Updates to Uniform Unincorporated Organization Acts

For the 2023 Informal Session
June 14, 2022

TO: Uniform Law Commissioners
FROM: Lisa R. Jacobs, Chair, Drafting Committee to Update UUOA
William H. Clark, Jr., Co-Reporter
David S. Walker, Co-Reporter
RE: Issues Memorandum for First Reading
DATE: June 13, 2022

This Drafting Committee was formed following the Annual Meeting of the Uniform Law Commission ("ULC") in July of 2020 upon the recommendation of the Joint Editorial Board for Uniform Unincorporated Organization Acts ("JEBUUOA") to the Executive Committee that it appoint one to make identified corrections and amendments to various Unincorporated Organizations Acts.[1] In particular, the subject Acts were the Uniform Partnership Act (1997) (Last Amended 2013) ("UPA") and the Uniform Limited Liability Company Act (2006) (Last Amended 2013) ("ULLCA"), though the Committee's scope extended to all of the Unincorporated Organization Acts, as appropriate, and to the Uniform Business Organization Code. The Drafting Committee has held ten meetings, and it has had Information Sessions for the Conference in June of 2021 and June of 2022[2] at which certain issues and proposed language were discussed. The Drafting Committee has addressed, and this Issues Memorandum follows, the sequence of issues enumerated and described in the JEB Report to the Executive Committee and certain other issues that have been considered by the Drafting Committee.

1. The Definition of "Partnership" and Related Issues. The definition of "partnership" in Section 102(11) of the UPA states that it "means an association of two or more persons to carry on as co-owners a business for profit formed" under the UPA or that becomes subject to it through relocation of its principal office under Section 104, election under Section 110, or fundamental change under Article 11. An association of two or more persons as co-owners of a business for profit is a core requirement for formation under Section 202, but a partnership may exist notwithstanding having fewer than two partners. The reason for this is that a partnership is an entity, not an aggregate of persons, and under Section 801(6) it is not

[1] *See* Joint Editorial Board on Uniform Unincorporated Organization Acts Report to the ULC Executive Committee, dated June 28, 2020, available at https://higherlogicdownload.s3-external-1.amazonaws.com/UNIFORMLAWS/c0d66afc-0355-d7e6-6482-d61276f3d627_file.pdf?AWSAccessKeyId=AKIAVRDO7IEREB57R7MT&Expires=1686690384&Signature=qMYEx%2BU%2Fa893jEJI6sRbo6Rgcvo%3D. References to the UPA, ULLCA and Uniform Limited Partnership Acts are references to those Acts as last amended in 2013.

[2] *See* Materials for Information Session, Thursday June 10, 2021, available at https://higherlogicdownload.s3-external-1.amazonaws.com/UNIFORMLAWS/ce442e6e-ed5a-aca7-56f3-7ca1ff87b53c_file.pdf?AWSAccessKeyId=AKIAVRDO7IEREB57R7MT&Expires=1686690462&Signature=IyfNvyIZhu9Ax6jcCCWaweGHQM4%3D.

dissolved until "the passage of 90 consecutive days during which the partnership does not have at least two partners." Section 302(d) of the UPA—providing that "[i]f a person holds all the partners' interests in the partnership, all the partnership property vests in that person" and further that that person may sign and file a record vesting the property in the person's name—is plagued, *inter alia,* by the same problem. The property remains partnership property for at least the period of 90 days provided in Section 801(6). Moreover, partnership property remains partnership property until it is monetized and distributed to partners and transferees, or distributed in kind. The issues presented to the Drafting Committee were (1) how to clarify the definition of partnership while preserving within the UPA the core requirement for formation and continuation after the grace period discussed in issue 2, and (2) whether to eliminate Section 302(d). The Committee's definition of "partnership" eliminates from the definitional Section 102(11) the language of "an association of two or more persons as co-owners of a business for profit" but that iconic language remains in Section 202 on partnership formation, to which the definition necessarily alludes by mention of "formed under this [act]". For the reasons stated, the Committee concluded that Section 302(d) should be deleted.

2. Dissolution of a Partnership When It Has Fewer Than Two or Has No Partners, and Rescission of Dissolution. As stated above, a partnership is not immediately dissolved because it has fewer than two partners; rather, it continues for 90 consecutive days following that development. Two situations are imaginable—a period during which the partnership had only one partner, and a conceivably separate and further period during which it has had no partners. In the case of the former, the surviving partner may admit a new partner under Section 402(b), and the requirement of two or more persons associated as co-owners of a business for profit will be satisfied. In the case of the latter, that is not possible. However, "a partnership is an entity distinct from its partners," UPA Section 201(a), and holders of transferable interests may not want to dissolve and wind up an otherwise viable business. If it were an LLC rather than a partnership, those owning a majority of the transferable interests could vote or consent to the admission of one or more persons as members, and upon the person's(s') acceptance, dissolution would be avoided. ULLCA Section 701(a)(3). Should the UPA be amended in like manner? The Committee believes it should be; and in proposed Section 801(6) and (7), it has also dealt separately with the two scenarios of one or no surviving partners.

A separate issue identified by the JEB and addressed by the Committee was whether the amendment of the UPA in 2013 had inadvertently eliminated from the 1997 UPA the right of a dissociating partner in a partnership at will, whose dissociation was not wrongful, to participate in any agreement to rescind dissolution. A dissociating partner may prefer the partnership be dissolved and wound up, whereas non-dissociating partners may prefer to avoid dissolution and simply buy out the dissociating partner. Section 802(b) of UPA (1997) provided that "all of the partners, including any dissociating partner other than a wrongfully dissociating partner," may waive the right to have the business wound up and the partnership terminated. In contrast, to rescind dissolution, Section 803 of UPA (1997) (Last Amended 2013) requires "the affirmative vote or consent of each partner," which apparently and at least arguably does not include the person who dissociated as a partner, and not wrongfully. The issue for the Committee was whether to restore the dissociating partner's right to participate in the vote to rescind dissolution or to clarify that the dissociating partner has no such right. The Committee chose the former and has also addressed the effect of rescission of dissolution upon third parties.

3. Distinguishing between Domestic and Foreign Entities in the UPA and ULLCA. In these and other of the ULC's Uniform Unincorporated Organization Acts the name of the entity has been applied to both a domestic and a foreign entity, though definitions make clear that the use of the term refers to a domestic such entity. (The later drafted and approved Uniform Protected Series Act does not do so.)

The issue was graphically illustrated several years ago, in *Fannie Mae v. Heather Apartments, LLC,* 2013 WL 6223564 (Minn. Ct. App. Dec. 2, 2013), when the Minnesota Court of Appeals considered whether Section 503 of Minnesota's LLC Act authorized issuance of a charging order and foreclosure of the charging order against the transferable interest of a member of a *foreign limited liability company.* Reasoning that the section does not explicitly so provide and that it mentions only "the limited liability company"—a defined term meaning an LLC formed under *this State's law, i.e.*, a domestic LLC, the Minnesota Court of Appeals held it does not authorize a charging order against a member of a foreign LLC. A further issue is that even if the Section is interpreted or amended to apply to the transferable interest of a judgment debtor in a foreign LLC, not all states authorize foreclosure of a charging order against the transferable interest of an LLC member/judgment debtor. The Drafting Committee was tasked with considering clarification of definitions, determining the applicability of the charging order remedy to a judgment debtor's transferable interest in a foreign partnership or foreign limited liability company, and determining, even if so, the availability of foreclosure in the case of a foreign LLC. In the specific context of the charging order remedy, the Committee decided to make the remedy available against the transferable interest in both a domestic and a foreign partnership or LLC but to limit the availability of foreclosure on the charging order to LLCs organized in states whose LLC statutes authorize foreclosure.

In a related point, the current draft adopts a more universally-applicable replacement term for "jurisdiction of formation". The new term is "governing jurisdiction". The term will be substituted throughout the act wherever the existing "jurisdiction of formation" was used. The concept originated with the Business Corporation Act (in the ULC's Business Organizations Code) and is designed to reflect the now fairly common ability to redomesticate (the entity becomes governed by the laws of a new jurisdiction) in any one of a number of ways.

4. Definitions of Merger, Interest Exchange, Conversion, and Domestication in META Section 102 and in Each Entity Act in Jurisdictions that Have Not Enacted UBOC OR META. Currently these terms are defined simply, and undescriptively, as "a transaction authorized by [e.g.,] Part [2, 3, 4, or 5]. Across the country there are differences in definitions, particularly in the case of domestication and conversion. In some states domestication means simply and solely a transaction in which an entity becomes governed by the law of a different jurisdiction, *e.g.*, an Arkansas LLC domesticates to Arizona and in consequence Arizona law governs its internal affairs. In other states the same result can be accomplished by a conversion transaction. In the former states, conversion refers only to a transaction in which an entity becomes a different type of entity. "Domestication" as defined in the former states is necessarily an interstate transaction; in the latter states, conversion does not necessarily mean an

interstate transaction. The issue for the Drafting Committee was whether and how to synthesize the differing terms in the Fundamental Change Articles of the various entity Acts, META, and UBOC. The Committee decided clarification was appropriate and further, as a result of questioning at the Information Session held on June 1, 2022 and the draft presented at the Annual Meeting in 2023, it has expanded the definitions to include "a similar law of another jurisdiction, however the transaction is denominated" and to describe the particular substantive effect of the transaction.

5. A Partner's or LLC Member's Competition with the Entity for a Partnership or Company Opportunity after Dissolution but Before Termination. Both UPA Section 409(b)(1) and ULLCA Section 409(b)(1) state that a partner's or LLC member's fiduciary duty of loyalty includes the duty "to account to the [partnership/the LLC] and hold as trustee for it any property, profit, or benefit derived by the [partner/the member]: . . . from the appropriation of a [partnership/LLC] opportunity." These sections then go on to provide that the duty of loyalty includes the duty "to refrain from competing with the [partnership/the LLC] in the conduct of the [partnership's/the LLC's] business before the dissolution of the [partnership/the LLC]," *i.e.,* without waiting for winding up to be undertaken or completed.

The entity continues after dissolution and until winding up has been completed. The issue for the Drafting Committee was whether a partner or LLC member was required to refrain from competition only until dissolution occurs and so was free to compete for and take an opportunity which was within the entity's line of business, in fact or fairly related to it, following dissolution but prior to completion of winding up? The Committee concluded that the clear intent of the Acts is to allow competition *after* dissolution and only to prohibit appropriation of a partnership or company opportunity *before* the dissolution of the company. The Committee draft, therefore, inserts the words "before the dissolution of the company" in Section 409(b)(1)(c) after "appropriation" and for stylistic purposes move them forward in Section 409(b)(3).

6. and 7. Allocation of Partnership Profits and Losses and Default Distribution of Losses under UPA Sections 401 and 806. The Drafting Committee completed its review and discussion of these issues as outlined in the JEB Report to the ULC Executive Committee, and as a result, concluded that former Section 401(a), providing for a partner's entitlement to an equal share of distributions and, in the non, LLP context, the responsibility on a proportionate basis for partnership losses, should be deleted. In the context of winding up, some clean-up changes have been made to Section 806 regarding distributions and how and when the calculus is determined.

In addition, this draft revises Section 901 of UPA to clarify that a statement of qualification (the trigger for a partnership becoming a limited liability partnership) may be delivered to a Secretary of State for filing contemporaneously with the formation of the partnership such that the LLP status occurs immediately upon the formation of the partnership.

8. Charging Orders in a Multi-Member Entity. In its June 28, 2020 Report to

the ULC Executive Committee,[3] the JEB identified as an issue for consideration, "[s]hould charging orders in a multiple-member entity be the sole remedy when all of the interests are owned by debtors of the same creditor?" The Drafting Committee considered this issue, and it concluded that changes to the existing Uniform Unincorporated Organization Acts were neither needed nor appropriate.

9. Dissolution and Winding Up: Known Claims and Other Claims against a Dissolved Limited Liability Partnership—What Claims May Be Barred? Like counterpart provisions in the other Uniform Unincorporated Organization Acts and the Model Business Corporation Act ("MBCA") followed by more than thirty states, Sections 807 and 808 of the UPA provide a procedure for giving notice to known and unknown creditors of a limited liability partnership and for their claims to be barred if not timely filed against the LLP as directed in the notice. The JEB noted as an issue whether partners in a general partnership, bearing joint and several liability for all debts, obligations, and other liabilities of the partnership under Section 306(a), "should be able to elect into an LLP and affect obligations incurred before LLP-status, [by extending] the 'notice-to-creditors/liability-discharge' provisions . . . currently applicable only to limited liability partnerships to non-LLP general partners . . . ."

As written in the current Acts, Sections 807 and 808 authorize a general partnership to elect LLP status just before dissolution and retroactively obtain discharge of and avoid the personal liability for which Section 306 provides for non-LLPs. As reported last year for the 2022 Information Session,[4] the Drafting Committee concluded that such discharge was overbroad and unwarranted and an inadvertent result of harmonization. Accordingly, the Committee draft confines the notice-and-discharge provisions to partnership obligations incurred when the dissolved partnership was a limited liability partnership. Obligations incurred when the partnership was *not* an LLP are not discharged and must otherwise have been or be addressed. As a result, the Committee draft deletes Section 810 ("If a claim against a dissolved partnership is barred under Section 807, 808, or 809, any corresponding claim under Section 306, 703, or 805 is also barred.") and the additional provisions added to the current draft are further clarifications of that concept.

10. The Term "Series". The term or concept of a "series" is used in several of ULC's Uniform Unincorporated Organization Acts, albeit differently expressed, and notably should be recognized in the provisions regarding the law governing foreign entities that register to do business in a state, *e.g.,* Section 1001 of the Uniform Limited Partnership Act contained in the Annual Meeting Draft and quoted immediately below. The issue for the Drafting Committee was how to recognize, articulate, and provide for a "series" in the different Acts. Except as explicitly provided otherwise in the Uniform Protected Series Act, the Committee is recommending that these provisions will state that the law of the jurisdiction of formation of the entity governs, *inter alia*,

[3] *See* Report cited in n.1, *supra.*
[4] *See* Materials cited in n.2, *supra.*

"(3) the liability of a series, protected series, protected cell, segregated account, or similar part of a structure that associates or otherwise segregates assets, liabilities, and partners among various parts of the structure, however the part is denominated, of the partnership; and

"(4) if the partnership has implemented a structure described in paragraph (3):
(A) the liability of the partnership for a liability of a part of the structure;
(B) the liability of one part of the structure for a liability of another part; and
(C) the liabilities of the partners of the partnership and of the partners associated with a part of the structure."

The 2023 Committee Draft also addresses a number of concerns raised since the2022 Annual Meeting relating to whether a jurisdiction in which a foreign Series LLC is registered to do business can require certain "home rule" protections that put a foreign Series LLC in the same position as a domestic LLC, or whether, as a result of permitting a foreign registration of a Series LLC, the enacting state is required to honor the vertical shields of a foreign LLC. The three options contained in the draft will, assuredly, be the topic of a robust discussion at both the Informal Session and the 2023 Annual Meeting.

In a similar vein, the Uniform Acts provide for the creation of a Series LLC, but not a partnership or limited partnership that can create protected series within it. The Committee started to address the philosophical issue of whether one of its Acts (ULPA) should permit foreign registration of a type of entity (a foreign series limited partnership) when its own limited partnership act does not authorize the creation of a series limited partnership. [5]

11. Protected Agreements. A "protected agreement" as defined in the MBCA and in the Unincorporated Organization Acts means a record evidencing indebtedness and any related agreement in effect on a given date and any agreement that is binding on any of the "governors" or "interest holders" of an entity that is the subject of a clause protecting it from change by means of a merger. As stated in the Comments to the Annual Meeting Draft, commenting on language applicable to a limited partnership as an example,

The purpose of the protected agreement concept is to protect persons that agreed to contracts or organic rules before conversions, domestications**,** and interest exchanges are authorized by the state and thus did not think to consider the consequences of the limited partnership engaging in one of those transactions. To protect those persons, the concept of a protected agreement looks at whether the agreement has provisions that apply if the limited partnership is a party to a merger. If that is the case, the provisions regarding merger will also apply if the limited

[5] While a similar issue may arise in the context of a state that has enacted its version of ULLCA, but has not included UPSA, the philosophical issues are, indeed slightly different – that enacting state COULD enact UPSA and it would be wholly consistent with the Uniform Unincorporated Acts paradigm. We do not offer a construct of a series LP within the Uniform Unincorporated Acts.

partnership enters into an interest exchange, conversion, or domestication even though the agreement does not mention those other types of transactions.

Issues presented to the Drafting Committee were (1) whether to continue or to eliminate the protected agreement concept and (2) if continued, as of what date the protected agreement has to have been in effect. The Committee decided not to eliminate the widely recognized concept of "protected agreements" in the Uniform Unincorporated Organization Acts and thus to leave that issue to individual states to determine. As to the date on which the protected agreement must have been in effect, the Committee Draft requires a "date certain" be determined; it has provided guidance as to the date selected, which may or may not be the effective date of the Act. Thus, as provided in the Legislative Note contained in the Annual Meeting Draft, a state may select the date on which conversions, domestications, and interest exchanges were first authorized by the law of the state, of if not all authorized at the same time, a different date based on when each type of transaction was first authorized, or a single date on which any one such transaction was authorized, or some other date. As stated in the Draft, however, for each it should be a "date certain."

12. Consideration of the Definition of the Term "Limited Liability." In a case decided in South Dakota Federal District Court, *SDIF Limited Partnership 2 vs. Tentexkota, LLC, Civil Action No. 1:17-CV-01002-CBK* (D.S.D. 2018), LLC members who had given personal guarantees of company indebtedness sought to avoid liability for company debts and obligations because the guarantees were not approved under the terms of the LLC operating agreement. The question whether a better definition of "limited liability" might be developed was raised as an issue the Drafting Committee might consider. The Committee considered the matter and did not see need to revisit or revise the definition provided in the Uniform Unincorporated Organization Acts, e.g., ULLCA Section 304. The draft is silent on the issue.

13. Merger Provisions in the Uniform Protected Series Act ("UPSA"). Because the notion of a "protected series" was still novel, with approximately one-third of the states or jurisdictions authorizing them, the UPSA Drafting Committee did not authorize a protected series or a series limited liability company to engage in entity transactions except for those within a "narrow channel." The issues to address were complicated enough without the myriad additional issues that entity transactions involving series would generate. The "narrow channel" or exception provided in the UPSA was for a merger between or among LLCs in which at least one of the LLCs was a series limited liability company and in which the surviving LLC, if a series LLC, existed before the merger took effect, *i.e.*, was not formed by the merger. That "narrow channel" was authorized in Section 604 and requirements described in ensuing sections of UPSA Article 6.

Issues presented to the Drafting Committee were (1) whether to continue to limit protected series and series limited liability companies to participation in a merger as described or instead, as some have urged, to break out of the "narrow channel" and authorize other entity transactions for a protected series or series limited liability company; and (2) whether to revise the relevant restrictive sections of the UPSA—Sections 602 and 603. For example, Section 602 makes no explicit account for the exception of

authorized mergers, and the intent of the Sections—the specificity of the transactions proscribed—only labeled the proscribed entity transactions insofar as the law of a foreign jurisdiction is concerned. A transaction might function as a conversion, domestication, or interest exchange, however, and be denominated differently under the law of a foreign jurisdiction, or the transaction might have the same substantive effect as any of these. Moreover, the caption to Section 603—"Restriction on Entity Transaction Involving Protected Series"—is misleading because the section is explicitly a restriction on entity transactions involving a series limited liability company.

As explained in last year's Materials for the Information Session[6] and affirmed this year, the Drafting Committee decided to retain the narrow channel and to revise the language of Sections 602 and 603 to provide greater clarity and guidance. More expressive definitional changes were made to Section 102's definition of "foreign protected series".

Issues 14-22—Issues Brought to the Drafting Committee's Attention by the ABA Corporate Laws Committee ("CLC"). In February of 2022, Commissioner and Co-Reporter Bill Clark brought to the Drafting Committee a number of issues noted by the CLC as it prepared a draft of a spoke version of the MBCA for inclusion in the Uniform Business Organization Code ("UBOC"). The CLC raised the issues as ones that the ULC might want to consider for possible amendments to the UBOC or to the various Uniform Unincorporated Organization Acts.

In a Memorandum to the Drafting Committee dated February 26, 2022, Co-Reporter Clark discussed those issues and included proposed drafting fixes should the Drafting Committee want to address some or all of them. The Drafting Committee met on March 11-12, 2022, to consider the issues the ABA CLC noted in addition to other issues on the Committee's agenda. As the Annual Meeting Draft reveals, the Committee approved a number of amendments to the UBOC, META, or various of the ULC's Uniform Unincorporated Organization Acts as noted by the CLC or suggested in Bill's Memorandum (in some cases, with modifications determined appropriate by the Committee). The February 26, 2022 Memorandum is attached and incorporated by reference here.

Issues 23-31 – Issues relating to conforming changes to META and UBOC. As a result of certain of the changes and conforming concepts the Drafting Committee considered in connection with both those changes referenced in the preceding paragraph and other definitional changes noted throughout this memorandum and the Act, a series of conforming changes to certain provisions of the Model Entity Transactions Act and the Uniform Business Organizations Code have been included. These should all be quite self-explanatory and non-controversial, but we do welcome all comments.

[6] *See* Materials cited in note 2, *supra,* at pp. 20-23.