D R A F T

FOR DISCUSSION ONLY

REVISED UNIFORM

LIMITED LIABILITY COMPANY ACT

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

May 2005

WITH PREFATORY AND REPORTERS' NOTES

DRAFTING COMMITTEE ON REVISIONS TO
UNIFORM LIMITED LIABILITY COMPANY ACT

DAVID S. WALKER, Drake University Law School, Des Moines, IA 50311, *Chair*
ANN CONAWAY ANKER, Widener University, School of Law, 4601 Concord Pike, Wilmington, DE 19803
DONALD K. DENSBORN, 8888 Keystone Crossing, Suite 1400, Indianapolis, IN 46240
STEVEN G. FROST, 111 W. Monroe St., Suite 1500, Chicago, IL 60603-4080
HARRY J. HAYNSWORTH, IV, 14866 Old Marine Tr. N, Marine on St. Croix, MN 55047
MICHAEL HOUGHTON, P.O. Box 1347, 1201 N. Market St., 18th Floor, Wilmington, DE 19899, *Enactment Plan Coordinator*
HARRIET LANSING, Court of Appeals, Judicial Bldg., 25 Rev. Dr. Martin Luther King Jr. Blvd., St. Paul, MN 55155
EDWIN E. SMITH, 150 Federal St., 21st Floor, Boston, MA 02110-1726
CARTER G. BISHOP, Suffolk University Law School, 120 Tremont St., Boston, MA 02108-4977, *Co-Reporter*
DANIEL S. KLEINBERGER, William Mitchell College of Law, 875 Summit Ave., St. Paul, MN 55105, *Co-Reporter*

EX OFFICIO

FRED H. MILLER, University of Oklahoma, College of Law, 300 Timberdell Rd., Room 3056, Norman, OK 73019, *President*
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AMERICAN BAR ASSOCIATION ADVISOR

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AMERICAN BAR ASSOCIATION SECTION ADVISORS

WILLIAM J. CALLISON, Suite 3200, 1700 Lincoln St., Denver, CO 80203, *ABA Business Law Section Advisor*
WILLIAM H. CLARK, JR., One Logan Square, 18th and Cherry Streets, Philadelphia, PA 19103-6996, *ABA Business Law Section Advisor*
THOMAS EARL GEU, University of South Dakota, School of Law, 414 Clark St., Suite 214, Vermillion, SD 57069-2390, *ABA Real Property, Probate and Trust Law Section Advisor*
JON T. HIRSCHOFF, One Landmark Square, 14th Floor, Stamford, CT 06901, *ABA Business Law Section Advisor*
ROBERT KRAPF, One Rodney Square, 920 King St., P.O. Box 551, Wilmington, DE 19899, *ABA Real Property, Probate and Trust Law Section Advisor*
PAUL L. LION, III, 755 Page Mill Rd., Palo Alto, CA 94304-1018, *ABA Business Law Section Advisor, California State Bar*

SCOTT E. LUDWIG, 200 Clinton Ave. W., Suite 900, Hunstville, AL 35801-4900, *ABA Business Law Section Advisor*
JOHN R. MAXFIELD, 555 17th St., Suite 3200, P.O. Box 8749, Denver, CO 80201, *ABA Tax Section Advisor*
ELIZABETH STONE MILLER, Baylor Law School, 1114 S. University Parks Dr., Waco, TX 76706, *ABA Business Law Section Advisor*
SANDRA K. MILLER, Widener University School of Business Administration, One University Place, Chester, PA 19013-5792
BARRY B. NEKRITZ, 8000 Sears Tower, 233 S. Wacker Dr., Chicago, IL 60606, *ABA Real Property, Probate and Trust Law Section Advisor*
THOMAS E. RUTLEDGE, 1700 PNC Plaza, 500 W. Jefferson St., Louisville, KY 40202-2874, *ABA Business Law Section Advisor*

EXECUTIVE DIRECTOR

WILLIAM H. HENNING, University of Alabama School of Law, Box 870382, Tuscaloosa, AL 35487-0382, *Executive Director*

Copies of this Act may be obtained from:
NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS
211 E. Ontario Street, Suite 1300
Chicago, Illinois 60611
312/915-0195
www.nccusl.org

REVISED UNIFORM LIMITED LIABILITY COMPANY ACT

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REVISED UNIFORM LIMITED LIABILITY COMPANY ACT

PREFATORY NOTE

Background to this Drafting Project:
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 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.

Sixteen 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 seven years have passed since the IRS opened the gate still further with the "check the box" regulations. Now seems 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.

REVISED UNIFORM LIMITED LIABILITY COMPANY ACT

[ARTICLE] 1

GENERAL PROVISIONS

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

Reporters' Notes

Issues to be considered: given that this act is intended as a wholesale replacement for the current uniform act, whether "Revised" is an appropriate description

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" means any benefit provided by a person to a limited liability company in order 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 successor statute of general application; or

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

(4) "Designated office" means:

(A) with respect to a limited liability company, the office that the limited liability company is required to designate and maintain under Section 112; and

(B) with respect to a foreign limited liability company, its principal office.

(5) "Distribution" means a transfer of money or other property from a limited liability company to a member in the member's capacity as a member or to a transferee on account of a transferable interest owned by the transferee.

(6) "Effective" means, with regard to a record required or permitted to be delivered to the [secretary of state] for filing under this [act], that the record has become effective under Section 206(c).

(7) "Foreign limited liability company" means an unincorporated entity formed under the laws of a jurisdiction other than this state and denominated by those laws as a limited liability company.

(8) "Limited liability company", except in the phrase "foreign limited liability company", means an entity formed under this [act].

(9) "Manager" means a person that is a manager under Section 407(b)(4) of a manager-managed limited liability company. The term does not include a person that has ceased to be a manager under Section 407(b)(4).

(10) "Manager-managed limited liability company" means a limited liability company which is so designated in its certificate of organization.

(11) "Member" means a person that is a member of a limited liability company under Section 401. The term does not include a person that has dissociated as a member under Section 601.

(12) "Member-managed limited liability company" means a limited liability

company which is so designated in its certificate of organization.

(13) “Operating agreement” means the agreement (whether referred to as an operating agreement and whether oral, in a record, implied, or in any combination thereof) of all the members, including a sole member, concerning the limited liability company. The term includes the agreement as amended.

(14) “Person” means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government; governmental subdivision, agency, or instrumentality; public corporation, or any other legal or commercial entity.

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

(16) “Record” 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.

(17) “Sign” means, with the present intent to authenticate a record:

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

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

(18) “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.

(19) “Transfer” includes an assignment, conveyance, deed, bill of sale, lease,

mortgage, security interest, encumbrance, gift, and transfer by operation of law.

(20) "Transferable interest" means a member's right to receive distributions.

(21) "Transferee" means a person to which all or part of a transferable interest has been transferred, whether or not the transferor is a member.

Reporters' Notes

Issues to be considered: whether in paragraph 8 (manager) it is clear that the term "manager" applies to an ex-manager with regard to events occurring before the person ceased to be a manager; whether in paragraph 10 (member) it is clear that the term "member" applies to a former member with regard to events occurring before the person dissociated as a member; whether in paragraph 12 (operating agreement) the all-encompassing scope of the definition means that any activity involving unanimous consent of the members comprises part of the operating agreement

Paragraph (1) [Certificate of organization] – At its February, 2005 meeting, the Drafting Committee decided to substitute "certificate of organization" for "articles or organization" to (i) signal that the certificate merely reflects the existence of an LLC (rather than determining the structure of the LLC); and (ii) separate the role of this document for LLCs from the significantly greater role played by corporate articles.

Paragraph (6) [Effective] – This definition is necessary in light of Section 302 but is useful throughout the act.

Paragraph (7) [Foreign limited liability company] – Some statutes have elaborate definitions addressing the question of whether a non-U.S. entity is a "foreign limited liability company." The NY 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.

NY CLS LLC § 102. ULLCA § 101(8) takes a similar but less complex approach ("an unincorporated entity organized under laws other than the laws of this State which afford limited liability to its owners comparable to the liability under Section 303 and is not required to obtain a certificate of authority to transact business under any law of this State other than this [Act]"). This Draft follows Delaware's still simpler approach. Del. Code Ann. tit. 6, § 18-101(4) ("denominated as such").

Former Paragraph (7) [Governance responsibility] – Deleted because the Draft's provisions on fiduciary duty no longer refer to this term.

Paragraph (8) [Limited liability company] – Query whether this definition should be revised to characterize the entity as necessarily "having at least one member upon formation."

Paragraph (9) [Manager] – This term is ubiquitous in LLC statutes, but it can cause confusion given other common usages of the term. 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 this act.

Paragraph (13) [Operating Agreement] – This definition must be read in conjunction with Section 110, which further describes the operating agreement. The current wording mostly follows ULPA (2001), which itself was an amalgam of RUPA and ULLCA. There is no standard NCCUSL wording. The text of those uniform act definitions as well as the Delaware definition are provided below.

An agreement to form an LLC is not itself an operating agreement, because the term "operating agreement" presupposes the existence of members, and a person cannot have "member" status until the LLC exists. However, the Act's very broad definition of "operating agreement" means that, as soon as a limited liability company is formed with even one member, the limited liability company 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. The LLC has an operating agreement, because "all the members" have agreed on who the members are" and that agreement – no matter how informal or rudimentary – is an agreement "concerning the limited liability company."

The same result follows when a person becomes the sole initial member of an LLC. It is not plausible that the person would lack any understanding or intention with regard to the LLC. That understanding or intention constitutes an "agreement of all the members, including a single member, concerning the limited liability company."

At its February, 2005 meeting, the Committee considered whether "concerning the limited liability company" is sufficient to indicate the all-encompassing scope of the operating agreement, or whether (perhaps paradoxically) more limiting phrasing might better connote broad scope. See the ULLCA and Delaware provisions below. Judge Lansing raised this issue, but there was no motion to amend the current definition.

The Committee is still considering whether the all-encompassing scope of this definition means that any activity involving unanimous consent of the members comprises part of the operating agreement. For example, if pursuant to an operating agreement, all the members consent to the redemption of one-half of the managing-member's transferable interest, does that action become part of the operating agreement? Moreover, does the answer to that conceptual question make any practical difference?

What is certainly true is that the "operating agreement" as defined and contemplated by this statute may comprise a number of separate documents, however denominated.

N.b., however, that – absent a contrary provision in the operating agreement – a threshold qualification for status as part of the "operating agreement" is the assent of all the then current members. As noted by the ABA Advisor (in a discussion in January, 2005, on the Drafting Committee's list serv):

> An agreement among less than all the members with respect to . . . the LLC (e.g., an agreement among some of the members to support or oppose an action) would not be an operating agreement but might be effective among the parties to the agreement.

Former Paragraph (14) ["Operational responsibilities"] -- Deleted because the Draft's provisions on fiduciary duty no longer refer to this term.

Former Paragraph (18) ["Required information"] – Deleted because at its October, 2004 meeting, the Drafting Committee decided to delete Section 111, thereby removing any obligation for an LLC to maintain particular types of information.

Paragraph (19) [Transfer] – Following RUPA and ULPA (2001), this Act uses the words "transfer" and "transferee" rather than the words "assignment" and "assignee." See RUPA § 503.

The reference to "transfer by operation of law" is significant in connection with Section 502 (Transfer of Member's 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.

Paragraph (20) [Transferable Interest] – On this point of terminology, this Draft follows RUPA and ULPA (2001) rather than ULLCA, which refers to "distributional interest." ULLCA § 101(6).

Paragraph (21) [Transferee] – "Transferee" has displaced "assignee" as the Conference's term of art.

SECTION 103. KNOWLEDGE AND NOTICE.

(a) A person knows a fact when any of the following apply:

(1) the person is an individual who is consciously aware of the fact;

(2) the person is deemed to know the fact under subsection (b) or (e) or other law.

(b) A person that is not a member is deemed to know of a limitation on authority to transfer real property as provided in Section 302(d).

(c) A person has notice of a fact when any of the following apply:

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

(2) the person is deemed to have notice of it under subsection (d) or (e);

(d) A person not a member has notice of:

(1) another person's dissociation as a member of a member-managed limited liability company, 90 days after a Section 604 statement of dissociation pertaining to the other person becomes effective;

(2) another person's ceasing to be a manager of a manager-managed limited liability company, 90 days after a Section 412 statement of manager cessation pertaining to the other person becomes effective;

(3) a limited liability company's dissolution, 90 days after a Section 710(1) statement of dissolution becomes effective;

(4) a limited liability company's termination, 90 days after a Section

710(2) statement of termination becomes effective; and

(5) a limited liability company's merger, conversion, or domestication, 90 days after an [article 10] statement of merger, conversion, or domestication becomes effective.

(e) A limited liability company is deemed to know or have notice of a fact relating to the limited liability company both as provided by other law and when either of the following apply:

(1) in a member-managed limited liability company, a member knows or has notice of the fact, except in the case of a fraud on the limited liability company committed by or with the consent of the member;

(2) in a manager-managed limited liability company, a manager knows or has notice of the fact, except in the case of a fraud on the limited liability company committed by or with the consent of the manager.

(f) In a manager-managed limited liability company, a member's knowledge or notice of a fact relating to the limited liability company is not knowledge of or notice to the limited liability company, except as provided:

(1) in subsection (e)(2)

(2) in Section 302 (statement of authority); and

(3) by law other than this [act].

Reporters' Notes

At its February, 2005 meeting, the Committee decided that, for the sake of clarity and simplicity, this Act should set aside the elaborate provisions that NCCUSL imported from the UCC into RUPA, ULLCA, and ULPA (2001) and, for the most part, confine this section to rules specifically tailored to this Act.

Several aspects of the Committee's decision warrant particular note. First, the defined term "notification" has been deleted, because that term appears nowhere in the Act. Second, generally applicable provisions concerning when an organization is charged with knowledge or notice have been deleted, because those imputation rules are (i) core topics within the law of agency, (ii) very complicated, and (iii) should not have any different content under this Act than in other circumstances.

Third, the Committee has reinstated a provision, deleted in April, 2004, explaining the imputation effects of knowledge and notice of LLC members. The April 2004 Draft had expanded on ULLCA § 102 (and followed RUPA and ULPA (2001)) by addressing the question of whether a member's knowledge, notice, etc. is attributed to the limited liability company. The April, 2004 meeting rejected that expansion as more properly handled in a Comment to the section concerning the power of members to bind the limited liability company. With the generally applicable provisions on how an organization knows or has notice stricken from this draft, bringing the LLC-specific provision back into the statutory text is necessary.

Fourth, this draft eliminates "knowledge" from the defined term "notice." Although conceptualizing the former as giving the latter makes logical sense and has a long pedigree, that conceptualization is somewhat counter-intuitive for the non-*aficionado*. In ordinary usage, knowledge and notice do not overlap. This draft follows current usage. Throughout the Act, therefore, where a provision formerly referred to "notice," the provision now refers to "knowledge or notice."

Subsection (a) – The February, 2005 Draft proposed changing the definition of "knowledge" from a tautology (knowledge = actual knowledge) to a conceptualization similar to the one expressed in the Comment to RUPA, § 103. ("Knowledge is cognitive awareness.") The Restatement (Third) of Agency, like the Restatement (Second), does not define "knowledge" in its black letter. The Reporter's Notes to the Restatement (Third), § 1.04 state:

> e. Knowledge and notice. The definition of notice is drawn from Restatement Second, Agency § 9. "Knowledge" itself is not defined in black letter by the Restatement Second of Agency. The Revised Uniform Partnership Act defines knowledge as "conscious [sic – should be cognitive] awareness." See Rev. Unif. Partnership Act § 102(a) comment. Under Model Penal Code § 2.02(b), a person acts "knowingly" with respect to a material element of an offense when, "if the element involves the nature of his conduct or the attendant circumstances, he is aware that his conduct is of that nature or that such circumstances exist; and ... if the element involves a result of his conduct, he is aware that it is practically certain that his conduct will cause such a result."

This subject generated lengthy but inconclusive debate. The President of the Conference opined that the tautology is purposeful as it remits to other the difficult but rarely significant question of forgotten knowledge. There was no motion to return to the tautology, so this draft preserves the “conscious awareness” language. This draft does, however, differ from the February, 2005 draft in limiting “conscious awareness” to individuals, because (i) an organization has no actual consciousness, and (ii) under agency law principles it may be that an organization, like an elephant, never forgets.

Subsection (a)(2) – The most important source of “other law” in this context is the common law of agency

Subsection (b) – The reference to Section 302 (statements of authority) and deemed knowledge is consistent with the Act’s principle of using this section as a central reference for all knowledge and notice provisions.

Subsection (c)(1) – The “facts known to the person at the time in question” include facts the person is deemed to know under subsection (a)(2) and (3).

SECTION 104. NATURE, PURPOSE, AND DURATION OF ENTITY.

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

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

(c) A limited liability company has perpetual duration.

Reporters’ Notes

Subsection (b) – This language states more directly what is the substance of the current uniform act. ULLCA § 112(a) provides that a limited liability company may be organized for any “lawful” purpose but contains two vestiges of a “business purpose” approach. The Section’s caption refers to “Nature of Business,” and subsection (a) is expressly subject to “any law of this State governing or regulating business.” The phrase “any lawful purpose” encompasses activities not intended to produce a profit, but ULLCA § 112(a) does not include the phrase “whether or not for profit.” (However, ULLCA § 101(3) defines “Business” as including “every trade, occupation, profession, and other lawful purpose, whether or not carried on for profit.”)

Most states permit a limited liability company to be organized for any “lawful purpose” but do not include the phrase “whether or not for profit.” A few states combine the expansive “lawful purpose” language with that further clarifying phrase. *See, e.g.,* 6 Del. C. § 18-106, K.S.A. § 17-7668, 18 Okl. St. §2002, and W. Va. Code § 31B-1-112. Some states impose a “lawful business” requirement. See, e.g., Cal. Corp Code § 17002, C.R.S § 7-80-103, or refer to any business purpose subject to other law. See e.g., Minn. Stat. § 322B.10, N.D. Cent. Code, §

10-32-04, and Tex. Rev. Civ. Stat. art. 1528n 2.01A . (The MBCA takes the "lawful business" approach. See MBCA § 3.01(a).)

The expansive approach is the modern trend for LLC statutes and comports with the Conference's most recently-adopted business entity statute. ULPA (2001) § 104(b) follows ULLCA § 112(a) and allows a limited partnership to be organized for any "lawful" purpose. It is thus possible to have a limited partnership that has no "for profit" purpose. *Compare* UPA § 6 (defining a general partnership as organized for profit), RUPA § 101(6) (same), and RULPA (1976/85) § 106 (delineating the "Nature of [a limited partnership's] Business" by linking back to "any business that a partnership without limited partners may carry on").

The subsection does not bar a limited liability company from being organized to carry on charitable activities, and this act does not include any protective provisions pertaining to charitable purposes. Those 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 (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). A comment will identify this issue, and perhaps a legislative note will suggest the need to assure that such other law refers not only to corporations but also to limited liability companies.

Another comment will state specifically that the phrase "regardless of whether for profit" indicates the issue of profit *vel non* is irrelevant to the question of whether an LLC has been validly formed.

Subsection (c) – In this context, the word "perpetual" is a misnomer, albeit one commonplace in LLC statutes. Like all current LLC acts, this act provides several avenues to avoid perpetuity: a term specified in the operating agreement or certificate; an event specified in the operating agreement or certificate; member consent. See Section 701 (events causing dissolution). There are other formulations possible, but the Drafting Committee has chosen to use the most common terminology, rather than the most technically precise.

Because a private document (the operating agreement) can vary this subsection, the public record pertaining to a limited liability company will not necessarily reveal whether the limited liability company actually has a perpetual duration. *Accord* ULPA (2001) § 103, comment to subsection (c) ("The partnership agreement has the power to vary this subsection [which provides for perpetual duration], either by stating a definite term or by specifying an event or events which cause dissolution. . . . . [The limited partnership act] 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.")

SECTION 105. 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.

Reporters' Notes

Following ULPA (2001), this Draft omits as unnecessary any detailed list of specific powers. Compare ULLCA § 112, which contains such a list.

The capacity to be sued is mentioned specifically so that Section 110(b) can prohibit the operating agreement from varying that capacity. The April 2004 version mentioned specifically the power to maintain an action against a member to establish that the limited liability company itself has standing to enforce the operating agreement. In this draft, that point is made instead in Section 110 (concerning the operating agreement). In any event, the limited liability company's standing to enforce the operating agreement is subject to change in the operating agreement.

Query whether an LLC should have the power to create series within it. *See e.g.* Del. Code Ann. tit. 6, § 18-215.

SECTION 106. GOVERNING LAW.

(a) 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 an obligation of the limited liability company.

(b) An agreement between a limited liability company and a manager that is not also a member may select, consistent with otherwise applicable choice of law rules, a different law to govern any term of that agreement which does not address a matter governed by this [act].

Reporters' Notes

At its October, 2004 meeting, the Drafting Committee decided to substitute the concept of "internal affairs" for the prior draft's list of seven items. That list is restated below and may become part of a Comment.

Subsection (a) – Restatement (Second) of Conflict of Laws § 302, comment a, defines "internal affairs" (with reference to a corporation) as "the relations inter se of the corporation, its shareholders, directors, officers or agents." Like any other legal concept, the concept of "internal affairs" may be indeterminate at its edges, but 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.

The Restatement does not consider the liability of owners and managers to third parties to be an internal affair. See, e.g., Restatement (Second) of Conflict of Laws § 307 (Shareholders' Liability). A few cases do, but many do not. See, e.g., *Kalb, Voorhis & Co. v. American Financial Corp.,* 8 F.3d 130, 132 (2nd Cir. 1993). All sensible authorities agree, however, that, except in extraordinary circumstances, "shield-related" issues should be determined according to the law of the state of organization.

Subsection (b) – In the prior draft, this provision was Section 110(g)(3) (June 16, 2004 teleconference version) and is relocated here per the Committee's instructions at the October, 2004 meeting.

SECTION 107. SUPPLEMENTAL PRINCIPLES OF LAW. Unless displaced by particular provisions of this [act], the principles of law and equity supplement this [act].

SECTION 108. NAME.

(a) The name of a limited liability company must contain "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) Unless authorized by subsection (c), the name of a limited liability company must be distinguishable in the records of the [Secretary of State] from:

(1) the name of each person, other than an individual, incorporated, organized, or authorized to transact business in this state; and

(2) each name reserved under Section 109 [or other state laws allowing the

reservation or registration of business names, including fictitious name statutes].

(c) A limited liability company may apply to the [Secretary of State] for authorization to use a name that does not comply with subsection (b). The [Secretary of State] shall authorize use of the name applied for if, as to each conflicting name:

(1) the present user, registrant, or owner of the conflicting name consents in a signed record to the use and submits an undertaking in a form satisfactory to the [Secretary of State] to change the conflicting name to a name that complies with subsection (b) and is distinguishable in the records of the [Secretary of State] from the name applied for; or

(2) the applicant delivers to the [Secretary of State] a certified copy of the final judgment of a court of competent jurisdiction establishing the applicant's right to use in this state the name applied for.

(d) Subject to Section 805, this section applies to any foreign limited liability company transacting business in this state, having a certificate of authority to transact business in this state, or applying for a certificate of authority.]

Reporters' Notes

Subsection (a) is taken verbatim from ULLCA § 105(a). The rest of the section is taken from ULPA (2001) § 108, which reflects the Conference's latest reworking of such provisions. At its April 2004 meeting, the Drafting Committee decided to bracket subsections (b) through (d), in recognition of the fact that in many jurisdictions this type of provision is routinely revised to fit the jurisdiction's standard approach to such matters.

[SECTION 109. RESERVATION OF NAME.

[(a) A person may reserve the exclusive use of the name of a limited liability company, including a fictitious name for a foreign company whose name is not available, by delivering an application to the [Secretary of State] for filing. The application must set forth the name and address of the applicant and the name proposed to be reserved. If the [Secretary of State] finds that the name applied for is available, it must be reserved for the applicant's exclusive use for a [nonrenewable] [renewable] 120 day period.

[(b) The owner of a name reserved for a limited liability company may transfer the reservation to another person by delivering to the [Secretary of State] for filing a signed notice of the transfer which states the name and address of the transferee.]

Reporters' Notes

Issue to be addressed: whether the address referred to in subsection (a) needs to be both a mailing and street address.

This section is bracketed for the reason stated in the Reporters' Notes to Section 108. At its October, 2004 meeting, the Drafting Committee decided to follow ULLCA rather than ULPA (2001) for this section, except to indicate that the question of renewability is a matter of choice for each legislature (thus the brackets within subsection (a)). This Draft accordingly replicates ULLCA § 106, with a slight change made in subsection (b) to conform to the convention used throughout this act regarding "delivered to the [Secretary of State] for filing."

SECTION 110. OPERATING AGREEMENT.

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

(1) relations among the members as members and between the members and the limited liability company; and

(2) the rights and duties under this [act] of a person in the capacity of manager and the rights under this [act] of a person in the capacity of a dissociated member or transferee.

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

(c) The operating agreement and any amendment to the operating agreement must be consented to by each member, except that a person that becomes a member in a limited liability company is bound by the operating agreement. When a limited liability company has only one member, the operating agreement is not unenforceable by reason of there being only one person that is a party to the operating agreement. The operating agreement may provide for the manner in which it may be amended, including by requiring the approval of a person that is not a party to the operating agreement or the satisfaction of conditions, and an amendment is ineffective if its adoption does not conform to the specified manner or satisfy the specified conditions.

(d) An agreement may be all or part of the operating agreement and simultaneously be part of another agreement, including an agreement that has as parties persons that are not members of the limited liability company.

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

(f) An operating agreement may not:

(1) vary a limited liability company's capacity under Section 105 to sue, be sued, and defend in its own name;

(2) vary the law applicable under Section 106(a);

(3) vary the power of the court under Section 205;

(4) eliminate the duty of loyalty under Sections 409(b) and 603(a)(2) or unreasonably reduce the duty of care under Sections 409(c) and 603(a)(3), but:

(i) the operating agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable;

(ii) all of the members or a number or percentage specified in the operating agreement may authorize or ratify after full disclosure of all material facts a specific act or transaction that otherwise would violate the duty of loyalty;

(iii) to the extent the operating agreement of a manager-managed limited liability company expressly and specifically relieves a manager of a responsibility that the manager would otherwise have under this [act] and imposes that responsibility on one or more members, the operating agreement may also eliminate or limit any fiduciary duty the manager would have had pertaining to that responsibility; and

(iv) the operating agreement may provide indemnification for a member or manager and may eliminate a member or manager's liability to the limited liability company and members for money damages, except for:

(A) breach of the duty of loyalty;

(B) a financial benefit received by the member or manager to which the member or manager is not entitled;

(C) a breach of a duty under Section 406;

(D) intentional infliction of harm on the limited liability company or a member;

(E) an intentional violation of criminal law.

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

(6) unreasonably restrict the obligations and rights stated in Section 411;

(7) vary the power of a court to decree dissolution in the circumstances specified in Section 701(a)(4) and (5);

(8) vary the requirement to wind up the limited liability company's business as specified in Section 702;

(9) unreasonably restrict the right to maintain an action under [Article] 9;

(10) restrict the right of a member under Section 1014 to approve a merger, conversion, or domestication; or

(11) restrict the rights under this [act] of a person other than in the person’s capacity as a member, dissociated member, transferee or manager.

(g) In determining under subsection (f) whether a provision of an operating agreement is manifestly unreasonable, the court shall make the determination, shall do so as of the time the provision was adopted or most recently amended, and shall consider:

(1) whether, in light of the purposes and activities of the limited liability company:

(A) the objective of the provision is patently unreasonable; and

(B) the provision is a patently unreasonable means to achieve the provision’s objective; and

(2) whether the essential ramifications of the provision can be understood

through the careful consideration of the provision's language.

Reporters' Notes

Issues to be resolved: whether the Act should prohibit the operating agreement from eliminating the distinction between direct and derivative claims; whether inter se the members the certificate will often (or sometimes) be evidence of the content of the operating agreement; whether the guidance newly stated in subsection (g) is useful and, if so, whether that guidance belongs in the statutory text or a comment.

A limited liability company is as much a creature of contract as of statute, and the operating agreement is the "cornerstone" of the typical LLC. Section 102(12) defines a very broad scope for "operating agreement," and, as a result, once an LLC comes into existence and has a member, the LLC necessarily has an operating agreement. Accordingly, this draft 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. Compare Cal. Corp. Code § 17050(a) ("In order to form a limited liability company, one or more persons shall execute and file articles of organization with, and on a form prescribed by, the Secretary of State and, either before or after the filing of articles of organization, the members shall have entered into an operating agreement.")

The operating agreement is the exclusive consensual process for modifying statutory default rules among the members and between the members and the limited liability company. The operating agreement also has power over the rights and obligations of managers and over the rights under the Act of dissociated members, transferees and managers.

The relationship between an amendment to an operating agreement and the rights of a manager, dissociated member, or transferee prejudiced by the amendment is not (yet?) stated in this section. With regard to the rights of manager, the Committee has decided that, except as provided in subsection (c), the amendment should be effective but subject to the manager's rights to claim breach under any separate agreement with the LLC. With regard to dissociated members and transferees, the remedy lies in Section 701(a)(5) (dissolution by court order).

At its February, 2005 meeting, the Drafting Committee again rejected language that would have expressly authorized the operating agreement to include a "no oral modification" provision or otherwise require that all amendments be memorialized in a writing or other record. The Committee also decided to (i) delete language that in prior drafts had expressly overridden any "one year" provision of a generally applicable statute of frauds and (ii) eliminate language permitting a non-member to be party to the operating agreement (which first appeared in the February, 2005 draft).

Subsection (a) – This Act comprises a set of rules that contains two mutually exclusive subsets – those rules that can be changed by the operating agreement and those that cannot. Subsection (a) delineates the realm of the former subset, and subsection (b) explains what happens within that realm to the extent left unaddressed by the operating agreement.

Subsection (a)(2) – This provision has been added to implement a consensus expressed at the February, 2005 meeting.

Subsection (c): It is important to remember that this subsection is a default rule. Therefore, if the operating agreement (initially agreed to by all the members) permits amendment by the consent of a majority of the members, an amendment agreed to by a majority of the members would be effective.

The second sentence is based on Del. Code Ann., tit. 6, § 18-101(7), as directed by the Drafting Committee at its February, 2005 meeting.

The effect of the third sentence is to permit non-members (as well as members) to have veto rights over amendments to the operating agreement. Such 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 the 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, but the non-member manager is not a party to the operating agreement. Later the LLC members amend the operating agreement to change the quantum to a simple majority and thereafter purport to remove the manager without cause. Although the LLC has undoubtedly breached its contract with the manager, the LLC probably has the power to effect the removal and the manager is remitted to a damage claim – unless the operating agreement provided the non-member manager a veto right over changes in the quantum provision.

The third sentence is derived from Del. Code Ann. tit. 6, § 18-302(e), which states:

> If a limited liability company agreement provides for the manner in which it may be amended, including by requiring the approval of a person who is not a party to the limited liability company agreement or the satisfaction of conditions, it may be amended only in that manner or as otherwise permitted by law (provided that the approval of any person may be waived by such person and that any such conditions may be waived by all persons for whose benefit such conditions were intended).

As originally drafted, the third sentence referred to waiver. At its February, 2005 meeting, the

Drafting Committee deleted that reference as surplus, in light of Section 107 (Supplemental principles of law).

Subsection (d): This subsection is added pursuant to a consensus discovered at the February, 2005 meeting of the Committee.

Subsection (f)(4) – This provision combines the references to duty of loyalty and duty of care in order to avoid repetition; two of the clauses [(iii) and (iv)] pertain to both duties.

Subsection (f)(11): This provision is new and attempts to perform the task assigned by the Committee to the co-reporters at the February, 2005 meeting.

Reporters' Notes to Former Section 111 [Required Information]

At its October, 2004 meeting, the Drafting Committee deleted this section, reasoning that the informal nature of the LLC made a required records provision inappropriate.

SECTION 111. BUSINESS TRANSACTIONS OF MEMBER WITH LIMITED LIABILITY COMPANY. A member may lend money to and transact other business with the limited liability company and has the same rights and obligations with respect to the loan or other transaction as a person that is not a member.

Reporters' Notes

At the suggestion of the ABA Advisor, the Comment to ULPA (2001), § 112 is replicated here with appropriate changes:

This section has no impact on a member's duty under Section [TBD] (duty of loyalty includes refraining from acting as or for an adverse party) and means rather that this Act does not discriminate against a creditor of a limited liability company that happens also to be a member. *See*, *e.g.*, *BT-I v. Equitable Life Assurance Society of the United States*, 75 Cal.App.4th 1406, 1415, 89 Cal.Rptr.2d 811, 814 (Cal.App. 4 Dist.1999). and *SEC v. DuPont, Homsey & Co.*, 204 F. Supp. 944, 946 (D. Mass. 1962), vacated and remanded on other grounds, 334 F2d 704 (1st Cir. 1964). This section does not, however, override other law, such as fraudulent transfer or conveyance acts.

SECTION 112. OFFICE AND AGENT FOR SERVICE OF PROCESS.

(a) A limited liability company shall designate and continuously maintain in this state:

(1) an office, which need not be a place of its activity in this state; and

(2) an agent for service of process.

(b) A foreign limited liability company shall designate and continuously maintain in this state an agent for service of process.

(c) An agent for service of process of a limited liability company or foreign limited liability company must be an individual who is a resident of this state or other person authorized to do business in this state.

Reporters' Notes

Source: ULPA (2001), § 114.

<u>**Issue to be considered:** whether to add the word "registered" to both office and agent.</u>

At its October, 2004 meeting, the Drafting Committee discussed using the adjective "registered" for both office and agent, in conformity with MBCA § 5.01. That usage is inconsistent with ULPA (2001) § 114, ULLCA § 108, RULPA § 104. Query why to change what has been consistent Conference usage since 1976.

SECTION 113. CHANGE OF DESIGNATED OFFICE OR AGENT FOR SERVICE OF PROCESS.

(a) A limited liability company or foreign limited liability company may change its designated office, agent for service of process, or the address of its agent for service of process by delivering to the [Secretary of State] for filing a statement of change containing:

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

(2) the street and mailing address of its current designated office;

(3) if the current designated office is to be changed, the street and mailing address of the new designated office;

(4) the name and street and mailing address of its current agent for service of process; and

(5) if the current agent for service of process or an address of the agent is to be changed, the new information.

(b) Subject to Section 206(c), a statement of change is effective when filed by the [Secretary of State].

Reporters' Notes

Source – ULPA (2001) § 115, which is based on ULLCA § 109.

Subsection (a) – This Draft uses "may" rather than "shall" here because other avenues exist. A limited liability company may also change the information by an amendment to its certificate of organization, Section 202, or through its annual report. Section 210(e). A foreign limited liability company may use its annual report. Section 210(e). However, neither a limited liability company nor a foreign limited liability company may wait for the annual report if the information described in the public record becomes inaccurate. See Sections 208 (imposing liability for false information in record) and 116(b) (providing for substitute service).

SECTION 114. RESIGNATION OF AGENT FOR SERVICE OF PROCESS.

(a) In order to resign as an agent for service of process of a limited liability company or foreign limited liability company, the agent shall deliver to the [Secretary of State] for filing a statement of resignation containing the name of the limited liability company or foreign limited liability company.

(b) After receiving a statement of resignation, the [Secretary of State] shall file it and mail a copy to the designated office of the limited liability company or foreign limited liability company and another copy to the principal office if the mailing address of the office appears in the records of the [Secretary of State] and is different from the mailing address of the designated office.

(c) An agency for service of process terminates on the 31st day after the [Secretary of State] files the statement of resignation.

Reporters' Notes

Source – ULPA (2001) § 116, which is based on ULLCA §110.

SECTION 115. SERVICE OF PROCESS.

(a) An agent for service of process appointed by a limited liability company or foreign limited liability company is an agent of the limited liability company or foreign limited liability company for service of any process, notice, or demand required or permitted by law to be served upon the limited liability company or foreign limited liability company.

(b) If a limited liability company or foreign limited liability company does not appoint or maintain an agent for service of process in this state or the agent for service of process cannot with reasonable diligence be found at the agent's street address, the [Secretary of State] is an agent of the limited liability company or foreign limited liability company upon whom process, notice, or demand may be served.

(c) Service of any process, notice, or demand on the [Secretary of State] may be made by delivering to and leaving with the [Secretary of State] duplicate copies of the process, notice, or demand. If a process, notice, or demand is served on the [Secretary of State], the

[Secretary of State] shall forward one of the copies by registered or certified mail, return receipt requested, to the limited liability company or foreign limited liability company at its designated office.

(d) Service is effected under subsection (c) at the earliest of:

(1) the date the limited liability company or foreign limited liability company receives the process, notice, or demand;

(2) the date shown on the return receipt, if signed on behalf of the limited liability company or foreign limited liability company; or

(3) five days after the process, notice, or demand is deposited in the mail, if mailed correctly addressed and with postage prepaid.

(e) The [Secretary of State] shall keep a record of each process, notice, and demand served pursuant to this section and record the time of, and the action taken regarding, the service.

(f) This section does not affect the right to serve process, notice, or demand in any other manner provided by law.

Reporters' Notes

Source – ULPA (2001) § 117, which is based on ULLCA §111.

[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 sign and deliver to the [Secretary of State] for filing a certificate of organization, which must state:

(1) the name of the limited liability company, which must comply with Section 108;

(2) the street and mailing address of the initial designated office and the name and street and mailing address of the initial agent for service of process; and

(3) whether the limited liability company is member-managed or manager-managed.

(b) A certificate of organization may also contain matters other than those required by subsection (a) but:

(1) are not effective as a statement of authority (Section 302); and

(2) may not vary or otherwise affect the provisions specified in Section 110(b) in a manner inconsistent with that section.

(c) A limited liability company is formed when the [Secretary of State] files the certificate of organization, unless the certificate states a delayed effective date pursuant to Section 206(c). If the certificate states a delayed effective date, a limited liability company is not formed if, before the certificate takes effect, the person who signed the certificate signs and delivers to the [Secretary of State] for filing a statement of cancellation.

(d) Subject to subsection (b), if a record that has delivered by the limited liability company to the [Secretary of State] for filing and become effective under this [act] is inconsistent with a provision of the operating agreement:

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

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

Reporters' Notes

Issues to be considered: whether subsection (a) should state that the organizers are to act on behalf of the "initial member or members"; whether subsection (d) should take into account that provisions of the certificate could be evidence of the contents of the operating agreement; whether subsection (c)'s provision for a statement of cancellation should provide a fallback rule, in case the person that signed the certificate of incorporation is incapacitated and therefore unable to sign a statement of cancellation

Subsection (a)(3) – This provision does not reflect a default rule. That is, a person seeking to form a limited liability company must make an affirmative choice between member-management and manager-management. The certificate will be rejected as non-conforming unless they specify the choice. The Drafting Committee has determined that this approach is appropriate, even though many LLC statutes (including ULLCA) typically default to member-management. At its February, 2005 meeting, the Committee again addressed this issue and re-affirmed its earlier decision.

Subsection (b)(1) – This provision was new in the February, 2005, added by the reporters because a person searching the public records for statements of authority might not also search the certificate. (The Drafting Committee has previously decided that statements of authority should not be deemed part of an LLC's certificate.) At the February, 2005 meeting, the Committee considered this section and no one questioned this subsection.

Subsection (d) – Source: ULLCA Section 203(c), which is also followed in ULPA (2001) § 201(d). At its February, 2005 meeting, the Drafting Committee accepted the co-reporters' recommendation to substitute a more streamlined provision. The new language follows one of the alternatives stated in the Reporters' Notes to the February, 2005 draft, further revised to reflect the Committee's current thinking about the effect of the operating agreement on the rights of managers, transferees, and dissociated members.

For further background, consider the following three paragraphs, which are from the comment to ULPA (2001) § 201(d), revised to refer to a limited liability company.

> A limited liability company is a creature of contract as well as a creature of statute. It will be possible, albeit improper, for the operating agreement to be inconsistent with the certificate of organization or other specified public filings relating to the limited liability company. For those circumstances, this subsection provides the rule for determining which source of information prevails.
>
> For members, managers and transferees, the operating agreement is paramount. For third parties seeking to invoke the public record, actual knowledge of that record is necessary and notice under Section 103(c) or (d) is irrelevant. A third party wishing to enforce the public record over the operating agreement must show reasonable reliance on the public record, and reliance presupposes knowledge.
>
> 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, detrimentally relies on the additional information. However, the policy reflected in this subsection seems equally applicable to that situation.

Note – as with prior uniform acts and prior drafts of this act, this subsection (d) does not apply to records filed on behalf of persons other than a limited liability company. Also, once the Drafting Committee has finalized the list of records that may be filed by a limited liability company, the language of this subsection must be cross-checked against that list.

SECTION 202. AMENDMENT OR RESTATEMENT OF CERTIFICATE OF ORGANIZATION.

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

(1) the name of the limited liability company;

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

(3) the changes the amendment makes to the certificate as most recently

amended or restated.

(b) A certificate of organization may be amended or restated at any time as determined by the limited liability company.

(c) A restated certificate of organization may be delivered to the [Secretary of State] for filing in the same manner as an amendment. A restated certificate of organization must be designated as such in the heading and state in the heading or in an introductory paragraph the limited liability company's present name and, if it has been changed, all of its former names and the date of the filing of its initial certificate of organization.

(d) Subject to Section 206(c), an amendment to or restatement of a certificate of organization is effective when filed by the [Secretary of State].

(e) 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 false when the certificate was filed or has become false owing 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 pursuant to Section 113 or a statement of correction pursuant to Section 207.

Reporters' Notes

Subsection (b) – At the April 2004 meeting, the Drafting Committee asked for more explanation about restated articles. In response, this subsection expressly authorizes restating the articles (now referred to as the "certificate of organization").

Subsection (c) – For the reason stated in the Notes to subsection (b), this draft includes an additional sentence (the second), which is taken verbatim from ULLCA. Query whether any name change should trigger the requirement for additional information or only a name change being made by the restatement itself. (The purpose of the additional information appears to be to facilitate tracking back through the Secretary of State's database.)

Subsection (e) – This subsection is taken from ULPA (2001) § 202(c), which imposes the responsibility on general partners. ULLCA has no comparable provision. This provision imposes an obligation directly on the members and managers rather than on the limited liability company. A member or manager's failure to meet this responsibility exposes the member or manager to liability to third parties under Section 208(a)(2) and might constitute a breach of the member or manager's operational duties under Section 409(a)(2). In addition, an aggrieved person may seek a remedy under Section 205 (Signing and Filing Pursuant to Judicial Order).

SECTION 203. STATEMENT OF TERMINATION. A dissolved limited liability company that has completed winding up may deliver to the [Secretary of State] for filing a statement of termination that states:

(1) the name of the limited liability company;

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

(3) any other information as determined by the limited liability company.

Reporters' Notes

This section is permissive and perhaps belongs in Article 7. Indeed, at the April 2004 meeting, a commissioner suggested relocating this section to that Article. However, that relocation would put this Act out of synch with the Conference's most recent enactment in the area (ULPA (2001)) – not only here but, as a result of renumbering, throughout the rest of Article 2. (The Drafting Committee liaison from the Committee on Style agrees that this section should be relocated to Article 7.)

SECTION 204. SIGNING OF RECORDS TO BE DELIVERED FOR FILING TO THE [SECRETARY OF STATE].

(a) Records delivered to the [Secretary of State] for filing pursuant to this [act] must be signed in the following manner:

(1) The initial certificate of organization must be signed by at least one

person

(2) A statement of cancellation under Section 201(c) must be signed by each person that signed the initial certificate of organization.

(3) Except as otherwise provided in paragraph (a)(4), a record signed on behalf of an existing limited liability company must be signed by:

(A) at least one member, if the limited liability company is member-managed; or

(B) at least one manager, if the limited liability company is manager-managed.

(4) A record filed on behalf of a dissolved limited liability company that has no members must be signed either by the person winding up the limited liability company's activities under Section 702(b) or a person appointed under Section 702(c) to wind up those activities.

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

(6) Any other record must be signed by the person on whose behalf the record is delivered to the [Secretary of State].

(b) Any record to be filed under this [act] may be signed by an authorized agent.

Reporters' Notes

Issues to be considered: whether subsection (a)(3) and (7) suffice to indicate that a statement of dissociation, Section 604, must be signed either by the dissociated member or the limited liability company, depending on who is delivering the document to the Secretary of State for filing; whether it is necessary to revise subsection (a)(2) to accommodate situations in which one of the original signers has ceased to exist or lacks capacity

This Draft uses "authorized agent" rather than "attorney in fact," because the latter usage seems needlessly recondite.

SECTION 205. 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 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 the person aggrieved under subsection (a) is not the limited liability company or foreign limited liability company to which the record pertains, the person shall make the limited liability company or foreign limited liability company a party to the action.

(c) A person aggrieved under subsection (a) may pursue the remedies provided in subsection (a) in the same action in combination or in the alternative.

(d) A record that is filed pursuant to this section is effective even if it has not been signed.

Reporters' Notes

Source – ULPA (2001) § 205, which is based on RULPA § 205, which was the source of ULLCA § 210.

At the April 2004 meeting of the Drafting Committee, at least two people suggested that this Section might be unnecessary, given the existence of F.R.Civ. P. 70. That rule states:

> If a judgment directs a party to execute a conveyance of land or to deliver deeds or other documents or to perform any other specific act and the party fails to comply within the time specified, the court may direct the act to be done at the cost of the

> disobedient party by some other person appointed by the court and the act when so done has like effect as if done by the party. On application of the party entitled to performance, the clerk shall issue a writ of attachment or sequestration against the property of the disobedient party to compel obedience to the judgment. The court may also in proper cases adjudge the party in contempt. If real or personal property is within the district, the court in lieu of directing a conveyance thereof may enter a judgment divesting the title of any party and vesting it in others and such judgment has the effect of a conveyance executed in due form of law. When any order or judgment is for the delivery of possession, the party in whose favor it is entered is entitled to a writ of execution or assistance upon application to the clerk.

For several reasons, the co-reporters believe that the present Section should be retained. (1) F.R.Civ. P. 70 requires a judgment as a predicate and therefore seems to grant a power ancillary to some other already contested matter. The present Section addresses situations in which the failure to sign *is* the contested matter. (2) Due to the rules of diversity jurisdiction, federal courts will rarely have jurisdiction over a case involving as parties an LLC and any of its members. (3) There is no assurance that in each state, the District of Columbia and each U.S. territory, local law includes a provision comparable to F.R.Civ. P. 70. (4) Language similar to the present Section appears in RULPA, ULLCA and ULPA (2001).

SECTION 206. DELIVERY TO AND FILING OF RECORDS BY [SECRETARY OF STATE]; EFFECTIVE TIME AND DATE.

(a) A record authorized or required to be delivered to the [Secretary of State] for filing under this [act] must be captioned to describe the record's purpose, be in a medium permitted by the [Secretary of State], and be delivered to the [Secretary of State]. If all filing fees have been paid, unless the [Secretary of State] determines that a record does not comply with the filing requirements of this [act], the [Secretary of State] shall file the record and:

(1) for a statement of denial, send a copy of the filed statement and a receipt for the fees to the person on whose behalf the statement was delivered for filing and to the limited liability company;

(2) for all other records, send a copy of the filed record and a receipt for

the fees to the person on whose behalf the record was filed.

(b) Upon request and payment of the requisite fee, the [Secretary of State] shall send to the requester a certified copy of the requested record.

(c) Except as otherwise provided in Sections 114 and 207, a record delivered to the [Secretary of State] for filing under this [act] may specify an effective time and a delayed effective date. Subject to Sections 114, 201(c), and 207, a record filed by the [Secretary of State] is effective:

(1) if the record does not specify an effective time and does not specify a delayed effective date, on the date and at the time the record is filed as evidenced by the [Secretary of State's] endorsement of the date and time on the record;

(2) if the record specifies an effective time but not a delayed effective date, on the date the record is filed at the time specified in the record;

(3) if the record specifies a delayed effective date but not an effective time, at 12:01 a.m. on the earlier of:

(A) the specified date; or

(B) the 90th day after the record is filed; or

(4) if the record specifies an effective time and a delayed effective date, at the specified time on the earlier of:

(A) the specified date; or

(B) the 90th day after the record is filed.

Reporters' Notes

Source – ULPA (2001) § 206, which was based on ULLCA §206.

Subsection (c) – If a person delivers to the Secretary of State for filing a record that contains an over-long delay in the effective date, the Secretary of State (i) will not reject the record and (ii) is neither required nor authorized to inform the person that this act will truncate the delay.

SECTION 207. CORRECTING FILED RECORD.

(a) A limited liability company or foreign limited liability company may deliver to the [Secretary of State] for filing a statement of correction to correct a record previously delivered by the limited liability company or foreign limited liability company to the [Secretary of State] and filed by the [Secretary of State], if at the time of filing the record contained false or erroneous information or was defectively signed.

(b) A statement of correction may not state a delayed effective date and must:

(1) describe the record to be corrected, including its filing date, or attach a copy of the record as filed;

(2) specify the incorrect information and the reason it is incorrect or the manner in which the signing was defective; and

(3) correct the incorrect information or defective signature.

(c) When filed by the [Secretary of State], a statement of correction is effective retroactively as of the effective date of the record the statement corrects, but the statement is effective when filed:

(1) for the purposes of Section 103(c); and

(2) as to persons relying on the uncorrected record and adversely affected by the correction.

Reporters' Notes

Source – ULPA (2001) § 207, which was based on ULLCA §207.

SECTION 208. LIABILITY FOR FALSE 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 false 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 false at the time the record was signed; and

(2) a member of member-managed limited liability company, or a manager of a manager-managed limited liability company, if the record was delivered for filing on behalf of the limited liability company and the member or manager has notice that the information was false when the record was filed or has become false because of changed circumstances for a reasonably sufficient time before the information is relied upon to enable the member or manager to effect an amendment under Section 202, file a petition pursuant to Section 205, or deliver to the [Secretary of State] for filing a statement of change pursuant to Section 113 or a statement of correction pursuant to Section 207.

(b) A person who signs a record authorized or required to be filed under this [act] thereby affirms under the penalties of perjury that the facts stated in the record are true.

Reporters' Notes

Source: ULPA (2001) § 207, which expanded on ULLCA § 209.

Issue to be considered: whether a defendant in an action under this section may escape liability proving that the plaintiff's reliance on the public record was unreasonable or even done with knowledge of the falsity

SECTION 209. CERTIFICATE OF EXISTENCE OR AUTHORIZATION.

(a) The [Secretary of State], upon request and payment of the requisite fee, shall furnish a certificate of existence for a limited liability company if the records filed in the [office of the Secretary of State] show that the [Secretary of State] has filed a certificate of organization and has not filed a statement of termination. A certificate of existence must state:

(1) the limited liability company's name;

(2) that it was duly formed under the laws of this state and the date of formation;

(3) whether all fees, taxes, and penalties due to the [Secretary of State] under this [act] or other law have been paid;

(4) whether the limited liability company's most recent annual report required by Section 210 has been filed by the [Secretary of State];

(5) whether the [Secretary of State] has administratively dissolved the limited liability company;

(6) whether the limited liability company has delivered to the [Secretary of State] for filing a statement of dissolution;

(7) that a statement of termination has not been filed by the [Secretary of State]; and

(8) other facts of record in the [office of the Secretary of State] which may be requested by the applicant.

(b) The [Secretary of State], upon request and payment of the requisite fee, shall furnish a certificate of authorization for a foreign limited liability company if the records filed in the [office of the Secretary of State] show that the [Secretary of State] has filed a certificate of authority, has not revoked the certificate of authority, and has not filed a notice of cancellation. A certificate of authorization must state:

(1) the foreign limited liability company's name and any alternate name adopted under Section 805(a) for use in this state;

(2) that it is authorized to transact business in this state;

(3) whether all fees, taxes, and penalties due to the [Secretary of State] under this [act] or other law have been paid;

(4) whether the foreign limited liability company's most recent annual report required by Section 210 has been filed by the [Secretary of State];

(5) that the [Secretary of State] has not revoked its certificate of authority and has not filed a notice of cancellation; and

(6) other facts of record in the [office of the Secretary of State] which may be requested by the applicant.

(c) Subject to any qualification stated in the certificate, a certificate of existence or certificate of authorization issued by the [Secretary of State] may be relied upon as conclusive evidence that the limited liability company or foreign limited liability company is in existence or is authorized to transact business in this state.

Reporters' Notes

Source – ULPA (2001) § 209, which was based on ULLCA Section 208.

SECTION 210. ANNUAL REPORT FOR [SECRETARY OF STATE].

(a) Each year a limited liability company or a foreign limited liability company authorized to transact business in this state shall deliver to the [Secretary of State] for filing a report that states:

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

(2) the street and mailing address of its designated office and the name and street and mailing address of its agent for service of process in this state;

(3) in the case of a limited liability company, the street and mailing address of its principal office; and

(4) in the case of a foreign limited liability company, the state or other jurisdiction under whose law the foreign limited liability company is formed and any alternate name adopted under Section 805(a).

(b) Information in an annual report must be current as of the date the report is delivered to the [Secretary of State] for filing.

(c) The first annual report must be delivered to the [Secretary of State] between [January 1 and April 1] of the year following the calendar year in which a limited liability company was formed or a foreign limited liability company was authorized to transact business. A report must be delivered to the [Secretary of State] between [January 1 and April 1] of each subsequent calendar year.

(d) If an annual report does not contain the information required in subsection (a), the [Secretary of State] shall promptly notify the reporting limited liability company or foreign limited liability company and return the report to it for correction. If the report is corrected to contain the information required in subsection (a) and delivered to the [Secretary of State] within 30 days after the effective date of the notice, it is timely delivered.

(e) If a filed annual report contains an address of a designated office or the name or address of an agent for service of process which differs from the information shown in the records of the [Secretary of State] immediately before the filing, the differing information in the annual report is considered a statement of change under Section 113.

Reporters' Notes

Source – ULPA (2001) § 210, which was based on ULLCA § 211.

[ARTICLE] 3

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

SECTION 301. AGENCY OF MEMBERS AND MANAGERS. Subject to the effect of a statement of limited liability company authority under Section 302, the following rules apply.

(1) In a member-managed limited liability company the following rules apply:

(A) Each member is an agent of the limited liability company for the purpose of its activities, and an act of a member, including the signing of an instrument in the limited liability company's name, for apparently carrying on in the ordinary course the limited liability company's activities or activities of the kind carried on by the limited liability company binds the limited liability company, unless the member had no authority to act for the limited liability company in the particular matter and the person with which the member was dealing knew or had notice that the member lacked authority.

(B) An act of a member which is not apparently for carrying on in the ordinary course the limited liability company's activities or activities of the kind carried on by the limited liability company binds the limited liability company only if the act was authorized by the other members.

(2) In a manager-managed limited liability company the following rules apply:

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

(B) Each manager is an agent of the limited liability company for the purpose of its activities, and an act of a manager, including the signing of an instrument in the limited liability company's name, for apparently carrying on in the ordinary course the limited liability company's activities or activities of the kind carried on by the limited liability company binds the limited liability company, unless the manager had no authority to act for the limited liability company in the particular matter and the person with which the manager was dealing knew or had notice that the manager lacked authority.

(C) An act of a manager which is not apparently for carrying on in the ordinary course the limited liability company's activities or activities of the kind carried on by the limited liability company binds the limited liability company only if the act was authorized under Section 407.

Reporters' Notes

Source – RUPA § 301.

This section differs somewhat from ULLCA § 301, because this Draft follows RUPA in providing for statements of authority. Compare Section 302 (statements of authority) with ULLCA § 301(c) (providing a somewhat comparable but more limited effect for statements in the articles of organization). The RUPA approach is preferable, because it allows "duplicate filing" in the real estate records without the need to file the entire articles of organization in those records. See Section 302(c)(2) and (3) of this Draft.

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 limited liability company authority. The statement:

(1) must include the name of the limited liability company and the street

and mailing address of its designated office;

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

(A) execute an instrument transferring real property held in the name of the limited liability company; and

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

(3) may, with respect to any person holding a specified position that exists in or with respect to the limited liability company, state the authority, or limitations on the authority of such person to:

(A) execute an instrument transferring real property held in the name of the limited liability company; and

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

(b) To amend or cancel a statement of authority previously filed by the [Secretary of State] under Section 206(a), a limited liability company may deliver to the [Secretary of State] for filing an amendment or cancellation stating:

(1) the name of the limited liability company;

(2) the street and mailing address of its designated office;

(3) the caption of the statement being amended or cancelled and the date the statement became effective; and

(4) either the contents of the amendment or a declaration that the statement

is cancelled.

(c) A statement of authority affects only the power of a person to bind a limited liability company to persons that are not members and does so according to the following rules:

(1) Except as otherwise provided in paragraphs (3), (4) and (5), a limitation on the authority of a person or a position contained in an effective statement of authority does not by itself cause any person to have knowledge or notice of the limitation.

(2) 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, without having knowledge to the contrary, except to the extent that:

(A) the statement has been cancelled or restrictively amended under subsection (b); or

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

(3) An effective statement of authority that grants authority to transfer real property held in the name of the limited liability company, which is by certified copy recorded in the office for recording transfers of that 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:

(A) the statement has been cancelled 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 that real property; or

(B) 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 that later effective statement is recorded in the office for recording transfers of that real property.

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

(5) An effective statement of dissociation or manager cessation is, for the purposes of paragraphs (3) and (4), a limitation on the authority of the person referred to in the statement. Subject to paragraph (6), an effective statement of dissolution or termination is a cancellation of any filed statement of authority for the purposes of paragraphs (3) and (4) and is a limitation on authority for the purposes of paragraph (4).

(6) 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 limited liability company authority that is designated as a post-dissolution statement of authority and that will operate as provided in paragraphs (3) and (4).

(7) Unless earlier canceled, an effective statement of limited liability company authority is canceled by operation of law five years after the date on which the statement, or the most recent amendment, became effective. This cancellation operates without need for any recording under paragraphs (3) and (4).

(d) An effective statement of denial (Section 303) operates as a restrictive amendment under this Section.

Reporters' Notes

Issues to be considered: whether transferees, dissociated members, and managers should be bound by and able to rely on statements of authority; whether even members are bound by properly recorded statements of authority pertaining to real estate; whether this section should expressly state the consequences when the certificate of organization conflict with an effective statement of authority; whether it is sufficiently apparent that in subsection (c)(4) the phrase "all persons" is limited to "all persons not members"

At its February, 2005 meeting, the Drafting Committee directed the co-reporters substitute the co-reporters' alternative language for this section. The Committee also decided, for the sake of simplicity, to eliminate any provisions pertaining to *restrictions* on authority not related to the transfers of real property. However, the co-reporters discovered an insurmountable barrier on this road to simplicity: (i) any statutory language that would be adequate to authorize a limited liability company to *grant* authority would necessarily suffice to authorize the LLC to *delimit* the authority granted, and therefore (ii) an LLC could use a statement of authority to *limit* authority through the artifice of purporting to grant limited authority.

Subsection (a)(3) – This language permits a statement to designate authority by position (or office) rather than by specific person. (Subsection (a)(2) covers the latter type of designation.)

Subsection (b) – For the requirement that the original statement, like any other record, be appropriately captioned, see Section 206(a).

Subsection (c) – The first clause contains a very important limitation – i.e., that statements do not operate *viz a viz* members. RUPA's text makes this very important point only obliquely. Direct authority is found in RUPA § 303, comment 4:

> It should be emphasized that Section 303 concerns the authority of partners to bind the partnership to third persons. As among the partners, the authority of a partner to take any action is governed by the partnership agreement, or by the provisions of RUPA governing the relations among partners, and is not affected by the filing or recording of a statement of partnership authority.

But query whether a statement of authority might, in some circumstances, be some evidence of the contents of the operating agreement? Query also what happens if a statement of authority conflicts with the certificate. Under this language, the statement controls as to a third party who gives value in reliance unless the party has "knowledge to the contrary." Reading the certificate might provide that contrary knowledge.

Query whether transferees, dissociated members, and managers should be bound by and able to rely on statements of authority. The answer is probably yes to the first two. Transferees do not typically have access to the operating agreement, and dissociated members do not typically have access to amendments effective after dissociation. For managers, the question is a closer one, because presumably a manager will have a contractual right (express or implied) to the "cornerstone" document of the organization being managed.

A comment will provide a reminder that "transfer" includes encumbrances.

Subsection (c)(4) – Per the opening sentence of subsection (c), the phrase "all persons" is limited to "all persons not members." Query whether that limitation is sufficiently apparent.

Subsection (c)(5) – To be effective with regard to the transfer of a parcel of real property, these statements must be appropriately recorded via certified copy in the office for recording transfers of that real property.

SECTION 303. STATEMENT OF DENIAL. A person named in a filed statement of limited liability company 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; and

(2) denies the grant of authority.

Reporters' Notes

For the effect of a statement of denial, see Section 302(d).

SECTION 304. LIMITED LIABILITY COMPANY LIABLE FOR MEMBER'S OR MANAGER'S ACTIONABLE CONDUCT.

(a) A member-managed limited liability company is liable for loss or injury caused to a person, or for a penalty incurred, as a result of a wrongful act or omission, or other actionable conduct, of a member acting in the ordinary course of business of the company or with authority of the limited liability company.

(b) If, in the course of a member-managed limited liability company's activities or while acting with authority of the member-managed limited liability company, a member receives or causes the limited liability company to receive money or property of a person that is not a member, and the money or property is misapplied by a member, the limited liability company is liable for the loss.

(c) In a manager-managed limited liability company the rules stated in subsections (a) and (b):

(1) apply to each manager of the limited liability company which is a member; and

(2) do not apply to a member in the member's capacity as a member.

Reporters' Notes

This section follows the paradigm of RUPA § 305, which combined UPA §§ 13 and 14 into a single section. ULLCA § 302 contains no parallel to RUPA § 305(b). That omission is reversed here, in subsection (b).

RUPA § 305 contains a confusing use of the word authority, which was carried forward in ULPA (2001) § 403. The following Comment to that section explains the usage issue:

Comment [to ULPA (2001) § 403]

> Source: RUPA Section 305. For the meaning of "authority" in subsections (a) and (b), see RUPA Section 305, Comment. The third-to-last paragraph of that Comment states:
>
> The partnership is liable for the actionable conduct or omission of a partner acting in the ordinary course of its business or "with the authority of the partnership." This is intended to include a partner's apparent, as well as actual, authority, thereby bringing within Section 305(a) the situation covered in UPA Section 14(a).
>
> The last paragraph of that Comment states:
>
> Section 305(b) is drawn from UPA Section 14(b), but has been edited to improve clarity. It imposes strict liability on the partnership for the

misapplication of money or property received by a partner in the course of the partnership's business or otherwise within the scope of the partner's actual authority.

Section 403(a) of this Act is taken essentially verbatim from RUPA Section 305(a), and Section 403(b) of this Act is taken essentially verbatim from RUPA Section 305(b).

SECTION 305. LIABILITY OF MEMBERS AND MANAGERS.

(a) Except as otherwise provided in subsection (c), the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, are solely the debts, obligations, and liabilities of the limited liability company. A member or manager is not personally liable for a debt, obligation, or liability of a limited liability company solely by reason of being or acting as a member or manager.

(b) The failure of a limited liability company to observe any particular formalities relating to the exercise of its powers or management of its activities is not a ground for imposing personal liability on the members or managers for the debts, obligations, or liabilities of the limited liability company.

(c) All or specified members or categories of members are liable in their capacity as members for all or specified debts, obligations, or liabilities of a limited liability company only if:

(1) the certificate of organization contains a provision to that effect; and

(2) a member so liable has consented in a record to the adoption of the provision or to be bound by the provision.

Reporters' Notes

Issues to be considered: whether to reinstate in subsection (b) the phrase "or requirements" after the word "formalities"; whether to retain subsection (c)

As originally presented to the Drafting Committee, this section came almost verbatim from ULLCA § 303.

Subsection (b) – At its April 2004 meeting, the Drafting Committee changed ULLCA's phrase "the usual limited liability company formalities" to "any particular formalities" on the theory that a limited liability company does not necessarily have any usual formalities. The Committee also deleted the phrase "or requirements", which in ULLCA follows the word "formalities". The effect of this change warrants further discussion. Some Committee members and advisors saw the change as merely removing surplus language. Others feared a substantive effect.

In any event, it might be useful for a Comment to explain that this provision does not pertain to a situation in which (i) a member or manager fails to obtain the consent required to have the actual authority to bind the LLC in a transaction with a third party; (ii) the member nonetheless purports to bind the LLC; (iii) under Section 301 the member or manager lacks the statutory apparent authority to bind the LLC; (iv) the LLC is not bound; and therefore (v) under the agency law doctrine of "warranty of authority," the member or manager is liable to the third party. In that circumstance, the liability is not *for* a "debt[], obligation[], [or] liability[y] of a limited liability company," but rather because the limited liability company is *not* indebted, obligated or liable.

Subsection (c) – At its April 2004 meeting, the Drafting Committee provisionally decided to retain this subsection, pending an inquiry into why the subsection was included in ULLCA. Co-reporter Bishop made that inquiry and spoke with Brian Schor, the ULLCA I proponent and ABA representative from NY, who has since left NY practice and is with a corporation. His recollection was that the provision was included for flexibility only. Professor Bishop's own "best recollection" (as Reporter for ULLCA I) was that, during the ULLCA I drafting process, someone stated that a particular, major bank would not deal with an LLC unless the statutory default itself could be disconnected. In that way, the bank could have the LLC's primarily liable with the LLC and not merely as guarantors.

If that rationale ever made sense, in the opinion of the co-reporters, it no longer does. Nothing prevents the operating agreement from varying this Section. The co-reporters recommend that the Drafting Committee deleted subsection (c).

This paragraph is moot, if the Committee accepts that suggestion. The Committee has also discussed whether the current language is adequate to authorize a provision in the certificate to set a cap on a member's subsection (c) liability – e.g., specifying that member X is liable only up to $500,000 to a specified obligee on a specified obligation, while member Y is liable for the full extent of that obligation (with or without the right of further contribution from X). The

Committee has tentatively decided that the current language is adequate in that regard but recommended that a Comment address this point.

Subsection (c)(2) – The April 2004 draft had changed the ULLCA language of "a member" to "each member". That change was intended to highlight a question to be resolved if the Drafting Committee decides to retain subsection (c) – namely, whether an obligation intended to apply to more than one member will apply to those who do consent if some of the members intended to be liable do not consent. The Drafting Committee decided emphatically that the answer to that question is yes. A member who wants to condition his, her or its subsection (c)(2) consent on the subsection (c)(2) consent of another must arrange that protection for him, her or itself. Accordingly, the ULLCA language has been reinstated.

[ARTICLE] 4

RELATIONS OF MEMBERS TO EACH OTHER AND TO LIMITED LIABILITY COMPANY

SECTION 401. BECOMING A MEMBER.

(a) A person becomes an initial member in connection with the formation of a limited liability company upon the formation of the limited liability company.

(b) After a limited liability company has had at least one initial member, a person becomes a member:

(1) as provided in an operating agreement;

(2) as the result of a merger, conversion, or domestication under [Article] 10;

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

(4) if within 90 days after the limited liability company ceases to have any members, the legal representative of the last person to have been a member consents to have the person become a member and the person consents to become a member.

(c) A person may become a member without acquiring a transferable interest and without making or being obligated to make a contribution to the limited liability company.

Reporters' Notes

History of this section and the issue of "shelf LLCs" -- At the November, 2003 meeting, discussion was intense and views divided as to whether this Act should allow "shelf" LLCs. The April 2004 draft tried to steer a middle course, recognizing that: (i) it is the filing of a public document that creates the LLC as a legal person, and (ii) LLCs are filed on behalf of one or more persons intending to become members upon formation.

At its April 2004 meeting, the Drafting Committee directed the co-reporters to go "back to the drawing boards" and to consider the approach taken by Del. Code Ann. tit. 6, § 18-301(a), except for that provision's reliance on the records of the LLC. However, the Delaware model was of limited use, because section 18-301(a)(2) depends on the notion that an LLC agreement can exist before the LLC is formed, even though Del. Code Ann. tit. 6, § 18-101(7) defines an LLC agreement as being "of the member or members" and Del. Code Ann. tit. 6, § 18-101(11) defines "member" as "a person who has been admitted to a [presumably existing] limited liability company". It was the co-reporters' position that a uniform act should not adopt such a "Klein bottle" approach, and accordingly in the February, 2005 draft subsubsection (a)(2) referred to "an agreement among the persons who are to become the initial members". (A "Klein bottle" is a mathematical construct – a bottle with neither inside nor outside, because the neck of the bottle is elongated and passes into the center of the bottle through the side of the bottle without the presence of a hole in the side. A Klein bottle can, therefore, be realized only in four dimensions.)

At its February, 2005 meeting, the Drafting Committee reached a consensus that this Act should <u>not</u> authorize shelf LLCs and this draft has been revised accordingly.

Subsection (b)(4) – This language is relocated from Section 701 (dealing with avoidance of dissolution when an LLC loses its last member), where it appeared in the prior draft. The legal representative could itself consent to become the member.

Subsection (c) – This subsection permits so-called "non-economic members."

SECTION 402. FORM OF CONTRIBUTION. A contribution may consist of tangible or intangible property or other benefit to the limited liability company, including money, services performed, promissory notes, other agreements to contribute cash or property, and contracts for services to be performed.

Reporters' Notes

Source – ULPA (2001) § 501, which took ULLCA § 401 essentially verbatim except that in ULLCA the last phrase is introduced with "or" instead of "and".

SECTION 403. LIABILITY FOR CONTRIBUTIONS.

(a) A person's obligation to make a contribution of money, property, or other benefit to, or to perform services for, a limited liability company is not excused by the person's death, disability, or other inability to perform personally. If a person does not make the required contribution of property or services, the person is obligated at the option of the limited liability company to contribute money equal to the value of that portion of the contribution which has not been made.

(b) A creditor of a limited liability company which extends credit or otherwise acts in reliance on an obligation described in subsection (a), and without notice of any compromise under Section 407, may enforce the original obligation.

Reporters' Notes

Source: ULLCA § 402, which is taken from RULPA § 502(b), which also gave rise to ULPA (2001) § 502.

This version differs from ULLCA § 402 in only four respects, none of them substantive. (1) In the first sentence of subsection (a), "make a contribution" replaces "contribute" so that the subsection's opening phrase uses a defined term. (2) The second sentence of subsection (a) omits the word "stated" immediately before the second occurrence of "contribution" ("value of the stated contribution which has not been made"). There is no apparent referent for this adjective (which appears in the ULLCA version), so it has been deleted. (3) Throughout subsection (a), "person" replaces "member" to indicate that the section applies not only to members but also to persons who have promised contributions and whose membership is conditioned on the making of the promised contribution (or some other event). (4) In subsection (b), consistent with the Style Committee's current approach, "which" replaces "who" following "creditor of the limited liability company".

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

(a) Any distributions made by a limited liability company before its dissolution and winding up must be in equal shares.

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

(c) A member does not have a right to demand or receive a distribution from a limited liability company in any form other than cash. Except as otherwise provided in Section 709(c), a limited liability company may distribute an asset in kind if each portion of the asset is fungible with each other portion and each member receives a percentage of the asset equal in value to the member's share of distributions.

(d) When 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 limited liability company's obligation to make a distribution is subject to offset for any amount owed to the limited liability company by the member or dissociated member on whose account the distribution is made.

Reporters' Notes

Issues to be considered: whether this Act should provide a default rule for the allocation of profits and losses.

This section is an amalgam of ULLCA § 405 and ULPA (2001) §§ 504 (interim distributions) 505 (no distribution on account of dissociation), 506 (distribution in kind) and 507 (right to distribution).

Subsection (d) – The first sentence is probably redundant of Section 405(e) (limitations on distributions; those entitled to distributions at parity with other general unsecured creditors). The same redundancy exists under ULPA (2001) §§ 507 and 508.

No default provision allocating profits and losses – To date, this Act has followed both ULLCA and ULPA (2001) in omitting any default rule for allocation of losses. The Comment to ULPA (2001), § 503 explains that omission as follows:

> This Act has no provision allocating profits and losses among the partners. Instead, the Act directly apportions the right to receive distributions.

> Nearly all limited partnerships will choose to allocate profits and losses in order to comply with applicable tax, accounting and other regulatory requirements. Those requirements, rather than this Act, are the proper source of guidance for that profit and loss allocation.

The omission has been criticized. Franklin A. Gevurtz, BUSINESS PLANNING (3rd ed.), Supp. 2005 at 24.

The ULPA (2001) drafting committee followed the urging of its Advisor from the ABA Tax Section and the example of ULLCA, concluded that the Act should not contain a provision that has meaning only in terms of tax law, and assumed that anyone sophisticated enough to include profit and loss sharing rules in a partnership agreement would be competent enough to include appropriate adjustment to the statute's default distribution rules.

Query whether the same conclusion is appropriate for ULLCA II, given that (i) many people form LLCs without obtaining sophisticated planning advice, and (ii) people are so used to seeing statutory provisions for profits/losses and distributions in tandem that the absence of one is disconcerting.

SECTION 405. LIMITATIONS ON DISTRIBUTION.

(a) A limited liability company may not make a distribution in violation of the operating agreement.

(b) A limited liability company may not make a distribution if after the distribution:

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

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

(c) A limited liability company may base a determination that a distribution is not prohibited under subsection (b) on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances or on a fair valuation or other method that is reasonable in the circumstances.

(d) Except as otherwise provided in subsection (g), the effect of a distribution under subsection (b) is measured:

(1) in the case of distribution by purchase, redemption, or other acquisition of a transferable interest in the limited liability company, as of the date money or other property is transferred or debt incurred by the limited liability company; and

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

(A) the distribution is authorized, if the payment occurs within 120 days after that date; or

(B) the payment is made, if payment occurs more than120 days after the distribution is authorized.

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

(f) A limited liability company's indebtedness, including indebtedness issued in connection with or as part of a distribution, is not a liability for purposes of subsection (b) if the terms of the indebtedness provide that payment of principal and interest are made only to the extent that a distribution could then be made to members under this section.

(g) If indebtedness is issued as a distribution, each payment of principal or interest on the indebtedness is treated as a distribution, the effect of which is measured on the date the payment is made.

Reporters' Notes

Source – ULPA (2001) § 508, which was derived from ULLCA § 406, which was in turn derived from MBCA § 6.40.

Subsection (c) – This subsection appears to impose a standard of ordinary care, in contrast with the more complicated approach stated in Sections 409 and 410.

SECTION 406. LIABILITY FOR IMPROPER DISTRIBUTIONS.

(a) If a member of a member-managed, or manager of a manager-managed, limited liability company consents to a distribution made in violation of Section 405 and the limited liability company satisfies Section 410 with regard to the member's or manager's giving of consent, the member or manager is personally liable to the limited liability company for the amount of the distribution which exceeds the amount that could have been distributed without the violation.

(b) A member or transferee that receives a distribution knowing that the distribution to that member or transferee was made in violation of Section 405 is personally liable to the limited liability company but only to the extent that the distribution received by the member or transferee exceeded the amount that could have been properly paid under Section 405.

(c) A person against which an action is commenced under subsection (a) may:

(1) implead in the action any other person that is liable under subsection (a) and compel contribution from the person; and

(2) implead in the action any person that received a distribution in violation of subsection (b) and compel contribution from the person in the amount the person received in violation of subsection (b).

(d) An action under this section is barred if it is not commenced within two years after the distribution.

Reporters' Notes

Source – Same derivation as Section 405.

Query – is it adequately clear that liability under this section is not affected by a person ceasing to be a member, manager or transferee after the time that the liability attaches? Consider Section 102(9) and (10) (defining "manager" and "member" to exclude former managers and former members).

SECTION 407. MANAGEMENT OF A LIMITED LIABILITY COMPANY.

(a) In a member-managed limited liability company, the following rules apply:

(1) Each member has equal rights in the management and conduct of the limited liability company's activities.

(2) A difference arising among members as to a matter in the ordinary course of the activities of a limited liability company may be decided by a majority of the members. An act outside the ordinary course of activities of a limited liability company may be undertaken only with the consent of all the members. An amendment to the operating agreement may be made only with the consent of all the members.

(b) 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 of the limited liability company may be exclusively decided by the managers.

(2) Each manager has equal rights in the management and conduct of the activities of the limited liability company.

(3) A difference arising among managers as to a matter in the ordinary course of the activities of a limited liability company may be decided by a majority of the managers. The consent of all the members is required to:

(A) amend the operating agreement;

(B) sell, lease, exchange, or otherwise dispose of all, or substantially all, of the limited liability company's property, with or without the good will, other than in the usual and regular course of the limited liability company's activities;

(C) approve a transaction under [Article] 10 (mergers, conversions, domestications); and

(D) undertake any other act outside the ordinary course of activities of the limited liability company;

(4) A manager may be chosen at any time by the consent of a majority of the members and remains a manager until a successor has been chosen, unless the manager sooner resigns, is removed, dies, or, in the case of a manager that is not an individual, terminates. A manager may be removed at any time by the consent of a majority of the members, and those members need not state or have cause and need not inform the manager in advance or provide the manager with an opportunity to be heard. A person need not be a member in order to be a manager, but the dissociation of a member who 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 cause the person to dissociate as a member.

(c) Action requiring the consent of members under this [act] may be taken without a meeting, and a member may appoint a proxy or other agent to consent or otherwise act for the member by signing an appointment record, either personally or by the member's agent.

(d) The dissolution of a limited liability company does not affect the application of this section. However, a person that wrongfully causes dissolution of the limited liability company loses the right to participate in management as a member and a manager.

Reporters' Notes

Source: ULLCA § 404; ULPA (2001) § 406

Issues to be resolved: whether, when an entity is a manager, dissolution or termination of the entity should be the event that terminates the entity's status as manager; whether, in a manager-managed LLC, a wrongfully dissolving member should lose even the limited rights of a member to participate in management

Subsection (b)(3) – At its February, 2005 meeting, the Drafting Committee decided by consensus that, in a manager-managed LLC, the members, rather than the managers, retain the power to decide extraordinary matters. This decision augments the bankruptcy-related argument that a non-managing member's governance rights resemble a personal services contract, although this point was not the motivation for the change.

Subsection (b)(4) – When an entity is a manager, should dissolution or termination of the entity be an event that terminates the entity's status as manager? The current language refers to termination. *Compare* Section 601(4)(E) (providing for dissociation of a member that is a partnership or limited liability company upon the entity's dissolution). It is possible that both this provision and Section 601(4)(E) have it wrong. Perhaps dissociation should occur only upon termination, but cessation of manager status should occur upon dissolution. (If so, query the effect of dissolution on the management rights of an entity that is a member in a member-managed LLC.)

Subsection (d) – Query whether, in a manager-managed LLC, a wrongfully dissolving member should lose even the limited rights of a member to participate in management? Note that this subsection does not govern management authority a member might have in a capacity other than that of a manager or member -- e.g., under a separate agreement as an agent of the LLC.

SECTION 408. MEMBER'S AND MANAGER'S RIGHTS TO PAYMENTS AND REIMBURSEMENT.

(a) A member-managed limited liability company shall reimburse a member for payments made and indemnify the member for liabilities reasonably incurred by the member in the ordinary and proper conduct of the activities of the limited liability company or for the preservation of its activities or property. A manager-managed limited liability company shall reimburse a manager for payments made and indemnify the manager for liabilities reasonably incurred by the manager in the ordinary and proper conduct of the activities of the limited liability company or for the preservation of its activities or property.

(b) 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 whether or not the operating agreement may provide for the member or manager to be indemnified against the same liability.

(c) A limited liability company shall reimburse a member for an advance to the company beyond the amount of contribution the member agreed to make.

(d) A payment or advance that gives rise to an obligation of a limited liability company under subsections (a) through (c) constitutes a loan to the limited liability company, which accrues interest from the date of the payment or advance.

(e) A member is not entitled to remuneration for services performed for a limited liability company even in the capacity of a manager of a manager-managed limited liability company, except for reasonable compensation for services rendered in winding up the activities of a limited liability company.

Reporters' Notes

Source: ULLCA § 403

Subsection (a) – This subsection states a default rule, which should correspond to the default rule on the duty of care. In the default mode, indemnification should not be available for conduct that breaches the duty of care. Otherwise, the statutory rule on indemnification will vitiate the statutory rule on the standard of care.

In this draft, the duty of care involves an "ordinary negligence" standard, see Section 408(c), so this section returns to language employed in the UPA and omitted in RUPA. Without explanation (at least in the official comments), RUPA removed both the word "reasonably" and the word "properly" from the indemnification provision. Because RUPA uses a "gross negligence" standard, removing "reasonably" was arguably reasonable and provided indemnification for negligent conduct that did not fall to the level of gross negligence.

However, the removal of "proper" made less sense, because much objectionable conduct can occur within the "ordinary course" of an enterprise's activities. For example, if a member-managed LLC operates a delivery service, a member's reckless conduct in driving the delivery van occurs with the "ordinary course" of the LLC's activities.

Subsection (b) – This language authorizes an LLC to purchase insurance to cover, e.g., a manager's intentional misconduct. It is unlikely that such insurance would be available.

SECTION 409. STANDARDS OF CONDUCT FOR MEMBERS AND MANAGERS.

(a) A member owes to the limited liability company and, subject to Section 901(b), the other members the fiduciary duties of loyalty and care stated in subsections (b) and (c).

(b) In a member-managed limited liability company, a member's duty of loyalty to the limited liability company and, subject to Section 901(b), the other members includes the following:

(1) to account to the limited liability company and to hold as trustee for it

any property, profit, or benefit derived by the member in the conduct or winding up of the limited liability company's business or derived from a use by the member of the limited liability company's property, including the appropriation of a limited liability company opportunity;

(2) to refrain from dealing with the limited liability company in the conduct or winding up of the limited liability company's business as or on behalf of a party having an interest adverse to the limited liability company; and

(3) to refrain from competing with the limited liability company in the conduct of the limited liability company’s business before the dissolution of the limited liability company.

(c) In a member-managed limited liability company, a member's duty of care to the limited liability company and, subject to Section 901(b), the other members in the conduct of and winding up of the limited liability company's activities includes acting 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 limited liability company. In discharging duties under this subsection, a member may rely in good faith upon opinions, reports, statements, or other information provided by another person that the member reasonably believes is a competent and reliable source for the information.

(d) A member of a member-managed company shall discharge the duties 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 of a member-managed limited liability company does not violate a duty or obligation under this [act] or under the operating agreement merely because the member's conduct furthers the member's own interest.

(f) In a manager-managed company:

(1) subject to paragraph (4), a member does not have any duties or obligations under this section in the member's capacity as a member, except that subsections (d) and (e) apply to the member's conduct in that capacity;

(2) a manager is held to the same standards of conduct prescribed for a member in subsections (a) through (d), except that the obligation stated under subsection (b)(3) continues until winding up is completed;

(3) subsection (e) does not apply to a person in the person's capacity as a manager;

(4) if an operating agreement imposes on a member that is not a manager a responsibility that this [act] would otherwise impose on a manager, the standards of conduct prescribed by this subsection for a manager apply to the member with regard to that responsibility.

Reporters' Notes

Issues to be considered: whether to return the gross negligence formulation for the duty of care

This section already has a lengthy history. At its November, 2003 meeting, at the urging of Commissioner Blackburn, the Drafting Committee decided to try to (i) eschew the "gross negligence" standard of care first promulgated in RUPA and afterwards followed in ULLCA and ULPA (2001); and (ii) incorporate something like the standard of care/standard of liability dichotomy recently adopted in MBCA §§ 8.30 and 8.31. Under the MBCA, that dichotomy exists principally for directors and not for officers, *cf.* MBCA 8.42(c) (stating that director standard of liability principles apply to officers if they "have relevance), and those positions reflect categorically different kinds of responsibilities.

In response, the co-reporters drafted and the Committee considered a version of this section and a companion section, Section 410, that together attempted to parallel *functionally* the MBCA's *positional* distinction by using the defined terms "governance responsibility" and "operational responsibilities." (The draft also differed from the MBCA approach by leaving unaffected the traditional rules for duty of loyalty violations.)

At its April 2004 meeting, the Drafting Committee discussed the proposal at length and with good-natured intensity. When the dust cleared, no one had moved to change any language. However, there was considerable sentiment expressed in favor of collapsing the two sections into one provision and somehow reinstating the gross negligence standard in combination with a business judgment rule formulation.

The chair of the Committee then directed the co-reporters to draft a single section, which was presented to and adopted by the Committee during a teleconference. That single section was distributed to the 2004 Annual Meeting as a supplement to the Act and was read in place of the Sections 409 and 410 included in the Annual Meeting draft. At its October, 2004 meeting, the Drafting Committee again vigorously debated the topic of fiduciary duty, but no changes were moved.

At its February, 2005 meeting, the Committee decided it was impracticable to cabin all fiduciary duties of loyalty within the "fence" created by RUPA. This draft accordingly returns the law to the pre-RUPA situation, codifying the core of the fiduciary duty of loyalty but eschewing the *hubris* of purporting to discern every possible category of overreaching. The most important consequence of this change is to allow courts to continue to use fiduciary duty concepts to police disclosure obligations in member-to-member and member-LLC transactions.

SECTION 410. RIGHT TO INFORMATION OF MEMBERS, MANAGERS, AND DISSOCIATED MEMBERS.

(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 limited liability company, any records maintained by the limited liability company regarding the limited liability company's activities, financial condition, and other circumstances, to the extent that the information is material to the member's rights and duties under the operating agreement or this [act].

(2) The limited liability company shall furnish to each member:

(A) without demand, any information concerning the limited liability company's activities, financial condition, and other circumstances which the limited liability company knows and is material to proper exercise of the member's rights and duties under the operating agreement or this [act], except to the extent that the limited liability company can establish that it reasonably believes the member already knows the information; and

(B) on demand, any other information concerning the limited liability company's activities, financial condition, and others circumstances, except to the extent the demand or the information demanded is unreasonable or otherwise improper under the circumstances.

(3) The obligation to furnish information, as stated in 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 information rights and obligations stated in subsection (a) apply to the managers instead of the members.

(2) During regular business hours and at a reasonable location specified by the limited liability company, a member may obtain from the limited liability company and inspect and copy true and full information regarding the activities, financial condition, and other circumstances of the limited liability company as is just and reasonable if:

(A) the member seeks the information for a purpose material to the member's interest as a member;

(B) the member makes a demand in a record received by the limited liability 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) Within 10 days after receiving a demand pursuant to paragraph (2)(B), the limited liability company shall in a record inform the member that made the demand:

(A) the information that the limited liability company will provide in response to the demand;

(B) when and where the limited liability company will provide the information; and

(C) if the limited liability company declines to provide any demanded information, the limited liability company's reasons for declining.

(5) Whenever this [act] or an operating agreement provides for a member to give or withhold consent to a matter, before the consent is given or withheld, the limited liability company shall, without demand, provide the member with all information that is known to the limited liability company and is material to the member's decision.

(c) On 10 days' demand made in a record received by the limited liability company, a dissociated member may have access to whatever information the person was entitled to while a member if (i) the information pertains to the period during which the person was a member; (ii) the person seeks the information in good faith; and (iii) the person satisfies the requirements imposed on a member by subsection (b)(2). The limited liability company shall respond to a demand made pursuant to this subsection in the same manner as provided in subsection (b)(3).

(d) A limited liability company may charge a person that makes a demand under this section reasonable costs of copying, limited to the costs of labor and material.

(e) A member or dissociated member may exercise 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 (g) applies both to the agent or legal representative and the member or dissociated member.

(f) The rights provided in this section do not extend to a person as transferee.

(g) In addition to any restrictions or conditions stated in the operating agreement, the limited liability company may, as a matter within the ordinary course of its activities, 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 limited liability company has the burden of proving reasonableness..

Reporters' Notes

Issue to be resolved: whether this section could be misread as providing an exhaustive set of disclosure obligations, in derogation of the Drafting Committee's decision to "open up" fiduciary duties

This section was extensively discussed at the Drafting Committee's February, 2005 meeting, and the Committee gave the co-reporters instructions for numerous revisions. The two most important are: (1) the elimination of any statutory text that specifically addresses disclosure obligations in member-to-member and LLC-member transactions; and (2) the imposition of a proper purpose test for a member's access to LLC records in a member-managed LLC. The first-mentioned change was made in connection with the Drafting Committee decision to "open up" fiduciary duties. See Section 409. The imposition of a proper purpose test even in a member-managed LLC reflects the entity concept – i.e., the information belongs to the LLC as entity not to its members in the aggregate. (This point was first articulated by the ABA Advisor to the Committee.)

Subsection (d) – Following ULPA (2001), this subsection formerly provided: "If a member dies, Section 504 applies." At its February, 2005 meeting, the Drafting Committee decided to relegate this point to a comment.

Subsection (g) – In prior drafts, this material appeared as subsection (e). It has been relocated to the end of the section to indicate by its position that it applies to all information covered by the section. The phrase "as a matter within the ordinary course of its activities" means that a mere majority consent is needed to impose a restriction or condition. See Section 407 (a)(2) and (b)(3). This phrase and meaning are 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.

SECTION 411. STATEMENT OF MANAGER CESSATION. If a person ceases to be a manager for any reason, the limited liability company may deliver to the [secretary of state] for filing a statement of manager cessation, which must state the name of the limited liability company, its street and mailing address, the name of the person that has ceased to be a manager and the date on which the cessation occurred.

Reporters' Notes

Issues to be considered: whether this provision warrants its own section instead of being part of Section 407 (Management of a Limited Liability Company); whether a manager should also have the power to file a statement of manager cessation (paralleling the power of a member of a member-managed LLC to file a statement of dissociation)

If this provision remains as a separate section, the next draft will place it as Section 408 and will renumber the following sections.

[ARTICLE] 5

TRANSFERABLE INTERESTS AND RIGHTS OF TRANSFEREES AND CREDITORS

SECTION 501. MEMBER'S TRANSFERABLE INTEREST.

(a) Except as otherwise provided in subsection (c), the only interest of a member which is transferable is the member's transferable interest. The interest is personal property.

(b) If the operating agreement so provides:

(1) a transferable interest may be evidenced by a certificate of the interest issued by the limited liability company in record form; and

(2) subject to Section 502, the interest represented by the certificate may be transferred by a transfer of the certificate.

(c) A member may transfer a right to consent on a matter under the operating agreement or this [act] to another member without obtaining the consent of the other members.

Reporters' Notes

Issue to be resolved: whether subsection (c) should be revised, or language added to Section 502, to make clear that a member may sell the entirety of the member's rights to another member without having to have the consent of fellow members

Source – This Article most directly follows ULPA (2001), Article 7, because ULPA (2001) reflects the Conference's most recent thinking on the issues addressed here. However, ULPA (2001), Article 7 is quite similar in substance to ULLCA, Article 5, and both those Articles derive from Article 5 of RUPA.

This Draft does not include ULLCA § 501(a), which provides: "A member is not a co-owner of, and has no transferable interest in, property of a limited liability company." Substantially equivalent language appeared in Section 104(a) of the April 2004 draft, but the Drafting Committee decided to delete that language as surplus and perhaps confusing.

Subsection (b) – As initially drafted, this subsection was taken verbatim from ULLCA §

501(c) (with the addition of the phrase "in record form") and read as follows:

> An operating agreement may provide that a transferable interest may be evidenced by a certificate of the interest issued in record form by the limited liability company and, subject to Section 502, may also provide for the transfer of any interest represented by the certificate.

The current language implements the salutary suggestions of our liaison from the Committee on Style.

Subsection (c) – At its November, 2003 meeting, the drafting committee decided, consistent with current law, that a member may transfer governance rights to another member without obtaining consent from the other members. Thus, the Act does not itself protect members from control shifts that result from transfesr among members (as distinguished from transfers to non-members who seek thereby to become members). This subsection reflects the November, 2003 decision.

SECTION 502. TRANSFER OF MEMBER'S TRANSFERABLE INTEREST.

(a) A transfer, in whole or in part, of a member's transferable interest:

(1) is permissible;

(2) does not by itself cause the member's dissociation or a dissolution and winding up of the limited liability company's activities; and

(3) subject to Section 504, does not, as against the other members or the limited liability company, entitle the transferee to:

(A) participate in the management or conduct of the limited liability company's activities;

(B) require access to information concerning the limited liability company's transactions except as otherwise provided in subsection (c) and Section 411(h); or

(C) inspect or copy the required information or the limited liability company's other records.

(b) A transferee has the right to receive, in accordance with the transfer:

(1) distributions to which the transferor would otherwise be entitled; and

(2) upon the dissolution and winding up of the limited liability company's activities, the net amount otherwise distributable to the transferor.

(c) In a dissolution and winding up, a transferee is entitled to an account of the limited liability company's transactions only from the date of dissolution.

(d) Except as otherwise provided in Section 601(a)(4)(B) and (C), upon transfer the transferor retains the rights of a member other than the interest in distributions transferred and retains all duties and obligations of a member.

(e) A limited liability company need not give effect to a transferee's rights under this section until the limited liability company has notice of the transfer.

(f) A transfer of a member's transferable interest in the limited liability company in violation of a restriction on transfer contained in the operating agreement is ineffective as to a person having notice of the restriction at the time of transfer.

(g) A transferee that becomes a member with respect to a transferable interest is liable for the transferor's obligations under Sections 403 and 406. However, the transferee is not liable for obligations unknown to the transferee at the time the transferee became a member.

Reporters' Notes

Issues to be decided:whether subsection (b)(2) is a subset of subsection (b)(1) and therefore redundant; whether to insert in subsection (b) language to make clear that a transferee "takes subject to" the operating agreement; whether to insert into subsection (b) language delineating the right of members to change the operating agreement after a transferee obtains an interest; whether the transferee liability established by subsection (g) should include Section 406(a) "decision maker" liability or just Section 406(b) "recipient" liability; whether language added here or in Section 501(c) to make clear that a member may sell the entirety of the member's rights to another member without having to have the consent of fellow members

Subsection (a)(3) – This draft adds the introductory phrase ("subject 504"), at the salutary suggestions of a self-described "dirt farmer."

Subsection (d) – Section 601(a)(4)(ii) and (iii) create a risk of dissociation when a member transfers all, or substantially all, of the member's transferable interest. .

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. To the extent necessary to effectuate the collection of distributions pursuant to the charging order, the court may:

(1) appoint a receiver of the share of the distributions due or to become due to the judgment debtor in respect of the transferable interest, with the power to make all inquiries the judgment debtor might have made; and

(2) make all other orders which the circumstances of the case may require.

(b) A charging order constitutes a lien on the judgment debtor's transferable interest and requires the limited liability company to pay over to the person issued the charging order any distribution that would otherwise be paid to the member or transferee whose interest is subject to the charging order. Upon a showing that distributions under the 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 that is subject to a charging order. The purchaser at the foreclosure sale:

(1) does not thereby become a member;

(2) obtains only the transferable interest; and

(3) unless the purchaser is the limited liability company or a person already a member, acquires the interest merely as a transferee.

(c) At any time before foreclosure, the judgment debtor 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.

(d) At any time before foreclosure, the limited liability company or one or more members whose transferable interests are not subject to the charging order may succeed to the charging order by satisfying the judgment and filing with the court that issued the charging order a certified copy of the satisfaction of judgment and an affidavit stating the amount paid to satisfy the judgment. The members may not use limited liability company property to satisfy the judgment under this subsection. The limited liability company may act under this subdivision only with the consent of all members whose transferable interests are not subject to the charging order. When a person succeeds to a charging order under this subsection:

(1) the amount of the lien is the amount paid to satisfy the judgment, plus interest from the date of satisfaction at the rate applicable to judgments;

(2) the lien's priority with regard to other creditors of the member or transferee whose transferable interest is subject to the charging order remains unchanged; and

(3) the successor has the same rights under this section as the judgment creditor that originally obtained the charging order but the successor's claim against the member or transferee whose transferable interest is subject to the charging order is limited to any distributions the successor is entitled to under the charging order and to the proceeds of any

foreclosure sale.

(e) This [act] does not deprive any member or transferee of the benefit of any exemption laws applicable to the member's or transferee's transferable interest.

(f) This section provides the exclusive remedy by which a person seeking to enforce a judgment against member or transferee may, in the capacity of judgment creditor, satisfy the judgment out of the judgment debtor's transferable interest.

Reporters' Notes

Issues to be considered: whether subsection (f) adequately reflects the interface with Article 9; whether the exclusive remedy language of subsection (f) would impede a court from effecting a "reverse pierce" where appropriate; whether this section should address the effect of mergers, conversions, etc. on a charging order; whether this section should state which court has jurisdiction to issue a charging order

Charging order provisions appear in various forms in UPA, ULPA, RULPA, RUPA, ULLCA, and ULPA (2001). At its April, 2004 meeting, the Drafting Committee authorized the Reporters to attempt to modernize the language and make explicit certain points that have been at best implicit. At its February, 2005 meeting, the Drafting Committee generally accepted the co-reporters' modernized language

Subsection (a) – The phrase "judgment debtor" encompasses both members and transferees. As a matter of civil procedure and due process, an application for a charging order must be served both on the limited liability company and the member or transferee whose transferable interest is to be charged.

Subsection (b) – Prior drafts empowered the court to order foreclosure "[a]t any time," which was language taken verbatim from RUPA. That language provides no standards to guide a court's discretion. 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., *Nigri v. Lotz*, 453 S.E.2d 780, 783 (Ga. Ct. App. 1995)

Subsection (c)(3) – Query why the consent of all the members should be necessary in a manager-managed LLC.

Subsection (d) – At its February, 2005 meeting, the Drafting Committee decided to jettison the confusing concept of redemption and to substitute an approach that more closely parallels the modern, real-world possibility of the LLC or its members buying the underlying judgment (and thereby dispensing with any interference the judgment creditor might seek to inflict on the LLC). When possible, buying the judgment remains superior to the mechanism provided by this subsection, because (i) this subsection requires full satisfaction of the underlying judgment, while the LLC or the other members might be able to buy the judgment for less than face value; and (ii) the subsection provides only non-recourse liability. 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.

As a matter of civil procedure and due process, the court filing under this subsection must be with notice to the member or transferee whose interest is subject to the charging order and with notice to the LLC (unless the filing is by the LLC itself).

Subsection (f) – This provision has been revised to respect the separate provisions of Article 9, which may provide different remedies for a secured creditor acting in that capacity. Query whether the exclusive remedy language would impede a court from effecting a "reverse pierce" where appropriate.

SECTION 504. POWER OF PERSONAL REPRESENTATIVE OF DECEASED MEMBER. If a member dies, the deceased member's personal representative or other legal representative may exercise the rights of a transferee as provided in Section 502(c) and, for the purposes of settling the estate, may exercise the rights of a current member under Section 411.

Reporters' Notes

This language was inserted in ULPA (2001) § 704 at the behest of the representative of the Probate Section of the ABA.

[ARTICLE] 6

MEMBER'S DISSOCIATION

SECTION 601. MEMBER'S POWER TO DISSOCIATE; WRONGFUL DISSOCIATION.

(a) A person does not have a right to dissociate as a member before the termination of the limited liability company. A person has the power to dissociate as a member at any time, rightfully or wrongfully, by express will under Section 602(1).

(b) A person's dissociation is wrongful only if:

(1) it is in breach of an express provision of the operating agreement; or

(2) it occurs before the termination 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 determination under Section 601(b)(5);

(C) the limited liability company is member-managed and the person is dissociated under Section 601(b)(7)(A) by becoming a debtor in bankruptcy; or

(D) in the case of a person that is not an individual, trust other than a business trust, or estate, the person is expelled or otherwise dissociated as a member because it willfully dissolved or terminated.

(c) A person that wrongfully dissociates is liable to the limited liability company and, subject to Section 901, to the other members for damages caused by the dissociation. The liability is in addition to any other obligation of the member to the limited liability company or to the other members.

Reporters' Notes

Source – ULPA (2001) § 603, which is based on RUPA Section 602. ULLCA § 602 is functionally identical in some respects but is not a good overall source, because that section presupposes the term/at-will paradigm.

At its February, 2005 meeting, the Drafting Committee decided to "flip" sections 601 and 602, placing this section as the first one in Article 6.

Subsection (a) – The first sentence is relocated from former Section 601(a). A person can occasion dissociation (by expulsion) by transferring all or substantially all of its transferable interest. See Section 602 (4)(B). Such expulsion is not wrongful dissociation by the expelled member.

SECTION 602. EVENTS CAUSING DISSOCIATION. A person is dissociated from a limited liability company upon the occurrence of any of the following events:

(1) the limited liability company's having notice of the person's express will to withdraw as a member or on a later date specified by the person;

(2) an event agreed to in the operating agreement as causing the person's dissociation;

(3) the person's expulsion as a member pursuant to the operating agreement;

(4) the person's expulsion as a member by the unanimous consent of the other members if:

(A) it is unlawful to carry on the limited liability company's activities with the person as a member;

(B) there has been a transfer of all of the person's transferable interest in the limited liability company, other than:

(i) a transfer for security purposes; or

(ii) a court order charging the person's transferable interest which has not been foreclosed;

(C) the person is a corporation and, within 90 days after the limited liability company notifies the person that it will be expelled as a member because the person has filed a certificate of dissolution or the equivalent, its charter has been revoked, or its right to conduct business has been suspended by the jurisdiction of its incorporation, the certificate of dissolution has not been revoked or its charter or right to conduct business has not been reinstated; or

(D) the person is a limited liability company or partnership that has been dissolved and whose business is being wound up;

(5) on application by the limited liability company, the person's expulsion as a member by judicial order because:

(A) the person engaged in wrongful conduct that adversely and materially affected the limited liability company's activities;

(B) the person willfully or persistently committed a material breach of the operating agreement or the person's duties or obligations under Section 409; or

(C) the person engaged in conduct relating to the limited liability company's activities which makes it not reasonably practicable to carry on the activities with the person as a member;

(6) in the case of a person who is an individual:

(A) the person's death;

(B) if the limited liability company is a member-managed limited liability company:

(i) the appointment of a guardian or general conservator for the person; or

(ii) a judicial determination that the person has otherwise become incapable of performing the person's duties as a member under the operating agreement;

(7) if the limited liability company is a member-managed limited liability company, the person's:

(A) becoming a debtor in bankruptcy;

(B) execution of an assignment for the benefit of creditors;

(C) seeking, consenting to, or acquiescing in the appointment of a trustee, receiver, or liquidator of the person or of all or substantially all of the person's property;

(8) in the case of a person that is a trust or is acting as a member by virtue of being a trustee of a trust, distribution of the trust's entire transferable interest in the limited liability company, but not merely by reason of the substitution of a successor trustee;

(9) 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, distribution of the estate's entire transferable interest in the limited liability company, but not merely by reason of the substitution of a successor personal representative;

(10) termination of a member that is not an individual, partnership, limited liability company, corporation, trust, or estate;

(11) the limited liability company's participation in a merger or conversion under

[Article] 10, if the limited liability company:

(A) is not the surviving or converted entity; or

(B) otherwise as a result of the merger or conversion, the person ceases to be a member;

(12) the limited liability company's participation in a domestication under [Article] 10, if as a result of the domestication the person ceases to be a member.

Reporters' Notes

Source – ULLCA § 601; RUPA Section 601; ULPA (2001) §§ 601 and 603.

Paragraph (4)(B) – Prior drafts stated different rules depending on whether the limited liability company was member-managed or manager-managed. At its February, 2005 meeting, the Drafting Committee opted for a simpler, conflated approach, which subjects a member to expulsion only upon transfer of all (not merely "substantially all") of the member's transferable interest. Under the new approach, a transferee can protect itself from the vulnerability of "bare transferee" status by obligating the transferor to retain a 1% interest and then to exercise its governance rights (including the right to bring a derivative suit) to protect the transferee's interests.

SECTION 603. EFFECT OF PERSON'S DISSOCIATION AS A MEMBER.

(a) When a person dissociates 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 terminates;

(2) the person's duty of loyalty as a member **[reserved until the Committee has made at least a firmer decision as to the contents of that duty]**

(3) the person's duty of care **[reserved until the Committee has made at least a firmer decision as to the contents of that duty]**;

(4) subject to Section 504 and [Article] 10, any transferable interest owned

by the person immediately before dissociation in the person's capacity as a member is owned by the person as a mere transferee;

(5) any power the person had in its capacity as a member under Sections 301, 304 and 703 to bind the limited liability company terminates, but, subject to Sections 103(c) and 604, the termination does not affect the person's power to bind the limited liability company under law other than this [act].

(b) A person's dissociation as a member does not of itself discharge the person from any obligation to the limited liability company or the other members which the person incurred while a member.

Reporters' Notes

Source – ULPA (2001) § 603, which was drawn from RUPA Section 603(b). ULLCA § 603 is functionally identical in some respects but is not a good overall source, because that section presupposes the term/at-will paradigm.

Subsection (a)(5) – A Comment will explain that "other law" includes the agency law doctrine of "lingering apparent authority." See Restatement (Third) Of Agency § 3.11, comment c (T.D. No. 2, 2001). The statement of dissociation, see Section 604, will be effective to cut off lingering apparent authority. Section 703 concerns the power of members and managers to bind an LLC post-dissolution.

SECTION 604. STATEMENT OF DISSOCIATION.

(a) A member-managed limited liability company or a person dissociated as a member of a member-managed limited liability company may deliver for filing in the office of the [Secretary of State] a statement of dissociation stating the name of the limited liability company and that the member is dissociated from the limited liability company.

Reporters' Notes

Source: ULLCA § 704. A statement of dissociation has constructive notice effect under Section 103(c).

At its February, 2005 meeting, the Drafting Committee decided to limit this provision to member-managed limited liability companies, on the theory that information about member status is immaterial in a manager-managed company.

[ARTICLE] 7

DISSOLUTION AND WINDING UP

SECTION 701. EVENTS CAUSING DISSOLUTION.

(a) A limited liability company is dissolved, and its business must be wound up, upon the occurrence of any of the following:

(1) an event specified in the operating agreement;

(2) the consent of all the members;

(3) the passage of 90 consecutive days during which the limited liability company has no members;

(4) on application by a member, the entry by [appropriate court] of an order dissolving the limited liability company on the grounds that:

(A) the conduct of all or substantially all of limited liability company's activities is unlawful; or

(B) it is not reasonably practicable to carry on the limited liability company's activities in conformity with the certificate of organization and the operating agreement; or

(5) on application by a member, a dissociated member that has retained a transferable interest, or transferee, the entry by [appropriate court] of an order dissolving the limited liability company on the grounds that the managers or those members in control of the limited liability company:

(A) have acted, are acting, or will act in a manner that is illegal or fraudulent; or

(B) have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant.

(b) In a proceeding brought under subsection (a)(5), the court may order a remedy other than dissolution.

Reporters' Notes

<u>Issues to be considered:</u> whether subsection (b) should be nonwaivable; whether to provide some greater definition of "oppressive"; whether to use "dissociated member" rather than "former member" and whether to define whichever term is chosen; whether the phrase "dissociated member that has retained a transferable interest" is sufficient to exclude a former member who, after dissociation, buys back into the LLC; whether the protections of subsection (a)(5) should also extend to a dissociated member that has not retained a transferable interest but has remained liable (as guarantor or otherwise) for obligations of the LLC

At its April, 2004 meeting, the Drafting Committee had extended and amicably intense discussions about this section. Paragraphs (1) to (3) of subsection (a) were not controversial. Paragraphs (4) and (5) and subsection (b) were. The Committee revisited both provisions at its October, 2004 meeting.

Subsection (a)(4) – The standard stated here is conventional. An earlier draft contained the arguably novel approach of conferring standing on *former* owners with a continuing economic stake in the enterprise. At its October, 2004 meeting the Committee considered the risk of former members using the provision to "freeze the deal" after their departure and decided to eliminate former members from the coverage of this provision. To maintain some protection for former members, subsection (a)(5) was revised to provide them standing under that provision.

Subsection (a)(5) – At its October, 2004 meeting, the Drafting Committee revised this provision to extend standing to former members. Note that a former member who is bought out and then subsequently becomes a transferee of another interest should *not* have standing on this provision. Query whether the protections of this provision should extend to a dissociated member that lacks a transferable interest but is still liable for the obligations of the LLC (e.g., as a guarantor).

ULLCA § 801(4)(v) contains a comparable provision, and, even without aid of that provision, courts have begun to apply close corporation "oppression" doctrine to LLCs. At its April, 2004 meeting, the Drafting Committee deleted language that would have cabined somewhat the vague term "oppressive." The deleted language provided that:

oppressive conduct has occurred only if the conduct complained of has directly harmed the applicant and:

(1) constitutes a material, uncured breach of the operating agreement or of the obligation of good faith and fair dealing stated in Section 409(d); or

(2) although not constituting a material, uncured breach under paragraph (1), has substantially defeated an expectation of the applicant which is entitled to protection because the expectation:

(A) is not contradicted by any term of the operating agreement nor by the reasonable implication of any term of that agreement;

(B) was central to the applicant'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;

(C) was known to other members, which expressly or impliedly acquiesced in it;

(D) is consistent with the reasonable expectations of all the members; and

(E) is otherwise reasonable under the circumstances.

Subsection (a)(5) is non-waivable. See Section 110(f)(7). **{need to check x-ref}**

Subsection (a)(5)(B) – The revision implements a suggestion made at the October, 2004 meeting by the Chair of the Conference's Executive Committee.

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. The Drafting Committee preferred to save courts and litigants the trouble of re-inventing that wheel in the LLC context. Because subsection (a)(5) is non-waivable, query whether subsection (b) should be non-waivable as well.

SECTION 702. WINDING UP.

(a) A limited liability company continues after dissolution only for the purpose of winding up its activities.

(b) In winding up its activities, the limited liability company:

(1) may file a statement of dissolution pursuant to Section 710(1), preserve the limited liability company activities and property as a going concern for a reasonable time, prosecute and defend actions and proceedings, whether civil, criminal, or administrative, transfer

the limited liability company's property, settle disputes by mediation or arbitration, file a statement of termination pursuant to Section 710(2), and perform other necessary acts; and

(2) shall discharge the limited liability company's liabilities, settle and close the limited liability company's activities, and marshal and distribute the assets of the limited liability company.

(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 of the limited liability company and has the powers of a member under Section 703(a). If the legal representative declines or fails to wind up the limited liability company's activities, 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 member under Section 703(a); and

(2) shall promptly amend the limited liability company's certificate of organization to state:

(A) that the limited liability company has no members;

(B) that the person has been appointed pursuant to this subsection to wind up the limited liability company; and

(C) the street and mailing address of the person.

(d) The [appropriate court] may order judicial supervision of winding up, including the appointment of a person to wind up the dissolved limited liability company's activities:

(1) on application of a member, if the applicant establishes good cause;

(2) on the application of a transferee or a dissociated member that has retained a transferable interest, if the limited liability company does not have member, the legal representative of the last person to have been a member declines or fails to wind up the limited liability company's activities, and within a reasonable time following the dissolution no person has been appointed pursuant to subsection (c); and

(3) in connection with a proceeding under Section 701(a)(4) or (5).

Reporters' Notes

Source – ULPA (2001) § 803, which was based on RUPA Sections 802 and 803.

Subsection (d) has been revised to take into account court-ordered dissolution proceedings in which standing extends to a person dissociated as a member or to a transferee. See Section 701(a)(4) and (5).

SECTION 703. POWER OF MEMBERS AND MANAGERS TO BIND LIMITED LIABILITY COMPANY AFTER DISSOLUTION. A member of a member-managed, and a manager of a manager-managed, limited liability company binds the limited liability company by an act after dissolution which:

(1) is appropriate for winding up the limited liability company's activities; or

(2) would have bound the limited liability company under Section 301 before dissolution, if, at the time the other party enters into the transaction, the other party does not have notice of the dissolution.

Reporters' Notes

Source: ULPA (2001) § 804, which was based on RUPA § 804.

Former subsection (b) has been deleted as duplicative of Section 603(a)(5).

SECTION 704. KNOWN CLAIMS AGAINST DISSOLVED LIMITED LIABILITY COMPANY.

(a) Except as otherwise provided in subsection (d), a dissolved limited liability company may dispose of the known claims against it by following the procedure described in subsection (b).

(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) provide a mailing address to which the claim is to be sent;

(3) state the deadline for receipt of the 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) in the case of a claim that is timely received but rejected by the dissolved limited liability company, the claimant does not commence an action to enforce the claim against the limited liability company within 90 days after the receipt of the notice of the rejection.

(d) This section does not apply to a claim based on an event occurring after the effective date of dissolution or a liability that is contingent on that date.

Reporters' Notes

Source – ULPA (2001) § 806, which was based on ULLCA § 807, which in turn was based on MBCA § 14.06.

Issues to be considered: whether some definition is needed of "known claims" (e.g., suppose the limited liability company knows of a claim but does not have any contact information for the claimant); whether this Act should include a provision allowing for a judicial proceeding to deal with contingent and unknown claims, perhaps following MBCA § 14.08.

At the October, 2004 meeting of the Drafting Committee, a question arose as to whether this section and Section 705 should be modernized to conform with changes in corporate law. However, the current language is quite similar to the most recent version of the MBCA.

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 limited liability company to present them in accordance with the notice.

(b) The notice must:

(1) be published at least once in a newspaper of general circulation in the [county] in which the dissolved limited liability company's principal office is located or, if it has none in this state, in the [county] in which the limited liability company's designated office is or was last located;

(2) describe the information required to be contained in a claim and provide a mailing address to which the claim is to be sent; and

(3) state that a claim against the limited liability company is barred unless

an action to enforce the claim is commenced within five 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 dissolved limited liability company within five 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 dissolved limited liability company but not acted on; and

(3) a claimant whose claim is contingent or based on an event occurring after the effective date of dissolution.

(d) A claim not barred under this section may be enforced:

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

(2) if assets of the limited liability 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 assets distributed to the member or transferee after dissolution, whichever is less, but a person's total liability for all claims under this paragraph does not exceed the total amount of assets distributed to the person after dissolution.

Reporters' Notes

Source – ULPA (2001) § 807, which was based on ULLCA § 808, which in turn was based on MBCA § 14.07.

Subsection (c) – Query whether this language sufficiently indicates that a claim that could have been addressed under Section 704 cannot be extinguished under this Section.

SECTION 706. ADMINISTRATIVE DISSOLUTION.

(a) The [Secretary of State] may dissolve a limited liability company administratively if the limited liability company does not, within 60 days after the due date:

(1) pay any fee, tax, or penalty due to the [Secretary of State] under this [act] or other law; or

(2) deliver its annual report to the [Secretary of State].

(b) If the [Secretary of State] determines that a ground exists for administratively dissolving a limited liability company, the [Secretary of State] shall file a record of the determination and serve the limited liability company with a copy of the filed record.

(c) If within 60 days after service of the copy the limited liability company does not correct each ground for dissolution or demonstrate to the reasonable satisfaction of the [Secretary of State] that each ground determined by the [Secretary of State] does not exist, the [Secretary of State] shall administratively dissolve the limited liability company by preparing, signing and filing a declaration of dissolution that states the grounds for dissolution. The [Secretary of State] shall serve the limited liability company with a copy of the filed declaration.

(d) A limited liability company administratively dissolved continues its existence but may carry on only activities necessary to wind up its activities and liquidate its assets under Sections 702 and 709 and to notify claimants under Sections 704 and 705.

(e) The administrative dissolution of a limited liability company does not terminate the authority of its agent for service of process.

Reporters' Notes

Source – ULPA (2001) § 809, which was based on ULLCA §§ 809 and 810. See also RMBCA §§ 14.20 and 14.21.

SECTION 707. REINSTATEMENT FOLLOWING ADMINISTRATIVE DISSOLUTION.

(a) A limited liability company that has been administratively dissolved may apply to the [Secretary of State] for reinstatement within two years after the effective date of dissolution. The application must be delivered to the [Secretary of State] for filing and state:

(1) the name of the limited liability company and the effective date of its administrative dissolution;

(2) that the grounds for dissolution either did not exist or have been eliminated; and

(3) that the limited liability company's name satisfies the requirements of Section 108.

(b) If the [Secretary of State] determines that an application contains the information required by subsection (a) and that the information is correct, the [Secretary of State] shall prepare a declaration of reinstatement that states this determination, sign, and file the original of the declaration of reinstatement, and serve the limited liability company with a copy.

(c) When reinstatement becomes effective, it relates back to and takes effect as of the effective date of the administrative dissolution and the limited liability company may resume its activities as if the administrative dissolution had never occurred.

Reporters' Notes

Source – ULPA (2001) § 810, which was based on ULLCA § 811. See also RMBCA

Section 14.22.

SECTION 708. APPEAL FROM REJECTION OF REINSTATEMENT.

(a) If the [Secretary of State] rejects a limited liability company's application for reinstatement following administrative dissolution, the [Secretary of State] shall prepare, sign, and file a notice that explains the reason or reasons for rejection and serve the limited liability company with a copy of the notice.

(b) Within 30 days after service of the notice of rejection, the limited liability company may appeal from the rejection of reinstatement by petitioning the [appropriate court] to set aside the dissolution. The petition must be served on the [Secretary of State] and contain a copy of the [Secretary of State's] declaration of dissolution, the limited liability company's application for reinstatement, and the [Secretary of State's] notice of rejection.

(c) The court may order the [Secretary of State] to reinstate the dissolved limited liability company or may take other action the court considers appropriate.

Reporters' Notes

Source – ULPA (2001) § 811, which was based on ULLCA § 812.

This section uses "rejection" rather than "denial" (the word used by both ULPA (2001) and ULLCA). The change is to avoid confusion with a "statement of denial" under Section 302.

Subsection (c) – Query why "summarily".

SECTION 709. DISTRIBUTION OF ASSETS IN WINDING UP LIMITED LIABILITY COMPANY'S BUSINESS.

(a) In winding up a limited liability company's business, the assets of the limited liability company must be applied to discharge its obligations to creditors, including members that are creditors.

(b) Any surplus remaining after the limited liability company complies with subsection (a) must be applied to distribute:

(1) to each member, an amount equal to the value of contributions made by the member and not previously returned; and

(2) then to all members, an equal share of any surplus still remaining.

(c) If the limited liability company does not have sufficient surplus to comply with subsection (b)(1), any surplus must be distributed among the members in proportion to the value of their respective unreturned contributions.

(d) All distributions made under subsection (b) and (c) must be paid in cash.

Reporters' Notes

Source: ULLCA § 806, restyled.

SECTION 710. STATEMENTS OF DISSOLUTION AND TERMINATION. A dissolved limited liability company may deliver to the [secretary of state] for filing:

(1) a statement of dissolution, stating the name of the limited liability company and that the limited liability company is dissolved; and

(2) a statement of termination, stating the name of the limited liability company and that the limited liability company is terminated.

Reporters' Notes

Issues to be considered: whether this provision warrants its own section instead of being part of Section 702 (Winding Up)

If this provision remains as a separate section, the next draft will place it as Section 703 and will renumber the following sections.

[ARTICLE] 8

FOREIGN LIMITED LIABILITY COMPANIES

SECTION 801. GOVERNING LAW.

(a) The laws of the state or other jurisdiction under which a foreign limited liability company is formed govern:

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

(2) the liability of a member as member and a manager as manager for an obligation of the foreign limited liability company.

(b) A foreign limited liability company may not be denied a certificate of authority by reason of any difference between the laws of the jurisdiction under which the foreign limited liability company is formed and the laws of this state.

(c) A certificate of authority does not authorize a foreign limited liability company to engage in any business or exercise any power that a limited liability company may not engage in or exercise in this state.

Reporters' Notes

This Section parallels the formulation stated in Section 106 for a domestic limited liability company.

SECTION 802. APPLICATION FOR CERTIFICATE OF AUTHORITY.

(a) A foreign limited liability company may apply for a certificate of authority to transact business in this state by delivering an application to the [Secretary of State] for filing. The application must state:

(1) the name of the foreign limited liability company and, if the name does not comply with Section 108, an alternate name adopted pursuant to Section 805(a).

(2) the name of the state or other jurisdiction under whose law the foreign limited liability company is formed;

(3) the street and mailing address of the foreign limited liability company's principal office and, if the laws of the jurisdiction under which the foreign limited liability company is formed require the foreign limited liability company to maintain an office in that jurisdiction, the street and mailing address of the required office; and

(4) the name and street and mailing address of the foreign limited liability company's initial agent for service of process in this state.

(b) A foreign limited liability company shall deliver with the completed application a certificate of existence or a record of similar import signed by the [Secretary of State] or other official having custody of the foreign limited liability company's publicly filed records in the state or other jurisdiction under whose law the foreign limited liability company is formed.

Reporters' Notes

Source – ULPA (2001) § 902, which was based on ULLCA § 1002.

SECTION 803. ACTIVITIES NOT CONSTITUTING TRANSACTING BUSINESS.

(a) Activities of a foreign limited liability company which do not constitute transacting business in this state within the meaning of this [article] include:

(1) maintaining, defending, and settling an action or proceeding;

(2) holding meetings of its members or carrying on any other activity concerning its internal affairs;

(3) maintaining accounts in financial institutions;

(4) maintaining offices or agencies for the transfer, exchange, and registration of the foreign limited liability company's own securities or maintaining trustees or depositories with respect to those securities;

(5) selling through independent contractors;

(6) soliciting or obtaining orders, whether by mail or electronic means or through employees or agents or otherwise, if the orders require acceptance outside this state before they become contracts;

(7) creating or acquiring indebtedness, mortgages, or security interests in real or personal property;

(8) securing or collecting debts or enforcing mortgages or other security interests in property securing the debts, and holding, protecting, and maintaining property so acquired;

(9) conducting an isolated transaction that is completed within 30 days and is not one in the course of similar transactions of a like manner; and

(10) transacting business in interstate commerce.

(b) For purposes of this [article], the ownership in this state of income-producing real property or tangible personal property, other than property excluded under subsection (a), constitutes transacting 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].

Reporters' Notes

Source – ULPA (2001) § 903, which was based on ULLCA § 1003.

SECTION 804. FILING OF CERTIFICATE OF AUTHORITY. Unless the [Secretary of State] determines that an application for a certificate of authority does not comply with the filing requirements of this [act], the [Secretary of State], upon payment of all filing fees, shall file the application, prepare, sign and file a certificate of authority to transact business in this state, and send a copy of the filed certificate, together with a receipt for the fees, to the foreign limited liability company or its representative.

Reporters' Notes

Source – ULPA (2001) § 904, which was based on ULLCA § 1004 and RULPA § 903.

SECTION 805. NONCOMPLYING NAME OF FOREIGN LIMITED LIABILITY COMPANY.

(a) A foreign limited liability company whose name does not comply with Section 108 may not obtain a certificate of authority until it adopts, for the purpose of transacting business in this state, an alternate name that complies with Section 108. A foreign limited liability company that adopts an alternate name under this subsection and then obtains a certificate of authority with the alternate name need not comply with [fictitious name statute]. After obtaining a certificate of authority with an alternate name, a foreign limited liability company shall transact business in this state under the alternate name unless the foreign limited liability company is authorized under [fictitious name statute] to transact business in this state under another name.

(b) If a foreign limited liability company authorized to transact business in this state changes its name to one that does not comply with Section 108, it may not thereafter transact business in this state until it complies with subsection (a) and obtains an amended certificate of authority.

Reporters' Notes

Source – ULPA (2001) § 905, which was based on ULLCA § 1005.

SECTION 806. REVOCATION OF CERTIFICATE OF AUTHORITY.

(a) A certificate of authority of a foreign limited liability company to transact business in this state may be revoked by the [Secretary of State] in the manner provided in subsections (b) and (c) if the foreign limited liability company does not:

(1) pay, within 60 days after the due date, any fee, tax, or penalty due to the [Secretary of State] under this [act] or other law;

(2) deliver, within 60 days after the due date, its annual report required under Section 210;

(3) appoint and maintain an agent for service of process as required by Section 112(b); or

(4) deliver for filing a statement of a change under Section 113 within 30 days after a change has occurred in the name or address of the agent.

(b) In order to revoke a certificate of authority, the [Secretary of State] must prepare, sign, and file a notice of revocation and send a copy to the foreign limited liability company's agent for service of process in this state, or if the foreign limited liability company does not appoint and maintain a proper agent in this state, to the foreign limited liability company's designated office. The notice must state:

(1) the revocation's effective date, which must be at least 60 days after the date the [Secretary of State] sends the copy; and

(2) the grounds for revocation under subsection (a).

(c) The authority of the foreign limited liability company to transact business in this state ceases on the effective date of the notice of revocation unless before that date the foreign limited liability company remedies each ground for revocation stated in the notice. If the foreign limited liability company remedies each ground, the [Secretary of State] shall so indicate on the filed notice.

Reporters' Notes

Source – ULPA (2001) § 906, which was based on ULLCA § 1006.

SECTION 807. CANCELLATION OF CERTIFICATE OF AUTHORITY; EFFECT OF FAILURE TO HAVE CERTIFICATE.

(a) In order to cancel its certificate of authority to transact business in this state, a foreign limited liability company must deliver to the [Secretary of State] for filing a notice of cancellation. The certificate is canceled when the notice becomes effective under Section 206.

(b) A foreign limited liability company transacting business in this state may not maintain an action or proceeding in this state unless it has a certificate of authority to transact business in this state.

(c) The failure of a foreign limited liability company to have a certificate of authority to transact business in this state does not impair the validity of a contract or act of the foreign limited liability company or prevent the foreign limited liability company from defending an action or proceeding in this state.

(d) A member of a foreign limited liability company is not liable for the obligations of the foreign limited liability company solely by reason of the foreign limited liability company's having transacted business in this state without a certificate of authority.

(e) If a foreign limited liability company transacts business in this state without a certificate of authority or cancels its certificate of authority, it appoints the [Secretary of State] as its agent for service of process for rights of action arising out of the transaction of business in this state.

Reporters' Notes

Source – ULPA (2001) § 907, which was based on RULPA § 907(d) and ULLCA § 1008.

SECTION 808. ACTION BY [ATTORNEY GENERAL]. The [Attorney General] may maintain an action to restrain a foreign limited liability company from transacting business in this state in violation of this [article].

Reporters' Notes

Source – ULPA (2001) § 908, which was based on RULPA § 908 and ULLCA § 1009.

[ARTICLE] 9

ACTIONS BY MEMBERS

SECTION 901. DIRECT ACTION BY MEMBER.

(a) Subject to subsection (b), a member may maintain a direct action against a manager, another member, or the limited liability company to enforce the member's rights and otherwise 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 commencing a direct action under this section is required to 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.

Reporters' Notes

Issues to be resolved: whether the operating agreement has the power to eliminate or modify the distinction between direct and derivative claims

At its February, 2005 meeting, the Drafting Committee determined that the direct-derivative distinction makes sense for a closely held LLC, even a member-managed LLC.

Subsection (a) – Source: ULPA (2001) § 1001(a), which was based on RUPA Section 405(b). The subsection has been somewhat re-styled and the phrase "for legal or equitable relief" has been deleted as unnecessary. At its February, 2005 meeting, the Drafting Committee deleted the reference to "with or without an accounting," on the theory that partnership remedy of accounting reflected the aggregate nature of a partnership and is inappropriate for an *entity* such as an LLC. A comment will explain this point and make clear that the equitable claim for an accounting (in the nature of a constructive trust) is unaffected.

Subsection (b) – Source: ULPA (2001) § 1001(b). The Comment to that subsection explains:

> 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,

> however, different circumstances may exist. A partner does not have a direct claim against another partner merely because the other partner has breached the operating agreement. Likewise a partner's violation of this Act does not automatically create a direct claim for every other partner. To have standing in his, her, or its own right, a partner plaintiff must be able to show a harm that occurs independently of the harm caused or threatened to be caused to the limited partnership.

Former subsection (c) – As originally drafted, this section had a subsection (c) that provided: "The accrual of, and any time limitation on, a right of action for a remedy under this section is governed by law other than this [act]. A right to an accounting upon a dissolution and winding up does not revive a claim barred by law."

At its February, 2005 meeting, the Drafting Committee decided to delete the second sentence, because a cause of action for accounting is inappropriate for an LLC, given the entity nature of the organization. A comment will mention the doctrine of "adverse domination" as applicable to statute of limitation issues. This draft also proposes deletion of the remaining sentence, because, in light of Section 107 (Supplemental principles of law), the sentence is surplusage.

SECTION 902. 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 limited liability 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 would be futile.

Reporters' Notes

Source – ULPA (2001) § 1002, which was a re-styled version RULPA § 1001.

Issues to be resolved: whether to jettison the demand futility notion and require that demand be made except where a TRO or temporary injunction is warranted

SECTION 903. PROPER PLAINTIFF. A derivative action may be maintained only by a person that is a member at the time the action is commenced and:

(1) that was a member when the conduct giving rise to the action occurred; or

(2) whose status as a member devolved upon 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.

Reporters' Notes

Source – ULPA (2001) § 1003, which was a re-styled version RULPA § 1002.

SECTION 904. 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.

Reporters' Notes

Source – ULPA (2001) § 1004, which was a re-styled version RULPA § 1003.

SECTION 905. SPECIAL LITIGATION COMMITTEE.

(a) When a limited liability company is named as a party in a derivative proceeding, the limited liability company may appoint a special litigation committee to investigate claims asserted in the proceeding and determine whether pursuing the proceeding is in the best interests of the limited liability company. If the limited liability company appoints a special litigation committee, on motion by the committee, made in the name of the limited liability company, the court shall stay discovery for the amount of time reasonably necessary to permit the committee to make its investigation.

(b) A special litigation committee may be composed of one or more persons, who may, but need not be, members. A special litigation committee may be appointed:

(1) in a member-managed limited liability company, by the consent of a majority of those members who are not named as defendants in the proceeding and, if there are none, by a majority of members; and

(2) in a manager-managed limited liability company, by:

(A) a majority of those managers that are not named as defendants in the proceeding; and

(B) if there are none, by a majority of members that are not named as defendants in the proceeding; and

(C) if there are none, by a majority of the managers.

(c) 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 special litigation committee;

(3) be settled on terms determined by the special litigation committee; or

(4) be dismissed.

(d) After making a determination under subsection (c), the special litigation shall file with the court a statement of its determination and its report supporting its determination, giving notice to the plaintiff. The court shall determine whether the special litigation committee conducted its investigation and made its recommendation in good faith and with reasonable care, with the special litigation committee having the burden of proof. If the court finds that the special litigation committee acted in good faith and with reasonable care, the court shall adopt and enforce the determination of the special litigation committee.

Reporters' Notes

Issues to be resolved: whether to include any special litigation committee (SLC) provision; whether to contemplate an SLC being formed in response to a pre-suit demand; whether the fallback rule in subsection (b)(2)(C) should be to the majority of members rather than managers.

At its February, 2005 meeting, the Drafting Committee directed the co-reporters to provide language authorizing the appointment of a special litigation committee. This language corresponds to the corporate law in most jurisdictions, modified to fit the typical governance structure of a limited liability company. The standard stated for judicial review of the SLC determination follows *Auerbach v. Bennett*, 47 N.Y.2d 619, 419 N.Y.S.2d 920 (N.Y. 1979) .rather than *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), as the latter's reference to the court's business judgment has not been followed by other states, is probably an oxymoron, and has lost favor even in Delaware.

SECTION 906. 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 derivative plaintiff;

(2) if the derivative plaintiff receives any proceeds, the derivative plaintiff shall immediately remit them to the limited liability 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, from the recovery of the limited liability company.

Reporters' Notes

Source – ULPA (2001) § 1005, which was a re-styled version RULPA § 1004.

[ARTICLE] 10

MERGER

[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. SEVERABILITY. 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.

SECTION 1103. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [act] modifies, limits, and supersedes the federal 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).

SECTION 1104. EFFECTIVE DATE. This [act] takes effect on [effective date].

SECTION 1105. REPEALS. Effective [all-inclusive date], the following acts and parts of acts are repealed: [the state limited liability company Act as amended and in effect immediately before the effective date of this [act]].

SECTION 1106. SAVINGS CLAUSE. This [act] does not affect an action commenced, proceeding brought, or right accrued before this [act] takes effect.

SECTION 1107. 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) With respect to a limited liability company formed before [the effective date of this [act]], the following rules apply except as the members otherwise elect in the manner provided in the operating agreement or by law for amending the operating agreement: **[TBD – this subsection will contain any provisions of ULLCA which should continue to apply preexisting limited liability companies even after the "all-inclusive" date to.]**