing start-up documentation and performing activities associated with the renovation of the business's premises").

This act does not contain a statute of frauds specifically applicable to promised contributions. Generally applicable statutes of fraud might apply, however. For example, a promise to contribute land to the LLC would be subject to the statute of frauds pertaining to land transfers. Likewise, a promise that by its terms requires performance that extends beyond one year from the making of the contract would be subject to the one-year provision of the statute of frauds. *See* the comment to Section 102(13).

SECTION 403. LIABILITY FOR CONTRIBUTIONS.

(a) A person's obligation to make a contribution to a limited liability company is not excused by the person's death, disability, termination, or other inability to perform personally.

(b) If a person does not fulfill an obligation to make a contribution other than money, the person is obligated at the option of the limited liability company to contribute money equal to the value of the part of the contribution which has not been made.

(c) The obligation of a person to make a contribution may be compromised only by the affirmative vote or consent of all the members. If a creditor of a limited liability company extends credit or otherwise acts in reliance on an obligation described in subsection (a) without knowledge or notice of a compromise under this subsection, the creditor may enforce the obligation.

Comment

Subsection (a) – Under common law principles of impracticability, an individual's death or incapacity will sometimes discharge a duty to render performance. RESTATEMENT (SECOND) OF CONTRACTS §§ 261 (Discharge by Supervening Impracticability), 262 (Death or Incapacity of Person Necessary For Performance). This subsection overrides those principles. Moreover, the reference to "perform personally" is not limited to individuals but rather may refer to any legal person (including an entity) that has a non-delegable duty.

Subsection (b) – This subsection is a statutory liquidated damage provision, exercisable at the option of the limited liability company, with the damage amount set according to the value of the promised, non-monetary contribution.

> EXAMPLE: In order to become a member, a person promises to contribute to the limited liability company various assets "free and clear," which the operating agreement values at $150,000. In return for the person's promise, and in light of the agreed value, the limited liability company admits the person as a member with a right to receive 25% of the LLC's distributions.
>
> However, the promised assets are subject to a security agreement, and, before the member can contribute the assets, the secured party forecloses on the security interest and sells the assets at a public sale for $75,000. Even if the $75,000 reflects the actual fair market value of the assets, under this subsection the limited liability company has a claim against the member for "money equal to the value of the part of the contribution which has not been made" – *i.e.,* $150,000.

EXAMPLE: Same facts as the previous example, except that the public sale brings $225,000. The limited liability company is neither obliged to invoke this subsection nor limited to the $150,000. The LLC may instead sue for breach of the promise to make the contribution, asserting the $225,000 figure as evidence of the actual loss suffered as a result of the breach.

Subsection (c) – The unanimity requirement expressed in the first sentence might indirectly benefit creditors, but the requirement is nonetheless a default rule and therefore may be varied by operating agreement. The right of each member to consent is not a "right[] under this [act] of a person other than a member or manager." *See* Section 105(c)(15) (preventing the operating agreement from affecting such rights). In contrast, the creditor right stated in the second sentence fits squarely within Section 105(c)(15) and therefore may not be varied by the operating agreement.

SECTION 404. SHARING OF AND RIGHT TO DISTRIBUTIONS BEFORE DISSOLUTION.

(a) Any distribution made by a limited liability company before its dissolution and winding up must be in equal shares among members and persons dissociated as members, except to the extent necessary to comply with a transfer effective under Section 502 or charging order in effect under Section 503.

(b) A person has a right to a distribution before the dissolution and winding up of a limited liability company only if the company decides to make an interim distribution. A person's dissociation does not entitle the person to a distribution.

(c) A person does not have a right to demand or receive a distribution from a limited liability company in any form other than money. Except as otherwise provided in Section 707(d), a company may distribute an asset in kind only if each part of the asset is fungible with each other part and each person receives a percentage of the asset equal in value to the person's share of distributions.

(d) If a member or transferee becomes entitled to receive a distribution, the member or transferee has the status of, and is entitled to all remedies available to, a creditor of the limited liability company with respect to the distribution. However, the company's obligation to make a distribution is subject to offset for any amount owed to the company by the member or a person dissociated as a member on whose account the distribution is made.

Comment

Past uniform unincorporated entity acts and many current LLC acts provide default rules for allocation of profits, and UPA (1997) even provided a default structure for maintaining capital accounts. For the following reasons, this act, incorporating changes made by the Harmonization Project, provides a default rule only for rights to share in distributions:

- Capital accounts are maintained for one purpose, to determine how distributions will be made to members. The rules for maintenance of capital accounts can be very complex. Generally, however, profits increase capital account balances (and increase the amounts that will be distributed to the members) and losses reduce capital account balances (and reduce the amounts that will be distributed to the members). If the statute has a simple default rule for how distributions are to be made to the members, providing an additional set of default profit and loss allocation provisions and capital account rules will be, at best, duplicative and, at worse, inconsistent with the distribution rules.
- Some argue that capital account rules and profit and loss allocation provisions are necessary to comply with tax requirements. Tax income or loss is allocated to "partners" (including members of an LLC taxed as a partnership) according to the partners' economic interests in the LLC, and these interests are based on distributions that would be made to partners on liquidation of the LLC. By including default distribution provisions, the act includes the information necessary to make these tax determinations. To the extent the tax law allows partners to make further tax elections or satisfy alternative safe harbors, the partners may look to the tax law for guidance and include necessary provisions in their agreements.

Subsection (a) – The rule stated applies to redemptions as well as operating distributions but is a default rule in both contexts. *See* the comment to Section 102(4)(A)**.**

Subsection (b) – The second sentence of this subsection accords with Section 603(a)(3) – upon dissociation a person is treated as a mere transferee of its own transferable interest. Like most *inter se* rules in this act, this one is subject change by the operating agreement. *See* the comment to Section 603(a)(3).

Subsection (d) – *See also* Section 405(d) (pertaining to the rights of members and transferees that receive a distribution in the form of indebtedness) and 405(e) (pertaining to solvency testing for payments on indebtedness issued to redeem an interest).

SECTION 405. LIMITATIONS ON DISTRIBUTIONS.

(a) A limited liability company may not make a distribution, including a distribution under Section 707, if after the distribution:

(1) the company would not be able to pay its debts as they become due in the ordinary course of the company's activities and affairs; or

(2) the company's total assets would be less than the sum of its total liabilities plus the amount that would be needed, if the company were to be dissolved and wound up at the time of the distribution, to satisfy the preferential rights upon dissolution and winding up of members and transferees whose preferential rights are superior to the rights of persons receiving the distribution.

(b) A limited liability company may base a determination that a distribution is not prohibited under subsection (a) on:

(1) financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances; or

(2) a fair valuation or other method that is reasonable under the circumstances.

(c) Except as otherwise provided in subsection (e), the effect of a distribution under subsection (a) is measured:

(1) in the case of a distribution as defined in Section 102(4)(A), as of the earlier of:

(A) the date money or other property is transferred or debt is incurred by the limited liability company; or

(B) the date the person entitled to the distribution ceases to own the interest or right being acquired by the company in return for the distribution;

(2) in the case of any other distribution of indebtedness, as of the date the indebtedness is distributed; and

(3) in all other cases, as of the date:

(A) the distribution is authorized, if the payment occurs not later than 120 days after that date; or

(B) the payment is made, if the payment occurs more than 120 days after the distribution is authorized.

(d) A limited liability company's indebtedness to a member or transferee incurred by reason of a distribution made in accordance with this section is at parity with the company's indebtedness to its general, unsecured creditors, except to the extent subordinated by agreement.

(e) A limited liability company's indebtedness, including indebtedness issued as a distribution, is not a liability for purposes of subsection (a) if the terms of the indebtedness provide that payment of principal and interest is made only if and to the extent that payment of a distribution could then be made under this section. If the indebtedness is issued as a distribution, each payment of principal or interest is treated as a distribution, the effect of which is measured on the date the payment is made.

(f) In measuring the effect of a distribution under Section 707, the liabilities of a dissolved limited liability company do not include any claim that has been disposed of under Section 704, 705, or 706.

Comment

Both this section and Section 406 were derived essentially from the Model Business Corporation. Act section 6.40. Both sections are necessary and appropriate because a limited liability company provides its members and managers a corporate-like liability shield. With the exception noted in the comment to Subsection (a)(2), the provisions of this section are non-waivable. Section 105(c)(15).

"Distribution" does not include "amounts constituting reasonable compensation for present or past service or payments made in the ordinary course of business under a bona fide retirement plan or other bona fide benefits program." Section 102(4)(B).

Subsection (a) – Insolvency is a fundamental issue under this section, and this subsection provides two tests of insolvency. The tests are disjunctive; a distribution violates this section if after the distribution the LLC fails either of the tests. The subsection applies both to interim and liquidating distributions.

Solvency is also a fundamental issue under bankruptcy and fraudulent transfer law, which provide their own respective definitions of the concept.

Subsection (a)(2) – The reference to "preferential rights upon dissolution and winding up" is a default rule, because removing this protection for preferred members or transferees is an *inter se* matter. *See* Section 105(d)(1)(B). The rest of the section is not subject to change in the operating agreement. Section 105(c)(15).

Subsection (b) – This subsection states a standard of ordinary care, in contrast with the generally-applicable standard stated in Section 409(c) (gross negligence).

Subsection (b)(2) – This alternative valuation provision is likely to be both useful and fair when the limited liability company has appreciated assets but for accounting purposes these assets are valued at book value less depreciation.

Subsection (c) – This subsection provides three alternative rules for determining the point(s) in time of as which to apply the Subsection (a) solvency tests. The timing depends on which of three categories encompasses a distribution: (i) a distribution in the nature of a redemption (regardless of whether the distribution includes a distribution of indebtedness); (ii) any distribution of indebtedness other than a distribution in the nature of a redemption; and (iii) any distribution that involves neither a redemption nor a distribution of indebtedness. A requirement for additional solvency testing pertaining to distributions of indebtedness appears in Subsection (e).

Subsection (c)(1) – Section 102(4)(A) encompasses distributions in the nature of a redemption.

Subsection (c)(1)(A) and (B) – Under Subparagraph (A), any beginning of payment activity triggers the rule and sets the date as of when to apply the solvency tests. Under Subparagraph (B), the LLC's complete acquisition of the rights is necessary to trigger the rule.

Subsection (c)(2) – This provision states the general rule for distributions in the form of debt which arenot connected with a redemption.

Subsection (c)(3) – This provision states alternative rules for all distributions of money or property (*i.e.*, not debt). The measuring date depends on the length of time between the authorization and payment of the distribution.

Subsection (d) – *Compare* Subsection (d), *with* Section 404(d) (characterizing as a creditor a person who has become entitled to receive a distribution).

Subsection (e) – This subsection contains two rules pertaining to indebtedness issued as part of a distribution and the solvency tests of Subsection (a). The first sentence states the sensible rule that indebtedness that is essentially subordinated to the solvency requirement – *i.e.*, not payable if making payment would transgress that requirement – is not counted in determining liabilities for purposes of the solvency tests. The second sentence applies the solvency tests to each payment of principal and interest on any indebtedness issued as a distribution, in addition to any previous testing required by Subsection (c)(1)(A) or (c)(2).

EXAMPLE: An LLC and one of its members agree that the LLC will buy out the member's entire ownership interest in the LLC in return for a promissory note from the LLC, payable in installments. Under the redemption agreement, the member surrenders all its interests and rights on January 15 and the LLC signs and delivers the note to the person dissociated as a member on February 15. Under the note, payment of interest is due monthly beginning March 15, with a balloon payment of the principal due December 30.

Under Subsection (c)(1)(B), the solvency tests are applied as of January 15. Under Subsection (e), the solvency tests are again applied on the March 15, April 15, etc., and again on December 30.

Subsection (f) – The cited sections provide methods for extinguishing or limiting the debts of an LLC that is winding up its affairs and activities and thus any debt affected by any of the cited sections is irrelevant for purposes of solvency testing.

SECTION 406. LIABILITY FOR IMPROPER DISTRIBUTIONS.

(a) Except as otherwise provided in subsection (b), if a member of a member-managed limited liability company or manager of a manager-managed limited liability company consents to a distribution made in violation of Section 405 and in consenting to the distribution fails to comply with Section 409, the member or manager is personally liable to the company for the amount of the distribution which exceeds the amount that could have been distributed without the violation of Section 405.

(b) To the extent the operating agreement of a member-managed limited liability company expressly relieves a member of the authority and responsibility to consent to distributions and imposes that authority and responsibility on one or more other members, the liability stated in subsection (a) applies to the other members and not the member that the operating agreement relieves of the authority and responsibility.

(c) A person that receives a distribution knowing that the distribution violated Section 405 is personally liable to the limited liability company but only to the extent that the distribution received by the person exceeded the amount that could have been properly paid under Section 405.

(d) A person against which an action is commenced because the person is liable under subsection (a) may:

(1) implead any other person that is liable under subsection (a) and seek to enforce a right of contribution from the person; and

(2) implead any person that received a distribution in violation of subsection (c) and seek to enforce a right of contribution from the person in the amount the person received in violation of subsection (c).

(e) An action under this section is barred unless commenced not later than two years after the distribution.

Comment

This section and Section 405 were derived essentially from Model Business Corporation Act section 6.40. As with Section 405, this section is appropriate and necessary due to the liability shield of a limited liability company. The provisions of this section are non-waivable. Section 105(c)(15).

This section contemplates two categories of liability: liability of those who have authorized improper distributions, Subsection (a), and the liability of those who have received improper distributions, Subsection (c). Liability that has accrued under this section is not affected by a person subsequently ceasing to be a member, manager or transferee.

The liability is to the LLC, not to the creditors of an insolvent LLC. *Weinstein v. Colborne Foodbotics, LLC*, 302 P.3d 263, 268 (2013); *Rev O, Inc. v. Woo*, 725 S.E.2d 45, 52 (N.C. Ct. App. 2012).

This section does not preclude or interfere with claims for fraudulent transfer. *See* the comment to Subsection (e).

Subsection (a) – The liability is not strict liability but rather attaches only to the extent a decision maker has failed to comply with the duties stated in Section 409. To the extent those duties have been permissibly revised by the operating agreement, the revised standards apply to this subsection. *See also* Section 405(b)(1) (permitting reasonable reliance on specified financial information).

Subsection (b) – *Compare* Subsection (b), *with* Section 105(d)(2) (generally permitting provisions of this type).

Subsection (c) – Actual knowledge is necessary to impose liability. Reason to know does not suffice. *Compare* Subsection (c), *with* Section 103(a)-(b).

Subsections (c) and (d)(2) – Liability could apply to a person who receives a distribution under a charging order, but only if the person meets the knowledge requirement. That situation is very unlikely unless the person with the charging order is also a member or manager.

Subsection (e) – When the distribution is in the form of indebtedness, the distribution may occur on several different dates. *See* the comment to Section 405(e).

This statute of limitations applies only to actions "under this section" and does not affect claims under other applicable law, which most often is fraudulent transfer law. For a different approach, see DEL. CODE ANN. tit. 6, § 17-607(c) (West 2013) (applying a 3-year statute of limitations to claims "under this chapter or other applicable law"); NY LTD. LIAB. CO. § 508(c) (McKinney 2013) (same). *But see, e.g., In re The Heritage Org., LLC*, 413 BR 438, 461 (Bankr. ND Tex. 2009) (invoking the Texas Uninform Fraudulent Act [TUFTA] to recover distributions made by a Delaware LLC headquartered in Texas; rejecting DEL. CODE ANN. tit. 6, § 18-607(c) on choice of law grounds; stating that "the Delaware legislature cannot limit the reach of TUFTA").

SECTION 407. MANAGEMENT OF LIMITED LIABILITY COMPANY.

(a) A limited liability company is a member-managed limited liability company unless the operating agreement:

(1) expressly provides that:

(A) the company is or will be "manager-managed";

(B) the company is or will be "managed by managers"; or

(C) management of the company is or will be "vested in managers"; or

(2) includes words of similar import.

(b) In a member-managed limited liability company, the following rules apply:

(1) Except as expressly provided in this [act], the management and conduct of the company are vested in the members.

(2) Each member has equal rights in the management and conduct of the company's activities and affairs.

(3) A difference arising among members as to a matter in the ordinary course of the activities and affairs of the company may be decided by a majority of the members.

(4) The affirmative vote or consent of all the members is required to:

(A) undertake an act outside the ordinary course of the activities and affairs of the company; or

(B) amend the operating agreement.

(c) In a manager-managed limited liability company, the following rules apply:

(1) Except as expressly provided in this [act], any matter relating to the activities and affairs of the company is decided exclusively by the manager, or, if there is more than one manager, by a majority of the managers.

(2) Each manager has equal rights in the management and conduct of the company's activities and affairs.

(3) The affirmative vote or consent of all members is required to:

(A) undertake an act outside the ordinary course of the company's activities and affairs; or

(B) amend the operating agreement.

(4) A manager may be chosen at any time by the affirmative vote or consent of a majority of the members and remains a manager until a successor has been chosen, unless the manager at an earlier time resigns, is removed, or dies, or, in the case of a manager that is not an individual, terminates. A manager may be removed at any time by the affirmative vote or consent of a majority of the members without notice or cause.

(5) A person need not be a member to be a manager, but the dissociation of a member that is also a manager removes the person as a manager. If a person that is both a manager and a member ceases to be a manager, that cessation does not by itself dissociate the person as a member.

(6) A person's ceasing to be a manager does not discharge any debt, obligation, or other liability to the limited liability company or members which the person incurred while a

manager.

(d) An action requiring the vote or consent of members under this [act] may be taken without a meeting, and a member may appoint a proxy or other agent to vote, consent, or otherwise act for the member by signing an appointing record, personally or by the member's agent.

(e) The dissolution of a limited liability company does not affect the applicability of this section. However, a person that wrongfully causes dissolution of the company loses the right to participate in management as a member and a manager.

(f) A limited liability company shall reimburse a member for an advance to the company beyond the amount of capital the member agreed to contribute.

(g) A payment or advance made by a member which gives rise to a limited liability company obligation under subsection (f) or Section 408(a) constitutes a loan to the company which accrues interest from the date of the payment or advance.

(h) A member is not entitled to remuneration for services performed for a member-managed limited liability company, except for reasonable compensation for services rendered in winding up the activities of the company.

Comment

Subsection (a) – This subsection follows implicitly from the definitions of "manager-managed" and "member-managed" limited liability companies, Section 102(10) and (12), but is included here for the sake of clarity. Although this act has eliminated the link between management structure and statutory apparent authority, the act retains the manager-managed and member-managed constructs as options for members to use to structure their *inter se* relationship. *See also* the comments to Sections 301 (No Agency Power of Member as Member), and 409 (Standards of Conduct).

Subsection (b) – The subsection follows essentially the long-standing default paradigm for management rights of general partners. *See* UPA (1914) § 18; UPA (1997) (Last Amended 2013) § 401. The stated rules are subject to change by the operating agreement. Section 105.

In general, a member's actual authority to act for an LLC will depend fundamentally on the operating agreement.

EXAMPLE: Rachael and Sam, who have known each other for years, decide to go into business arranging musical tours. They fill out and electronically sign a one page form available on the website of the filing office and become the organizers of MMT, LLC. They are the only members of the LLC, and their understanding of who will do what in managing the enterprise is based on several lengthy, late-night conversations that preceded the LLC's formation. Sam is to "get the acts," and Rachael is to manage the tour logistics. There is no written operating agreement.

In the terminology of this act, MMT, LLC is member-managed, Section 407(a), and the understanding reached in the late night conversations has become part of the LLC's operating agreement, Section 102(13). In the terminology of agency law, the operating agreement constitutes a manifestation by the LLC to Rachael and Sam concerning the scope of their respective authority to act on behalf of the LLC. RESTATEMENT (THIRD) OF AGENCY § 2.01, cmt. c (2006) (explaining that a person's actual authority depends first on some manifestation attributable to the principal and stating: "[a]ctual authority is a consequence of a principal's expressive conduct toward an agent, through which the principal manifests assent to be affected by the agent's action, and the agent's reasonable understanding of the principal's manifestation").

Circumstances outside the operating agreement can also be relevant to determining the scope of a member's actual authority.

EXAMPLE: Homeworks, LLC is a manager-managed LLC with three members. The LLC's written operating agreement:

- specifies in considerable detail the management responsibilities of Margaret, the LLC's manager-member, and also states that Margaret is responsible for "the day-to-day operations" of the company;
- puts Garrett, a non-manager member, in charge of the LLC's transportation department; and
- specifies no management role for Brooksley, the third member.

When the LLC's chief financial officer quits suddenly, Margaret asks Brooksley, a CPA, to "step in until we can hire a replacement."

Under the operating agreement, Margaret's request to Brooksley is within Margaret's actual authority and is a manifestation attributable to the LLC. If Brooksley manifests assent to Margaret's request, Brooksley will have the actual authority to act as the LLC's chief financial officer.

In the unlikely event that two or more people form a member-managed LLC without any understanding of how to allocate management responsibility, agency law, operating in the context the act's "gap fillers" on management responsibility, will produce the following result:

A single member of a multi-member, member-managed LLC:

- has no actual authority to bind the LLC to any matter "outside the ordinary course of the activities of the company," Section 407(b)(3); and
- has the actual authority to bind the LLC to any matter "in the management and conduct of the company's [ordinary course of] activities and affairs," Section 407(b)(2), unless the member has reason to know that other members might disagree

or the member has some other reason to know that consultation with fellow members is appropriate.

For an explanation of this result, see Section 407(c), comment, which provides a detailed analysis in the context of a multi-manager LLC whose operating agreement is silent on the analogous question.

For a discussion of the apparent authority of a member to bind an LLC, see Section 301(b), comment.

Subsection (b)(4) – This list is not exhaustive. Other approval rights appear in the context of the provisions to which the rights apply. *E.g.*, Section 401(c)(3) (providing that "[a]fter formation of a limited liability company, a person becomes a member … with the affirmative vote or consent of all the members"); Section 703(b)(1) requiring "the affirmative vote or consent of each member" to rescind dissolution); Sections 1023, 1033, 1043, 1053 (same with regard to Article 10 transactions).

Subsection (c) – Like Subsection (b), this subsection states default rules that, under Section 105, are subject to the operating agreement. For example, a limited liability company's operating agreement might state "This company is manager-managed," Sections 102(10) and 407(a), while providing that managers must submit specified ordinary matters for review by the members.

The actual authority of an LLC's manager or managers is a question of agency law and depends fundamentally on the contents of the operating agreement and any separate management contract between the LLC and its manager or managers. These agreements are the primary source of the manifestations of the LLC (as principal) from which a manager (as agent) will form the reasonable beliefs that delimit the scope of the manager's actual authority. RESTATEMENT (THIRD) OF AGENCY § 3.01 (2006). *See also* RESTATEMENT (SECOND) OF AGENCY §§ 15, 26 (1958).

Other information may be relevant as well, such as the course of dealing within the LLC, unless the operating agreement effectively precludes consideration of that information. *See* the comment to Section 105(a)(4) (stating that the operating agreement governs "the means and conditions for amending the operating agreement").

If the operating agreement and a management contract conflict, the reasonable manager will know that the operating agreement controls the extent of the manager's rightful authority to act for the LLC– despite any contract claims the manager might have. *See* the comment to Section 105(a)(2) (stating that the operating agreement governs "the rights and duties under this [act] of a person in the capacity of manager"). *See also* RESTATEMENT (THIRD) OF AGENCY § 8.13, cmt. b (2006) and RESTATEMENT (SECOND) OF AGENCY § 432, cmt. b (1958) (stating that, when a principal's instructions to an agent contravene a contract between the principal and agent, the agent may have a breach of contract claim but has no right to act contrary to the principal's instructions).

If: (i) an LLC's operating agreement merely states that the LLC is manager-managed and does not further specify the managerial responsibilities; and (ii) the LLC has only one manager, the actual authority analysis is simple. In that situation, this subsection:

- serves as "gap filler" to the operating agreement; and thereby
- constitutes the LLC's manifestation to the manager as to the scope of the manager's authority; and thereby
- delimits the manager's actual authority, subject to whatever subsequent manifestations the LLC may make to the manager (*e.g.,* by a vote of the members, or an amendment of the operating agreement).

If the operating agreement states only that the LLC is manager-managed and the LLC has more than one manager, the question of actual authority has an additional aspect. It is necessary to determine what actual authority any one manager has to act alone.

Paragraphs (c)(1)-(3), combine to provide the answer. A single manager of a multi-manager LLC:

- has no actual authority to commit the LLC to any matter encompassed in Paragraph (c)(3) or for which this act elsewhere requires unanimity;
- has the actual authority to commit the LLC to usual and customary matters, unless the manager has reason to know that: (i) other managers might disagree; or (ii) for some other reason consultation with fellow managers is appropriate; and
- has no actual authority to take unusual or non-customary actions that will have a substantial effect on the LLC.

The first point follows self-evidently from the language of Paragraph (c)(3) and other provisions requiring the affirmative vote or consent of the members, which reserves specified matters to the members. Given that language, no manager could reasonably believe to the contrary (unless the operating agreement provided otherwise).

The second point follows because:

Subsection (c) serves as the gap-filler manifestation from the LLC to its managers and does *not* require managers of a multi-manager LLC to act *only* in concert or after consultation. To the contrary, subject to the operating agreement Subsection (c)(2) expressly provides that "each manager has equal rights in the management and conduct of the company's activities and affairs."

- It would be impractical to require collective action on even the smallest of decisions.
- However, to the extent a manager has reason to know of a possible difference of opinion among the managers, Paragraph (c)(1) requires decision by "a majority of the managers."

The third point is a matter of common sense. The more serious the matter, the less likely it is that a manager has actual authority to act unilaterally. *Cf.* RESTATEMENT (THIRD) OF AGENCY § 3.03, cmt. c (2006) (noting the unreasonableness of believing, without more facts, that an individual has "an unusual degree of unilateral authority over a matter fraught with enduring consequences for the institution" and stating that "[t]he gravity of the matter from the standpoint of the organization is relevant to whether a third party could reasonably believe that the manager has authority to proceed unilaterally").

The common law of agency will also determine the apparent authority of an LLC's manager or managers, and in that analysis what the particular third party knows or has reason to know about the management structure and business practices of the particular LLC will always be relevant. RESTATEMENT (THIRD) OF AGENCY § 3.03, cmt. d (2006) ("The nature of an organization's business or activity is relevant to whether a third party could reasonably believe that a [manager] is authorized to commit the organization to a particular transaction.").

As a general matter, absent countervailing facts, courts may see the position of manager as clothing its occupants with the apparent authority to take actions that reasonably appear within the ordinary course of the company's business. The actual authority analysis stated above supports that proposition; absent a reason to believe to the contrary, a third party could reasonably believe that a manager possesses the authority contemplated by the gap-fillers of this act. *But see* the comment to Section 102(9) (stating that "confusion around the term 'manager' is common to almost all LLC statutes").

Subsection (c)(1) – For limited liability companies that have more than one manager, this act provides that in most circumstances a "matter relating to the activities and affairs of the company is decided … by a majority of the managers." However, unlike corporate statutes, this act does not provide a rule for the quantum of participation necessary to constitute "a majority." *Cf., e.g.,* MINN. STAT. § 302A.237 (2014) (providing rules for determining the votes need to constitute "an act of the board"). If a manager-managed LLC has more than one manager, the operating agreement should consider what "a majority" means in the event a manager position is vacant.

Subsection (c)(3) – This list is not exhaustive. *See* the comment to Subsection (b)(4).

Subsection (c)(4) – Under the default rule stated in this paragraph, dissolution of an entity that is a manager of an LLC does not end the entity's status as manager. Likewise, dissolution of entity that is a member does not cause the entity to dissociate. *See* Section 602(11) (providing that termination of such an entity causes dissociation).

An LLC does not cease to be "manager-managed" simply because no managers are in place. In that situation, absent additional facts, the LLC is manager-managed and the manager position is vacant. Non-manager members who exercise managerial functions during the vacancy (or at any other time) will have duties as determined by other law, most particularly the law of agency.

Subsection (c)(6) – For example, the obligation to safeguard trade secrets and other confidential or propriety information learned when the person is a manager remains in force after the person ceases to be a manager.

Subsection (d) – In this context, the doctrine of *noscitur a sociis* limits the authorized extent of a proxy holder or other agent. (The doctrine of *noscitur a sociis* holds "that the meaning of an unclear word or phrase should be determined by the words immediately surrounding it." BLACK'S LAW DICTIONARY (9th ed. 2009).

In particular, unless the operating agreement so provides, neither a proxy nor other agent may be used to circumvent the transfer restrictions that are fundamental to the law of limited liability companies. *See* Article 5 and RESTATEMENT (SECOND) OF CONTRACTS § 318(2) (1981) (stating that "a promise requires performance by a particular person … to the extent that the obligee has a substantial interest in having that person perform or control the acts promised").

Subsection (e), second sentence – The default rules of this act do not contemplate a person wrongfully causing dissolution, as distinguished from wrongfully dissociating. *Compare* Section 701, *with* Section 601(b). However, the operating agreement might contemplate wrongful dissolution, and then the second sentence of this subsection would apply unless the operating agreement provided otherwise.

Subsection (h) – This provision traces back to the UPA (1914) § 18(f) and is included to avoid its absence being misinterpreted as implying a contrary rule.

This act does not provide for remuneration to a manager of a manager-managed LLC. That issue is for the operating agreement, or a separate agreement between the LLC and the manager. A manager may also have a common law right to compensation. RESTATEMENT (THIRD) AGENCY § 8.13, cmt. d (2006) ("Unless an agreement between a principal and an agent indicates otherwise, a principal has a duty to pay compensation to an agent for services that the agent provides.").

SECTION 408. REIMBURSEMENT; INDEMNIFICATION; ADVANCEMENT; AND INSURANCE.

(a) A limited liability company shall reimburse a member of a member-managed company or the manager of a manager-managed company for any payment made by the member or manager in the course of the member's or manager's activities on behalf of the company, if the member or manager complied with Sections 405, 407, and 409 in making the payment.

(b) A limited liability company shall indemnify and hold harmless a person with respect to any claim or demand against the person and any debt, obligation, or other liability incurred by the person by reason of the person's former or present capacity as a member or manager, if the claim, demand, debt, obligation, or other liability does not arise from the person's breach of Section 405, 407, or 409.

(c) In the ordinary course of its activities and affairs, a limited liability company may advance reasonable expenses, including attorney's fees and costs, incurred by a person in connection with a claim or demand against the person by reason of the person's former or present capacity as a member or manager, if the person promises to repay the company if the person ultimately is determined not to be entitled to be indemnified under subsection (b).

(d) A limited liability company may purchase and maintain insurance on behalf of a member or manager against liability asserted against or incurred by the member or manager in that capacity or arising from that status even if, under Section 105(c)(7), the operating agreement could not eliminate or limit the person's liability to the company for the conduct giving rise to the liability.

Comment

Subsections (a) and (b) – A limited liability company's obligation, if any, to reimburse or indemnify others (*e.g.*, employees, independent contractors, other agents) is a question for other law, including the law of agency, contract and restitution. The fact a person has dissociated as a member or ceased to be a manager does not affect any obligations incurred by the limited liability company under these subsections for conduct occurring before the dissociation or cessation.

Subsection (a) – The reimbursement obligation stated here is a default rule and roughly parallels a rule of agency law. RESTATEMENT (THIRD) OF AGENCY § 8.14(2)(a) (2006) (stating that "[a] principal has a duty to indemnify an agent … when the agent makes a payment (i) within the scope of the agent's actual authority, or (ii) that is beneficial to the principal, unless the agent acts officiously in making the payment").

This subsection applies only to managers of manager-managed limited liability companies and members of member-managed companies. The definite article in the phrase "the member or manager"" and "the member's" refers back to the original phrase: "A limited liability company shall reimburse a member of a member-managed company or the manager of a manger-managed company ...."

A limited liability company's obligation, if any, to reimburse others (including LLC employees and non-managing members of a manager-managed LLC) is a question for other law, including the law of agency and restitution. The fact a person has ceased to be a member of a member-managed LLC or a manager of a manager-managed LLC does not affect any obligations incurred by the LLC under this subsection for payments made before the cessation.

To the extent an operating agreement modifies or displaces the default rules stated in Sections 407 and 409, the agreement should also address this section. For example, if the operating agreement establishes a duty of ordinary care (modifying Section 409(c)), the agreement should specify which level of care is necessary to satisfy this subsection. It is not necessary that the levels of care be the same, only that the operating agreement make the situation clear and thereby avoid difficult issues of interpretation.

Subsection (b) – This subsection provides for indemnification but only as a default rule. Subject only to Section 105(c)(7), the operating agreement can relax these preconditions substantially. The agreement can also impose stricter preconditions.

The rule's eligibility requirements correspond to the default rules on management duties, which is appropriate because otherwise the statutory default rule on indemnification could undercut or even vitiate the statutory default rules on duty. To the extent an operating agreement modifies or displaces the default rules stated in Sections 405, 407, or 409, the agreement should also address this section. *See* the comment to Subsection (a).

Although referring broadly to any "person," this subsection is actually limited to present and former members or managers. The indemnification obligation applies only to a "debt, obligation, or other liability incurred by the person by reason of the person's former or present capacity as a member or manager." Thus, by its terms this subsection does not apply to a person in the capacity of an "officer," unless being an officer constitutes being a manager. For a discussion of the vagaries of the term "manager," see Section 102(9), comment.

Of course, the operating agreement may mandate indemnification to officers, employees, and other persons providing services to or acting for the limited liability company. Within the limitations stated in Section 105(c)(7), the operating agreement may obligate an LLC to indemnify a person even when the person has breached a managerial duty or the operating agreement itself.

Subsection (c) – This subsection authorizes but does not require a limited liability company to provide advances to cover expenses. *Cf. Majkowski v. American Imaging Mgmt. Servs., LLC*, 913 A.2d 572, 589 (Del. Ch. 2006) ("Because rights to indemnification and advancement differ in important ways, our courts have refused to recognize claims for advancement not granted in specific language clearly suggesting such rights."). The phrase "hold harmless" likewise does not encompass advances. *Id* The authorization applies only to those persons eligible for indemnification under Subsection (b), but the operating agreement certainly can authorize a broader scope and also make advances obligatory.

The reference to "ordinary course" pertains to Section 407(b)(3) (stating that any "difference arising among members [in a member-managed LLC] as to a matter in the ordinary course of the activities of the company may be decided by a majority of the members"). As for a manager-managed LLC, see Section 407(c)(1) ("Except as expressly provided in this [act], *any* matter relating to the activities and affairs of the [manager-managed] company is decided exclusively by the manager, or, if there is more than one manager, by a majority of the managers.") (emphasis added).

Subsection (d) – This subsection's language is very broad and authorizes an LLC to purchase insurance to cover, *e.g.,* a manager's intentional misconduct. It is unlikely that such insurance would be available. In contrast to Subsection (a), this subsection encompasses all members, not just members in a member-managed LLC. This authorization comes from the act, not the operating agreement, and therefore is not subject to Section 105(c)(7).

SECTION 409. STANDARDS OF CONDUCT FOR MEMBERS AND MANAGERS.

(a) A member of a member-managed limited liability company owes to the company and, subject to Section 801, the other members the duties of loyalty and care stated in subsections (b) and (c).

(b) The fiduciary duty of loyalty of a member in a member-managed limited liability company includes the duties:

(1) to account to the company and hold as trustee for it any property, profit, or benefit derived by the member:

(A) in the conduct or winding up of the company's activities and affairs;

(B) from a use by the member of the company's property; or

(C) from the appropriation of a company opportunity;

(2) to refrain from dealing with the company in the conduct or winding up of the company's activities and affairs as or on behalf of a person having an interest adverse to the company; and

(3) to refrain from competing with the company in the conduct of the company's activities and affairs before the dissolution of the company.

(c) The duty of care of a member of a member-managed limited liability company in the conduct or winding up of the company's activities and affairs is to refrain from engaging in grossly negligent or reckless conduct, willful or intentional misconduct, or knowing violation of law.

(d) A member shall discharge the duties and obligations under this [act] or under the operating agreement and exercise any rights consistently with the contractual obligation of good faith and fair dealing.

(e) A member does not violate a duty or obligation under this [act] or under the operating agreement solely because the member's conduct furthers the member's own interest.

(f) All the members of a member-managed limited liability company or a manager-managed limited liability company may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty.

(g) It is a defense to a claim under subsection (b)(2) and any comparable claim in equity or at common law that the transaction was fair to the limited liability company.

(h) If, as permitted by subsection (f) or (i)(6) or the operating agreement, a member enters into a transaction with the limited liability company which otherwise would be prohibited by subsection (b)(2), the member's rights and obligations arising from the transaction are the same as those of a person that is not a member.

(i) In a manager-managed limited liability company, the following rules apply:

(1) Subsections (a), (b), (c), and (g) apply to the manager or managers and not the members.

(2) The duty stated under subsection (b)(3) continues until winding up is completed.

(3) Subsection (d) applies to managers and members.

(4) Subsection (e) applies only to members.

(5) The power to ratify under subsection (f) applies only to the members.

(6) Subject to subsection (d), a member does not have any duty to the company or to any other member solely by reason of being a member.

Comment

This section states some of the core aspects of the fiduciary duty of loyalty, provides a duty of care, and incorporates the contractual obligation of good faith and fair dealing. The section follows the structure of many LLC acts, first stating the duties of members in a member-managed limited liability company and then using that statement and a "switching" mechanism, Subsection (i), to allocate duties in a manager-managed company. The duties stated in this section are subject to the operating agreement, but Section 105(c) and (d) contain important limitations on the power of the operating agreement to affect fiduciary and other duties and the obligation of good faith and fair dealing.

For the effect of dissociation on a person's duties under this section, see Section 603(a)(2).

Subsection (a) – This subsection recognizes two core managerial duties but, unlike some earlier uniform acts, does not purport to state all managerial duties. Indeed, many cases characterize a manager's duty to disclose as a fiduciary duty. *E.g., Salm v. Feldstein*, 20 A.D.3d 469, 470, 799 N.Y.S.2d 104, 105 (N.Y. App. Div. 2005) (stating that, "[a]s the managing member of the [limited liability] company and as a co-member with the plaintiff, the defendant owed the plaintiff a fiduciary duty to make full disclosure of all material facts"); *Metro Commc'n Corp. BVI v. Advanced Mobilecomm Technologies Inc.*, 854 A.2d 121, 156 n. 78 (Del. Ch. 2004) (referring to "certain standards governing the disclosure-related duties of the fiduciaries of Delaware business entities;" noting that "[t]hese standards have been mostly articulated in the corporate context but the corporate standards often serve as the default rule in the alternative entity context").

Subsection (b) – This subsection states three core aspects of the fiduciary duty of loyalty: (i) not "usurping" company opportunities or otherwise wrongly benefiting from the company's operations or property; (ii) avoiding conflict of interests in dealing with the company (whether directly or on behalf of another); and (iii) refraining from competing with the company. Essentially the same duties exist in agency law and under the law of all types of business organizations.

The subsection applies beginning with "the conduct of the company's activities and affairs," which by definition cannot exist before the company exists; thus the stated duties do not apply to pre-formation activities. In some circumstances, comparable duties might arise from other law, particular the law of agency. *See, e.g.,* Section 401(a) and (b) (stating that the organizer acts "on behalf of others").

The stated duties comprise a default rule. Under Section 105(d)(3)(A): "If not manifestly unreasonable, the operating agreement may … alter or eliminate the aspects of the duty of loyalty stated in Section 409(b)."

Subsection (b)(1) – The phrase "hold as trustee" dates back to UPA (1914) § 21 and reflects the availability of disgorgement remedies, such as a constructive trust. In contrast to an actual trustee, a person subject to this duty does not: (i) face the special obstacles to consent characteristic of trust law; or (ii) enjoy protection for decisions taken in reliance on the governing instrument and other sources of information. *Cf.* UNIFORM STATUTORY TRUST ENTITY ACT (2009) (Last Amended 2013) § 506 ("A trustee [of a statutory trust]… is not liable to the trust or to a beneficial owner for breach of any duty, *including a fiduciary duty*, to the extent the breach results from reasonable reliance on: (i) a term of the governing instrument; (ii) a record of the statutory trust; or (iii) an opinion, report, or statement of another person that the person to which the opinion, report, or statement is made or delivered reasonably believes is within the other person's professional or expert competence and is made or delivered to the trustee … .")

(emphasis added).

Subsection (b)(1)(A) – This provision is consistent with a basic principle of agency law – namely, that an agent may not benefit at all from the performance of the agency unless the principal consents. RESTATEMENT (THIRD) OF AGENCY § 8.06, cmt. c (2006). Typically, however, the operating agreement will legitimize particular benefits – *e.g.*, a management fee paid to a managing member in addition to that member's share of distributions. Also, an agreed allocation of distributions takes those benefits outside the reach of this provision.

Subsection (b)(1)(B) – For the expansive meaning of "property," see Section 102(17). The term includes confidential information.

Subsection (b)(1)(C) – This act does not specify what constitutes "a company opportunity," but ample case law exists. *See, e.g.*, *Ebenezer United Methodist Church v. Riverwalk Development Phase, II, LLC,* 45 A.3d 883, 887 (Md. App. 2012) (discussing the "interest or reasonable expectancy test"); *In re McCook Metals, L.L.C.*, 319 B.R. 570, 596 (Bkrtcy. N.D.Ill. 2005) (discussing the "line of business test").

This duty continues through winding up, although in that context the scope of company opportunities inevitably narrows.

In most, if not all, situations, usurping a company opportunity also breaches the duty not to compete, Paragraph (b)(3), but not *vice versa*.

Subsection (b)(2) – In this context, the phrase "adverse interest" is a term of art, meaning "to be on the other side of the table" in some dealing with the limited liability company. Absent informed consent by the LLC, this duty is breached by the mere existence of the conflict of interest; the LLC need not prove that the outcome of the dealing was adverse to the LLC. *But see* Subsection (g) (permitting the defense of fairness). This duty continues through winding up.

Subsection (b)(3) – Although competition is often thought of in terms of potential customers, this duty applies equally to competition for resources, including employees. The duty not to compete continues longer in a manager-managed LLC. *See* Subsection (i)(2).

Subsection (c) – ULLCA (2006) §409(c) stated a different rule: "Subject to the business judgment rule, the duty of care of a member of a member-managed limited liability company in the conduct and winding up of the company's activities is to act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member reasonably believes to be in the best interests of the company." As part of the Harmonization Project, the ULLCA duty of care was conformed to the duty of care stated in ULPA (2001) and UPA (1997).

Neither this act nor the two harmonized partnership acts refer to the duty of care as a fiduciary duty, because: (i) the duty of care applies in many non-fiduciary situations; and (ii) breach of the duty of care is remediable only in damages while breach of a fiduciary duty gives rise also to equitable remedies, including disgorgement, constructive trust, and rescission. *See* ULPA (2001) (Last Amended 2013) § 409(c) and UPA (1997) (Last Amended 2013) § 409(c).

The change in label is consistent with the RESTATEMENT (THIRD) OF AGENCY § 8.02 (2006), which refers to the agent's "fiduciary duty to act loyally, but eschews the word "fiduciary" when stating the agent's duties of "care, competence, and diligence." *Id.* § 8.08. However, the change in label is merely semantics; no change in the law is intended.

The operating agreement can raise the standard of care, or subject to Sections 105(c)(7) and (d)(3)(C), lower it. A person's practical exposure for breaching the duty of care involves not only the standard of care but also any operating agreement provision that: (i) exonerates the person from liability for breach of the duty of care, Section 105(c)(7); or (ii) entitles the person to indemnification despite such breach, Section 408(b), comment.

Subsection (d) – This subsection refers to the "*contractual* obligation of good faith and fair dealing" (emphasis added) and thereby invokes the implied obligation that exists in every contract. *See* RESTATEMENT (SECOND) CONTRACTS § 205 (1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."). The adjective ("contractual") should help avoid decisions like *Phelps v. Frampton*, 2007 MT 263, 339 Mont. 330, 342-43, 170 P.3d 474, 483 (2007) (holding that Montana's version of UPA (1997) creates a statutory obligation of good faith and fair dealing separate from the implied contractual covenant).

At first glance, it may seem strange to apply a contractual obligation to statutory duties and rights – *i.e.*, duties and rights "under this [act]." However, for the most part those duties and rights apply to relationships *inter se* the members and the LLC and function only to the extent not displaced by the operating agreement. These statutory default rules are intended in essence to function like a contract; applying the contractual notion of good faith and fair dealing therefore makes sense.

The contractual obligation of "good faith" has nothing to do with the corporate concept of good faith that for years bedeviled courts and attorneys trying to understand: (i) Delaware's famous corporate law exoneration provision; and (ii) that provision's exception "for acts or omissions not in good faith." DEL. CODE ANN. tit. 8, § 102(b)(7) (2012). In that context, good faith is an aspect of the duty of loyalty. *See Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 369-70 (Del. 2006).

Likewise, the contractual obligation of good faith and fair dealing has nothing to do with the "utmost good faith" sometimes used to describe the fiduciary duties that owners of closely held businesses owe each other. *See, e.g., Meinhard v. Salmon*, 249 N.Y. 458, 477, 164 N.E. 545, 551 (1928) ("[W]here parties engage in a joint enterprise each owes to the other the duty of the utmost good faith in all that relates to their common venture. Within its scope they stand in a fiduciary relationship."); *Donahue v. Rodd Electrotype Co. of New England, Inc.,* 367 Mass. 578, 593, 328 N.E.2d 505, 515 (1975) ("[S]tockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise1 that partners owe to one another. In our previous decisions, we have defined the standard of duty owed by partners to one another as the utmost good faith and loyalty.") (footnotes omitted) (citations omitted) (internal quotations omitted).

To the contrary, the contractual obligation of good faith and fair dealing is not a fiduciary duty, does not command altruism or self-abnegation, and does not prevent a member from acting in the member's own self-interest:

> "Fair dealing" is not akin to the fair process component of entire fairness, *i.e.,* whether the fiduciary acted fairly when engaging in the challenged transaction as measured by duties of loyalty and care … . It is rather a commitment to deal "fairly" in the sense of consistently with the terms of the parties' agreement and its purpose. Likewise "good faith" does not envision loyalty to the contractual counterparty, but rather faithfulness to the scope, purpose, and terms of the parties' contract. Both necessarily turn on the contract itself and what the parties would have agreed upon had the issue arisen when they were bargaining originally.

Gerber v. Enter. Products Holdings, LLC, 67 A.3d 400, 418-19 (Del. 2013) (quoting *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, 50 A.3d 434, 440–42 (Del. Ch. 2012), *aff'd in part, rev'd in part on other grounds*, 68 A.3d 665 (Del. 2013)) (footnotes omitted) (citations omitted) (internal quotations omitted without ellipsis by *Gerber*). *See also* Subsection (e).

Courts should not use the contractual obligation to change *ex post facto* the parties' or this act's allocation of risk and power. To the contrary, the obligation should be used only to protect agreed-upon arrangements from conduct that is manifestly beyond what a reasonable person could have contemplated when the arrangements were made.

The operating agreement or this act may grant discretion to a member or manager, and the contractual obligation of good faith and fair dealing is especially salient when discretion is at issue. However, a member or manager may properly exercise discretion even though another member suffers as a consequence. Conduct does not violate the obligation of good faith and fair dealing merely because that conduct substantially prejudices a party. Indeed, parties allocate risk precisely because prejudice may occur.

The exercise of discretion constitutes a breach of the obligation of good faith and fair dealing only when the party claiming breach shows that the conduct has no honestly-held purpose that legitimately comports with the parties' agreed-upon arrangements:

> An implied covenant claim ... looks to the past. It is not a free-floating duty unattached to the underlying legal documents. It does not ask what duty the law should impose on the parties given their relationship at the time of the wrong, but *rather what the parties would have agreed to themselves had they considered the issue in their original bargaining positions at the time of contracting*.

Gerber v. Enter. Prods. Holdings, LLC, 67 A.3d 400, 418 (Del. 2013) (quoting *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, 50 A.3d 434, 440–42 (Del. Ch. 2012), *aff'd in part, rev'd in part on other grounds*, 68 A.3d 665 (Del. 2013)) (emphasis added) (footnotes omitted) (citations omitted) (internal quotations omitted without ellipsis by *Gerber*).

In sum, the purpose of the contractual obligation of good faith and fair dealing is to protect the arrangement the members have chosen for themselves, not to restructure that arrangement under the guise of safeguarding it.

As to the power of the operating agreement to affect the contractual obligation of good faith and fair dealing, see Section 105(c)(6) (prohibiting elimination but allowing the agreement to "prescribe standards, if not manifestly unreasonable, by which the performance of the obligation is to be measured"). For examples, see Section 105(c)(6), comment. As to whether the obligation stated in this subsection applies to transferees, see Section 107(b), comment.

Subsection (e) – A member in a member-managed LLC has at least two different roles: (i) as a party to the operating agreement, with rights and obligations under that agreement; and (ii) as manager or co-manager of the enterprise. This provision pertains to the first role. A member's exercise of rights under the operating agreement is subject to the obligation of good faith and fair dealing, Subsection (d), but a person does not breach that contractual obligation "solely because the [person's exercise of rights] furthers the [person's] own interest." In contrast, this provision is ineffective with regard to a member's duties as manager or co-manager. For example, a member's liability under Section 409(b)(3) (prohibiting competition) is not "solely because the member's conduct furthers the member's own interest." Rather, the liability results from the breach of a specific obligation – *i.e.*, the codified aspect of the duty of loyalty that prohibits competition.

With regard to a manager-managed LLC: (i) the same analysis applies to a member that is a manager; and (ii) with regard to a non-managing member the analysis as to contractual rights applies and the analysis as to managerial duties is inapposite.

Subsection (f) – Here and elsewhere in this act, information "is material if there is a substantial likelihood that a reasonable [decision maker] would consider it important in deciding how to vote" or take other action under this act or the operating agreements. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 2132 (1976).

The operating agreement can provide additional or different methods of authorization or ratification, subject to the strictures of Section 105(c)(5), (d)(1), and (d)(3)(A)(B) and (D).

Subsection (g) – This subsection codifies judge-made law applicable to all business entities. *See, e.g., Gottsacker v. Monnier*, 281 Wis. 2d 361, 379, 697 N.W.2d 436, 444 (Wisc. 2005) (referring to "a willful failure to deal fairly with the LLC or its other members"); *Lonergan v. EPE Holdings, LLC*, 5 A.3d 1008, 1019 (Del. Ch. 2010) (discussing "entire fairness" in the context of a limited partnership"); *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994) (discussing "entire fairness" in the context of a corporation's merger with an affiliate); *Lonergan v. EPE Holdings, LLC*, 5 A.3d 1008, 1019 (Del. Ch. 2010) (discussing "entire fairness" in the context of a limited partnership").

Subsection (h) – This subsection is the modern, reformulated version of a language that sought to overturn the now-defunct notion that debts to owners were categorically inferior to debts to non-owner creditors. *See, e.g.*, ULPA (2001) § 112 ("A partner may lend money to and transact other business with the limited partnership and has the same rights and obligations with respect to the loan or other transaction as a person that is not a partner."). The reformulation makes clear that this provision has nothing to do with the fiduciary duty pertaining to conflict of interests. *See BT-I v. Equitable Life Assurance Soc'y of the United States*, 75 Cal. App. 4th 1406, 1415, 89 Cal. Rptr. 2d 811 (1999) (examining the prior formulation, explaining its history and stating "[w]e cannot discern anything in the purpose of [the prior formulation] that suggests an intent to affect a general partner's fiduciary duty to limited partners").

This subsection states a default rule. The operating agreement may provide that debt to a member (or members generally) is subordinate to other limited liability company obligations. The agreement that creates the debt may do likewise.

Subsection (i) – This is the "switching" mechanism, referred to in the introduction to this comment. The list does not include Subsection (h).

Subsection (i)(1) – This provision switches most managerial duties to the managers and away from members. Of course, if a member is a manager, the duties apply to the member-manager in the person's capacity of manager.

Subsection (i)(2) – On the assumption that the members of a manager-managed LLC are dependent on the manager, this paragraph extends the duty not to compete longer than in a member-managed LLC.

Subsection (i)(3) – The contractual obligation of good faith and fair dealing applies to members regardless of whether they are managers; non-managing members have rights and perhaps duties under the operating agreement and under this act. As to non-member managers, the operating agreement (and the corresponding obligation of good faith and fair dealing) are relevant regardless of whether the manager is party to the agreement. *See* Section 105(a)(2) (stating that the operating agreement "governs … the rights and duties under this [act] of a person in the capacity of manager"). Also, non-member managers will have rights and obligations under this act, which per Subsection (d) are also subject to the obligation of good faith and fair dealing.

Subsection (i)(4) – As explained in the comment to Subsection (e), that provision does not apply to the managerial function.

Subsection (i)(5) – The power to ratify belongs to the entity's owners; thus Subsection (f) does not switch from members to managers.

Subsection (i)(6) – This paragraph merely negates a claim of fiduciary duty that is exclusively status-based and does not immunize misconduct.

> EXAMPLE: Although a limited liability company is manager-managed, one member who is not a manager owns a controlling interest and effectively, albeit indirectly, controls the company's activities. A member owning a minority interest brings an action for dissolution under Section 701(a)(4)(C)(ii) (oppression by "the managers or those members in control of the company"). This paragraph does not prevent the court from construing the claim as alleging a breach of fiduciary duty by the controlling member.

SECTION 410. RIGHTS TO INFORMATION OF MEMBER, MANAGER, AND PERSON DISSOCIATED AS MEMBER.

(a) In a member-managed limited liability company, the following rules apply:

(1) On reasonable notice, a member may inspect and copy during regular business hours, at a reasonable location specified by the company, any record maintained by the company regarding the company's activities, affairs, financial condition, and other circumstances, to the extent the information is material to the member's rights and duties under the operating agreement or this [act].

(2) The company shall furnish to each member:

(A) without demand, any information concerning the company's activities, affairs, financial condition, and other circumstances which the company knows and is material to the proper exercise of the member's rights and duties under the operating agreement or this [act], except to the extent the company can establish that it reasonably believes the member already knows the information; and

(B) on demand, any other information concerning the company's activities, affairs, financial condition, and other circumstances, except to the extent the demand for the information demanded is unreasonable or otherwise improper under the circumstances.

(3) The duty to furnish information under paragraph (2) also applies to each member to the extent the member knows any of the information described in paragraph (2).

(b) In a manager-managed limited liability company, the following rules apply:

(1) The informational rights stated in subsection (a) and the duty stated in subsection (a)(3) apply to the managers and not the members.

(2) During regular business hours and at a reasonable location specified by the company, a member may inspect and copy information regarding the activities, affairs, financial condition, and other circumstances of the company as is just and reasonable if:

(A) the member seeks the information for a purpose reasonably related to the member's interest as a member;

(B) the member makes a demand in a record received by the company, describing with reasonable particularity the information sought and the purpose for seeking the information; and

(C) the information sought is directly connected to the member's purpose.

(3) Not later than 10 days after receiving a demand pursuant to paragraph (2)(B), the company shall inform in a record the member that made the demand of:

(A) what information the company will provide in response to the demand and when and where the company will provide the information; and

(B) the company's reasons for declining, if the company declines to provide any demanded information.

(4) Whenever this [act] or an operating agreement provides for a member to vote on or give or withhold consent to a matter, before the vote is cast or consent is given or withheld, the company shall, without demand, provide the member with all information that is known to the company and is material to the member's decision.

(c) Subject to subsection (h), on 10 days' demand made in a record received by a limited liability company, a person dissociated as a member may have access to the information to which the person was entitled while a member if:

(1) the information pertains to the period during which the person was a member;

(2) the person seeks the information in good faith; and

(3) the person satisfies the requirements imposed on a member by subsection (b)(2).

(d) A limited liability company shall respond to a demand made pursuant to subsection (c) in the manner provided in subsection (b)(3).

(e) A limited liability company may charge a person that makes a demand under this section the reasonable costs of copying, limited to the costs of labor and material.

(f) A member or person dissociated as a member may exercise the rights under this section through an agent or, in the case of an individual under legal disability, a legal representative. Any restriction or condition imposed by the operating agreement or under subsection (h) applies both to the agent or legal representative and to the member or person dissociated as a member.

(g) Subject to Section 504, the rights under this section do not extend to a person as transferee.

(h) In addition to any restriction or condition stated in its operating agreement, a limited liability company, as a matter within the ordinary course of its activities and affairs, may impose reasonable restrictions and conditions on access to and use of information to be furnished under this section, including designating information confidential and imposing nondisclosure and safeguarding obligations on the recipient. In a dispute concerning the reasonableness of a restriction under this subsection, the company has the burden of proving reasonableness.

Comment

This section is derived from the Uniform Limited Partnership Act (2001) §§ 304 (rights to information of limited partners and former limited partners) and 407 (rights to information of general partners and former general partners). The rules stated here are what might be termed "quasi-default rules" – subject to some change by the operating agreement. *See* Section 105(c)(8) (prohibiting unreasonable restrictions on the information rights stated in this section).

Although the rights and duties stated in this section are extensive, they are not necessarily all-inclusive. This act's statement of fiduciary duties is not exhaustive, *see* the comment to Section 409(a), and some cases characterize owners' information rights as reflecting a fiduciary duty of those with management power. *E.g., Bakerman v. Sidney Frank Importing Co., Inc.*, No. Civ.A. 1844–N, 2006 WL 3927242 at *14 (Del. Ch. Oct. 16, 2006) (holding that an LLC manager owed "certain duties to members of the LLC" and stating that "[w]hen fiduciaries communicate with their beneficiaries in the context of asking the beneficiary to make a discretionary decision—such as whether to consent to a sale of substantially all the assets of an LLC—the fiduciary has a duty to disclose all material facts bearing on the decision at issue") (citing *Loudon v. Archer–Daniels–Midland Co.*, 700 A.2d 135, 137 (Del.1997)). Also, the rights stated in this section are in addition to whatever discovery rights a party has in a civil suit.

Subsection (a) – Paragraph 1 states the rule pertaining to information memorialized in "any record maintained by the company." Paragraph 2 applies to information not in such a record. Appropriately, Paragraph (2) sets a more demanding standard for those seeking such information.

Subsection (a)(2) and (3) – In appropriate circumstances, violation of either or both of these provisions might cause a court to enjoin or even rescind action taken by the LLC, especially when the violation has interfered with an approval or veto mechanism involving member consent. *E.g.*, *Blue Chip Emerald LLC v. Allied Partners Inc*., 299 A.D.2d 278, 279-80 (N.Y. App. Div. 2002) (invoking partnership law precedent as reflecting a duty of full disclosure and holding that "[a]bsent such full disclosure, the transaction is voidable").

Subsection (a)(2) – This paragraph imposes a duty on the limited liability company, not the members who manage the LLC. However, a member could be liable in damages if the member were to: (i) breach a duty under Section 409 or the operating agreement; and (ii) in doing so cause or suffer the LLC to breach the duty stated in this paragraph.

Subsection (a)(2)(A) – For the meaning of "material" as applied to information, see Section 409(f), comment.

Subsection (a)(3) – This paragraph imposes a duty directly on each member. Therefore, a member's violation of this paragraph is actionable in damages without need to show a violation of a duty stated in Section 409.

Subsection (b)(1) – This is a switching provision. The comments to Paragraph (a)(2) and (3) apply here by analogy.

Subsection (b)(2) – This paragraph refers to "information" rather than "records maintained by the company" so in some circumstances the company might have an obligation to memorialize information. *Compare* Subsection (b)(2), *with* Subsection (a). Such circumstances will likely be rare or at least unusual. This section generally concerns providing existing information, not creating it. In any event, a member does not trigger the company's obligation under this paragraph merely by satisfying Subparagraphs (A) through (C). The member must also satisfy the "just and reasonable" requirement.

Subsection (b)(4) – For the meaning of "material" as applied to information, see Section 409(f), comment.

Subsection (c) – When a member dies, Section 504 provides information rights to the legal representative of the deceased member.

Subsection (c)(1) – A person dissociated as a member has information rights in that capacity only as to the period during which the person was a member. To the extent that further information is accessible under Section 504(2) (providing access to the legal representative of a deceased partner), that access is limited both in purpose ("for purposes of settling the estate") and in scope ("the rights the deceased partner had under Section 410").

Subsection (f) – Some old cases involved conflicts over whether a shareholder could exercise inspection rights through another person. *White v. Coeur D'Alene Big Creek Mining Co.*, 55 P.2d 720, 723 (Idaho 1936) (stating that "[t]he refusal to permit respondent [shareholder] to appoint his own attorney or agent to make the examination [of the corporation's books] was in effect a denial of his right" of inspection); *State v. Monida & Yellowstone Stage Co.*, 124 N.W. 971, 972 (Minn. 1910) (upholding a trial court's mandamus order, "which shall provide that [the shareholder complainant], or such attorney or agent as he may select, … shall be allowed to inspect the books, records, and papers of the defendant [corporation]"). In light of that history, for the avoidance of doubt, this subsection expressly authorizes taking action through an agent. No negative inference should be drawn about using agents to take other action under this act.

Subsection (h) – This provision provides fallback protection for gaps in the operating agreement. For example, those managing an LLC may protect trade secrets from disclosure prohibit various misuses of confidential information even if the operating agreement omits to do so.

The reference to "ordinary course" pertains to Section 407(b)(3) (stating that any "difference arising among members [in a member-managed LLC] as to a matter in the ordinary course of the activities of the company may be decided by a majority of the members"). As for a manager-managed LLC, see Section 407(c)(1) ("Except as expressly provided in this [act], *any* matter relating to the activities and affairs of the [manager-managed] company is decided exclusively by the manager, or, if there is more than one manager, by a majority of the managers.") (emphasis added). This approach is necessary, lest a requesting member (or manager-member) have the power to block imposition of a reasonable restriction or condition needed to prevent the requestor from abusing the LLC.

The burden of persuasion under this subsection contrasts with the burden of persuasion under Section 105(c)(8) (prohibiting unreasonable limitations on the information rights provided by this section). Under that subsection, as a matter of ordinary procedural law the burden is on the person making the claim.

[ARTICLE] 5

TRANSFERABLE INTERESTS AND RIGHTS OF TRANSFEREES AND CREDITORS

SECTION 501. NATURE OF TRANSFERABLE INTEREST. A transferable interest is personal property.

Comment

For the definition of transferable interest, see Section 102(24). Absent a contrary provision in the operating agreement or the consent of the members, a "transferable interest" is the only interest in an LLC which can be transferred to a person who is not already a member. *See* Section 502. As to whether a member may transfer governance rights to a fellow member, the question is moot absent a provision in the operating agreement changing the default rule, *see* Section 407(b)(2) (allocating governance rights *per capita*). In the default mode, a member's transfer of governance rights to another member: (i) does not increase the transferee's governance rights; (ii) eliminates the transferor's governance rights; and (iii) thereby changes that denominator but not the numerator in calculating governance rights.

> EXAMPLE: LCN Company, LLC is a member-managed limited liability company with three members, Laura, Charles, and Nora. The operating agreement does not displace this act's default rule on the allocation of governance rights among members. Thus, each member has 1/3 of those rights. Laura transfers her entire ownership interest to Charles. The transfer does not increase Charles's governance rights but does eliminate Laura's. After the transfer, Laura has no governance rights (regardless of whether Charles and Nora agree to expel Laura under Section 602(5)(B)). As a result, Charles and Nora each have 1/2 of the governance rights.

Whether a transferable interest pledged as security is governed by Article 8 or 9 of the Uniform Commercial Code depends on the rules stated in those articles.

SECTION 502. TRANSFER OF TRANSFERABLE INTEREST.

(a) Subject to Section 503(f), a transfer, in whole or in part, of a transferable interest:

(1) is permissible;

(2) does not by itself cause a person's dissociation as a member or a dissolution and winding up of the limited liability company's activities and affairs; and

(3) subject to Section 504, does not entitle the transferee to:

(A) participate in the management or conduct of the company's activities and affairs; or

(B) except as otherwise provided in subsection (c), have access to records or other information concerning the company's activities and affairs.

(b) A transferee has the right to receive, in accordance with the transfer, distributions to which the transferor would otherwise be entitled.

(c) In a dissolution and winding up of a limited liability company, a transferee is entitled to an account of the company's transactions only from the date of dissolution.

(d) A transferable interest may be evidenced by a certificate of the interest issued by a limited liability company in a record, and, subject to this section, the interest represented by the certificate may be transferred by a transfer of the certificate.

(e) A limited liability company need not give effect to a transferee's rights under this section until the company knows or has notice of the transfer.

(f) A transfer of a transferable interest in violation of a restriction on transfer contained in the operating agreement is ineffective if the intended transferee has knowledge or notice of the restriction at the time of transfer.

(g) Except as otherwise provided in Section 602(5)(B), if a member transfers a transferable interest, the transferor retains the rights of a member other than the transferable interest transferred and retains all the duties and obligations of a member.

(h) If a member transfers a transferable interest to a person that becomes a member with respect to the transferred interest, the transferee is liable for the member's obligations under Sections 403 and 406 known to the transferee when the transferee becomes a member.

Comment

One of the most fundamental characteristics of LLC law is its fidelity to the "pick your partner" principle. *See, e.g., Bynum v. Frisby*, 73 Nev. 145, 149-50, 311 P.2d 972, 975 (1957) (stating that (i) "the assignment of a partnership interest from one partner to a stranger does not bring that stranger into fiduciary relationship with the remaining partners" and (ii) absent consent by the remaining partners "[t]he stranger remains a stranger" with no rights to management or even information).

This section is the core of the act's provisions reflecting and protecting that principle. A member's rights in a limited liability company are bifurcated into economic rights (the transferable interest) and governance rights (including management rights, consent rights, rights to information, rights to seek judicial intervention). Unless the operating agreement otherwise provides, a member acting without the consent of all other members lacks both the power and the right to: (i) bestow membership on a non-member, Section 401(d); or (ii) transfer to a non-member anything other than some or all of the member's transferable interest, Section 502(a)(3). The rights of a mere transferee are quite limited – *i.e.*, to receive distributions, Section 502(b), and, if the LLC dissolves and winds up, to receive specified information pertaining to the LLC from the date of dissolution. Section 502(c).

This section applies regardless of whether the transferor is a member, a transferee of a member, a transferee of a transferee, etc. *See* Section 102(24) (defining "transferable interest" in terms of a right "initially owned by a person in the person's capacity as a member" regardless of "whether or not the person remains a member or continues to own any part of the right").

This section does not directly consider whether a member may transfer governance rights to another member without obtaining consent from all the other members. As noted above, Section 501, cmt., the question is moot under this act's default rule for allocating governance rights.

However, the question can be pivotal when the operating agreement displaces the default rule on governance rights but does not determine whether transfer restrictions (whether contractual, statutory, or both) apply to transfers of governance rights from one member to another. Case law is scant but suggests that this act does not protect members from control shifts that result from transfers among members (as distinguished from transfers to non-members who seek thereby to become members). *Blythe v. Bell*, No. 11 CVS 933. 2012 WL 7807800, at ¶ 6 (N.C. Dist. Dec. 10, 2012) (holding in a case of "first impression in North Carolina" that "in the absence of articles of incorporation or an operating agreement to the contrary . . . the assignment of control (*i.e.*, governance) interests between members is effective without unanimous member consent;" *Achaian, Inc. v. Leemon Family L.L.C.*, 25 A.3d 800, 810 (Del. Ch. 2011) (Strine, Ch.) (holding that the terms of the LLC agreement did not preclude one member of a three-member LLC from transferring the member's entire interest (including governance rights) to a second member without first having the consent of the third member; stating that the third member's "argument relies on a very thinly sliced version of [the "pick-your-partner principle, the strained version being] . . . that once one chooses his initial co-members, one continues to hold a veto over how much additional voting power they may acquire;" explaining that "[t]he problem for [the third member] is that nothing in the LLC Agreement supports [that member's] reading of it that would require an already admitted Member, like [the acquirer – *i.e.*, the second member], to be become once, twice (or even three times) a Member each and every time that Member acquires an additional block of Interests").

Other law may affect the applicability of this section. *See* 11 U.S.C. § 541(c)(1) (providing that, initially at least, all property of a debtor becomes part of the bankruptcy estate regardless of restrictions on transfer); UCC §§ 9-406, 9-408 (overriding specified restrictions on assignment in specified circumstances, regardless of whether state law or a contract imposes the restrictions).

In any event, this section does not apply to the transfer of ownership interests in a member that is an entity.

> EXAMPLE: ABC, LLC has three members: Ralph (an individual), Alice, Inc. ("Alice"), and Norton, LLC ("Norton"). Section 502 applies to any attempt by Ralph, Alice, or Norton to transfer their respective membership interest in ABC. Section 502 is inapplicable, however, to a change in control of Alice or Norton or even a complete change in their respective membership.

Subsection (a)—The definition of "transfer," Section 102(23), and this subsection's reference to "in whole or in part" combine to mean that this section encompasses not only unconditional, permanent, and complete transfers but also temporary, contingent, and partial ones. Thus, for example, a charging order under Section 503 effects a transfer of part of the judgment debtor's transferable interest, as does the pledge of a transferable interest as collateral for a loan and the gift of a life-interest in a member's rights to distribution.

Subsection (a)(2)—The phrase "by itself" contemplates Section 602(5)(B), which creates a risk of dissociation via expulsion when a member transfers all of the member's transferable interest.

Subsection (a)(3)—Mere transferees have no right to participate in management or otherwise intrude as the members carry on the affairs of the limited liability company and their activities as members.

Because Section 102(22)(G) defines "transfer" to include "a transfer by operation of law," this section affects the power of other law to effect transfers of a member's ownership interest. For example, a divorce court lacks the power to award a member's spouse anything beyond the member's transferable interest. Nor does the member have the power to enter into a property settlement purporting to effect any greater transfer.

For the divorce court, the best solution is to value the member's complete ownership interest (*i.e.*, the transferable interest as enhanced by the management and information rights and the standing to sue) and: (i) if possible, award the member's spouse marital property of equal value; or (ii) if not possible, award the member's spouse a money judgment and a charging order to enforce the judgment.

Granting the non-member any part of member's transferable interest is almost always imprudent; marital discord will almost inevitably carry over into the business relationship. Granting the member's ex-spouse the entire transferable interest is rarely a viable alternative. If the member is an active participant in the limited liability company, the approach is impossible. The member's transferable interest will typically constitute much or all of the member's remuneration for the partner's activity. Even if the member is essentially passive, granting the transferable interest to the ex-spouse puts him or her at great risk as a "bare naked assignee." *See* the comment to Section 107(b).

When a member dies, subject to the operating agreement other law may effect a transfer of the member's transferable interest to the member's estate or personal representative. However, for the reasons just stated, other law lacks the power to transfer anything more than a transferable interest. (Section (504) does provide extra information rights for the purposes of settling the estate of the deceased member.)

Subsection (a)(3)(B)—*See* Section 410(g) (providing that that section's information rights do not apply to transferees).

Subsection (b)—Amounts due under this subsection are of course subject to offset for any amount owed to the limited liability company by the member or person dissociated as a member on whose account the distribution is made. Section 404(d). As to whether an LLC may properly offset for claims against a transferor that was never a member is matter for other law, specifically the law of contracts dealing with assignments.

Subsection (c)—This very limited grant of information rights encompasses only transactions occurring at or after the date of the LLC's dissolution. The transferee has only the right to information as to the allocation of net assets among the LLC's creditors, members, and transferees—and only from the date of dissolution.

This subsection does not prevent a transferee from contracting with a member-transferor to require the member-transferor to disclose further information to the transferee. Whether such an agreement would breach the operating agreement, the implied contractual obligation of good faith and fair dealing, Section 409(d), or a fiduciary duty depends on the circumstances.

If a dissolved LLC rescinds its dissolution, Section 703, this subsection no longer applies.

Subsection (d)—The use of certificates can raise issues relating to Articles 8 and 9 of the Uniform Commercial Code.

Subsection (f)—This provision originated as UPA (1997) § 503(e), was then consistent with U.C.C section 9-318(3), and is now consistent with U.C.C section 9-406(a) (stating that "an account debtor . . . may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee").

The term "notice" includes "reason to know," Section 103(b)(1), and ordinarily a potential transferee has reason to inquire about transfer restrictions that might be contained in the operating agreement.

Subsection (g)—Under this subsection, a member remains a member (with all attendant rights and obligations) even after permanently transferring the entirety of the transferable interest, unless: (i) the other members opt for expulsion under Section 602(5)(B); or (ii) as otherwise provided in the operating agreement.

SECTION 503. CHARGING ORDER.

(a) On application by a judgment creditor of a member or transferee, a court may enter a charging order against the transferable interest of the judgment debtor for the unsatisfied amount of the judgment. Except as otherwise provided in subsection (f), a charging order constitutes a lien on a judgment debtor's transferable interest and requires the limited liability company to pay over to the person to which the charging order was issued any distribution that otherwise would be paid to the judgment debtor.

(b) To the extent necessary to effectuate the collection of distributions pursuant to a charging order in effect under subsection (a), the court may:

(1) appoint a receiver of the distributions subject to the charging order, with the power to make all inquiries the judgment debtor might have made; and

(2) make all other orders necessary to give effect to the charging order.

(c) Upon a showing that distributions under a charging order will not pay the judgment debt within a reasonable time, the court may foreclose the lien and order the sale of the transferable interest. Except as otherwise provided in subsection (f), the purchaser at the foreclosure sale obtains only the transferable interest, does not thereby become a member, and is subject to Section 502.

(d) At any time before foreclosure under subsection (c), the member or transferee whose transferable interest is subject to a charging order under subsection (a) may extinguish the charging order by satisfying the judgment and filing a certified copy of the satisfaction with the court that issued the charging order.

(e) At any time before foreclosure under subsection (c), a limited liability company or one or more members whose transferable interests are not subject to the charging order may pay to the judgment creditor the full amount due under the judgment and thereby succeed to the rights of the judgment creditor, including the charging order.

(f) If a court orders foreclosure of a charging order lien against the sole member of a limited liability company:

(1) the court shall confirm the sale;

(2) the purchaser at the sale obtains the member's entire interest, not only the member's transferable interest;

(3) the purchaser thereby becomes a member; and

(4) the person whose interest was subject to the foreclosed charging order is dissociated as a member.

(g) This [act] does not deprive any member or transferee of the benefit of any exemption law applicable to the transferable interest of the member or transferee.

(h) This section provides the exclusive remedy by which a person seeking in the capacity of judgment creditor to enforce a judgment against a member or transferee may satisfy the judgment from the judgment debtor's transferable interest.

Comment

The charging order concept dates back to the English Partnership Act of 1890 and in the United States has been a fundamental part of law of unincorporated business organizations since 1914. *See* UPA (1914) § 28. As much a remedy limitation as a remedy, the charging order is the sole method by which a person acting as judgment creditor of a member or transferee can extract value from the member's or transferee's ownership interest in a limited liability company. *See* the comment to Subsection (h).

Under this section, the judgment creditor of a member or transferee is entitled to a charging order against the relevant transferable interest. While in effect, that order entitles the judgment creditor to whatever distributions would otherwise be due to the member or transferee whose interest is subject to the order. However, the judgment creditor has no say in the timing or amount of those distributions. The charging order does not entitle the judgment creditor to accelerate any distributions or to otherwise interfere with the management and activities of the limited liability company.

By its terms, this section does not apply to foreign limited liability companies. *See* Section 102(8) (defining "[l]imited liability company" to mean "an entity *formed under this [act] or which becomes subject to this [act]*") (emphasis added); *see also Fannie Mae v. Heather Apartments Ltd. P'ship*, A13-0562, 2013 WL 6223564, at *6 (Minn. Ct. App. Dec. 2, 2013) (considering the remedies available to a judgment creditor with respect to the judgment debtor's interest in a Cook Islands LLC; rejecting the debtor's argument that the creditor's "only remedy is to obtain a charging order under" [the Minnesota LLC statute]; explaining that "this argument fails because that statute only applies to Minnesota limited liability companies" which that statute "defines . . . as 'a limited liability company, other than a foreign limited liability company, *organized or governed by this chapter*'") (emphasis added) (statutory citations omitted).

The operating agreement has no power to alter the provisions of this section to the prejudice of third parties. Section 105(c)(15).

Subsection (a)—The phrase "judgment debtor" encompasses both members and transferees. The lien pertains only to a distribution, which excludes "amounts constituting reasonable compensation for present or past service or payments made in the ordinary course of business under a bona fide retirement plan or other bona fide benefits program." Section 102(4)(B). A judgment creditor that wishes to levy on such amounts should use the appropriate creditor's remedy, such as garnishment (which may be subject to exemptions or exclusions not relevant to a charging order). *Cf. PB Real Estate, Inc. v. Dem II Props.*, 719 A.2d 73, 76 (Conn. 1998) (rejecting the contention of an LLC's two members that "payments of $28,000 to each of them" should be treated "as expenses for wages" rather than as distributions).

Whether an application for a charging order must be served on the limited liability company, the judgment debtor, or both is a matter for other law, principally the law of remedies and civil procedure. The order itself must be served on the limited liability company. Whether the order must also be served on the judgment debtor is a matter for other law.

If a distribution consists of rights to acquire interests in a limited liability company, the charging order applies only to those rights within the definition of transferable interest. *See* Section 102(24) (defining transferable interest).

Subsection (b)—Paragraph (2) refers to "other orders" rather than "additional orders." Therefore, given appropriate circumstances, a court may invoke Paragraph (1), Paragraph (2), or both.

Subsection (b)(1)—The receiver contemplated here is emphatically not a receiver for the limited liability company, but rather a receiver for the distributions subject to the charging order. The principal advantage provided by this paragraph is an expanded right to information. However, that right goes no further than "the extent necessary to effectuate the collections of distributions pursuant to a charging order." For a correctly narrow reading of this provision, see *Wells Fargo Bank, Nat. Ass'n v. Continuous Control Solutions, Inc.*, No. 11-1285, 2012 WL 3195759 (Iowa Ct. App. Aug. 8, 2012).

Subsection (b)(2)—This paragraph must be understood in the context of: (i) the very limited nature of the charging order; and (ii) the importance of preventing overreaching on behalf of a person that is not a judgment creditor of the LLC, has no claim on the LLC's assets, and has no right to interfere in the activities, affairs, and management of the LLC. In particular, the court's power to make "all other orders" is limited to "orders necessary to give effect to the charging order."

> EXAMPLE: A judgment creditor with a charging order believes that the limited liability company should invest less of its surplus in operations, leaving more funds for distributions. The creditor moves the court for an order directing the limited liability company to restrict re-investment. Subsection (b)(2) does not authorize the court to grant the motion.

> EXAMPLE: A judgment creditor with a judgment for $10,000 against a member obtains a charging order against the member's transferable interest. Having been properly served with the order, the limited liability company nonetheless fails to comply and makes a $3000 distribution to the member. The court has the power to order the limited liability company to pay $3000 to the judgment creditor to "give effect to the charging order."

Under Subsection (b)(2), the court has the power to decide whether a particular payment is a distribution, because that decision determines whether the payment is part of a transferable interest subject to a charging order.

> EXAMPLE: Member A of ABC, LLC has for some years received distributions form the LLC. However, when a judgment creditor of Member A obtains a charging order against Member A's transferable interest, the LLC ceases to make distributions to Member A and instead provides a salary to Member A equivalent to former distributions. A court might deem this salary a disguised distribution. (In any event, however, the salary will be

subject to garnishment.)

This act has no specific rules for determining the fate or effect of a charging order when the limited liability company undergoes a merger, conversion, interest exchange, or domestication under [Article] 10. In the proper circumstances, such an organic change might trigger an order under Subsection (b)(2).

Subsection (c)—The phrase "that distributions under the charging order will not pay the judgment debt within a reasonable period of time" comes from case law. *See, e.g.*, *Stewart v. Lanier Park Med. Office Bldg.*, Ltd., 578 S.E.2d 572, 574 (Ga. Ct. App. 2003) ("Judicial sale may be appropriate where . . . it is apparent that distributions under the charging order will not pay the judgment debt within a reasonable amount of time."); *Nigri v. Lotz*, 453 S.E.2d 780, 783 (Ga. Ct. App. 1995).). A purchaser at a foreclosure sale obtains only the very limited rights of a transferee under Section 502 and is in some ways more vulnerable and less powerful than the holder of a charging order. After foreclosure and sale, Subsection (b) no longer applies. More generally, the court is no longer involved in the matter. For the vulnerability of a transferee, see Section 107(b), comment.

Subsection (d)—This provision allows the judgment debtor to end the charging order without need for a hearing.

Subsection (e)—Traditionally, charging order provisions referred to the possibility of "redeeming" an interest subject to a charging order. That usage was confusing, leaving several important questions unanswered. This act substitutes a far simpler approach, contemplating the limited partnership or its members buying the underlying judgment and thereby dispensing with any interference the judgment creditor might seek to inflict on the partnership.

In many circumstances, buying the judgment is superior to the mechanism provided by this subsection, because: (i) this subsection requires full satisfaction of the underlying judgment; and (ii) the LLC or the other members might be able to buy the judgment for less than face value. On the other hand, this subsection operates without need for the judgment creditor's consent, so it remains a valuable protection in the event a judgment creditor seeks to do mischief to the LLC.

Whether a member-managed LLC's decision to invoke this subsection is "ordinary course" or "outside the ordinary course," Section 407(b)(3) and (4)(A), depends on the circumstances. However, the involvement of this subsection does not by itself make the decision "outside the ordinary course." For a manager-managed LLC, the distinction is irrelevant. Section 407(c)(1).

Subsection (f)—The charging order remedy—and, more particularly, the exclusiveness of the remedy—protect the "pick your partner" principle. That principle is inapposite when a limited liability company has only one member. The exclusivity of the charging order remedy was never intended to protect a judgment debtor, but rather only to protect the interests of the judgment debtor's co-owners.

Put another way, the charging order remedy was never intended as an "asset protection" device for judgment debtors. *See Olmstead v. F.T.C.*, 44 So. 3d 76, 83 (Fla. 2010) (recognizing "the full scope of a judgment creditor's rights with respect to a judgment debtor's freely alienable membership interest in a single-member LLC"); *In re Albright*, 291 B.R. 538, 540 (Bankr. D. Colo. 2003) (holding that, "[b]ecause there are no other members in the LLC, . . . the Debtor's bankruptcy filing effectively assigned her entire membership interest in the LLC to the bankruptcy estate, and the Trustee obtained all her rights, including the right to control the management of the LLC"). Accordingly, when a charging order against an LLC's sole member is foreclosed, the member's entire ownership interest is sold and the buyer replaces the judgment debtor as the LLC's sole member.

This subsection was added during the Harmonization Project but not for the purposes of harmonization. The subsection addresses an issue that does not exist with partnerships; neither a general nor a limited partnership can continue perpetually in existence with only one partner. *See* ULPA (2001) (Last Amended 2013) § 801(a)(5) (stating that dissolution is caused upon "the passage of 90 consecutive days during which the partnership has only one partner"); UPA (1997) (Last Amended 2013) § 801(6) (stating that dissolution is caused upon "the passage of 90 consecutive days during which the partnership does not have at least two partners").

Subsection (g)—This subsection preserves otherwise applicable exemptions but does not create any. *In re Foos*, 405 B.R. 604, 609 (Bankr. N.D. Ohio 2009) (interpreting the comparable provision in UPA (1997) and stating, "it is clear that [the provision] does not create an exemption").

Subsection (h)—This subsection does not override Uniform Commercial Code, Article 9, which may provide different remedies for a secured creditor acting in that capacity. A secured creditor with a judgment might decide to proceed under Article 9 alone, under this section alone, or under both Article 9 and this section. In the last-mentioned circumstance, the constraints of this section would apply to the charging order but not to the Article 9 remedies.

This subsection is not intended to prevent a court from effecting a "reverse pierce" where appropriate. In a reverse pierce, the court conflates the entity and its owner to hold the entity liable for a debt of the owner. *Litchfield Asset Mgmt. Corp. v. Howell*, 799 A.2d 298, 312 (Conn. App. Ct. 2002) (approving a reverse pierce where a judgment debtor had established a limited liability company in a patent attempt to frustrate the judgment creditor), *overruled on other grounds by*, *Robinson v. Coughlin*, 830 A.2d 1114 (Conn. 2003). Likewise, this subsection does not supplant fraudulent transfer law.

SECTION 504. POWER OF LEGAL REPRESENTATIVE OF DECEASED MEMBER. If a member dies, the deceased member's legal representative may exercise:

(1) the rights of a transferee provided in Section 502(c); and

(2) for the purposes of settling the estate, the rights the deceased member had under Section 410.

Comment

The estate and those claiming through the estate are transferees, and as such they have very limited rights to information. This section provides temporary, additional information rights to the legal representative of the estate. Sections 410 and 502(c) pertain only to information rights.

[ARTICLE] 6

DISSOCIATION

SECTION 601. POWER TO DISSOCIATE AS MEMBER; WRONGFUL DISSOCIATION.

(a) A person has the power to dissociate as a member at any time, rightfully or wrongfully, by withdrawing as a member by express will under Section 602(1).

(b) A person's dissociation as a member is wrongful only if the dissociation:

(1) is in breach of an express provision of the operating agreement; or

(2) occurs before the completion of the winding up of the limited liability company and:

(A) the person withdraws as a member by express will;

(B) the person is expelled as a member by judicial order under Section 602(6);

(C) the person is dissociated under Section 602(8); or

(D) in the case of a person that is not a trust other than a business trust, an estate, or an individual, the person is expelled or otherwise dissociated as a member because it willfully dissolved or terminated.

(c) A person that wrongfully dissociates as a member is liable to the limited liability company and, subject to Section 801, to the other members for damages caused by the dissociation. The liability is in addition to any debt, obligation, or other liability of the member to the company or the other members.

Comment

This article deals with the dissociation of a person as a member. Article 7 deals with the dissolution of a limited liability company.

Subsection (a)—The operating agreement can vary this provision, even to the extent of negating a member's power to dissociate. Doing so, however, is fundamentally at odds with the concept of a limited liability company as a creature of contract. *See* the comment to Section 105 (Role and Inevitability of Operating Agreement). Only in exceptional circumstances does a party to a contract lack the power to breach, and courts will not enjoin a person to remain in an ongoing contractual relationship that involves trust and confidence. E. ALLAN FARNSWORTH, CONTRACTS § 12.7, at 781 (3d ed. 1999) ("A court will not grant specific performance of a contract to provide a service that is personal in nature. This refusal . . . is based [in part] of the undesirability of compelling the continuance of personal relations after disputes have arisen and confidence and loyalty have been shaken and the undesirability, in some instances, of imposing what might seem like involuntary servitude.") (footnote omitted). Moreover, eliminating or even substantially restricting a member's power to dissociate may have dreadful practical consequences.

Subsection (b)—This subsection list exhaustively ("only if") the dissociations that are "wrongful," but the list is a default rule. The operating agreement can expand the list; *e.g.*, by making wrongful a dissociation that beaches the implied contractual covenant of good faith and fair dealing. In theory, the operating agreement can provide for liquidated damages (subject to the requirements of contract law) and, in theory, can also contract or even eliminate the list of wrongful dissociations.

Subsection (b)(1)—The reference to "an express provision of the operating agreement" means that a person's dissociation as a member in breach of the obligation of good faith and fair dealing is not wrongful dissociation for the purposes of this section. The breach might be actionable on other grounds.

Subsection (b)(2)(C)—This subsection refers to Section 602(8), which involves *inter alia* dissociation on account of bankruptcy, which in turn is subject to bankruptcy law. *See, e.g.,* 11 U.S.C.A. § 365(e) (invalidating "ipso facto" clauses, subject to some exceptions).

Subsection (c)—A person who prematurely dissociates as a member risks liability for any resulting damages. For example, the limited liability company might incur substantial expenses in replacing the member's expertise, reputation, or creditworthiness.

In effect, this subsection equates wrongful dissociation with breach of contract. Accordingly, courts should look to contract law to determine what consequential damages are recoverable. *See Hadley v. Baxendale*, 9 Exch. 341 (1854); RESTATEMENT (SECOND) OF CONTRACTS § 351 (1981); *see also Williams v. Hildebrand*, 247 S.W.2d 356, 358 (Ark. 1952) (interpreting UPA (1914) § 38(2)(a)(II), pertaining to wrongful dissolution, and stating that "the measure of damages, when the partnership was to have continued for a fixed term, is the profits that the injured partner would have received").

SECTION 602. EVENTS CAUSING DISSOCIATION. A person is dissociated as a member when:

(1) the limited liability company knows or has notice of the person's express will to withdraw as a member, but, if the person has specified a withdrawal date later than the date the company knew or had notice, on that later date;

(2) an event stated in the operating agreement as causing the person's dissociation occurs;

(3) the person's entire interest is transferred in a foreclosure sale under Section 503(f);

(4) the person is expelled as a member pursuant to the operating agreement;

(5) the person is expelled as a member by the affirmative vote or consent of all the other members if:

(A) it is unlawful to carry on the limited liability company's activities and affairs with the person as a member;

(B) there has been a transfer of all the person's transferable interest in the company, other than:

(i) a transfer for security purposes; or

(ii) a charging order in effect under Section 503 which has not been foreclosed;

(C) the person is an entity and:

(i) the company notifies the person that it will be expelled as a member because the person has filed a statement of dissolution or the equivalent, the person has been administratively dissolved, the person's charter or the equivalent has been revoked, or the person's right to conduct business has been suspended by the person's jurisdiction of formation; and

(ii) not later than 90 days after the notification, the statement of dissolution or the equivalent has not been withdrawn, rescinded, or revoked, the person has not been reinstated, or the person's charter or the equivalent or right to conduct business has not been reinstated; or

(D) the person is an unincorporated entity that has been dissolved and whose activities and affairs are being wound up;

(6) on application by the limited liability company or a member in a direct action under Section 801, the person is expelled as a member by judicial order because the person:

(A) has engaged or is engaging in wrongful conduct that has affected adversely and materially, or will affect adversely and materially, the company's activities and affairs;

(B) has committed willfully or persistently, or is committing willfully or persistently, a material breach of the operating agreement or a duty or obligation under Section 409; or

(C) has engaged or is engaging in conduct relating to the company's activities and affairs which makes it not reasonably practicable to carry on the activities and affairs with the person as a member;

(7) in the case of an individual:

(A) the individual dies; or

(B) in a member-managed limited liability company:

(i) a guardian or general conservator for the individual is appointed; or

(ii) a court orders that the individual has otherwise become incapable of performing the individual's duties as a member under this [act] or the operating agreement;

(8) in a member-managed limited liability company, the person:

(A) becomes a debtor in bankruptcy;

(B) signs an assignment for the benefit of creditors; or

(C) seeks, consents to, or acquiesces in the appointment of a trustee, receiver, or liquidator of the person or of all or substantially all the person's property;

(9) in the case of a person that is a testamentary or inter vivos trust or is acting as a member by virtue of being a trustee of such a trust, the trust's entire transferable interest in the limited liability company is distributed;

(10) in the case of a person that is an estate or is acting as a member by virtue of being a personal representative of an estate, the estate's entire transferable interest in the limited liability company is distributed;

(11) in the case of a person that is not an individual, the existence of the person terminates;

(12) the limited liability company participates in a merger under [Article] 10 and:

(A) the company is not the surviving entity; or

(B) otherwise as a result of the merger, the person ceases to be a member;

(13) the limited liability company participates in an interest exchange under [Article] 10 and, as a result of the interest exchange, the person ceases to be a member;

(14) the limited liability company participates in a conversion under [Article] 10;

(15) the limited liability company participates in a domestication under [Article] 10 and, as a result of the domestication, the person ceases to be a member; or

(16) the limited liability company dissolves and completes winding up.

Comment

This section mostly states default rules, which the operating agreement may vary. However, it would make no sense to vary some of the rules – *e.g.,* to provide that the death of a member who is an individual does not cause the individual's dissociation as a member, Paragraph (7)(A), or that an entity remains a member even *after* the existence of the person has terminated. Paragraph (11).

Paragraph (1)—Operating agreements often require notice of dissociation to be in writing and to specify the effective date of the dissociation.

Paragraph (3)—The cited section pertains to a charging order against the transferable interest of the sole member of a limited liability company.

Paragraph (4)—Many operating agreements provide for "no cause" expulsion, and courts considering such provisions will likely look to cases addressing the issue in the context of partnerships. In that context, courts have taken somewhat different approaches. *Compare Gelder Med. Grp. v. Webber*, 363 N.E.2d 573, 576 (N.Y. 1977), *with Winston & Strawn v. Nosal*, 664 N.E.2d 239, 245 (Ill. App. Ct. 1996). *See also* the comment to Section 409(d) (stating and explaining the implied contractual covenant of good faith and fair dealing).

Paragraph (5)(B)—This paragraph permits expulsion when a member no longer has any "skin in the game." Under this paragraph (unless the operating agreement provides otherwise), a member's transferee can protect itself from the vulnerability of "bare naked assignee" status, Section 107(b), cmt., by obligating the member/transferor to retain a one-percent interest and exercise the member's governance rights (including the right to bring a derivative suit) to protect the transferee's interests.

Paragraph (6)—The reference to "a direct action under Section 801(b)" reflects the "separate entity" nature of a limited liability company. Section 801(b) limits a member's standing to bring a direct action to circumstances in which the member can "plead and prove an actual or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the limited liability company." For example, a member might invoke Paragraph (6)(B) if another member's breach of the operating agreement harmed the first member directly. If a member has suffered only indirect harm, the Paragraph (6)(B) claim belongs to the LLC and not the member. If the LLC fails to bring suit, the member may assert the claim derivatively. *See* Sections 802–06.

Although the operating agreement can revise or eliminate the possibility of judicial expulsion, doing so requires careful planning. *Cf. Huatuco v. Satellite Healthcare*, CV 8465-VCG, 2013 WL 6460898, at *1, n.2 (Del. Ch. Dec. 9, 2013) (stating that "the right to judicial dissolution is a default right which the parties may eschew by contract" while reserving the question of "[w]hether the parties may, by contract, divest this Court of its authority to order a dissolution in all circumstances, even where it appears manifest that equity so requires—leaving, for instance, irreconcilable members locked away together forever like some alternative entity version of Sartre's Huis Clos").

For examples of conduct warranting an expulsion order, see *All Saints Univ. of Med. Aruba v. Chilana*, A-2628-09T1, 2012 WL 6652510 (N.J. Super. Ct. App. Div. Dec. 24, 2012) (discussing a pattern of conduct); *Sherwood Park Bus. Ctr., L.L.C. v. Taggart*, 323 P.3d 551, 561 (Or. Ct. App. 2014) (upholding expulsion of a member who "had stolen a large amount of money from [the limited liability company], had intentionally failed to provide financial information, and had made himself unavailable to carry on the business"); *CCD, L.C. v. Millsap,* 116 P.3d 366, 373 (Utah 2005) (holding that a member's "misappropriat[ion of] trust account funds totaling at least $11,540.06 for his personal use" warranted expulsion, where the member's "misconduct continued the pattern of behavior that [had previously] resulted in losses to the company of $625,000[, where the new misconduct] . . . took place after [the member's] prior wrongdoing had been discovered and after [the limited liability company] had assented to permit [the member] to atone for his misdeeds by fulfilling the terms of the amended operating agreement").

For an analysis that helps distinguish Paragraph (6)(C) from Paragraphs (6)(A) and (B), see *All Saints Univ. of Med. Aruba v. Chilana*, A-2628-09T1, 2012 WL 6652510, at *15 (N.J. Super. Ct. App. Div. Dec. 24, 2012) (interpreting predecessor law and noting that the "not reasonably practicable standard" does not require a showing of wrongful conduct). *Cf. Dunnagan v. Watson*, 204 S.W.3d 30, 40 (Tex. Ct. App. 2006) (same issue in the context of dissolution). Where grounds exist for both dissociation and dissolution, a court has the discretion to choose between the alternatives. *Robertson v. Jacobs Cattle Co.*, 830 N.W.2d 191, 201–02 (Neb. 2013) (discussing analogous provisions of UPA (1997)). "[T]here is no textual basis for imposing a higher burden of proof for dissociation than dissolution." *Brennan v. Brennan Assocs.*, 977 A.2d 107, 121 (Conn. 2009) (general partnership).

Paragraph (6)(C)—This provision has an analog among the causes for dissolution. *See* Section 701(a)(4)(B).

Paragraph (7)(B)—This provision does not apply to a manager-managed limited liability company because, given the limited rights of non-manager members, the stated occurrences do not necessarily justify dissociation. For a parallel provision approach under the uniform limited partnership act, see ULPA §§ 601(b)(6) (2001) (Last Amended 2013) (limited partner), 603(6)(B) and (C) (general partner). As for the effect of the stated occurrences on a person's role as a manager, see Section 407(c)(4) (permitting the removal of a manager "at any time by the affirmative vote or consent of a majority of the members without notice or cause").

Paragraph 8(A)—This provision is subject to bankruptcy law. *See, e.g.,* 11 U.S.C.A. § 365(e) (invalidating "ipso facto" clauses, subject to some exceptions).

Paragraphs (9) and (10)—A change in trustee or personal representation does not cause dissociation.

Paragraph (11)—This provision is the entity analog to Paragraph (7)(A) (death of an individual). Although in theory the operating agreement could change this rule, doing so would be nonsensical. *See* the comment to Section 703(a) (noting that a terminated limited liability company cannot rescind its dissolution because "a 'dead' entity lacks both the capacity and power to bring itself back from the dead").

Paragraph (12)(A)—If a limited liability company disappears as part of a merger, no person can continue as a member of the company. When the merger takes effect, the members of the disappearing company are perforce dissociated. Depending on the plan of merger, those persons may become members of a surviving limited liability company. In those circumstances, the merger will have dissociated them from one LLC and admitted them into membership in the surviving LLC. *See* Sections 401(c)(2), 1026(c)(10).

Paragraph (12)(B)—It is possible for a plan of merger to "shuffle the equity" of the surviving entity, even to the extent of "taking out" some or all of the owners of the surviving entity. A reverse triangular merger involving a limited liability company as the surviving entity would dissociate all the members of the LLC.

Paragraph (14)—By definition, a limited liability company that converts ceases to be a limited liability company. *See* Section 1046. Thus, when the plan of conversion takes effect, all the members of the converted entity are dissociated from that entity. In many cases, those persons will all be owners of the converted entity. In some cases, the conversion will "shuffle the equity" and "take out" some of the members of the converting LLC.

Paragraph (15)—Domestication does not by itself dissociate a member, because the domesticated entity remains both a limited liability company and "the same entity without interruption as the domesticating company." Section 1056(a)(1)(B). However, an "equity shuffle" could dissociate a member.

SECTION 603. EFFECT OF DISSOCIATION.

(a) If a person is dissociated as a member:

(1) the person's right to participate as a member in the management and conduct of the limited liability company's activities and affairs terminates;

(2) the person's duties and obligations under Section 409 as a member end with regard to matters arising and events occurring after the person's dissociation; and

(3) subject to Section 504 and [Article] 10, any transferable interest owned by the person in the person's capacity as a member immediately before dissociation is owned by the person solely as a transferee.

(b) A person's dissociation as a member does not of itself discharge the person from any debt, obligation, or other liability to the limited liability company or the other members which the person incurred while a member.

Comment

Subsection (a)—This provision makes no reference to power-to-bind matters, because the act provides that a member *qua* member has no power to bind the LLC. Section 301.

Subsection (a)(2)—This provision establishes a dividing line, separating out "matters arising and events occurring after the person's dissociation." If the limited liability company has continuing projects with clients, ongoing relationships with clients, or both, the dividing line requires special attention with regard to non-competition and partnership opportunities duties. *See* Section 409(b)(1), (3).

Disputes involving law firms have generated much of the relevant case law. *See, e.g.*, *Jewel v. Boxer*, 156 Cal. App. 3d 171, 175 (Cal. Ct. App. 1984); *Meehan v. Shaughnessy*, 535

N.E.2d 1255, 1257 (Mass. 1989). To a large extent, a well-drawn operating agreement can delineate the parties' respective rights and responsibilities and thereby avoid problems. However, if the company becomes insolvent, the bankruptcy court may well scrutinize the members' *inter se* arrangements. *See Geron v. Robinson & Cole L.L.P.*, 476 B.R. 732, 743 (S.D.N.Y. 2012) (considering whether a law firm had "fraudulently transferred . . . assets when its partners adopted the Jewel Waiver [releasing rights recognized by *Jewel v. Boxer*] on the eve of dissolution without consideration").

This provision applies regardless of whether the limited liability company is member-managed or manager-managed. However, in the latter case, the pre-dissociation duties will be much narrower, because in a manager-managed LLC a member *qua* member has no management duties. Section 409(i)(1). But each member remains subject to the obligation of good faith and fair dealing. Section 409(i)(3).

This provision does not determine the effect of a person's dissociation as a member on the person's future obligations or rights under the operating agreement. Some contractual obligations typically extend beyond dissociation – *e.g.*, non-competition provisions, buyout arrangements. To the extent provisions of the operating agreement continue to apply, the common law obligation of good faith continues to apply as well. *See* the comment to Section 409(d) (explaining that the subsection "invokes the implied obligation that exists in every contract" as a matter of common law).

Subsection (a)(3)—This paragraph accords with Section 404(b)—dissociation does not result in a distribution. In general, when a person dissociates as a member, the person's rights as a member disappear and the person's status degrades to that of a mere transferee—even when the dissociation takes the form of expulsion. *All Saints Univ. of Med. Aruba v. Chilana*, A-2628-09T1, 2012 WL 6652510, at *12 (N.J. Super. Ct. App. Div. Dec. 24, 2012).

Like most *inter se* rules in this act, this one is subject to the operating agreement. For example, the operating agreement has the power to provide for the buyout of a person's transferable interest in connection with the person's dissociation.

Section 504 provides additional information rights when an individual's death has caused dissociation. Article 10 covers organic transactions such as mergers and conversions.

Subsection (b)—In a member-managed limited liability company, a member's obligation to safeguard trade secrets and other confidential or proprietary information is incurred when the member learns or otherwise obtains the information. This subsection preserves the obligation post-dissociation. (In a manager-managed LLC, any obligations of a non-manager member viz–a–viz proprietary information would be a matter for the operating agreement, the obligation of good faith and fair dealing, or other law.)

[ARTICLE] 7

DISSOLUTION AND WINDING UP

SECTION 701. EVENTS CAUSING DISSOLUTION.

(a) A limited liability company is dissolved, and its activities and affairs must be wound up, upon the occurrence of any of the following:

(1) an event or circumstance that the operating agreement states causes dissolution;

(2) the affirmative vote or consent of all the members;

(3) the passage of 90 consecutive days during which the company has no members unless before the end of the period:

(A) consent to admit at least one specified person as a member is given by transferees owning the rights to receive a majority of distributions as transferees at the time the consent is to be effective; and

(B) at least one person becomes a member in accordance with the consent;

(4) on application by a member, the entry by [the appropriate court] of an order dissolving the company on the grounds that:

(A) the conduct of all or substantially all the company's activities and affairs is unlawful;

(B) it is not reasonably practicable to carry on the company's activities and affairs in conformity with the certificate of organization and the operating agreement; or

(C) the managers or those members in control of the company:

(i) have acted, are acting, or will act in a manner that is illegal or fraudulent; or

(ii) have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant; or

(5) the signing and filing of a statement of administrative dissolution by the [Secretary of State] under Section 708.

(b) In a proceeding brought under subsection (a)(4)(C), the court may order a remedy other than dissolution.

Comment

"Dissolution" has been a term of art in the law of unincorporated business organizations since at least the time of Roman law. JOSEPH STORY, COMMENTARIES ON THE LAW OF PARTNERSHIP § 266, at 408 (2d ed. 1850) ("The Roman law . . . declared, that partnership might be dissolved in various ways . . . ."). Dissolution does not end a limited liability company's existence but rather changes the purpose of that existence: "A dissolved limited liability company shall wind up its activities and affairs and . . . the company continues after dissolution only for the purpose of winding up." Section 702(a). The company may, but need not, filed a statement of dissolution. Section 702(b)(2)(A). The limited liability company terminates when winding up is complete. The company may, but need not, file a statement of termination. Section 702(b)(2)(F).

Except for Paragraphs (a)(4) and (5), this section comprises default rules. Paragraph 5 is fully mandatory, Section 105(c)(3)(B); Paragraph 4 is mandatory only with regard to the stated grounds for dissolution. *See* the comment to Section 105(c)(9). Moreover, an operating agreement can provide additional causes of dissolution. *See* Subsection (a)(1). Variations to the statutory causes of dissolution are commonplace.

Section 703 permits rescission of dissolution in some circumstances. In some circumstances, an amendment to the operating agreement might avert dissolution (*e.g.*, by revising an agreed-upon deadline for selling the LLC's assets and winding up the business). A retroactive amendment may also be possible. *See Kindred Ltd. P'ship v. Screen Actors Guild, Inc.*, CV082220PSGPJWX, 2009 WL 279080, at *5–6 (C.D. Cal. Feb. 3, 2009) (giving effect to an amendment that retroactively eliminated an event of dissolution; noting that UPA (1997) § 802(b) permitted a partnership to rescind dissolution).

Subsection (a)(4)—The operating agreement cannot vary the causes of dissolution stated in this provision. However, the operating agreement may contain a forum selection clause or change the forum from "the appropriate court" to binding arbitration. Section 105(c)(9), cmt.

As to whether the court of another jurisdiction can properly order dissolution of a limited liability company formed under this act, the majority rule is clearly no. "[T]he courts of several states have held that jurisdiction to dissolve a corporation rests only in the courts of the state of incorporation." *In re Blixseth*, 484 B.R. 360, 370 (B.A.P. 9th Cir. 2012) (citing cases, including a case involving an LLC). *But see In re Mercantile Guar. Co.*, 238 Cal. App. 2d 426, 430–33 (Cal. Ct. App. 1965) (explaining that "[w]e are . . . required to determine whether the courts of a state in which a foreign corporation has done business and in which its assets are there located have jurisdiction to wind up its affairs, even though the corporation was organized in another state," stating that "the question is not one of jurisdiction or power in the court of the state which is not the legal domicile of a foreign corporation, but it is a question . . . of the balance of convenience, of whether considerations of public policy, efficiency, expedience and justice to all parties interested demand that jurisdiction be retained in the foreign court, or that it be declined under the rule of forum *non conveniens*," and holding that "[t]he circumstances of the case at bench require a holding that the California courts assume jurisdiction of the winding up of [a Delaware corporation's] affairs preparatory to a dissolution").

Subsection (a)(4)(B)—The standard stated here is conventional, deriving originally from the law of limited partnerships. *See, e.g.*, *Kirksey v. Grohmann*, 754 N.W.2d 825, 828–30 (S.D 2008) (discussing cases and noting that "cases interpreting language similar to our statutory terminology, whether involving a partnership or a limited liability company, are instructive"). For discussion of the meaning of the standard, see *Venture Sales, L.L.C. v. Perkins*, 86 So. 3d 910, 914–15 (Miss. 2012) (discussing cases); *In re 1545 Ocean Ave., LLC*, 72 A.D.3d 121, 129–30 (N.Y. 2010) (same).

The court-ordered expulsion of a miscreant member can negate a claim for dissolution. *Dunbar Grp., LLC v. Tignor*, 267 Va. 361, 367-68, 593 S.E.2d 216, 219 (2004) ("Although Tignor's actions in [the] capacities [of member and manager of Xpert] had created numerous problems in the operation of Xpert, his expulsion as a member changed his role from one of an active participant in the management of Xpert to the more passive role of an investor in the company. The record fails to show that after this change in the daily management of Xpert, it would not be reasonably practicable for Xpert to carry on its business pursuant to its operating authority.").

However, where grounds exist for both dissociation and dissolution, a court has the discretion to choose between the alternatives. *Robertson v. Jacobs Cattle Co.*, 830 N.W.2d 191 201–02 (Neb. 2013). "[T]here is no textual basis for imposing a higher burden of proof for dissociation than dissolution." *Brennan v. Brennan Assocs.*, 977 A.2d 107, 121 (Conn. 2009) (general partnership).

This provision has an analog among the grounds for dissociation. *See* Section 602(6)(c).

Subsection (a)(4)(C)—The provision's reference to "those members in control of the company" implies that such members have a duty to avoid acting oppressively toward fellow members.

The act does not define "oppressively," but "oppression" is a concept well-grounded in the law of close corporations. *See, e.g.*, *Kiriakides v. Atlas Food Sys. & Servs., Inc.*, 541 S.E.2d 257, 264–66 (S.C. 2001); Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 69, 70 (1993) (referring to then "evolving cause of action of shareholder oppression"). In many jurisdictions the concept equates to or at least includes the frustration of the plaintiff's reasonable expectations. *Baur v. Baur Farms, Inc.*, 832 N.W.2d 663, 670 (Iowa 2013) (stating that "perhaps the most widely adopted [approach] links oppression to the frustration of the reasonable expectations of the corporation's shareholders"). (This concept of reasonable expectations is entirely separate from the "fruits of the bargain" and "reasonable expectations" language sometimes used in explaining the implied contractual obligation of good faith and fair dealing.)

Courts have extrapolated close corporation doctrine to unincorporated organizations. *See, e.g.*, *Alloy v. Wills Family Trust*, 944 A.2d 1234, 1262–64 (Md. Ct. Spec. App. 2008) (discussing cases). Indeed many cases simply conflate the two contexts. *E.g. Kohannim v. Katoli*, 08-11-00155-CV, 2013 WL 3943078, at *9 (Tex. Ct. App. July 24, 2013) ("A member oppression claim may exist when: (i) a majority shareholder's conduct substantially defeats the minority's expectations that objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture; or (ii) burdensome, harsh, or wrongful conduct, a lack of probity and fair dealing in the company's affairs to the prejudice of some members, or a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely."); *Pinnacle Data Servs., Inc. v. Gillen*, 104 S.W.3d 188, 196 (Tex. Ct. App. 2003) (explaining oppression of "members" in terms of shareholder oppression).

However, applying close corporation law to limited liability companies requires some caution. Close corporation law developed in part because the standard corporate governance structure exalts majority power and does not presuppose contractual relationships among the shareholders.

In contrast, while an LLC depends on the sovereign for legal existence and the all-important liability shield, LLC governance is fundamentally contractual. Therefore, in most situations, the operating agreement should reflect and comprise members' reasonable expectations. As a result, a court considering a claim of oppression by an LLC member should consider, with regard to each reasonable expectation invoked by the plaintiff, whether the expectation: (i) contradicts any term of the operating agreement or any reasonable implication of any term of that agreement; (ii) was central to the plaintiff's decision to become a member of the limited liability company or for a substantial time has been centrally important in the member's continuing membership; (iii) was known to other members, who expressly or impliedly acquiesced in it; (iv) is consistent with the reasonable expectations of all the members, including expectations pertaining to the plaintiff's conduct; and (v) is otherwise reasonable under the circumstances. *See* the comment to Sections 102(13) ("[T]he definition [of 'operating agreement'] puts no limits on the form of the operating agreement. To the contrary, the definition contains the phrase 'whether oral, implied, in a record, or in any combination thereof.'"), Section 105(a)(4), cmt. (explaining how a written operating agreement, if properly drafted, can provide that amendments must be in writing and signed to be effective).

> EXAMPLE: From its formation, Work-Here, LLC has had three members, been member-managed, involved all three members in company operations, and allocated distributions in part in reference to the members' work for the company. The operating agreement is brief, informal, contains no integration clause, and makes no reference to a member's right to work for the company.
>
> After ten years, two of the members: (i) take a vote; (ii) purport to oust the third member from any continuing role in company operations; and (iii) announce that the third member's distributions will be substantially reduced.
>
> The ousted member has at least three theories of recovery:
>
> - breach of an implied-in-fact term of the operating agreement, under which each member is entitled to work for the company and be compensated for the work;

- violation of Section 407(b)(4)(A) (requiring "[t]he affirmative vote or consent of all the members . . . to . . . undertake an act outside the ordinary course of the activities and affairs of the company"); and
- oppression under Section 701(4)(C)(ii).

On the limited facts stated, these theories are undoubtedly plausible, although of course not necessarily persuasive. *See* Section 409(d) (incorporating "the contractual obligation of good faith and fair dealing").

Subsection (a)(5)—The operating agreement may not vary this provision.

Subsection (b)—In the close corporation context, many courts have reached this position without express statutory authority, most often with regard to court-ordered buyouts of oppressed shareholders. *See, e.g.*, *Kirtz v. Grossman*, 463 S.W.2d 541, 545 (Mo. Ct. App. 1971) (per curiam); *Brenner v. Berkowitz*, 634 A.2d 1019, 1031 (N.J. 1993); *N.D. ex rel. Heitkamp v. Family Life Servs.*, 616 N.W.2d 826, 838 (N.D. 2000); *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387, 394–96 (Or. 1973); *Davis v. Sheerin*, 754 S.W.2d 375, 380 (Tex. Ct. App. 1988). *Contra White v. Perkins*, 189 S.E.2d 315, 320 (Va. 1972).

This subsection saves courts and litigants the trouble of re-inventing that wheel in the LLC context. However, unlike Subsection (a)(4), Subsection (b) can be overridden by the operating agreement. Thus, the members may agree to restrict or eliminate a court's power to craft a lesser remedy, even to the extent of confining the court (and themselves) to the all-or-nothing remedy of dissolution.

SECTION 702. WINDING UP.

(a) A dissolved limited liability company shall wind up its activities and affairs and, except as otherwise provided in Section 703, the company continues after dissolution only for the purpose of winding up.

(b) In winding up its activities and affairs, a limited liability company:

(1) shall discharge the company's debts, obligations, and other liabilities, settle and close the company's activities and affairs, and marshal and distribute the assets of the company; and

(2) may:

(A) deliver to the [Secretary of State] for filing a statement of dissolution stating the name of the company and that the company is dissolved;

(B) preserve the company activities, affairs, and property as a going concern for a reasonable time;

(C) prosecute and defend actions and proceedings, whether civil, criminal, or administrative;

(D) transfer the company's property;

(E) settle disputes by mediation or arbitration;

(F) deliver to the [Secretary of State] for filing a statement of termination stating the name of the company and that the company is terminated; and

(G) perform other acts necessary or appropriate to the winding up.

(c) If a dissolved limited liability company has no members, the legal representative of the last person to have been a member may wind up the activities and affairs of the company. If the person does so, the person has the powers of a sole manager under Section 407(c) and is deemed to be a manager for the purposes of Section 304(a).

(d) If the legal representative under subsection (c) declines or fails to wind up the limited liability company's activities and affairs, a person may be appointed to do so by the consent of transferees owning a majority of the rights to receive distributions as transferees at the time the consent is to be effective. A person appointed under this subsection:

(1) has the powers of a sole manager under Section 407(c) and is deemed to be a manager for the purposes of Section 304(a); and

(2) shall deliver promptly to the [Secretary of State] for filing an amendment to the company's certificate of organization stating:

(A) that the company has no members;

(B) the name and street and mailing addresses of the person; and

(C) that the person has been appointed pursuant to this subsection to wind up the company.

(e) [The appropriate court] may order judicial supervision of the winding up of a dissolved limited liability company, including the appointment of a person to wind up the company's activities and affairs:

(1) on the application of a member, if the applicant establishes good cause;

(2) on the application of a transferee, if:

(A) the company does not have any members;

(B) the legal representative of the last person to have been a member declines or fails to wind up the company's activities; and

(C) within a reasonable time following the dissolution a person has not been appointed pursuant to subsection (c); or

(3) in connection with a proceeding under Section 701(a)(4).

Comment

Under the default rules of this act, dissolution does not change governance arrangements. However, dissolution does change the context for determining, with regard to a member-managed LLC, whether a matter is in or outside "the ordinary course of the activities of the company." Section 407(b)(3), (4).

As for determining the post-dissolution power of a member or manager to bind the LLC, other law, primarily agency law, supplies the rules. Thus, dissolution does not change the applicable source of law for determining actual and apparent authority. Section 301, cmt.

Subsection (a)—*See* the comment to Section 701(a).

Subsection (b)—The particular circumstances determine how long winding up may continue without giving "good cause" for court intervention under Section 702(e). The case law is partnership law and applies by analogy. There is no "hard and fast" rule. *See, e.g.*, *Mathis v. Meyeres*, 574 P.2d 447, 450 (Alaska 1978) (stating that we are aware of [no authority] requiring that deadlines be set in the winding up of a partnership"); *8182 Md. Assocs., Ltd. P'ship v. Sheehan*, 14 S.W.3d 576, 581 (Mo. 2000) ("The Uniform Partnership Law contemplates that dissolved partnerships may continue in business for a short, long or indefinite period of time ….") (quoting *Schoeller v. Schoeller*, 497 S.W.2d 860, 867 (Mo. Ct. App. 1973)).

"Winding up usually entails the time necessary for the partners to finish old business, collect and pay debts, and finally distribute remaining assets to the partners." *Gibson v. Deuth*, 270 N.W.2d 632, 635 (Iowa 1978). "Generally the best interests of the partnership will be served by winding up the partnership affairs as quickly as possible." *Doting v. Trunk*, 259 Mont. 343, 349, 856 P.2d 536, 540 (1993). However, in some circumstances, a long period of winding up is not only appropriate but necessary. *Lebanon Trotting Ass'n v. Battista*, 306 N.E.2d 769, 772 (Ohio Ct. App. 1972) ("[I]f the only means of availing the partners of the benefit of the value of the lease would be to continue to operate under such lease until its expiration, then such operation may continue as part of the winding up of the partnership affairs after dissolution. It is not necessary that a partnership, in the absence of the consent of all the partners, abandon a valuable asset upon dissolution merely because it may have no ready market value, but the value of such asset can continue to inure to the benefit of the partners through the continuation of the partnership after dissolution.")

Subsection (b)(2)(A) and (F)—For the constructive notice effect of a statement of dissolution or termination, see Sections 103(d)(2)(A) and (B) and 302(h).

Subsection (c)—Section 304 provides a shield for managers as well members against automatic, vicarious liability for an LLC's debts, obligations, and other liabilities. Section 407 provides default rules for a manager's actual authority. Some of those rules provide for consent by members. *See* Section 407(c)(3). Those rules are inapposite in the circumstances contemplated by this subsection.

Section 409 does not apply to a person appointed under this section. Such person will inevitably be an agent of the dissolved limited liability company, acting pursuant to a contract. Thus, agency and contract law will determine the person's duties.

Subsection (d)(1)—See the comment to Subsection (c).

Subsection (e)—Section 409 does not apply to a person appointed under this section. The applicable standards of conduct might come from any or all of these sources: the court order, state law pertaining to receiverships, agency law, and contract law.

Subsection (e)(1)—Managers do not have standing under this provision. If a non-member manager has so lost control of the limited liability company as to desire dissolution, the non-manager's remedy is to: (i) seek court enforcement of the relevant provisions of the operating agreement, management agreement, or both; or (ii) resign.

SECTION 703. RESCINDING DISSOLUTION.

(a) A limited liability company may rescind its dissolution, unless a statement of termination applicable to the company has become effective, [the appropriate court] has entered an order under Section 701(a)(4) dissolving the company, or the [Secretary of State] has dissolved the company under Section 708.

(b) Rescinding dissolution under this section requires:

(1) the affirmative vote or consent of each member; and

(2) if the limited liability company has delivered to the [Secretary of State] for filing a statement of dissolution and:

(A) the statement has not become effective, delivery to the [Secretary of State] for filing of a statement of withdrawal under Section 208 applicable to the statement of dissolution; or

(B) if the statement of dissolution has become effective, delivery to the [Secretary of State] for filing of a statement of rescission stating the name of the company and that dissolution has been rescinded under this section.

(c) If a limited liability company rescinds its dissolution:

(1) the company resumes carrying on its activities and affairs as if dissolution had never occurred;

(2) subject to paragraph (3), any liability incurred by the company after the dissolution and before the rescission has becomes effective is determined as if dissolution had never occurred; and

(3) the rights of a third party arising out of conduct in reliance on the dissolution before the third party knew or had notice of the rescission may not be adversely affected.

Comment

The Harmonization Project added this section, which is based on UPA (1997) § 802(b)(1) permitting the partners to "waive the right to have the partnership's business wound up and the partnership terminated" after which "the partnership resumes carrying on its business as if dissolution had never occurred").

Subsection (a)—The first exclusion results inevitably from the effect of a statement of termination (*i.e.*, the limited liability company ceases to exist). A "dead" entity lacks both the capacity and power to bring itself back from the dead.

The second and third exclusions pertain to dissolutions affected by outsiders (*i.e.*, the court and the filing office).

Subsections (b)(1)—The requirement of unanimous consent protects any vested rights of, or reliance by, members. However, the operating agreement may vary this provision.

Subsection (c)(3)—This paragraph protects third parties. *E.g.*, *Neurobehavorial Assocs., P.A. v. Cypress Creek Hosp., Inc.*, 995 S.W.2d 326, 331 (Tex. Ct. App. 1999) ("If the Hospital had the right to terminate the Agreement when it did because the Association was then dissolved, then even though the Association can revoke articles of dissolution and have that relate back to the date of dissolution, it would be grossly unfair to let the Association assert its ex post facto change as a defense. Surely the Association would be estopped from doing so, having created the very conditions that gave the Hospital the correct impression that it was then dissolved.").

SECTION 704. KNOWN CLAIMS AGAINST DISSOLVED LIMITED LIABILITY COMPANY.

(a) Except as otherwise provided in subsection (d), a dissolved limited liability company may give notice of a known claim under subsection (b), which has the effect provided in subsection (c).

(b) A dissolved limited liability company may in a record notify its known claimants of the dissolution. The notice must:

(1) specify the information required to be included in a claim;

(2) state that a claim must be in writing and provide a mailing address to which the claim is to be sent;

(3) state the deadline for receipt of a claim, which may not be less than 120 days after the date the notice is received by the claimant; and

(4) state that the claim will be barred if not received by the deadline.

(c) A claim against a dissolved limited liability company is barred if the requirements of subsection (b) are met and:

(1) the claim is not received by the specified deadline; or

(2) if the claim is timely received but rejected by the company:

(A) the company causes the claimant to receive a notice in a record stating that the claim is rejected and will be barred unless the claimant commences an action against the company to enforce the claim not later than 90 days after the claimant receives the notice; and

(B) the claimant does not commence the required action not later than 90 days after the claimant receives the notice.

(d) This section does not apply to a claim based on an event occurring after the date of dissolution or a liability that on that date is contingent.

Comment

Sections 704 through 706 provide rules under which a dissolved limited liability company may achieve finality with regard to claims.

This section is derived almost verbatim from Model Business Corporation Act section 14.06.

SECTION 705. OTHER CLAIMS AGAINST DISSOLVED LIMITED LIABILITY COMPANY.

(a) A dissolved limited liability company may publish notice of its dissolution and request persons having claims against the company to present them in accordance with the notice.

(b) A notice under subsection (a) must:

(1) be published at least once in a newspaper of general circulation in the [county] in this state in which the dissolved limited liability company's principal office is located or, if the principal office is not located in this state, in the [county] in which the office of the company's registered agent is or was last located;

(2) describe the information required to be contained in a claim, state that the claim must be in writing, and provide a mailing address to which the claim is to be sent; and

(3) state that a claim against the company is barred unless an action to enforce the claim is commenced not later than three years after publication of the notice.

(c) If a dissolved limited liability company publishes a notice in accordance with subsection (b), the claim of each of the following claimants is barred unless the claimant commences an action to enforce the claim against the company not later than three years after the publication date of the notice:

(1) a claimant that did not receive notice in a record under Section 704;

(2) a claimant whose claim was timely sent to the company but not acted on; and

(3) a claimant whose claim is contingent at, or based on an event occurring after, the date of dissolution.

(d) A claim not barred under this section or Section 704 may be enforced:

(1) against a dissolved limited liability company, to the extent of its undistributed assets; and

(2) except as otherwise provided in Section 706, if assets of the company have been distributed after dissolution, against a member or transferee to the extent of that person's proportionate share of the claim or of the company's assets distributed to the member or transferee after dissolution, whichever is less, but a person's total liability for all claims under this paragraph may not exceed the total amount of assets distributed to the person after dissolution.

Comment

This section is derived almost verbatim from Model Business Corporation Act section 14.07.

Subsection (d)(2)—Liability under this paragraph extends to those who have received distributions under a charging order. *See* the comment to Section 502(a) (explaining that the beneficiary of a charging order is a transferee). Unlike Section 406(c) (recapture of improper distributions), this paragraph contains no "knowledge" element.

SECTION 706. COURT PROCEEDINGS.

(a) A dissolved limited liability company that has published a notice under Section 705 may file an application with [the appropriate court] in the [county] where the company's principal office is located or, if the principal office is not located in this state, where the office of its registered agent is or was last located, for a determination of the amount and form of security to be provided for payment of claims that are reasonably expected to arise after the date of dissolution based on facts known to the company and:

(1) at the time of application:

(A) are contingent; or

(B) have not been made known to the company; or

(2) are based on an event occurring after the date of dissolution.

(b) Security is not required for any claim that is or is reasonably anticipated to be barred under Section 705.

(c) Not later than 10 days after the filing of an application under subsection (a), the dissolved limited liability company shall give notice of the proceeding to each claimant holding a contingent claim known to the company.

(d) In a proceeding under this section, the court may appoint a guardian ad litem to represent all claimants whose identities are unknown. The reasonable fees and expenses of the guardian, including all reasonable expert witness fees, must be paid by the dissolved limited liability company.

(e) A dissolved limited liability company that provides security in the amount and form ordered by the court under subsection (a) satisfies the company's obligations with respect to claims that are contingent, have not been made known to the company, or are based on an event occurring after the date of dissolution, and such claims may not be enforced against a member or transferee on account of assets received in liquidation.

Comment

This section is derived almost verbatim from Model Business Corporation Act section 14.08.

SECTION 707. DISPOSITION OF ASSETS IN WINDING UP.

(a) In winding up its activities and affairs, a limited liability company shall apply its assets to discharge the company's obligations to creditors, including members that are creditors.

(b) After a limited liability company complies with subsection (a), any surplus must be distributed in the following order, subject to any charging order in effect under Section 503:

(1) to each person owning a transferable interest that reflects contributions made and not previously returned, an amount equal to the value of the unreturned contributions; and

(2) among persons owning transferable interests in proportion to their respective rights to share in distributions immediately before the dissolution of the company.

(c) If a limited liability company does not have sufficient surplus to comply with subsection (b)(1), any surplus must be distributed among the owners of transferable interests in proportion to the value of the respective unreturned contributions.

(d) All distributions made under subsections (b) and (c) must be paid in money.

Comment

Subsection (a)—This subsection is non-waivable as to creditors who are not members. *See* Section 105(c)(15) (stating that the operating agreement may not "restrict the rights under this [act] of a person other than a member or manager"). However, if a creditor is willing, a dissolved limited liability company may certainly make agreements with the creditor specifying the terms under which the LLC will "discharge its obligations" to the creditor.

Subsections (b), (c) and (d)—For the most part, these subsections state default rules. For example, operating agreements often provide for different distribution rights upon liquidation than during operations. However, distributions under these subsections (or otherwise under the operating agreement) are subject to Section 503 (charging orders). As to the extent the operating agreement can be amended to affect the distribution rights of persons already transferees, see Section 107(b).

SECTION 708. ADMINISTRATIVE DISSOLUTION.

(a) The [Secretary of State] may commence a proceeding under subsection (b) to dissolve a limited liability company administratively if the company does not:

(1) pay any fee, tax, interest, or penalty required to be paid to the [Secretary of State] not later than [six months] after it is due;

(2) deliver [an annual] [a biennial] report to the [Secretary of State] not later than [six months] after it is due; or

(3) have a registered agent in this state for [60] consecutive days.

(b) If the [Secretary of State] determines that one or more grounds exist for administratively dissolving a limited liability company, the [Secretary of State] shall serve the company with notice in a record of the [Secretary of State's] determination.

(c) If a limited liability company, not later than [60] days after service of the notice under subsection (b), does not cure or demonstrate to the satisfaction of the [Secretary of State] the nonexistence of each ground determined by the [Secretary of State], the [Secretary of State] shall administratively dissolve the company by signing a statement of administrative dissolution that recites the grounds for dissolution and the effective date of dissolution. The [Secretary of State] shall file the statement and serve a copy on the company pursuant to Section 210.

(d) A limited liability company that is administratively dissolved continues in existence as an entity but may not carry on any activities except as necessary to wind up its activities and affairs and liquidate its assets under Sections 702, 704, 705, 706, and 707, or to apply for reinstatement under Section 709.

(e) The administrative dissolution of a limited liability company does not terminate the authority of its registered agent.

Comment

Many failures to comply with statutory requirements that may give rise to administrative dissolution occur because of oversight or inadvertence and are usually corrected promptly when brought to the entity's attention. Subsections (b) and (c) therefore provide a mandatory notice by the filing office to each limited liability company subject to administrative dissolution and a sixty-day grace period following the notice before the statement of administrative dissolution may be filed.

In most instances, the issue whether the limited liability company is subject to administrative dissolution will not be controverted. If a limited liability company is administratively dissolved, it may petition the filing office for reinstatement under Section 709 and, if reinstatement is denied, the company may appeal to the courts under Section 710.

As a practical matter, administrative dissolution permits the filing office to clear the record of "dead wood" and free up names.

SECTION 709. REINSTATEMENT.

(a) A limited liability company that is administratively dissolved under Section 708 may apply to the [Secretary of State] for reinstatement [not later than [two] years after the effective date of dissolution]. The application must state:

(1) the name of the company at the time of its administrative dissolution and, if needed, a different name that satisfies Section 112;

(2) the address of the principal office of the company and the name and street and mailing addresses of its registered agent;

(3) the effective date of the company's administrative dissolution; and

(4) that the grounds for dissolution did not exist or have been cured.

(b) To be reinstated, a limited liability company must pay all fees, taxes, interest, and penalties that were due to the [Secretary of State] at the time of the company's administrative dissolution and all fees, taxes, interest, and penalties that would have been due to the [Secretary of State] while the company was administratively dissolved.

(c) If the [Secretary of State] determines that an application under subsection (a) contains the required information, is satisfied that the information is correct, and determines that all payments required to be made to the [Secretary of State] by subsection (b) have been made, the [Secretary of State] shall:

(1) cancel the statement of administrative dissolution and prepare a statement of reinstatement that states the [Secretary of State's] determination and the effective date of reinstatement; and

(2) file the statement of reinstatement and serve a copy on the limited liability company.

(d) When reinstatement under this section has become effective, the following rules apply:

(1) The reinstatement relates back to and takes effect as of the effective date of the administrative dissolution.

(2) The limited liability company resumes carrying on its activities and affairs as if the administrative dissolution had not occurred.

(3) The rights of a person arising out of an act or omission in reliance on the dissolution before the person knew or had notice of the reinstatement are not affected.

Comment

Some states require that reinstatement be sought within two years of administrative dissolution. Other states provide a longer time, or do not impose any time limit. Imposing no limit risks abuse by unscrupulous people seeking to reinstate and appropriate for improper ends a dormant limited liability company that has been abandoned by its members. On the other hand, reinstatement is intended as a safety net for the inattentive (*i.e.*, for people in charge of a limited liability company who have neglected to file an annual report or otherwise subjected the LLC to administrative dissolution). If the deadline comes too soon, the safety net may be gone before the inattentive even learn that administrative dissolution has occurred.

Subsection (a)(1)—This provision will apply if, before the limited liability company is reinstated, another entity has taken the company's name. *See* Section 112(b)(1).

Subsection (d)(3)—This paragraph provides an exception to the retroactive effect provided by this subsection's Paragraphs (1) and (2). The exception could preclude a reinstated LLC's use of its own name. *See* Section 112(b)(1) (indirectly permitting a limited liability company to use the name of an LLC that has been administratively dissolved). Comparable provisions exist in other uniform acts pertaining to entities. *E.g.*, UPA (1997) (Last Amended 2013) § 902(c)(2).

SECTION 710. JUDICIAL REVIEW OF DENIAL OF REINSTATEMENT.

(a) If the [Secretary of State] denies a limited liability company's application for reinstatement following administrative dissolution, the [Secretary of State] shall serve the company with a notice in a record that explains the reasons for the denial.

(b) A limited liability company may seek judicial review of denial of reinstatement in [the appropriate court] not later than [30] days after service of the notice of denial.

Comment

Because the grounds for administrative dissolution under Section 708 are limited and straight-forward, it is unlikely there will be a dispute about whether a limited liability company has corrected the reasons for its administrative dissolution. If a dissolved limited liability company disagrees with a determination by the filing office to deny the company's application for reinstatement, this section gives the company a limited right to seek judicial review of the denial of reinstatement.

[ARTICLE] 8

ACTIONS BY MEMBERS

SECTION 801. DIRECT ACTION BY MEMBER.

(a) Subject to subsection (b), a member may maintain a direct action against another member, a manager, or the limited liability company to enforce the member's rights and protect the member's interests, including rights and interests under the operating agreement or this [act] or arising independently of the membership relationship.

(b) A member maintaining a direct action under this section must plead and prove an actual or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the limited liability company.

Comment

Subsection (a)—A member's rights under this subsection are subject to the rule of standing stated in Subsection (b). The phrase "otherwise protect the member's interests" pertains to remedies and creates no additional causes of action.

The last phrase of this subsection ("or arising independently . . . ") does not create any new rights, obligations, or remedies, and is included merely to emphasize that a person's membership in an LLC does not preclude the person from enforcing rights existing "independently of the membership relationship" (*e.g.*, as a creditor).

Subsection (b)—This subsection codifies the rule of standing that predominates in entity law. *See, e.g.*, *PacLink Commc'ns Int'l, Inc. v. Superior Court*, 109 Cal. Rptr. 2d 436, 441 (Cal. Ct. App. 2001) (noting that, "[i]n determining whether an individual action as opposed to a derivative action lies, a court looks at 'the gravamen of the wrong alleged in the pleadings'"; holding that "[a] contextual reading of [plaintiffs'] complaint makes clear that they are not suing based upon a claim that as members of the LLC they were entitled to a distribution which was not made, but instead are suing for financial injury caused by fraudulent transfer of the company's assets") (quoting *Nelson v. Anderson*, 84

Cal. Rptr. 2d 753. (Cal. Ct. App. 1999)); *Mallia v. PaineWebber, Inc.*, 889 F. Supp. 277, 282 (S.D. Tex. 1995) ("[T]o bring a direct representative action against a general partner, a limited partner must demonstrate either direct injury or an injury that exists independently of the partnerships.'"); *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1039 (Del. 2004) (expressly disapproving "both the concept of 'special injury' and the concept that a claim is necessarily derivative if it affects all stockholders equally;" stating that "a court should look to the nature of the wrong and to whom the relief should go;" requiring that any "claimed direct injury . . . be independent of any alleged injury to the [entity]"); *Tzolis v. Wolff*, 884 N.E.2d 1005, 1008 (N.Y. 2008) (holding that derivative actions exist under New York LLC law and referring to "the traditional line between direct and derivative claims"); *see also CML V, LLC v. Bax* 6 A.3d 238, 245 (Del. Ch. 2010) (noting that issues of standing viz-a-viz direct and derivative claims are comparable regardless of whether the entity is a limited partnership, a limited liability company, or a corporation), *aff'd*, 28 A.3d 1037 (Del. 2011).

The distinction between direct and derivative claims protects the operating agreement. If any member can sue directly over any management issue, the mere threat of suit can interfere with the members' agreed-upon arrangements.

Although in ordinary contractual situations it is axiomatic that each party to a contract has standing to sue for breach of that contract, within a limited liability company different circumstances typically exist. A member does not have a direct claim against a manager or another member merely because the manager or other member has breached the operating agreement. Likewise a member's violation of this act does not automatically create a direct claim for every other member. To have standing in his, her, or its own right, a member plaintiff must be able to show a harm that occurs independently of the harm caused or threatened to be caused to the limited liability company.

> EXAMPLE: Through grossly negligent conduct, in violation of Section 409(c), the manager of a manager-managed LLC reduces the net assets of an LLC by fifty percent, which in turns decreases the value of Member A's investment by $3,000,000. Member A has no standing to bring a direct claim; the damage is merely derivative of the damage first suffered by the LLC. Member A may, however, bring a derivative claim. Sections 802–806.

> EXAMPLE: Same facts, except in addition to violating Section 409(c), the manager's conduct breaches an express provision of the operating agreement to which Member A is a signatory. The analysis and the result are the same.

> EXAMPLE: An operating agreement defines "distributable cash" and requires the LLC to periodically distribute that cash among all members. The LLC's manager fails to distribute the cash. Each member has a direct claim against the manager and the LLC.

The reference to "threatened injury" is to encompass potential claims for preventative relief, such as a temporary restraining order or preliminary injunction.

This section's standing rule is subject to reasonable alterations by the operating agreement. *See* the comment to Section 105(c)(11).

SECTION 802. DERIVATIVE ACTION. A member may maintain a derivative action to enforce a right of a limited liability company if:

(1) the member first makes a demand on the other members in a member-managed limited liability company, or the managers of a manager-managed limited liability company, requesting that they cause the company to bring an action to enforce the right, and the managers or other members do not bring the action within a reasonable time; or

(2) a demand under paragraph (1) would be futile.

Comment

Paragraph (1)—The demand requirement recognizes that, presumptively at least, the decision to cause a limited liability company to bring suit is a business decision, to be made by those who manage the business. Deborah A. DeMott, SHAREHOLDER DERIVATIVE ACTIONS: LAW AND PRACTICE § 5.9 (Westlaw, November 4, 2012) (Demand on directors—Rationales for demand).

Paragraph (2)—Some jurisdictions have a "universal demand" requirement, but the approach stated here is by far the majority one. Deborah A. DeMott, SHAREHOLDER DERIVATIVE ACTIONS: LAW AND PRACTICE § 5.12 (Westlaw, November 4, 2012).

SECTION 803. PROPER PLAINTIFF. A derivative action to enforce a right of a limited liability company may be maintained only by a person that is a member at the time the action is commenced and:

(1) was a member when the conduct giving rise to the action occurred; or

(2) whose status as a member devolved on the person by operation of law or pursuant to the terms of the operating agreement from a person that was a member at the time of the conduct.

Comment

The rule stated here is conventional in both the law of unincorporated entities and corporate law. Persons dissociated as members have no standing to bring a derivative action. *A fortiori*, mere transferees have no standing. *See* the comments to Sections 107(b) and 502.

Paragraph (2)—This paragraph will be inapposite if the limited liability company has only two members, one of whom is the derivative plaintiff. In that limited circumstance, the plaintiff's death would cause the derivative action to abate. The "pick your partner" principal enshrined in Section 502 would prevent the decedent's heirs from succeeding to plaintiff status in the derivative action (except in the unlikely event that the remaining member consents to the heirs becoming members). The analysis and result will be the same if the derivative plaintiff is an entity whose existence terminates.

This act takes no position on whether:

- the death of member abates a direct claim against the LLC or a fellow member; and
- bringing a direct claim precludes a person from being a proper plaintiff for a derivative claim.

As to the latter issue, see, *e.g.*, *Cordts-Auth v. Crunk, L.L.C.*, 815 F. Supp. 2d 778, 793–94 (S.D.N.Y. 2011) (discussing the potential conflict of interest), *aff'd*, 479 F. App'x 375 (2d Cir. 2012).

SECTION 804. PLEADING. In a derivative action, the complaint must state with particularity:

(1) the date and content of plaintiff's demand and the response to the demand by the managers or other members; or

(2) why demand should be excused as futile.

Comment

This section parallels Section 802. The pleading requirement first appeared in a uniform act in 1976. ULPA (1976) § 1003.

SECTION 805. SPECIAL LITIGATION COMMITTEE.

(a) If a limited liability company is named as or made a party in a derivative proceeding, the company may appoint a special litigation committee to investigate the claims asserted in the proceeding and determine whether pursuing the action is in the best interests of the company. If the company appoints a special litigation committee, on motion by the committee made in the name of the company, except for good cause shown, the court shall stay discovery for the time reasonably necessary to permit the committee to make its investigation. This subsection does not prevent the court from:

(1) enforcing a person's right to information under Section 410; or

(2) granting extraordinary relief in the form of a temporary restraining order or preliminary injunction.

(b) A special litigation committee must be composed of one or more disinterested and independent individuals, who may be members.

(c) A special litigation committee may be appointed:

(1) in a member-managed limited liability company:

(A) by the affirmative vote or consent of a majority of the members not named as parties in the proceeding; or

(B) if all members are named as parties in the proceeding, by a majority of the members named as defendants; or

(2) in a manager-managed limited liability company:

(A) by a majority of the managers not named as parties in the proceeding; or

(B) if all managers are named as parties in the proceeding, by a majority of the managers named as defendants.

(d) After appropriate investigation, a special litigation committee may determine that it is in the best interests of the limited liability company that the proceeding:

(1) continue under the control of the plaintiff;

(2) continue under the control of the committee;

(3) be settled on terms approved by the committee; or

(4) be dismissed.

(e) After making a determination under subsection (d), a special litigation committee shall file with the court a statement of its determination and its report supporting its determination and shall serve each party with a copy of the determination and report. The court shall determine whether the members of the committee were disinterested and independent and whether the committee conducted its investigation and made its recommendation in good faith, independently, and with reasonable care, with the committee having the burden of proof. If the court finds that the members of the committee were disinterested and independent and that the committee acted in good faith, independently, and with reasonable care, the court shall enforce the determination of the committee. Otherwise, the court shall dissolve the stay of discovery entered under subsection (a) and allow the action to continue under the control of the plaintiff.

Comment

Although special litigation committees are best known in the corporate field, they are no more inherently corporate than derivative litigation or the notion that an organization is a person distinct from its owners. An "SLC" can serve as an ADR mechanism, help protect an agreed upon arrangement from strike suits, protect the interests of members who are neither plaintiffs nor defendants (if any), and bring the benefits of a specially tailored business judgment to any judicial decision.

This section's approach corresponds to established law in most jurisdictions, modified to fit the typical governance structures of a limited liability company. Use of an SLC is optional. An operating agreement can preclude the use of SLCs, rendering this section inapplicable, but cannot otherwise vary this section. *See* Section 105(c)(12).

Subsection (a)(1)—Section 410 pertains to information rights. On the availability of remedies pending the SLC's investigation, *compare* Section 410, *with Kaufman v. Computer Assocs. Int'l, Inc.*, No. Civ.A. 699-N, 2005 WL 3470589, at *1 (Del. Ch. Dec. 21, 2005) (presenting "the question of whether to stay a books and records action under 8 Del. C. § 220 at the request of a special litigation committee when a derivative action encompassing substantially the same allegations of wrongdoing filed by different plaintiffs is pending in another jurisdiction"; concluding "[f]or reasons that have much to do with the light burden imposed by the plaintiff's demand in this case . . . that the special litigation committee's motion to stay the books and records action should be denied").

Subsection (e)—The standard stated for judicial review of the SLC determination follows *Auerbach v. Bennett*, 393 N.E.2d 994 (N.Y. 1979) rather than *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), because the latter's reference to a court's business judgment has generally not been followed in other states. In essence, an SLC is intended to function as a surrogate decision-maker, allowing the limited liability company to make what is fundamentally a business decision. If a court determines that "the members of the committee were disinterested and independent and whether the committee conducted its investigation and made its recommendation in good faith, independently, and with reasonable care, with the committee having the burden of proof," it makes no sense to substitute the court's legal judgment for the business judgment of the SLC.

Houle v. Low, 556 N.E.2d 51, 58 (Mass. 1990) contains an excellent explanation of the court's role in reviewing an SLC decision:

> The value of a special litigation committee is coextensive with the extent to which that committee truly exercises business judgment. In order to ensure that special litigation committees do act for the [entity]'s best interest, a good deal of judicial oversight is necessary in each case. At the same time, however, courts must be careful not to usurp the committee's valuable role in exercising business judgment. . . . [A] special litigation committee must be independent, unbiased, and act in good faith. Moreover, such a committee must conduct a thorough and careful analysis regarding the plaintiff's derivative suit. . . . The burden of proving that these procedural requirements have been met must rest, in all fairness, on the party capable of making that proof—the [entity].

For an extensive discussion of how a court should approach the question of independence, see *Einhorn v. Culea*, 612 N.W.2d 78, 91 (Wis. 2000).

SECTION 806. PROCEEDS AND EXPENSES.

(a) Except as otherwise provided in subsection (b):

(1) any proceeds or other benefits of a derivative action, whether by judgment, compromise, or settlement, belong to the limited liability company and not to the plaintiff; and

(2) if the plaintiff receives any proceeds, the plaintiff shall remit them immediately to the company.

(b) If a derivative action is successful in whole or in part, the court may award the plaintiff reasonable expenses, including reasonable attorney's fees and costs, from the recovery of the limited liability company.

(c) A derivative action on behalf of a limited liability company may not be voluntarily dismissed or settled without the court's approval.

Comment

Subsection (c)—This provision is intended to prevent collusion.

[ARTICLE] 9

FOREIGN LIMITED LIABILITY COMPANIES

SECTION 901. GOVERNING LAW.

(a) The law of the jurisdiction of formation of a foreign limited liability company governs:

(1) the internal affairs of the company;

(2) the liability of a member as member and a manager as manager for a debt, obligation, or other liability of the company; and

(3) the liability of a series of the company.

(b) A foreign limited liability company is not precluded from registering to do business in this state because of any difference between the law of its jurisdiction of formation and the law of this state.

(c) Registration of a foreign limited liability company to do business in this state does not authorize the foreign company to engage in any activities and affairs or exercise any power that a limited liability company may not engage in or exercise in this state.

Comment

Subsection (a)—This subsection provides that the laws of the jurisdiction of formation of a foreign limited liability company, rather than the laws of this state, govern both the internal affairs of the foreign LLC and the liability of its members and managers for the obligations of the LLC. An operating agreement cannot change this provision. Section 105(c)(15).

This subdivision parallels Section 104 (pertaining to the governing law for domestic LLCs). *See* the comment to Section 104.

Subsection (a)(3)—The LLC statutes of several states authorize limited liability companies to have asset-partitioning series. According to those statutes, if series are properly created, a debt, obligation, or liability associated with the property of a particular series is enforceable only against property of that series, and not against the property of the LLC generally or any other series thereof.

This act does not provide for asset-partitioning series. However, under this provision, the law of this state will respect the "internal shields" created under the series provisions of another jurisdiction's limited liability company statute. This provision does *not* address the myriad of other unsettled issues pertaining to series.

For an explanation of how the asset-partitioning concept of series differs from the traditional concept, see Section 1031, comment.

Subsections (b) and (c)—These sections together make clear that, although a foreign limited liability company may not be denied registration simply because of a difference between the laws of its jurisdiction of formation and the laws of this state, the foreign limited liability company "may not engage in any activity or exercise any power that a limited liability company may not engage in or exercise in this state." Subsection (c).

SECTION 902. REGISTRATION TO DO BUSINESS IN THIS STATE.

(a) A foreign limited liability company may not do business in this state until it registers with the [Secretary of State] under this [article].

(b) A foreign limited liability company doing business in this state may not maintain an action or proceeding in this state unless it is registered to do business in this state.

(c) The failure of a foreign limited liability company to register to do business in this state does not impair the validity of a contract or act of the company or preclude it from defending an action or proceeding in this state.

(d) A limitation on the liability of a member or manager of a foreign limited liability company is not waived solely because the company does business in this state without registering to do business in this state.

(e) Section 901(a) and (b) applies even if a foreign limited liability company fails to register under this [article].

Comment

Subsection (a)—Following a long-established tradition, this act does not state what constitutes "do[ing] business in this state." Instead, Section 905 provides a non-exhaustive list of "[a]ctivities of a foreign limited liability company which do not constitute doing business in this state."

Subsection (b)—The purpose of this subsection is to induce foreign limited liability companies to register without imposing harsh or erratic sanctions. Often the failure to register is a result of inadvertence or bona fide disagreement as to the scope of Section 905, which is necessarily imprecise. Thus, the imposition of harsh sanctions in those situations is inappropriate. The sanction of closing the courts of the state to suits brought by foreign LLCs that should have registered is not a punitive one. If a foreign LLC should have registered and failed to do so, it may still enforce its contractual and other rights simply by registering.

However, if a court dismisses a case under this subsection rather than staying the proceedings pending the foreign LLC's registration, a statute of limitations problem may occur. *See Corco, Inc. v. Ledar Transport, Inc.* 946 P.2d 1009, 1010 (Kan. Ct. App. 1997) ("[T]he proper remedy was to dismiss [the unregistered entity's] counterclaim without prejudice rather than with prejudice. This would leave [the entity] the opportunity to comply with the statutes and then reassert its claim against [the defendant]. On the other hand, it would also leave the risk that the statute of limitations might run against [the entity].").

This subsection does not prevent a foreign LLC that has failed to register from "defending" an action or proceeding. The distinction between "maintaining" an action or proceeding under this subsection and "defending" an action or proceeding under Subsection (c) is determined on the basis of whether affirmative relief is sought. A nonregistered foreign LLC may interpose any defense or permissive or mandatory counterclaim to defeat a claimed recovery, but may not obtain an affirmative judgment based on the counterclaim without first registering.

Subsection (c)—In addition to permitting a non-registered foreign LLC doing business in this state to defend (but not maintain) an action or proceeding, this section makes clear that failure to register does not impair the validity of a foreign LLC's acts.

Subsection (d)—This subsection preserves the effectiveness of a foreign LLC's liability shield applicable under the LLC's governing law.

SECTION 903. FOREIGN REGISTRATION STATEMENT. To register to do business in this state, a foreign limited liability company must deliver a foreign registration statement to the [Secretary of State] for filing. The statement must state:

(1) the name of the company and, if the name does not comply with Section 112, an alternate name adopted pursuant to Section 906(a);

(2) that the company is a foreign limited liability company;

(3) the company's jurisdiction of formation;

(4) the street and mailing addresses of the company's principal office and, if the law of the company's jurisdiction of formation requires the company to maintain an office in that jurisdiction, the street and mailing addresses of the required office; and

(5) the name and street and mailing addresses of the company's registered agent in this state.

Comment

The foreign registration statement provides certain basic information about the foreign limited liability company to ensure that citizens of the state have access to that information in their dealings with the foreign limited liability company. The statement also facilitates making the foreign company subject to the jurisdiction of the courts of the state.

Once registered, a foreign limited liability company must file an annual/biennial report. Section 212.

SECTION 904. AMENDMENT OF FOREIGN REGISTRATION STATEMENT. A registered foreign limited liability company shall deliver to the [Secretary of State] for filing an amendment to its foreign registration statement if there is a change in:

(1) the name of the company;

(2) the company's jurisdiction of formation;

(3) an address required by Section 903(4); or

(4) the information required by Section 903(5).

Comment

This section works in tandem with the annual/biennial report required by Section 212 to keep up to date the information of record in the office of the filing office about a registered foreign limited liability company.

SECTION 905. ACTIVITIES NOT CONSTITUTING DOING BUSINESS.

(a) Activities of a foreign limited liability company which do not constitute doing business in this state under this [article] include:

(1) maintaining, defending, mediating, arbitrating, or settling an action or proceeding;

(2) carrying on any activity concerning its internal affairs, including holding meetings of its members or managers;

(3) maintaining accounts in financial institutions;

(4) maintaining offices or agencies for the transfer, exchange, and registration of securities of the company or maintaining trustees or depositories with respect to those securities;

(5) selling through independent contractors;

(6) soliciting or obtaining orders by any means if the orders require acceptance outside this state before they become contracts;

(7) creating or acquiring indebtedness, mortgages, or security interests in property;

(8) securing or collecting debts or enforcing mortgages or security interests in property securing the debts and holding, protecting, or maintaining property;

(9) conducting an isolated transaction that is not in the course of similar transactions;

(10) owning, without more, property; and

(11) doing business in interstate commerce.

(b) A person does not do business in this state solely by being a member or manager of a foreign limited liability company that does business in this state.

(c) This section does not apply in determining the contacts or activities that may subject a foreign limited liability company to service of process, taxation, or regulation under law of this state other than this [act].

Comment

This act does not attempt to formulate an inclusive definition of what constitutes doing business in a state. Rather, the concept is defined in a negative fashion by Subsections (a) and (b), which state that certain activities do not constitute doing business.

In general terms, any conduct more regular, systematic, or extensive than that described in Subsection (a) constitutes doing business and requires the foreign limited liability company to register to do business. Typical conduct requiring registration includes maintaining an office to conduct local intrastate business, selling personal property not in interstate commerce, entering into contracts relating to the local business or sales, and owning or using real estate for general purposes. But the passive owning of real estate for investment purposes does not constitute doing business. *See* Subsection (a)(10).

The test of "doing business" defined in a negative way in Subsections (a) and (b) applies only to the question whether a foreign limited liability company's contacts with the state are such that it must register under this section. The test is not applicable to other questions such as whether the foreign LLC is amenable to service of process under state "long-arm" statutes or liable for state or local taxes. A foreign LLC that has registered (or is required to register) will generally be subject to suit and state taxation in the state, while a foreign LLC that is subject to service of process or state taxation in a state will not necessarily be required to register.

Subsection (a)—The list of activities set forth in this subsection is not exhaustive.

Subsection (a)(1)—A foreign limited liability company is not "doing business" solely because it resorts to the courts of the state to recover an indebtedness, enforce an obligation, recover possession of personal property, obtain the appointment of a receiver, intervene in a pending proceeding, bring a petition to compel arbitration, file an appeal bond, or pursue appellate remedies. Similarly, a foreign LLC is not required to register merely because it files a complaint with a governmental agency or participates in an administrative proceeding within the state.

Subsection (a)(2)—A foreign limited liability company does not "do business" within a state under this section merely because some of its internal affairs occur within a state. Thus, a foreign LLC may hold meetings of its managers or members within a state without first registering. A foreign LLC also may maintain offices or agencies within a state relating solely to the transfer, exchange or registration of its interests without registering. Other activities relating to the internal affairs of the foreign LLC that do not constitute doing business under this section include having officers or representatives who reside within or are physically present in the state; while there, the officers or representatives may make executive decisions relating to the internal affairs of the foreign LLC without imposing on the foreign LLC the requirement that it register, if these activities are not so regular and systematic as to cause the residence to be viewed as a business office.

Subsection (a)(5)—Under this paragraph, a foreign limited liability company need not register if it sells goods in the state through independent contractors. These transactions are viewed as transactions by the independent contractors, not by the foreign LLC itself even though the foreign LLC sets some limits or ground rules for its contractors. If these controls are sufficiently pervasive, however, the foreign LLC may be deemed to be selling for itself in intrastate commerce, and not through the independent contractors and therefore engaged in doing business in the state.

Subsection (a)(7) and (8)—The mere act of making a loan by a foreign limited liability company that is not in the business of making loans does not constitute doing business in the state in which the loan is made. On the same theory, a foreign LLC may obtain security for the repayment of a loan, and foreclose or enforce the lien or security interest to collect the loan, without being deemed to be doing business. Similarly, a refunding or "roll over" of a loan or its adjustment or compromise does not involve doing business.

Subsection (a)(9)—The concept of "doing business" involves regular, repeated, and continuing business contacts of a local nature. A single agreement or isolated transaction within a state does not constitute doing business if there is no intention to repeat the transaction or engage in similar transactions. This act does not impose the limitation found in some statutes, such as section 15.01(b)(10) of the Model Business Corporation Act, that the isolated transaction be completed within thirty days. A foreign LLC should not be required to register simply because it engages in an isolated transaction that takes longer than thirty days to complete.

Subsection (a)(11)—A foreign limited liability company is not "doing business" within the meaning of this section if it is transacting business in interstate commerce. *See* Subsection (a)(6) (stating that soliciting or obtaining orders that must be accepted outside the state before they become contracts is not "doing business" within the meaning of this section).

These exclusions reflect the provisions of the United States Constitution that grant to the United States Congress exclusive power over interstate commerce, and preclude states from imposing restrictions or conditions upon this commerce. This subsection should be construed in a manner consistent with judicial decisions under the United States Constitution. Under those decisions, a foreign entity is not required to register even though it sells goods within the state if they are shipped to the purchasers in interstate commerce. Thus, a foreign LLC need not register even if it also does work and performs acts within the state incidental to the interstate business (*e.g.*, if it takes or enforces a security interest incidental to these transactions). Nor is it required to register merely because it sends traveling salespeople or solicitors into a state so long as contracts are not made within the state. Similarly, an office may be maintained by a foreign LLC in this state without registering if the office's functions relate solely to interstate commerce. Purchases of goods may of course be in interstate commerce as readily as sales. Thus, the purchase of personal property in this state by a foreign limited liability company for shipment in interstate commerce out of the state does not require the entity to register.

SECTION 906. NONCOMPLYING NAME OF FOREIGN LIMITED LIABILITY COMPANY.

(a) A foreign limited liability company whose name does not comply with Section 112 may not register to do business in this state until it adopts, for the purpose of doing business in this state, an alternate name that complies with Section 112. A company that registers under an alternate name under this subsection need not comply with [this state's assumed or fictitious name statute]. After registering to do business in this state with an alternate name, a company shall do business in this state under:

(1) the alternate name;

(2) the company's name, with the addition of its jurisdiction of formation; or

(3) a name the company is authorized to use under [this state's assumed or fictitious name statute].

(b) If a registered foreign limited liability company changes its name to one that does not comply with Section 112, it may not do business in this state until it complies with subsection (a) by amending its registration to adopt an alternate name that complies with Section 112.

Comment

A foreign limited liability company must register under its true name if that name satisfies the requirements of Section 112. If the true name is unavailable because it is not distinguishable upon the records of the filing office from a name already in use or reserved or registered, the foreign LLC may use an alternate name.

A foreign limited liability company that registers to do business in the state may do business under a fictitious name to the same extent as a domestic entity.

SECTION 907. WITHDRAWAL DEEMED ON CONVERSION TO DOMESTIC FILING ENTITY OR DOMESTIC LIMITED LIABILITY PARTNERSHIP. A registered foreign limited liability company that converts to a domestic limited liability partnership or to a domestic entity whose formation requires delivery of a record to the [Secretary of State] for filing is deemed to have withdrawn its registration on the effective date of the conversion.

Comment

When a registered foreign limited liability company has converted to a domestic "filing entity" or domestic limited liability partnership, information about the entity in its capacity as a domestic entity will continue to be of record in the filing office. At that point, there is no further reason for the entity to be registered as a foreign LLC, and this section automatically treats its prior registration as withdrawn.

SECTION 908. WITHDRAWAL ON DISSOLUTION OR CONVERSION TO NONFILING ENTITY OTHER THAN LIMITED LIABILITY PARTNERSHIP.

(a) A registered foreign limited liability company that has dissolved and completed winding up or has converted to a domestic or foreign entity whose formation does not require the public filing of a record, other than a limited liability partnership, shall deliver a statement of withdrawal to the [Secretary of State] for filing. The statement must state:

(1) in the case of a company that has completed winding up:

(A) its name and jurisdiction of formation;

(B) that the company surrenders its registration to do business in this state; and

(2) in the case of a company that has converted:

(A) the name of the converting company and its jurisdiction of formation;

(B) the type of entity to which the company has converted and its jurisdiction of formation;

(C) that the converted entity surrenders the converting company's registration to do business in this state and revokes the authority of the converting company's registered agent to act as registered agent in this state on behalf of the company or the converted entity; and

(D) a mailing address to which service of process may be made under subsection (b).

(b) After a withdrawal under this section has become effective, service of process in any action or proceeding based on a cause of action arising during the time the foreign limited liability company was registered to do business in this state may be made pursuant to Section 119.

Comment

When a registered foreign limited liability company has dissolved and completed winding up, or has converted to a "nonfiling entity" other than a limited liability partnership, there is no further reason for information about the entity to appear in the records of the filing office. This section thus requires delivery of a statement of withdrawal for the purpose of removing the foreign LLC from the rolls of registered foreign entities.

Subsection (a)—The exclusion of limited liability partnerships from this provision is merely technical; Section 907 covers conversion to a domestic LLP.

SECTION 909. TRANSFER OF REGISTRATION.

(a) When a registered foreign limited liability company has merged into a foreign entity that is not registered to do business in this state or has converted to a foreign entity required to register with the [Secretary of State] to do business in this state, the foreign entity shall deliver to the [Secretary of State] for filing an application for transfer of registration. The application must state:

(1) the name of the registered foreign limited liability company before the merger or conversion;

(2) that before the merger or conversion the registration pertained to a foreign limited liability company;

(3) the name of the applicant foreign entity into which the foreign limited liability company has merged or to which it has been converted and, if the name does not comply with Section 112, an alternate name adopted pursuant to Section 906(a);

(4) the type of entity of the applicant foreign entity and its jurisdiction of formation;

(5) the street and mailing addresses of the principal office of the applicant foreign entity and, if the law of the entity's jurisdiction of formation requires the entity to maintain an office in that jurisdiction, the street and mailing addresses of that office; and

(6) the name and street and mailing addresses of the applicant foreign entity's registered agent in this state.

(b) When an application for transfer of registration takes effect, the registration of the foreign limited liability company to do business in this state is transferred without interruption to the foreign entity into which the company has merged or to which it has been converted.

Comment

The purpose of this section is to clarify the status of the foreign limited liability company in the public records of the state. A filing under this section has the two-fold effect of canceling the authority of the foreign LLC to do business in the state while at the same time reregistering the former foreign LLC as the new type of foreign entity. If the reregistered foreign entity subsequently wishes to cancel its registration to do business in the state, it may do so under the statute of this state pertaining to the registration of the new type of foreign entity.

SECTION 910. TERMINATION OF REGISTRATION.

(a) The [Secretary of State] may terminate the registration of a registered foreign limited liability company in the manner provided in subsections (b) and (c) if the company does not:

(1) pay, not later than [60] days after the due date, any fee, tax, interest, or penalty required to be paid to the [Secretary of State] under this [act] or law other than this [act];

(2) deliver to the [Secretary of State] for filing, not later than [60] days after the due date, [an annual] [a biennial] report required under Section 212;

(3) have a registered agent as required by Section 115; or

(4) deliver to the [Secretary of State] for filing a statement of a change under Section 116 not later than [30] days after a change has occurred in the name or address of the registered agent.

(b) The [Secretary of State] may terminate the registration of a registered foreign limited liability company by:

(1) filing a notice of termination or noting the termination in the records of the [Secretary of State]; and

(2) delivering a copy of the notice or the information in the notation to the company's registered agent or, if the company does not have a registered agent, to the company's principal office.

(c) The notice must state or the information in the notation must include:

(1) the effective date of the termination, which must be at least [60] days after the

date the [Secretary of State] delivers the copy; and

(2) the grounds for termination under subsection (a).

(d) The authority of a registered foreign limited liability company to do business in this state ceases on the effective date of the notice of termination or notation under subsection (b), unless before that date the company cures each ground for termination stated in the notice or notation. If the company cures each ground, the [Secretary of State] shall file a record so stating.

Comment

This section is analogous to the procedures for administrative dissolution under Section 708.

SECTION 911. WITHDRAWAL OF REGISTRATION OF REGISTERED FOREIGN LIMITED LIABILITY COMPANY.

(a) A registered foreign limited liability company may withdraw its registration by delivering a statement of withdrawal to the [Secretary of State] for filing. The statement of withdrawal must state:

(1) the name of the company and its jurisdiction of formation;

(2) that the company is not doing business in this state and that it withdraws its registration to do business in this state;

(3) that the company revokes the authority of its registered agent to accept service on its behalf in this state; and

(4) an address to which service of process may be made under subsection (b).

(b) After the withdrawal of the registration of a foreign limited liability company, service of process in any action or proceeding based on a cause of action arising during the time the company was registered to do business in this state may be made pursuant to Section 119.

Comment

The statement of withdrawal must set forth an address where service of process may be made on the foreign limited liability company pursuant to Section 119. There is no limit on how long the withdrawn company must keep that address up to date.

SECTION 912. ACTION BY [ATTORNEY GENERAL]. The [Attorney General] may maintain an action to enjoin a foreign limited liability company from doing business in this state in violation of this [article].

Comment

The authority stated here has been part of corporate law for more than a century and has been carried over into the law of unincorporated business entities. Nowadays, the authority is rarely if ever invoked in either realm of entity law.

[ARTICLE] 10

MERGER, INTEREST EXCHANGE, CONVERSION, AND DOMESTICATION

Introductory Comment

This article deals comprehensively with both same-type and cross-type mergers and interest exchanges and with conversions and domestications. For this article to apply, at least one participant organization must be a domestic limited liability company. For a foreign organization to be involved, its organic law must permit the organization's participation.

Part 1 contains definitions specific to this article as well as provisions applicable to all transactions authorized by this article.

Part 2 governs mergers and is an amalgamation of existing entity law, both unincorporated and incorporated.

Part 3 governs interest exchanges, previously a feature only of corporate law. Part 3 is derived from the share exchange provisions in chapter 11 of the Model Business Corporation Act.

Part 4 governs conversions, a one-step procedure by which an entity changes from one type of entity to another type while nonetheless continuing in existence as the same legal entity.

Part 5 governs domestications, a procedure by a domestic limited liability company can become a foreign limited liability company or vice versa, in each instance with the company remaining the same legal entity.

Part 2 sets the paradigm for Parts 3, 4, and 5, because mergers are long-established and merger rules and concepts are familiar to business lawyers. Moreover, conversions and domestications could formerly be accomplished via mergers (with a new entity), and an interest exchange produces the same result as a triangular merger. The comments to Part 2 are thus relevant to understanding Parts 3, 4, and 5.

This article contemplates transactions in which the surviving entity is neither a filing entity nor otherwise of record in the filing office (*e.g.*, the merger of an LLC into a non-LLP general partnership). As a result, a filing under this article may be the first time that a filing office takes cognizance of an entity's existence.

[PART] 1

GENERAL PROVISIONS

SECTION 1001. DEFINITIONS. In this [article]:

(1) "Acquired entity" means the entity, all of one or more classes or series of interests of which are acquired in an interest exchange.

(2) "Acquiring entity" means the entity that acquires all of one or more classes or series of interests of the acquired entity in an interest exchange.

(3) "Conversion" means a transaction authorized by [Part] 4.

(4) "Converted entity" means the converting entity as it continues in existence after a conversion.

(5) "Converting entity" means the domestic entity that approves a plan of conversion pursuant to Section 1043 or the foreign entity that approves a conversion pursuant to the law of its jurisdiction of formation.

(6) "Distributional interest" means the right under an unincorporated entity's organic law and organic rules to receive distributions from the entity.

(7) "Domestic", with respect to an entity, means governed as to its internal affairs by the law of this state.

(8) "Domesticated limited liability company" means the domesticating limited liability company as it continues in existence after a domestication.

(9) "Domesticating limited liability company" means the domestic limited liability company that approves a plan of domestication pursuant to Section 1053 or the foreign limited

liability company that approves a domestication pursuant to the law of its jurisdiction of formation.

(10) "Domestication" means a transaction authorized by [Part] 5.

(11) "Entity":

(A) means:

(i) a business corporation;

(ii) a nonprofit corporation;

(iii) a general partnership, including a limited liability partnership;

(iv) a limited partnership, including a limited liability limited partnership;

(v) a limited liability company;

[(vi) a general cooperative association;]

(vii) a limited cooperative association;

(viii) an unincorporated nonprofit association;

(ix) a statutory trust, business trust, or common-law business trust; or

(x) any other person that has:

(I) a legal existence separate from any interest holder of that person; or

(II) the power to acquire an interest in real property in its own name; and

(B) does not include:

(i) an individual;

(ii) a trust with a predominantly donative purpose or a charitable trust;

(iii) an association or relationship that is not an entity listed in subparagraph A and is not a partnership under the rules stated in [Section 202(c) of the Uniform

Partnership Act (1997) (Last Amended 2013)] [Section 7 of the Uniform Partnership Act (1914)] or a similar provision of the law of another jurisdiction;

(iv) a decedent's estate; or

(v) a government or a governmental subdivision, agency, or instrumentality.

(12) "Filing entity" means an entity whose formation requires the filing of a public organic record. The term does not include a limited liability partnership.

(13) "Foreign", with respect to an entity, means an entity governed as to its internal affairs by the law of a jurisdiction other than this state.

(14) "Governance interest" means a right under the organic law or organic rules of an unincorporated entity, other than as a governor, agent, assignee, or proxy, to:

(A) receive or demand access to information concerning, or the books and records of, the entity;

(B) vote for or consent to the election of the governors of the entity; or

(C) receive notice of or vote on or consent to an issue involving the internal affairs of the entity.

(15) "Governor" means:

(A) a director of a business corporation;

(B) a director or trustee of a nonprofit corporation;

(C) a general partner of a general partnership;

(D) a general partner of a limited partnership;

(E) a manager of a manager-managed limited liability company;

(F) a member of a member-managed limited liability company;

[(G) a director of a general cooperative association;]

(H) a director of a limited cooperative association;

(I) a manager of an unincorporated nonprofit association;

(J) a trustee of a statutory trust, business trust, or common-law business trust; or

(K) any other person under whose authority the powers of an entity are exercised and under whose direction the activities and affairs of the entity are managed pursuant to the organic law and organic rules of the entity.

(16) "Interest" means:

(A) a share in a business corporation;

(B) a membership in a nonprofit corporation;

(C) a partnership interest in a general partnership;

(D) a partnership interest in a limited partnership;

(E) a membership interest in a limited liability company;

[(F) a share in a general cooperative association;]

(G) a member's interest in a limited cooperative association;

(H) a membership in an unincorporated nonprofit association;

(I) a beneficial interest in a statutory trust, business trust, or common-law business trust; or

(J) a governance interest or distributional interest in any other type of unincorporated entity.

(17) "Interest exchange" means a transaction authorized by [Part] 3.

(18) "Interest holder" means:

(A) a shareholder of a business corporation;

(B) a member of a nonprofit corporation;

(C) a general partner of a general partnership;

(D) a general partner of a limited partnership;

(E) a limited partner of a limited partnership;

(F) a member of a limited liability company;

[(G) a shareholder of a general cooperative association;]

(H) a member of a limited cooperative association;

(I) a member of an unincorporated nonprofit association;

(J) a beneficiary or beneficial owner of a statutory trust, business trust, or common-law business trust; or

(K) any other direct holder of an interest.

(19) "Interest holder liability" means:

(A) personal liability for a liability of an entity which is imposed on a person:

(i) solely by reason of the status of the person as an interest holder; or

(ii) by the organic rules of the entity which make one or more specified interest holders or categories of interest holders liable in their capacity as interest holders for all or specified liabilities of the entity; or

(B) an obligation of an interest holder under the organic rules of an entity to contribute to the entity.

(20) "Merger" means a transaction authorized by [Part] 2.

(21) "Merging entity" means an entity that is a party to a merger and exists immediately before the merger becomes effective.

(22) "Organic law" means the law of an entity's jurisdiction of formation governing the internal affairs of the entity.

(23) "Organic rules" means the public organic record and private organic rules of an entity.

(24) “Plan” means a plan of merger, plan of interest exchange, plan of conversion, or plan of domestication.

(25) “Plan of conversion” means a plan under Section 1042.

(26) “Plan of domestication” means a plan under Section 1052.

(27) “Plan of interest exchange” means a plan under Section 1032.

(28) “Plan of merger” means a plan under Section 1022.

(29) “Private organic rules” means the rules, whether or not in a record, that govern the internal affairs of an entity, are binding on all its interest holders, and are not part of its public organic record, if any. The term includes:

(A) the bylaws of a business corporation;

(B) the bylaws of a nonprofit corporation;

(C) the partnership agreement of a general partnership;

(D) the partnership agreement of a limited partnership;

(E) the operating agreement of a limited liability company;

[(F) the bylaws of a general cooperative association;]

(G) the bylaws of a limited cooperative association;

(H) the governing principles of an unincorporated nonprofit association; and

(I) the trust instrument of a statutory trust or similar rules of a business trust or common-law business trust.

(30) “Protected agreement” means:

(A) a record evidencing indebtedness and any related agreement in effect on [the effective date of this [act]];

(B) an agreement that is binding on an entity on [the effective date of this [act]];

(C) the organic rules of an entity in effect on [the effective date of this [act]]; or

(D) an agreement that is binding on any of the governors or interest holders of an entity on [the effective date of this [act]].

(31) "Public organic record" means the record the filing of which by the [Secretary of State] is required to form an entity and any amendment to or restatement of that record. The term includes:

(A) the articles of incorporation of a business corporation;

(B) the articles of incorporation of a nonprofit corporation;

(C) the certificate of limited partnership of a limited partnership;

(D) the certificate of organization of a limited liability company;

[(E) the articles of incorporation of a general cooperative association;]

(F) the articles of organization of a limited cooperative association; and

(G) the certificate of trust of a statutory trust or similar record of a business trust.

(32) "Registered foreign entity" means a foreign entity that is registered to do business in this state pursuant to a record filed by the [Secretary of State].

(33) "Statement of conversion" means a statement under Section 1045.

(34) "Statement of domestication" means a statement under Section 1055.

(35) "Statement of interest exchange" means a statement under Section 1035.

(36) "Statement of merger" means a statement under Section 1025.

(37) "Surviving entity" means the entity that continues in existence after or is created by a merger.

(38) "Type of entity" means a generic form of entity:

(A) recognized at common law; or

(B) formed under an organic law, whether or not some entities formed under that organic law are subject to provisions of that law that create different categories of the form of entity.

Comment

This section defines the terms that are used in this article. Many of the definitions describe attributes that are significant in some forms of entity and not in others. For example, the concept of separate "distributional" and "governance" interests are inherent in unincorporated entities but have no counterpart in corporations. In addition, because some statutes use different terms to describe the same transaction, the definitions are intended to be broad enough to encompass those similar transactions, regardless of how described. *See*, *e.g.*, Paragraph 10 (defining "domestication").

"Acquired entity" [(1)]—This definition recognizes that an interest exchange may involve only the acquisition of a particular "class" or "series" of interests in an entity. Model Business Corporation Act section 6.01 does not expressly define "classes" or "series." Because the interests of members in an unincorporated business organization often tend to be distinctive, it may be that each member's interest will comprise a separate class or series. For an explanation of a new and different meaning of the word "series," see Section 1031, introductory comment. The term "acquired entity" does not encompass series under that new meaning.

"Acquiring entity" [(2)]—An "acquiring entity" is an entity that acquires the interests of the acquired entity in an interest exchange governed by Part 3 of this article.

"Conversion" [(3)]—The term "conversion" means a transaction authorized by Part 4 pursuant to which an entity of one type is converted into an entity of another type. As used in this act, the term "conversion" does not include a transaction in which an entity changes the jurisdiction in which it is organized but does not change to a different form of entity; that type of transaction is referred to in this act as a "domestication" and is governed by Part 5.

"Converted entity" [(4)]—This term is used in Part 4 to describe the entity that results from a conversion.

"Converting entity" [(5)]—A converting entity is the entity that becomes the converted entity under Part 4.

"Distributional interest" [(6)]—This term is similar to the concept of a "transferable interest" found in this act and the organic laws of several other types of unincorporated entities, but has a broader meaning because the scope of this act includes entities in addition to those whose organic law uses the term "transferable interest."

"Domestic" [(7)]—The term "domestic", when used in this article with respect to an entity, refers to an entity whose internal affairs are governed by the organic laws of this state. Except in the case of general partnerships and unincorporated nonprofit associations, this will mean an entity that is formed, organized, or incorporated under domestic law. In the case of a general partnership organized under UPA (1997) (Last Amended 2013), the term will mean a general partnership whose governing law under UPA (1997) § 104 is the law of the adopting state. Under that section, the governing law is determined by the location of the partnership's principal office, except for limited liability partnerships whose governing law is the law of the state where the LLP's statement of qualification is filed. It is a factual question whether the activities and organization of an unincorporated nonprofit association make it a domestic or foreign entity.

"Domesticated limited liability company" [(8)]—This term is used in Part 5 and means the entity that is domesticated pursuant to Part 5. By the nature of the transaction, the domesticated entity will be of the same type as the domesticating entity (*i.e.*, an LLC).

"Domesticating limited liability company" [(9)]—This term is used in Part 5 and means the entity that is domesticated pursuant to Part 5.

"Domestication" [(10)]—The term "domestication" means a transaction of the kind authorized by Part 5 pursuant to which an entity may change its *jurisdiction* of formation *but not its type* so long as the laws of the foreign jurisdiction permit the domestication. The legal effect of the domestication of a limited liability company out of this state will be governed by the laws of both this state and the foreign jurisdiction. Some statutes include what is described in this act as "domestication" in their definition of a "conversion." *See, e.g.*, COLO. REV. STAT. § 7-90-201. It is intended that the domestication provisions of this act will apply to a transaction that may be characterized under another act as a "conversion" if the transaction meets the definition of "domestication" under this act.

"Entity" [(11)]—This definition determines the overall scope of the act because only an "entity" may participate in the transactions authorized by Parts 2 (mergers), 3 (interest exchanges), 4 (conversions), and 5 (domestications). *See* Sections 1021 (authorization of mergers), 1031(authorization of interest exchanges), 1041(authorization of conversions), 1051(authorization of domestications).

Subparagraph (A)(x) is a "catch-all" provision that includes within the definition of "entity" any type of organization recognized under the law of this state, which is not listed specifically in the preceding paragraphs of this definition. Subparagraph (A)(x) is intended to include all forms of private organizations, regardless of whether organized for profit, and artificial legal persons other than those excluded by Subparagraph (B). This definition does not exclude regulated entities such as public utilities, banks, and insurance companies. Should a state desire to exclude certain types of regulated entities or any of the entities listed in Subparagraph (A)(i)–(x) from participating in transactions permitted by this act for policy reasons, that may be done by listing those types of entities in Section 1007(a), or by permitting those type of entities to engage in transactions under this act generally but prohibiting certain types of transactions by listing those transactions in Section 1007(b).

Unincorporated nonprofit associations are treated as a type of entity in Subparagraph (A)(viii) because section 5 of the Uniform Unincorporated Nonprofit Association Act (2008) (Last Amended 2013) specifically states that an unincorporated nonprofit association is an entity. In many states, the status of a nonprofit association may not be clear. Nevertheless, in most states a nonprofit association has the power to acquire an interest in real property in its own name and therefore would qualify as an "entity" under Subparagraph (A)(x). See Section 6 of the UUNAA, which gives an unincorporated nonprofit association the power to acquire in its own name an interest in real property.

Subparagraph (B)(i) of this definition excludes a sole proprietorship from the concept of an "entity."

Trusts with a predominately donative purpose, such as inter vivos and testamentary trusts and charitable trusts, are treated in many states as having a separate legal existence, but they have been excluded from the definition of "entity" (and thus are not within the scope of this article) under Subparagraph (B)(ii) because they should not be able to engage in transactions under this act as a matter of public policy. Trusts that carry on a business, however, such as business and statutory entity trusts, are "entities." *See* Subparagraph (A)(ix).

Subparagraph (B)(iii) of this definition excludes from the concept of an "entity" any form of co-ownership of property or sharing of returns from property that is not listed in Subparagraph (A) and is not a partnership under UPA (1997). In that connection, Section 202(c) of that act provides in part:

> In determining whether a partnership is formed, the following rules apply:
> (1) Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or part ownership does not by itself establish a partnership, even if the co-owners share profits made by the use of the property.
> (2) The sharing of gross returns does not by itself establish a partnership, even if the persons sharing them have a joint or common right or interest in property from which the returns are derived.

Limited liability partnerships and limited liability limited partnerships are "entities" because they are general partnerships and limited partnerships respectively that have made the additional required election claiming LLP or LLLP status. A limited liability partnership is not, therefore, a separate type of entity from the underlying general or limited partnership that has elected limited liability partnership status. Thus, for example, the election of a general partnership to become a limited liability partnership is not a conversion subject to Article 4.

Under Subparagraph (B)(iv), decedent's estates are excluded from the definition of an entity for the same policy reason as trusts with a predominately donative purpose and charitable trusts.

This same public policy rationale is the justification for the exclusion of governmental subdivisions, agencies, or instrumentalities in Subparagraph (B)(v).

"Filing entity" [(12)]—Whether an entity is a filing entity is determined by reference to whether its legal existence requires the filing of a document with the state filing officer. To fit within this definition, the filing must be necessary but need not be sufficient to form the entity. *See, e.g.*, Section 201(d) ("A limited liability company is formed when the company's certificate of organization becomes effective *and* at least one person becomes a member.") (emphasis added).

While the statute refers to the "formation" of an entity, the term is intended to encompass corporations that are "incorporated," as well as other filing entities whose statutes refer to them as being "organized." Business trusts present a special problem. In some states, a business trust could be a filing entity or a common law relationship, while in other states business trusts are only recognized at common law. A statutory trust entity formed under the Uniform Statutory Trust Entity Act (2009) (Last Amended 2013) § 201(a) is a filing entity, because a statutory trust entity is formed by the filing office filing a certificate of trust pertaining to the entity.

The term "filing entity" does not include a limited liability partnership because, while a filed document is a precondition to LLP status, that document (a statement of qualification under UPA (1997) (Last Amended 2013) § 901) does not form the underlying entity. A limited liability limited partnership, on the other hand, is a filing entity because the underlying limited partnership is formed by filing a certificate of limited partnership. ULPA (2001) (Last Amended 2013) § 201(a).

"Foreign" [(13)]—The term "foreign entity" includes any non-domestic entity of any type. Where a foreign entity is a filing entity, the entity is governed by the laws of the state of filing. A nonfiling foreign entity is governed by the laws governing its internal affairs. It is a factual question whether a general partnership whose internal affairs are governed by UPA (1914) is a domestic or foreign partnership. A UPA (1914) partnership will likely be deemed to be a domestic entity where the greatest nexus of contacts are found. The domestic or foreign characterization of partnerships under the UPA (1997) (Last Amended 2013) that have not become limited liability partnerships will be governed by Section 104(2) ("the law of the jurisdiction in which the partnership has its principal office") or the partnership agreement. (Section 104(2) is a default rule.)

"Governance interest" [(14)]—A governance interest is typically only part of the interest that a person will hold in an unincorporated entity and is usually coupled with a distributional interest (or economic rights). Memberships in some nonprofit corporations and unincorporated nonprofit associations consist solely of governance interests and memberships in other nonprofit entities may not include either governance interests or distributional interests. In some unincorporated business entities, including limited liability companies, there is a more limited right to transfer governance interests than there is to transfer distributional interests. An interest holder in such an unincorporated business entity who transfers only a distributional interest and retains the governance interest will also retain the status of an interest holder. Whether a transferee who acquires only a distributional interest will acquire the status of an interest holder is determined by the definition of "interest holder."

Governors of an entity have the kinds of rights listed in the definition of "governance interest" by reason of their position with the entity. For a governor to have a "governance interest," however, requires that the governor also have those rights for a reason other than the governor's status as such. A manager who is not a member in a limited liability company, for example, will not have a governance interest, but a manager who is a member will have a governance interest arising from the ownership of a membership interest.

"Governor" [(15)]—This term has been chosen to provide a way of referring to a person who has the authority under an entity's organic law to make management decisions regarding the entity that is different from any of the existing terms used in connection with particular types of entities. Depending on the type of entity or its organic rules, the governors of an entity may have the power to act on their own authority, or they may be organized as a board or similar group and only have the power to act collectively, and then only through a designated agent. In other words, a person having only the power to bind the organization pursuant to the instruction of the governors is not a governor. Under the organic rules, particularly those of unincorporated entities, most or all of the management decisions may be reserved to the members or partners. Thus, if a manager of a limited liability company were limited to having authority to execute management decisions made by the members and did not have any authority to make independent management decisions, the manager would not be a governor under this definition.

"Interest" [(16)]—In the usual case, the interest held by an interest holder will include both a governance interest and a distributional interest. Members in nonprofit corporations or unincorporated nonprofit associations generally do not have any distributional interest because they do not receive distributions, but they nonetheless may hold a governance interest in which case they would have the status of interest holders under this article.

"Interest exchange" [(17)]—The term "interest exchange" means a transaction authorized by Part 3 pursuant to which an entity may acquire interests in another entity. The consideration that may be provided to the interest holders whose interests are being acquired in an exchange may consist in whole or part of interests in a third party that is not one of the two parties to the exchange itself. *See* Section 1031(a).

"Interest holder" [(18)]—This act does not refer to "equity" interests or "equity" owners or holders because the term "equity" could be confusing in the case of a nonprofit entity whose members do not have an interest in the assets or results of operations of the entity but have only a right to vote on its internal affairs.

"Interest holder liability" [(19)]—This term is used to describe the vicarious liability of an interest holder, by virtue of being an interest holder, for liabilities of the entity. The term includes only personal liability of an interest holder for a debt of the entity imposed on the interest holder either by statute or by the organic rules to the extent authorized pursuant to the organic law. Liabilities that an interest holder incurs in any other fashion are not interest holder liabilities for purposes of this act. Thus, for example, if a state's business corporation law makes shareholders personally liable for unpaid wages because of their status as shareholders, that liability would be an "interest holder liability." If, on the other hand, a shareholder were to guarantee payment of an obligation of a corporation, that liability would not be an "interest holder liability" because it is a direct liability and not based on the status of being a shareholder. Similarly, the liability to return an improper distribution is not an interest holder liability because it is a direct liability of the interest holder based on receipt of the distribution.

"Merger" [(20)]—The term means a transaction in which two or more entities are combined into a single entity pursuant to a filing with the filing office. The term "merger" in this act includes the transaction known as a consolidation in which a new entity results from the combination of two or more pre-existing entities.

"Merging entity" [(21)]—The term "merging entity" refers to each entity that is in existence immediately before a merger and is a party to the merger. It will include the surviving entity if the surviving entity exists before the merger becomes effective. It does not include an entity that provides consideration to be received by interest holders if that entity is not a party to the merger.

"Organic law" [(22)]—Organic law means statutes that govern the internal affairs of an entity. For example, this act is the organic law of a limited liability company formed under this act.

Entity laws in a few states purport to require that some of their internal governance rules applicable to a domestic entity also apply to a foreign entity with significant ties to the state. *See, e.g.*, CAL. CORP. CODE § 2115 (Foreign Corporations); N.Y. NOT-FOR-PROFIT-CORP. §§ 1318–21 (Liabilities of Directors and Officers of Foreign Corporations); 15 PA. CONS. STAT. § 6145 (Applicability of Certain Safeguards to Foreign Corporations). Such a "sticky fingers" law is not included within the definition of "organic law" for purposes of this act because those laws are not part of the law of the entity's jurisdiction of formation.

"Organic rules" [(23)]—The term "organic rules" means an entity's public organic record and the private organic rules. The organic rules, together with this act, the organic law, and the common law, provide the rules governing the internal affairs of the entity. For example, this act and the operating agreement comprise the organic rules of a limited liability company formed under this act.

"Plan" [(24)]—The term "plan" is a short-hand way of referring to the plan of merger, interest exchange, conversion, or domestication, as the case may be, depending on which form of transaction is taking place. *See* Sections 1022 (plan of merger), 1032 (plan of interest exchange), 1042 (plan of conversion), 1052 (plan of domestication).

"Private organic rules" [(29)]—The term private "organic rules" is intended to include all governing rules of an entity that are binding on all of its interest holders, whether or not in record form, except for the provisions of the entity's public organic record, if any. The term is intended to include agreements in "record" form such as corporate bylaws, as well as oral partnership agreements and oral operating agreements among LLC members.

"Protected agreement" [(30)]—The term "protected agreement" refers to evidences of indebtedness and agreements binding on the entity or any of its governors or interest holders that are unpaid or executory in whole or in part on the effective date of the act. Thus, a revolving line of credit from a bank to a corporation would constitute a protected agreement even if advances were not made until after the effective date of the act. Likewise, an operating agreement in effect under this act or a predecessor to this act is a "protected agreement."

If a protected agreement has provisions that apply if an entity merges, those provisions will apply if the entity enters into an interest exchange, conversion, or domestication even though the agreement does not mention those other types of transactions. *See* Sections 1031(c) (interest exchange), 1041(c) (conversion), 1051(c) (domestication).

"Public organic record" [(31)]—A "public organic record" is a record that is filed publicly to form, organize, incorporate, or otherwise create an entity. The term does not include a statement of authority filed under UPA (1997) (Last Amended 2013) § 303 or any of the other statements that may be filed under that act since those statements do not create a new entity. The same is true for statements filed under this act.

For the same reason, a statement of qualification filed under UPA (1997) (Last Amended 2013) § 1001 is not a "public organic record." The limited liability partnership that results from the filing is the same entity as the partnership that delivered the statement to the filing office. Similarly, the term does not include a statement of authority filed under section 7 of the Revised Uniform Unincorporated Nonprofit Association Act (2008) (Last Amended 2013), a statement appointing a registered agent filed under section 31 of that act, or any of the various statements filed under this act.

In those states where a deed of trust or other instrument is publicly filed to create a business trust, that filing will constitute a public organic record. But in those states where a business trust is not created by a public filing, the deed of trust or similar record will be part of the private organic rules of the business trust.

Where a public organic document has been amended or restated, the term means the public organic document as last amended or restated.

"Registered foreign entity" [(32]—This term refers to a foreign entity that is registered to transact business in this state pursuant to a public filing.

"Surviving entity" [(37)]—The term "surviving entity" refers to either a merging entity that survives the merger or the new entity created by the merger.

"Type of entity" [(38]—The term "type of entity" has been developed in an attempt to distinguish different legal forms of entities. It is sometimes difficult to decide whether one is dealing with a different form of entity or a variation of the same form. For example, a limited partnership, although it has long been characterized or even defined as a partnership, is a different type of entity from a general partnership, while a limited liability partnership is not a different type of entity from a general partnership. In some states cooperatives are categories of business corporations or nonprofit corporations, while in other states cooperatives are a separate type of entity.

SECTION 1002. RELATIONSHIP OF [ARTICLE] TO OTHER LAWS.

(a) This [article] does not authorize an act prohibited by, and does not affect the application or requirements of, law other than this [article].

(b) A transaction effected under this [article] may not create or impair a right, duty or obligation of a person under the statutory law of this state other than this [article] relating to a change in control, takeover, business combination, control-share acquisition, or similar transaction involving a domestic merging, acquired, converting, or domesticating business corporation unless:

(1) if the corporation does not survive the transaction, the transaction satisfies any requirements of the law; or

(2) if the corporation survives the transaction, the approval of the plan is by a vote of the shareholders or directors which would be sufficient to create or impair the right, duty, or obligation directly under the law.

Comment

This section preserves existing regulatory law in an adopting state in general terms. Adopting states should consider more carefully integrating this act with their various regulatory laws. For example, in some states certain professions are limited in their use of limited liability entities. *See* Section 1003.

Laws other than this act that will apply to transactions under this act include, for example, fraudulent transfer and fraudulent conveyance acts, state insolvency statutes, federal bankruptcy law, and Articles 8 and 9 of the Uniform Commercial Code.

Subsection (b)—Many states have enacted "antitakeover" statutes intended to make it more difficult to acquire control of a publicly traded corporation. Those statutes often provide that their application to a particular corporation cannot be changed unless the corporation obtains certain specified approvals, such as a vote of disinterested directors or a supermajority vote by the shareholders. The purpose of the special requirements in this subsection on varying the application of an antitakeover statute is to protect against a hostile acquirer or group of shareholders seeking to use the act to avoid the application of the antitakeover statute.

This subsection protects the application of antitakeover statutes from being affected by a transaction under this act by requiring that the transaction be approved in a manner that would be sufficient to approve changing the application of the antitakeover statute. If a transaction is approved in that manner, there is no policy reason to prohibit the application of the antitakeover statute from being varied by a transaction under this act. If the application of an antitakeover statute cannot be varied by action of an entity subject to it, then a transaction under this act will be permissible only if the antitakeover provision continues to apply after the transaction or the transaction itself is permissible under the antitakeover statute.

SECTION 1003. REQUIRED NOTICE OR APPROVAL.

(a) A domestic or foreign entity that is required to give notice to, or obtain the approval of, a governmental agency or officer of this state to be a party to a merger must give the notice or obtain the approval to be a party to an interest exchange, conversion, or domestication.

(b) Property held for a charitable purpose under the law of this state by a domestic or foreign entity immediately before a transaction under this [article] becomes effective may not, as a result of the transaction, be diverted from the objects for which it was donated, granted, devised, or otherwise transferred unless, to the extent required by or pursuant to the law of this state concerning cy pres or other law dealing with nondiversion of charitable assets, the entity obtains an appropriate order of [the appropriate court] [the Attorney General] specifying the disposition of the property.

(c) A bequest, devise, gift, grant, or promise contained in a will or other instrument of donation, subscription, or conveyance which is made to a merging entity that is not the surviving entity and which takes effect or remains payable after the merger inures to the surviving entity.

(d) A trust obligation that would govern property if transferred to a nonsurviving entity applies to property that is transferred to the surviving entity under this section.

Legislative Note: *As an alternative to enacting Subsection (a), a state may identify each of its regulatory laws that requires prior approval for a merger of a regulated entity, decide whether regulatory approval should be required for an interest exchange, conversion, or domestication, and make amendments as appropriate to those laws.*

As with Subsection (a), an adopting state may choose to amend its various laws with respect to the nondiversion of charitable property to cover the various transactions authorized by this act as an alternative to enacting Subsection (b).

Comment

Subsection (a)—Because at least some of the provisions of this act will be new in most states, it is likely that existing state laws that require regulatory approval of transactions by businesses such as banks, insurance companies, or public utilities may not be worded in a fashion that will include at least some of the transactions authorized by this act. The purpose of this subsection is to ensure that transactions under this act will be subject to the same regulatory approval as mergers. This subsection is based on whether a merger by a regulated entity requires prior approval because the transactions authorized by this act may be effectuated indirectly in many cases under existing law by establishing a wholly-owned subsidiary of the desired type and then merging into it.

The consequence of violating this subsection should be the same as in the case of a merger consummated without the required approval.

Subsection (b)—This act applies generally to nonprofit corporations and unincorporated nonprofit associations. As in the case of laws regulating particular industries, a state's laws governing the nondiversion of charitable property to other uses may not cover some of the transactions authorized by this act. To prevent the procedures in this act from being used to avoid restrictions on the use of charitable property held by nonprofit entities, this subsection requires approval of the effect of transactions under this act by the appropriate arm of government having supervision of nonprofit entities.

An approval or order obtained under this section may impose conditions or specify the disposition of assets or liabilities in a manner different than would otherwise be the case. In such an instance, the approval or order will control over the provisions of this act specifying the effects of a transaction. *See* Sections 1026 (effect of merger), 1036 (effect of interest exchange), 1046 (effect of conversion), 1056 (effect of domestication).

Subsection (c)—This subsection clarifies the legal effect of a merger on bequests, etc. that were originally made to an entity that does not survive the merger. This issue does not arise in an interest exchange, conversion, or domestication transaction because the entity to which the bequest, etc. was made survives in some form after the transaction.

SECTION 1004. NONEXCLUSIVITY. The fact that a transaction under this [article] produces a certain result does not preclude the same result from being accomplished in any other manner permitted by law other than this [article].

Comment

This section allows a transaction that has the same end result as one of the transactions governed by this act, but that is accomplished in a manner not within the scope of this act, to be exempt from this act. For example, a sale of assets and transfer of liabilities by two entities to a third entity followed by the liquidation of the two transferring entities can be accomplished pursuant to statutory provisions pertaining to sale of assets rather than under Part 2 of this article, even though the end result of the transaction is essentially the same as if the two entities had merged into a third entity.

SECTION 1005. REFERENCE TO EXTERNAL FACTS. A plan may refer to facts ascertainable outside the plan if the manner in which the facts will operate upon the plan is specified in the plan. The facts may include the occurrence of an event or a determination or action by a person, whether or not the event, determination, or action is within the control of a party to the transaction.

Comment

This section is based on, but more concise than, section 1.20(k) of the Model Business Corporation Act.

SECTION 1006. APPRAISAL RIGHTS. An interest holder of a domestic merging, acquired, converting, or domesticating limited liability company is entitled to contractual appraisal rights in connection with a transaction under this [article] to the extent provided in:

(1) the operating agreement; or

(2) the plan.

Comment

In corporate law, appraisal rights developed when corporate statutes were amended to permit mergers with less than unanimous consent of the shareholders. This article provides no appraisal rights, because, as a default rule, transactions under this article require the consent or affirmative vote of all the members. Where the operating agreement changes this default rule, parties may wish to consider contractual appraisal rights.

This subsection validates the grant of such contractual appraisal rights. *Cf.* 6 DEL. CODE §§ 15-120 (general partnerships), 17-212 (limited partnerships), 18-210 (limited liability companies) (validating "contractual appraisal rights"); MBCA § 13.02(5) (permitting the articles of incorporation, bylaws, or a resolution of the board of directors to confer appraisal rights in contexts in which they would otherwise not be available). Legislative authorization in this subsection of the grant of contractual appraisal rights removes any question as to whether a court would have jurisdiction to hear a case in which the parties were attempting to create jurisdiction in the court by private agreement.

In this section, the term "appraisal rights" refers to any arrangement, either in the operating agreement or the plan, providing for the buy-out of members that object to a transaction under this article.

[SECTION 1007. EXCLUDED ENTITIES AND TRANSACTIONS.

(a) The following entities may not participate in a transaction under this [article]:

(1)

(2).

(b) This [article] may not be used to effect a transaction that:

(1)

(2).]

Legislative Note: *Subsection (a) may be used by states that have special statutes restricted to the organization of certain types of entities. A common example is banking statutes that prohibit banks from engaging in transactions other than pursuant to those statutes.*

Nonprofit entities may participate in transactions under this act with for-profit entities, subject to compliance with Section 1003. If a state desires, however, to exclude entities with a charitable purpose or to exclude other types of entities from the scope of this article, that may be *done by referring to those entities in Subsection (a).*

Subsection (b) may be used to exclude certain types of transactions governed by more specific statutes. A common example is the conversion of an insurance company from mutual to stock form. There may be other types of transactions that vary greatly among the states.

[PART] 2

MERGER

SECTION 1021. MERGER AUTHORIZED.

(a) By complying with this [part]:

(1) one or more domestic limited liability companies may merge with one or more domestic or foreign entities into a domestic or foreign surviving entity; and

(2) two or more foreign entities may merge into a domestic limited liability company.

(b) By complying with the provisions of this [part] applicable to foreign entities, a foreign entity may be a party to a merger under this [part] or may be the surviving entity in such a merger if the merger is authorized by the law of the foreign entity's jurisdiction of formation.

Comment

The merger transaction authorized by this act involves the combination of one or more domestic limited liability companies with or into one or more other domestic or foreign entities. It also contemplates the consolidation of two or more foreign entities into a single domestic limited liability company. Upon the effective date of the merger, all the assets and liabilities of the constituent entities vest in the surviving entity as a matter of law. As such, mergers require the existence of at least two separate entities before the transaction and only one entity may survive the merger. If independent existence of the constituent entities is desired following the conclusion of the transaction, a restructuring transaction other than a merger must be used to accomplish the transfer of assets and liabilities.

This act authorizes a merger for state entity law purposes. Federal law and other state law will independently determine how a merger transaction will be taxed.

Subsection (a)(1)—This paragraph states the general rule that subject to Subsection (b) one or more domestic limited liability companies may merge with or into a domestic or foreign surviving entity.

Subsection (a)(2)—This paragraph provides that two or more foreign entities may merge into a domestic surviving limited liability company so long as the requirements of Subsection (b) are met.

Subsection (b)—This subsection provides that a foreign entity may be a party to a merger or may be the surviving entity in a merger only if the merger is authorized by the laws of the foreign entity's jurisdiction of formation.

SECTION 1022. PLAN OF MERGER.

(a) A domestic limited liability company may become a party to a merger under this [part] by approving a plan of merger. The plan must be in a record and contain:

(1) as to each merging entity, its name, jurisdiction of formation, and type of entity;

(2) if the surviving entity is to be created in the merger, a statement to that effect and the entity's name, jurisdiction of formation, and type of entity;

(3) the manner of converting the interests in each party to the merger into interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing;

(4) if the surviving entity exists before the merger, any proposed amendments to:

(A) its public organic record, if any; and

(B) its private organic rules that are, or are proposed to be, in a record;

(5) if the surviving entity is to be created in the merger:

(A) its proposed public organic record, if any; and

(B) the full text of its private organic rules that are proposed to be in a record;

(6) the other terms and conditions of the merger; and

(7) any other provision required by the law of a merging entity's jurisdiction of formation or the organic rules of a merging entity.

(b) In addition to the requirements of subsection (a), a plan of merger may contain any other provision not prohibited by law.

Comment

Subsection (a)—This subsection states the requirements for the plan of merger. They are similar to plan of merger provisions in corporation statutes. *See* MBCA § 11.02(c). The requirements stated in this subsection are mandatory. *See* Section 105(c)(14).

Subsection (a)(1)—This paragraph requires that the plan of merger identify the parties to the merger. The name of a merging entity as it appears in the plan of merger will be its name in its jurisdiction of formation.

Subsection (a)(3)—The language of this paragraph is similar to Model Business Corporation Act section 11.02(c)(3). What may be done under this paragraph with respect to providing for continuing interests in the surviving entity for some holders of interests of a class or series of a party to the merger while paying some other form of consideration to other holders of the same class or series of interests in that entity will vary depending on the type of entity involved and the extent to which its organic rules provide for non-uniform treatment of interest holders in a manner that is permissible under its organic law. Similarly, the ability to use a merger to reorganize the capital structure of the surviving entity will vary depending on the type of entity involved and whether the entity has appropriately adopted relevant provisions in its organic rules.

If the organic law and organic rules of an unincorporated entity permit a non-uniform "equity shuffle" to be accomplished in a merger involving the unincorporated entity, the minority owners of the unincorporated entity will not necessarily be entitled to the statutory appraisal rights currently afforded to minority stockholders in merging corporate entities. Any perceived unfairness in the shuffle would be addressed either: (i) under principles of fiduciary duties and the contractual obligations of good faith and fair dealing, assuming, of course, that such duties and obligations have not been contractually modified or eliminated to the extent permitted by the applicable organic law; or (ii) by the exercise of whatever rights the minority owners may have to veto the transaction or to withdraw or to dissociate and be paid the value of their interests.

The Model Business Corporation Act generally requires that shares of the same class or series be treated in the same manner in a merger unless the corporation has adopted an applicable provision of its articles of incorporation pursuant to section 6.01(e) of that act providing for variations in the treatment of holders of the same class or series of shares. Thus a determination of what may be done by way of an equity shuffle in the case of a corporation will require reference to its organic law and organic rules.

The consideration paid to the interest holders of the merging parties may be supplied in whole or part by a person who is not a party to the merger.

Subsection (b)—This subsection provides the statutory authority for a merging party to include a provision in a plan of merger that is not specifically listed in Subsection (a). One such possibility is contractual appraisal rights as provided in Section 1006(b).

SECTION 1023. APPROVAL OF MERGER.

(a) A plan of merger is not effective unless it has been approved:

(1) by a domestic merging limited liability company, by all the members of the company entitled to vote on or consent to any matter; and

(2) in a record, by each member of a domestic merging limited liability company which will have interest holder liability for debts, obligations, and other liabilities that are incurred after the merger becomes effective, unless:

(A) the operating agreement of the company provides in a record for the approval of a merger in which some or all of its members become subject to interest holder liability by the affirmative vote or consent of fewer than all the members; and

(B) the member consented in a record to or voted for that provision of the operating agreement or became a member after the adoption of that provision.

(b) A merger involving a domestic merging entity that is not a limited liability company is not effective unless the merger is approved by that entity in accordance with its organic law.

(c) A merger involving a foreign merging entity is not effective unless the merger is approved by the foreign entity in accordance with the law of the foreign entity's jurisdiction of formation.

Comment

Subsection (a)—In the uniform acts pertaining to unincorporated business organizations, unanimity is the default rule for approving a merger. The operating agreement certainly can change this rule, but care should be taken in doing so. For example, a merger can revise the operating agreement. Section 1022(a)(4). Thus, if a merger requires less-than-unanimous consent, the operating agreement is subject to amendment by the same quantum of consent. "Exit rights" also require consideration. This act does not provide appraisal rights, because such rights are inapposite when unanimous consent is required. *See* the comment to Section 1006.

Subsection (a)(2)—This provision is not a default rule, Section 105(c)(14), and deals with the situation in which a member of an LLC that is a party to a merger will have vicarious liability for the liabilities of the surviving entity that are incurred after the merger becomes effective. The special approval requirement in Subsection (a)(2) will be applicable; for example, to members of an LLC that merges into a general partnership that is not a limited liability partnership if the members become general partners of the surviving general partnership.

The consent of a member required by Subsection (a)(2)(B) may be given either by: (i) signing or agreeing generally to the terms of an operating agreement that includes the required provision permitting less than unanimous approval of a merger in which members become subject to "interest holder liability"; or (ii) voting for or consenting to an amendment to the operating agreement to add such a provision.

Subsection (b)—Where a domestic entity other than a limited liability company is a party to a merger under this act, this subsection defers to that entity's organic law for the requirements for approval of the merger by that entity.

Subsection (c)—Where a foreign entity is a party to a merger under this act, this subsection defers to the laws of the foreign jurisdiction for the requirements for approval of the merger by the foreign entity. Those laws will include the organic law of the foreign entity and other applicable laws. The laws of the foreign jurisdiction will also control the application of any special approval requirements found in the organic rules of the foreign entity.

SECTION 1024. AMENDMENT OR ABANDONMENT OF PLAN OF MERGER.

(a) A plan of merger may be amended only with the consent of each party to the plan, except as otherwise provided in the plan.

(b) A domestic merging limited liability company may approve an amendment of a plan of merger:

(1) in the same manner as the plan was approved, if the plan does not provide for the manner in which it may be amended; or

(2) by its managers or members in the manner provided in the plan, but a member that was entitled to vote on or consent to approval of the merger is entitled to vote on or consent to any amendment of the plan that will change:

(A) the amount or kind of interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing, to be received by the interest holders of any party to the plan;

(B) the public organic record, if any, or private organic rules of the surviving entity that will be in effect immediately after the merger becomes effective, except for changes that do not require approval of the interest holders of the surviving entity under its organic law or organic rules; or

(C) any other terms or conditions of the plan, if the change would adversely affect the member in any material respect.

(c) After a plan of merger has been approved and before a statement of merger becomes effective, the plan may be abandoned as provided in the plan. Unless prohibited by the plan, a domestic merging limited liability company may abandon the plan in the same manner as the plan was approved.

(d) If a plan of merger is abandoned after a statement of merger has been delivered to the [Secretary of State] for filing and before the statement becomes effective, a statement of abandonment, signed by a party to the plan, must be delivered to the [Secretary of State] for filing before the statement of merger becomes effective. The statement of abandonment takes effect on filing, and the merger is abandoned and does not become effective. The statement of abandonment must contain:

(1) the name of each party to the plan of merger;

(2) the date on which the statement of merger was filed by the [Secretary of State]; and

(3) a statement that the merger has been abandoned in accordance with this section.

Comment

This section sets out the requirements for amending or abandoning the plan of merger. They are similar to provisions for amending or abandoning mergers found in existing corporation merger statutes. *See* MBCA §§ 11.02(e), 11.08.

SECTION 1025. STATEMENT OF MERGER; EFFECTIVE DATE OF MERGER.

(a) A statement of merger must be signed by each merging entity and delivered to the

[Secretary of State] for filing.

(b) A statement of merger must contain:

(1) the name, jurisdiction of formation, and type of entity of each merging entity that is not the surviving entity;

(2) the name, jurisdiction of formation, and type of entity of the surviving entity;

(3) a statement that the merger was approved by each domestic merging entity, if any, in accordance with this [part] and by each foreign merging entity, if any, in accordance with the law of its jurisdiction of formation;

(4) if the surviving entity exists before the merger and is a domestic filing entity, any amendment to its public organic record approved as part of the plan of merger;

(5) if the surviving entity is created by the merger and is a domestic filing entity, its public organic record, as an attachment; and

(6) if the surviving entity is created by the merger and is a domestic limited liability partnership, its statement of qualification, as an attachment.

(c) In addition to the requirements of subsection (b), a statement of merger may contain any other provision not prohibited by law.

(d) If the surviving entity is a domestic entity, its public organic record, if any, must satisfy the requirements of the law of this state, except that the public organic record does not need to be signed.

(e) A plan of merger that is signed by all the merging entities and meets all the requirements of subsection (b) may be delivered to the [Secretary of State] for filing instead of a statement of merger and on filing has the same effect. If a plan of merger is filed as provided in this subsection, references in this [article] to a statement of merger refer to the plan of merger filed under this subsection.

(f) If the surviving entity is a domestic limited liability company, the merger becomes effective when the statement of merger is effective. In all other cases, the merger becomes effective on the later of:

(1) the date and time provided by the organic law of the surviving entity; and

(2) when the statement is effective.

Comment

The filing of a statement of merger makes the transaction a matter of public record.

Subsection (a)—This subsection pertains to all merging entities involved in a merger, not merely any merging domestic limited liability company. Other filings may be required by the organic law of other entities participating in the merger.

Subsection (b)(1) and (2)—The names of foreign entities set forth in the statement of merger will generally be their names in their jurisdiction of formation, except that if a foreign entity has been required to adopt a different name in order to register to do business in this state, the foreign qualification statute will likely require that, when the entity does business in this state, the entity must use the name adopted for the purposes of registering to do business. Engaging in a merger under this act will be part of the business done by the entity in this state and the name of the entity set forth in the statement of merger will thus need to be the name under which the entity has registered to do business. Use of the name under which the entity has registered to do business will allow the records in the filing office to associate the registration of the entity to do business with the statement of merger.

Subsection (b)(3)—*See* the comment to Subsection (f).

Subsection (b)(4)—The statement in this paragraph that the plan of merger was approved by each entity in accordance with this article necessarily presupposes that the plan was approved in accordance with any valid, special requirements in the organic rules of each merging entity.

Subsection (b)(5) and (6)—The public organic record of a domestic surviving entity created by the merger that is attached to the statement of merger becomes the original, officially filed text of the public organic record of the surviving entity when the statement of merger takes effect. It is not necessary, or appropriate, to make any other filing to create the surviving entity.

Similarly, a statement of qualification for a domestic limited liability partnership created by the merger that is attached to the statement of merger does not need to be filed separately.

Subsection (d)—Organic laws typically require that an initial filing that creates an entity be signed by the person serving as the incorporator or other organizer. This subsection, however, provides that the public organic record of the surviving entity does not need to be signed since the record is attached to a signed record.

This subsection also permits the public organic record of the surviving entity to omit any provision that is not required to be included in a restatement of the public organic record. Pursuant to this provision, for example, the public organic record of a business corporation created as the surviving entity in the merger would not need to state the name and address of each incorporator even though that information would be required by the Model Business Corporation Act section 2.02(a)(4) if the corporation were being incorporated outside the context of the merger.

Subsection (e)—A plan of merger that contains all the information required in the statement of merger may be filed instead of the statement of merger. The plan must be in a record and signed by each merging party.

Subsection (f)—A merger in which the surviving entity is a domestic limited liability company takes effect when the statement of merger takes effect. A merger in which the surviving entity is a foreign entity will usually also take effect when the statement of merger takes effect because the practice is to coordinate the filings that need to be made when a merger involves both a domestic entity and also a foreign entity so that the filings in each jurisdiction take effect at the same time.

However, when the surviving limited liability company is a foreign limited liability company, it is possible that the filing in the foreign jurisdiction will take effect at a different time. For that reason, this subsection provides that the merger will take effect at the later of: (i) when the statement of merger takes effect; and (ii) when the merger takes effect under the law of the foreign jurisdiction. This rule avoids the possibility that the merger will take effect in this state before it takes effect in the foreign jurisdiction, which would produce the undesirable result that the merging domestic limited liability company would cease to appear as an active entity on the records of this state before the records of the foreign jurisdiction reflect a completed merger.

It is only necessary for the filing office to record the effective date of the statement of merger and the filing office does not need to be concerned with the effective date of the merger itself. Persons wishing to determine the effective date of a merger involving both a domestic and a foreign entity will be able to do so by consulting the records of the filing offices in each jurisdiction.

SECTION 1026. EFFECT OF MERGER.

(a) When a merger becomes effective:

(1) the surviving entity continues or comes into existence;

(2) each merging entity that is not the surviving entity ceases to exist;

(3) all property of each merging entity vests in the surviving entity without transfer, reversion, or impairment;

(4) all debts, obligations, and other liabilities of each merging entity are debts,

obligations, and other liabilities of the surviving entity;

(5) except as otherwise provided by law or the plan of merger, all the rights, privileges, immunities, powers, and purposes of each merging entity vest in the surviving entity;

(6) if the surviving entity exists before the merger:

(A) all its property continues to be vested in it without transfer, reversion, or impairment;

(B) it remains subject to all its debts, obligations, and other liabilities; and

(C) all its rights, privileges, immunities, powers, and purposes continue to be vested in it;

(7) the name of the surviving entity may be substituted for the name of any merging entity that is a party to any pending action or proceeding;

(8) if the surviving entity exists before the merger:

(A) its public organic record, if any, is amended to the extent provided in the statement of merger; and

(B) its private organic rules that are to be in a record, if any, are amended to the extent provided in the plan of merger;

(9) if the surviving entity is created by the merger, its private organic rules are effective and:

(A) if it is a filing entity, its public organic record becomes effective; and

(B) if it is a limited liability partnership, its statement of qualification becomes effective; and

(10) the interests in each merging entity which are to be converted in the merger are converted, and the interest holders of those interests are entitled only to the rights provided to them under the plan of merger and to any appraisal rights they have under Section 1006 and the

merging entity's organic law.

(b) Except as otherwise provided in the organic law or organic rules of a merging entity, the merger does not give rise to any rights that an interest holder, governor, or third party would have upon a dissolution, liquidation, or winding up of the merging entity.

(c) When a merger becomes effective, a person that did not have interest holder liability with respect to any of the merging entities and becomes subject to interest holder liability with respect to a domestic entity as a result of the merger has interest holder liability only to the extent provided by the organic law of that entity and only for those debts, obligations, and other liabilities that are incurred after the merger becomes effective.

(d) When a merger becomes effective, the interest holder liability of a person that ceases to hold an interest in a domestic merging limited liability company with respect to which the person had interest holder liability is subject to the following rules:

(1) The merger does not discharge any interest holder liability under this [act] to the extent the interest holder liability was incurred before the merger became effective.

(2) The person does not have interest holder liability under this [act] for any debt, obligation, or other liability that is incurred after the merger becomes effective.

(3) This [act] continues to apply to the release, collection, or discharge of any interest holder liability preserved under paragraph (1) as if the merger had not occurred.

(4) The person has whatever rights of contribution from any other person as are provided by this [act], law other than this [act], or the operating agreement of the domestic merging limited liability company with respect to any interest holder liability preserved under paragraph (1) as if the merger had not occurred.

(e) When a merger becomes effective, a foreign entity that is the surviving entity may be served with process in this state for the collection and enforcement of any debts, obligations, or other liabilities of a domestic merging limited liability company as provided in Section 119.

(f) When a merger becomes effective, the registration to do business in this state of any foreign merging entity that is not the surviving entity is canceled.

Comment

With the exception of Subsections (c) and (d), this section is similar to statutory provisions on the effect of a merger of a corporation with a corporation. *See* MBCA § 11.07.

Subsection (a)—This subsection states the general understanding that in a merger the assets and liabilities of the merging entities automatically vest in the surviving entity. The surviving entity becomes the owner of all real and personal property of the merged entities and is subject to all debts, obligations, and liabilities of the merging entities. A merger does not constitute a transfer, assignment, or conveyance of any property held by the merging entities before the merger. A merger also does not give rise to a claim that a contract with a merging entity is no longer in effect on the ground of nonassignability, unless the contract specifically provides that it does not survive a merger. The contract rights that are vested in the surviving entity include the right to enforce subscription agreements for interests and obligations to make capital contributions entered into or incurred before the merger. *See* Section 1003(c) (dealing with the surviving entity's rights in trust obligations of a nonsurviving party in a merger and transactions such as bequests made to a nonsurviving party to a merger that take effect after the merger).

After a merger becomes effective, the law of the surviving entity's jurisdiction of formation governs the surviving entity.

Sections 1003(a) and (b), modify the provisions of this section with respect to the effects of a merger to the extent a regulatory law provides otherwise or any of the parties holds property committed to charitable purposes.

Subsection (a)(2)—A merger cannot have the effect of making an interest holder of a domestic merging entity subject to interest holder liability for the debts, obligations, or other liabilities of any other person or entity unless the interest holder has signed a separate written consent to become subject to such liability or previously agreed to the effectuation of a transaction having that effect without the interest holder's consent. The operating agreement cannot change this provision. Section 105(c)(14).

Subsection (a)(7)—All pending proceedings involving either the survivor or a party whose separate existence ceased as a result of the merger are continued. Under this paragraph, the name of the survivor may be, but need not be, substituted in any pending proceeding for the name of a party to the merger whose separate existence ceased as a result of the merger. The substitution may be made whether the survivor is a complainant or a respondent, and may be made at the instance of either the survivor or an opposing party. Such a substitution has no substantive effect because, whether or not the survivor's name is substituted, the survivor succeeds to the claims, and is subject to the liabilities, of any party to the merger whose separate existence ceased as a result of the merger.

Subsection (a)(8)(B)—The private organic rules of an unincorporated entity typically may be either oral or written. The plan of merger is not required to set forth amendments to oral provisions of the private organic rules of the surviving entity, and thus this provision is limited in scope to amendments to the private organic rules that are to be in a record, if any.

Subsection (a)(10)—*See* the comments to Section 1006.

Subsections (c) and (d)—These subsections set forth rules for two circumstances that typically do not exist in a merger where all the entities involved are corporations. Subsection (c) deals with the situation where an interest holder that does not have vicarious liability for the obligations of a merging entity before the merger has interest holder liability after the merger. An example would be a corporate shareholder who agrees to be the general partner in a limited partnership that is the surviving entity in a merger between a corporation and a limited partnership that is not a limited liability limited partnership. Subsection (d) deals with the situation where an interest holder has vicarious liability for the obligations of one of the merging parties before the merger but ceases to have any interest holder liability for the obligations of the surviving entity after the merger becomes effective. An example would be a general partner in a general partnership that merges into a corporation.

The effects of Subsections (c) and (d) will depend on when a liability is incurred, which is determined by other law. For a discussion of the issue in a related context, see UPA (1997) (Last Amended 2013) § 306(c), cmt. (The Temporal Nexus – When Claim Incurred).

These subsections apply not only to merging domestic limited liability companies but also to any other domestic entity involved in the merger.

Subsection (c)—This subsection sets forth the general rule that an interest holder that was not liable for the liabilities of a merging entity before the merger but will have personal liability for the obligations of the surviving entity after the merger will be personally liable only for the liabilities of a domestic surviving entity that are incurred after the effective date of a merger. When a liability is incurred will be determined by other applicable law.

Subsection (d)—This subsection provides four rules with respect to an interest holder who ceases to have interest holder liability after the effective date of the merger:

(1) the interest holder remains personally liable for any obligations that were incurred before the effective date of the merger;

(2) the interest holder does not have any personal liability for obligations of the surviving entity;

(3) the pre-existing personal liability of the interest holder is enforced against the interest holder on the same basis as if the merger had not taken place; and

(4) the interest holder has the same rights of contribution from other interest holders of the merging entity as the interest holder would have had if the merger had not occurred.

See the comment to Section 1046(d).

Subsection (e)—When a merger becomes effective, this subsection provides that a foreign entity that is the surviving entity may be served with process in this state. The proceedings covered by this subsection include a proceeding to enforce the rights of any interest holders of each domestic merging entity who are entitled to and exercise appraisal rights. One of the liabilities that a foreign surviving entity succeeds to is the obligation of a merging entity to pay the amount, if any, to which its interest holders who assert appraisal rights are entitled.

[PART] 3

INTEREST EXCHANGE

SECTION 1031. INTEREST EXCHANGE AUTHORIZED.

(a) By complying with this [part]:

(1) a domestic limited liability company may acquire all of one or more classes or series of interests of another domestic entity or a foreign entity in exchange for interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing; or

(2) all of one or more classes or series of interests of a domestic limited liability company may be acquired by another domestic entity or a foreign entity in exchange for interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing.

(b) By complying with the provisions of this [part] applicable to foreign entities, a foreign entity may be the acquiring or acquired entity in an interest exchange under this [part] if the interest exchange is authorized by the law of the foreign entity's jurisdiction of formation.

(c) If a protected agreement contains a provision that applies to a merger of a domestic limited liability company but does not refer to an interest exchange, the provision applies to an interest exchange in which the domestic limited liability company is the acquired entity as if the interest exchange were a merger until the provision is amended after [the effective date of this [act]].

Comment

An interest exchange is the same type of transaction as the share exchange provided for in section 11.03 of the Model Business Corporation Act. The effect of an interest exchange is that: (i) the separate existence of the acquired entity is not affected; and (ii) the acquiring entity acquires all of the interests of one or more classes of the acquired entity. An interest exchange also allows an indirect acquisition through the use of consideration in the exchange that is not provided by the acquiring entity (*e.g.*, consideration from another or related entity).

Neither share exchanges nor interest exchanges are universally recognized in either corporation or unincorporated entity laws. The effect of an interest exchange can be achieved through a triangular merger in which the acquiring entity forms a new subsidiary and the acquired entity is then merged into the new subsidiary. Part 3 allows the interest exchange to be accomplished directly in a single step, rather than indirectly through the triangular merger route.

The "series" referenced in Subsection (a) are not the series contemplated by the Uniform Statutory Entity Trust Act §§ 401–05 and some LLC statutes. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-215 (2012); 805 ILL. COMP. STAT. 180/37-40 (2012). Instead, in this context "series" refers to a subset of a class, which is a meaning commonly found in corporation law. *See, e.g.*, MBCA § 6.02. Specific provisions authorizing classes and series are less common in unincorporated entity law but do exist. *See, e.g.*, MINN. STAT. § 322B.155 (2012). In any event, an operating agreement certainly has the power to create classes and series as contemplated by this section.

Subsection (a)—For this section to apply, a domestic limited liability company must be either the acquiring or acquired entity.

The acquiring entity is not required to acquire all of the interests in the acquired entity. For example, assume that an LLC with three classes of membership interests enters into an interest exchange with an acquiring entity. The acquiring entity need only acquire all of the ownership interests of one or more classes of the LLC membership interests.

Subsection (b)—This subsection allows a foreign entity to effectuate an interest exchange with a domestic limited liability company if the interest exchange is authorized by the organic law of the foreign entity.

Subsection (c)—This subsection deals with rights of parties to protected agreements (defined in Section 1001(30)) when an interest exchange takes place. Because the concept of an interest exchange is relatively new, a person contracting with a domestic limited liability company or loaning it money who drafted and negotiated special rights relating to the transaction before the enactment of this article should not be charged with the consequences of not having dealt with the concept of an interest exchange in the context of those special rights. Similarly, when the governance structure of an entity has been negotiated before the enactment of this act, the concept of an interest exchange may not have been reflected in any special governance arrangements; for example, special approval rights may have been provided for fundamental transactions, but those rights fail to include language that would make them applicable to an interest exchange.

Accordingly, this subsection provides a transitional rule that is intended to protect such special rights. If, for example, a limited liability company is a party to a contract that provides that the company cannot participate in a merger without the consent of the other party to the contract, the requirement to obtain the consent of the other party will also apply to an interest exchange in which the entity is the acquired entity. If the limited liability company fails to obtain the consent, the result will be that the other party will have the same rights it would have had if the entity were to participate in a merger without the required consent.

The transitional rule in this subsection ceases to make sense at such time as the provisions of the agreement giving rise to the special rights are first amended after the effective date of this article because at that time the provision may be amended to address expressly an interest exchange. The transitional rule will continue to apply, however, if a provision other than the specific provisions giving rise to the special rights is amended.

SECTION 1032. PLAN OF INTEREST EXCHANGE.

(a) A domestic limited liability company may be the acquired entity in an interest exchange under this [part] by approving a plan of interest exchange. The plan must be in a record and contain:

(1) the name of the acquired entity;

(2) the name, jurisdiction of formation, and type of entity of the acquiring entity;

(3) the manner of converting the interests in the acquired entity into interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing;

(4) any proposed amendments to:

(A) the certificate of organization of the acquired entity; and

(B) the operating agreement of the acquired entity that are, or are proposed to be, in a record;

(5) the other terms and conditions of the interest exchange; and

(6) any other provision required by the law of this state or the operating agreement of the acquired entity.

(b) In addition to the requirements of subsection (a), a plan of interest exchange may contain any other provision not prohibited by law.

Comment

This section sets forth the requirements for the plan of interest exchange, which must be approved by the acquired entity in accordance with Section 1031. The content of the plan of interest exchange is similar to the content of a plan of merger. *See* Section 1022.

The plan of interest exchange may, but need not, be filed instead of the statement of interest exchange, Section 1035, so long as the plan contains all the information required to be in the statement and is delivered to the filing office for filing after the plan has been adopted and approved. *See* Section 1035(d).

Subsection (a)—The requirements stated in this subsection are mandatory. *See* Section 105(c)(14).

Subsection (a)(3)—Under this paragraph, interest holders in the acquired entity may receive interests or securities of the acquiring entity or of a party other than the acquiring entity, obligations, rights to acquire interests or securities, cash, or other property. *See* the comment to Section 1022(a)(3).

Subsection (b)—This subsection authorizes the plan to contain any other provision the parties wish to include, unless the provision is prohibited by law.

SECTION 1033. APPROVAL OF INTEREST EXCHANGE.

(a) A plan of interest exchange is not effective unless it has been approved:

(1) by all the members of a domestic acquired limited liability company entitled to vote on or consent to any matter; and

(2) in a record, by each member of the domestic acquired limited liability company that will have interest holder liability for debts, obligations, and other liabilities that are incurred after the interest exchange becomes effective, unless:

(A) the operating agreement of the company provides in a record for the approval of an interest exchange or a merger in which some or all of its members become subject to interest holder liability by the affirmative vote or consent of fewer than all the members; and

(B) the member consented in a record to or voted for that provision of the operating agreement or became a member after the adoption of that provision.

(b) An interest exchange involving a domestic acquired entity that is not a limited liability company is not effective unless it is approved by the domestic entity in accordance with its organic law.

(c) An interest exchange involving a foreign acquired entity is not effective unless it is approved by the foreign entity in accordance with the law of the foreign entity's jurisdiction of formation.

(d) Except as otherwise provided in its organic law or organic rules, the interest holders of the acquiring entity are not required to approve the interest exchange.

Comment

This section sets forth the required approval of an interest exchange. An interest exchange transaction governed by this article only requires approval by the acquired entity, unless the applicable organic law or the organic rules of the acquiring entity otherwise provide, Subsection (d), a condition that rarely exists.

Subsection (a)(2)—For an explanation of this interest holder liability provision, see Section 1023(a)(2), comment.

SECTION 1034. AMENDMENT OR ABANDONMENT OF PLAN OF INTEREST EXCHANGE.

(a) A plan of interest exchange may be amended only with the consent of each party to the plan, except as otherwise provided in the plan.

(b) A domestic acquired limited liability company may approve an amendment of a plan of interest exchange:

(1) in the same manner as the plan was approved, if the plan does not provide for the manner in which it may be amended; or

(2) by its managers or members in the manner provided in the plan, but a member that was entitled to vote on or consent to approval of the interest exchange is entitled to vote on or consent to any amendment of the plan that will change:

(A) the amount or kind of interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing, to be received by any of the members of the acquired company under the plan;

(B) the certificate of organization or operating agreement of the acquired company that will be in effect immediately after the interest exchange becomes effective, except for changes that do not require approval of the members of the acquired company under this [act] or the operating agreement; or

(C) any other terms or conditions of the plan, if the change would adversely affect the member in any material respect.

(c) After a plan of interest exchange has been approved and before a statement of interest exchange becomes effective, the plan may be abandoned as provided in the plan. Unless prohibited by the plan, a domestic acquired limited liability company may abandon the plan in the same manner as the plan was approved.

(d) If a plan of interest exchange is abandoned after a statement of interest exchange has been delivered to the [Secretary of State] for filing and before the statement becomes effective, a statement of abandonment, signed by the acquired limited liability company, must be delivered to the [Secretary of State] for filing before the statement of interest exchange becomes effective. The statement of abandonment takes effect on filing, and the interest exchange is abandoned and does not become effective. The statement of abandonment must contain:

(1) the name of the acquired company;

(2) the date on which the statement of interest exchange was filed by the [Secretary of State]; and

(3) a statement that the interest exchange has been abandoned in accordance with this section.

Comment

This section parallels provisions in Parts 2 (mergers), 4 (conversions), and 5 (domestications). *See* Sections 1024 (mergers), 1044 (conversions), 1054 (domestications).

SECTION 1035. STATEMENT OF INTEREST EXCHANGE; EFFECTIVE DATE OF INTEREST EXCHANGE.

(a) A statement of interest exchange must be signed by a domestic acquired limited liability company and delivered to the [Secretary of State] for filing.

(b) A statement of interest exchange must contain:

(1) the name of the acquired limited liability company;

(2) the name, jurisdiction of formation, and type of entity of the acquiring entity;

(3) a statement that the plan of interest exchange was approved by the acquired company in accordance with this [part]; and

(4) any amendments to the acquired company's certificate of organization approved as part of the plan of interest exchange.

(c) In addition to the requirements of subsection (b), a statement of interest exchange may contain any other provision not prohibited by law.

(d) A plan of interest exchange that is signed by a domestic acquired limited liability company and meets all the requirements of subsection (b) may be delivered to the [Secretary of State] for filing instead of a statement of interest exchange and on filing has the same effect. If a plan of interest exchange is filed as provided in this subsection, references in this [article] to a statement of interest exchange refer to the plan of interest exchange filed under this subsection.

(e) An interest exchange becomes effective when the statement of interest exchange is effective.

Comment

This section applies only when the acquired entity is a domestic limited liability company. The filing makes the transaction a matter of public record.

This act has no filing requirement when the only domestic limited liability company involved is the acquiring entity.

Subsection (b)—This subsection states the requirements for a statement of interest exchange, which are essentially the same as the requirements for a statement of merger under Section 1025(b).

Subsection (d)—A plan of interest exchange can be used as a substitute for the statement of interest exchange so long as the plan satisfies the requirements in Subsection (b).

Subsection (e)—This subsection applies when the acquiring entity is a domestic limited liability company, and Section 207 determines when a record delivered for filing under this act becomes effective. A statement of interest exchange may specify a delayed effective time and date, subject to the ninety-day limit stated in Section 207(3) and (4).

If the acquiring entity is not a domestic limited liability company, the effectiveness of the interest exchange will occur when provided by the law of the jurisdiction of formation of the acquiring entity.

SECTION 1036. EFFECT OF INTEREST EXCHANGE.

(a) When an interest exchange in which the acquired entity is a domestic limited liability company becomes effective:

(1) the interests in the acquired company which are the subject of the interest exchange are converted, and the members holding those interests are entitled only to the rights provided to them under the plan of interest exchange and to any appraisal rights they have under Section 1006;

(2) the acquiring entity becomes the interest holder of the interests in the acquired company stated in the plan of interest exchange to be acquired by the acquiring entity;

(3) the certificate of organization of the acquired company is amended to the extent provided in the statement of interest exchange; and

(4) the provisions of the operating agreement of the acquired company that are to be in a record, if any, are amended to the extent provided in the plan of interest exchange.

(b) Except as otherwise provided in the operating agreement of a domestic acquired limited liability company, the interest exchange does not give rise to any rights that a member, manager, or third party would have upon a dissolution, liquidation, or winding up of the acquired company.

(c) When an interest exchange becomes effective, a person that did not have interest holder liability with respect to a domestic acquired limited liability company and becomes subject to interest holder liability with respect to a domestic entity as a result of the interest exchange has interest holder liability only to the extent provided by the organic law of the entity and only for those debts, obligations, and other liabilities that are incurred after the interest exchange becomes effective.

(d) When an interest exchange becomes effective, the interest holder liability of a person that ceases to hold an interest in a domestic acquired limited liability company with respect to which the person had interest holder liability is subject to the following rules:

(1) The interest exchange does not discharge any interest holder liability under this [act] to the extent the interest holder liability was incurred before the interest exchange became effective.

(2) The person does not have interest holder liability under this [act] for any debt, obligation, or other liability that is incurred after the interest exchange becomes effective.

(3) This [act] continues to apply to the release, collection, or discharge of any interest holder liability preserved under paragraph (1) as if the interest exchange had not occurred.

(4) The person has whatever rights of contribution from any other person as are provided by this [act], law other than this [act], or the operating agreement of the acquired company with respect to any interest holder liability preserved under paragraph (1) as if the interest exchange had not occurred.

Comment

This section applies only when the *acquired* entity is a domestic limited liability company, and this part states no rule for the effect of an interest exchange when the only domestic limited liability company involved is the *acquiring* entity. For that situation, the other provisions of this act must be consulted, because this act is the organic law of the acquiring entity.

Subsection (a)—In contrast to a merger, an interest exchange does not in and of itself affect the separate existence of the parties, vest in the acquiring entity the assets of the acquired entity, or render the acquiring entity liable for the liabilities of the acquired entity. Thus, Subsection (a) is significantly simpler than Section 1026(a) with respect to the effects of a merger.

When an interest exchange becomes effective: (i) the interests of the acquired domestic limited liability company are exchanged, converted, or canceled as provided in the plan; (ii) the only rights of the former members and transferees of the acquired LLC whose interests are affected by the interest exchange are those rights related to the exchange, conversion, or cancellation; (iii) the acquiring entity becomes the owner of the acquired LLC's interests as provided in the plan; (iv) the certificate of organization of the acquired LLC is amended as provided in the statement of interest exchange, thus obviating the need for repetitive filings (*i.e.*, a filing as to the entity interest exchange and another filing to reflect amendments to certificate); and (v) the provisions of the operating agreement of the acquired LLC that are to be in a record, if any, are amended to the extent provided in the plan of interest exchange.

Subsection (c)—This subsection provides the rule for future interest holder liability pertaining to domestic entities and parallels analogous provisions in Parts 2 (mergers), 4 (conversions), and 5 (domestications). *See* the comment to Section 1026.

Subsection (d)—This subsection provides the rule for past interest holder liability and parallels analogous provisions in Parts 2 (mergers), 4 (conversions), and 5 (domestications). *See* the comments to Sections 1026(d) and 1046(d).

[PART] 4

CONVERSION

SECTION 1041. CONVERSION AUTHORIZED.

(a) By complying with this [part], a domestic limited liability company may become:

(1) a domestic entity that is a different type of entity; or

(2) a foreign entity that is a different type of entity, if the conversion is authorized by the law of the foreign entity's jurisdiction of formation.

(b) By complying with the provisions of this [part] applicable to foreign entities, a foreign entity that is not a foreign limited liability company may become a domestic limited liability company if the conversion is authorized by the law of the foreign entity's jurisdiction of formation.

(c) If a protected agreement contains a provision that applies to a merger of a domestic limited liability company but does not refer to a conversion, the provision applies to a conversion of the company as if the conversion were a merger until the provision is amended after [the effective date of this [act]].

Comment

This part of Article 10 permits an entity to change to a different type of entity in its jurisdiction of formation or in a foreign jurisdiction. A transaction in which an entity changes its jurisdiction of organization but does not change its type is a domestication and is the subject of Part 5.

Subsection (a)(2)—For this provision to apply, this type of conversion must be authorized by the law of the foreign jurisdiction. If this is not the case, it may be possible to achieve the same result by forming an entity of the type desired in the foreign jurisdiction and then merging the domestic entity into the new foreign entity under Part 2 of Article 10.

Subsection (b)—This subsection allows a foreign entity to effectuate a conversion into a domestic limited liability company, but only if the conversion is permitted by the laws of the foreign entity's jurisdiction of formation. When a foreign entity becomes a domestic limited liability company pursuant to this part of Article 10, the effect of the conversion will be as provided in Section 1046. The procedures by which the conversion is approved, however, will be determined by the laws of the foreign entity's jurisdiction of formation. *See* Section 102(7) (defining "jurisdiction of formation").

Subsection (c)—*See* the comment to Section 1031(c).

SECTION 1042. PLAN OF CONVERSION.

(a) A domestic limited liability company may convert to a different type of entity under this [part] by approving a plan of conversion. The plan must be in a record and contain:

(1) the name of the converting limited liability company;

(2) the name, jurisdiction of formation, and type of entity of the converted entity;

(3) the manner of converting the interests in the converting limited liability

company into interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing;

(4) the proposed public organic record of the converted entity if it will be a filing entity;

(5) the full text of the private organic rules of the converted entity which are proposed to be in a record;

(6) the other terms and conditions of the conversion; and

(7) any other provision required by the law of this state or the operating agreement of the converting limited liability company.

(b) In addition to the requirements of subsection (a), a plan of conversion may contain any other provision not prohibited by law.

Comment

This section sets forth the requirements for the plan of conversion, which must be approved by the converting entity in accordance with Section 1043. The content of a plan of conversion is similar to the content of a plan of merger. *See* Section 1022.

Subsection (a)—The requirements stated in this subsection are mandatory. *See* Section 105(c)(14).

Subsection (a)(3)—Interest holders in the converting entity may receive interests or other securities of the converted entity or of any other person, obligations, rights to acquire interests or other securities, cash, or other property. *See* Sections 1022(a)(3) (mergers), 1032(a)(3) (interest exchanges), 1052(a)(3) (domestications).

Subsection (b)—This subsection authorizes the plan to contain any other provision the parties wish to include, unless the provision is prohibited by law.

SECTION 1043. APPROVAL OF CONVERSION.

(a) A plan of conversion is not effective unless it has been approved:

(1) by a domestic converting limited liability company, by all the members of the limited liability company entitled to vote on or consent to any matter; and

(2) in a record, by each member of a domestic converting limited liability

company which will have interest holder liability for debts, obligations, and other liabilities that are incurred after the conversion becomes effective, unless:

(A) the operating agreement of the company provides in a record for the approval of a conversion or a merger in which some or all of its members become subject to interest holder liability by the affirmative vote or consent of fewer than all the members; and

(B) the member voted for or consented in a record to that provision of the operating agreement or became a member after the adoption of that provision.

(b) A conversion involving a domestic converting entity that is not a limited liability company is not effective unless it is approved by the domestic converting entity in accordance with its organic law.

(c) A conversion of a foreign converting entity is not effective unless it is approved by the foreign entity in accordance with the law of the foreign entity's jurisdiction of formation.

Comment

Subsection (a)(1)—This provision is a default rule, subject to change in the operating agreement.

Subsection (a)(2)—This provision is not a default rule. Section 105(c)(14). For an explanation of this interest holder liability provision, see Section 1023(a)(2), comment.

SECTION 1044. AMENDMENT OR ABANDONMENT OF PLAN OF CONVERSION.

(a) A plan of conversion of a domestic converting limited liability company may be amended:

(1) in the same manner as the plan was approved, if the plan does not provide for the manner in which it may be amended; or

(2) by its managers or members in the manner provided in the plan, but a member that was entitled to vote on or consent to approval of the conversion is entitled to vote on or

consent to any amendment of the plan that will change:

(A) the amount or kind of interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing, to be received by any of the members of the converting company under the plan;

(B) the public organic record, if any, or private organic rules of the converted entity which will be in effect immediately after the conversion becomes effective, except for changes that do not require approval of the interest holders of the converted entity under its organic law or organic rules; or

(C) any other terms or conditions of the plan, if the change would adversely affect the member in any material respect.

(b) After a plan of conversion has been approved by a domestic converting limited liability company and before a statement of conversion becomes effective, the plan may be abandoned as provided in the plan. Unless prohibited by the plan, a domestic converting limited liability company may abandon the plan in the same manner as the plan was approved.

(c) If a plan of conversion is abandoned after a statement of conversion has been delivered to the [Secretary of State] for filing and before the statement becomes effective, a statement of abandonment, signed by the converting entity, must be delivered to the [Secretary of State] for filing before the statement of conversion becomes effective. The statement of abandonment takes effect on filing, and the conversion is abandoned and does not become effective. The statement of abandonment must contain:

(1) the name of the converting limited liability company;

(2) the date on which the statement of conversion was filed by the [Secretary of State]; and

(3) a statement that the conversion has been abandoned in accordance with this

section.

Comment

This section parallels analogous provisions in Parts 2 (mergers), 3 (interest exchanges), and 5 (domestications). *See* Sections 1024 (mergers), 1034 (interest exchanges), 1054 (domestications).

SECTION 1045. STATEMENT OF CONVERSION; EFFECTIVE DATE OF CONVERSION.

(a) A statement of conversion must be signed by the converting entity and delivered to the [Secretary of State] for filing.

(b) A statement of conversion must contain:

(1) the name, jurisdiction of formation, and type of entity of the converting entity;

(2) the name, jurisdiction of formation, and type of entity of the converted entity;

(3) if the converting entity is a domestic limited liability company, a statement that the plan of conversion was approved in accordance with this [part] or, if the converting entity is a foreign entity, a statement that the conversion was approved by the foreign entity in accordance with the law of its jurisdiction of formation;

(4) if the converted entity is a domestic filing entity, its public organic record, as an attachment; and

(5) if the converted entity is a domestic limited liability partnership, its statement of qualification, as an attachment.

(c) In addition to the requirements of subsection (b), a statement of conversion may contain any other provision not prohibited by law.

(d) If the converted entity is a domestic entity, its public organic record, if any, must satisfy the requirements of the law of this state, except that the public organic record does not need to be signed.

(e) A plan of conversion that is signed by a domestic converting limited liability company and meets all the requirements of subsection (b) may be delivered to the [Secretary of State] for filing instead of a statement of conversion and on filing has the same effect. If a plan of conversion is filed as provided in this subsection, references in this [article] to a statement of conversion refer to the plan of conversion filed under this subsection.

(f) If the converted entity is a domestic limited liability company, the conversion becomes effective when the statement of conversion is effective. In all other cases, the conversion becomes effective on the later of:

(1) the date and time provided by the organic law of the converted entity; and

(2) when the statement is effective.

Comment

This section applies regardless of whether a domestic limited liability company is the converting or converted entity. A foreign entity seeking to convert to a domestic LLC must therefore comply with this section.

If either the converting or converted entity is a foreign entity, the organic law of the foreign entity's jurisdiction must also be consulted.

The filing of a statement of conversion makes the transaction a matter of public record.

Subsection (b)—This subsection sets forth the requirements for a statement of conversion. They are essentially the same as the requirements for a statement of merger in Section 1025.

Subsection (e)—A plan of conversion can be used as a substitute for the statement of conversion so long as the plan satisfies the requirements in Subsection (b).

Subsection (f)—Section 207 determines when a record delivered for filing under this act becomes effective. A statement of conversion may specify a delayed effective time and date, subject to the ninety-day limit stated in Section 207(3) and (4).

When the statement of conversion becomes effective under this subsection, the conversion transaction occurs if the converted entity is a domestic limited liability company. A conversion in which the converted entity is a foreign entity will usually also take effect when the statement of conversion takes effect because the best practice will be to coordinate the filings that need to be made when a conversion involves both a domestic entity and also a foreign entity so that the filings in each jurisdiction take effect at the same time.

However, when the converting limited liability company is a foreign limited liability company, it is possible that the filing in the foreign jurisdiction will take effect at a different time. For that reason, this subsection provides that the conversion will take effect at the later of: (i) when the statement of conversion takes effect; and (ii) when the conversion takes effect under the law of the foreign jurisdiction. This rule avoids the possibility that the conversion will take effect in this state before it takes effect in the foreign jurisdiction, which would produce the undesirable result that the converting domestic limited liability company would cease to appear as an active entity on the records of this state before appearing as its active, converted self on the records of the foreign jurisdiction.

It is only necessary for the filing office to record the effective date of the statement of conversion and the filing office does not need to be concerned with the effective date of the conversion itself. Persons wishing to determine the effective date of a conversion involving both a domestic limited liability company and a foreign entity will be able to do so by consulting the records of the filing offices in each jurisdiction.

SECTION 1046. EFFECT OF CONVERSION.

(a) When a conversion becomes effective:

(1) the converted entity is:

(A) organized under and subject to the organic law of the converted entity; and

(B) the same entity without interruption as the converting entity;

(2) all property of the converting entity continues to be vested in the converted entity without transfer, reversion, or impairment;

(3) all debts, obligations, and other liabilities of the converting entity continue as debts, obligations, and other liabilities of the converted entity;

(4) except as otherwise provided by law or the plan of conversion, all the rights, privileges, immunities, powers, and purposes of the converting entity remain in the converted entity;

(5) the name of the converted entity may be substituted for the name of the converting entity in any pending action or proceeding;

(6) the certificate of organization of the converted entity becomes effective;

(7) the provisions of the operating agreement of the converted entity which are to be in a record, if any, approved as part of the plan of conversion become effective; and

(8) the interests in the converting entity are converted, and the interest holders of the converting entity are entitled only to the rights provided to them under the plan of conversion and to any appraisal rights they have under Section 1006.

(b) Except as otherwise provided in the operating agreement of a domestic converting limited liability company, the conversion does not give rise to any rights that a member, manager, or third party would have upon a dissolution, liquidation, or winding up of the converting entity.

(c) When a conversion becomes effective, a person that did not have interest holder liability with respect to the converting entity and becomes subject to interest holder liability with respect to a domestic entity as a result of the conversion has interest holder liability only to the extent provided by the organic law of the entity and only for those debts, obligations, and other liabilities that are incurred after the conversion becomes effective.

(d) When a conversion becomes effective, the interest holder liability of a person that ceases to hold an interest in a domestic converting limited liability company with respect to which the person had interest holder liability is subject to the following rules:

(1) The conversion does not discharge any interest holder liability under this [act] to the extent the interest holder liability was incurred before the conversion became effective;

(2) The person does not have interest holder liability under this [act] for any debt, obligation, or other liability that arises after the conversion becomes effective.

(3) This [act] continues to apply to the release, collection, or discharge of any interest holder liability preserved under paragraph (1) as if the conversion had not occurred.

(4) The person has whatever rights of contribution from any other person as are

provided by this [act], law other than this [act], or the organic rules of the converting entity with respect to any interest holder liability preserved under paragraph (1) as if the conversion had not occurred.

(e) When a conversion becomes effective, a foreign entity that is the converted entity may be served with process in this state for the collection and enforcement of any of its debts, obligations, and other liabilities as provided in Section 119.

(f) If the converting entity is a registered foreign entity, its registration to do business in this state is canceled when the conversion becomes effective.

(g) A conversion does not require the entity to wind up its affairs and does not constitute or cause the dissolution of the entity.

Comment

A converted entity is the same entity as it was before the conversion; the entity just has a different legal form.

Subsection (a)—This subsection states the principal legal effects of a conversion. The converted entity remains the owner of all real and personal property and remains subject to all the liabilities, actual or contingent, of the converted entity. A conversion is not a conveyance, transfer, or assignment. A conversion does not give rise to: (i) claims of reverter or impairment of title based on a prohibited conveyance or transfer; or (ii) to a claim that a contract with the converting entity is no longer in effect on the ground of nonassignability, unless the contract specifically provides that it does not survive a conversion. The contract rights that remain in the converted entity include, without limitation, the right to enforce subscription agreements for interests and obligations to make capital contributions entered into or incurred before the conversion.

When a conversion becomes effective, the internal affairs of the converting entity are no longer governed by its former organic law but instead by the organic law of the converted entity. As a result, filings that may have been made under the organic law of the converting entity, such as the following, will no longer be effective: a statement of qualification as a limited liability partnership under UPA (1997) (Last Amended 2013) § 901, a statement of partnership authority under section 303 of that act, a statement of authority under ULLCA (2006) (Last Amended 2013) § 302, or under Uniform Unincorporated Nonprofit Association Act (2008) (Last Amended 2013) § 7.

Subsection (a)(5)—All pending proceedings involving the converting entity are continued. The name of the converted entity may be, but need not be, substituted in any pending proceeding for the name of the converting entity.

Subsection (c)—This subsection provides the rule for future interest holder liability and parallels provisions in Parts 2 (mergers), 3 (interest exchanges), and 5 (domestications). *See* the comment to Section 1026(c).

Subsection (d)—Subsection (d) provides the rule for past interest holder liability and parallels analogous provisions in Parts 2 (mergers), 3 (interest exchanges), and 5 (domestications). *See* the comment to Section 1026(d).

At first glance, this subsection might seem to apply to the null set; members of an LLC typically do not have interest holder liability. However, the definition of interest holder liability also includes "personal liability for a liability of an entity which is imposed on a person . . . by the organic rules of the entity which make one or more specified interest holders or categories of interest holders liable in their capacity as interest holders for all or specified liabilities of the entity." Section 1001(19)(A)(ii).

Subsection (e)—For this provision to apply, the converting entity must have been a domestic limited liability company. When a domestic LLC becomes a foreign entity as a result of a conversion, some mechanism is needed to facilitate the enforcement of claims by the creditors and interest holders of the converting LLC. This subsection, which parallels analogous provisions in Parts 2 (mergers) and 5 (domestications), authorizes service of process for all such claims in this state.

Subsection (g)—When a conversion takes effect, the entity continues to exist—simply in a different form. This subsection thus makes clear that the conversion does not require the entity to wind up its affairs and does not constitute or cause the dissolution of the entity.

[PART] 5

DOMESTICATION

SECTION 1051. DOMESTICATION AUTHORIZED.

(a) By complying with this [part], a domestic limited liability company may become a foreign limited liability company if the domestication is authorized by the law of the foreign jurisdiction.

(b) By complying with the provisions of this [part] applicable to foreign limited liability companies, a foreign limited liability company may become a domestic limited liability company if the domestication is authorized by the law of the foreign limited liability company's jurisdiction of formation.

(c) If a protected agreement contains a provision that applies to a merger of a domestic limited liability company but does not refer to a domestication, the provision applies to a domestication of the limited liability company as if the domestication were a merger until the provision is amended after [the effective date of this [act]].

Comment

A domestication authorized by Part 5 of Article 10 differs from a conversion in that a domestication requires that the domesticating entity be the same type of entity as the domesticated entity. In a conversion, by contrast, the converting entity changes its type.

As with a conversion, all rights and privileges, debts, obligations and other liabilities, and actions or proceedings of a domesticating entity vest unimpaired in the domesticated entity. A domestication is not a sale, transfer, assignment, or conveyance and does not give rise to a claim of reverter or impairment of title.

Part 5 of Article 10 governs the legal effect of a foreign limited liability company domesticating in this state. On the other hand, the organic laws of the foreign jurisdiction, and not Part 5, will govern the legal effect of most aspects of a domestication of a domestic limited liability company in another jurisdiction. In the latter scenario, Part 5 authorizes the domestication of the domestic entity in the foreign jurisdiction, but Part 5 does not create a right in the domestic entity to be received in the foreign jurisdiction. Similarly, this section does not provide a right on the part of a foreign limited liability company to become a domestic limited liability company if the domestication is not authorized by the laws of the foreign jurisdiction. If the foreign jurisdiction does not authorize a domestication transaction, the same results can be accomplished by forming a new limited liability company in this state and merging the existing foreign limited liability company into the new domestic limited liability company.

Subsection (c)—*See* Section 1031(c).

SECTION 1052. PLAN OF DOMESTICATION.

(a) A domestic limited liability company may become a foreign limited liability company in a domestication by approving a plan of domestication. The plan must be in a record and contain:

(1) the name of the domesticating limited liability company;

(2) the name and jurisdiction of formation of the domesticated limited liability company;

(3) the manner of converting the interests in the domesticating limited liability company into interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing;

(4) the proposed certificate of organization of the domesticated limited liability company;

(5) the full text of the provisions of the operating agreement of the domesticated limited liability company that are proposed to be in a record;

(6) the other terms and conditions of the domestication; and

(7) any other provision required by the law of this state or the operating agreement of the domesticating limited liability company.

(b) In addition to the requirements of subsection (a), a plan of domestication may contain any other provision not prohibited by law.

Comment

This section sets forth the requirements for the plan of domestication for a domestic limited liability company seeking to become a limited liability company existing under the law of another jurisdiction. For a foreign limited liability company seeking to become a domestic limited liability company, the organic law of the foreign limited liability company governs the requirements for a plan of domestication. The content of a plan of domestication is similar to the content of a plan of merger. *See* Section 1022.

Subsection (a)—The requirements stated in this subsection are mandatory. *See* Section 105(c)(14).

Subsection (a)(3)—Interest holders in the domesticating limited liability company may receive interests or other securities of the domesticated limited liability company or any other entity, obligations, rights to acquire interests or other securities, cash, or other property. *See* the comment to Section 1022(a)(3).

Subsection (b)—This subsection authorizes the plan to contain any other provision the parties wish to include, unless the provision is prohibited by law.

SECTION 1053. APPROVAL OF DOMESTICATION.

(a) A plan of domestication of a domestic domesticating limited liability company is not effective unless it has been approved:

(1) by all the members entitled to vote on or consent to any matter; and

(2) in a record, by each member that will have interest holder liability for debts,

obligations, and other liabilities that are incurred after the domestication becomes effective, unless:

(A) the operating agreement of the domesticating company in a record provides for the approval of a domestication or merger in which some or all of its members become subject to interest holder liability by the affirmative vote or consent of fewer than all the members; and

(B) the member voted for or consented in a record to that provision of the operating agreement or became a member after the adoption of that provision.

(b) A domestication of a foreign domesticating limited liability company is not effective unless it is approved in accordance with the law of the foreign limited liability company's jurisdiction of formation.

Comment

Subsection (a)(1)—This provision is a default rule, subject to change in the operating agreement.

Subsection (a)(2)—This provision is mandatory. Section 105(c)(14). For an explanation of the provision, see Section 1023(a)(2), comment.

Subsection (b)—In the case of a foreign limited liability company that is domesticating in this state, this subsection provides that the required approval is determined by the laws of the foreign limited liability company's jurisdiction of formation.

SECTION 1054. AMENDMENT OR ABANDONMENT OF PLAN OF DOMESTICATION.

(a) A plan of domestication of a domestic domesticating limited liability company may be amended:

(1) in the same manner as the plan was approved, if the plan does not provide for the manner in which it may be amended; or

(2) by its managers or members in the manner provided in the plan, but a member

that was entitled to vote on or consent to approval of the domestication is entitled to vote on or consent to any amendment of the plan that will change:

(A) the amount or kind of interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing, to be received by any of the members of the domesticating limited liability company under the plan;

(B) the certificate of organization or operating agreement of the domesticated limited liability company that will be in effect immediately after the domestication becomes effective, except for changes that do not require approval of the members of the domesticated limited liability company under its organic law or operating agreement; or

(C) any other terms or conditions of the plan, if the change would adversely affect the member in any material respect.

(b) After a plan of domestication has been approved by a domestic domesticating limited liability company and before a statement of domestication becomes effective, the plan may be abandoned as provided in the plan. Unless prohibited by the plan, a domestic domesticating limited liability company may abandon the plan in the same manner as the plan was approved.

(c) If a plan of domestication is abandoned after a statement of domestication has been delivered to the [Secretary of State] for filing and before the statement becomes effective, a statement of abandonment, signed by the domesticating limited liability company, must be delivered to the [Secretary of State] for filing before the statement of domestication becomes effective. The statement of abandonment takes effect on filing, and the domestication is abandoned and does not become effective. The statement of abandonment must contain:

(1) the name of the domesticating limited liability company;

(2) the date on which the statement of domestication was filed by the [Secretary of State]; and

(3) a statement that the domestication has been abandoned in accordance with this section.

Comment

This section parallels provisions in Parts 2 (mergers), 3 (interest exchanges), and 4 (conversions). *See* Sections 1024 (mergers), 1034 (interest exchanges), 1044 (conversions).

SECTION 1055. STATEMENT OF DOMESTICATION; EFFECTIVE DATE OF DOMESTICATION.

(a) A statement of domestication must be signed by the domesticating limited liability company and delivered to the [Secretary of State] for filing.

(b) A statement of domestication must contain:

(1) the name and jurisdiction of formation of the domesticating limited liability company;

(2) the name and jurisdiction of formation of the domesticated limited liability company;

(3) if the domesticating limited liability company is a domestic limited liability company, a statement that the plan of domestication was approved in accordance with this [part] or, if the domesticating limited liability company is a foreign limited liability company, a statement that the domestication was approved in accordance with the law of its jurisdiction of formation; and

(4) the certificate of organization of the domesticated limited liability company, as an attachment.

(c) In addition to the requirements of subsection (b), a statement of domestication may contain any other provision not prohibited by law.

(d) The certificate of organization of a domestic domesticated limited liability company must satisfy the requirements of this [act], but the certificate does not need to be signed.

(e) A plan of domestication that is signed by a domesticating domestic limited liability company and meets all the requirements of subsection (b) may be delivered to the [Secretary of State] for filing instead of a statement of domestication and on filing has the same effect. If a plan of domestication is filed as provided in this subsection, references in this [article] to a statement of domestication refer to the plan of domestication filed under this subsection.

(f) If the domesticated entity is a domestic limited liability company, the domestication becomes effective when the statement of domestication is effective. If the domesticated entity is a foreign limited liability company, the domestication becomes effective on the later of:

(1) the date and time provided by the organic law of the domesticated entity; and

(2) when the statement is effective.

Comment

Regardless of whether a domestic limited liability company is the domesticating or domesticated entity:

- This section applies and, therefore, a foreign limited liability company seeking to domesticate and thereby become a domestic LLC must comply with this section.
- The organic law of the foreign LLC's jurisdiction must also be consulted.

The filing of a statement of domestication makes the transaction a matter of public record.

Subsection (b)—This subsection sets forth the requirements for a statement of domestication. They are essentially the same as the requirements for a statement of merger in Section 1025.

Subsection (e)—A plan of domestication can be used as a substitute for the statement of domestication so long as the plan satisfies the requirements in Subsection (b).

Subsection (f)—Section 207 determines when a record delivered for filing under this act becomes effective. A statement of domestication may specify a delayed effective time and date, subject to the ninety-day limit stated in Section 207(3) and (4).

When the statement of domestication becomes effective under this subsection, the domestication transaction occurs if the domesticated entity is a domestic limited liability company. A domestication in which the domesticated entity is a foreign limited liability company will usually also take effect when the statement of domestication takes effect because the best practice will be to coordinate the filings that need to be made in each jurisdiction so that they take effect at the same time.

However, when the domesticated limited liability company is a foreign limited liability company, it is possible that the filing in the foreign jurisdiction will take effect at a different time. For that reason, this subsection provides that the domestication will take effect at the later of: (i) when the statement of domestication takes effect; and (ii) when the domestication takes effect under the law of the foreign jurisdiction. This rule avoids the possibility that the domestication will take effect in this state before it takes effect in the foreign jurisdiction, which would produce the undesirable result that the domesticating domestic limited liability company would cease to appear as an active entity on the records of this state before appearing as its active, domesticated self on the records of the foreign jurisdiction.

It is only necessary for the filing office to record the effective date of the statement of domestication and the filing office does not need to be concerned with the effective date of the domestication itself. Persons wishing to determine the effective date of a domestication will be able to do so by consulting the records of the filing offices in each jurisdiction.

SECTION 1056. EFFECT OF DOMESTICATION.

(a) When a domestication becomes effective:

(1) the domesticated entity is:

(A) organized under and subject to the organic law of the domesticated entity; and

(B) the same entity without interruption as the domesticating entity;

(2) all property of the domesticating entity continues to be vested in the domesticated entity without transfer, reversion, or impairment;

(3) all debts, obligations, and other liabilities of the domesticating entity continue as debts, obligations, and other liabilities of the domesticated entity;

(4) except as otherwise provided by law or the plan of domestication, all the rights, privileges, immunities, powers, and purposes of the domesticating entity remain in the domesticated entity;

(5) the name of the domesticated entity may be substituted for the name of the domesticating entity in any pending action or proceeding;

(6) the certificate of organization of the domesticated entity becomes effective;

(7) the provisions of the operating agreement of the domesticated entity that are to be in a record, if any, approved as part of the plan of domestication become effective; and

(8) the interests in the domesticating entity are converted to the extent and as approved in connection with the domestication, and the members of the domesticating entity are entitled only to the rights provided to them under the plan of domestication and to any appraisal rights they have under Section 1006.

(b) Except as otherwise provided in the organic law or operating agreement of the domesticating limited liability company, the domestication does not give rise to any rights that a member, manager, or third party would otherwise have upon a dissolution, liquidation, or winding up of the domesticating company.

(c) When a domestication becomes effective, a person that did not have interest holder liability with respect to the domesticating limited liability company and becomes subject to interest holder liability with respect to a domestic company as a result of the domestication has interest holder liability only to the extent provided by this [act] and only for those debts, obligations, and other liabilities that are incurred after the domestication becomes effective.

(d) When a domestication becomes effective, the interest holder liability of a person that ceases to hold an interest in a domestic domesticating limited liability company with respect to which the person had interest holder liability is subject to the following rules:

(1) The domestication does not discharge any interest holder liability under this [act] to the extent the interest holder liability was incurred before the domestication became effective.

(2) A person does not have interest holder liability under this [act] for any debt, obligation, or other liability that is incurred after the domestication becomes effective.

(3) This [act] continues to apply to the release, collection, or discharge of any

interest holder liability preserved under paragraph (1) as if the domestication had not occurred.

(4) A person has whatever rights of contribution from any other person as are provided by this [act], law other than this [act], or the operating agreement of the domestic domesticating limited liability company with respect to any interest holder liability preserved under paragraph (1) as if the domestication had not occurred.

(e) When a domestication becomes effective, a foreign limited liability company that is the domesticated company may be served with process in this state for the collection and enforcement of any of its debts, obligations, and other liabilities as provided in Section 119.

(f) If the domesticating limited liability company is a registered foreign entity, the registration of the company is canceled when the domestication becomes effective.

(g) A domestication does not require a domestic domesticating limited liability company to wind up its affairs and does not constitute or cause the dissolution of the company.

Comment

Subsection (a)(1)—The domesticated entity is the same entity as the domesticating entity; it has merely changed its jurisdiction of formation.

Subsection (a)(2)—A domestication is not a sale, conveyance, transfer, or assignment and does not give rise to claims of reverter or impairment of title that may be based on a prohibition on transfer, assignment, or conveyance.

Subsection (a)(4)—All pending proceedings involving the domesticating entity are continued. The name of the domesticated entity may be, but need not be, substituted in any pending proceeding for the name of the domesticating entity.

Subsection (a)(8)—The interests of the domesticating limited liability company are reclassified into whatever rights were negotiated in the domestication and the members and transferees of the domesticating LLC are only entitled to those rights. Paragraph 8, on its face, allows for certain members of the domesticating LLC to be entitled to a continuing equity interest in the domesticated LLC whereas other members of the domesticating LLC may be cashed out as a result of the transaction.

Subsection (c)—This subsection provides the rule for future interest holder liability and parallels analogous provisions in Parts 2 (mergers), 3 (interest exchanges), and 4 (conversions). *See* the comment to Section 1026(c).

Subsection (d)—This subsection provides the rule for past interest holder liability and parallels analogous provisions in Parts 2 (mergers), 3 (interest exchanges), and 4 (conversions). *See* the comments to Sections 1026(d) and 1046(d).

Subsection (e)—When a domestic domesticating limited liability company becomes a foreign LLC as a result of a domestication, some mechanism is needed to facilitate the enforcement of claims by the creditors and interest holders of the domesticating LLC. This subsection, which parallels analogous provisions in Parts 2 (mergers) and 4 (conversions), authorizes service of process for all such claims in this state.

Subsection (g)—When a domestication takes effect, the entity continues to exist—simply as a domestic entity under the laws of a different state. This subsection thus makes clear that the domestication does not require the limited liability company to wind up its affairs and does not constitute or cause the dissolution of the limited liability company.

[ARTICLE] 11

MISCELLANEOUS PROVISIONS

SECTION 1101. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

SECTION 1102. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [act] modifies, limits, and supersedes the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., but does not modify, limit, or supersede Section 101(c) of that act, 15 U.S.C. Section 7001(c), or authorize electronic delivery of any of the notices described in Section 103(b) of that act, 15 U.S.C. Section 7003(b).

Comment

This section responds to specific language of the Electronic Signatures in Global and National Commerce Act and is designed to avoid preemption of state law under that federal legislation.

SECTION 1103. SAVINGS CLAUSE. This [act] does not affect an action commenced, proceeding brought, or right accrued before [the effective date of this [act]].

Comment

This section continues prior law after the effective date of this act with respect to rights accrued and proceedings. But for this section, the new law of this act would displace the old laws in some circumstances. The power of a new act to displace the old statute with respect to conduct occurring before the new act's enactment is substantial. Millard H. Ruud, *The Savings Clause—Some Problems in Construction and Drafting*, 33 TEX. L. REV. 285, 286–93 (1955). A court generally applies the law that exists at the time it acts.

Eventually, this act will apply all to pre-existing limited liability companies—whether by choice under Section 110(a)(2) (permitting an early opt-in), or without choice on the "all-inclusive date." Section 110(b). In this context, the phrase "before [the effective date of this [act]]" should be understood as referring to the date upon which this act became applicable to the particular limited liability company at issue.

[SECTION 1104. SEVERABILITY CLAUSE. If any provision of this [act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [act] which can be given effect without the invalid provision or application, and to this end the provisions of this [act] are severable.]

Legislative Note: *Include this section only if this state lacks a general severability statute or decision by the highest court of this state stating a general rule of severability.*

SECTION 1105. REPEALS. The following are repealed:

(1) [the state limited liability company act, as [amended, and as] in effect immediately before [the effective date of this [act]];

(2) . . . .

(3) . . . .

SECTION 1106. EFFECTIVE DATE. This [act] takes effect . . . .

Comment

For the effect of the act's effective date on pre-existing limited liability companies, see Section 110.