REVISED AGENDA (9-13-16)
(reflecting comments received to the original agenda)

Uniform Limited Liability Company Protected Series Act
Topic for Internet Meeting, Wednesday, September 14, 2016

Section 402

Section 402 is the topic for the Drafting Committee's first internet meeting (Wednesday, September 14, 2016, from 2–3:30 PM Central Time). Below are the text and comment to Section 402, , plus the text of three relevant definitions. The text is somewhat revised from the 2016 annual meeting draft, for reasons explained in footnotes, and the comments re-lettered accordingly.

We need to consider the following issues, plus any other issues raised by any member of, advisor to, or observer of the drafting committee. (If you wish to raise an additional issue, please let Steve Frost and Dan Kleinberger know as soon as possible.)

- Style issues noted (but not for current discussion):
  - Should Subsection (a) be moved to later in the section?
  - Should Subsection (e) [now former Subsection (c)] refer to "an action enforcing a claim under this section" rather than to "a proceeding under this section.
  - Usage consistency re: "asset of" versus "asset owned by".
  - Usage consistency re: when "protected series" is followed by "of a series limited liability company".
- Are there any mechanical problems with the section as drafted?
- {An improvement to Section 402's core rule depends on this definition.}Should the Section 402 rights of creditors be subordinated to the rights of "innocent" associated members of a protected series? {Debated and determined previously [answer: no] but entitled to re-consideration in what is now the final stage of the committee's work.}
- Should from Subsection (g) [former Section (e)] be relegated to a comment?
- How should the loophole described below be closed?

The Loophole Problem

At the moment, Section 402 contains a huge loophole – the power of a protected series or series LLC to transfer an *asset* after a Section 402 claim is asserted. How should the loophole be closed?

- freeze the asset – i.e., preclude the company or protected series from transferring the asset?
- create a lien on the affected asset?
- give the claimant a right to any proceeds resulting from any transfer of the asset and provide consequences if the transfer is for less than equivalent value?
- some combination of the foregoing?
- something even more effective yet simpler?

SECTION 402. ENFORCEMENT OF CLAIM AGAINST NON-ASSOCIATED ASSET.

(a) For purposes of this section, a claimant first seeks enforcement of a claim against an asset when the claimant first serves process on the owner of the asset, seeking enforcement of the claim under this section by attachment, levy, or the like.

(b) [1]A claim against a series limited liability company may be enforced against an asset of a protected series of the company only if the asset was a non-associated asset of the protected series when the liability giving rise to the claim was incurred or is a non-associated asset of the protected series when enforcement is first sought.[2]

(c) A claim against a protected series may be enforced against an asset of the series limited liability company only if the asset was a non-associated asset of the company when the liability giving rise to the claim was incurred or is a non-associated asset of the company when enforcement is first sought.

(d) A claim against a protected series may be enforced against an asset of another protected series of the company only if the asset was a non-associated asset of the other protected series when the liability giving rise to the claim was incurred or is a non-associated asset of the other protected series when enforcement is first sought.

(e) In a proceeding under this section, the party asserting that an asset is an associated asset of a series limited liability company or a protected series of the company has the burden of proof on the issue.

(f) A proceeding under this section is an action to enforce a judgment.

(g) This section supplements and does not displace the principles of law and equity concerning:

(1) a fraudulent or voidable conveyance, transfer, or transaction;

(2) a lien, mortgage, security interest, or other encumbrance; or

(3) the determination of ownership of property.

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Comment

This section creates a novel, important protection for creditors and a very important inducement in support of Section 301's recordkeeping requirements. Under this section, a creditor may enforce a claim against one protected series of a series limited liability company by pursuing non-associated assets owned by the company or another protected series of the company. Comparable recourse exists for creditors of the company.

Put another way: non-associated assets of a protected series of a series limited liability company are "up for grabs" not only to creditors of the protected series but also to creditors of the

[1] Inaccurate.

[2] More succinct – type of the hat to Jim McKay.

company and creditors of any other protected series of the company. Likewise, non-associated assets of each protected series of a series limited liability company are "up for grabs" not only to creditors of the protected series but also to creditors of the company and creditors of other protected series of the company.

{{NTDC – Open issue: once a claimant seeks enforcement against an asset under this section, may the asset's owner dispose of the asset? If so, are the proceeds then subject to enforcement? If so, what if the proceeds are not of equivalent value?}}

The exposure is "asset by asset" and does not otherwise implicate the internal shields. However, this section is largely moot to the extent a piercing claim succeeds against an internal shield. For example, suppose that, as a result of a piercing claim, a series limited liability company is adjudged liable for a debt of a protected series of the company. Whether an asset of the company is an associated asset of the company is, at least in the first instance, immaterial to the judgment creditor. The judgment creditor will be enforcing a judgment against the company itself; all the company's assets are subject to enforcement regardless of whether associated with the company. In fact, the judgment debtor would prefer for each asset of the company to be an associated asset. If so, the asset is not "up for grabs" – i.e., the asset is available only to creditors of the company, including (given the successful piercing claim) the judgment creditor.

This section does not affect the extent to which pre-judgment attachment is available. Other law will make that determination. Other law also determines what, if any, claims a protected series or the company has, and against whom, when the protected series or the company loses an asset under this section due to inadequate recordkeeping. See Prefatory Note, Part 6 (Non-Liability and Non-Recourse Rules), note 9.

Subsection (a) – The phrase "attachment, levy or the like" comes from the definition of "lien creditor" in UCC § 9-102(a)(52).

Subsections (b), (c), and (d) – This subsection applies "asset by asset" and involves analysis at two points in time: when the claim against the asset is first made and when the liability giving rise to the claim was incurred.

<u>When liability incurred</u>

- if asset owned but not associated — asset available to claimant (assuming still as asset of target)
- if asset not owned or owned and associated — availability depends on "when claim first made" analysis

When claim first made

- if non-associated asset: asset available to claimant
- if associated asset: availability to claimant depends on "when liability incurred" analysis

The concept of "liability incurred" has been part of uniform law since 1914. See UPA (1997) (Last Amended 2013) § 306(b), cmt. This act does not determine when a liability is incurred.

Subsection (e) – Various persons might assert associated status, including the owner of the asset, a creditor of the owner of the asset, or the trustee in bankruptcy of the owner of the asset.

Subsection (f) – This subsection provides a means to enforce an existing judgment, and is not a separate action to establish or re-litigate the underlying liability which resulted in that judgment. *See, e.g.*, David C. Olson, Inc. v. Denver & Rio Grande W. R. Co., 789 P.2d 492, 494-95 (Colo. App. 1990) ("The liability arising from a judgment is a new one, distinct from the liability upon which the judgment is based, and any prior liability merges into that judgment.") Therefore, a claim under this section is timely so long as the judgment is viable.

Subsection (g) – This subsection's specific references to particular categories of "principles of law or equity" should not be interpreted as limiting the effect of ULLCA (2013) § 111 (stating that "[u]nless displaced by particular provisions of this [act], the principles of law and equity supplement this [act]") (brackets in original) or of comparable provisions in other limited liability company statutes.

SECTION 102. DEFINITIONS. In this [act]:

(1) "Asset" means property:

(A) in which a series limited liability company or protected series has rights; or

(B) as to which the company or protected series has the power to transfer rights.

(2) "Associated asset" means an asset that meets the requirements stated in Section 301.

….

(6) "Non-associated asset" means ~~an asset~~, with respect to:

(A) ~~of~~ a series limited liability company, an asset of the company that is not an associated asset of the company; and

(B) ~~or~~ a protected series ~~of the company which~~, an asset of the protected series that is not an associated asset of the ~~company or~~ protected series.