

**Drafting Committee on Amendments to the
Uniform Limited Liability Company Act**

National Conference of Commissioners on Uniform State Laws
Atlanta Meeting, May 2 – 4, 2003

Briefing Memo from the Reporters

Background

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 amended several times. LLC filings are significant in every U.S. jurisdiction, and in some 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 novel and of uncertain tax status, are now popular both for sole proprietorships and as corporate subsidiaries.

ULLCA was revised in 1996 in anticipation of the “check the box” regulations and has been adopted in several states, but state LLC laws are far from uniform. In many other states, the LLC statute includes RUPA-like provisions. 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 similar 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 might dominate the field.

These and other developments make it time to reexamine ULLCA and its presuppositions. The following materials (i) focus on some of ULLCA’s major provisions and the assumptions underlying those provisions; (ii) pose specific questions to stimulate discussion; and (iii) comprise an *initial*,

tentative list of major issues for the Drafting Committee to consider.¹

Major ULLCA Provisions

DURATION

Explanation of Current Rule – ULLCA adopts a two-track approach, permitting an LLC either to have a term or be at will. ULLCA § 203(a)(5) provides that “the [a]rticles of organization of a limited liability company must set forth . . . whether the company is to be a term company and, if so, the term specified.” The Comment notes that “A company will be at-will unless it is designated as a term company and the duration of its term is specified in its articles under Section 203(a)(5).” See also ULLCA §§ 101(2) (defining an “At-will company” as “a limited liability company other than a term company” and 101(19) (defining “Term company” as “a limited liability company in which its members have agreed to remain members until the expiration of a term specified in the articles of organization”). A member’s exit rights are substantially greater in an at-will company than in a term company. Compare ULLCA § 603(a)(1) and (2). The notion of an at-will company and the two-track approach follow the law of general partnerships.

State LLC Law Developments – The notion of an at-will LLC never took hold, and at one time the typical approach was to require an LLC to have a term. Today, a majority of states provide that an LLC, like a corporation, has a perpetual duration unless the owners provide otherwise.

Issues for the Drafting Committee –

Perpetuity? – Should the Act follow the majority of the states? A “perpetual term” approach will substantially simplify the Act and will conform the Act to most existing statutes. The impact on member’s “exit” rights would depend on how the Act handles the consequences of a member’s dissociation.

Variations on perpetuity? -- If the presumptive term is perpetual, should the Act provide, as a default rule, some mechanism for dissolving the LLC, and, if so:

- ~ what quantum of consent should be specified?
- ~ in a manager-managed LLC,
 - should the consent mechanism distinguish between manager consent and member consent?
 - should the dissociation of a manager give rise to an opportunity to dissolve the LLC?

What document should suffice to vary the term? -- If the presumptive term is perpetual, to what extent may that term be varied by an LLC’s private organic document (i.e., the operating agreement) rather than the articles of organization? ULLCA generally follows RUPA’s contractual approach, considering the operating agreement to be the central document among the members and the articles the relevant document as to the third parties. ULLCA § 203(c). An entity’s term affects both owners and third parties, however, and ULLCA § 203(a)(5) requires the articles of organization to state “whether the company is to be a term company and, if so, the

¹ In the background to all the issues is this question: who will be the primary users of the new Act? This is perhaps the most fundamental question, because most of the Act’s rules will be default rules, and the default rules should be designed to serve those enterprises most likely to use the Act. For example, should the Act’s default rules be designed for closely held operating businesses? venture capital enterprises? non-business uses?

term specified.” In contrast, ULPA (2001), the Conference’s most recent business entity act, permits the partnership agreement to vary the perpetual term established by that act.²

How to handle the consequences of perpetuity and limited access to dissolution? – If the Act provides for perpetual duration and only minimal opportunity to dissolve the entity, the inevitable effect will be greater member lock-in. ULLCA § 701 currently provides default rules enabling any dissociating member to require the LLC to purchase the member’s interest. Should these rules apply equally to member-managed and manager-managed LLCs and should these rules be adjusted in the context of a single-member LLC?

MANAGEMENT STRUCTURE

Explanation of Current Rule – Here, too, ULLCA adopts a two-track approach, in this instance permitting an LLC to be either member-managed or manager-managed. ULLCA § 203(a)(6) provides that “the [a]rticles of organization of a limited liability company must set forth . . . whether the company is to be manager-managed, and, if so, the name and address of each initial manager.” The Comment notes that “A company will be member-managed unless it is designated as manager-managed under Section 203(a)(6).” See also ULLCA §§ 101(11) (defining “Manager-managed company” as “a limited liability company which is so designated in its articles of organization”) and 101(12) (defining “Member-managed company” as “a limited liability company other than a manager-managed company”).

Subject to contrary provisions in the operating agreement:

- each member in a member-managed LLC shares equally in the LLC’s management, regardless of the value of the member’s contribution to the LLC, ULLCA § 404(a)(1);
- a member in a manager-managed LLC has limited management rights, ULLCA § 404(b)(2) and (c), and no fiduciary duties as a member. ULLCA § 409(h)(1); and
- to the extent the operating agreement of a manager-managed LLC reallocates manager-type authority from a manager to a member, the member assumes and the manager is relieved of fiduciary duty pertaining to that authority, ULLCA § 408(h)(3) and (4).

As to a member’s power to bind by position (what might be termed “statutory apparent authority”), the LLC’s “track choice” is determinative. Each member of a member-managed LLC has *qua* member statutory power to bind the LLC. ULLCA § 301(a). In a manager-managed LLC, only managers have that statutory power. ULLCA § 301(b).

State LLC Law Developments – Although a few LLC statutes provide corporate-type governance structures, the overwhelming majority of states follow the two track (member-managed/manager-managed) approach. A few states permit an LLC’s private organic document (i.e., its operating agreement) to negate a member (or manager’s) statutory power to bind.

Issues for the Drafting Committee –

² See ULPA (2001) § 103, comment to subsection (c) (“The partnership agreement has the power to vary this subsection, either by stating a definite term or by specifying an event or events which cause dissolution. Sections 110(a) and 801(1). Section 801 also recognizes several other occurrences that cause dissolution. Thus, the public record pertaining to a limited partnership will not necessarily reveal whether the limited partnership actually has a perpetual duration.”)

Should the Act provide a “default” structure? – That is, should the Act choose one of the “tracks” as applicable absent a contrary provision, or should the Act require each LLC to affirmatively choose one structure or another? ULLCA currently suggests a member-management default rule by requiring the articles to state whether the LLC will be *manager*-managed..

Which document should determine which structure applies? -- Which organic document – public (articles of organization) or private (operating agreement) -- should state an LLC’s chosen structure? This issue should be understood in connection with the Act’s rules on the authority of a member to bind the LLC.

Should the Act continue per capita management rights as the default rule? – ULLCA follows general partnership law and provides a “per capita” rule for allocating management rights among members in a member-managed LLC, ULLCA § 404(a)(1). Should this approach be preserved, or should the Act allocate management rights in proportion to the value of a member’s contribution?

What should be the rights and obligations of members in a manager-managed LLC? -- What rights (including informational rights) should non-managing members have? What, if any, duties should non-managing members have (including duties to safeguard and not misuse company information)? If a non-managing member owns a controlling interest in an LLC, what (if any) duties should that member have?

Should a manager-managed LLC have different rules as to transferability of interests? – In light of the limited rights possessed by members in a manager-managed LLC, should non-managing members be permitted to transfer entire membership interests without the consent of the other members? Should the Act provide different transferability rules for closely-held manager-managed LLCs?

Are LLPs and LLLPs converging with LLCs? -- How (if at all) should the Act distinguish a member-managed LLC from an LLP? a manager-managed LLC from an ULPA (2001) LLLP? What impact, if any, does this phenomenon have on the default management structure choice? If other entity forms are evolving and filling the gaps, should the Act continue to lean toward member-management?

CAPITAL STRUCTURE

Current Rule – Again following the law of general partnerships, ULLCA provides as a default rule that members share distribution per capita. ULLCA § 405(a).

State LLC Law Developments – Many LLC statutes allocate distributions in proportion to each member's contributions to the LLC.

Issues for the Drafting Committee –

Preserve the current default rule? -- Should the Act preserve the current default rule or:

- adopt a contribution-based default rule for all LLCs, or
- maintain the current default rule for member-managed LLCs and adopt a contribution-based rule for manager-managed LLCs?

Provide for separate classes of interests in a manager-managed LLC? – For self-employment tax purposes, it is essential to distinguish between members who resemble limited partners and those who do not. It might facilitate making that distinction to have the Act establish two classes of interests in a manager-managed LLC – one for managers who may also be members and the other for members who are not also managers.

OPERATING AGREEMENT

Current Rule – ULLCA makes the operating agreement the fundamental document as to the members. ULLCA §§ 103(a) (providing plenary power to the operating agreement to “regulate the affairs of the company and the conduct of its business, and to govern relations among the members, managers, and company,” subject to a list of exceptions) and 203(c)(1) (providing that, *inter se* the members and as to transferees, the operating agreement prevails over the articles). The Act specifically states that the operating agreement “need not be in writing.”

State LLC Law Developments – All LLC statutes accord a primary role to the operating agreement; a few states use a different name for the agreement (e.g. “limited liability company agreement”). LLC statutes generally do not require the operating agreement to be in writing, although some statutes specify a few statutory rules that can be altered only by a written provision of an operating agreement.

Issues for the Drafting Committee –

Adopt a writing requirement for the operating agreement? – Although the modern trend is away from statutes of fraud, allowing oral and course-of-conduct operating agreements may create traps for the unwary. Should the Act establish a writing requirement applicable to operating agreements at least in manager-managed LLCs? At a minimum, should the Act expressly authorize a written operating agreement to include a “no oral modification” provision?

Should the Act expressly authorize the adoption of an operating agreement before the LLC comes into existence? – Some statutes expressly permit an LLC's operating agreement to be assented to before the LLC comes into existence. Should the Act so provide?

Should the Act expressly provide for the operating agreement's effect on new members -- Many LLC statutes expressly consider the relationship between an operating agreement and the status of a new member. Should the Act do so? If so, should the Act condition membership on assent to the operating agreement, or provide that by becoming a member a person is deemed to assent?

What about a “freedom of contract” provision? -- Many LLC statutes (not just Delaware’s) exalt freedom of contract and contain no express limitations on the power of the operating agreement. Following RUPA, ULLCA § 103(b) states specific limits for the operating agreement. (ULPA (2001) takes the same approach.) Should the Act follow a more purely contractarian approach?

Should the Act authorize the operating agreement to provide for penalties? – Some LLC statutes (notably Delaware’s and Virginia’s) expressly authorize an operating agreement to provide for penalties (which would otherwise be unenforceable as a matter of public policy). Should the Act follow this example and expand the power of the operating agreement?

FIDUCIARY DUTY; GOOD FAITH AND FAIR DEALING

Current Rule -- ULLCA § 409 follows RUPA § 404 except that ULLCA § 409 provides that in a manager-managed LLC the duties apply to the manager(s) and not to any non-managing member. Under ULLCA § 409(d) and (h)(2), the statutory obligation of good faith and fair dealing applies only to members in a member-managed LLC and managers in a manager-managed LLC.

State LLC Law Developments – LLC statutes vary widely in how they state fiduciary duties. Many statutes take an approach similar to ULLCA’s, although only ULLCA- and RUPA-based statutes include a statutory obligation of good faith and fair dealing.

Issues for the Drafting Committee –

Fiduciary duties for non-managing members? – If a non-managing member owns a controlling interest in a manager-managed LLC, should that member owe fiduciary duties to the LLC? to the other members? Or, to the contrary, should the Act prevent a court from attributing such duties to the member? The same issues apply to the obligation of good faith and fair dealing.

Apply the obligation of good faith and fair dealing to non-managing members? – ULPA (2001) § 305(b) imposes this obligation on limited partners. The implications depend upon the obligations the Act or the operating agreement impose upon non-managing members.

Different rules for closely held LLCs? -- Should non-managing members in a closely-held LLC have fiduciary duties or a good faith obligation to other members? In most states, the law of close corporations recognizes shareholder-to-shareholder fiduciary duties (which are sometimes labeled as obligations of good faith), and those duties can extend to a minority shareholder in situations in which that shareholder has veto power.

Narrow the scope of information available to non-managing members, or impose a duty to protect confidential information? -- ULLCA § 408 provides broad information rights. Should these rights be narrowed for non-managing members so as to more closely resemble the information rights of shareholders or limited partners? Should the Act require non-managing members to protect and not misuse the LLC’s confidential information? Should the acquisition of confidential information from the LLC by a non-managing member cause a limitation on that member’s right to compete with the LLC?

Adjust access to remedies for managerial conduct that injures the LLC? ULLCA recognizes the distinction between direct and derivative claims. Compare ULLCA §§ 410 (actions by members) and 1101 (“action in the right of the company”) and see § 410, Comment (“A member pursues [under § 410] only that member’s claim against the company or another member under this section. Article 11 governs a member’s derivative pursuit of a claim on behalf of the company.”). Should the Act preserve the demand requirement for derivative suits? ULLCA §§ 1101 and

1103. Should the Act follow ULPA (2001) and permit the operating agreement to circumscribe a member's right to bring a derivative action? Should transferees have the right to bring derivative actions? Direct actions?

Provide remedies for oppressive conduct that injures members in their capacity as members?

Over the past 50 years, the law of close corporations has developed important remedies for oppressed (or unfairly prejudiced) shareholders. Few LLC statutes provide such remedies. ULLCA § 801(a)(4)(v) is a noteworthy exception, allowing a court to decree dissolution “on application by a member or a dissociated member” upon a finding that “the managers or members in control of the company have acted, are acting, or will act in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the petitioner.” Should the Act continue its current approach? Add (or substitute) a judicially-ordered buy-out provision? If the Act does retain anti-oppression remedies, should the operating agreement have the power to narrow or even eliminate access to those remedies? Should the Act provide a court the option of requiring one of the parties to purchase the other party's interests? If so, what should be the effect of operating agreement provisions that establish a purchase price in other cases (e.g., death)?

MEMBER'S DISSOCIATION FROM THE LLC

Current Rule – This rubric encompasses myriad issues including: whether a member has the right to dissociate, whether a member has the power to dissociate even when lacking the right; whether the transfer of a member's entire economic interest should cause the member's dissociation; whether in the default mode the LLC (or fellow members) has the right to expel a member; what circumstances warrant a court expelling a member; what are the economic consequences of dissociation. ULLCA Article 6 and 7 largely follow RUPA's approach on these issues, although ULLCA § 602(1) makes clear that the operating agreement can eliminate both a member's right and power to dissociate. If a member is dissociated from an at-will LLC and the LLC does not dissolve, the LLC is obligated to promptly buy out the dissociated member. ULLCA § 701(a)(1) and (b). If the LLC is for a term and the LLC does not dissolve as a result of the dissociation, the buy-out is timed according to “the expiration of the specified term that existed on the date of the member's dissociation if the expiration of the specified term does not result in a dissolution and winding up of the company's business.” ULLCA § 701(a)(2) and (b).

State LLC Law Developments – LLC statutes vary widely on these issues.

Issues for the Drafting Committee –

What will be the “ripple effect” if the Act provides for a perpetual term? Extrapolation of the current approach (buy-out must await expiration of the term) would “freeze in” the economic interest of each dissociated member. Many LLC statutes now take that approach. Moreover, corporate law does not entitle a shareholder to “put” its interest to the corporation; instead, a shareholder seeking to “exit” must find a “willing buyer.”

Make inviolable a member’s power to dissociate? Especially if the Act or the operating agreement can “freeze in” a member’s economic interest, is it necessary to deprive a member of the power to terminate membership? ULLCA § 602(a) currently allows the operating agreement to vary a member’s power to withdraw.

Allow the operating agreement to circumscribe the court’s power to expel a member? ULPA (2001) provides some precedent, permitting the partnership agreement to vary or even eliminate a court’s power to expel a general partner. See ULPA (2001) § 603, comment to Paragraph (5). ULLCA § 103(b)(5) is contra.

Provide different events of dissociation for non-managing members in a manager-managed LLC? – It is not clear, for example, why the bankruptcy of a non-managing member should cause dissociation. It is also not clear why any other form of member disengagement (e.g., sale of an interest) should cause dissociation. Certainly if the Act provides for free transferability of the interest of a non-managing member, such event must not be considered dissociation. In essence, should the Act provide a different default posture that replaces the dissociation rule with a free transferability right?

TRANSFER OF INTERESTS

Current Rule – ULLCA follows RUPA’s approach, which derives from the UPA and has also been followed by ULPA (2001):

- a membership interest is conceptually bifurcated into economic rights (i.e., distributions) and other rights (e.g., management rights, information rights, right to bring derivative claims), ULLCA §§ 101(6) (defining “distributional interest”) and 501 – 503 (delineating a member’s right to transfer the distributional interest and limiting the rights of a transferee);³
- as to a member’s ability to transfer a membership interest:
 - a member may freely transfer economic rights without the consent of the other members, ULLCA § 501(b);
 - transfer of any management rights requires the consent of all the other members, ULLCA §§ 404(c)(7), 502 and 503.⁴

³ A “member” is defined differently for state law and tax purposes. State LLC law typically defines a member as a person owning some governance rights (even if that person does not also own any economic rights). In contrast, federal tax law defines a “partner” as a person owning some economic rights (even if that person does not also own any governance rights).

⁴ Under ULLCA and many state LLC statutes, this area of law is tightly connected, both conceptually and through language, to the charging order remedy. See below.

State LLC Law Developments – All LLC statutes take essentially the same approach to this area of law. Some statutes require less than unanimous consent for the transfer of management rights. Recently, some states have amended their respective LLC (and partnership) statutes in an attempt to negate or override UCC §§ 9-406 and 9-408.

Issues for the Drafting Committee –

What, if anything, should be done about UCC §§ 9-406 and 9-408? -- These sections contain important provisions overriding restrictions on the assignability of rights. Some states (e.g. Delaware and Virginia) have enacted provisions purporting to override §§ 9-406 and 9-408 with regard to interests in partnerships and LLCs. Such “overrides” create significant choice of law issues.

Provide protections for transferees? -- Like partnership statutes, ULLCA and other LLC statutes contemplate a transferee interest surviving the dissociation of the owner whose ownership gave rise to the assigned interest. It is therefore possible for a transferee interest to exist without any predicate ownership interest existing. At best, such “mere” transferees occupy a vulnerable position within the LLC. ULLCA §§ 601(3) and (5)(ii) provide, respectively, that the transferor member is dissociated by the act of a transfer of all the economic interest or by the expulsion by a unanimous vote of the other members following a transfer of substantially all of the economic interest.⁵ Dissociation eliminates the related governance rights. ULLCA § 603(b)(1).

UPA, RUPA and ULLCA have provided at least some protection to transferees. The protection relates to these organizations being either at will or for a specified term.⁶ UPA § 32(2) provided for a judicial decree of dissolution *inter alia*:

On the application of the purchaser of a partner’s interest [whether the purchase occurred voluntarily or through foreclosure of a charging order]

(a) After the termination of the specified term or particular undertaking,

(b) At any time if the partnership was a partnership at will when the interest was assigned or when the charging order was issued.

RUPA continued this approach, adding (or, arguably, making explicit) a requirement that the court determine that it is “equitable” to wind up the business. RUPA § 801(6). ULLCA § 801(a)(5) follows RUPA § 801(6) essentially verbatim and provides for dissolution of an LLC *inter alia*:

on application by a transferee of a member’s interest, [upon] a judicial determination that it is equitable to wind up the company’s business:

(i) after the expiration of the specified term, if the company was for a specified term at the time the applicant became a transferee by member dissociation, transfer, or entry of a charging order that gave rise to the transfer; or

(ii) at any time, if the company was at will at the time the applicant became a transferee by member dissociation, transfer, or entry of a charging order that gave rise to the transfer.

⁵ Under partnership law it was not clear that this result obtained. For example, some cases held that notwithstanding a foreclosure sale of a general partner’s interest to the limited partner, the general partner retained the management rights and liability of a general partner – albeit without any associated economic rights. See *Tupper v. Kroc*, 494 P.2d 1275 (NV 1972).

⁶ These protections extend to a transferee regardless of whether the transferor remains an owner.

Recent uniform acts have essentially abandoned even the little protection provided by the UPA, RUPA and ULLCA by authorizing “entity transactions” (i.e., mergers, conversions, domestications, etc.) through which an entity might substantially prejudice transferee interests. For example, ULPA (2001): (i) provides for a perpetual duration and accordingly does not permit a transferee to seek dissolution on the grounds that the limited partnership has “overstayed its welcome”; and (ii) authorizes various entity transactions affecting transferee interests but leaves to “other law” the question of what rights transferees might have to object to an expropriating or otherwise unfair transaction.⁷ UEnTA (scheduled for adoption at this year’s annual meeting) is NCCUSL’s latest word on mergers, conversions, etc. for unincorporated business entities and leaves the rights of transferees exclusively to other law. However, “other law” provides transferees NO RIGHTS.⁸

N.b. -- In this area, partnership and LLC law differ dramatically from corporate law. Under corporate law, an assignee interest can exist only in connection with an existing share (and shareholder). An assignee therefore can (and should) look to the assignor/shareholder to protect the assignee’s interest in the event the corporation undertakes some major restructuring or other change affecting the assignee’s rights. The assignor can provide that protection by exercising the assignor’s rights as a shareholder. (Given corporate law’s approach to free transferability of interests, the assignment may have included the right to exercise the assignor’s shareholder rights.)

⁷ See, e.g., ULPA (2001) § 1102, Comment (“This Act does not state any duty or obligation owed by a converting limited partnership or its partners to mere transferees. That issue is a matter for other law.”).

⁸ See, e.g., *Bauer v. Blomfield Company/Holden Joint Venture*, 849 P.2d 1365, (Alaska 1993). An assignee of a partnership interest objected to a commission arrangement with a third party which had been approved by all partners. The arrangement had the effect of drying up all the partnership profits, but the majority rejected the assignee’s claim out of hand. A mere assignee “was not entitled to complain about a decision made with the consent of all the partners.” *Id.* at 1367. In a footnote, the majority explained, “We are unwilling to hold that partners owe a duty of good faith and fair dealing to assignees of a partner’s interest.” *Id.* at 1367, n.2. A vehement dissent served to sum up not only the law in Alaska but also the law in general. “It is a well-settled principle of contract law that an assignee steps into the shoes of an assignor as to the rights assigned. Today, the court summarily dismisses this principle in a footnote and leaves the assignee barefoot.” *Id.* at 1367-1368 (Matthews, J., dissenting). As for the majority’s rationale that its decision served the purpose of the partnership statute: “The statute’s intent is to assure that an assignee does not interfere in the management of the partnership while receiving ‘the profits to which the assigning partner would otherwise be entitled.’ As interpreted by the court, the statute now allows partners to deprive an assignee of profits to which he is entitled by law for whatever outrageous motive or reason. The court’s opinion essentially leaves the assignee of a partnership interest without remedy to enforce his right.” *Id.* at 1368 (Matthews, J., dissenting) (statutory citation omitted). The notion that “other law” will protect transferees is thus reminiscent of a scene from a cartoon version of *THE WIND IN THE WILLOWS*, in which a judge charges the jury: “The prisoner is entitled to the benefit of the doubt, BUT IN THIS CASE THERE IS NO DOUBT.” Similarly, *Bane v. Ferguson*, 890 F.2d 11 (IL 1989) (POSNER, J.) held that a partnership did not owe a fiduciary duty of care to a former partner to safeguard his retirement benefits by not voting against a disastrous merger with another law partnership.

CHARGING ORDERS⁹

Current Rule – ULLCA § 504 follows RUPA § 504’s approach, which was also followed by ULPA (2001) § 703. RUPA took its approach from UPA § 28, which was taken from the English Partnership Act 1890. A charging order is a remedy available to a judgment creditor of an LLC member or transferee and serves not only to delineate a channel of collection but also to protect the LLC and its assets from interference by creditors who have no rights in or as to those assets. Under ULLCA § 504(e), a charging order “provides the *exclusive remedy* by which a judgment creditor of a member or a transferee may satisfy a judgment out of the judgment debtor’s distributional interest in a limited liability company.”¹⁰

The charging order scenario has several potential stages:

1. A creditor of an LLC member or transferee obtains a judgment against that member or transferee.¹¹
2. The creditor obtains a court order charging that member’s or transferee’s distributional (i.e., economic) interest in the LLC. The charging order functions like a lien; while the order is in effect, any distribution the LLC would otherwise make to the member or transferee is diverted to the holder of the charging order.¹² The holder of the charging order has no rights in the management of the LLC, no claim on the property of the LLC, and does not own the economic interest that is subject to the charging order.
3. “The court may order a foreclosure of a lien on a distributional interest subject to the charging order at any time.” ULLCA § 504(b). (The “at any time” language means that a court could order foreclosure simultaneously with granting the request for a charging order.) None of the uniform acts supply any criteria to guide a court in determining whether to order foreclosure. “At any time before foreclosure, a distributional interest in a limited liability company which is charged may be redeemed: (1) by the judgment debtor; (2) with property other than the company’s property, by one or more of the other members; or (3) with the company’s property, but only if permitted by the operating agreement.” ULLCA § 504(c).
4. Foreclosure involves a sale of the charged interest. “A purchaser at the foreclosure sale has the rights of a transferee.” ULLCA § 504(b). The sale is not a strict foreclosure under common law but rather a judicial sale where other partners and members will have the right and opportunity to bid on a purchase of the interest.

State LLC Law Developments – Most LLC statutes have charging order provisions. A few of these statutes omit the “exclusive remedy” provision.

Issues for the Drafting Committee –

⁹ This topic was the subject of much informed and fruitful discussion at the April, 2003 meeting of the Prototype LLC Act Subcommittee of the Committee on Partnerships & Unincorporated Business Organizations of the ABA Business Law Section.

¹⁰ Emphasis added. UPA, RUPA and ULPA (2001) also contain “exclusive remedy” provisions.

¹¹ The judgment need not (and, typically, will not) relate to the business of the LLC. Otherwise the authority of the member or partner to enter the transaction may implicate the entity.

¹² The charging order could presumably limit the scope of the lien and resulting diversion.

Does the Act sufficiently protect LLCs from interference by the court in the management and activities of the LLC? Some practitioners express grave concerns in this area and recount horror stories (e.g., a court order requiring a partnership to sell land in order to create distributions that would flow to the holder of the charging order). ULLCA § 504(a) – like other uniform acts – contains some very broad language authorizing the court to “make all other orders, directions, accounts, and inquiries . . . which the circumstances may require to give effect to the charging order.” However, horrific, reported cases are difficult (if not impossible) to find. A Comment to ULPA (2001) seeks to warn courts away from excessive involvement in the entity’s affairs.¹³ Should the Act go further and expressly prohibit the court from attaching or directing the disposition of the LLC’s assets?

What does (or should) it mean to redeem the interest? For example, if another member redeems the interest, does that member own the interest as if purchased in foreclosure? What if the redemption price (i.e., the amount remaining due on the judgment) is less than the fair value of the interest? Does the redeeming member have to account to the debtor member for the surplus? Or, does the redeeming member merely have a right to distributions made on account of the interest until those distributions equal the amount paid plus reasonable interest? If the LLC redeems the interest, what happens to the distribution rights that comprise the interest? What if those rights include a positive capital account?

Should the Act provide criteria for a court to consider when deciding whether to order foreclosure? Sensible criteria would have to take into account what a judgment creditor gains through foreclosure which cannot be gained by assigning the proceeds from the charging order. This seems to be the general trend of the courts.

LIABILITY SHIELD

Current Rule – ULLCA § 303(a) provides a full liability shield applicable both to members and managers. This shield protects only against liability by status and does not apply to liability arising from a person’s conduct (e.g., personal guaranties, torts, obligations to make contributions.) ULLCA § 303(b) implicitly recognizes the concept of “piercing” and provides that: “The failure of a limited liability company to observe the usual company formalities or requirements relating to the exercise of its company powers or management of its business is not a ground for imposing personal liability on the members or managers for liabilities of the company.” ULLCA § 303(c) provides for partial removal of the shield as to “[a]ll or specified members” if the articles of organization so provide and the unshielded members have consented in writing.

State LLC Law Developments – The liability shield is part of the LLC’s *raison d’être*, and every LLC statute provides a shield. A few statutes expressly address the piercing concept. Every court that has considered the piercing issue has applied the principle, whether or not the LLC statute mentioned it. A few LLC statutes include a “de-shielding” provision like ULLCA § 303(a). The Delaware LLC Act provides for independent “series” of interests within a single LLC, and purports to create internal shields

¹³ ULPA (2001), § 703, Comment (“This section balances the needs of a judgment creditor of a partner or transferee with the needs of the limited partnership and non-debtor partners and transferees. The section achieves that balance by allowing the judgment creditor to collect on the judgment through the transferable interest of the judgment debtor while prohibiting interference in the management and activities of the limited partnership.”).

– i.e., to prevent creditors of one series from levying on the property of another series.

Issues for the Drafting Committee –

Should the Act directly refer to piercing and give courts affirmative as well as negative guidance on piercing factors? -- ULLCA § 303(b) tells courts what not to consider. Some statutes expressly incorporate the well-developed corporate case law. Almost every court that has applied piercing to an LLC has invoked the corporate case law.

Should the Act provide for “internal shields” – i.e., the Delaware “series” approach?

Is it still necessary to provide that an LLC’s articles of organization may remove the shield?

SINGLE MEMBER LIMITED LIABILITY COMPANIES (SMLLCs)

Current Rule – ULLCA § 202(a) expressly authorizes single member LLCs, stating that “[o]ne or more persons may organize a limited liability company, consisting of one or more members. . . .” ULLCA does not provide any rules to handle situations unique to (or especially salient for) SMLLCs.

State LLC Law Developments – All states and the District of Columbia now permit single member LLCs. (Massachusetts was the last holdout).

Issues for the Drafting Committee –

What, if any, special rules should the Act provide to accommodate single member LLCs? – For example, what should the Act provide as to entity continuity (or dissolution) when an LLC’s sole member dissociates? Also, ULLCA § 103 contemplates that an LLC will use its operating agreement to alter statutory default rules as desired.¹⁴ What is the meaning and role of an operating *agreement* in an entity that has only one owner?

¹⁴ The comment states that “an operating agreement may modify or eliminate any rule specified in any section of this Act except matters specified in subsection (b).”