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Family Limited Partnerships (FLPs) and Limited Liability Companies (LLCs) are used as estate planning devices which enable older generation family members to transfer certain types of property to younger generation family members without relinquishing control over the property. Substantial gift tax valuation discounts may be obtained for the transfers due to recent favorable IRS rulings.

In the case of an FLP, older generation family members will transfer property to the FLP in exchange for general partnership units and limited partnership units and then embark on a plan of gifting the limited partnership units to younger generation family members. As general partners, the older generation family members will retain control of the underlying partnership assets. Due to valuation discounts for lack of marketability and minority interest, the limited partnership units will have a value for gift tax purposes that is 30 to 60 percent less than the value of underlying assets of the partnership representing such interests.

For example, if the parents in a family transferred $1,000,000 in assets to an FLP and gifted limited partnership units representing 90% of the partnership interests, those units would be valued at approximately $630,000, compared with the $900,000 value of the underlying partnership assets represented by those limited partnership units. Thus, when the parents transfer the limited partnership units to the younger generation, their transfer taxes will be significantly lower than if they had transferred the partnership assets directly to the younger family members.

Once the FLP has been established and funded, limited partnership units may be given to younger family members by means of an annual program taking advantage of the $10,000 gift tax exclusion. Parents may make tax-free gifts of limited partnership units with a value of $10,000 ($20,000 if married) to each child or grandchild each year. The discounts described above will be used in determining the value of these gifts, removing the property from the parents’ estates at a lower value. In addition, the future appreciation in the value of the limited partnership units will be excluded from the parents’ gross estates for estate tax purposes. Over time, a series of gifts of partnership units made in this manner can result in large transfer tax savings.

Similarly, older generation family members can form an LLC, retain control, and transfer non-manager member interests to younger family members, obtaining valuation discounts for such transfers. Since LLCs are taxed as partnerships for income tax purposes, there is no difference between an LLC and an FLP for income tax purposes. The major advantage of an LLC compared to an FLP is that no individual member has personal liability in an LLC. In an FLP, the general partner has personal liability. Therefore, if a client’s primary concern is protection from liability as in the case where commercial and industrial real property is transferred to the entity, the LLC should be the entity of choice.
In all other cases, the FLP is the preferred entity because under current law valuation discounts for FLPs will be greater. In calculating the amount of valuation discount afforded to a gift of an FLP or LLC interest, one factor which increases the discount and lowers the value of the gift is the transferee's inability to withdraw his or her interest from the entity and "cash out." Therefore, for valuation purposes (as well as control purposes) it is desirable that a limited partner or non-manager member could not withdraw his or her interest from the entity. Section 2704(b) of the Internal Revenue Code provides that any applicable restriction will be ignored in determining the estate or gift tax value of an interest in a corporation or a partnership transferred to, or for the benefit of, a member of the transferor's family. An "applicable restriction" is a limitation on the ability to liquidate the entity, in whole or in part, that is more restrictive than the limitation that would apply under state law generally applicable to the entity in the absence of the governing instrument restriction.

If the provision in the FLP or LLC agreement prohibiting withdrawal of a partner or member was more restrictive than what applicable state law provided in the absence of such provision, the restriction would be ignored under §2704(b) for gift tax valuation purposes resulting in a reduced discount. Therefore, if a state's law permits the withdrawal of a limited partner or LLC member, a provision in the limited partnership agreement or operating agreement which prohibits withdrawal would be more restrictive than state law and ignored for valuation purposes. Currently, unless otherwise provided in the applicable limited partnership agreement, the limited partnership statutes of the states of Delaware, Florida, Georgia, California, Washington and South Dakota, effectively provide that a partner cannot withdraw from the partnership. A provision prohibiting withdrawal in a limited partnership agreement formed in one of those states would not be more restrictive than state law. Accordingly, a maximum discount would be obtained for partnerships formed under those states' laws.

LLC statutes generally provide that members can withdraw their interests. Therefore, a provision in an LLC agreement prohibiting withdrawal would be ignored for valuation purposes and a maximum discount would not be obtained. Unless the default provisions of LLC statutes are changed to prohibit withdrawal (or otherwise effectively to address the valuation issue), it will be more advantageous for family planning purposes to use an FLP formed in a state which prohibits withdrawal, unless creditor protection is a primary concern.
Revision of the Revised Uniform Limited Partnership Act

By: Martin I. Lubaroff
Wilmington, Delaware

The National Conference of Commissioners on Uniform State Laws has embarked upon a project to revise the Revised Uniform Limited Partnership Act. In that regard, NCCUSL has appointed a Drafting Committee and an initial meeting of that Committee was held in early March. The Committee has determined that all existing provisions of the Revised Uniform Limited Partnership Act will be examined and, where appropriate, revised, and that the addition of numerous provisions to RULPA will also be considered. It is contemplated that a second meeting of the Drafting Committee will be held before the end of 1997.

The Drafting Committee is open to suggestions concerning the revision of RULPA. In that regard, Martin I. Lubaroff has been appointed the ABA Advisor to the Committee and George W. Coleman has been appointed the ABA Advisor to the Committee from the ABA Business Law Section. Messrs. Lubaroff and Coleman would welcome comments and suggestions concerning the proposed revision of RULPA. Marty Lubaroff can be contacted at Richards, Layton & Finger, P.O. Box 551, Wilmington, Delaware 19899, (302) 651-7610, and George Coleman can be contacted at Jenkens & Gilchrist, 1445 Ross Avenue, Suite 3200, Dallas, Texas 75202-2799, (214) 855-4307.
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Self-Employment Tax Regulations and the "Stealth Tax"

By: Steven G. Frost  
Chicago, Illinois

On January 10, 1997, the Internal Revenue Service (the "Service" or the "IRS") issued proposed regulations defining the term "limited partner" for self-employment tax purposes. The regulations substantially revise existing proposed regulations that address the same issue. Generally, while a partner's share of partnership income is included in "net earnings from self-employment" for purposes of calculating self-employment tax, the distributive share of a limited partner is excluded from the tax base and is not subject to the tax. Identifying a "limited partner" may be an easy task in the case of a general or limited partnership, however, the rapid growth of LLCs requires adoption of some method for identifying members of an LLC who will be treated as limited partners for this purpose, and crafting a definition that works for members of LLCs is not a simple task.

Amazingly, the new proposed regulations have attracted the attention of an august group of public figures, including Senator Christopher S. "Kit" Bond, Congressman Newt Gingrich, Senator William V. Roth, Jr., and Mr. Steven Forbes, as well as other government agencies (the Small Business Administration). On May 5, 1997, the Wall Street Journal (the "Journal") added its "two cents worth" to the public discussion. Certain comments have focused on IRS' authority to issue the regulations, and discussion of these comments is beyond the scope of this article. Unfortunately, many of the remaining comments raise unwarranted criticisms that lose sight of the real underlying issues and detract from the discussion and debate that is necessary to improve the proposed regulations. For example, the editorial in the Journal is entitled "Stealth Tax." The Journal's analysis begins with the observation that "a technical explanation for why the IRS thinks it can do this would bog readers down in the Everglades of partnership law" and the editorial ultimately concludes (apparently without understanding either partnership or tax law) that the IRS proposed regulation "imposes a tax on capital and risk" and is nothing more than a "stealth tax." Why all this attention

The self-employment tax (the editorial focuses on the Medicare tax, which is but a part of the self-employment tax) is imposed on "self-employment income" which, generally, includes an individual's share of income from a partnership. For this purpose, a "partnership" includes any entity treated as a partnership for tax purposes; e.g., many LLCs and general and limited partnerships. However, the law also provides that net earnings from self-employment does not include a limited partner's share of income, other than certain salary-like payments to that partner for services. The exclusion from net earnings from self-employment for income of limited partners was enacted in 1977. Interestingly, the impetus for this change was a tax shelter program under which promoters would "solicit investments in limited partnerships as a means for an investor to become insured for social security benefits." Because Congress did not believe people should be able to buy limited partnership interests to generate income that would be subject to a small self-employment tax and included in the base for determining social security benefits, it enacted a narrow exclusion from the definition of self-employment income for income of a limited partner.
Thus, existing law for partnerships is well settled: a general partner is subject to self-employment tax on all of his or her income from the partnership (regardless of whether the partner is active in the partnership business and regardless of whether the partner's income is attributable to capital investment or services). Also, a limited partner is not subject to the self-employment tax on his or her income, except for payments for services (again, regardless of whether the partner is active in the partnership business and regardless of whether the partner's income is attributable to capital investment or services). Simple and straight-forward, right?

In LLCs that are taxed as partnerships, members of the LLC are subject to self-employment tax on their shares of LLC income under the general rule that applies to owners of all entities treated as partnerships for tax purposes. However, a member of an LLC is not a limited partner, so without further action by Congress or the IRS, all members of an LLC are arguably subject to self-employment tax on their income from an LLC.

Enter the IRS. In 1994, IRS issued proposed regulations addressing when a member of an LLC would be treated as a limited partner for self-employment tax purposes. While discussion of the prior regulations is beyond the scope of this article, a number of the comments written in response to the prior regulations warrant mention. The prior regulations did not consider activity (or lack thereof) in identifying LLC members who would be treated as limited partners, and many people suggested that new regulations be adopted that focus on the level of a member's activity in the LLC. The ABA Tax Section Task Force on LLCs submitted comments noting that under current law participation and capital are irrelevant factors for self-employment tax purposes; e.g., a passive general partner who invests capital in a partnership is subject to the tax while an active limited partner who invests little capital is generally exempt from the tax. In the opinion of the Task Force, the key distinction today between general and limited partners is the authority that a general partner possesses to act on behalf of the partnership. Finally, the Task Force was concerned that any proposal ultimately adopted result in consistent consequences, whether taxpayers form an LLC or a partnership, so that taxes are not the primary factor in selecting between these entities. For further discussion, see Banoff, Frost and Keatinge, "Defining General Partner' and Limited Partner' for Federal Tax Purposes," 70 Tax Notes 1019 (February 19, 1996).

Personnel at IRS and at Treasury were very interested in the public's comments. Early this year, IRS issued new and substantially revised proposed regulations. Essentially, the new regulations provide a general rule (the "general rule") that a member of a partnership, including an LLC, will be treated as a limited partner unless the individual --

(i) has personal liability for the debts of or claims against the partnership by reason of being a partner;

(ii) has authority (under the law of the jurisdiction in which the partnership is formed) to contract on behalf of the partnership; or

(iii) participates in the partnership's trade or business for more than 500 hours during the partnership's taxable year.

Even if one of these requirements is satisfied, that person will not be treated as other than a limited partner if other members hold the same interests and don't work for the partnership. Specifically, an individual holding more than one class of interest in the partnership who would not otherwise be treated as a limited partner under the general rule is treated as a limited partner with respect to a specific class of partnership interest held by the individual if, immediately after the individual acquires that class of interest --

(i) limited partners (within the meaning of the general rule) own a substantial, continuing interest in that specific class of partnership interest; and

(ii) the individual's rights and obligations with respect to that specific class of interest are identical to the rights and obligations of that specific class of partnership interest held by the limited partners described in paragraph (i).

The proposed regulations include another exemption for individuals with only one class of interests. An individual who is not treated as a limited partner under the general rule solely because that individual participates in the partnership's trade or business for more than 500 hours during the partnership's taxable year is treated as a limited partner with
respect to the individual’s partnership interest if, immediately after the individual acquires that interest --

(i) limited partners (within the meaning of the general rule) own a substantial, continuing interest in that specific class of partnership interest; and

(ii) the individual’s rights and obligations with respect to the specific class of interest are identical to the rights and obligations of the specific class of partnership interest held by the limited partners described in paragraph (i).

The new proposal also includes a rule for service partnerships that is intended to result in consistent tax consequences for such an entity, regardless of whether the owners form a state law general partnership or an LLC to conduct their business. An individual who is a service partner in a service partnership may not be a limited partner. For these purposes --

(i) A service partner is a partner who provides services to or on behalf of the service partnership’s trade or business. A partner is not considered to be a service partner if that partner only provides a de minimis amount of services to or on behalf of the partnership.

(ii) A service partnership is a partnership substantially all the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, or consulting.

Although these rules are relatively simple and straightforward, they do raise various questions. For example, if an individual receives an interest as compensation, can that person’s rights and obligations ever be identical to the rights and obligations of other holders of the interest who pay “full” (or maybe just different) consideration? Further, while the new proposed regulations generally have been well received by tax practitioners, they are not without controversy within these circles. For example, the proposed regulations apply by their terms to limited partners of state law limited partnerships, and there is disagreement among tax lawyers as to whether IRS has the authority to apply these rules to partners of state law partnerships given the language in the 1977 legislation. This and other issues must be addressed, which is likely why IRS issued proposed regulations for public comment instead of finalizing the prior proposed regulations.

While one of the negative comment letters I read actually cites to provisions in the regulations, none that I have read clearly identify specific problems. If there is a specific concern, it may be possible to “fix” the regulation so that all of the investors in LLCs can still have certainty on their treatment for this purpose. For example, the Journal editorial focused on limited partners who are active in the business of Clarendon Flavor Engineering. If the concern is that limited partners, such as limited partners of Clarendon Flavor Engineering, who work extensively in the business of their partnership, are subject to self-employment tax under this regulation and the issue is whether the IRS has authority to treat state-law limited partners as other than limited partners for self-employment tax purposes, then debate this specific issue and modify the regulation appropriately. (I must admit I do not understand the policy reasons for subjecting my partnership income to the self-employment tax because I am a general partner while exempting from this tax income of the hard-working partners in the editorial because they are limited partners, and it is ironic that this attack on the proposed regulation is based on the “plight” of people who clearly were not the intended beneficiaries when Congress changed the law for limited partners in 1977!) However, the key point is that discussion of the facts and specific concerns by any and all of these commentators would only further this process, whereas a “throwing out the baby with the bath water” approach is bad tax policy.

In conclusion, I do not know why the proposed regulations have attracted all this attention. However, the self-employment tax issue cannot be resolved without understanding the “Everglades of partnership law” and the specifics of the IRS proposal. The only “simple solution” of which I am aware is to subject a specified portion of the income from any partnership to self-employment tax, which the Journal correctly points out was rejected by Congress in 1994. If one does not support a simple solution, then one must understand the facts to develop a solution that is fair, administrable and that results in consistent consequences for members of LLCs and partners of partnerships. The worst possible solution is to fight for withdrawal of a regulation that would, if implemented, exempt the overwhelming majority of passive investors in LLCs from the
tax. If the Journal's editorial is correct and the regulation amounts to a "stealth tax," it must be the first such tax increase that significantly reduces both the number of taxpayers who are subject to tax as well as the amount of taxes that will be collected!!
Cases Involving Limited Liability Companies and Registered Limited Liability Partnerships - Part II

By: Elizabeth S. Miller
Waco, Texas

The December 1996 issue of the PUBOGRAM contained a summary of LLC and LLP cases prepared in the summer of 1996 and distributed at the August 1996 meeting of the Partnerships and Unincorporated Business Organizations Committee in Orlando. Predictably, cases involving these entities are arising with increasing frequency. The following cases surfaced in the second half of 1996 and early 1997.

**Limited Liability Companies:**
1. ING (U.S.) Securities, Futures & Options, Inc. v. Bingham Investment Fund, L.L.C., 934 F. Supp. 987 (N.D. Ill. 1996). In this case, a futures commission merchant sued an LLC and two of its members to collect the deficit balance in the LLC’s trading account. The court determined that it lacked personal jurisdiction over the LLC members based upon the fiduciary shield doctrine (described by the court as prohibiting the exercise of personal jurisdiction over a nonresident whose only contacts with the forum state were "solely on behalf of his employer or other principal"). The plaintiff attempted to avoid the effect of the fiduciary shield doctrine by relying on the corporate alter ego doctrine. The defendants countered with an affidavit reciting that the LLC’s assets were not treated as the assets of the individual defendants, that the LLC maintained necessary corporate records, that the LLC did not commingle its assets with those of the individual defendants, and that the LLC maintained a separate banking account. The affidavit was uncontradicted, and the court rejected the alter ego argument.

2. Worms v. WGB Partners, L.L.C., No. CV 950149182S, 1996 WL 571464 (Conn. Super. Ct. Sept. 26, 1996). This case also involved personal jurisdiction over nonresident individuals who were members of an LLC, but the plaintiff here was a fellow member of the LLC asserting various causes of action arising from an agreement to form and operate a partnership and LLC. The plaintiff and two defendants formed a Georgia LLC to provide investment banking services in both Atlanta and Greenwich, Connecticut, but never came to an agreement on the terms of the operating agreement. They subsequently terminated their relationship. (The plaintiff claimed that the parties actually formed a general partnership which they then changed to an LLC. The court refers to the business relationship in varied terms throughout the opinion, including a "partnership," "limited liability company" and "limited liability corporation"). The defendants apparently resided in Georgia and contended that their only dealings with the plaintiff consisted of negotiations by correspondence and telephone between Connecticut and Georgia about the operating agreement. The defendants argued that they did not transact business in Connecticut for purposes of a Connecticut statute granting personal jurisdiction. The court found that the defendants had transacted business in Connecticut and thus were subject to the court’s jurisdiction. The court additionally concluded that the situation did not involve a claim against the LLC itself; the claim that the defendants breached their agreement to operate the business was a claim that could be asserted against them in their individual capacities.
3. Cornerstone Orthopedic Hospital v. Marquez, 944 F. Supp. 451 (W.D.N.C. 1996). This is yet another case in which the issue was personal jurisdiction. In this case, the defendant was a doctor who was a limited partner in a limited partnership formed under North Carolina law to operate a hospital in McAllen, Texas. The limited partnership was formed as the result of a conversion from an LLC formed by the defendant and others. The parties involved in the creation of the LLC and limited partnership had a falling out, and the defendant was sued by the limited partnership in North Carolina. The defendant, who emphasized that he had never visited North Carolina, challenged the court's personal jurisdiction. The court found that the defendant had the requisite minimum contacts under North Carolina's long arm statute and the Constitution to warrant the exercise of jurisdiction. The court relied on the fact that the defendant played an active role in creating the limited partnership and assumed obligations to North Carolina business entities. In particular, the court stressed his participation in forming the LLC that was the predecessor to the limited partnership. The court pointed out that all of the business entities created by the parties were created under North Carolina law and that the defendant participated in the decisions regarding formation of the entities. (The court at one point mentions that he signed the "articles of incorporation" of the LLC. This is in keeping with the court's later reference to another LLC as a "North Carolina corporation.")

In connection with formation of the LLC, the defendant executed an operating agreement and a subscription agreement governed by North Carolina law. The defendant argued that status as a limited partner is not enough to create personal jurisdiction; however, the court distinguished the defendant from the type of passive investor that is a limited partner in a large limited partnership and is comparable to a shareholder in a large corporation. The defendant was more than a passive investor, according to the court, because he was one of the parties involved in forming the limited partnership and he undertook obligations that differed from those assumed by passive investors. The court concluded that the defendant was more akin to a general partner than a shareholder.

4. Reid v. Town of Hebron, No. CV 9354384S, 1996 WL 634254 (Conn. Super. Ct. Oct. 22, 1996). In this case, the individual plaintiff was denied a building permit to build a house on a lot he owned. The plaintiff appealed the decision of the Hebron Conservation Commission, claiming that the decision deprived him of any reasonable use or practical value of his property and amounted to a taking of the property without just compensation. During the course of the appeal, the plaintiff transferred his interest in the lot to an LLC in which he owned a fifty percent interest. The defendant argued that the plaintiff was not aggrieved by the denial of the permit and thus could not pursue the appeal because he did not sustain his interest in the property at issue throughout the course of the proceedings. The plaintiff relied on his ownership in the LLC to establish his aggrievement. The court quoted the LLC statute to the effect that property transferred to or otherwise acquired by an LLC is property of the LLC and not of the members individually. The court held that, because the property was transferred to another party who was not a party before the Commission and not a party to the appeal, the plaintiff was not aggrieved and had no standing to appeal. (Had the plaintiff been the sole member of the LLC, it appears the court would have treated him as the beneficial owner of the property based upon a prior case in which the court treated the sole stockholder of a corporation as beneficial owner of land owned by the corporation.)

5. Taurus Advisory Group, Inc. v. Sector Management, Inc., No. CV 960150830, 1996 WL 502187 (Conn. Super. Ct. Aug. 29, 1996). Here, the plaintiffs, Taurus Advisory Group, Inc. (TAG) and Taurus Advisory Group, LLC (Taurus LLC), sued several parties for breach of contract, negligent misrepresentation, breach of the duty of good faith and fiduciary relationship, and other claims arising from an agreement among TAG and the defendants to form Taurus LLC. The defendants sought dismissal of the case on the grounds that the complaint asserted derivative claims that TAG attempted to bring individually and that TAG lacked the authority to commence an action in the name of Taurus LLC. The court first noted that Delaware law applied since the LLC was formed under Delaware law (citing Restatement (Second) of Conflict of Laws - 302). The court then accepted the parties' analogy of an LLC to a corporation, finding members to be similar to stockholders. The court accepted this analogy based on caselaw analogizing limited partners in a limited partnership (which the court referred to as a limited liability partnership) to corporate shareholders. The court determined that TAG's claims relating to the defendants' failure to make agreed contributions of capital and services alleged a direct injury and TAG could bring the suit on its own behalf. The court further decided that the complaint did not state an individual cause of action in favor of TAG for breach of fiduciary relationship because the only articulated harm was to the LLC (which the court referred to at that point as a corporation), and because the complaint did not set out a relationship comparable to that involving a majority shareholder's duties toward the minority shareholders since the capital contributions were in equal amounts.
In this case, the plaintiff sold its interest in an LLC to the parent company of the other member of the LLC. The plaintiff claimed that the terms of the LLC agreement and another agreement regarding the LLC entitled it to a pro rata payment of LLC funds for the portion of the month before the close of the sale of its interest in the LLC. The defendant claimed that the terms of the agreements precluded such a distribution. The court examined various provisions of the agreements and concluded that one of the provisions required a distribution to be made to the plaintiff for its pro rata share of the LLC’s net cash flow for the month at issue.

7. Barbieri v. Swing-N-Slide Corp., No. 14239, 1997 WL 55956 (Del. Ch. Jan. 29, 1997). Here, Greengrass Management LLC (Management) and Greengrass Capital (Capital) formed a general partnership, Greengrass Holdings (Holdings). Management was organized by several senior officers of Swing-N-Slide Corp., including Mueller, a director and the president and CEO of Swing-N-Slide. Holdings executed a two-step tender offer to acquire a majority stake in Swing-N-Slide. Barbieri, a Swing-N-Slide shareholder, brought an action challenging the transaction. He argued that because Mueller had an ownership interest in Management, and Management was one of the two general partners of Holdings, Management and Holdings owed fiduciary duties to the Swing-N-Slide shareholders. The court found that the persons who formed Management, as senior officers of Swing-N-Slide, owed fiduciary duties to Swing-N-Slide. Thus, the issue of apparent first impression was whether a legal entity must take on the pre-existing fiduciary duties of those who form and control it. The court determined that the fiduciary duties of the Swing-N-Slide director and officers must be imputed to the LLC they formed because "[n]either Mueller nor the others would escape their fiduciary obligations to [Swing-N-Slide] had they not formed Management. To allow them to use this State’s laws allowing the formation of the limited liability company as a vehicle to avoid those very duties would be unconscionable." As to Holdings’ liability, the court found that Holdings was made up of two partners, Management and Capital. Capital had no pre-existing fiduciary duties to Swing-N-Slide or its shareholders, and the court refused to assume that Management "so controls or otherwise so dominates the affairs of the partnership that the partnership itself must take on the fiduciary obligations of a single partner." Thus, the court determined that Holdings need not take on the imputed fiduciary duties of Management.

8. Hagan v. Adams Property Associates, Inc., No. 961332, 1997 WL 97815 (Va. Feb. 28, 1997). In this case, the plaintiffs, Ralph and Maureen Hagan (the Hagans), executed an agreement with the defendant, Adams Property Associates, Inc. (Adams), giving Adams the exclusive right to sell the Hagans’ apartment complex for $1,600,000. The agreement provided that if the property was "sold or exchanged" within one year, with or without Adams’ assistance, the Hagans would pay Adams a fee of six percent of the "gross sales amount." Before the year had expired, the Hagans and two other parties formed an LLC, and Hagan transferred the property to the LLC in exchange for an interest in the LLC, the LLC’s assumption of debt on the property, and a promissory note from the LLC secured by a second deed of trust on the property. The Hagans argued that transfer of legal title to the property constituted valid consideration for the contribution. The Virginia Supreme Court found that the benefits received by the Hagans by virtue of the transfer of the property constituted valid consideration. It further distinguished the cases cited by the Hagans for the proposition that the transfer was capitalization on the basis that those cases involved the capitalization of a partnership rather than an LLC. The court stated that a partnership is not an entity separate from its partners, thus a partner’s transfer of property to the partnership is "only a change in the form of ownership." The court characterized an LLC as an entity separate from its members and concluded that the member’s transfer of the property to the LLC thus amounted to a sale.

9. In re D&B Countryside, L.L.C. (D&B Countryside, L.L.C. v. Newell), Case No. 95-11946-SSM, Adv. Proceeding No. 96-1110 (February 24, 1997). The issue in this proceeding was the authority or apparent authority of LLC managers to execute deeds of trust against the LLC’s assets and obligate the LLC for repayment of certain loans to the managers. Robert and Marilyn DeLuca were members and managers of D&B Countryside, L.L.C., a Virginia LLC. Newell loaned the DeLucas substantial amounts of money secured by various deeds of trust on property owned by the LLC. Eventually, the DeLucas also executed a note on behalf of the LLC. The deeds of trust and note were executed by the DeLucas without the consent of the other members of the LLC. The court examined the operating agreement of the LLC and concluded that it did not confer

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actual authority on the DeLucas to execute the deeds of trust or the note. The court then considered whether the DeLucas had apparent authority to bind the LLC. Relying on common law principles and provisions of the Virginia LLC act, the court concluded that the DeLucas did not have apparent authority to execute the deeds of trust or the note.

10. JM Avalon Investments, LLC v. Nischan, No. CV 960330010, 1997 WL 133939 (Conn. Super. Ct. March 7, 1997). JM Avalon Investments, LLC and one of its members, Gaspero, sued the other member of the LLC, Nischan and her husband for conversion, fraud, negligence, breach of contract and unjust enrichment. Nischan sought to have the case dismissed on the basis that the LLC lacked standing to sue. Nischan argued first that the LLC was not authorized to bring the suit because Nischan, a fifty percent owner of the LLC, had not consented to the suit. The Connecticut LLC act provides that suit may be brought in the name of an LLC by any member or members who are authorized to sue by the vote of a majority in interest of the members. However, the court relied on another provision of the act that stated that the vote of any member who has in interest in the outcome of the suit that is adverse to the LLC shall be excluded. Since the suit alleged wrongdoing by Nischan, the court determined that the remaining member, Gaspero, had authority to bring the suit in the name of the LLC without the vote of Nischan. Nischan next argued that her resignation as a member of the LLC dissolved the LLC and left it without standing to sue. The court relied on various provisions of the LLC act in concluding that the remaining member, Gaspero, had authority to wind up the LLC, which included bringing suit on its behalf.

The court granted the request inasmuch as the claims did not involve the real property. The court pointed out that Gattoni did not have an interest in specific LLC property. Rather, Gattoni had a membership interest in the LLC, and the membership interest was personal property. The court rejected the argument that his claim for dissolution involved a claim for partition of the real property owned by the LLC. The court also addressed a request by Gattoni for a preliminary injunction that would essentially order preservation of the real property and prohibit its transfer. The court denied the request for injunctive relief based upon its conclusions that Gattoni failed to establish likelihood of success on the merits of his claims and did not show that Zacarro was likely to dispose of the property in a way that would thwart winding up and dissolution of the LLC.

Registered Limited Liability Partnerships: 1. Reisman v. KPMG

Peat Marwick LLP, No. CIV.A. 96-10521-WGY, 1997 WL 136382 (D. Mass. Feb. 28, 1997). The plaintiffs sued KPMG Peat Marwick LLP (Peat Marwick) in federal district court in Massachusetts asserting federal securities fraud claims and various state law claims. The court determined that the federal claims were time-barred; therefore, the court had to determine whether diversity was present to support subject matter jurisdiction over the remaining state law claims. Peat Marwick is a Delaware LLP, and the court noted that there was no reported decision regarding the citizenship of an LLP for diversity purposes. The court concluded that the Supreme Court case of C.T. Carden v. Arkoma Assoc., 494 U.S. 185 (1990) was controlling and that an LLP is a citizen of every state in which one of its partners resides. In Carden, the Court reiterated the rule that the citizenship of an unincorporated association is determined based upon the citizenship of all of its members. Specifically, the Court held that a limited partnership is a citizen of every state in which a general or limited partner resides. In view of that holding, the Massachusetts court rejected the plaintiff's argument that the citizenship of partners in an LLP who are not potentially liable should not be considered. The court stated that it was "particularly troubled that a Big Six accounting firm which operates offices within every state in the United States has effectively immunized itself from the reach of the diversity jurisdiction of the federal courts simply by organizing itself as a limited liability partnership rather than a corporation.

Nevertheless, until Congress addresses the jurisdictional implications of this new class of business entities, this Court can reach no other result."

The court noted by way of footnote that Peat Marwick may have "won" more than it bargained for because it would now be judicially estopped from advancing a contrary argument in any other court and "the doors of the federal courts ought now to be closed to Peat Marwick save in cases
that involve a federal litigant or which pose a federal question." The court estimated that Peat Marwick was currently a litigant in approximately 93 diversity cases that ought not to be pending and stated that, if it had the database to determine all such cases, it would notify every court in which such a case was pending.
Case Note Addendum

By: Peter D. Hutcheon
Somerville, New Jersey

Muscarelle v. Castano N.J. Super (A.D., June 23, 1997). After the death of the general partner in a real estate limited partnership in 1989, the Chancery Division of Superior Court appointed an administrator for purposes of liquidating the partnership. The limited partners were the spouse, son and two daughters. In the course of litigation among the family as to the sale of assets, the administrator obtained Chancery Court approval of a particular transaction. The Appellate Division affirmed citing the need to protect the interests of the daughters, as minority partners, in the face of a competing bid from the son supported by his mother (who together held 60% of the interests in the partnership).

White v. Caesar N.J. Super (A.D. June 25, 1997). Plaintiff, a 5% partner in a law firm general partnership under an oral agreement claimed a right to one-third on dissolution of the firm and also a right to unpaid salary. The Appellate Division affirmed the trial court rejection of plaintiff's per capita distribution claim (which was based on the UPA provision stating that each partner shares equally in profits and surplus, subject to other agreement). The Appellate Division reversed the trial court's dismissal of the salary claim, as there had been apparent oral agreement to pay the salary which varied the general UPA rule of no compensation to partners for partnership service.
Small's "World Tour"; Sabbatical Highlights

By: John H. Small Wilmington, Delaware In late August of last year, I took a four month Sabbatical from my practice. The PUBOGRAM Editor asked me to prepare something on the highlights of my trip. In chronological order: Pennsylvania: golf with college class mate at Laurel Valley and the Kahkwa Club in Erie; Chicago: a Labor Day game at Comiskey Park and dinner at the Pump Room with Gayle Fink; Minnesota: celebrating my 50th birthday with my parents at my birthplace (Minneapolis), lunch with Dean Harry Henning, a visit to my mother's hometown (Luverne); South Dakota: golf with my father at the Westward Ho Country Club in Sioux Falls, a visit to the St. Joseph's Indian School and Museum in Chamberlain, the Badlands, Mt. Rushmore, the Black Hills and Deadwood; Wyoming: golf at the Cheyenne Country Club and a visit to the old family cemetery in Cheyenne; Colorado: lunch and dinner with Bob Keatinge Rockies game, Broncos game, visit to my old grade school, and golf at the Broadmoor; Kansas: a toilet stop in Bob Dole's hometown (Russell); Missouri: a Royals game in Kansas City, golf with college roommate in St. Louis, great seats at a Cardinals-Cubs game at Busch Stadium; Ohio: golf and a great home-cooked dinner with Harry and Sandy Henning; Wisconsin: Cedarburg with Gayle; North Carolina: golf with my father and brother-in-law in Greensboro; England: golf with old friends at their clubs in the Midlands; Rome: joining the throngs for the Papal blessing in St. Peter's Square, the Coliseum and Trevi Fountain; Vienna: St. Stephen's Cathedral, St. Ruprecht's and other churches and the art museums; British Air First Class service from London to Hong Kong: the Dunhill Masters Golf Tournament, the Star Ferry, the Peak, day trip to Macau and golf in Red China; Singapore: the Jurong Bird Park, the Botanical Gardens, the Art Museum, and a visit with the Ambassador at the American Embassy; Australia: being in the welcoming crowd at Freemantle as a 17 year-old finished his solo around-the-world sail; Perth: golf at Collier Park and the Vines; New Norcea: Benedictine Monastery founded in the bush 150 years ago; the Indian Ocean, especially at the far southwest corner of Australia; Adelaide and Kangaroo Island; golf and wine-testing in the Barossa Valley; the Great Ocean Road from Adelaide to Melbourne, including lunch at "Lunch" in Port Fairy, the 12 Apostles and Apollo Bay; Melbourne: the Art Museum and a Supreme Court trial; Tasmania: the wombats and devils, the Tasman Peninsula, golf at "Rotho", the oldest course in the Southern Hemisphere, and Thanksgiving dinner at the Tasmanian Parliament as a guest of the majority leader; Sydney: ballet at the Opera House, the Harbor, St. Mary's Cathedral, the World War I Memorial and the Aquarium; snorkeling on the Great Barrier Reef, including a helicopter ride back over the reefs and the rain forest; New Zealand: golf at Titirangi, which was designed by Alistair McKenzie; golf in Rotorua among the thermal vent hazards; the drive from Rotorua through the southern part of the North Island to Wellington; Wellington: Christ Church; including the cathedral and golf at the Christ Church Golf Club; Akaroa harbor; Mount Cook; including a helicopter ride up to the glaciers and the Hermitage Lodge; Queenstown: including golf at the Queenstown Golf Course, the flight in a small plane over the Southern Alps and Milford Sound and the boat ride on Milford Sound; Dunedin: including golf at Balmacewan and St. Claire Golf Clubs; playing in the Auckland Taxi Drivers tournament at Pukekohe Golf Club; First Class on Qantas from Auckland to Los Angeles; Los Angeles: the refusal in the Bank of America Branch in Century City to cash my American Express travelers checks because I didn't have an account with B. of A. (the trip's low point);
back in Wilmington just in time for the Prickett, Jones’ partners Christmas dinner. What a blast! I’m ready to go again.
American Bar Association
Section of Business Law
Pubogram Newsletter
Committee on Partnerships and Unincorporated Business Organizations

Over Thirty

It has been said that all art consists of repetition and variation, with the frequency of repetition establishing the secular rhythm of the piece. One might muse (at least one Muse, perchance) that life in the law holds somewhat analogous consequences. (So often when we chance upon a variation not yet fully recognized as but an extension or reformation of prior experience, we reason by analogy; secure in our analytical prowess on other fronts and convinced in our uncertainty of the very necessity of parallelism). So it is with our burgeoning unincorporated creatures and the infinite variety of arrangement in which one claims partnership with all of the punctilios which ensue.

Thus our Committee will seek to open the Golden Gate of knowledge through that ancient law school exercise: briefing the case. Ably led by Prof. Beth Miller (and what Jeremiad would then dare declaim that nothing good came out of Waco), we seek to find the structures of meaning that will give pattern (and with pattern, rhythm) to the disparate decisions of the judiciary, each on its own specific facts (or are they?). An appetizer for the Tuesday, August 5 program (8-10 a.m.) can be found in the pages here. We find solace in the applications of the learnings of the past to the various inventions of the future.

So Steve Frost (who much like his nominal affiliate, cannot help but notice birches swinging from left to right across the line of straighter darker trees and how others sometimes walk in the shadows, so it seems to me, not of trees only) urges that we actually master the facts before objecting to the regulatory proposal. A bit of Kingsford or even Casner, Byse or perhaps "Bull" Warren in those words. And again we return to a time and place apart from now yet strangely the same in the structures of our imaginings.

And best (not merely for the Trinitarian impact of this completion of observances) we learn the essence of a Small World; fortunately replete with friends and 18 holes. Each different from the other, yet giving great comfort in the shared similarities. All finally leading back to home and the codal passage of return to where it all began. So partnership begins with two, extends across all commerce, and returns to the essence of itself. How apt that even in a place of just two Counties (three at low tide), Marty Lubaroff announces the inception of 5-another project of revision, perhaps radically "de-linked" from its predecessors, yet entirely derived from them.

It is a Small World after all and we delight in the continuing exploration of its dimensions; join us in San Francisco as we check the woof in the warp drive.