BUSINESS LAW TODAY

April 2015

Feature Articles

- **Our Mini-Theme: The Uniform Business Organizations Code and Its Constituent Acts**
- **Articles I and II of the Harmonized Uniform Business Organization Code (the Hub and META)**
  In 2006, the Uniform Law Commission Harmonization of Business Entity Acts Project focused on organizing all business entity filing requirements into one legislative act. The project yielded a succinct location for all the entity common filing requirements called the "Harmonized Business Organization Code," or "Hub," and included the harmonization of the Model Entity Transactions Act (META). This article provides a thumbnail sketch of Article I of the Hub and of Article II, META.
- **Protecting the Deal: Enforcing and Protecting the Owners' Agreement**
  Unlike a corporation, a limited liability company takes its fundamental governance rules from a private agreement, rather than from a state statute. This article explains how the newly-harmonized Uniform Limited Liability Company Act (2013) protects the deal that the members have made for themselves.
- **A Uniform Unincorporated Business: Understanding the Rights of an Owner's Personal Creditors**
  A creditor seeking to enforce state law collection remedies against an owner of an unincorporated business owner faces a unique difficulty unknown in the corporate world: statutory restrictions on the transfer of an ownership interest. This creates unique challenges for creditors of an owner, which this article explores and illustrates.

Other Feature Articles

- **Pre-Filing Advice for Individual Chapter 11 Debtors: Practical Tips and Pitfalls**
  Representing an individual debtor in a Chapter 11 case presents unique problems and challenges for the practitioner and for the debtor. Explaining those problems to the prospective client in writing, before the case commences, often is essential to manage client expectations, to plan for contingencies in advance, and to ensure that the client makes an informed judgment about whether Chapter 11 is worth the risks.

Departments

- **KEEPING CURRENT: Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund: Liability for Opinions in Registration Statements**
  The U.S. Supreme Court's March 24 decision in Omnicare addressed the requirement in Section 11 of the Securities Act of 1933 that a registration statement not contain an untrue statement of a material fact or omit to state a material fact necessary to make the statements therein not misleading. The Court's guidance is significant in light of the importance of pleading standards and motions to dismiss in securities litigation.
- **KEEPING CURRENT: Finally, State Securities Filings Electronically: NASAA's Electronic Filing Depository**
  On December 15, 2014, the North American Securities Administrators Association announced the launch of the online Electronic Filing Depository (EFD) to enhance the efficiency of the state regulatory filing process for certain exempt securities offerings. EFD is an online system that allows an issuer to submit a Form D for a Regulation D, Rule 506 exempt offering to most state securities regulators and pay related fees. The EFD website also enables the public to search and view Form D filings made with state securities regulators.
- **DELAWARE INSIDER: Statutory Appraisal: An Old Workhorse with a New Lease on Life**
  Since the Delaware Court of Chancery's decision in In re Appraisal of Transkaryotic Therapies, Inc., 2007 WL 1378345 (Del. Ch. May 2, 2007), some stockholders have engaged in the investment strategy of acquiring shares of target corporations after a merger is announced with the hope of obtaining higher consideration in an appraisal proceeding brought in the Court of Chancery – now commonly referred to as "appraisal arbitrage." The uptick in appraisal litigation has resulted in a number of interesting opinions from the Delaware Courts and proposed amendments to 8 Del. C. § 262.
- **MEMBER SPOTLIGHT: An Interview with Laura Stein**
  It's clear why Laura Stein, General Counsel and Executive Vice President of The Clorox Company, was named one of the 20 most influential general counsel in America by the National Law Journal. She's gone far beyond mastering the skills necessary to run a top-notch legal department, prompting the Harvard Law Bulletin to highlight her as "one of the 50 alumnae who have used their law degree to take them to extraordinary places."
- **INSIDE BUSINESS LAW**
  This month, "Inside Business Law" highlights the five most attended CLE programs at the Spring Meeting held last week in San Francisco, as well as the articles published in the Spring Edition of The Business Lawyer. The Spring Edition has not yet been mailed, but is available on the Section's website. Links to the content of the Spring Edition are contained in the column.

EDITORIAL BOARD

BUSINESS LAW TODAY

Our Mini-Theme:

The Uniform Business Organizations Code and Its Constituent Acts

By Harry J. Haynsworth

Since the early 1990s, the Uniform Law Conference (ULC) has promulgated, or in several cases revised, eight unincorporated business entity acts:

- Revised Uniform Partnership Act (1997)
- Revised Uniform Limited Partnership Act (2001)
- Revised Uniform Limited Liability Company Act (2006)
- Model Registered Agents Act (2006)
- Uniform Limited Cooperative Association Act (2007)
- Model Entity Transactions Act (2007)
- Revised Uniform Unincorporated Nonprofit Association Act (2008)
- Uniform Statutory Trust Entity Act (2009).

In 2006, the ULC authorized a project to integrate all these eight acts into the Uniform Business Organization Code, using the same type of hub-and-spoke structure used in the Uniform Commercial Code. The project, known as the Harmonization of Business Entity Acts Project (Harmonization Project or "Hub"), involved four steps: (1) the creation of the Hub, which contains provisions such as definitions, filing requirements, etc., which appear in almost all of the eight statutes; (2) harmonizing and updating the eight acts, which also continue to exist as stand-alone acts; (3) making the stand-alone acts "Code-ready" by removing from each act most of the provisions contained in the Hub and all provisions contained in the Model Entity Transactions Act; and (4) compiling the Code, by converting the Code-ready harmonized acts into separate articles of the Code.

The ULC originally approved the Hub, which is Article 1 of the Uniform Business Organizations Code ("the Code"), in 2011. The harmonization of the unincorporated entities acts phase of the Harmonization Project was completed and approved in 2013. The integration of the various Code-ready harmonized acts into the Code was completed in 2015.

The Code, as well as all the stand-alone acts, are available on the ULC website: www.uniformlaws.org. There are two versions for each act, one with and one without the official comments. Some states that have enacted the uniform business entity acts include the comments in their code. Even if the comments are not included in the state code, they can provide useful background information and guidance to practitioners and judges. The ULC website for each act also contains other useful information, including a map showing which states have enacted an unincorporated entity act.

Article 1 of the Code (the Hub) contains basic definitions and provisions concerning filing requirements, entity names, registered agents (based on the Model Registered Agents Act), foreign entities, and administrative dissolution.

Article 2 is the Model Entity Transactions Act (2007) (last amended 2013) (META (2013)). It is a junction-box statute that governs intra-entity and inter-entity merger, interest exchange, conversion, and domestication transactions for all types of unincorporated as well as corporate entities.

- Article 3 is the Uniform Partnership Act (1997) (last amended 2013) (UPA (2013)).
- Article 4 is the Uniform Limited Partnership Act (2001) (last amended 2013) (ULPA (2013)).
- Article 5 is the Uniform Limited Liability Company Act (2006) (last amended 2013) (ULLCA (2013)).
- Article 6 is the Uniform Limited Cooperative Association Act (2007) (last amended 2013) (ULCAA (2013)).
- Article 7 is the Uniform Unincorporated Nonprofit Association Act (2008) (last

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amended 2013) (UUNAA (2013)).

- Article 8 is the Uniform Statutory Trust Entity Act (2009) (last amended 2013) (USTEA (2013)).

It is contemplated that in the future the ULC and the American Bar Association Business Law Section will approve the inclusion of the Model Business Corporation Act and the Model Nonprofit Corporation Act into the Code. Articles 9 and 10 of the Code are listed as "Reserved" for this purpose.

The two corporate acts are promulgated by the American Bar Association Business Law Section. The Code has already benefitted by the ABA's involvement with the drafting of the Hub, META, and MORAA. Because these acts cover corporate as well as unincorporated entities, their respective drafting projects were sponsored jointly by the ULC and the ABA.

States can choose to enact the entire Code, or substantial portions of it (for example Articles 1 through 5 (Hub, META, UPA, ULPA, and ULLCA)), in a single bill, or enact the individual stand-alone harmonized entity acts. States may also choose to enact one or more of the stand-alone entity acts and then enact the Code.

Enacting the Code is not difficult, particularly by a state that already has one or more of the major stand-alone entity acts, such as the ULLCA. The issues warranting specific review are basically the same in all the articles of the Code. Thus, one bar association or legislative study review committee can review all the articles of the Code that are included in the proposed act. This review process is much more efficient than having separate review committees for each act.

Moreover, because the language in parallel provisions is the same in all the articles of the Code dealing with specific entities, it is a simple process to make sure that amendments to one provision are made in all the articles with similar provisions. Similarly, if a state has enacted the Code, an amendment can be made in the filing provisions or in the other provisions in Article 1 and it will no longer be necessary to make sure that the amendment is made in all the state's other entity acts – a process that often does not occur, leading to unintended, inconsistent provisions in the state's entity acts.

The three articles in this mini-series discuss only a few of the issues that are covered in the Code and the stand-alone acts.

Garth Jacobson's article describes some of the major issues and innovative features of the Hub (Article 1 of the Code) and META (2013) (Article 2 of the Code).

Professor Kleinberger's article deals with the critically important issue of how the UPA (2013), ULPA (2013), and ULLCA (2013) protect and enforce the agreement between the participants in a partnership and limited liability company.

Professor Bishop's article provides an overview of the provisions in the UPA (2013), ULPA (2013), and ULLCA (2013) concerning the rights of creditors of a partner in a partnership and a member of an LLC, a topic that has not received the attention it should have given recent statutory and case law developments, particularly in the bankruptcy courts.

While there are no articles on ULLCA (2013), UUNAA (2013), or USTEA (2013), and these acts have not been as widely enacted as UPA (2013), ULPA (2013), and ULLCA (2013), these acts should not be overlooked in considering revisions of a state's business entity acts.

ULCAA (2013) is a "new generation" cooperative act that allows a cooperative to engage in any type of activity, whether or not for-profit, and authorizes non-patron investors to have management and voting rights. ULCAA (2013) does not replace more traditional limited activity agriculture and utility cooperative acts. Rather, it authorizes an additional alternative form of cooperative.

Like ULCAA (2013), USTEA (2013) is an alternative act to the more traditional common law and statutory business trusts. Statutory entity trusts are widely used in Delaware and several other states for series organizations of mutual funds, and sophisticated securitization transactions.

UUNAA (2013) provides entity status, vicarious liability protection, and basic default governance rights for unincorporated nonprofit associations. Under common law principles, UNAs are considered as aggregates rather than entities, and the members are jointly and severally liable for the debts, obligations, and other liabilities of the UNA. Every nonprofit organization that is not incorporated is a UNA. There are thousands of UNAs in every state. Examples include churches that cannot or have not incorporated, educational, scientific, and literary clubs and associations, trade associations, little league teams, and unincorporated community condominiums and homeowners associations. The existing statutory framework covering UNAs in most states is very fragmentary. Having a uniform act that provides basic protections and governance rights for the members of a UNA is an important development.

Harry J. Haynsworth is Dean Emeritus of William Mitchell College of Law. He was Chair of the Harmonization of Business Entities Harmonization Project and is Chair of the ULC Enactment Committee for Unincorporated Entity Acts.

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ADDITIONAL RESOURCES
For other materials related to this topic, please refer to the following.

ABA Web Store

How Recent Harmonization Efforts Will Affect Your State's Unincorporated Business Entity Statutes and Your Clients (Audio Download) (CD-ROM) (Online Course)

Recording date: Thursday, November 20, 2014
ABA CLE – 1.5 Hours CLE

Over the past 20 years, the Uniform Law Commission (ULC) has developed a broad range of unincorporated business entity acts. In 2013, the ULC completed a major project revising all of the unincorporated business entity acts, harmonizing the language in them, updating the official comments, and integrating the acts into a single statute known as the Uniform Business Organizations Code (UBOC).

In this program, our esteemed panelists discuss the Uniform Law Commission's Harmonization Project and:

- Explore the rationale for the project
- Discuss the most significant changes made in the various unincorporated entity Acts
- Review the content of the Uniform Business Organizations Code

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BUSINESS LAW TODAY

Articles I and II of the Harmonized Uniform Business Organization Code (the Hub and META)

By Garth B. Jacobson

In 2006, the Uniform Law Commission (ULC) Harmonization of Business Entity Acts Project (Harmonization Project) tackled the matter of organizing all business entity filing requirements into one legislative act. The project yielded an organized and succinct location for all the entity common filing requirements called the Harmonized Business Organization Code, otherwise known as the "Hub." Thereafter, the ULC project harmonized all of the unincorporated business entities in its harmonization of business entities project. The Harmonization Project included the harmonization of the Model Entity Transactions Act (META) (2007). META provides the mechanism for entities to merge, transform, or morph into other entities, entity forms, or domesticate into another jurisdiction. This article provides a thumbnail sketch of Article I of the Hub and of Article II, META. While much more can be written about these acts, this article provides an introduction and some interesting features.

The Hub

Most attorneys know very little about how business entities documents get filed and the issues related to filing office procedures. Likewise, when business entity statutes are drafted, unless a filing office official or someone experienced with the filing procedure is present, the drafting committee may face resistance during the legislative process from the secretary of state's filing office, because the proposed statutes don't comport with the established procedures of the office. Those procedures are often driven by the computer system database and storage methods of the office and the office culture; perhaps called "tradition." Regardless of the background for the procedures, they are generally set up to create a logical, efficient method to receive a business entity document and file it so it is preserved in the record. Ultimately, the public has access to the information contained therein. The procedures usually apply to all documents submitted and create the workflow. The Hub captures these commonalities of filing procedure and places it in one place for uniform application to all business filing entities. But at the very least, the Hub provides an attorney a valuable roadmap through entity filing procedures that are otherwise scattered throughout entity statutes.

The Hub, as the name connotes, is the one place of commonality amongst all business filing entities. It is in essence the hub, and then each entity type is a spoke off the hub. While some may argue about harmonizing language of similar business entity types, no one on the committee disagreed about the value of placing all filing requirements in one location. The drafting committee relied heavily upon input from the representative from the International Association of Commercial Administrators (IACA) and the few attorneys on the committee familiar with filing procedures. The Hub serves two important functions. First, it creates an easily understandable, consistent, statutory location for the filing instructions and related matters. Second, it prevents the inconsistencies that now exist due to drafting committees or legislatures amending entity laws in erratic manors. Those errors may have been made in the past by drafting legislation attorneys who didn't know better. Once enacted, the Hub filing procedure changes would go through the Hub and not the individual business entities statutes, and hopefully be reviewed by the filing office. It should be also noted that the Hub establishes the general methodology for the filing process. However, various jurisdictions may alter the procedures based upon their operational differences. For example, the name "filing standards" may be different from what is prescribed in the Hub. That is, some states may choose to use a "deceptively different name" standard instead of the "distinguishable on the record" standard prescribed in the uniform Hub legislation. Even though this is a uniform act, it is contemplated that alternative methods may be used in various filing offices. The result remains the same: that

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there will be internal consistency within the jurisdiction, but not necessarily total consistency between jurisdictions.

The Hub consists of six substantive parts:

- Part 1 provides basic definitions and grants authority to the filing office through rules and procedures not necessarily specified in the statutes.
- Part 2 specifies the filing procedures and protocol. This creates the nuts and bolts of how to file a document.
- Part 3 details the name standards for entities and the necessary nomenclature for entity identifiers.
- Part 4 places the Model Registered Agent Act into the Hub. These provisions address the requirements for naming and maintaining a registered agent where service of process can be delivered and how service is made. It establishes an innovative feature that recognizes the commercial registered agents and their special needs and procedures they must abide.
- Part 5 deals with the requirements for foreign entities registering with the filing office and the actions that need to be taken to qualify to do business in the jurisdiction.
- Part 6 prescribes the procedures for involuntary dissolution of business entities. This function serves as a penalty for entities who fail to file their annual report or fees. The annual report provides some entity transparency and notifies the public certain information about who controls the entity. Additionally, it serves to remove the deadwood entities from the record that cease operations and simply walk away without following the proper dissolution procedures.

Part 1 contains the very important definitions section. The committee spent much time and effort to establish effective definitions that carry throughout all of the other parts and into the other entity acts. This structure borrows from the Uniform Commercial Code. However, if the Hub is enacted as a separate act and used exclusively for the central location of the filing office provisions (such as pending 2015 legislation in Washington State Legislature (SB 5387)), then the definitions section is pared down to just the terms related to the Hub itself. In that case, the other business entity acts then stand alone with definitions not drawn from the Hub. But note, with the adoption of the Hub, the entity statutes reference back to the Hub the file provisions that otherwise would be included in that entity statute and remove any definitions related to filing matters.

Part 2 drills down into the mechanics of filing documents. The legislation specifically authorizes electronic filing as determined by the filing office. While almost all filing offices permit electronic filing in some form or another, they all have different twists on the method and means. This legislation recognizes electronic filing and permits the filing office to set the requirements. Also of note is the modification of execution of documents. "The entity filing must be signed by an individual or on behalf of a person authorized or required under this [act] to sign" Section 1-201(4). This permits an entity to form another entity, but ultimately, there must be a human listed and identifying his or her capacity to sign. Part 2 also establishes the requirement for entities to disclose certain information in an annual report. This requirement may be well established in many states and lacking in others jurisdiction. The Hub specifies the minimum entity disclosure information include the name of one "governor" for transparency purposes. Likewise this named "governor" establishes a point of contact for secondary service, as explained later.

Another interesting feature of Part 2 is the specifying the date and time applied to the filing. While the delivery determines the time of filing, the completion of filing will likely occur sometime after the recorded time of filing. This enables the filing office to complete the filing review process and to determine if the document information is complete. However, if the filing office creates expedited filing, then the potential exists for conflicts between the expedited filing and regular filings. While the delivery establishes the filing date, the filing office decides the order of processing. Conceivably, the first delivered would not get processed before the line-cutter expedited filing. The net result could be the expedited filing could beat out the regular filing in races to obtain a business entity name. However, the Hub does not contemplate expedited filing procedures; it just specifies the date and time given to the filing. Of note, Delaware has expedited filings as short as one half hour. Therefore, a conflict could exist in jurisdictions that create expedited filings.

One other section that stands out concerns the opportunity to correct a filing after its submission. Section 1-205 permits the submitter to, at some later date, correct an inaccuracy or error in the original filing. A surprising number of filings are corrected due to mistakes made by attorneys or formation agents. This section permits a correction that reverts back to the filing date unless someone relied on the "uncorrected filed record and adversely affected by the correction."

Lastly, Part 2 provides for certificates of good standing. The committee debated for some time the need for certificates of good standing as opposed to certificates of existence or even a certificate at all. The committee decided that while "existence" probably better describes the certificate, "good standing" makes the due diligence people happier, or just sounds better. Even though it appears conclusive, the certificate is limited to the information contained within the filing office and may not reflect the status of other taxes or matters that could affect the entities standing with the state. Entity due diligence requires going beyond the simple certificate of good standing.

Part 3 discusses at length the requirements for business entity names. Parenthetically, it is my experience that the two biggest complaints among document filers are disputes over the use of business names and the attempt to use the name-filing process as a means to obfuscate the trademark process. Name filing under any standard is not a trademark per se. The name standard specifies that the name of an entity must

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be “distinguishable on the records” of the filing office from another business entity name. This standard replaces a prior widely-used standard of “deceptively similar.” The latter has already been phased out in most states because it required a judgment call by the filing office. The “distinguishable on the record” standard permits names with the slightest of variance to be filed. However, note that the Hub does not recognize the entity-type identifier as a distinguishable variance of a name. Additionally, just because the name was fileable does not protect it against a trademark infringement action. Alternatively, there are provisions for filing identical names upon the consent of the first filed entity. However, there must be a different identifier of the type of entity. Therefore, XYZ Inc. could consent to the filing of XYZ LLC. Generally, these circumstances occur between affiliated entities.

Part 4 deals with registered agents by incorporating the Model Registered Agent Act (MoRAA), which was promulgated before the Hub. Many eyes have reviewed and refined MoRAA. The International Association of Commercial Administrators (IACA) initiated and developed MoRAA. The American Bar Association Business Law Section further refined the act and referred it to ULC. ULC organized the MoRAA Drafting Committee and developed the legislation into its final form, which in turn was integrated into the Hub. It should be noted that MoRAA has been enacted in 12 jurisdictions: Alaska, Colorado, District of Columbia, Hawaii, Idaho, Maine, Michigan, Montana, Nevada, North Dakota, South Dakota and Utah, with variations in Kansas and Wyoming.

The Hub/MoRAA focuses on the required element that all filing-created business entities have in common, namely, the registered agent. Initially, it is important to understand the function of a registered agent. A registered agent is the person or entity designated to receive service of process on behalf of a business entity. Because business entities are treated as separate from the people who own and operate them, there is a need to establish a portal where the entity can be found and served. The Hub/MoRAA requires the business entity to have an agent for service of process. Entities can either self-represent themselves or delegate that duty to someone else, such as a law firm or service company. This is the basis for “commercial registered agents,” that is, persons who represent many other entities as their registered agent. MoRAA creates the recognition and guidelines of the activities of commercial registered agents.

The Hub/MoRAA establishes procedures for handling the registration of commercial registered agents. It prescribes how they can change their name or address; or merge, convert, or cease doing business. These procedures greatly reduce the number of filings and improve the efficiency of the filing process that has occurred due to electronic filing and improved data management.

Notable to litigation attorneys is the substitute service provision if the registered agent cannot be found. The legislation bypasses service of process on the secretary of state and directs the plaintiff to serve by registered or certified mail, an entity’s governor (officer, director, manager, etc.) at the address of the listed principal office in the last annual report. The assumption is that service on the secretary of state (SOS) is unnecessary if the service would be performed the same way anyway. Likewise, service on the SOS would fare no better or worse in a due process challenge to vacate a default judgment. However, some states may want to keep that requirement of service on the SOS for the sake of tradition or legal culture of that state.

Section 5 prescribes the procedures for registration of a foreign entity. In most states, this requirement formerly referred to “qualification to do business” in that jurisdiction. Please note the term “foreign entity” refers to any business formed outside the state. The Hub specifies that the internal affairs of the foreign entity are governed by its formation jurisdiction. Generally, the SOS is the gatekeeper for foreign entities seeking to do business in the state. The Hub requires that all foreign business entities “doing business in the state” must register the entity with the SOS’ office. The difficult question is, “What constitutes doing business in the state?” The Hub in Section 1-505 defers to the long existing language found in corporation and LLC statutes that provide a laundry list of exceptions to the registration requirement. The white paper, *What Constitutes Doing Business* (CT Corporation System/Wolters Kluwer, 2012), explains the exceptions, so there is no need to discuss them here. The state’s attorney general’s office prosecutes injunctive enforcement for the failure to register a business. This replaces prior procedures that include accumulating stiff fines. The failure to register does not impair any contracts, but precludes initiating an action in that state’s court. However, an entity can still defend itself in an action in that jurisdiction.

The Hub establishes a straightforward registration process. It should be noted that if name of the foreign entity is already in use in the state, then the foreign entity can complete its registration, but must use an assumed business name in the state it enters. Trademark law controls name disputes, but the registration process still controls what name is permitted in that state. In that case, the foreign entity cannot use its name in that state. No doubt it would it would challenge the name in a trademark infringement suit, but that would not control the initial registration process.

Section 6 contains the provisions for administrative dissolution of a business entity. The Hub permits the administrative dissolution of an entity for failing to pay annual fees, taxes or licenses, or for failing to file an annual report or maintain a registered agent in the state. The SOS provides notice to the entity of the deficiency, and if not cured within 60 days, is administratively dissolved. Thereafter, the administratively dissolved entity can reinstate by filing for reinstatement and curing the deficiency. This usually means submitting annual reports with unpaid annual fees. Thereafter, it is restored with all the rights and duties as if it had not been dissolved, with the exception as to persons who acted in reliance of the

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dissolution before the person knew of the reinstatement. Note that if another entity registered the dissolved entity's name during the dissolution gap period, the dissolved entity would need to reinstate with a new name. The period permitted for reinstatement varies from state to state. Most states will opt to retain their existing time standards. However, after that period expires, reinstatement may not be possible without judicial relief. This becomes a rude awakening if years after a company is dissolved it wants to transfer property associated with the entity and needs to reinstate the entity for the purpose of making that transfer.

Some people walk away from their entity and effectuate administrative dissolution instead of using the formal dissolution process. However, this could result in problems other than the one described above. It should be noted that one of the latest trends is for people not associated with the dissolved entity to reinstate it and then use it for money laundering or other nefarious purposes. Presumably, only a person authorized by the entity can reinstate the entity. But the filing office has no way of knowing who is or is not authorized to reinstate the entity. This opens the door for someone to hijack the entity through the reinstatement process. While there may be penalties for submitting false documents, the disreputable individual will simply add that to his or her list of crimes. So for those who intentionally or unintentionally let their company become administratively dissolved, there may be a potential need to explain the circumstances to law enforcement.

META

Closely related to the Hub is the Harmonized Model Entity Transaction Act (META). META is the junction box that enables business entities to transform into some other entity through the process of a merger, interest exchange, conversion, or domestication. Without the junction box, the transaction would likely be more difficult, with many extra steps.

During my time at the Montana SOS office I served on the Montana State Bar LLC Drafting Committee. At the time, the newness of LLCs created many uncertainties and potential traps for the unwary. Our committee took the paternal approach to prohibit corporations merging into LLCs because of the potential adverse tax consequences. While the corporate law would permit the merger, the LLC law prohibited it. This sort of baked-in prohibition or incongruity between entity statutes is what META seeks to eliminate. In most states, the statutes regarding META transactions are inconstant, incomplete, and often scattered throughout the state's entity statutes. META cures this problem because it deals comprehensively with same-type and cross-type merger, interest exchange for all types of for profit and nonprofit type entities. This is all placed in one central location.

Part 1 of META provides the definitions and matters potentially related to all transactions specific to the act, such as regulation approval, compliance with anti-takeover laws, protection provisions against diversion of property held for charitable purposes, and member appraisal rights. It also enables carve outs that may be particular to that jurisdiction.

Part 2 contains the roadmap for mergers. Mergers can be unfettered or limited based upon the desires of the business/legal culture of the enacting jurisdiction. The limitations may include only mergers of the same entity type or other limitations thereto. The part lays out the requirements and resulting consequences of a merger. This includes merger filings plan approval, filing statements, consent requirements, and plan abandonment. While META generally permits and prescribes mergers, the organic entity law or organization rules may establish other limitations in the form of supermajority or unanimous consent to a merger.

Part 3 specifies the requirements for interest or share exchanges. This establishes exchange transactions not necessarily recognized in many jurisdictions. The provisions of this part parallel the requirements specified for mergers in Part 2. The part provides one more tool for complex transactions. It permits a triangular merger being collapsed into one transaction.

Part 4 permits internal conversions of business entities from one type into another, either foreign or domestic. While there may be tax implications associated with a conversion of a corporation into a LLC, the process is much easier than forming a target organization and merging into it to create the same result.

Part 5 enables a foreign entity to domesticate into a similar entity in another jurisdiction. Domestication requires the reciprocity authority between the two jurisdictions. This again collapses and simplifies the process of changing the jurisdiction of a business entity. This could come about due to more favorable business treatment or tax reductions in a certain state, or the discovery that the formation state and the state where the business operates should be collapsed into only one state, because the entity is paying taxes or fees in two states and submitting duplicate annual reports. META enables this in a simple filing transaction.

In conclusion, the Hub and META create consistency and streamlined operations for all forms of business entities. These acts approach the ultimate goal to create easily understood, reliable, and predictable instructions regarding the public record and for creating, maintaining, transforming, or terminating business entities. Hopefully, attorneys and the public will not have to call the filing office and seek answers due to confusion in the entity filing laws. Enactment will be beneficial to lawyers, entrepreneurs, and the filing offices.

Garth B. Jacobson, Senior Attorney, Government Relations for CT Corporation, served as an observer/advisor to various Uniform Laws Commission business entity drafting committees. Currently he assists as an "observer" on the Series LLC Drafting Committee and ABA advisor to the Wage Garnishment Drafting Committee. He is a member of the ABA Business Law and the Science and Technology Sections where he serves as Co-chair on both ULC Committee and E-filing Committee and LLC Committee Subcommittee Chair.

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BUSINESS LAW TODAY

Protecting the Deal: Enforcing and Protecting the Owners' Agreement

By Daniel S. Kleinberger

From 2009 through 2013, a drafting committee of Uniform Law Conference (ULC) worked to harmonize nine separate uniform acts dealing with business entities (the "Harmonization Project"). The acts address topics ranging from registered agents to statutory trust entities, but for most practitioners, the three most important acts will be those providing respectively for limited liability companies (ULLCA (2013)), general partnerships (UPA (2013)), and limited partnerships (ULPA (2013)).

Due to the Harmonization Project, most provisions in these three acts now use essentially identical wording. Moreover, each of the acts is designed to "protect the deal" made by the owners through their operating or partnership agreement. The following article explains those deal protection provisions.

* * *

According to the comments to ULLCA (2013), "A limited liability company is as much a creature of contract as of statute," and the same assertion appears in the comments to UPA (2013) and ULPA (2013) – i.e., the harmonized general and limited partnership acts. These three acts comprise the most widely enacted business entity statutes promulgated by the Uniform Law Commission, and each of the three features nine important protections for the deal the owners have made for themselves.

These protections include provisions:

1. Establishing the primacy of the operating or partnership agreement over the default rules established by each act;
2. Providing certainty as to what an operating or partnership agreement may and may not do;
3. Empowering the operating or partnership agreement to fundamentally reshape the fiduciary duties of those who manage the entity;
4. Bringing clarity to the implied contractual covenant of good faith and fair dealing;
5. Accommodating sophisticated deals by authorizing the operating or partnership agreement to control the manner of its amendment, while defining the agreement in a way that reflects business practices in thousands of small enterprises (especially those formed and operating without legal advice);
6. Making those who claim membership automatically subject to the operating or partnership agreement and making the entity itself subject to and able to enforce the agreement;
7. Resolving the tension between the rights of members or partners still participating in the business and the rights of former owners and other transferees of economic rights;
8. Codifying the question of who has standing to enforce the operating or limited partnership agreement; and
9. Protecting the agreed-upon allocation of management authority in LLCs and limited partnerships by authorizing special litigation committees (SLC).

As a result of the Harmonization Project, ULLCA, ULPA, and UPA use essentially identical wording to protect the agreement the members or partners have made for themselves. The harmonization extends even to the numbering of statutory sections. For simplicity's sake, the rest of this article discusses ULLCA. However, except as noted below concerning derivative suits, the points made about ULLCA apply equally to UPA and ULPA.

The Fulcrum of the Act – Sections 105–107

The key to understanding how ULLCA protects the members' agreement is to understand Sections 105, 106, and 107. As the comment to Section 105 explains: "The operating agreement is pivotal to a limited liability company, and Sections 105 through 107 are pivotal to this act. They must be read together, along with Section 102(13) (defining the operating agreement)."

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Of the three sections, Section 105 is the most detailed. Again according to its comment:

> This section performs five essential functions. Subsection (a) establishes the primacy of the operating agreement in establishing relations inter se the limited liability company, its member or members, and any manager. Subsection (b) recognizes this act as comprising mostly default rules – i.e., gap fillers for issues as to which the operating agreement provides no rule. Subsection (c) lists the few mandatory provisions of the act. Subsection (d) lists some provisions frequently found in operating agreements, authorizing some unconditionally and others so long as "not manifestly unreasonable." Subsection (e) delineates in detail both the meaning of "not manifestly unreasonable" and the information relevant to a determining a claim that a provision of an operating agreement is manifestly unreasonable.

As for Sections 106 and 107, Section 106 details the effect of an operating agreement on the limited liability company and on persons becoming members of an LLC. Section 107 concerns the effect of an operating agreement on third parties.

The Primacy of the Operating Agreement

Many LLC statutes sprinkle throughout their respective provisions statements that this or that statutory rule applies "except as otherwise provided by the operating agreement." In contrast, ULLCA provides a general, centralized grant of authority, and, moreover, makes clear that the operating agreement is the first place to look for the rules governing the members and their enterprise. Thus, Section 105(a) states that, subject to limited exceptions: "[T]he operating agreement governs: (1) relations among the members as members and between the members and the limited liability company; (2) the rights and duties under this [act] of a person in the capacity of manager; (3) the activities and affairs of the company and the conduct of those activities and affairs; and (4) the means and conditions for amending the operating agreement." The statutory rules apply only where the agreement has gaps or with regard to selected issues warranting special treatment.

If laws were algorithms and lawyers and judges were computers, ULLCA's "primacy" approach would produce the same outcomes as would a statute that prefaces each of its default rules with "except as otherwise provided in the agreement." But, despite the growing primacy of LLCs over corporations (except in the publicly-traded sphere), law schools still pay scant attention to LLCs. As a result, most judges and lawyers remain schooled only in the world of corporations, where the corporate statute establishes the primary governance rules and agreements among the owners are secondary. In a world in which courts and practitioners still occasionally refer to "limited liability corporations," it is crucial to emphasize that an LLC is a contract-based organization and that analysis of inter se issues must always begin (and often end) with the operating agreement.

Providing Certainty as to the Powers and Limitations of the Operating Agreement

In addition to centralizing the power of the operating agreement, ULLCA also centralizes the few limitations on that power. Section 105(c) lists these limitations – e.g., no power to change requirements for submitting documents to the filing office; no power to "eliminate the contractual obligation of good faith and fair dealing;" no power to entirely eliminate the fiduciary nature of a manager's (or managing member's) duties.

But even as to the stated limitations, ULLCA authorizes various work-arounds "if not manifestly unreasonable." For example, under Section 105(c)(6), the operating agreement "may not . . . eliminate the contractual obligation of good faith and fair dealing," but does have the power to "prescribe the standards, if not manifestly unreasonable, by which the performance of the obligation is to be measured." The comment to Section 105(c)(6) shows how an operating agreement might use that power to clarify a manager's rights in conflict-of-interest situations.

> EXAMPLE: The operating agreement of a manager-managed LLC gives the manager the discretion to cause the LLC to enter into contracts with affiliates of the manager (so-called "Conflict Transactions"). The agreement further provides: "When causing the Company to enter into a Conflict Transaction, the manager complies with [the implied contractual covenant of good faith and fair dealing] if a disinterested person, knowledgeable in the subject matter, states in writing that the terms and conditions of the Conflict Transaction are equivalent to the terms and conditions that would be agreed to by persons at arm's length in comparable circumstances." [In a way that is not manifestly unreasonable, this] provision "prescribe[s] the standards by which the performance of the [good faith] obligation is to be measured."

The inquiry as to whether a particular term is "manifestly unreasonable" is carefully delineated in Section 105(e). As the comment explains, "Subsection (e) is fundamental to this act, because: (i) this act generally defers to the agreement among the members; and (ii) Subsection (e) safeguards the operating agreement in . . . [several] ways." According to the comment, those safeguards include rules for:

- who decides the issue of "manifestly unreasonable"
  - "the court . . . as a matter of law," Subsection (e);
- the framework for determining the issue
  - determination to be made "in light of the purposes, activities, and affairs of the limited liability company," Subsection (e)(2);
- the temporal setting for determining the issue
  - "determination [to be made] as of the time the challenged term became part of the operating agreement," Subsection (e)(1); and
- what information is admissible for deter-

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mining the issue

- "only circumstances existing" when "the challenged term became part of the operating agreement," Subsection (e)(1).

Perhaps most importantly, Subsection (e)(2) sets a very high standard for claimants: "The court . . . may invalidate the term only if, in light of the purposes, activities, and affairs of the limited liability company, *it is readily apparent* that: (A) the objective of the term is unreasonable; or (B) the term is an unreasonable means to achieve the term's objective." (Emphasis added.)

Operating Agreement's Power to Re-Shape Fiduciary Duty

The power of an operating agreement to change the fiduciary duties of managers and managing members has been much debated. For example, the Delaware LLC statute is famous for permitting an operating agreement to eliminate all fiduciary duties. Yet, two of Delaware's leading jurists have recently written: "As judges who have seen our fair share of alternative entity disputes, we do not immediately grasp why ["the elimination of fiduciary duties and the establishment of a purely contractual relationship between entity managers and investors"] would be seen as a compelling advantage." Leo E. Strine, Jr., J. Travis Laster, "The Siren Song of Unlimited Contractual Freedom," *Elgar Handbook on Alternative Entities* (Eds. Mark Lowenstein and Robert Hillman) (forthcoming 2015) available at SSRN: http://ssrn.com/abstract=2481039.

As explained in the comment to Section 105(d)(3), ULLCA "rejects the ultra-contractarian notion that fiduciary duty within a business organization is merely a set of default rules and seeks instead to balance the virtues of 'freedom of contract' against the dangers that inescapably exist when some persons have power over the interests of others." However, Section 105(d)(3) specifically authorizes the operating agreement to reshape, restrict, and even eliminate fiduciary duties:

> If not manifestly unreasonable, the operating agreement may: (A) alter or eliminate the aspects of the duty of loyalty stated in [the act]; (B) identify specific types or categories of activities that do not violate the duty of loyalty; (C) alter the duty of care, but may not authorize conduct involving bad faith, willful or intentional misconduct, or knowing violation of law; and (D) alter or eliminate any other fiduciary duty.

The comment to Section 105(d)(3)(A) provides a useful example:

> EXAMPLE: ABC LLC ("ABC") is a manager-managed limited liability company with three managers and two entirely separate lines of business, the Alpha business and the Beta business. Under ABC's operating agreement:
>
> - Manager 1's responsibilities pertain exclusively to the Alpha business; responsibility for:
> - the Beta business is allocated exclusively to Manager 2; and
> - ABC's overall operations is allocated exclusively to Manager 3.
> - Manager 2's responsibilities pertain exclusively to the Beta business; responsibility for:
> - the Alpha business is allocated exclusively to Manager 1; and
> - ABC's overall operations is allocated exclusively to Manager 3.
> - Manager 1 has no fiduciary duties pertaining to the Beta business.
> - Manager 2 has no fiduciary duties pertaining to the Alpha business.
>
> The "not manifestly unreasonable" standard applies to these provisions under Subsection (d)(3)(A) and (D), and the provisions are not manifestly unreasonable.

Implied Contractual Covenant of Good Faith and Fair Dealing

The implied covenant of good faith and fair dealing can be a useful and bargain-respecting tool for dealing with gaps in contractual language. The covenant can also be a vehicle for "buyer's remorse" and an invitation to judges to rewrite contracts to protect a party from a risk the party agreed to take. Using both the statutory text and official comments, ULLCA takes the first approach.

Section 409(d) refers to "the *contractual* obligation of good faith and fair dealing." (Emphasis added.) As the comment explains, "the adjective ('contractual')" should preclude courts from deciding that the statute creates an obligation separate from "the implied obligation that exists in every contract." Such a separate obligation would be without definition and therefore without limitation.

The comment takes great pains to explain what the implied obligation is and is not. "[T]he purpose of the contractual obligation of good faith and fair dealing is to protect the arrangement the members have chosen for themselves, not to restructure that arrangement under the guise of safeguarding it." Moreover:

> Courts should not use the contractual obligation to change ex post facto the parties' or this act's allocation of risk and power. To the contrary, the obligation should be used only to protect agreed-upon arrangements from conduct that is manifestly beyond what a reasonable person could have contemplated when the arrangements were made. . . . Conduct does not violate the obligation of good faith and fair dealing merely because that conduct substantially prejudices a party. Indeed, parties allocate risk precisely because prejudice may occur.

Amendments – For Both the Sophisticated and the Non-Lawyer

Each year, the overwhelming majority of new LLCs are formed with neither benefit of counsel nor a written operating agreement. For these deals, the conduct and words of the members provide key data for determining the members' actual agreement. At the other end of the spectrum are highly-lawyered deals, with detailed operating agreements reflecting lengthy and careful negotiations. For these deals,

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it is highly disruptive and expensive to allow claims that conduct or statements have changed the written agreement.

ULLCA accommodates both ends of the spectrum. The definition of operating agreement, Section 102(13), is very inclusive: "'Operating agreement' means the agreement, whether or not referred to as an operating agreement and *whether oral, implied, in a record, or in any combination thereof*, of all the members of a limited liability company. . . ." (Emphasis added.) At the same time, ULLCA permits the operating agreement to control its manner amendment (and thereby reduce the definition's inclusivity). Section 105(a)(4) states: "[T]he operating agreement governs . . . the means and conditions for amending the operating agreement." Section 107(a) states: "An operating agreement may specify that its amendment requires the approval of a person that is not a party to the agreement or *the satisfaction of a condition*. An amendment is ineffective if its adoption does not include the required approval or *satisfy the specified condition*." (Emphasis added.) Despite courts' well-known penchant for allowing waiver of "no oral modification provisions," an operating agreement certainly can make a signed writing a condition to amending the agreement.

Clarifying Who is Bound By and Who May Enforce the Operating Agreement

Although LLCs involve contractual relationships, most LLC operating agreements are not typical contracts. In addition to the oxymoron of an agreement of "a sole member," special issues arise as to: (1) whether an LLC is subject to and can enforce the operating agreement; (2) how to address claims that a person has become a member without having acquiesced to the operating agreement; and (3) whether transferees of economic rights can acquire the same protectable interest as can traditional contract assignees.

ULLCA resolves each of these issues. "A limited liability company is bound by and may enforce the operating agreement, whether or not the company has itself manifested assent to the operating agreement. A person that becomes a member is deemed to assent to the operating agreement." ULLCA § 106(a) & (b).

As for the rights of transferees of economic interests, the comment to ULLCA 107(b) is instructive:

> The law of unincorporated business organizations is only beginning to grapple in a modern way with the tension between the rights of an organization's owners to carry on their activities as they see fit (or have agreed) and the rights of transferees of the organization's economic interests. Such transferees can include the heirs of business founders as well as former owners who are "locked in" as transferees of their own interests. If the law categorically favors the owners, there is a serious risk of expropriation and other abuse. On the other hand, if the law grants former owners and other transferees the right to seek judicial protection, that specter can "freeze the deal" as of the moment an owner leaves the enterprise or a third party obtains an economic interest.

ULLCA follows the case law and favors the rights of members continuing the business over rights of transferees of economic rights. Subject to limited exceptions, Section 107(b)(1) provides that "an amendment to the operating agreement made after a person becomes a transferee or is dissociated as a member is effective with regard to any debt, obligation, or other liability of the limited liability company or its members to the person in the person's capacity as a transferee or person dissociated as a member." As the comment notes: "The question of whether, in extreme and sufficiently harsh circumstances, transferees might be able to claim some type of duty or obligation to protect against expropriation awaits development in the case law."

Protecting the Deal by Delineating Standing

An operating agreement is both a contract among the members and the LLC's foundational governance document. The latter characteristic differentiates the operating agreement from typical contracts and requires special attention to the question of who has standing to enforce the agreement.

ULLCA is the only LLC statute which provides that attention. Section 901(b) states: "A member maintaining a direct action under this section must 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." The comment notes: "This subsection codifies the rule of standing that predominates in entity law." The comment then explains: "The distinction between direct and derivative claims protects the operating agreement. If any member can sue directly over any management issue, the mere threat of suit can interfere with the members' agreed-upon arrangements." (ULPA contains a comparable provision, but UPA does not. Although a general partnership is an entity separate from its partners, the drafters of UPA (1997) decided not to provide for derivative claims and the Harmonization Project did not revisit that decision.)

Special Litigation Committees and Deal Protection

ULLCA expressly authorizes an LLC to appoint a special litigation committee. The comment to Section 901(a) explains:

> Although special litigation committees are best known in the corporate field, they are no more inherently corporate than derivative litigation or the notion that an organization is a person distinct from its owners. An "SLC" can serve as an ADR mechanism, *help protect an agreed upon arrangement from strike suits*, protect the interests of members who are neither plaintiffs nor defendants (if any), and bring the benefits of a specially tailored business judgment to any judicial decision.
>
> (Emphasis added.)

Conclusion: Maximum Effect for the Contract of the Members

Some LLC statutes express a general policy of giving "maximum effect to free-

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dom of contract." ULLCA eschews that pronouncement as ambiguous and unnecessary, but – as outlined above – ULLCA is constructed to give maximum effect to the contract the members have made for themselves.

Daniel S. Kleinberger was a co-reporter for the Uniform Law Commission's Harmonization Project and was the principal drafter of the new comments to the Uniform Partnership Act, the Uniform Limited Partnership Act, and the Uniform Limited Liability Company Act. He serves regularly as an expert witness, consulting expert, arbitrator, and special consensual magistrate. This article reflects Professor Kleinberger's opinions as an individual and does not state the views of the Uniform Law Commission.

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BUSINESS LAW TODAY

A Uniform Unincorporated Business: Understanding the Rights of an Owner's Personal Creditors

By Carter G. Bishop

A creditor seeking to enforce state law collection remedies against an owner of an unincorporated business owner faces a unique difficulty unknown in the corporate world: statutory restrictions on the transfer of an ownership interest. Unlike corporate stock that bundles management and economic rights in a transferable stock ownership interest, an ownership interest in an unincorporated business entity uniquely unbundles these two fundamentals for the purpose of imposing two different transfer rules: only economic rights are freely transferable, while management rights may only be transferred with the consent of the remaining owners. Understanding this dynamic is critical, because both the corporate and unincorporated rules are merely default rules. A shareholder agreement can make stock nontransferable or subject a transfer to a right of first refusal. Similarly, a partnership or operating agreement of an unincorporated entity can make the management rights freely transferrable or preclude transfer of the economic rights or subject a transfer to a right of first refusal.

Because of these dramatically different transfer paradigms, the collection remedies of an owner's personal creditors are uniquely tailored to respect the statutory transfer restriction imposed on unincorporated entity management rights. As a direct result, the exclusive collection remedy is a combination of a court imposed charging order lien that may be foreclosed if the lien is not satisfied with a reasonable time. A creditor can never, in either case, obtain the management rights without the consent of the remaining owners. When an owner enters bankruptcy however, the rules change because federal bankruptcy law preempts state entity law and state law agreements. But a creditor of a corporate shareholder can usually obtain the bundled management rights both in and outside bankruptcy. This singular and historic transfer paradigm thus creates unique challenges for creditors of an owner, which this article explores and illustrates.

Prelude

In 2013, the Uniform Law Commission completed an effort to harmonize the language in various unincorporated business entity laws. This article explores the rights of an owner's creditors in the context of three specific acts including the Uniform Partnership Act (1997) (last amended 2013) (UPA (2013)), the Uniform Limited Partnership Act (2001) (last amended 2013) (ULPA (2013)), and the Uniform Limited Liability Company Act (2006) (last amended 2013) (ULLCA (2013)). More specifically, this article explores the impact of the harmonized language in these acts with respect to (1) a charging order against an owner and foreclosure of the charging order lien, (2) fraudulent conveyances and entity clawback of illegal distributions, and (3) the effect on the entity of the bankruptcy of an owner.

Charging Orders and Foreclosure

The English Partnership Act (1895) provided that a judgment creditor of a partner was entitled to a charging order directing the partnership to pay the partner's distributions directly to the judgment creditor. The charging order was a unique collection remedy specifically designed to preclude a partner's personal creditors from gaining any access to the partnerships assets to satisfy the personal debts of a partner. *Brown, Janson & Co. v. A. Hutchinson & Co.*, 1895 Q.B. 737 (Eng. C.A.). Early American partnership law adopted the same approach and obliquely provided that the judgment creditor could foreclose its charging order lien if not satisfied within a reasonable time. UPA (1914) § 28. However, the pur-

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chaser at a foreclosure sale never acquired the partner's management rights but rather only the partner's economic interest. Then existing statutory language made this perfectly clear as the purchase of the interest, whether by assignment or conveyance, did not "entitle the assignee, during the continuance of the partnership, to interfere in the management or administration of the partnership business or affairs, or to require any information or account of partnership transactions, or to inspect the partnership books; but it merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled." UPA (1914) § 27(1).

So, from the earliest annals of American partnership law, a partner's personal creditors could not acquire a partner's management rights without the consent of the remaining partners. Over time, this "pick-your-partner" principle became the central hallmark feature of American unincorporated business entity law. The harmonized unincorporated acts now make clear that a judgment creditor with a charging order holds a lien only entitling the creditor to receive distributions that would otherwise be paid to the partner or limited liability company (LLC) member. UPA (2013) § 504(a), ULPA (2013) § 703(a), and ULLCA (2013) § 503(a). Moreover, the harmonized acts make clear that the purchaser at a foreclosure sale obtains only the ownership of economic rights and does not become a partner or member and thus does not acquire any management rights. UPA (2013) § 504(c), ULPA (2013) § 703(c), and ULLCA (2013) § 503(c).

The right to foreclose is not a uniform statutory rule as many states expressly preclude foreclosure. C. Bishop, "Fifty State Series: LLC Charging Order Statute Table," http://ssrn.com/abstract=1542244. This lack of uniformity creates "conflict of laws" problems among the states. For example, which state law applies when a person resident in State A (foreclosure permitted) is a member of an LLC formed in State B (foreclosure precluded)? Which state law applies when a judgment creditor seeks collection remedies in State A (since the LLC interest usually travels with the owner)? Two views have developed and both must be considered "under development" as none are opinions issued by the highest state court. One view, based on the definitions of domestic and foreign LLCs, suggests that the State A charging order limitations only apply to a domestic LLC and since the debtor is a member of a foreign LLC, the local rules and limitations are not available. This view applies the law of the foreign jurisdiction (State B). *See Hanna v. Baier*, No. 20-C-12-007903 (Md. Cir. Ct. Jan. 30, 2013) and *Fannie Mae v. Heather Apartments Ltd. Partnership*, Not Reported in N.W.2d, 2013 WL 6223564 (Minn. Ct. App., Dec. 2, 2013) (No. A13-0562). The other view applies local State A LLC law under a conflicts analysis suggesting that foreclosure is an important legislative policy directive and so the local State A will not defer to the foreign State B jurisdiction law. *Wells Fargo Bank, N.A. v. Barber*, 2015 WL 470589 (M.D. Fla. 2015). The issue must await resolution from a state supreme court and then see if other state supreme courts agree. *See e.g., Advanced Bionics Corp. v. Medtronic, Inc.*, 59 P.3d 231 (Cal. 2002).

Thus, under no ordinary circumstances may a judgment creditor acquire a judgment debtor partner or member's management rights without the consent of the remaining partners or members. One quite special circumstance remained elusive and was judicially explored in a famous Florida case that permitted a judgment creditor of the only member of a single member LLC (SMLLC) to access all the assets of the LLC itself. *Olmstead v. Federal Trade Commission*, 44 So. 3d 76 (Fla. 2010). The case triggered a flurry of statutory amendments across the country with some states expressly following the *Olmstead* result and some not. C. Bishop, "Fifty State Series: LLC Charging Order Statute Table," http://ssrn.com/abstract=1542244. After extensive discussion, the harmonized uniform laws followed the *Olmstead* result by granting the judgment creditor of the only member of a SMLLC a right to acquire the member's entire interest, including management rights. ULLCA (2013) § 503(f). This grants the judgment creditor total power over the entity and its assets so the creditor can acquire the assets and sell or sell the entire entity intact with goodwill by selling the sole member's interest acquired by foreclosure. States adopting a contrary rule usually do so preferring the use of a SMLLC as an asset protection device. If the judgment creditor can only acquire the sole member's economic right upon foreclosure, the sole member retain management control over the entity and will usually simply make no distributions, thereby frustrating the foreclosing creditor or forcing the creditor to resell the interest to the member at a discount. However, notwithstanding these statutes, a frustrated judgment creditor may nevertheless seek an equitable remedy in the form of a "reverse piercing" of the liability shield to impose the sole owner's debt on the entity itself. *See generally* C. Bishop, "Reverse Piercing: A Single Member LLC Paradox," 54 *S.D. L. Rev.* 199 (2009) (cited by the Olmstead dissent).

The original American partnership laws permitted a court issuing a charging order to further "then or later appoint a receiver of his share of the profits, and of any other money due or to fall due to him in respect of the partnership, and all other orders, directions, accounts and inquiries which the debtor partner might have made, or which the circumstances of the case may require." UPA (1914) § 28(1). The power of a court to appoint a receiver or issue "other orders" as circumstances may require has largely been retained in the harmonized acts. UPA (2013) § 504(b), ULPA (2013) § 703(b), and ULLCA (2013) § 503(b). While these provisions may create concern that the accompanying orders may open up the charging order process to serious creditor abuse and interference in the internal affairs of the business, case law has generally not supported this conclusion. In general, courts have concluded that under these provisions a judgment creditor is not entitled to any more information than an actual purchaser of economic rights. *See Wells Fargo Bank, NA v. Continuous Control Solutions, Inc.*,

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821 N.W.2d 777 (Iowa Ct. App 2012) and C. Bishop, "Fifty State Series: LLC Charging Order Case Table," http://ssrn.com/abstract=1565595.

Fraudulent Transfers and Illegal Distributions

Distributions to owners when an entity is insolvent may unfairly reduce assets otherwise available to pay entity creditors. Entity creditors blocked by an entity's liability shield protecting owners from entity liabilities must have some method to clawback improper distributions to the entity so that its debts may be fairly paid. While large entity creditors may seek contractual protections by precluding distributions in loan documents, unless all the entity owners guarantee the loan, the covenant merely creates entity liability when it is breached. The creditors remain blocked by the entity's liability shield protecting owners from status liability for entity debts. Of course, there is no need for these protections when owners are liable for entity debts by operation of law. For example, general partners in a general partnership that is not a limited liability partnership (LLP) are already liable for all partnership obligations. UPA (2013) § 306(a). There is no point for a separate provision creating liability for improper distributions to protect partnership creditors since the partners are liable for the entire partnership debt.

However, once a general partnership becomes an LLP, partners are immune from personal liability for entity liabilities. UPA (2013) § 306(c). Consequently, a clawback provision for improper distributions is necessary to protect entity creditors. The harmonized partnership act makes this clear by harmonizing the LLP clawback provisions with the other acts. UPA (2013) §§ 406–407, ULPA (2013) §§ 504–505, and ULLCA (2013) §§ 405–406.

This is a vast improvement over states that still follow the original 1914 Uniform Partnership Act, subsequently amended that law to add provisions allowing a general partnership to become an LLP, but failed to include a distribution clawback provision. In these circumstances, the more general fraudulent transfer or conveyances acts will apply. For example, an important New York case determined that distributions to partners when the firm was arguably insolvent allowed the partnership trustee in bankruptcy to recapture nearly all partner payments since partnership law provided that partners were not entitled to payments for services rendered. *In re Dewey & LeBoeuf, LLP*, 518 B.R. 766 (Bankr. S.D. NY 2014) and UPA (1914) § 18(f). The court applied the bankruptcy insolvency provision that allows a trustee to avoid a constructively fraudulent transfer because New York partnership law negated a reasonable equivalent value defense. 11 U.S.C. § 548(a)(1)(B). Arguably, the harmonized partnership act fixes the statutory problem. Like the original 1914 act, the 2013 harmonized act provides that a partner is not entitled to remuneration for services as a default rule. *Compare* UPA (1914) § 18(f) with UPA (2013) § 401(j). However, unlike the 1914 act, the 2013 act defines the term "distribution" to exclude amounts constituting reasonable compensation for present or past services. UPA (2103) § 102(4)(B). As a result, the outcome of *In re Dewey & LeBoeuf* would not be the same and the trustee could not clawback partner distributions.

The harmonized laws universally include provisions expressly governing distributions to owners when a shielded entity is insolvent. UPA (2013) §§ 406-407, ULPA (2013) §§ 504–505, and ULLCA (2013) §§ 405–406. Since distribution liability is specifically addressed in the statute, presumably the common law "fraudulent" transfer rules do not apply. See Uniform Voidable Transactions Act (2014).

The drafting paradigm separates the definition of an improper distribution from liability for a distribution that is defined as improper. For example, an LLC distribution is "improper" if after the distribution the LLC would not be able to pay debts due in the ordinary course or LLC assets are less than the sum of liabilities if the LLC liquidates. ULLCA (2013) § 405(a)(1)–(2). There are rules for what information the LLC may rely upon as well as when the effect of the distribution is measured. ULLCA (2013) § 405(b)–(c). Once a distribution is "improper" under these standards, liability attaches to those who decided to make the distribution as well as those who received it. Any member with management authority who consented to an improper distribution in violation of standards of conduct, is personally liable for an amount by which the improper distribution exceeds the proper distribution amount. ULLCA (2013) § 406(a). However, a person who merely receives such a distribution is liable for the same excess only if that person knew the distribution was improper. ULLCA (2013) § 406(c). Any person who is liable may seek contribution from other persons also liable. ULLCA (2013) § 406(d). Any action seeking liability must be commenced within two years after the distribution. ULLCA (2013) § 406(e).

Bankruptcy of Managing Owners

The bankruptcy of an entity owner may be problematic for the entity itself and the remaining owners. In general, statutory and entity agreement provisions triggered by bankruptcy are invalid ipso facto clauses and hence cannot preclude the bankrupt debtor's entity ownership from becoming part of the bankruptcy estate. 11 U.S.C. § 541(c)(1)(B). Indeed, bankruptcy law trumps and preempts all inconsistent state law under the Supremacy Clause. U.S. Const. art. VI, cl. 2. Once the debtor's interest becomes part of the bankruptcy estate, the lingering concern is whether the bankruptcy trustee will step into the debtor's shoes so that the estate owns not only the debtor's economic rights, but also whether the trustee has the right to exercise the debtor's management rights. If so, this is highly problematic for both the entity and its remaining members. Unlike the remaining members, the trustee's sole interest is to realize the full economic value of the ownership interest either through a sale of the interest or voting to liquidate the entity to sell its assets. As the discussion below indicates, the outcome of the trustee's goals depends upon a difficult interpretation of a few complex bankruptcy statutes that di-

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rectly conflict with state law that attempts to maintain management rights under the exclusive control of the now bankrupt member. Specifically, since the trustee may usually sell to a third party only what the debtor could sell, the trustee may not transfer the debtor's management rights to a third party without the consent of the remaining members. 11 U.S.C. § 363(f)(1) (respecting applicable non-bankruptcy law). This returns the principal focus and question as to whether the trustee may assume the debtor's management rights in order to vote the interest in the best interest of the estate. This extraordinarily complex question depends on whether the partnership or operating agreement is considered an "executory contract" and, if so, whether the debtor's duties are in the nature of unique personal services thereby precluding the trustee from assuming these duties to impose the trustee's services on those who bargained for the debtor. 11 U.S.C. § 365(c).

The first issue is whether any statutory or contractual provision can preclude an unincorporated entity ownership interest from becoming part of the bankruptcy estate, including both the debtor's economic rights as well as the management rights. The answer is no, but perhaps oddly, the result does not preclude efforts to make certain the debtor's management rights do not enter the estate. For example, all harmonized acts "dissociate" a member with management rights upon filing bankruptcy. UPA (2013) § 601(6)(A), ULPA (2013) § 603(7)(A), and ULLCA (2013) § 602(8)(A). The effect of dissociation terminates am owner's management rights. UPA (2013) § 603(b), ULPA (2013) § 605(a), and ULLCA (2013) § 603(a). So, it is clear that state law attempts to terminate a debtor's management rights and thereby devalue the interest to the estate. However, bankruptcy law provides that when a person becomes a debtor in bankruptcy the estate includes "all" the debtor's legal or equitable property interests. 11 U.S.C. § 541(a)(1). Further, bankruptcy law invalidates state law provisions triggered by a bankruptcy filing. 11 U.S.C. § 541(c)(1)(B). So, under the Supremacy Clause, these state law provisions are all unenforceable in bankruptcy. Moreover, these "applicable nonbankruptcy law" provisions are not enforceable because they operate as a forfeiture, modification, or termination of the debtor's interest in property. 11 U.S.C. § 541(c)(1)(B). Case law supports the understanding that stripping management rights is a forfeiture, modification, or termination. *See, e.g., In re Warner*, 480 BR 641, 656 (Bankr. N.D. WV 2012).

Once it becomes clear the entire unincorporated entity ownership, both economic and management rights, become part of the bankruptcy estate by operation of law (not by way of a transfer), the focus turns to the use of the management rights by the trustee. Obviously, the intent of unincorporated entity law is to require the consent of all remaining members for any person other than the owner to exercise that owner's management rights.

The first step in the analysis requires a determination of whether the applicable partnership or operating agreement is an "executory contract." If executory, the trustee may "assume or reject" the agreement. 11 U.S.C. § 365(a). If assumed, the estate becomes a party to the agreement. While the estate is entitled to the benefits of the contract, if it later rejects or otherwise breaches the obligations, the injured parties breach claim is elevated to an administrative expense priority. 11 U.S.C. §§ 503(b), 507(a)(2) and *In re Klein Sleep Prods., Inc.*, 78 F.3d 18 (2nd Cir. 1996). However, if rejected the breach claim is relegated to a low-level priority pre-petition unsecured claim for damages. 11 U.S.C. § 365(g)(1). However, if the agreement is not executory, the trustee may not reject it, and the contract by operation of law becomes property of the estate. 11 U.S.C. § 541(a), *In re Excide Technologies*, 607 F.3d 957 (3rd Cir. 2012). However, a trustee may simply abandon the agreement if no net value exists. 11 U.S.C. § 544(a).

Given the ongoing nature of every unincorporated entity, one would think this analysis routine and that the agreement would always have the requisite degree of unperformed duties making it executory by nature. The primary touchstone of executory analysis is the Countryman test stating that a "contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." V. Countryman, "Executory Contracts in Bankruptcy," 57 *Minn. L. Rev.* 439, 460 (1973) (material breach standard). But case law has not always followed such a simplistic analysis. For example, one recent case determined an LLC operating agreement was not executory per se because a breach by the debtor did not discharge the obligations of the other members under the material breach standard. *In re Denman*, 513 B.R. 720 (Bankr. W.D. Tenn 2014). While most cases reject a per se analysis, several still reject executory characterization. Compare *In re Tsiaoushis*, 383 B.R. 616, 620 (Bankr. E.D. Va. 2007) (per se rule rejected) with *In re Allentown Ambassadors, Inc.*, 361 B.R. 422 (Bankr. E.D. Pa. 2007) (executory status determined under a factor analysis).

The executory characterization is quite important because bankruptcy law carefully constructs limitations on a trustee assuming a debtor's position in an executory contract that requires the debtor to render personal services. Specifically, a trustee may not assume or assign a debtor's position in an executory agreement if "applicable law" excuses another party from accepting performance from any person other than the debtor without the other party's consent. Without the consent of the remaining owners, an owner may only transfer the economic rights and not the right to participate in management. UPA (2013) § 503(a), ULPA (2013) § 702(a), and ULLCA (2013) § 502(a). So, if a partnership agreement or operating agreement is an "executory contract," state law transfer restrictions are protected. The trustee cannot assume and assign. 11 U.S.C. § 365(c)(1)(A).

Finally, the bankruptcy of the only member of a SMLLC presents special issues in bankruptcy law just as discussed earlier when a judgment creditor seeks a charging order-foreclosure action against the only

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member. In both cases, the "pick-your-partner" principle is not in play because there are no other members to object to the trustee exercising dominion and control of the entity. As with a multi-member entity, the bankruptcy estate of the only member of a SMLLC will be included in the bankruptcy estate, both economic and management rights. 11 U.S.C § 541(a).

So, unless constrained by executory contract limitations imposed by state law, the trustee may exercise the debtor's full membership rights. This would include the right to liquidate the LLC and sell its assets for the benefit of the estate. Some case law exists determining that an operating agreement is per se not an executory contract because there is only one party to the agreement. *In re First Protection, Inc.*, 440 B.R. 821 (9th Cir. BAP Ariz. 2010).

But some early decisions bypass the executory contract analysis because there is only one member and the absence of other members leaves the pick-your-partner rule intact. *In re Albright*, 291 B.R. 538 (Bankr. D. Col. 2003). As a consequence, the trustee was able to liquidate the SMLLC and gain access to the entity assets.

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BUSINESS LAW TODAY

Pre-Filing Advice for Individual Chapter 11 Debtors: Practical Tips and Pitfalls

By Jeffrey C. Toole

Representing an individual debtor in a Chapter 11 case presents unique problems and challenges for the practitioner and for the debtor. Informing the client of these considerations before filing the case is imperative so that the client can make an informed judgment about whether Chapter 11 is worth the risks. Putting that advice in writing is one way to ensure that the client understands the issues. Some of the considerations may be set forth in the engagement agreement. Others, however, may belong instead in a side-letter. If the individual debtor is not satisfied with how the case ends, that side-letter may be the only thing standing between the practitioner and a malpractice claim, especially if the client does not recall the verbal advice the practitioner gave months before.

But why use a side-letter, instead of just describing the potential problems and land mines in the engagement agreement? One reason is that the rules for engagement of attorneys in Chapter 11 cases are different from the rules in Chapter 7 and 13 cases. Unlike in Chapters 7 or 13, a debtor in Chapter 11 may retain professionals only with court approval – even if the debtor is an individual. An application to retain counsel must set forth the engagement's terms and satisfy other disclosure obligations that the bankruptcy law and rules impose. In many jurisdictions, the debtor is expected to attach a copy of the engagement agreement as an exhibit to the retention application. In those jurisdictions, publicly disclosing confidential advice or risk assessments in the engagement agreement could vitiate the attorney-client privilege and give creditors a leg-up at the negotiating table. A side-letter may minimize such concerns.

While negotiating the engagement arrangements and preparing the side-letter, a practitioner must identify and evaluate the legal issues that the particular individual debtor may face in the Chapter 11 case. Those issues may include: the nature of the debtor's fiduciary duties; what may happen if a trustee is appointed to oversee the bankruptcy estate; what the debtor can and cannot do without first obtaining court approval; potential limitations on what the practitioner can do or advise; and how the practitioner will be paid.

Identifying the "Client"

Initiating a bankruptcy case creates an estate that includes a debtor's legal and equitable interests in most types of property. The vast majority of courts have held that a debtor's attorney in a business bankruptcy case represents the estate*,* rather than the business's individual principals or decision-makers. Practitioners sometimes do not realize, though, that the same is true if the Chapter 11 debtor is an individual. The attorney represents the individual debtor's bankruptcy *estate,* not the individual personally. Drawing a distinction between the individual and that individual's estate seems nonsensical to a lay person. (As noted below, it also creates a tension for practitioners between fulfilling their own duties to the estate and zealously representing their individual clients.) Nonetheless, the individual must understand what the distinction means. A side-letter may give the practitioner an opportunity to explain this.

The explanation should address at least two points: First, advising the individual debtor of his or her fiduciary duty to creditors; second, articulating the estate attorney's duties to the client and estate in the Chapter 11 case. An individual Chapter 11 debtor owes a fiduciary duty to his or her creditors to act in the estate's best interests. In general, this means the individual debtor must put creditors' interests ahead of the debtor's personal interests, and must work to benefit the estate even if this may disadvantage the debtor personally. Fulfilling these fiduciary duties can raise issues on which courts disagree or have not spoken and that may place the attorney in an awkward position.

For example, can an individual Chapter 11 debtor claim and defend exemptions for his or her property, given that doing so would make those assets unavailable

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to pay creditors' claims? Conversely, does the individual Chapter 11 debtor have a fiduciary duty to relinquish his or her own exemptions in order to maximize creditors' recoveries? The duty to benefit the estate also may require individual debtors to pursue actions to set aside preferential transfers, even if this may increase the debtor's exposure on guarantied debts.

An individual debtor's attorney must advise the prospective client of these obligations, but at the same time is constrained from advising the individual how to improve his or her financial position at the expense of the estate and creditors. In a prefiling side-letter, the practitioner can alert the client to these and other issues and the limitations they may impose on the practitioner's advice.

In the side-letter, the practitioner also can explain the possible adverse consequences that may occur if a Chapter 11 debtor does not fulfill these fiduciary duties. For instance, the debtor may be sanctioned. The debtor's case might be dismissed. If permissible, the case might be converted to a Chapter 7 liquidation, in which a trustee would be appointed to marshal the debtor's non-exempt assets, sell or otherwise liquidate them, and distribute the proceeds to pay expenses of administration and creditors' claims. Potentially, a trustee might even be appointed in the Chapter 11 case itself, wresting control of the estate from the individual debtor and seeking the maximum return for creditors. It may be prudent for the practitioner to include admonitions about these points in the side-letter.

Attorney-Client Privilege Issues

If a trustee displaces the individual as the manager of the debtor's estate, the debtor may face another risk – the trustee may be able to learn what the debtor and the debtor's counsel have discussed during the representation. This means the trustee might find out what the practitioner advised the debtor before or during the case, whether verbally or in any side-letter. In some situations, the trustee may be able to use that information to challenge actions the individual debtor took before or during the bankruptcy case.

In business bankruptcy cases, who holds the attorney-client privilege basically is settled. In *Commodity Futures Trading Corporation v. Weintraub*, 471 U.S. 343 (1985), the Supreme Court held that in a corporation's Chapter 7 bankruptcy case the attorney-client privilege belongs to the trustee, and that the trustee can waive the privilege notwithstanding the objections of the debtor's pre-bankruptcy management. But the Court declined to extend its holding to individual debtors' bankruptcy cases:

> [R]espondents maintain that the result we reach today would also apply to *individuals* in bankruptcy, a result that respondents find 'unpalatable.' . . . But our holding today has no bearing on the problem of individual bankruptcy, which we have no reason to address in this case. As we have stated, a corporation, as an inanimate entity, must act through agents. . . . When the corporation is solvent, the agent that controls the corporate attorney-client privilege is the corporation's management. Under our holding today, the power passes to a trustee because the trustee's functions are more closely analogous to those of management outside of bankruptcy than are the functions of the debtor's directors. An individual, in contrast, can act for himself; there is no 'management' that controls a solvent individual's attorney-client privilege. If control over the privilege passes to a trustee, it must be under some theory different from the one we embrace in this case.

(Italics in original; citations omitted).

In the absence of controlling Supreme Court precedent on this question for individual debtors, how the practitioner explains to the prospective client that the attorney-client privilege might be waived likely will depend upon which view the courts in the applicable jurisdiction follow.

At least three viewpoints exist regarding whether an individual Chapter 11 debtor "owns" or controls the attorney-client privilege and, therefore, whether a trustee succeeding to the debtor's bankruptcy estate can waive the privilege and require the individual debtor's attorney to disclose communications with the debtor or other confidential information gained during the representation. Some courts believe that the attorney-client privilege passes to the estate. Under this view, the debtor is expected to exercise the attorney-client privilege to fulfill the debtor's fiduciary duty to creditors. That may include having to waive the privilege if doing so is necessary to benefit the estate. Likewise, under this view a trustee succeeding to an individual debtor's bankruptcy estate may be able to waive the attorney-client privilege.

Under the second view, some courts have concluded that the attorney-client privilege belongs to the individual debtor, both before and during the Chapter 11 case, and that, therefore, a trustee appointed in an individual's case cannot waive that privilege. Courts applying this approach have concluded that the attorney-client privilege should not pass to the estate or to an individual debtor's trustee due to the enhanced privacy concerns that exist when an individual holds the privilege.

Still other courts take an intermediate approach, weighing the particular circumstances of the case. Such courts may balance the policies underlying the privilege and the potential harm that disclosure may cause to the individual debtor against a bankruptcy trustee's duty to maximize the value of the estate. Courts following this intermediate view generally conclude that an individual debtor does not retain an attorney-client privilege for *post*-petition communications with the estate's attorney, because the estate's attorney ordinarily cannot give an individual debtor legal advice (in the debtor's capacity as an individual) while acting as the estate's attorney. Nonetheless, courts adhering to this approach also typically conclude that the privilege applies to *pre*-bankruptcy communications between the individual debtor and the debtor's attorney.

Accordingly, in the side-letter practitioners should advise individual debtors carefully about who the practitioner will represent in the Chapter 11 case (typically, the

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bankruptcy estate) and the effect this may have upon the attorney-client privilege. They also should caution individual debtors about the risk that a trustee who succeeds to the bankruptcy estate may be able to waive the privilege and learn what the individual debtor and the estate's attorney discussed.

Ordinary Course Expenses: What Can a Debtor Pay?

The side-letter also should explain what types of actions an individual Chapter 11 debtor can and cannot undertake without first seeking court approval. The list of acts requiring judicial blessing may surprise the client.

An individual debtor's responsibility to seek judicial pre-approval of various actions arises primarily from two factors: First, because of the principle that most property that an individual Chapter 11 debtor owns or acquires during the bankruptcy is property of the estate; second, because of the rule that a debtor, absent court permission, may pay only "ordinary course of business" expenses from property of the estate.

As in Chapter 12 and 13 cases, property of an individual debtor's Chapter 11 estate encompasses three categories: First, all legal and equitable interests in property that existed on the petition date, with certain exceptions (e.g., exempt property); second, most property the debtor acquires during the case; and third, the individual debtor's earnings from services performed between the commencement and closing of the case.

The estate's breadth can create problems for an individual in Chapter 11. One such problem concerns the debtor's living expenses. A Chapter 11 debtor can pay only "ordinary course of business" expenses from wages and other property of the estate under Sections 363(c)(1) and 1108 of the Bankruptcy Code without court approval. If the expenses do not qualify as "ordinary course," the debtor may need to seek court permission first under Section 363(b)(1). Some courts have recognized living expenses as "ordinary course" because, without paying them, the debtor cannot remain gainfully employed and continue to generate post-petition wages to enhance the estate.

But even under this permissive view other questions can emerge, such as which expenses courts will consider to be "ordinary." For example, can an individual debtor pay an emancipated child's wedding expenses, or pay a grandchild's college tuition bill, cover a spouse's automobile lease payments, or pay mortgage debt on a vacation home? Are charitable donations, tithing, or contributions into a 401k, IRA, or other retirement plan "ordinary course" expenses? Even if a court in one instance answers "yes" to these and other, similar questions, doubt may linger in other instances.

Unless these issues are settled in the applicable jurisdiction, the practitioner's side-letter should set forth these concerns. The side-letter also may propose solutions. One potential solution is to have the client prepare a detailed budget at the outset of the case that sets forth all expenses he or she proposes to pay from estate income, and then request the court's approval to pay those expenses. In some judicial districts, local rules or standing orders require an individual Chapter 11 debtor to do this. Seeking early judicial approval minimizes the risk that creditors later might challenge a given disbursement as being impermissible or unreasonable.

Aside from warning an individual Chapter 11 debtor about paying expenses outside the "ordinary course," the practitioner's side-letter also should alert the debtor about other activities that may not be "ordinary course" and that, therefore, may require prior court approval. Examples include conveying or selling estate property, granting liens on estate property, loaning money to the debtor's business, entering into transactions with family members or other "insiders," or incurring substantial debt. Depending upon the particular debtor's situation, a new car loan or car lease, a new credit card or line of credit, refinancing a mortgage loan, or guarantying repayment of a child's college loans, to name just a few, might be actions outside the ordinary course that require the court's imprimatur. A practitioner presumably cannot anticipate every possible contingency, so the side-letter might explain that any such list is not exhaustive and advise the debtor that, if in doubt about undertaking a particular act, the debtor should ask the practitioner beforehand.

Attorney Compensation

The engagement agreement and application to retain the debtor's attorney typically must recite the attorney's anticipated services and compensation arrangements, but that does not necessarily mean that the estate can or will pay the attorney for all work performed. A Chapter 11 debtor ordinarily can pay the attorney from post-petition wages or other estate income for services that benefit the estate, upon application to and approval of the court and after notice and opportunity for hearing. The same may not be true for services the practitioner renders on the debtor's *personal* issues that do not also benefit the estate. Section 330(a)(4)(B) of the Bankruptcy Code expressly authorizes an individual debtor to pay counsel from property of the estate for personal services rendered during Chapter 12 and 13 cases. But it does not mention payment for such services in a Chapter 11 case. Consequently, unless the services benefit the estate too, an individual in Chapter 11 potentially cannot pay counsel to handle criminal, domestic relations, discharge, exemption, tax, or other personal matters. To the extent a practitioner anticipates performing "personal services" for which the estate may not be permitted to pay, the practitioner might consider obtaining a prebankruptcy retainer for such work. This arrangement should be addressed in the engagement agreement and disclosed to the court in the retention application.

But, even in that situation, the individual debtor and the practitioner may not be out of the woods. Section 329 provides that an attorney representing a debtor in connection with the case must file a statement of the compensation paid (or agreed to be paid) within the year preceding the filing for services rendered (or to be rendered) in con-

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templation of or in connection with the case, as well as the source of that compensation. If that compensation exceeds the "reasonable value of any such services," the court may cancel the agreement or order the return of any excessive amount to the estate, if applicable, or to the entity that paid that amount. Accordingly, before commencing the case the practitioner and prospective debtor client should think through what "personal service" work the debtor may need, check the prevailing case law in the circuit or district, and, if needed, quantify (and disclose) a suitable retainer or other permissible method to ensure payment.

Plan Confirmation Hurdles

The ultimate objective of a Chapter 11 case is to obtain bankruptcy court approval ("confirmation") of a reorganization plan that improves a debtor's balance sheet and provides for payment of creditors' claims in accordance with the repayment hierarchy the Bankruptcy Code establishes. To be "confirmed," the debtor and the Chapter 11 plan must satisfy numerous requirements. If those requirements are not fulfilled, the plan will not be confirmed.

In many respects, the confirmation requirements for an individual debtor are the same as for a business debtor. For example, as in a business case, an individual debtor's Chapter 11 plan must group holders of claims into various categories called "classes." A class of claims is "impaired" if the plan will alter the claimants' rights. Each impaired class can vote to accept or reject the debtor's plan. To be confirmed, a plan must be accepted by all impaired classes; if it is not, the debtor may be able to "cram-down" the plan on dissenting classes and obtain confirmation anyway. "Cram-down" requires the debtor to meet additional requirements.

Obtaining Chapter 11 plan confirmation is a challenge in business cases, and for various reasons it can be even more difficult for individual debtors. Ultimately, this is where the greatest client dissatisfaction can arise. If a court refuses to confirm a plan, the disgruntled debtor will question counsel's decisions. The practitioner therefore should consider memorializing the most likely obstacles to plan confirmation in the side-letter, such as those listed below.

For an individual debtor, creditors have several ways to prevent plan confirmation. First, if any class of claims is impaired under the plan, at least one impaired class must vote to accept the plan (without counting the vote of any creditor who is related to the debtor or otherwise is an "insider"). If no impaired class votes to accept the plan, the court cannot confirm it. Because individual debtors often have few impaired classes of claims – perhaps only one secured creditor class (such as a mortgagee) and a single class of unsecured claims – convincing even one impaired class to accept may be difficult.

Second, even if all impaired classes of creditors vote to accept the plan, a single objecting creditor may be able to impede plan confirmation. If any creditor objects, the individual Chapter 11 debtor likely will be required to make distributions to creditors with a value not less than the debtor's "projected disposable income" for five years or the duration of the plan, whichever period is longer, to repay the claims in the objector's class.

Third, if an impaired class of creditors rejects the individual debtor's Chapter 11 plan, the "absolute priority rule" may derail the debtor's plan. Under this rule, each "dissenting" class of claims must be paid in full before any classes that include holders of junior claims or ownership interests can receive or retain any property or distributions on account of those junior claims or ownership interests. A Chapter 11 debtor invariably wishes to keep as many assets as possible (especially if the debtor operates a business and the debtor's assets are the sole means of supporting the business), but the debtor's ownership interest in estate property is junior to all creditors' claims. Therefore, if any impaired class of claimants rejects the plan, the debtor's plan cannot be confirmed unless the debtor pays that dissenting class in full or modifies the plan in such a way that the dissenting class accepts less than full repayment.

Section 1129(b)(2)(B)(ii) of the Bankruptcy Code includes an exception to the absolute priority rule regarding how much property an individual Chapter 11 debtor may keep without paying creditors in full, but courts disagree regarding how expansive that exception is. Those courts that follow a "narrow" interpretation assert that Section 1129(b)(2)(B)(ii) enables a debtor to retain only *post*-petition property and earnings from services, but does *not* permit a debtor to retain pre-petition property or, potentially, exempt property, without paying dissenting unsecured classes in full. The Fifth and Sixth Circuits, as well as numerous lower courts, have adopted this interpretation. Various lower and intermediate courts following the "broad," more forgiving interpretation have concluded that Section 1129(b)(2)(B)(ii) enables individual Chapter 11 debtors to retain *all* property of the estate, whether arising post-petition or existing pre-petition, without having to pay all dissenting classes in full.

Any one of these three impediments may require a debtor to give creditors larger recoveries under the plan (to obtain those classes' acceptance) than the debtor anticipated when filing bankruptcy. This may mean having to contribute money that the debtor borrows or is given by family or friends, or having to contribute some or all of the debtor's "exempt" property to enhance creditors' payouts. If the debtor lacks sufficient disposable income, outside sources of capital, or exempt assets from which to pay creditors a large enough dividend under the plan, the debtor's attempt to reorganize in Chapter 11 may fail. Once again, these are among the risks a practitioner should consider including in a side-letter.

Conclusion

An individual Chapter 11 debtor faces many unsettled problems – problems that may jeopardize the debtor's ability to reorganize successfully or that may require the debtor to pay more to creditors than the debtor hoped or expected. Managing the client's expectations and mitigating the risk

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of professional liability therefore are critical. An up-front side-letter that explains the most common legal hurdles a debtor may encounter is one method to further both of those objectives.

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BUSINESS LAW TODAY

Keeping Current:

Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund: Liability for Opinions in Registration Statements

By Brian T. Frawley, Robert J. Giuffra, Jr., Brent J. McIntosh, and Jeffrey B. Wall

On March 24, in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 575 U.S. ___, No. 13-435, slip op. 6 (Mar. 24, 2015), the U.S. Supreme Court addressed the requirement in Section 11 of the Securities Act of 1933 that a registration statement not "contain[] an untrue statement of a material fact" or "omit[] to state a material fact . . . necessary to make the statements therein not misleading." Specifically, the Court considered what plaintiffs need to plead under each of those phrases with respect to statements of opinion. The Court's guidance is significant in light of the importance of pleading standards and motions to dismiss in securities litigation. The Court held, consistent with a majority of the federal courts of appeals, that a pure statement of opinion offered in a Section 11 filing is "an untrue statement of material fact" only if the plaintiff can plead (and ultimately prove) that the issuer did not actually hold the stated belief. At the same time, the Court held that the omission of certain material facts can render even a pure statement of opinion actionably misleading under Section 11. But the Court emphasized that pleading an omissions claim will be difficult because a plaintiff must identify specific, material facts whose omission makes the opinion statement misleading to a reasonable person reading the statement fairly and in context. The Supreme Court's decision should curtail Section 11 litigation over honestly held opinions that turn out to be wrong, but it may cause the plaintiffs' bar to bring claims that issuers have not accompanied their opinions with sufficient material facts underlying those opinions. To ward off the risk of such lawsuits, issuers should consider supplementing their disclosure documents with information about the bases of their opinions that could be material to a reasonable investor.

Background

Section 11 of the Securities Act of 1933 authorizes private suits when a registration statement "contain[s] an untrue statement of material fact" or "omit[s] to state a material fact [that is] necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a). The dispute in *Omnicare* arose out of a registration statement that Omnicare filed in connection with a public offering of common stock. Omnicare provides pharmacy services to residents of nursing homes, and the company expressed in its registration statement its opinion that the company's business model – which includes accepting rebates from pharmaceutical manufacturers – was in compliance with federal and state laws. Omnicare disclosed, however, that the federal government had expressed concerns over manufacturer rebates, and that some states had initiated enforcement actions against manufacturers for providing such rebates.

Pension funds that had purchased Omnicare stock brought suit, contending that the company's opinions about its legal compliance violated Section 11. The district court dismissed the suit because the funds had not alleged *subjective* falsity – i.e., that Omnicare did not actually believe its opinion statements at the time they were made. 2012 WL 462551, at *4–5 (E.D. Ky. Feb. 13, 2012). But the Sixth Circuit reversed, holding that the funds needed only to allege *objective* falsity – i.e., that the opinions were in fact untrue at the time they were expressed (because Omnicare was not in legal compliance). 719 F.3d 498, 505–07 (6th Cir. 2013). Because the Sixth Circuit's decision conflicted with decisions of other federal courts of appeals, the Supreme Court granted review.

The Supreme Court's Decision

In its decision, the Supreme Court reversed the Sixth Circuit's conclusion "that a statement of opinion that is ultimately found incorrect – even if believed at the time made – may count as an 'untrue statement of a material fact.'" Writing for a seven-Justice majority, Justice Kagan explained that the Sixth Circuit's position "wrongly conflates facts and opinions." When a speaker makes a pure statement of opinion, that statement "explicitly affirms one fact: that the speaker actually holds the stated belief."

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Accordingly, a pure statement of opinion in a registration statement gives rise to Section 11 liability as "an untrue statement of a material fact" only if the issuer does not actually hold the opinion at the time.

The Court recognized, however, that some statements of opinion contain embedded factual assertions. For instance, the Court offered the example of an electronics executive who says, "I believe our TVs have the highest resolution available because we use a patented technology to which our competitors do not have access." That statement, the Court reasoned, offers two facts: one about the speaker's state of mind (that the product is superior) and one about the company (that the company has an exclusive and patented technology). The Court held that Section 11 may impose liability for "an untrue statement of a material fact" in that circumstance either "if the speaker did not hold the belief she professed" or also "if the supporting fact she supplied were untrue." The Court nevertheless concluded that Omnicare's statements were pure opinion and thus could not give rise to liability under Section 11 as "an untrue statement of a material fact."

The Supreme Court then considered whether Omnicare had "omitted to state facts necessary" to make its opinions on legal compliance "not misleading." The Court rejected Omnicare's argument that a statement of belief can never convey anything more than the speaker's own mindset in expressing that opinion. Rather, drawing on common law principles respecting the tort of misrepresentation, the Court held that "a reasonable investor may, depending on the circumstances, understand an opinion statement to convey facts about how the speaker has formed the opinion – or, otherwise put, about the speaker's basis for holding that view." In the Court's view, for example, if an issuer offers an opinion on a specific legal compliance matter "without having consulted a lawyer," "in the face of its lawyers' contrary advice," or without disclosing "that the Federal Government was taking the opposite view," the issuer's opinion about the legality of its conduct might be "misleadingly incomplete" and give rise to Section 11 liability.

The Court stressed the limits on its interpretation of Section 11's omission clause. An opinion statement "is not necessarily misleading," the Court explained, "when an issuer knows, but fails to disclose, some fact cutting the other way," because "[a] reasonable investor does not expect that *every* fact known to an issuer supports its opinion statement." (Emphasis in original.) The Court also observed that "[r]easonable investors understand that opinions sometimes rest on a weighing of competing facts; indeed, the presence of such facts is one reason why an issuer may frame a statement as an opinion, thus conveying uncertainty." In addition, the opinion statement must be read in context, "in light of all its surrounding text, including hedges, disclaimers, and apparently conflicting information," as well as "the customs and practices of the relevant industry." Further, the Court reaffirmed the doctrine that statements that are "mere puffery" cannot be actionable, but rather must be "determinate, verifiable statement[s]."

In remanding the case to the lower courts to address the funds' omission claim, the Court emphasized the hurdles that an investor must clear in pressing such a claim: "[t]he investor must identify particular (and material) facts going to the basis for the issuer's opinion – facts about the inquiry the issuer did or did not conduct or the knowledge it did or did not have – whose omission makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context." According to the Court, "[t]hat is no small task for an investor," which cannot rely on "conclusory assertions" to plead its claim. Cabined in that way, the Court disagreed with Omnicare that "liability for misleading opinions [would] chill disclosures useful to investors."

Justices Scalia and Thomas both concurred in separate opinions. Each agreed with the majority that a pure statement of opinion in a registration statement is "an untrue statement of material fact" only if the issuer did not actually hold the opinion at the time of the filing. Both Justices disagreed, however, with the Court's treatment of Section 11's omission clause. Justice Scalia would have held that issuers are ordinarily liable for opinions only when the speaker does not truly hold the belief or understands that he lacks any reasonable basis for the stated belief. Justice Thomas would not have addressed omissions liability but would have left that for the lower courts to address in the first instance.

Implications

The Supreme Court's decision provides important guidance on how Section 11 applies to statements of opinions. The Court's guidance is significant in light of the critical role of pleading standards and motions to dismiss in securities litigation. The Court's decision confirms that Section 11 does not authorize lawsuits based on honestly held opinions in registration statements that subsequently turn out to be wrong. Although the Sixth Circuit's approach had allowed "Monday morning quarterbacking an issuer's opinions," other federal courts of appeals had disagreed, and the Supreme Court's decision settles the law in line with those other courts by requiring plaintiffs to plead (and ultimately prove) that the speaker did not actually hold the challenged opinion. But when opinion statements contain embedded factual assertions – i.e., when an issuer says that it holds a particular opinion because of some fact – issuers should be careful that they have taken measures to verify the factual assertions underlying those opinions.

The decision may encourage plaintiffs' lawyers to bring litigation over whether issuers have adequately accompanied their opinions with statements about how they formed those opinions – i.e., "facts about the inquiry the issuer did or did not conduct or the knowledge it did or did not have." But the Supreme Court made clear that, "to avoid exposure for omissions under [Section] 11, an issuer need only divulge an opinion's basis, or else make clear the real tentativeness of its belief." The Court emphasized that pleading an omissions claim is "no small task for an investor," because the investor must identify specific,

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material facts "going to the basis for the issuer's opinion . . . whose omission makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context."

To guard against the possibility of omissions liability, issuers should consider setting forth the bases for opinion statements in disclosure documents where necessary to prevent any potential confusion. Issuers also should consider whether there are any material assumptions underlying their opinion statements that would not be apparent from the context of the opinion and may be material to a reasonable investor. Because the Supreme Court emphasized the importance of context, including "hedges, disclaimers, or qualifications," issuers should consider accompanying their opinion statements with language making clear the opinions' uncertainty or limited nature or scope.

Although the Supreme Court's decision rested on the language of Section 11, plaintiffs' lawyers may seek to extend the Court's rationale to claims under other provisions of the securities laws, such as Section 12 of the Securities Act and Sections 10(b) and 14(a) of the Securities Exchange Act of 1934, including with respect to oral or written statements of opinion not crafted with the care and forethought applied to registration statements. The Supreme Court was clear, however, that plaintiffs have substantially less room to claim to have been misled by opinions outside the context of carefully drafted registration statements and similar documents: "Investors do not, and are right not to, expect opinions contained in those [registration] statements to reflect baseless, off-the-cuff judgments, of the kind that an individual might communicate in daily life." Defendants may wish to resist any attempt to extend the Court's decision beyond litigation under Section 11 in the context of registration statements.

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BUSINESS LAW TODAY

Keeping Current:

Finally, State Securities Filings Electronically: NASAA's Electronic Filing Depository

By Scott C. Withrow

The United States Securities and Exchange Commission (SEC) installed its electronic disclosure system, EDGAR, beginning with a pilot program in 1984, and culminating in a full phase-in by 1996. EDGAR accepts, stores, and disseminates federal securities filings in the form of discrete electronic files based on paper disclosure documents. State securities regulators have lagged behind the SEC for decades, relying on paper filings with no integrated method of electronically filing in multiple states simultaneously with a federal filing in EDGAR.

NASAA's Electronic Filing Depository

On December 15, 2014, the North American Securities Administrators Association (NASAA) announced the launch of the online Electronic Filing Depository (EFD) to enhance the efficiency of the regulatory filing process for certain exempt securities offerings. EFD is an online system that allows an issuer to submit a Form D for a Regulation D, Rule 506 exempt offering to state securities regulators and pay related fees. The EFD website also enables the public to search and view, free of charge, Form D filings made with state securities regulators through EFD. EFD is available at: https://www.efdnasaa.org.

Rule 506 of Regulation D is a "safe harbor" for the private offering exemption of Section 4(a)(2) of the Securities Act, and also provides an exemption for public offerings to verified accredited investors. Issuers relying on the Rule 506 exemption do not have to register their offerings of securities with the SEC or state securities regulators, but they must file what is known as a "Form D" with the SEC and state securities regulators. Form D contains limited information about the securities being offered and the issuer offering those securities.

The EFD system is available 24 hours a day, seven days a week, unless the website is undergoing maintenance. In addition to the filing fees required by the states, there is a one-time $150 system use fee for each offering making its filings through EFD. This one-time system fee covers initial, amendment and renewal filings made through EFD. The EFD system is initially limited to Form D filings for Regulation D, Rule 506 offerings, but NASAA expects the filing system will be expanded to include additional state securities registration and notice filing materials.

Not All States Yet

The EFD system is presently available for 41 out of a total of 53 states and territories (including the District of Columbia, Puerto Rico, and the U.S. Virgin Islands). The 12 states not yet available are: Arizona, California, Connecticut, Delaware, Florida, Louisiana, Massachusetts, Michigan, Minnesota, New York, North Carolina, and Oregon. The author recently used the EFD system for a multi-state offering involving Georgia, Illinois, South Carolina, Tennessee, and Texas.

File Form D with SEC First

The issuer must first file a Form ID electronically with the SEC in order to obtain a EDGAR Central Index Key (CIK) – see https://www.filermanagement.edgarfiling.sec.gov. There is a trick in the Form ID process. Even though the Form ID is submitted electronically, the issuer must manually sign a PDF of the Form ID, *and have the signature notizaried* (the notary requirement does not appear in the instructions), and include the manually signed and notarized Form ID as an attachment to the electronic transmission.

The SEC will transmit the CIK via e-mail within a couple of business days after the Form ID is properly filed. Once the issuer receives the CIK, the issuer then can immediately generate access codes through the EDGAR website that are necessary to file the Form D with the SEC. The issuer then uses the access codes to log into the EDGAR Filing website – https://www.onlineforms.edgarfiling.sec.gov. The issuer will complete Form D, and should make a PDF version of the Form D just before transmitting to the SEC. After the Form D is transmitted to the SEC, the SEC will acknowledge the filing by an e-mail which

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includes a link to the EFD system:

> STATE FILINGS: If you want to submit this filing to one or more U.S. states or territories, please visit the Electronic Filing Depository at: https://efdnasaa.org.

EFD System – Login, Filing Fees and Payment

A first-time filer in the EFD system must register to create a login name and password. Once logged in the EFD system, the filer must search for the Form D as filed with the SEC using the CIK number. The filer can then create state notices for any of the 41 jurisdictions in the EFD system by simply checking a box.

The EFD system will calculate and summarize the applicable state filing fees and the EFD system use fee. In the author's five-state example, the fees were as follows:

Georgia	New Notice Fee	$ 250.00
Illinois	New Notice Fee	$ 100.00
South Carolina	New Notice Fee	$ 300.00
Tennessee	New Notice Fee	$ 500.00
Texas	New Notice Fee	$ 500.00
EFD	System Use Fee	$ 150.00
Total Fees		$1,800.00

Currently, payments must be made by Automated Clearinghouse Payments (ACH), like an online check. NASAA is considering adding credit card functionality to the EFD system in the future. Once the ACH payment data is submitted, the filer can simultaneously transmit all selected state filings. The EFD system will acknowledge the filing by an e-mail and the EFD website will reflect all state filings made by the logged-in filer.

Conclusion

The EFD system is a welcome complement to EDGAR for Rule 506 Form D filings. The EFD system is intuitive and easy to use, and the $150 system fee is justified by efficiencies in a multistate offering. Some major states are not available in EFD, including California, Florida, and New York. NASAA should press forward to get all states in the EFD system, and expand the system to other state securities filings.

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BUSINESS LAW TODAY

Delaware Insider:

Statutory Appraisal: An Old Workhorse with a New Lease on Life

By [Dominick T. Gattuso] and [Samuel T. Hirzel]

In an odd twist of fate, appraisal – a statutory remedy for aggrieved stockholders once described as "pointless" – is now the darling of activist shareholders and hedge funds alike. Statutory appraisal rights provide a limited, legislative remedy to stockholders who dissent from a merger or consolidation, claiming that the share price offered in the transaction was inadequate. Section 262 of the Delaware General Corporation Law (DGCL), which governs appraisal, provides that dissenting stockholders who perfect their appraisal rights are entitled to a judicial determination of the "fair value" of their shares. Simply put, "fair value" is the going-concern value of the target company immediately before the merger, but excluding any value relating to the merger, such as control premiums and synergies.

Statutory appraisal was an underutilized remedy prior to Chancellor William B. Chandler's decision in *In re Appraisal of Transkaryotic Therapies, Inc*., 2007 WL 1378345 (Del. Ch. May 2, 2007), because transactions can often be structured to avoid appraisal rights altogether and, even if a transaction triggers an appraisal right, the expense and risk associated with appraisal often precludes all but the largest, most well-financed stockholders from pursuing it. In *Transkaryotic*, the court ruled that a beneficial owner who acquired shares after the record date but before the merger vote could seek appraisal of the shares without establishing that these newly acquired shares had not been voted in favor of the merger by the prior beneficial owner. *Transkaryotic* helped to facilitate a phenomenon now commonly referred to as appraisal arbitrage, a practice in which hedge funds and activist shareholders, among others, acquire shares of the target after the merger is announced with the hope of obtaining higher consideration in an appraisal. By 2011, the rate of appraisal petitions had doubled over the rate for the prior five-year period. The rate continued to increase in 2013 and 2014. The uptick in appraisal litigation has generated several interesting decisions from the Delaware courts as well as proposed amendments to the appraisal statute.

Huff Fund Investment Partnership v. CKx, Inc., 2013 WL 5878807 (Del. Ch. Nov. 1, 2013), *aff'd*, 2015 WL 631586 (Del. Feb. 12, 2015), involved the appraisal of a company holding the rights to certain entertainment assets. The company's most lucrative asset was its right to license the *American Idol* franchise under an exclusive and perpetually renewable license with Fox Entertainment. At the time of the merger, the company was in the process of negotiating a renewed license with Fox for *American Idol*. Thus, the future value of the company's primary revenue stream was uncertain. Management had, however, prepared projections that it described as its "best estimate" of a forward five year projection and "potentially achievable"; those projections were provided to potential bidders and used in presentations to the company's lenders for purposes of assessing the company's credit risk. Both sides utilized discounted cash flow (DCF) valuations. Petitioners relied upon the contemporaneous management projections. Respondent's expert adjusted the management projections downward. Vice Chancellor Glasscock found that management's projections were not reliable because of the uncertainty of the company's revenues from *American Idol* due to the pending negotiations with Fox. The Court of Chancery also rejected the parties' respective comparable companies and comparable transactions analyses finding that the companies and transactions used were not sufficiently comparable. In the absence of (1) reliable projections to use in a DCF analysis and (2) comparable companies or transactions to guide a comparable companies or comparable transactions analysis, the court concluded that the negotiated deal price was the most reliable evidence of the value of the company and appraised the company at the deal price, because the sales process was "thorough, effective, and free from any specter of self-interest or disloyalty." *Huff*, which was affirmed without opinion by the Delaware Supreme Court recently, marked the high

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water line in the use of the merger price to determine appraised value for a little over a year.

In re Appraisal of Ancestry.com, Inc., 2015 WL 399726 (Del. Ch. Jan. 30, 2015), involved the appraisal of the online family history resource. The company's management did not prepare management projections in the ordinary course of business, but did prepare projections that were approved by the board and presented to bidders in connection with the sale process (the "Bidder Projections"). Management described the Bidder Projections as "optimistic" and "aggressive." Management also prepared more conservative projections after bidders and the company's financial advisor commented that the assumptions were optimistic and aggressive (the "Revised Projections"). Both parties relied exclusively on DCF valuations and eschewed comparable companies and comparable transactions analyses. Petitioners' expert developed a set of blended projections that weighted the Bidder Projections and the Revised Projections equally. Respondent's expert relied exclusively on the more conservative Revised Projections. Vice Chancellor Glasscock (the same member of the Court who decided *Huff*) found that both sets of projections were "imperfect": management did not prepare projections in the regular course of business; the Bidder Projections were aggressive to bolster a potential sale; and the Revised Projections were prepared to support a fairness opinion, at a time that management was contemplating large rollovers of their own stock, and the CEO was preparing private "hacks" showing a higher growth rate for his rollover interest. The court also found that both experts tailored their DCF analyses in a "results-oriented" manner. After conducting his own DCF valuation that resulted in a valuation very close to the merger price, Vice Chancellor Glasscock found that the "relatively untainted" auction was unlikely to have left significant value unaccounted for and, because it was a non-strategic acquisition, he could not identify any synergies that were likely to push the purchase price above fair value. Thus, even with projections available to conduct a DCF valuation, Vice Chancellor Glasscock (again) concluded that the merger consideration was better evidence of fair value.

Vice Chancellor Glasscock's reliance on merger price in *Huff* and *Ancestry.com* has garnered a great deal of attention. However, more than a decade earlier, then-Vice Chancellor Strine relied on merger price in *The Union Illinois 1995 Investment L.P. v. Union Financial Group, Ltd.*, 847 A.2d 340, 357 (Del. Ch. 2003), reasoning that merger price less synergies was the "most reliable evidence of fair value" following a reliable, untainted sales process. "This real-world market check is overridingly important evidence of value," where, as here, it was not "a squeeze-out merger." Notwithstanding, the Court of Chancery conducted a DCF analysis as a check on the merger price, using management's projections and more generous assumptions than it felt was warranted. That DCF analysis reflected a per share value of the company that was lower than the merger price less synergies. Nevertheless, the court gave full weight to the merger price as the best indication of fair value, and awarded the merger price less synergies to the petitioners.

Some commentators have cheered Vice Chancellor Glasscock's reliance on merger price as an indicator of fair value in *Huff* and *Ancestry.com* as a potential check on the recent growth of appraisal arbitrage. That praise misses the mark, however. Neither *Huff* and *Ancestry.com* nor *Union* should be read as creating a presumption in favor of merger price simply because there was an untainted auction. Even in an untainted auction, poor timing of the transaction and other market forces could result in a merger price that does not reflect the fair value of the company as a going concern. Recall that in both *Union* and *Ancestry.com* the Court of Chancery conducted a DCF analysis as a check on the merger price. Thus, merger price should be, and is, only one of several factors a trial court may consider in appraisal litigation. Management projections are another. And, as for those commentators hoping for the early demise of appraisal arbitrage, who better to test the fairness of the merger price than large, well-heeled stockholders who are capable of bearing the well-known risks and significant costs associated with appraisal?

Indeed, in connection with the proposal of two amendments to Section 262 of the DGCL, the Council of the Corporation Law Section of the Delaware State Bar Association (the "Corporate Council"), which is responsible for recommending amendments to the DGCL, determined that appraisal arbitrage does not upset the balance between corporations' ability to engage in value-enhancing transactions and stockholders' rights to dissent and seek appraisal. The proposed amendment to 262(g) seeks to lessen, if not eliminate, nuisance-type appraisal proceedings by permitting the court to dismiss an appraisal proceeding unless "(1) the total number of shares entitled to appraisal exceeds 1% of the outstanding shares of the class or series entitled to appraisal, (2) the value of the consideration provided in the merger or consolidation for such total number of shares exceeds $1 million, or (3) the merger was approved pursuant to § 253 or § 276" of the DGCL. The proposed amendment to Section 262(g) applies only to shares for which appraisal is sought that were listed on a national securities exchange. Of course, such issues are generally not in play in the context of appraisal arbitrage.

The proposed amendment to Section 262(h) would permit corporations to limit the accrual of interest on appraisal awards by allowing a corporation to pay a sum of money (of its choosing) to the appraisal petitioners in advance. Interest at the statutory rate of 5 percent over the Federal Reserve discount rate would only accrue on a judicial award that exceeds the amount the corporation paid to the appraisal petitioners in advance. Some commentators have urged the Corporate Council to go further and reduce the statutory interest rate available under Section 262, arguing that it provides a relatively high rate of return as compared to the current government yields and money markets and, thus, encourages appraisal arbitrage. That concern appears to be overstated, given that hedge funds engaged in

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appraisal arbitrage typically achieve a rate of return in excess of the legal rate. The call to reduce the statutory rate of interest also ignores the fact that appraisal petitioners have been cashed out of their chosen investment and now bear the unsecured credit risk associated with an appraisal proceeding. Interestingly, the proposal to limit the accrual of interest awarded to appraisal petitioners by an upfront payment may have unintended consequences: it may encourage more "appraisal arbitrage" by freeing up funds for redeployment in the next deal.

Delaware's appraisal law will continue to evolve at a measured pace in response to changes in the marketplace, as it should. And though *Union*, *Huff*, and *Ancestry.com* highlight the risk that appraisal petitioners face, even when there are contemporaneous management projections that may justify a higher DCF valuation, the fact remains that merger price is only one of several factors the court may consider to ascertain fair value under Section 262, and even then, it should do so only in exceptional circumstances.

Dominick T. Gattuso and Samuel T. Hirzel are partners at Proctor Heyman Enerio LLP. The opinions expressed in this article are those of the authors and not necessarily those of Proctor Heyman Enerio LLP or its clients.

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BUSINESS LAW TODAY

Member Spotlight:

An Interview with Laura Stein

It's clear why Laura Stein, General Counsel and Executive Vice President of The Clorox Company, was named one of the 20 most influential general counsel in America by the National Law Journal. *She's gone far beyond mastering the skills necessary to run a top-notch legal department, prompting the* Harvard Law Bulletin *to highlight her as "one of the 50 alumnae who have used their law degree to take them to extraordinary places."*

She's served as a leader in the legal profession, helping to promote diversity and inclusion, and also provided pro bono work to the underrepresented. Her list of accomplishments and activities is, quite frankly, staggering. She serves on the Clorox Executive Committee, chairs the Women's Employee Resource Group, and cosponsors the company's social responsibility and enterprise risk and crisis management programs. Then there's her work with nonprofits and the ABA. She serves on the board of Equal Justice Works, the Leadership Council on Legal Diversity, the Harvard Law School Center on the Legal Profession, and the American Law Institute Counsel. On and on. "I've been blessed with a very high level of energy," she says. "And I also love what I do."

* * *

You speak six languages. When did you start studying languages?

I first started studying German in first grade, but I don't claim German as one of my languages. I studied French in middle school and advanced French in college. But my strongest language other than English is Italian. I was a foreign exchange student in Italy in Porto Potenza Picena, where, to this day, very few people speak English. It's one of the most wonderful places on Earth. But the toughest language to learn was Chinese, and that took several hours a day in college; then I lived in Beijing and took advanced Chinese in law school. I don't think it's a language where you can claim fluency. You just do your best.

Do you use any of these languages for your work?

The two that I use most frequently are Spanish and Chinese. We have a big international business in Latin America. I have done compliance training and meetings in Spanish and Chinese. I've recently joined a board in Montreal, so I'm enjoying hearing French again.

Prior to attending Harvard Law School, you lived in Beijing and worked as a writer and editor for *China Daily*, a state-owned English-language newspaper. What was a highlight of that experience?

The culture and the people. This was the early '80s and China was just emerging from the Cultural Revolution. The Chinese, for good reason, are very proud of all of the inventions and contributions they've made to the world. People were very warm and took time to befriend me. I also really enjoyed working as a journalist. The *China Daily* was created because, at the time, there was no English-language media in China. People from other countries were starting to visit, so China created a newspaper to give them an introduction to the country.

Wherever I went in China, crowds would surround me and stare, because, in many cases, I was the first non-Chinese person they'd ever seen or the first one trying to speak a bit of Chinese.

Your father was Dean of the University of Minnesota Law School. What were your dinner conversations like? Were you immersed in law?

You'd think so, seeing that I have two wonderful sisters who both went to top law schools as well, and they're both practicing lawyers to this day. And so many family friends were lawyers. But I think our parents just really wanted us to have curiosity about life and to be happy. We were also huge sports fans. We went to all University of Minnesota football, basketball, and hockey games from a young age. We loved to travel as a family.

What was your view of the law as a girl and how did it change, once you started law school and became a lawyer?

When I was a girl, my view of the law was a result of knowing so many lawyers. My dad, when he was a professor, would have

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his law students and colleagues over. So it seemed normal that many people were lawyers. I also got a sense of all the various fields you could practice in as a lawyer. And I understood the importance of lawyers for democracy, protecting the rule of law, and access to justice. When I started law school, I gravitated toward business and international because that was my interest. As general counsel, you are immersed in a little of everything, all over the globe. My view of the law is that it's incredibly important to preserve freedom and access to justice and fairness. At the end of the day, it still is a way to promote transparency and fairness.

You took a leave and returned to your alma mater, Dartmouth, and earned a Master of Arts. How has that experience helped you as a lawyer?

I was admitted as a Tuck special student, but I only had one year, rather than the two needed to get an MBA, so I got a Masters of Arts and studied at Tuck. The experience was terrific, and I think it helped me as a lawyer by understanding more about business. Working in-house, you need to be financially literate, and so increasing my financial literacy was very helpful. It's good to see things from different disciplines and points of view. I did my master's thesis on the regulation of the Japanese securities industry, so it was fun to broaden my Asia experience.

You also had two children 20 months apart. Did you take a break from the law and if not, how did you balance it all?

I had a great maternity leave with my first child, with four and a half months of not working. After my leave, it was a very busy time because I was traveling internationally. When I had my son, I was getting my masters and, when you're a graduate student, you don't get a maternity leave, so that was a little bit difficult. I had two 20-page papers due about two weeks after he was born.

I was able to balance it because I'm very fortunate to have a tremendous spouse. If you have a supportive partner, you work together as a team to raise your children. For both of us, our children are our highest priority. They both played traveling soccer for about 10 years, and even though I was commuting cross-country during several of those years, we were at their soccer games during the weekends.

I think balance is often a state of mind, but also everybody should seek balance while living a very full life because it's a very short life, and it's a shame not to make the most of it.

Prior to your current position, you were senior vice president and general counsel for H.J. Heinz Company. What was the highlight from this experience?

Heinz, like Clorox, is a great company with leading brands around the globe. I loved being a part of the executive team. We had a top-notch legal team, like we do at Clorox.

One highlight was serving as a member of senior management and working with the board. We were actively reshaping the portfolio to move into higher-margin, faster-growing businesses, so we divested some businesses. We did a pretty complex transaction, where some of our slower- growing, lower-margin businesses were spun in a tax-free transaction to all shareholders of Del Monte. It was a really rewarding deal to work on. I also loved the global aspect of the job. More than 60 percent of Heinz's sales and profits were outside the U.S. My team had lawyers in about a dozen countries and I traveled extensively.

Then you joined Clorox as senior vice president and general counsel in 2005. I read that you've worked on more than 50 acquisitions and divestures. You obviously enjoy deal-making.

By now, I think it's well north of 50. I like deals because I like reshaping our portfolio to benefit shareholders by focusing on businesses that are strategic, that can provide faster growth and better margins, and give excitement to a company.

I really like dissecting a business to make sure an acquisition is the right next step to be added to the portfolio. Then working to identify and integrate which capabilities and skills get added to your company.

I also really like being involved in innovation. Clorox is known for its innovation, as we've been achieving more than three points of incremental net customer sales from innovations in the past few years.

You chair the Clorox Women's Employee Resource Group. What is that group designed to do and why did you become involved?

Clorox has employee resource groups, and we also have networks to give employees who want to be involved with these groups a chance to lead and work together to make Clorox a better place. I've sponsored our women's group with women around the globe. Together we determine what we want to focus on to support women, both in the workplace and in our lives outside the workplace.

It's a great way for women to gain leadership experience. We support at-risk women and girls around the world through different initiatives. We also try to drive opportunity and advance women in the workplace. Clorox has great leadership development and mentoring programs and, through our women's group, we also bring in speakers. We focus on ways we can be mentored and learn and advance in our careers and gain skills that will help us achieve success, such as financial, communication, and leadership skills.

It's been a great opportunity to meet really terrific women at Clorox that in my day-to-day I might not otherwise interact with or develop friendships with.

What barriers are still facing women in senior legal positions?

So much depends on the culture of the place where you work. I do feel very fortunate that at Clorox, about a third of our board and about a third of our executive leadership team are women, half of our legal leadership team are women, as are about half of our senior lawyers.

If you're in a culture that encourages everyone to be authentic and bring their best, it can be a rewarding place. Some of the

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issues generally facing women in senior legal positions, as well as other diverse lawyers, are addressing implicit bias that may exist and also ensuring that people aren't isolated. That is, that they feel part of a team, a culture that is welcoming.

We've made great progress, but looking at the numbers, we need to retain more women, minorities, and other diverse talent in the law and advance more women and other diverse talent both in partnerships with firms and in senior legal positions.

You're also involved in Clorox's pro bono initiatives.

I'm really proud that our legal team, through people's passion and volunteerism, lead our pro bono efforts. A hallmark program has been supporting domestic violence survivors in family court. We work to get restraining orders or custody, guardianship, and on other issues. For the holidays, we also support families whose mothers and children are domestic violence survivors. We have a group of IP lawyers who are involved with Lawyers for the Arts, helping artists on all kinds of IP-related legal issues. We also have a group that represents tenants in landlord matters and we staff other clinics. Through these experiences, our attorneys learn a lot about leadership and becoming better lawyers, as well as how rewarding it feels to give back.

This is the first year that we're sponsoring an Equal Justice Works fellow in conjunction with Morrison & Foerster law firm. The fellow is Whitney Rubenstein, who is with the East Bay Community Law Center, which is another group that we are involved with. We've partnered with East Bay Community Law Center to help people get rid of minor criminal records, so they can get jobs.

How many Clorox lawyers are involved in pro bono efforts?

It's well over half of our department, and includes other legal staff as well.

You were named one of the 20 most influential general counsel in America. What role do you see in-house general counsel playing in developing the legal system in the U.S. and internationally?

Being a general counsel is a great role, and it's an increasingly strategic role. We wear many different hats, but clearly we act first and foremost as a trusted counselor to proactively guide and protect our company and proactively counsel the board, the CEO, and senior management on legal matters globally where the company is the client. We help to develop the legal system by trying to drive transparency and fairness and access to justice.

We also have the ability to shape the legal profession – in the U.S. and internationally – by driving professional responsibility and diversity, as well as the rule of law. We help ensure that lawyers focus on professional development because it's an increasingly complex, global, and regulated world, where lawyers need to constantly sharpen their skills and develop themselves.

I read your daughter was studying Chinese in Beijing.

My daughter is now working for a start-up in San Francisco, but she studied in Beijing and she worked at law firms in Shanghai following college. She has the same level of Chinese proficiency that I have. She minored in Chinese. We're slightly competitive, so we keep each other on our toes. When she was in Beijing and Shanghai I got to visit her, which was fantastic.

You're active in the community, serving on so many boards. How do you find the time and energy to stay so involved with a high-powered, demanding job?

I've been blessed with a very high level of energy. I also love what I do. Being general counsel is definitely demanding, but incredibly rewarding, especially when you work with a top-notch legal team and for a company you really respect and want to be involved in enhancing its reputation.

It's important as lawyers to give back, because we've been given so much. When you get involved in the community, legal services groups, pro bono or diversity matters, you also develop lifelong friendships with people with big hearts.

You've also been very involved with the ABA. What's been the value of your involvement with the ABA?

The ABA should be the voice of lawyers and represent us at national and global levels. I've enjoyed the issues I've been involved with. I was Chair of the Asia Rule of Law Board for several years and was very involved in ABA Rule of Law efforts, and Chair of the Domestic Violence Commission for several years. It was really an honor and a privilege to work with other experts to increase access and justice and safety for domestic violence victims. I've also been involved in the preservation of justice work to increase funding of the courts. I care a lot about the Business Law Section and served as Co-chair of the Corporate Counsel Committee. From a professional development and relationship standpoint, I've created lifelong friendships with people who are leaders and tremendous lawyers.

Over your career you've received so many awards. Is there one that's most meaningful to you?

It's flattering to be recognized, but that's not what drives me. And most of the awards are a reflection of the entire team with whom I work. I felt very good about receiving the Margaret Brent Award, which is the highest award given to women lawyers within the ABA. When I look at the women who have received that award, I'm just very humbled and privileged to be part of that group.

You once told a Pennsylvania business magazine that your dream jobs included being a college basketball coach or president of the United States. Does one still interest you?

It would be incredibly rewarding to be a college basketball coach because I love college basketball; I love sports generally. You're focused on strategy. You're focused on making a team stronger and really leveraging strengths and the chemistry of a team. I like working on teams, which I clearly do in my present role. President of the United States is an amazing job as well.

Thank you so much for your time.

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BUSINESS LAW TODAY

Inside Business Law

The 2015 Spring Meeting's Most Attended Programs

The Business Law Section of the American Bar Association held its Spring Meeting, April 16–18, 2015, at the San Francisco Marriot Marquis and InterContinental San Francisco. The Spring Meeting included 68 continuing legal education programs (including 6 ethics programs), 56 full Committee meetings, and 256 Subcommittee meetings. These programs and meetings featured 597 speakers.

Following are descriptions of the five CLE programs with the highest attendance, as well as a link to the program materials presented at those programs.

What's Unfair and Deceptive Now? – presented by the Consumer Financial Services Committee and cosponsored by the Credit Unions Committee.

Prohibitions on unfair and deceptive practices are old news, but new agencies and interpretations are remaking these standards, and reinventing the process of how these standards are enforced. The panel of state and federal enforcement lawyers, and private practitioners, reviewed the process and substance behind UDAAP, claims made by the Federal Trade Commission, the Consumer Financial Protection Bureau, and state financial regulators in state and federal courts and administrative tribunals.

The program was chaired and moderated by Eric Mogilnicki, Partner, Wilmer Cutler Pickering Hale and Dorr, LLP, Washington, DC. Speakers included Kristen Donoghue, Deputy Enforcement Director for Policy and Strategy, Consumer Financial Protection Bureau, Washington, DC; Joy Feigenbaum, Executive Deputy Superintendent, Financial Frauds & Consumer Protection, New York State Department of Financial Services, New York, NY; Carolyn L. Hann, Senior Staff Attorney, Federal Trade Commission, Washington, DC; and Lucy Morris, Partner, Hudson Cook, LLP, Washington, DC.

The materials for this program are located here.

Fisher Memorial Program: Enhanced Government Regulation – The Path to Consumer Protection or an Obstacle to Innovation – presented by the Consumer Financial Services Committee.

This panel discussion explored the effects of enhanced regulation in the financial services area and considered whether that regulatory environment is creating impediments to innovation in underwriting and delivery of services. It also considered the actions of the Consumer Financial Services Bureau in attempting to accommodate those potentially conflicting concerns.

The program was chaired by James Swartz, Director of Legal Affairs, FCE Bank, London, England, and co-chaired and moderated by John R. Chiles, Partner, Burr & Forman LLP, Fort Lauderdale, FL. Speakers included Thomas Brown, Attorney, Paul Hastings LLP, San Francisco, CA; Ryan Falvey, Director, Innovation Labs, Center for Financial Services Innovation, San Francisco, CA; and Lauren E. Willis, Professor of Law, Loyola Law School, Los Angeles, CA.

Materials for this program can be found here.

Cyber Security: The Cold, Hard Reality of Protecting Financial Information – presented by the Banking Law Committee and cosponsored by the Cyberspace Law Committee.

This panel explored the increasingly sophisticated threats banks face in cyberspace, from DDoS attacks perpetrated by nation-states, to digital mobsters looking to cash in on customers' accounts, to "hacktivists" who target banks for political reasons. The panel also discussed the evolving regulatory framework, and how victims of cyberattacks are caught between criminal prosecutors seeking to bring perpetrators to justice, regulators who view the banks as potentially culpable for the hack, and private litigants who seek recompense for harms stemming from the attacks. How can banks best balance these competing concerns while protecting their customers and their assets?

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The program was co-chaired by Hugh C. Conroy, Counsel, Cleery Gottlieb Steen & Hamilton LLP, New York, NY, and co-chaired and moderated by Paul L. Lee, Of Counsel, Debevoise & Plimpton LLP, New York, NY. Speakers included David Bitkower, Deputy Assistant Attorney General, U.S. Department of Justice, Washington, DC; Thomas Brown, Senior Managing Director, FTI Consulting, New York, NY; Kevin Greenfield, Director for Bank Information Technology Policy, Office of the Comptroller of the Currency, Washington, DC; Rena Mears, Managing Director, BuckleySandler LLP, Washington, DC; James L. Pastore, Counsel, Debevoise & Plimpton LLP, New York, NY; and Robert Patchett, Chief Privacy Officer, MUFG Americas, San Francisco, CA.

The program materials can be found here.

The CFPB's Lawsuit to Regulate the Practice of Law: What are its Implications for Lawyer Professional Responsibility? – presented by the Consumer Financial Services Committee.

The CFPB has sued a Georgia law firm alleging that it did not exercise sufficient professional judgment when filing lawsuits to collect consumer debt. Asserting the position that it can regulate an attorney's exercise of professional judgment in rendering legal services, the CFPB has labeled the court's exclusive regulation of attorney professional conduct as a "quaint notion." The panel analyzed the authority which formed the basis for the CFPB's lawsuit and the implications it has upon lawyer professional responsibility.

The program was chaired by Donald S. Maurice, Jr., Attorney, Maurice & Needleman, P.C., Flemington, NJ. Speakers included Hon. Phil Johnson, Justice, Supreme Court of Texas, Austin, TX; Donald C. Lampe, Partner, Morrison & Foerster LLP, Washington, DC; Joann Needleman, President, National Association of Retail Collection Attorneys, Wayne, PA; Manuel H. Newburger, Partner, Barron & Newburger, P.C., Austin, TX; Leah M. Nichols, Staff Attorney, Public Justice, P.C., Washington, DC; and Jennifer S. Wagner, Mountain State Justice, Inc., Clarksburg, WV.

Program materials can be found here.

50 Ways to Leave Your Lover, err . . . Business Partner: The Essentials of Business Divorce in Privately Held Entities – presented by the Business and Corporate Litigation Committee and co-sponsored by the Middle Market and Small Business Committee.

Panelists discussed the definition of "business divorce" and issues peculiar to such situations, which included a discussion of litigation alternatives for "business divorce" in corporations and LLCs, including dissolution and corporate opportunity litigation, as well as transactional alternatives for "business divorce" in corporations and LLCs, including "squeeze-out" transactions in corporations and utilization of specific dissolution/buyout provisions in LLCs.

The program was chaired by Thomas J. Walsh, Jr., Principal, Brody Wilkinson, Fairfield, CT, and was co-chaired and moderated by Kurt Heyman, Founding Partner, Proctor Heyman LLP, Wilmington, DE. Speakers included Melissa N. Donimirski, Associate, Proctor Heyman LLP, Wilmington, DE; Peter B. Ladig, Partner, Morris James LLP, Wilmington, DE; Eric Milby, Partner, Lundy Beldecos & Milby P.C., Narberth, PA; Hon. Donald F. Parsons, Jr., Vice Chancellor, Delaware Court of Chancery, Wilmington, DE; and Michaela L. Sozio, Partner, Tressler LLP, Los Angeles, CA.

Program materials are here.

The Spring Issue of The Business Lawyer

The Spring Issue of *The Business Lawyer*, Volume 70, No. 2, was recently published by the Business Law Section. Articles include the following. Titles are linked to the full text of the article.

Harmony or Dissonance? The Good Governance Ideas of Academics and Worldly Players, by Robert C. Clark.

This lecture asks questions concerning ideas about what constitutes good corporate governance that are espoused by academics, such as financial economists and law professors, and by more worldly players such as legislators, rule makers, governance rating firms, large institutional investors, law firms that represent corporate clients, and courts. Are there discernible trends and patterns in the views espoused by these different categories of actors, despite all the differences among individual actors within each category? The author proposes that there are such patterns, offers some initial thoughts about the characteristic themes and differences, and hypothesizes about the reasons for the differences. At the end, he reflects on what a benign policy maker interested in increasing overall social welfare might do with these observations.

Financial Innovation and Governance Mechanisms: The Evolution of Decoupling and Transparency, by Henry T. C. Hu.

Financial innovation has fundamental implications for the key substantive and information-based mechanisms of corporate governance. "Decoupling" undermines classic understandings of the allocation of voting rights among shareholders (via, e.g., "empty voting"), the control rights of debtholders (via, e.g., "empty crediting" and "hidden interests"/"hidden non-interests"), and of takeover practices (via, e.g., "morphable ownership" to avoid section 13(d) disclosure and to avoid triggering certain poison pills). Stock-based compensation, the monitoring of managerial performance, the market for corporate control, and other governance mechanisms dependent on a robust informational predicate and market efficiency are undermined by the transparency challenges posed by financial innovation. The basic approach to information that

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the SEC has always used – the "descriptive mode," which relies on "intermediary depictions" of objective reality – is, according to the author, manifestly insufficient to capture highly complex objective realities, such as the realities of major banks heavily involved with derivatives. Ironically, the primary governmental response to such transparency challenges – a new system for public disclosure that became effective in 2013, the first since the establishment of the SEC – also creates difficulties. This new parallel public disclosure system, developed by bank regulators and applicable to major financial institutions, is not directed primarily at the familiar transparency ends of investor protection and market efficiency.

As starting points, this article offers brief overviews of (1) the analytical framework developed in 2006–2008 for "decoupling" and its calls for reform, and (2) the analytical framework developed in 2012–2014 reconceptualizing "information" in terms of three "modes" and addressing the two parallel disclosure universes.

As to decoupling, the article proceeds to analyze some key post-2008 developments (including the status of efforts at reform) and the road ahead. Regarding information, the article begins by outlining the calls for reform associated with the 2012–2014 analytical framework. The article concludes with a concise version of the analytical framework's thesis that the new morphology of public information – consisting of two parallel regulatory universes with divergent ends and means – is unsustainable in the long run and involve certain matters that need statutory resolution. However, certain steps involving coordination among the SEC, the Federal Reserve, and others can be taken in the interim.

An Overview of the General Counsel's Decision Making on Dispute-Resolution Strategies in Complex Business Transactions, by E. Norman Veasey and Grover C. Brown.

This article is an overview of the hard choices that face a general counsel (GC) when weighing the pros and cons of whether and when a particular complex business dispute is better suited for litigation in the public courtroom or through a carefully constructed alternate dispute-resolution (ADR) process, including mediation and/or arbitration. Is either choice inherently more expensive, time consuming, or problematic than the other? The obvious answer is that each of these decisions is fact-intensive, dependent on myriad factors, and neither choice is "inherently" better or worse than the other.

The authors focus exclusively on complex commercial disputes between businesses and analyze the issues that would likely be considered by the GC and other corporate decision makers in choosing and navigating the route that provides the best opportunity for optimal results in resolving a domestic or international business dispute. These dispute resolution choices often must be faced in the negotiation of the terms of a business transaction, and thus before there is a dispute.

The authors go on to explore the pros and cons of how the panoply of dispute-resolution mechanisms may play out down the road. In doing so, they are mindful of the complicated job of the GC in foreseeing at the negotiation stage how the optimal dispute-resolution process should be analyzed and drafted.

***Halliburton II*: It All Depends on What Defendants Need to Show to Establish No Impact on Price**, by Merritt B. Fox.

Rule 10b-5 private damages actions cannot proceed on a class basis unless the plaintiffs are entitled to the fraud-on-the-market presumption of reliance. In *Halliburton II*, the Supreme Court provides defendants with an opportunity, before class certification, to rebut the fraud-on-the market presumption through evidence that the misstatement had no effect on the issuer's share price. It left unspecified, however, the standard by which the sufficiency of this evidence should be judged.

This article explores the two most plausible approaches to setting this standard. One approach would be to impose the same statistical burden on defendants seeking to show there was no price effect as is currently imposed on plaintiffs to show that there was a price effect when the plaintiffs later need to demonstrate loss causation. The other approach would be to decide that defendants can rebut the presumption of reliance simply by persuading the court that the plaintiffs will not be able meet their statistical burden. If the courts choose the first approach, *Halliburton II* is unlikely to have much effect on the cases that are brought or on their resolution by settlement or adjudication. If they choose the second approach, the decision's effect will be more substantial. The article concludes with a brief discussion of some of the considerations that should be relevant to courts in their choice between the two approaches.

The Spring issue also includes:

- **Summary of Mendes Hershman Student Writing Contest Prize Essay: A Closer Look at the Mandatory Victims Restitution Act and Whether the Costs of a Corporation's Independent Internal Investigation Should Be Included in a Criminal Defendant's Mandatory Restitution Order**, by Michelle Nichols DeLong.
- A report by the Model Nonprofit Corporation Act Subcommittee of the Committee on Nonprofit Organizations, titled **Adoption of Changes to the Model Nonprofit Corporation Act: Miscellaneous and Technical Amendments.**
- A Report by the Audit Responses Committee, titled **Statement on Updates to Audit Response Letters**.

The Spring issue also includes the following Surveys:

- **Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions**, by the Annual Survey Working Group of the M&A Jurisprudence Subcommittee, Mergers and Acquisitions Committee.
- **Survey: Consumer Financial Services**, by the Committee on Consumer Financial Services.

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