Unincorporated Organization Acts Committee
background material for the April 26, 2021 meeting
(fifth)
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These materials cover the three issues on the agenda for the April 26, 2012 Meeting:

- Second Issue, Merger Provisions in UPSA
- Sixth Issue, Definition of Partnership and Status of Partnership Property When Next-to-Last Partner Dissociates: UPA (2013) §§ 102(11); 302(d)
- Seventh Issue, Becoming an LLP to Create Retroactive Shield for Already Incurred, Non-LLP Obligations (and associated changes re: dissolution notices)

## Second Issue – UPSA Merger Provisions

### Recap of Discussion to Date

The Committee has discussed on several occasions issues relating to the prohibition on participation by protected series in fundamental transactions, and the focus of the discussion has evolved. The following list recaps our steps, topic by topic.[1]

1. Starting point – a technical question regarding cross-references
    a. UPSA, Section 602 appears to ban all involvement of a protected series in any type of entity transaction.
    b. Other provisions of UPSA, however, contemplate some limited involvement. (See Sections 605(d)(2); 607(2)).
    c. Question: should Section 602 include an appropriate cross reference to the two other provisions.
2. The Committee decided to answer that question in the affirmative; however the Committee's discussion of Section 602 did not end there.
3. Instead, the original issue occasioned discussion about other language in Section 602 – namely, "substantially similar to".
    a. Section 602 uses two prongs to effect its ban:
        i. the first prong: the four established types of entity transactions that appear in the Model Entity Transactions Act ("META"), UPA (2013), ULPA (2013), and ULLCA (2013) – identified [only] by name: merger, conversion, domestication, interest exchange; and
        ii. the second prong: any other transaction "substantially similar to" any of the named entity transactions.
    b. Discussion has centered on the second prong[2] and initially focused on whether "substantially similar to" is too vague and whether "same substantive effect" might provide better guidance. Initially, the discussion presupposed that new

[1] The list is mostly chronological, although the discussion of some list items occurred in more than one meeting.
[2] Committee discussion has referred to the function of the second prong variously as penumbra, prophylactic, "putting a fence around the Torah" (by religious analogy), and "purposeful overbreadth". The reporter has often referred to any arrangement seeking to end-run the Section 602 ban as a "shenanigan".

comments will elucidate the meaning of whichever phrase the Committee chooses.

4. The discussion comparing the two phrases naturally involved exploring defects in each of the phrases, which led to a discussion as to whether the statute should take a "belt and suspender" approach to the second prong; i.e.,
    a. the belt – general phrase (e.g., "same substantial effect")
    b. the suspender:
        i. list in the statute of the essential attributes of the various transactions; and
        ii. ban any arrangement with any of the essential attributes (attribute approach).
5. On the word choice, consensus developed in favor of "same substantial effect".
6. On the belt and suspenders question, the reporter undertook to prepare attribute language pertaining to mergers, conversions, and domestications (leaving interest exchange aside pending the committee's decision as to whether to use the attribute approach).
7. When the Committee considered the draft "attribute" language, the sense of the Committee seemed to warrant the reporter preparing attribute language for interest exchanges. However, reservations were expressed about the "turgidness" of the proposed language coupled with the view that the "suspenders" should appear in the comments rather than the statute.
8. When the Committee next considered Section 602, the Committee decided that the "suspenders" do indeed belong in the comments.
9. The Committee also discussed the danger of the belt being interpreted as banning an "arrangement": [3]
    a. accomplished by purely consensual means; and
    b. <u>not</u> involving any derogation to rights of non-parties.[4]
10. That discussion, together with the reporter's further reflection on the attributes, has led to additional language to accompany "same substantive effect."
11. The same discussion also raised concerns as to whether the Section 602 ban might be undesirably underinclusive. In particular, would Section 602 prevail if some other law of the enacting state appears to authorize an arrangement with the same substantive effect as contemplated by Section 602?.
    a. The Committee has two choices for approaching this concern:
        i. Provide expressly for the desired result in the language of the statute.
            - In the revised draft (below), a new subsection (b) effects this approach.
        ii. State the desired result in the comment only.
    b. Each approach is problematic.

[3] A prior draft used "arrangement" in the statutory language, in apparent contrast to "transaction". The reporter noted that no contrast was intended, and the revised statutory text does not include "arrangement". "Arrangement" is employed in this discussion for purposes of contemplating activity that could come within the two terms under consideration if properly detailed.

[4] For example, the ban should not affect the reallocation, pursuant to the operating agreement of associated property from one protected series to another.

i. The "expressly in the statute" approach risks implying the contrary result for the rest of the UPSA.
ii. The "comment only" approach is unlikely to persuade a court, except when the standard rules of statutory interpretation fail to point the way.[5]
iii.

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## Section 602 language proposed in the March 29, 2021 meeting materials

***newly proposed language follows***

**SECTION 602. PROTECTED SERIES MAY NOT BE PARTY TO ENTITY TRANSACTION.** Except as otherwise stated in Sections 605(d)(2) and 607(2), a ~~A~~ protected series may not~~:~~

~~(1) be an acquiring, acquired, converting, converted, merging, or surviving entity;~~

~~(2) participate in a domestication; or~~

~~(3)~~ be a party to, participate in, or be formed, organized, established, or created in a transaction ~~substantially like~~ that is:

(1) a merger, interest exchange, conversion, or domestication;

(2) a transaction that achieves the same substantive effect as a transaction listed in Section 602(1); {Per points TBD above, the "belt"}

(3) an arrangement through which, by operation of law: {Per points TBD above, the first three [of four] parts of the "suspenders"}

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[5] Although jurisdictions differ somewhat on the issue, in general:
1. The court attempts (strenuously if necessary) to harmonize the provisions.
2. If step #1 fails:
   a. sometimes the court chooses the more specific over the more general statute; and
   b. sometimes the court chooses the later enacted provision.

A. the obligations of one legal person become, vest in, or continue as the obligations or another legal person;

B. an entity of one type becomes an entity of another type; or

C. an entity organized under, or whose internal affairs are governed by,[1] the laws of one jurisdiction becomes organized under, or its internal affairs governed by, the laws of another jurisdiction; or

(4) a transaction: {Per points TBD above, the fourth [of four] parts of the "suspenders"}

A. that is effected under a statute;

B. by which all ownership interests in a legal person, or in a class or
C. subclass of ownership interests in the legal person, are transferred to another person chosen, and on terms established, under the statute; and

D. that is approved by the vote or consent required by the statute.

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[1] "Governed by" is intended to capture a general partnership. However, query how this language relates to California's "sticky fingers" approach (purporting to govern particular internal affairs of a foreign corporation with substantial, defined nexus to California).

## Re-revised Draft of Section 602
### for April 26, 2021 Meeting
### (fifth)

**SECTION 602. PROTECTED SERIES MAY NOT BE PARTY TO ENTITY TRANSACTION.**

(a) Except as otherwise stated in Sections 605(d)(2) and 607(2), a ~~A~~ protected series may not~~:~~

~~(1) be an acquiring, acquired, converting, converted, merging, or surviving entity;~~

~~(2) participate in a domestication; or~~

~~(3)~~ be a party to, participate in, or be formed, organized, established, or created, ~~in a transaction substantially like~~ by means of:

(1) a merger, interest exchange, conversion, or domestication; or

(2) a transaction or two or more related transactions that, under law of this [state] other than this [act], achieve by operation of law the same substantive effect as a transaction listed in Section 602(1).

(b) If law of this state other than this [act] is inconsistent with this section, this section prevails.

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Sixth Issue – Definition of Partnership and Status of Partnership Property When Next-to-Last Partner Dissociates
UPA (2013) §§ 102(11); 302(d)
JEB Report– June 2020, Issue # 1

The June 2020 JEB Report explains the issue:

> Definition of Partnership and related issues: RUPA §§ 102(11); 302(d). The existing RUPA definition requires "an association of two or more persons",

rendering the definition inconsistent with RUPA § 801(6) (the passage of 90 consecutive days during which the partnership does not have at least two partners). One proposed corrected definition of "partnership," is "an entity created under RUPA 201", eliminating and no longer including the "two or more" requirement. There is a related issue under RUPA § 302(d) (If a person holds all the partners' interests in the partnership, all the partnership property vests in that person). There are two reasons to eliminate § 302(d): (i) it is inconsistent with Section § 801(6), and (ii) it reflects the abandoned "aggregate" theory of partnerships.

Two alternative proposed revisions follow. Alternative B differs from Alternative A only in making narrower the reference to Section 202:

**SECTION 102. DEFINITIONS.** In this [act]:

….

*Alternative A*

(11) "Partnership", except in [Article] 11, means an entity ~~association of two or more persons to carry on as co-owners a business for profit~~ formed under this [act] or that becomes subject to this [act] under [Article] 11 or Section 110. The term includes a limited liability partnership.

*Alternative B*

(11) "Partnership", except in [Article] 11, means an entity ~~association of two or more persons to carry on as co-owners a business for profit~~ formed under ~~this [act]~~ Section 202 or that becomes subject to this [act] under [Article] 11 or Section 110. The term includes a limited liability partnership.

**SECTIONS 201 AND 202**
**NO REVISIONS – FOR CONTEXT ONLY**

**SECTION 201. PARTNERSHIP AS ENTITY.**

(a) A partnership is an entity distinct from its partners.

(b) A partnership is the same entity regardless of whether the partnership has a statement of qualification in effect under Section 901.

**SECTION 202. FORMATION OF PARTNERSHIP.**

(a) Except as otherwise provided in subsection (b), the association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership.….

(b) An association formed under a statute other than this [act], a predecessor statute, or a comparable statute of another jurisdiction is not a partnership under this [act].[6]

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**SECTION 302. TRANSFER OF PARTNERSHIP PROPERTY.**

(a) Partnership property may be transferred as follows:.

(b) A partnership may recover partnership property from a transferee only if ….

(c) A partnership may not recover partnership property from a subsequent transferee if ….

~~(d) If a person holds all the partners' interests in the partnership, all the partnership property vests in that person. The person may sign a record in the name of the partnership to evidence vesting of the property in that person and may file or record the record.~~

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Seventh Issue – Becoming an LLP to Create Retroactive Shield for Already Incurred, Non-LLP Obligations
(and associated changes re: dissolution notices)
JEB Report– June 2020, Issue # 9

Background on the Seventh Issue is provided as follows:

[6] This provision may be overbroad and therefore warrant revision. For an example, once "dragged in", a partnership formed under UPA (1914) [a predecessor statute] is "a partnership under this [act]".

- the explanation from the June 2020 JEB Report
- the relevant statutory provisions
- analysis, including possible resolutions
- reporter's recommendation

Issues as Explained in the June 2020 JEB Report

The June 2020 JEB Report explains the issue as follows:

> RUPA §§ 807-810. Re-evaluating whether partners should be able to elect into an LLP and affect obligations incurred before LLP status, whether to extend the "notice-to-creditors/liability-discharge" provisions, §§ 807-809 [similar to ULLCA §§ 704-706 and MBCA §§ 1407-1409], currently applicable only to limited liability partnerships, to non-LLP general partners[hips]; and other revisions discussed in February 2019:
>
> (i) proposal to extend to general partnerships notice-to-creditor/liability-discharge provisions (currently limited to limited liability partnerships);
> (ii) whether to cross reference 306(c) – temporal limitation (note - would need to address in limited partnerships as well);
> (iii) revise § 810 (providing that discharge of partnership also discharges partners) to more clearly encompass piercing liability;
> (iv) consideration of general policy determinations regarding the cutoff of liability of general partners following notice given in connection with dissolution. A critical concern is that a general partnership can cut off GP liability by filing a notice of conversion to an LLP and then immediately dissolving

Relevant Provisions from UPA (2013)
(language of greatest pertinence is double-spaced and highlighted)

**SECTION 807. KNOWN CLAIMS AGAINST DISSOLVED LIMITED LIABILITY PARTNERSHIP.**

(a) Except as otherwise provided in subsection (d), a dissolved limited liability partnership may give notice of a known claim under subsection (b), which has the effect provided in subsection (c).

(b) A dissolved limited liability partnership 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;

(4) state that the claim will be barred if not received by the deadline; and

(5) unless the partnership has been throughout its existence a limited liability partnership, state that the barring of a claim against the partnership will also bar any corresponding claim against any partner or person dissociated as a partner which is based on Section 306.

(c) A claim against a dissolved limited liability partnership 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 limited liability partnership:

(A) the partnership 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 partnership 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.

**SECTION 808. OTHER CLAIMS AGAINST DISSOLVED LIMITED LIABILITY PARTNERSHIP.**

(a) A dissolved limited liability partnership may publish notice of its dissolution and request persons having claims against the partnership 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 partnership'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 partnership'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;

(3) state that a claim against the partnership is barred unless an action to enforce the claim is commenced not later than three years after publication of the notice; and

(4) unless the partnership has been throughout its existence a limited liability

partnership, state that the barring of a claim against the partnership will also bar any corresponding claim against any partner or person dissociated as a partner which is based on Section 306.

(c) If a dissolved limited liability partnership 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 partnership 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 807;

(2) a claimant whose claim was timely sent to the partnership 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 807 may be enforced:

(1) against a dissolved limited liability partnership, to the extent of its undistributed assets;

(2) except as otherwise provided in Section 809, if assets of the partnership have been distributed after dissolution, against a partner or transferee to the extent of that person's proportionate share of the claim or of the partnership's assets distributed to the partner 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; and

(3) against any person liable on the claim under Sections 306, 703, and 805.

**SECTION 809. COURT PROCEEDINGS**

(a) A dissolved limited liability partnership that has published a notice under Section 808 may file an application with [the appropriate court] in the [county] where the partnership'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 partnership and: ….

**SECTION 810. LIABILITY OF PARTNER AND PERSON DISSOCIATED AS PARTNER WHEN CLAIM AGAINST PARTNERSHIP BARRED.** If a claim against a dissolved partnership is barred under Section 807, 808, or 809, any corresponding claim under Section 306,[7] 703,[8] or 805[9] is also barred.

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Analysis

To understand this issue requires understanding the following information:

- The Harmonization Project added the provisions on notice to creditors and discharge of obligations ("notice/discharge provisions"), deriving the language almost verbatim from provisions of the Model Business Corporation Act.
- *Accordingly*, the UPA (2013) notice/discharge provisions encompass all the obligations of a dissolving general partnership – regardless of whether any or all of the obligations were incurred while the partnership was not an LLP.
- Because, in a non-LLP partnership, a general partner's personal liability is derivative – i.e., for an obligation of the partnership, it seems to follow logically that the discharge of a partnership obligation necessarily discharges any derivative partner obligation.

This result seems significantly overbroad. Certainly, neither the MBCA nor the uniform LLC acts address discharge of "unshielded" obligations of an entity. (None such exist.)

As a practical matter, a general partnership that has never been an LLP can opt into LLP status just before dissolution and then use the notice/discharge provisions to retroactively create a shield protecting the partners from liability for all obligations incurred during the non-LLP phase (i.e., the entire pre-dissolution period).[10]

The possible responses to this situation include:

i. no change (let sleeping dogs lie);
ii. retain the current approach but make the results more explicit; or
iii. undo the overbreadth by eliminating the current rule that :

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[7] SECTION 306. PARTNER'S LIABILITY.
[8] SECTION 703. DISSOCIATED PARTNER'S LIABILITY TO OTHER PERSONS.
[9] SECTION 805. STATEMENT OF DISSOLUTION. ???? Cross reference probably should be to SECTION 806. PARTNER'S LIABILITY TO OTHER PARTNERS AFTER DISSOLUTION.
[10] On information and belief, only major creditors are likely to learn of the notice and take the necessary steps to preserve claims.

- ~ allows the discharge of LLP debts to discharge the partnership's liability for all outstanding obligations incurred in the non-LLP phase; and
- ~ accordingly, allows the discharge of all partner vicarious liability for non-LLP debts.

Reporter's Recommendation

Having been part of the process that created the overbreadth and being unable to recall any discussion that espoused the overbreadth as correct policy, the reporter recommends the third above-listed response.

**SECTION 807. KNOWN CLAIMS AGAINST DISSOLVED LIMITED LIABILITY PARTNERSHIP.**

(a) Except as otherwise provided in subsection (d), a dissolved limited liability partnership may give notice of a known claim[11] under subsection (b), which has the effect provided in subsection (c).

(b) A dissolved limited liability partnership may in a record notify its known claimants of the dissolution. The notice must:

(1) state that the partnership is a limited liability partnership at the time of the notice;

(2) identify the time during which the dissolved partnership has been a limited liability partnership;

(3) specify the information required to be included in a claim;

(~~2~~4) state that a claim must be in writing and provide a mailing address to which the claim is to be sent;

[11] In these provisions, "claim" is being used to mean two different things. Here, an obligation (and potentially a cause of action). Below (as highlighted in (b)(3) – the document reflecting the cause of action. Fixing this problem would require a similar fix to ULLCA, UPA, and UBOC. Query whether warranted?

(~~3~~5) 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

(6) state that ~~the~~ a claim for an obligation incurred by the partnership while a limited liability partnership will be barred if not received by the deadline.

~~(5) unless the partnership has been throughout its existence a limited liability partnership, state that the barring of a claim against the partnership will also bar any corresponding claim against any partner or person dissociated as a partner which is based on Section 306~~.

(c) A claim against a dissolved limited liability partnership for an obligation incurred by the partnership while a limited liability partnership 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 limited liability partnership:

(A) the partnership 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 partnership 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.

**SECTION 808. OTHER CLAIMS AGAINST DISSOLVED LIMITED LIABILITY PARTNERSHIP.**

(a) A dissolved limited liability partnership may publish notice of its dissolution and request persons having claims against the partnership 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 partnership'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 partnership's registered agent is or was last located;

(2) state that the partnership is a limited liability partnership at the time of the notice,

(3) identify the time during which the dissolved partnership has been a limited liability partnership; and

(4) 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~~5) state that a claim against the partnership for an obligation incurred by the partnership while a limited liability partnership is barred unless an action to enforce the claim is commenced not later than three years after publication of the notice~~; and~~

~~(4) unless the partnership has been throughout its existence a limited liability partnership, state that the barring of a claim against the partnership will also bar any corresponding claim against any partner or person dissociated as a partner which is based on~~

~~Section 306~~.

(c) If a dissolved limited liability partnership publishes a notice in accordance with subsection (b), the claim on an obligation incurred by the partnership while a limited liability partnership of each of the following claimants is barred unless the claimant commences an action to enforce the claim against the partnership 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 807;

(2) a claimant whose claim was timely sent to the partnership 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 807 may be enforced:

(1) against a dissolved limited liability partnership, to the extent of its undistributed assets;

(2) except as otherwise provided in Section 809, if assets of the partnership have been distributed after dissolution, against a partner or transferee to the extent of that person's proportionate share of the claim or of the partnership's assets distributed to the partner 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; and

(3) against any person liable on the claim under Sections ~~306,~~[12] 703, and 805.[13]

….

~~**SECTION 810. LIABILITY OF PARTNER AND PERSON DISSOCIATED AS PARTNER WHEN CLAIM AGAINST PARTNERSHIP BARRED.** If a claim against a dissolved partnership is barred under Section 807, 808, or 809, any corresponding claim under Section 306, 703, or 805 is also barred.~~[14]

[12] 306 = shield provision. Because revised version applies only to claims arising when the partnership has been an LLP, Section 306 would never impose liability. As to Sections 703 and 805, see nn. 2-3, *supra*.
[13] 805 = special litigation committee???? [Should be 806.]
[14] Revisions to earlier sections moot Section 810 because, as revised, the notice/discharge provisions no longer encompass any "corresponding claim".