

To: Steve Harris, Ed Smith
From: Ken Kettering
Date: May 4, 2021
Re: UCC & Emerging Technologies Committee:
Miscellaneous amendments – definition of “person” in UCC 1-201(b)(27)

This memorandum addresses a subject that was on the agenda for yesterday’s plenary meeting of the drafting committee and observers but was not covered. I am addressing this memo to you two, but feel free to share with anyone.

Steve Harris’ memo of April 23, 2021 sets forth the following proposed revision of the definition of “person” in 1-201(b)(27). I have placed in brackets terms in the current definition that are not carried forward in the revision:¹

(27) “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~~ an individual, estate, business or nonprofit entity, public corporation, government or governmental subdivision, agency, or instrumentality, or other legal entity. The term includes a protected series, however denominated, of an entity if the protected series is established under law that limits, or limits if conditions specified under law are satisfied, the ability of a creditor of the entity or of any other protected series of the entity to satisfy a claim from assets of the protected series.

The first sentence of the proposed revision deletes the UCC’s time-honored definition of “person” and replaces it with the ULC’s current standard definition of “person” as set forth in the ULC’s 2012 Drafting Rules. (Hereafter in this memo, references to the ULC’s standard definition are to the definition in the 2012 Drafting Rules, unless otherwise stated.)

I became acquainted with the ULC’s standard definition of “person” first in connection with the 2015 amendments to the Uniform Fraudulent Transfer Act aka Uniform Voidable Transactions Act, which when initially promulgated replaced that act’s definition of “person” with the ULC’s standard definition. States studying the amendments for enactment objected to

¹ “Not carried forward” means “not carried forward explicitly.” Some of the bracketed terms are legal entities and so should be carried forward by the revision’s concluding pick-up of “any legal entity.” (Doubt is raised on this point by PEB Commentary No. 23, which asserts that the interpretative canon of *ejusdem generis* applies to this definition [or at least to the UCC version of this definition]. If *ejusdem generis* applies, then the definition doesn’t pick up all legal entities, as it says, but only legal entities that a court decides are “of the same type,” in some undefined sense, as the creatures enumerated in the list preceding the reference to “any legal entity.” In my opinion PEB Commentary 23 is wrong on this point. See my memo of December 2, 2020 delivered with this.)

The revision also picks up any “business or nonprofit entity”. I do not know how that phrase is supposed to differ from the concluding reference to “any legal entity.” The phrase first appeared in the 2012 version of the ULC’s standard definition, and if the ULC’s Committee on Style had any source for the phrase or any articulable purpose for adding it, they did not publish an explanation so far as I am aware. Depending on how the phrase is interpreted it too might pick up some of the bracketed terms.

that, and so that change had to be quickly reversed.² I studied the ULC's standard definition further last summer: Carl Bjerre asked me to help out with the PEB's project to prepare an official master edition of the UCC, and I prepared drafts of master editions of Articles 1, 2 and 2A. In the course of doing that I learned that the ULC's Drafting Rules have set forth a standard definition of "person" since 1991.³ From 1991 through 2012 the ULC's standard definition tracked the UCC definition closely. Thus, before the 2012 revision the ULC's standard definition read as follows:

Drafting Rules 2006. "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, [public corporation, government or governmental subdivision, agency, or instrumentality,] or any other legal or commercial entity. [The term does not include a public corporation, government, or governmental subdivision, agency, or instrumentality.] *Note: Delete one of the bracketed phrases to ensure inclusion or exclusion of governmental entities.*

Earlier versions of the ULC's standard definition, back to the original version in 1991, were substantively identical to the above. The 2012 version was a large substantive change. I do not know why the ULC's Committee on Style revised their standard definition in 2012, but the revision certainly had nothing to do with the UCC and was not drafted with the UCC in mind.

I am enclosing with this a memo I wrote to the PEB, dated December 2, 2020, entitled "PEB Commentary No. [], Protected Series under the Uniform Protected Series Act (2017) — Revised Draft for Public Comment dated October 5, 2020." That December memo commented on the then-draft PEB Commentary on protected series that was later issued (with minor changes) as PEB Commentary No. 23 (Feb. 24, 2021), which has been distributed to the present drafting committee. My December memo disagrees with the analysis of the UCC definition of "person" in the PEB Commentary. It also includes the remarks I wrote last summer to the PEB in connection with the master edition of Article 1 on the errors in the UCC comments to the definitions of "person" and "organization."

The foregoing is background to my view of the proposed revision of the UCC's definition of "person." The revision has two parts, corresponding to its two sentences. The first sentence deletes the current UCC definition and replaces it with the ULC's standard definition. The second sentence declares every protected series to be a UCC "person." I will address these two changes in turn.

1. Replacement of the time-honored UCC definition with the ULC's 2012 standard definition. In my opinion it would be a major mistake to replace the current UCC definition and with the ULC's standard definition. No reason is offered for this change, so my presumption is that it stems from no more than a sense of neatness. The attempted replacement of the

² The first objection was from North Carolina, which pointed out that the deletion of "partnership" would change the law in that state because North Carolina is one of many states that has in force the original 1914 version of the Uniform Partnership Act, under which a partnership is not a legal entity.

³ The ULC's staff was able to provide me with editions of the ULC's Drafting Rules from 1991 onward. Based on references in other materials I believe that the ULC did not have a standard definition of "person" before 1991. Because I have not seen pre-1991 editions I cannot absolutely swear that the ULC did not have a standard definition of "person" before 1991, but this memo speaks of the 1991 version as the original version.

UFTA/UVTA's time-honored definition of "person" in 2014 was similarly motivated by neatness, and that speedily proved to be a mistake that had to be reversed.

The ULC standard definition is narrower than the UCC definition because the ULC standard definition is, or appears to be, limited to creatures that are legal entities.⁴ By contrast, the UCC's definition picks up many creatures that are not legal entities. This point is conspicuously underlined by the concluding language of the UCC definition, which picks up any "commercial entity" as well as any "legal entity."

One example is partnerships. The UCC definition picks up any "partnership." The ULC's standard definition does not pick up partnerships, and so a partnership is picked up by the ULC definition only if it is picked up by its concluding reference to "other legal entity."⁵ Some partnerships are legal entities and some are not. This entity status of a partnership was a matter of lively debate in the early 20th Century, when the original codification projects were undertaken, and under the Uniform Partnership Act (1914), which remains in force in about a dozen states, a partnership is not a legal entity.⁶ Accordingly, if the UCC definition is revised as proposed, a partnership will no longer be a "person" for UCC purposes unless it qualifies as a legal entity, which will be true in some states but not in others. If a partnership is not a UCC "person," it will not qualify as a "debtor" under Article 9 (9-102(b)(28)). Presumably property that would be considered owned by "the partnership" if the partnership were a legal entity is instead treated as being co-owned by each of the partners as "tenants in partnership." (See Uniform Partnership Act § 25 and, presumably, common-law equivalents in states that have not codified their partnership law.) Financing statements thus differ radically in the two cases. And practitioners will have to become sensitive to the different consequences that attach to dealing with a partnership, depending upon the jurisdiction under whose law it is organized.

Another example is trusts. The UCC definition picks up any "trust." The ULC's standard definition does not pick up trusts, and so a trust is picked up by the ULC definition only if it is picked up by the concluding reference to "other legal entity." A common-law trust is not a legal entity.⁷ Accordingly, if the UCC definition is revised as proposed, a common-law trust will

⁴ Whether the ULC's standard definition is limited to legal entities is a debatable point. The definition now ends "any other legal entity". This deletes the ULC's former broader language that, like the UCC, referred to "any other legal or commercial entity." It also strongly suggests that all of the terms previously enumerated are intended to be included only insofar as they are legal entities. Some of the enumerated creatures in fact are not legal entities. For instance, a standard source flatly states, citing cases, that an "estate" – *i.e.*, a decedent's estate – is not a legal entity. 31 AM. JUR.2D EXECUTORS AND ADMINISTRATORS § 3. Assuming that is so, does the ULC standard definition pick up decedent's estates because it picks up "estates"? Or are decedent's estates excluded from the definition because its final words limit the definition to legal entities?

⁵ A partnership might also be picked up by the phrase "business or nonprofit entity," but as previously noted it is not clear what, if anything, that phrase adds anything to "legal entity." I will not continue to repeat this point.

⁶ The Revised Uniform Partnership Act in 1994 changed the approach of the original Uniform Partnership Act and declares a partnership to be a legal entity.

⁷ "A trust is not a legal entity. A trust is not an entity distinct from its trustees and capable of legal action on its own behalf . . ." AM. JUR. 2D TRUSTS § 3 (2013); AMY MORRIS HESS, GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, BOGERT'S TRUSTS AND TRUSTEES § 712 (2012) ("A trust is not a legal person, nor is the trust property."). See also *Greenspan v. LADT, LLC*, 191 Cal. App.4th 486, 521 (Cal. Ct. App. 2010) ("because '[a] trust is not a legal entity,' it 'cannot sue or be sued, but rather legal proceedings are properly directed at the trustee.'").

no longer be a “person” for UCC person, and hence will not qualify as a “debtor” under Article 9. Financing statements thus differ radically in the two cases. Moreover, the non-personhood of a trust couples oddly with 9-503(a)(3), which provides the name of a trust for financing statement purposes.

One could go one and note other creatures that are “persons” under the UCC definition but not the ULC definition. But the point has been made. Jettisoning the UCC definition after 70 years would cause considerable upheaval in commercial lawyers’ practice and in the way they must think about legal relationships. Such a disturbance is not justified unless there is good reason for it, and I am not aware of any reason for it at all.

2. Addition of any and all protected series to the definition. The second sentence of the proposal would add to the definition of “person” any and all protected series, whether or not the protected series is a legal entity. This is a considerable extension of the point made by PEB Commentary No. 23 (Feb. 24, 2021). That Commentary by its terms is limited to protected series formed under the Uniform Protected Series Act (“UPSA”), and the UPSA explicitly declares that a UPSA protected series is a “person.” That differs from many state statutes on protected series, which duck the “personhood” issue or address it opaquely.

The proposal is weird in that it kills off the time-honored application of the definition of “person” to such ancient creatures as the partnership and the trust because they are not legal entities, yet takes pains to extend the definition to one and only one creature that is not a legal entity: the newly-minted protected series. As stated in part 1 of this memo, however, there is no justification for replacing the UCC’s time-honored definition with the ULC’s standard definition, so I presume that the UCC definition will remain the base. If the UCC definition remains the base, there is no structural reason to resist the additional sentence adding protected series to the happy list of “persons.”

Whether the additional sentence on protected series is good policy is a question that I can only call “political.” The ULC, or its higher-ups, have been energetically pursuing uniform acts crafted to foster protected series. That extended even to decreeing that the Uniform Fraudulent Transfer Act aka Uniform Voidable Transfer Act, when we amended it in 2014, must contain a lengthy, intricate, and altogether weird provision aimed at a quirk of protected series law. In the course of the UFTA/UVTA project I hung out for a time with the committee working on protected series, then at a fairly young stage, to learn more of what was going on. My question to that committee was: what is the point of a protected series? What legitimate purpose can be served by a protected series that cannot be not served by traditional structure (*e.g.*, a corporate family)? I expected that this subject would have been discussed to death, and was surprised to find that it was received as a new thought, worthy of consideration by the whole group! Protected series appear to have originated as a device for mutual fund families to organize and minimize their paperwork and filing fees with the SEC, with the knowledge and consent of the SEC. Likewise, captive insurance companies, another highly regulated industry, also find the protected series a convenient way to organize regulatory compliance. (See Annex A, an excerpt from an article I wrote about the 2014 amendments to the UFTA/UVTA, in which I set forth the background of protected series as I had learned it.) The foregoing uses of protected series essentially amount to a short-form amendment by a regulator to its regulations and fee schedule,

which is benign but very limited and hardly justified the activity or many lawyers to further the protected series concept and enact it in many states. The only suggestions I heard about other possible uses of protected series were much less benign: to further the cheating of creditors (aka “asset protection”), or to further regulatory evasion in ways less benign than those just mentioned.

My own feeling, at least at this point, is that it is bad policy to encourage use of protected series unless there is reason to believe that easing the use of this odd creature is likely to do more good than harm. I haven’t heard even an attempt to make that case. I therefore am skeptical of the second sentence of the proposal. I acknowledge, though, that the time for skepticism may be over if the train has truly left the station so far as widespread enactment of protected series statutes is concerned. I also acknowledge that if the higher-ups at the ULC and ALI have views on this point, they must be considered.

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A concluding thought is to wonder whether this proposed change to the UCC definition of “person” has been adequately canvassed among practitioners and scholars. The participants in this project I recognize from my short period of engagement are mostly oriented toward secured finance and securities holding. This proposed change, if implemented, would affect everything touched by any portion of the UCC. Also, the name of this committee is “UCC and Emerging Technologies,” and this proposed change has nothing to do with emerging technologies, so query whether persons potentially affected are paying attention. I have no opinion on this point myself, and raise it for your consideration.

KCK

Attachment: Annex A

Enclosure: Memorandum, dated December 2, 2020, from Kenneth C. Kettering to the Permanent Editorial Board for the Uniform Commercial Code, *PEB Commentary No. []*, *Protected Series under the Uniform Protected Series Act (2017) – Revised Draft for Public Comment, dated October 5, 2020*

Extract from Kenneth C. Kettering, *The Uniform Voidable Transactions Act; or, the 2014 Amendments to the Uniform Fraudulent Transfer Act*, 70 BUS. LAW. 777, 828-31 (2015)

H. SERIES ORGANIZATIONS

One may or may not like the 2014 amendments, but at least they are easy to understand, as a rule. An exception to that rule is new section 11, which is apt to puzzle the uninitiated.

Section 11 relates to “series organizations”—that is, organizations that are empowered to create “series.” Series organizations are the latest fashion in forms of business organization.²⁰⁸ Statutes authorizing the formation of series organizations have been enacted to date in twelve states, the District of Columbia, and Puerto Rico. The terminology of those enactments differs; not all of them use the word “series.” Indeed the “series” terminology is unfortunate, because “series” in this context has nothing to do with the traditional use of that word to denote a class of securities. Most series enactments to date apply to limited liability companies (“LLCs”), but any form of business organization might be empowered to create series, and in 2009 NCCUSL promulgated a uniform act that empowers a statutory business trust to create series.²⁰⁹ For specificity, let us consider a series organization that is an LLC.

If the law of an LLC’s state of organization empowers the LLC to create series, what does that mean? It means that the LLC may, if it wishes, create on its books an account called a “series,” and identify a set of the LLC’s assets as being associated with that series. The LLC may create more than one series (for example, Series A and Series B), allocating different assets to each. The enabling law will provide that each series is responsible to pay obligations pertaining to its own assigned assets or activities, but neither the assets of Series B nor the unassigned assets of the “mother ship” LLC may be charged with liability for obligations pertaining to the assets or activities of Series A, nor may the assets of Series A be charged with liability for obligations pertaining to the assets or activities of Series B or of the “mother ship” LLC. This liability shield between any two series, and between each series and the mother ship, is the central feature of the series concept. The effect is to make the LLC and its series analogous to a parent corporation and its subsidiary corporations. When a series is formed, the documentation may provide that profits of the series are to be distributed to designated persons associated with the series (who are thus the equivalent of equity owners of the series); absent such a designation, distributions go to the “mother ship” LLC.

The original use of the series concept seems to have been by investment companies regulated by the Securities and Exchange Commission. An investment manager commonly will form a family of different mutual funds, each with a different investment objective. It is convenient to organize the whole fund family as a single series organization, each fund being a series and the investors in each fund being the persons entitled to receive distributions from that series. That is because the SEC will allow the whole fund family to file a single registration statement under the Investment Company Act of 1940, resulting in a saving of the paperwork and filing fees that would be required if each fund had to file separately.²¹⁰ Captive insurance companies, another highly regulated group, also use the series concept. A captive insurer’s contractual

²⁰⁸ A concise introduction to the series concept is the Reporter’s Introductory Note to the current draft, dated October 23, 2014, of the Series of Unincorporated Business Entities Act. That draft is the work in progress of the Series Project referred to in the text *infra* at note 215. The Reporter for that drafting committee is Daniel S. Kleinberger. The draft is available from the drafting committee’s page at NCCUSL’s website, www.uniformlaws.org. The foregoing Reporter’s Introductory Note is referred to hereinafter as the “Kleinberger Note.” See also Thomas E. Rutledge, *Again, For the Want of a Theory: The Challenge of the “Series” to Business Organization Law*, 46 AM. BUS. L.J. 311 (2009).

²⁰⁹ UNIF. STATUTORY TRUST ENTITY ACT §§ 401–404 (2009).

²¹⁰ See Kleinberger Note, *supra* note 208, at 4; Rutledge, *supra* note 208, at 313.

obligation to a given participant is often segregated into a series, together with the assets to fund that obligation. That allows each series to function, for regulatory purposes, more or less as if it were a separate captive insurance company.²¹¹ In 1996 Delaware became the first state to enact legislation extending the series concept to LLCs, and it did so without restricting the uses to which that form of organization may be put. Since then this form of organization has been widely used, in several states, by the unregulated.

The 2014 amendments add new section 11 to the UVTA in response to an eccentric feature of the emerging law of series organizations: namely, it may not be clear whether a series is a legal person distinct from the mother ship and other series, or whether a series is instead a nonperson akin to a division of a corporation. Compliance with the regulations to which investment companies and captive insurance companies are subject may necessitate treatment of a series as a nonperson.²¹² NCCUSL's 2009 uniform act on statutory business trusts straightforwardly declares that a series is not an entity separate from the mother ship statutory trust,²¹³ but for no very clear reason the various state enactments to date mostly duck the "personhood" issue or address it opaquely.²¹⁴ In 2013 NCCUSL appointed a committee to draft a uniform act to provide for creation of series by unincorporated business organizations of all types (the "Series Project"). As of this writing in November 2014 the participants in the Series Project are still wrestling with what their act should say about the personhood *vel non* of a series.²¹⁵

No small degree of metaphysical confusion would arise from a regime that purported to declare that a series is not a legal person, yet can own property (for, while the concept of "ownership" can be fuzzy, ownership by the series seems to follow inevitably from the asset allocation and liability shields that are the core of the series concept). One point, however, is clear. If a series is not a legal person, then no disposition of the property allocated to it to another series or to the "mother ship" can possibly be a voidable transfer under the UFTA. That is because a "transfer" avoidable under the UFTA can be made only by a "person."²¹⁶ As a result, if an LLC's insolvent Series A were to convey a valuable asset gratis to Series B, a creditor of Series A could not reach that asset in the hands of Series B: the liability shield provided by the law enabling the creation of the series allows the creditor to pursue only property of Series A, and the conveyance of the asset in question could not be avoided under the UFTA. That plainly cannot be allowed. That is the purpose of section 11, which simply states, in effect, that Series A is deemed a legal person for purposes of the UVTA, whether or not it is considered a legal person for other purposes.²¹⁷

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²¹¹ For captive insurers, the series concept was early implemented by state laws limited to insurers (and which typically used terminology such as "cell" rather than "series"). Lately, some states have allowed captive insurers to make use of general series enactments. See Matthew J. O'Toole & Robert L. Symonds, Jr., *A Winning Combination*, CAPTIVE REV., Jan. 2011, at 19, 19 (Supp., Del. Report 2011), available at www.delawarecaptive.org/files/Symonds&O'Toole2.pdf.

²¹² See Kleinberger Note, *supra* note 208, at 5.

²¹³ UNIF. STATUTORY TRUST ENTITY ACT § 401(b) (2009).

²¹⁴ See Kleinberger Note, *supra* note 208, at 5; Rutledge, *supra* note 208, at 314–21.

²¹⁵ See Kleinberger Note, *supra* note 208, at 5–6.

²¹⁶ UFTA § 1(9) (1984) ("person"); *id.* § 1(12) ("transfer"). The 2014 amendments redesignated those definitions respectively as UVTA §§ 1(11), 1(16) (2014), and amended both slightly, but those amendments have nothing to do with series. The amended definition of "person" merely conforms that definition to the standard wording now used by NCCUSL in uniform acts. The amendment to the definition of "transfer" conforms to an analogous usage in the Uniform Commercial Code. See UVTA § 1 cmts. 11, 16 (2014).

²¹⁷ Section 11 uses the term "protected series" rather than "series." It equally well could have used the term "eggplant." The term is only a placeholder for its definition, and section 11 defines this creature by reference to its attributes, not by reference to names it has been given. "Protected series" was used largely because the participants in the Series Project expect to use that term for the creature defined similarly in the uniform act they are drafting.