FROM THE CHAIR

Garth Jacobson
CT Corporation
Seattle, Washington

Dear Fellow Committee Members:

It is so hard to step into the shoes of the past chair Tom Rutledge, or measure up to the chairs of the years past. These past chairs all have shared their talent, knowledge and skill with the committee to make it, as Tom says, “The best damn committee in the ABA.” Each has contributed in their own way for our benefit and given us a reason to meet regularly and stay connected for many years. I am very proud to be part of this group and hope I can, as they say in wilderness hiking, “leave the campsite, in as good a condition, if not better, than how I found it.” It will be hard to match up because Tom has provided three great years at the helm with record attendance for the programs and many useful publications. But although he may escape the chair position he will continue to provide us the great committee publication that proves most useful and informative. As they say, “no good deed goes unpunished.” Thank you Tom for the so much you have done and continue to do for our committee. Likewise, Tom deserves the credit for the great lineup at the upcoming LLC Institute.

LLCs, Partnerships, and Unincorporated Entities run deep into my legal career roots. In the early 90s I participated on the LLC legislative drafting committee for the great flyover state of Montana. We relied upon the ABA LLC Prototype Act for our guidance in drafting the legislation. Because Montana was an early adopter of the legislation, we lacked much guidance from other states or court decisions.
Therefore the Prototype Act provided the essential information for the formulation of our act. We made modifications to help attorneys and self-help entrepreneurs avoid tax traps for the unwary by defaulting the legislation to pass the “two out of four test” (predecessor to the check the box) and prevent corporations from merging into LLCs. There were other features that are now arcane but useful at the time. I was proud to be one minuscule part of the effort that resulted in tsunami of legislation that engulfed the country and has made the LLC the most popular and fastest growing form of business entity everywhere in the US. Likewise I taught CLE programs and business law courses that included discussions about LLCs. Because I needed a better understanding of the tax law issues I left the Montana for Seattle to obtain my LL.M in taxation. However, despite my intention, I never returned to Montana, but stayed in Seattle and eventually ended up connecting with the LPUE committee.

The predecessors of our committee provided the important information needed to draft the legislation. The attorneys and many users of this business entity owe gratitude to our committee and its members for their great efforts to draft legislation, explain how LLCs work and report and explain the LLC case law. The committee has produced the who’s who of attorneys willing to share their experience and knowledge with the rest of us. You need only look to the recipients of the Martin I. Lubaroff Award for the start of the list of great committee members that have served so well. We cannot thank them enough.

The process of evolution continues with the development of the series LLC. Our committee has packed the membership of the ULC Series LLC drafting committee. Steve Frost and Dan Kleinburger have performed yeoman’s jobs in trying to make lemonade out of lemons. They and the committee have transformed an impossible to understand entity and shaped it to something that might be useful. Unlike those LLCs that have been formed and used by many who never used attorneys, the Series LLC in its present form will require lawyering up to make it work. There are many traps for the unwary, but hopefully it will not be a scam waiting to happen. The final year of heavy lifting will culminate in the “Protective Series LLC Act” going final next summer. Let’s as a committee take a careful look at the Act at the LLC Institute and provide constructive suggestions, if needed. Likewise as with regular LLCs, we can provide the intellectual support to those attorneys sorting through the issues drafting series legislation at the state level and the attorneys drafting series documents to avoid mistakes or traps for the unwary.

One final note about the LLC Institute. Those of you who have had the pleasure of attending the LLC Institute know what a wonderful educational experience it is. Not only are the panels of presenters well qualified but also the members in the audience provide effective questions that heighten the quality of the program. There is still time to register for the Institute but the rooms and the seats are going fast. It should be noted that Scott Ludwig started the Institute as a way to showcase the talent of the committee and provide an excellent opportunity to stay current of the latest issues affecting LLCs. Additionally we also use this event as an opportunity to award the Martin I. Lubaroff Award at our annual dinner. This year’s recipient is Scott Ludwig.

Scott served as the chair of our committee and in that position as mentioned started the LLC Institute. He has served on many legislative drafting committees that have helped shape LLC law. Likewise he has herded cats (authors) on ABA BLS Publication Committee and made sure it was content worthy. There are many other aspects of his service to his fellow attorneys, but I will leave that to those who “roast” him at the award dinner. He has been there countless times for other LPUE committee members and provided advice and assistance to all. Despite what Scott says about being a “dirt farmer from Alabama,” he can ask the really tough questions but always in a true southern gentleman manner. His kindness always comes through to those around him. Like the previous Lubaroff Award winners he certainly is deserving. This is truly an honor befitting him.

I hope all of you can attend the LLC Institute. It is time well spent and a good time is always had by all. In the end it is the friends we make that make the difference. I must say I value the friendships of our committee members the most and will do everything I can to promote opportunities for all of us to continue to connect with our common interests. The LLC Institute best provides us that opportunity.
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The 2016 LLC Institute
LLCs, Partnerships and Unincorporated Entities Committee
2016 LLC Institute
October 20 – 21, 2016
Agenda

Thursday, October 20, 2016

7:20 a.m. - 8:00 a.m.  Breakfast (included in registration)

8:10 a.m. – 8:30 a.m. Welcome; Housekeeping

8:30 a.m. - 10:30 a.m. Program (2 hrs.) Case Law Update (Non-Delaware)

Elizabeth Miller, Dan Sheridan, Sean Ducharme and Tom Rutledge

This panel will discuss recent LLC and partnership cases other than from Delaware on various topics of significance, including cases dealing with fiduciary duties and veil piercing and cases illustrating pitfalls in drafting operating agreements.

10:30 a.m. - 10:45 a.m. Break

10:45 a.m. - 12:15 p.m. Program (1.5 hrs.) Case Law Update (Delaware)

Lou Hering, Melissa Stubenberg and Matt O'Toole

This panel will discuss recent LLC and partnership cases from Delaware on various topics of significance, including cases dealing with fiduciary duties and veil piercing and cases illustrating pitfalls in drafting operating agreements.

12:30 p.m. - 1:45 p.m. Luncheon with Keynote Speaker – Professor Robert Thompson

“LLCs in the Mainstream of Business Associations Law: The Key Trends over the Last Two Decades”

2:00 p.m. - 3:30 p.m. Program (1.5 hrs.) Addressing Deadlock in LLCs

Lou Conti, Lisa Jacobs, Steve Leitess and Christina Houston

This panel will discuss deadlock breaking mechanisms in LLC operating agreements, with a focus on the types and forms of such provisions, their effectiveness and limitations, and the issues involved in drafting, enforcing, and litigating them, including statutory and case law developments affecting them.

3:30 p.m. - 3:45 p.m. Break
3:45 p.m. - 5:15 p.m.  **Program (1.5 hrs.) Nonprofit LLCs and UNPAs**

Lisa A. Runquist, Cassady A. “Cass” Brewer and Elizabeth Carrott Minnigh

This panel will address the increasingly common intersection of LLCs with the nonprofit sector. Topics to be discussed include: using LLCs as tax-exempt subsidiaries; charitable gifts to LLCs, including a recent, odd Tax Court decision respecting a single-member LLC for charitable contribution valuation purposes; using LLCs in lieu of private foundations for charitable giving; using unincorporated associations and/or stand-alone LLCs as tax-exempt entities; hybrid LLCs such as the benefit LLC, the L3C, and state-law nonprofit LLCs; program-related investments and LLCs; and the joint venture rules for LLCs with both tax-exempt and non-tax-exempt members.

6:30 p.m. - 7:30 p.m.  **Cocktail Hour – Cash Bar**

7:30 p.m. - 10:00 p.m.  **Lubaroff Award Dinner** - (this event is a separately ticketed event - obtain through the registration process)

**Friday, October 21, 2016**

7:30 a.m. - 8:00 a.m.  Breakfast (included in registration)

8:00 a.m. - 10:00 a.m.  **Program (2 hrs.) Back Office Ethics: Risk Management Wisdom to Keep the Law Firm Running**

George Coleman, A.J. Singleton

In the context of the ABA Model Rules of Professional Conduct, this presentation will be a review a lawyer’s basic duties to clients and a discussion of best practices. It will address the importance of new matter submission policies and procedures, including conflict checking and engagement letters; representation management, including disengagement letters and “I’m Not Your Lawyer” letters; due diligence screening and integration of lateral hires; maintaining the confidentiality of information relating to the representation of clients; and other pearls of wisdom.

10:30 a.m. - 10:15 a.m.  Break

10:15 a.m. – 11:45 a.m.  **Program (1.5 hrs.) Structuring the Management of a LLC “Board”**

Brad Borden, Christine Hurt and Tom Rutledge

Management provisions can raise issues ranging from the effect of default rules to principles of agency law to concepts of corporate law. This panel will begin with a general discussion of agency concepts and how state default rules bestow agency on members and managers of LLCs. It will also draw upon language from numerous LLC operating agreements to consider how effectively those agreements incorporate or block the default rules. After establishing that basic groundwork, it will proceed to an in-depth analysis of management provisions that incorporate a board of managers or directors, and discuss how some
effectively mimic the management structure of corporations and how some may cause management confusion. The discussion will review recent case law that has addresses LLC boards and how the management structure can affect whether courts rely upon principles of corporate law or partnership law to determine parties’ rights to management.

11:45 p.m. - 12:30 p.m.  Luncheon: Working Committee Meeting

12:30 p.m. - 2:30 p.m.  Program (2 hrs.) Uniform Series LLC Act

Steven Frost, Daniel Kleinberger, Marla Norton, Scott Ludwig and Allan Donn

This panel will discuss significant developments in the recently revised Uniform Limited Liability Company Protected Series Act which underwent a Second Reading at the 2016 Uniform Law Conference Annual Meeting in July 2016. The Final Reading of this Uniform Act is scheduled for July 2017.

3:00 p.m. - 3:15 p.m.  Break

3:15 p.m. - 4:45 p.m.  Program (1.5 hrs.) The New Partnership Audit Rules and Related Operating Agreement Drafting Considerations

Warren Kean, Chip Lion and George Hani

The repeal of TEFRA and the dawn of an entirely new set for IRS audits of partnership returns (generally effective for partnership years starting in 2018) warrants advance planning and preparation. This panel will discuss the new audit paradigm (and the many remaining open questions) as well as review how partnership and LLC agreements could be written (or rewritten) to adjust to the new paradigm.

4:45 p.m. - 5:00 p.m.  Wrap-Up
The Committee would like to thank National Corporate Research, Ltd. (NCR) for their continued support – 5 years sponsoring the LLC Institute!

Established in 1980, National Corporate Research, Ltd. (NCR) is a professional registered agent company that provides nationwide and international corporate, secured transactions, business license, real property, court, agency and library services for all industries, including the nonprofit sector. NCR is qualified to act as registered agent in all 50 states and the District of Columbia and provides statutory representation and process agent services for tens of thousands of companies across the country. NCR also offers registered agent services in many other countries throughout the world. With full-service offices in key cities from coast to coast in the U.S. and offices in Hong Kong and the United Kingdom, NCR has become a global resource for its customers. For more information, visit our website: www.nationalcorp.com.
Scott Ludwig to Receive the 2016 Martin I. Lubaroff Award

Scott E. Ludwig, a former chair of the Committee, is the 2016 recipient of the Martin I. Lubaroff Award.

Scott received his J.D. from the University of Alabama School of Law, and his LL.M. from the University of Florida Levin College of Law, where he received the Richard B. Stephens Scholarship in recognition of being first in his graduating class.

Scott is a partner in Bradley Arant Bolt Cummings resident in the firm’s Huntsville, Alabama office, where he serves as the chair of Bradley’s Life Sciences Industry Team. He advises a broad range of clients on corporate and tax issues, including advising companies in high technology, life sciences, biotechnology and traditional products and services, including start-up and established companies.

Mr. Ludwig is actively involved in the ABA’s Business Law Section. He has served as chair of the Committee on LLCs, Partnerships and Unincorporated Entities, which oversees the development of the laws governing limited liability companies, partnerships, limited partnerships, statutory trusts, and other unincorporated entities throughout the United States. He has also served the Section as its first Content Officer, a Council member, chair of its Publications Board, chair-elect of the Joint Editorial Board for Unincorporated Entities, chair of the L3C and B Corporation Evaluation Committee for the Whitehouse Staff in the Office of Science and Technology Policy, chair of the Revised Prototype Limited Liability Company Act subcommittee, and co-chair of the Prototype Limited Liability Partnership Agreement subcommittee. Mr. Ludwig was recently appointed to the Section’s Corporate Laws Committee. He has also served the Section as a member of the Editorial Board of The Business Lawyer, an advisor to the Uniform Law Commission’s Revised Uniform Limited Liability Company Act, the Omnibus Business Organizations Code Study Committee, and the Series LLC Act. For his service to the Section, Mr. Ludwig received the ABA Business Law Section Chair’s Award in 2010.

Scott is a member of the Alabama State Bar, having been the chair of the Tax Section and the Alabama Limited Liability Partnership Committee and a member of the Alabama Business and Nonprofit Entity Code Revision Committee, the Alabama Limited Liability Company Law Revision Committee, the Alabama Limited Partnership Law Revision Committee, the Alabama Business Corporation Law Revision Committee, and the Alabama Nonprofit Corporation Law Revision Committee. He has been President of the Alabama Federal Tax Clinic and President of the Huntsville Financial and Estate Planning Council.

Mr. Ludwig is an elected member of the American College of Tax Counsel and the Alabama Law Institute. He is listed in The Best Lawyers in America © (Biotechnology, Corporate, Non-Profit/Charities, Tax, and Trust and Estates), Super Lawyers and Who’s Who in American Law, is a Fellow in the American Bar Foundation, as well as an author and contributor to numerous articles, publications, and speeches.

He is involved in numerous civic and charitable activities. Mr. Ludwig is married to Kathy Ludwig, and they have two sons, Chase and Hayes.

Bradley Chairman of the Board and Managing Partner Beau Grenier:

“I cannot think of a more deserving candidate than Scott, who has tirelessly served—and continues to serve—the state and American bar associations. His dedication and performance have earned him deserved state and national esteem.”

Beth Miller wrote:

Scott Ludwig is a most fitting recipient of the Lubaroff Award. I cannot think of anyone who has been more dedicated to the development and improvement of the law of unincorporated entities than Scott. He has worked tirelessly on drafting projects in his own state and as a drafter, advisor, or observer on model, prototype, and uniform statutes promulgated by various arms of the ABA and NCCUSL. He was the moving force behind the Revised Prototype LLC Act, which I can say with certainty would not have come to fruition without Scott’s passion and commitment. As the Chair of the LLCs, Partnerships and Unincorporated Entities Committee (f/k/a the Partnerships and Unincorporated Business Organizations Committee), Scott spearheaded the renaming of
the Committee to more clearly identify its scope and communicate its relevance. He also launched the Committee’s signature annual event—the LLC Institute—as well as putting in place a leadership structure of the Committee that facilitated greater member involvement in, and effective administration of, Committee activities.

Scott’s participation in any project ensures that stones that would otherwise go unturned get moved so that bugs can be flushed out. I cannot count the occasions on which any number of brilliant minds have been over something, and Scott then spotted issues that had not been adequately addressed or considered. He is truly deserving of this award as one who embodies the professional and personal qualities we honor in remembering Marty Lubaroff. Those who know Scott have the utmost respect and fondness for him based on his wisdom, good humor, and many kindnesses. Countless others who have never met Scott are in his debt based on his dedication and commitment to the Alabama bar and the ABA Business Law Section. Scott’s personal life is also an example and inspiration to others. He is generous in spirit—giving freely of his time and resources to his friends and community. He is also loyal and devoted to his family. I am so glad to see Scott receive this honor that he so richly deserves.

Bill Callison wrote:

Congratulations to my circle-plowing, dirt-farming friend. This honor is well deserved.

Lauris G.L. Rall wrote:

Pretty easy - Mr. Organization Spectacular. Scott brought us out of the friendly confines of informal (sometimes default) entities into the modern world of LLCs. Slowly but surely he convinced and cajoled the world that we needed to aid the development of LLCs more systematically and with a broad reach into the "corporate" transaction bar. Of course I was dragged kicking and screaming but even I have seen the rightness of his ways. As many will remark, the LLC Institute was his crowning achievement and upon the earlier of his passing in 50 or so years or his retirement in 50 or so years I will move (from above or below depending...) that the LLC Institute be named the LLLC Institute!!! THE "Ludwig LLC Institute"!!!!!!

Steven G. Frost wrote:

When I think of Marty Lubaroff and the recipients of the Luberoff Award, I realize that each was not only brilliant and a respected authority in partnership and LLC law, but each was a mensch who cared about this Committee and its members. Scott shares these qualities. I have worked with Scott on Uniform Law Conference drafting committees as well as LPUE committee projects, and whether he agrees with your position, he cares about each of us and wants deeply to advance the law and our understanding of the law. Few have done as much as Scott to improve LPUE. For example, we would not have the LLC Institute today if not for Scott. I also knows he cares deeply about his wonderful wife and children, as did Marty and each of the other recipients of this award. Scott’s only shortcoming is his sense of humor, or lack thereof, which, growing up as a dirt farmer, he had little time to develop or practice, as is painfully apparent to this day. Still, I am proud to be able to say Scott is a friend, and I congratulate him for receiving this well deserved honor.

Peter D. Hutcheon wrote:

These are a few agriculturally-related remarks about a self-described "Alabama dirt farmer" (where I am uncertain whether the first word is locational or descriptive). Nurtured in the town of Huntsville, home of a major part of America’s space and missile defense programs, Scott is not only perhaps the leading throw-weight in its legal firmament, he is also the quickest in the Committee to send large plants as comforters to those facing serious medical issues, as I can testify occurred twice in my life to date. One of those plants, which embody survival, has even survived my "ministrations".

I dare to speak a bit about Scott’s background, having myself served in a USAF Strategic Missile Wing which included 6 weeks of legal training at Air University just outside of Montgomery, Alabama. Alabama IS different. AND Scott is too! He has brought practicality and humility to the Committee. He led us to substantial accomplishments with gentle prodding. And he conceived of and organized the Committee’s signature annual LLC Institute in Arlington.

Scott is also very brand conscious, in a way much more "Mad Men" than "Mayberry". While
the Committee was long known as the Partnership and Unincorporated Business Organization Committee (except at a Spring Meeting at the Mayflower Hotel in D.C., where it was signed as “The Partnership and Unintelligible Business Organization Committee), Scott saw the rapid growth of the use of LLC’s as an opportunity to boost the Committee's visibility and membership. So now are The LLC, Partnership and Unincorporated Entities Committee, leading with our LLC focus. Perhaps the only negative consequence is that our Newsletter has gone from “The PUBOGRAM” to “The LPUE Newsletter”, which may for those of us of a certain age may bring to mind “Pepe LaPew”, but that's a name of a different odor - although one perhaps not unknown to an "Alabama dirt farmer" AND our own "ROCKET MAN"!

Dan Kleinberger (perhaps channeling Peter Hutcheon?) writes:

As we all know, Scott is inclined to disparage his own talents – as in the phrase “just an Alabama dirt farmer.” In this connection, a song by Robert Burns comes to mind and the following verse is particularly apt:

A prince can mak’ a belted knight
A marquise, duke, an’ a'[ll] that
But an honest man's aboon
[above] his might
Gude faith, he maunna fa' [must not fault] that
For a’ that an’ a'[ll] that
Their dignities an’ a'[ll] that
The pith o’ sense an’ pride o’ worth
Are higher rank that a'[ll] that.

Kelley Bender writes:

The first meeting LPUE Committee meeting that I attended was the first LLC Institute in 2012, when Scott was the Chair of the Committee, and that was also my first time meeting Scott. He was so kind and welcoming to me and immediately encouraged me to get involved with the Committee. It should not surprise anyone that being a newbie around this group can sometimes be a bit intimidating, but Scott has always made me feel like one of the gang. Congratulations, Scott!

Robert Keatinge writes:

I have been honored to know Scott for many years. He is a simple dirt farmer who, like most simple dirt farmers _inter alia:_ has a BS in accounting and JD (both with various honors) from the University of Alabama and an LLC from the University of Florida; is or has been an active participant in the Boy Scouts of America since 2003, a director of the Huntsville Museum of Art, a member and Chair of the ABA Business Law Section Publications Board, a member and Content Officer of the Business Law Section Council, a fellow of the American College of Tax Counsel; and received the ABA Business Law Section Chair’s Award in 2010 and the Dean’s Service Award from the University of Alabama. He has been instrumental in drafting Alabama’s business organization laws, serveal Uniform acts, and the Revised Prototype Limited Liability Company Acts. He has chaired the committee and created the LLC institute.

In all of these successes, Scott has combined his hard work, intelligence, and sense of humor with his greatest gift: a care for people and an understanding of relationships. This care and understanding – a rare virtue indeed – has engendered both respect and affection from all of us who have had the privilege to work with him and learn from him. Beth, Allan, Tom, Paul and I had the benefit of Scott’s leadership on the Revised Prototype Limited Liability Company Act. Scott demonstrated not only the wisdom but the patience and understanding of relationships to bring the project to a successful conclusion. Using this skill, Scott has been able to lead legal and civic organizations his entire life (ever since he was drum captain at Virgil I. Grissom High School) in a manner that is considerate and draws the best each of the participants have to offer. And isn’t that the skill
we all try to bring to our practice as partnership lawyers?

Jim Wheaton writes:

Back in the old days, when the ABA was experimenting with summer meetings in tropical climates, the Business Section’s summer meeting hotel was the Disney Contemporary Resort in Orlando. That was the first week I recall becoming aware of Scott at one of our meetings. I’ll talk more about that first impression at Scott’s banquet, but suffice it to say that “dirt farmer” did not come to mind.

Over the years, I’ve had the opportunity to watch Scott tackle some of the most contentious issues facing the committee, and have always been bowled over by his level of focus and persistence. I followed him onto the section Publications Committee, and he succeeded me as chair of the LPUE committee. As Vice Chair and then Chair, he was the driving force for the name change, the Institute, the expansion of our membership reach and leadership roster, and the redraft of the ABA Prototype LLC Act. The same level of commitment pervades all that he does. I’ve tracked the accomplishments of his sons, and we’ve shared a lot of discussions about the Scouting program and the benefits our children have derived from it. Many of our generation bemoan the distractions and distractedness that characterize the millennial cohort our kids belong to, but it’s no small feat that Scott and Kathy raised two Eagle Scouts.

So where does the dirt farmer come in? Perhaps it’s simply the plain-spokenness we each experience with Scott. He’s not a natural politician, and he doesn’t take long to let you know what he thinks. He doesn’t defer to the reality of ABA or ULC or federal government politics. And that’s ok, because the points of view he brings to the table are well-developed, add to both the practical and scholarly aspects of what we do, and always improve the end product.

David Tingstad writes:

Scott is the definition of a “gentlemen and a scholar.” When I joined the committee as a lowly non-Delaware lawyer, Scott made me feel welcome and valued. Over the years, I have been blessed by his thinking on a host of issues and my practice is better because of his contributions. Congratulations on a well-deserved honor!

Christina Houston writes:

I love him to death. He’s my brother. I have nothing eloquent to say.

Lou Conti writes:

Let’s see, when I think of Scott Ludwig, I think of the “poor dirt farmer” from Alabama, who neither looks nor acts like a poor dirt farmer. I think of someone who is articulate, thoughtful, insightful, considerate, opinionated (in a good way), friendly, but not overly so, charming even, and a fine gentleman. Scott is also the kind of man that anyone fortunate enough to know, would consider a true friend. Someone to be relied upon and trusted at all times.

We are fortunate to have Scott as a colleague and pillar of LPUE and the ABA.

Joseph Boucher writes:

As a relative newcomer to the national LLC scene, Scott really made me feel wanted and comfortable to contribute. It was a pleasure to get to know him. He is truly a wonderful person and easy to work with.

Dan Sheridan writes:

There are certain qualities that mark a true leader. We know that intelligence helps. We also know that arrogance hurts. But beyond being smart and nice, those who lead effectively possess a true “x” factor. Much ink has been spilled on the importance of “humility” as an essential character trait of a leader. Curiously, nowhere has it been mentioned that being a poor dirt farmer from Alabama is apparently a most effective crucible for developing and refining this virtue. Fortunately for those of us privileged to know him, Scott Ludwig has and continues to prove the truth of this hypothesis. Many members of the unincorporated entity bar have had the pleasure of knowing Scott for much longer than I have, and certainly much better than I do. When I initially got involved, Scott was just assuming the reins of the LPUE Committee. He immediately welcomed my interest. It was not just a polite overture from a Committee Chair to a new member, but was an act of authentic kindness and respect. In the years since, he has played the role of champion, mentor, supporter and coach. Perhaps most importantly, he has extended the hand of friendship – for which I am very grateful. The progress of the LPUE
Committee is a reflection of the tradition of leadership that Scott inherited and very capably passed on. Scott's contributions go far beyond his scholarship and far beyond his tireless efforts towards the development of the law and legal practice in the LPUE arena. They reflect a spirit of generous service that many of us wish we could emulate, but few of us actually do. Congratulations Scott, and thank you.

Joan Heminway writes:

I must repeatedly remind myself to overlook Scott Ludwig's poor judgment in attending two other Southeastern Conference schools for his undergraduate and legal education. :>) That aside, I am so grateful for Scott's long-term leadership in the LLC & Partnerships and Unincorporated Entities Committee—including his roles as chair of the committee and as a chair, co-chair, or active member of multiple subcommittees and task forces over time. I have learned much from his guidance and management of the committee's work and from the substance of his work over the years. His generosity and warmth are hallmarks of his participation in ABA activities. He is so worthy of the exceptional honor that the Lubaroff Award represents, and I offer him the most sincere congratulations as the recipient of that award this year.

Jay Adkisson writes:

To define balance, common sense, and a deep appreciation of the issues involved in anything to be considered would be to define Scott Ludwig; somebody who never takes honest dispute personally, and the very beau ideal of what a lawyer is and should be. To say that I am proud to have worked on projects with the simple Alabama dirt farmer is a substantial understatement, as it has been for everyone that I have known who have been similarly blessed with such opportunity.

Laura A. D'Angelo writes:

So happy that Scott is receiving this much deserved reward. Despite being a busy and active practitioner, husband and dad, Scott has given selflessly of his time to contribute to and chair this Committee. In addition, he was always more than willing to aid, assist and mentor those of us (much younger) lawyers as we became involved with the committee - and for that, I and many others, owe him a debt of gratitude.

Heather Jefferson writes:

Scott Ludwig: the charming Southern gentleman, a wonderful mentor to new lawyers and "newbies" to the ABA Section of Business Law and a skilled lawyer. I am so glad that I had the privilege of meeting him when I first started attending the Business Law meetings, although I was always slightly confused as to why the "Rutwig" moniker was placed on him......Tom was really in good company on that one!

Cristin Keane writes:

Congratulations, Scott, on this recognition of your intellect, hard work, and love of the law. The only thing I appreciate more than your thoughtful analysis of LLC and partnership issues is the fact that you are also an amazing tax lawyer! You have given so much of yourself to this wonderful committee and to the development and understanding of unincorporated entities. I sincerely come away from every interaction with you feeling like I've learned something, whether it's about LLCs, partnership tax, state law, working together towards a common goal, professionalism, or even parenting skills (seriously - I hear your Southern words of parenting wisdom in my head often when I'm dealing with my kids and I hope I exhibit your patience and good judgment). I am truly honored to know you and I am so excited to raise a glass of wine to celebrate your receipt of this distinguished and well-deserved recognition. Congratulations!

George Coleman writes:

I cannot remember when we first met -- too many years have gone by. However many years doesn't matter, it's the sustaining friendship that counts! All the ABA Business Law Section meetings, the Committee meetings, and the telephone calls were made much more productive and pleasant as a result of your work and interest. Your leadership of the Committee and the work you put into it kept us moving forward at great speed and with great style.

Congratulations!

Allan Donn writes:

In considering Scott Ludwig's contributions to the law of unincorporated business organizations two of his accomplishments come readily to mind. First, he was the chairman of the committee that prepared the Revised Prototype Limited Liability
Company Act. That Act and its Comments of more than 100 pages in the Business Lawyer provide a valuable resource for any state that is reviewing and revising its unincorporated entity statutes. Second, he led the creation and development of the LLC Institute at which he will be honored this year. The Institute has become the preeminent national program for the education of the law of its subject.

Among the personal qualities for which Marty Lubaroff is memorialized and for which Scott is honored this year are his being gentle, kind, and courteous. I have personally benefitted from those qualities by his having granted to me express permission to edit his emails.

Warren Kean writes:

We are very fortunate to have Scott’s leadership on the committee. Scott is the type of person that every organization needs to be successful. While being a very talented lawyer, he has fully invested himself in the committee and committee activities, always pushing himself and others to do more. Scott is responsible for many of the initiatives of the committee, from numerous worthwhile projects to the extremely successful and well-considered annual LLC Institute. Scott is a difference maker and very deserving recipient of the Lubaroff Award.

Tom Rutledge writes:

Scott is far smarter than he lets on, is generous to a fault, and is incapable of hubris. He is a great friend, and all of us, especially myself, are far better for knowing him.
NY Law, Dewey Partners and the Dewey Lease

By: Michael A. Bamberger
Dentons US LLP
New York, New York

On April 5, 2016, Justice Salliann Scarpulla of the New York Supreme Court (a trial court) held that the landlord of Dewey & LeBouef LLP's ("D&L") New York City offices could not impose personal liability on D&L's present and prior partners, or the partners of its predecessor firms, for unpaid rent for D&L's New York office. 1301 Properties Owner LP v. Abelson, 51 Misc. 32 1207, 2016 NY Slip. Op. 50446 (Sup. Ct. N.Y. Co. 4/1/06). While the facts are complex and contested, and while the Court decided a number of issues (both factual and legal), I propose to discuss only the Court's treatment of NY Partnership Law §26(b), which provides that:

no partner of a partnership which is a registered limited liability partnership is liable or accountable, directly or indirectly (including by way of indemnification, contribution or otherwise for any debt, obligations of liabilities of, or chargeable to, the registered limited partnership or each other, ... which are incurred, created or assumed by such partnership while such partnership is a registered limited liability partnership, solely by reason of being such a partner ...

There is an exception to §26(b) in §26(d) if "a majority of the partners shall have agreed" to such personal liability.

There is a related issue under N.Y. Partnership Law § 28, which reads:

A person admitted as a partner into an existing partnership is liable for all the obligations of the partnership arising before his admission as though he had been a partner when such obligations were incurred, except that his liability shall be satisfied only out of partnership property.

The lease, which is complex and in some respects ambiguous, was executed on December 8, 1989 by Dewey, Ballantine, Busby, Palmer & Wood (a NY general partnership) ("DBBPW"), the predecessor (in several stages) of D&L, and Tishman Speyer Trammell Crow LP, the predecessor-in-interest of plaintiff.

As the Court summarized the facts, the original lease provided that (a) partners of DBBPW's successors or assigns would be personally liable for the lease in the event of breach; and (b) DBBPW would be required to demonstrate its creditworthiness by submitting an annual financial certification to the landlord. Although the lease stated that partners of DBBPW's successors would be personally liable, the lease also contained a "non-recourse provision" that apparently limited liability for partners of DBBPW if certain conditions were met. The lease further allowed successor partners who retired or withdrew from the partnership to be released from personal liability upon satisfaction of certain conditions.

The lease remained in effect from 1989 until May 25, 2012, when Plaintiff terminated the lease. During the two decades that the lease was effective, several relevant events occurred: (i) the parties to the lease changed, (ii) the terms of the lease were amended twelve times, and (iii) the New York Legislature amended the Partnership Law to permit the organization of registered limited liability partnerships. None of the amendments (including those to which LLP entities were partners) deleted the personal liability provisions; one of them slightly modified them.

Of particular importance were changes to the tenant entities that occupied the leased premises, which in sequence were DBBPW, Dewey Ballantine (both general partnerships), Dewey Ballantine LLP and D&L. The changes in tenancy resulted from DBBPW's name change, to Dewey Ballantine's conversion to a limited liability partnership Dewey Ballantine LLP in 1997; and Dewey Ballantine LLP's combination with LeBouef Lamb LLP to form D&L in 2007.


2 There is no Uniform Act equivalent to this provision.

Plaintiff brought suit against 426 D&L partners and partners of each of the predecessor partnerships. (Subsequently the action was dismissed as to 49 of them.) Although the Court does not distinguish among the partner categories, defendants include D&L partners who had been partners of one or both of the predecessor general partnerships, some of whom were partners of D&L on the date of default; partners of one of both predecessor general partnerships who never were D&L partners; and partners who were only partners of Dewey Ballantine LLP and D&L.

The Court found that:

the agreement by the original contracting parties to impose personal liability on the general partners of Tenant, DBBPW's successors, is unenforceable as against the limited liability partners of Dewey Ballantine LLP and Dewey & LeBoeuf LLP because the successor parties failed to comply with the procedure set forth in Partnership Law §26(d). . . . Partnership Law §26(d) sets forth a statutory procedure for imposing personal liability on partners of an LLP, not merely a default rule that parties may contract around. This statute is designed to safeguard partners and provide them with fair notice of the circumstances under which they will be held personally liable for the partnership's debts, against their ordinary and reasonable expectation that they are otherwise protected from personal liability as partners of an LLP.

In response to the argument that partners of the general partnerships should remain liable even after the firm became an LLP, the Court states:

While there may have been a reasonable time period following Dewey Ballantine's conversion to a limited liability partnership in 1997, the contracting parties had ample opportunity to update the lease and comply with Partnership Law §26 by securing a majority or other agreement among the partners to be held personally liable. The contracting parties, however, failed to do so, even in the fifteen intervening years after the LLP law went into effect. To enforce their agreement now and impose personal liability upon the defendants would be directly contrary to, and defeat the purpose of Partnership Law §26(d).

This suggests that under NY law, when a NY general partnership becomes an LLP, the general partners' prior obligations (as, for example, under a line of credit or term loan) become automatically unenforceable, at least after some "reasonable time period" for the parties to have renegotiated their deal.5 But what if the partners — about to be relieved of personal liability — choose not to negotiate and the terms of the agreement with the third-party do not require them to do so?

I would think that an appropriate analysis of the application of §§ 26 and 28 requires consideration of the facts to each category of partner. The factual issues include the meaning of the ambiguous and possibly conflicting terms of the lease; whether the lease constitutes a single continuing obligation through the years or whether, absent a default, an obligation is incurred when each monthly rental payment is made, not when the lease is made; and whether the answer to the preceding question is affected by the existence of amendments of the lease. The resolution of these factual issues may vary from state to state.

As to general partners of either of the two general partnerships, the determinative issue will be when the obligation for the lease occurred. If, as some argue it should, in the context of becoming an LLP, be the date of making the lease, there would be continuing liability (assuming the "non-recourse provision" did not apply). If, on the other hand, the lease

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4 A result apparently assumed by the comments to § 306 of the Uniform Partnership Act (1997) (amended 2013).

5 Section 26 does not appear to contemplate such a grace period.
were an obligation at the outset, then arguably only those general partners who were partners at the date of execution would have their personal assets at risk. Under § 28, the remaining general partners of the general partnerships would risk only their interest in partnership property.

As to those partners who joined the firm after it became LLP, whether the lease was a pre-existing obligation or one that arose monthly, Justice Scarpulla appears to be correct in applying § 28(b) and (d) to protect them from liability since 26(d) suggests that the only way an LLP obligation can impose personal liability on partners is by agreement of "a majority of the partners." 6

While the trial court’s decision may or may not be correct and the decision is on appeal to N.Y.’s intermediate appellate court, the broad brush applicability of §§ 26(b) and (d) should concern creditors and creditors’ counsel. Not all partnerships are as large and visible as Dewey Ballantine was. If a New York business general partnership becomes an LLP with pre-existing liabilities such as credit or leasehold obligations that are not immediately due, with no statutory obligation to notify creditors, even with the statutorily unsanctioned litigation provision imposed by Judge Scarpulla, the landlord or lender may lose an important part of its expected bargain.

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6 The statute goes on to say "unless otherwise provided in any agreement among the partners," presumably permitting a higher or lower voting requirement.

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Professor Joan Heminway

Professor Joan Heminway of the University of Tennessee College of Law has been appointed to the Rick Rose Distinguished Professorship. As you will no doubt recall, Joan has presented to our Committee, including at the LLC Institute, and is as well a co-author, including with Professor Mark Loewenstein, of the book BUSINESS ENTERPRISES, LEGAL STRUCTURES, GOVERNANCE AND POLICY.
New Partnership Audit Rules Require Action Now in Respect to Partnership Agreements

By Fred F. Murray*
Grant Thornton LLP
Washington, DC

Drafters of complex partnership agreements have in the past not always taken the existing rules relating to tax examinations of partnerships into account in fashioning their complex structures of “waterfalls” and revaluations and other economic events anticipated in the life of the business entity. Though such considerations might have been helpful, they may not in all events been necessary. That consideration may not have seemed important because of the ways in which the current rules work and the relative infrequency of examinations by the IRS.

That will not be the case as new rules recently enacted to replace the existing regime take effect—tax counsel and business lawyers alike will have to anticipate the consequences of examinations and make provision for their effects on both the partnership and the partners—past, present and future. The new rules work in very different ways, and the IRS is reorganizing with a view, among other goals, to make audits of partnerships, particularly large partnerships, more common.

This column contained an article last year that noted many of the issues that larger partnerships raise in the context of the existing examination rules under the Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”) and called for change. It is sometimes said: Be careful what you ask for! The new rules seem likely to resolve many of the issues, but have created others, and will likely have to be further refined going forward in order to answer some of the questions already being asked in relation to them.

The following includes a primer on and brief summary of some very complex areas of the tax law but will seek to illuminate some of the considerations involved. Some of the tax process issues, and related drafting issues, are already apparent—but others will only become so as the process evolves further.

The Existing TEFRA Regime

There are currently three different audit regimes that may apply to a partnership, depending on the number of partners in the partnership and whether the partnership has elected the TEFRA partnership audit rules to apply. For partnerships with 10 or fewer partners, the IRS generally applies the audit procedures for individual taxpayers, auditing the partnership and each partner separately. For most large partnerships with more than 10 partners, the IRS conducts a single administrative proceeding (a TEFRA audit) to resolve audit issues regarding partnership items that are more appropriately determined at the partnership level than at the partner level. A third audit regime, enacted in 1997, applies to partnerships with 100 or more partners that elect to be treated as electing large partnerships (ELPs) for flow-through reporting and audit purposes.

TEFRA Audit Rules

TEFRA established unified audit rules applicable to all but certain small partnerships. These complex rules require the tax treatment of all “partnership items” to be determined at the partnership, rather than the partner, level. In addition to partnership income, gain, deductions and credits, the term partnership item includes other items such as tax preference items, nondeductible expenditures and partnership liabilities. TEFRA shifted the audit of partnership items to the partnership level with this change and similarly provided that the applicability of any penalty, addition to tax or additional amount that relates to an adjustment to a partnership item, must be made at the partnership level.

The rules also require a partner to report all partnership items consistently with the partnership return, unless the partner notifies the IRS of any inconsistency. If a partner provides the IRS with a notice of inconsistency, the IRS may audit the partner even if the IRS does not audit the partnership. However, if the partner does not provide the IRS with a notice of inconsistency, the IRS may immediately assess the partner under the math error procedures. The consistency requirement applies not only upon the filing of each partner’s return but also if the partnership return is adjusted as the result of an audit (in which case each partner’s return is required to be modified to be consistent with such adjustments).

The IRS may challenge the reporting position of a partnership by conducting a single unified administrative proceeding to resolve the issue with respect to all partners. Nevertheless, the IRS must still assess any resulting adjustment against each of the taxpayers who
were partners in the year in which the misstatement of tax liability arose. In addition, any partner can make an administrative adjustment request (AAR) or request a refund for his or her own separate tax liability and participate in partnership-level administrative proceedings.

The TEFRA partnership rules also require the IRS to give notice within certain time limits of the beginning of partnership-level administrative proceedings ("NBAP"), and any resulting administrative adjustment, to the Tax Matters Partner (TMP) as well as to all partners whose names and addresses are furnished to the IRS. Meeting these time limits can be a challenge for the IRS if the partnership does not designate a TMP.

TEFRA created a primary representative of the partnership in dealing with the IRS as well as the partners. The TMP is usually a general partner (as opposed to a limited partner) designated by the partnership or, if no designation is made, the general partner with the largest profits interest.

The TMP conducts the partnership’s participation in the examination. The TMP keeps the partners informed of the TEFRA examination. The partners’ individual returns are generally not under examination. All partners have the right to attend significant conferences.

When the examination is complete, a Summary Report and Form 886-S are issued to the TMP. If the adjustments are agreed, a Form 870-PT is signed by the partners. If the adjustments are not agreed, the TMP or a notice partner may protest the 60-day letter (investor-settlement package) adjustments to Appeals. If the issues are not settled at Appeals, a notice of final partnership administrative adjustment (FPAA) is issued. When the partnership-level examination is concluded, computational adjustments are made to the individual partners' returns at an IRS Campus, and a notice of tax due is sent to the individual partners. The partners may accept the changes resulting from the examined issues or may challenge them.

The FPAA is subject to judicial review in the Tax Court, the Claims Court or the U.S. District Court in the district in which the partnership has its principal place of business. The strict time limits for various actions, and the rules regarding who may file for court review are complex, to say the least.

Electing Large Partnership Regime

Effective for tax years beginning after December 31, 1997, a new elective category of partnerships for purposes of both partnership reporting and partnership audit purposes was created by Congress to ease reporting burdens and facilitate compliance checks by the IRS—the ELP. The primary purposes of the changes were twofold: to create a simplified flow-through regime that would reduce the sheer number of items reported to partners and, thereby, ease the reporting burden of partners and facilitate matching by the IRS and to create a simplified audit regime.

An ELP is generally any partnership whose number of partners in the previous year is 100 or more that makes an election under the provision. For this purpose, partners performing substantial services in connection with the partnership’s activities do not count. Personal service partnerships and commodity partnerships are excluded.

While the ELP rules are technically part of the TEFRA rules, the ELP audit regime differs from the TEFRA regime in several important respects. For one, unlike under the TEFRA audit regime, partnership adjustments generally flow through to the current-year partners who hold their partnership interest during the year in which the adjustment takes effect. The adjustments generally will not affect prior-year returns of any partners (except in the case of changes to any partner’s distributive share). In lieu of flowing an adjustment through to its partners, the partnership may elect to pay an imputed underpayment. Regardless of whether an election is made to pay the tax due at the partnership level, the partnership, rather than the partners individually, is liable for any interest and penalties that result from a partnership adjustment. Unlike under the general TEFRA rules, under the ELP audit rules, a partner is not allowed to take a position inconsistent with the partnership return even by filing a notice of inconsistent treatment with the IRS. Moreover, a single representative (who may be a nonpartner) must be appointed (or, if not appointed, the IRS may designate any partner) to represent the partnership in all proceedings. The IRS will deal solely with the designated (or appointed) representative, and no partner has the right individually to participate in settlement conferences or to request a refund. Similarly, the IRS is not required to give notice to
individual partners of commencement of an administrative proceeding or of a final adjustment, and, while administrative adjustments can still be challenged in the U.S. Tax Court, the U.S. Court of Federal Claims or the U.S. District Court in which the partnership’s principal place of business is located, only the partnership, and not the partners individually, can petition for a readjustment of partnership items. Finally, absent an agreement otherwise and absent false or fraudulent returns, a substantial omission of income or the failure to file a partnership return, the IRS cannot adjust a partnership item of an ELP more than three years after the later of the filing of the partnership return or the last day for filing the partnership return.

The New Bipartisan Budget Act Regime

The Bipartisan Budget Act of 2015 (BBA) (enacting new Code Secs. 6221–6241) repealed the TEFRA partnership regime summarized above and replaced it with an entirely new set of rules that in some respects seem to be derived from the ELP rules, and which are now coming to be known as the “BBA” regime. The new regime not only has some similarities to the old TEFRA unified partnership examination provisions but also adopts significant changes to the rules controlling how partnerships, and entities that elect to be treated as partnerships for tax purposes (e.g., limited liability companies) (jointly referred to here as “partnerships”), deal with the IRS with respect to the tax examination, litigation and collection process.

The BBA moves much of what TEFRA previously allowed or required the partners to do in that process to the partnership, allowing the IRS to collect an underpayment of tax, penalty and interest from the partnership itself. In the course of which the new provisions place exposure on the current partners to tax liabilities of prior partners. The BBA provisions create a new role for a Partnership Representative (the partnership’s designated liaison with the IRS) that is different from the role of the TEFRA “TMP,” placing increased powers in that representative and generally decreasing the ability of the partners to participate in the process. Much of the outline of the process provided by the new BBA provisions is left to regulations yet to be promulgated by the Treasury.

These changes and the terminology that is part of their mechanisms are very different from those contemplated by and contained in typical partnership agreements that have become commonplace.

The New Examination and Collection Paradigm

As under TEFRA, tax adjustments will be made at the partnership level. However, unlike under TEFRA, the tax attributable to an adjustment will be collected, subject to certain adjustments, at the partnership level from the partnership, unless the partnership makes an election out of the procedures (available annually, and subject to certain eligibility requirements more fully described below) that is provided and does in fact make the election:

Under the centralized system, the audit of a partnership takes place at the partnership level. Any adjustment to items of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year, and any partner’s distributive share thereof, generally are determined at the partnership level. Any tax attributable to these items generally is assessed and collected at the partnership level. The applicability of any penalty, addition to tax, or additional amount that relates to an adjustment of any item of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year or to any partner’s distributive share thereof is determined at the partnership level. Unlike prior law, distinctions between partnership items and affected items are no longer made. An underpayment of tax determined as a result of an examination of a taxable year is imputed to the year during which the adjustment is finally determined, and generally is assessed against and collected from the partnership with respect to that year rather than the reviewed year. [Citation omitted.]

Because of the overwhelming difficulties the IRS has faced in trying to conduct examinations at the partner level of these aggregate
businesses and investments, the decision was made to put the burden on the partnership. It must be noted, however, as further briefly described below, that in three situations the new law allows some or most of the process to be shifted out to the partners. However, to take advantage of these mechanisms, the partners will need to make provision for them in the partnership agreement.

To understand the new mechanisms, it is first necessary to understand new terms created to define them. The new regime discards certain well-known TEFRA terms (e.g., “Tax Matters Partner”) and creates completely new operative terms.

An examination performed by IRS will be conducted on the reviewed year. The term “reviewed year” means the partnership taxable year to which the item being adjusted relates. That review will normally be conducted later in time, at which time, if one is to be made, an adjustment is proposed and then either agreed or imposed. For these purposes, the term “adjustment year” means the partnership taxable year in which—(A) in the case of an adjustment pursuant to the decision of a court in a proceeding brought under Code Sec. 6234, such decision becomes final; (B) in the case of an AAR under Code Sec. 6227, such AAR is made; or (C) in any other case, notice of the final partnership adjustment is mailed under Code Sec. 6231. That determination is important because the payment mechanisms become operative in the adjustment year, and it is the partners who are partners of the partnership in the adjustment year who bear the burden of the adjustment. These adjustment year partners may not necessarily be the partners who were partners of the partnership in the reviewed year.

Under the default rule, the tax to be paid is based on another new concept, in a calculation called the “imputed underpayment.” Generally, except as otherwise provided, the imputed underpayment is calculated at the highest tax rate for the reviewed year on the net income amount that results from netting the adjustments. Allowed reductions must be approved by the IRS. The partnership must submit information to the IRS sufficient to justify the modification not later than the close of the 270-day period beginning on the date on which the notice of a proposed partnership adjustment is mailed under Code Sec. 6231 unless such period is extended with the consent of the Secretary.

Code Sec. 6225(a) provides for the payment of the tax attributable to an “imputed underpayment” as follows:

In the case of any adjustment by the Secretary in the amount of any item of income, gain, loss, deduction, or credit of a partnership, or any partner’s distributive share thereof—

(1) the partnership shall pay any imputed underpayment with respect to such adjustment in the adjustment year as provided in section 6232, and

(2) any adjustment that does not result in an imputed underpayment shall be taken into account by the partnership in the adjustment year—

(A) except as provided in subparagraph (B), as a reduction in non-separately stated income or an increase in non-separately stated loss (whichever is appropriate) under section 702(a)(8), or

(B) in the case of an item of credit, as a separately stated item.

Note that both adjustments that result in increases and decreases are taken into account in the Code Sec. 6225 mechanism (except to the extent that Code Sec. 6225(b)(2) applies).

Interest due is determined at the partnership level and accrues, except as otherwise provided (see below where the partnership elects the alternative payment method under Code Sec. 6226, and as part of which the underpayment is determined at the partner level) at the rate applicable to underpayments. Penalties (and defenses) are determined at partnership level.

The BBA also changed the statute of limitations for partnership assessments. Under the new law, the statute of limitations starts to run only when the partnership’s tax return is filed and no longer takes into consideration the date of the filing of the individual partner’s return.
Drafting Points. Should the agreement include indemnification, escrow, or other provisions to address potential tax liabilities from prior years? Consider the adequacy and scope of the existing indemnification provisions – do they provide appropriately for the partners’ payment so the imputed underpayments? Does the agreement provide that a former partner will indemnify the partnership and adjustment year partners for its share of the reviewed year liability? Should the indemnification include costs of the partnership and partners in complying with the requirements of the process?

Should the agreement provide for withholding of cash flows to wholly or partly fund future tax liabilities? How would that get determined, and at what times?

Should transferor (former) partner or transferee (new) partner or both (joint and several) be liable to the partnership for the share of tax attributable to tier interest?

Ways to Modify or Avoid Tax Assessment and Collection at the Partnership Level

Where the characteristics of the partnership permit, the centralized “imputed underpayment” process can be modified or even avoided in one of several ways provided by the statute. In addition to filing an AAR, the partnership may avail itself of the three mechanisms generally described below. Each of these scenarios may involve some complex arrangements and may not be available unless the partners have reached the necessary agreements.

1. Annual Election to Opt-Out of Partnership-Level Proceedings

First, as an alternative to the Code Sec. 6221(a) and Code Sec. 6225 partnership-level determination, certain partnerships that have no more than 100 partners and otherwise meet the requirements of the election can make an annual “opt out” election on a timely filed tax return. If a partnership elects out of the new regime, the partnership and partners will be examined under the rules applicable to individual taxpayers. Having the IRS examine each of the partners may in some cases be a simpler and more optimal solution to the complexities presented by the new statutory process, but it is likely to create its own set of problems, including the possibility of inconsistent treatment among the partners.

Drafting Points. Should the partnership agreement provide, or be amended, to limit the number of partners to 100? Should other partnerships or flow-through entities be allowed to become a partner in the partnership? Should the agreement allow this election or preclude it?

It may not in all cases be the optimal solution to opt-out of the Code Sec. 6225 process. If a partner is individually examined, in addition to the partnership items, all what was called “affected items” under TEFRA in that partner’s return are taken into account. Further, the examination may also extend to unrelated items, i.e., any item on the return. That may be problematic for some partners. Perhaps the most perplexing problem though is that the partner must have complied with its recordkeeping obligations under Code Sec. 6001. That section requires certain records be kept to support the items on the return, and without them, the items are subject to disallowance. This may be difficult if the partner must sustain positions taken on the partnership return, as the partner, normally would not have or keep such records.

Should the agreement require the partnership to provide all necessary information to the partners whose returns are being examined?

2. Alternative to Payment of Imputed Underpayment by Partnership Where “Reviewed Year” Partners Pay Share of Tax with Current-Year Partner Returns

Under Code Sec. 6226, a partnership, regardless of size or composition, may elect out of the “imputed underpayment” process within 45 days of receiving a notice of final partnership adjustment, if it provides each partner of the partnership for the reviewed year and the IRS with “a statement of each partner’s share of any adjustment to income, gain, loss, deduction, or credit (as determined in the notice of final partnership adjustment).”
Drafting Points: In some cases, payment by the partnership at the partnership level under Code Sec. 6225 may be advantageous. For example, there is no Code Sec. 1411 tax when making the Code Sec. 6225 payment. In addition, the partnership-level payment does not trigger additional partner-level tax created by affected items, i.e., increased from other items in the partner return that are triggered by the increased partnership item taxes. The interest rate is likely lower under section 6225, but the interest may not be deductible by a partner. Computing an understatement penalty at the partnership level and an individual partner’s level may have differing results. Intervening years may only be included if the years produce increases in the tax liability. The partnership must provide the IRS with an allocation of the liability to each partner, and that, particularly where tiered partnerships are involved, may not only be difficult but also undesirable (e.g., the partnership tiers may have to inform the source partnership of the identity of their partners and the partners’ interests). The partnership has to inform the partners that a “mistake” has been made in regard to its taxes and that additional taxes are due (however that needs to be packaged). Particularly, where the adjustment is not significant, it may not be desirable to require the partners to do the partner-level computations and perform the necessary actions to pay their respective share of the tax liability. Does the partnership have to notify partners of the need to set up “FIN 48″ (ASC 740-10) liability or other financial statement implications?

In other situations, the Code Sec. 6226 election should be considered. How will these issues be considered and decided and by whom (or will they be considered)? Are there procedures in place to take the necessary actions within the relatively short time frame? Should current and former partners be required to provide the partnership the information it may need to make elections under Code Sec. 6226? In tiered partnerships, the recipient partnership and its reviewed year partners and adjustment year partners may have entered into indemnification agreements with respect to the risk of tax liability of reviewed year partners being borne economically by partners in the year that includes the date of the statement. These agreements should take into account that because the payment of tax by a partnership under the centralized system is nondeductible, payments under an indemnification or similar agreement with respect to the tax are nondeductible. Similarly, RICs and REITs may wish to make agreements for a deficiency dividend. (See JCS-1-16, at 70.)

Under this procedure, “reviewed year” partners calculate their share of additional tax due based on the statement (an amended Schedule K-1 or similar statement), and the “reviewed year” partners will pay the additional amount with their respective current-year individual tax returns. There is a downside to this election—making the election increases the applicable underpayment interest rate by two percentage points.40 Further, the partner has little ability to contest the result.41

The Code Sec. 6226 provisions allow for tiered partnerships. According to the Joint Committee on Taxation explanation, in such a case, a partnership that receives a statement from the partnership under examination is treated similarly to an individual partner who receives a similar statement. The recipient partnership that is a partner takes into account the aggregate of the adjustment amounts determined for the partner’s taxable year including the end of the reviewed year, plus the adjustments to tax attributes in the following taxable years of the recipient partnership. The recipient partnership pays the tax attributable to adjustments with respect to the reviewed year and the intervening years, calculated as if it were an individual (consistently with Code Sec. 703), for the taxable year that includes the date of the statement.42 Questions have been raised though about whether the recipient partnership may itself push out the liability to its partners through its own election and other related complexities. This is an area of the new rules where more discussion and clarity is needed.

3. Imputed Underpayment of the Partnership Is Modified and Reduced Where Reviewed-Year Partner(s) Files Amended Reviewed-Year Tax Return

The amount of the “imputed underpayment” payable by the partnership may be reduced if one or more of the “reviewed year” partners of the partnership files an amended return and pays the tax attributable to the adjustment allocable to that partner.43 To implement this approach, the partners must complete their filings within 270 days of the notice of proposed adjustment.44
The New Partnership Representative

Code Sec. 6223(a) requires that "[e]ach partnership shall designate (in the manner prescribed by the Secretary) a partner (or other person) with a substantial presence in the United States as the Partnership Representative who shall have the sole authority to act on behalf of the partnership under this subchapter. In any case in which such a designation is not in effect, the Secretary may select any person as the Partnership Representative." The "person" so designated need not be a partner in the partnership or an individual, raising the possibility that trust or asset management companies may be selected, for example.

Drafting Points: Amended returns may be advantageous to some or all of the partners. The tax liability may be less by taking into account allocated decreases; and, even unrelated items may be changed in the amended return.

Amended returns may not be advantageous to others, particularly because of the effects on unrelated items. In this connection, it is important to note that the filing will reopen the statutes of limitation on the entire return. Further, the filing will require a new jurat on the return based on information known at the time of the amended filing. Some thought must be given to intervening events.

Should the agreement allow the partnership to require partners to file, or prohibit them from filing, amended returns under Code Sec. 6225(c)(2)?

Among other provisions, the partnership agreement may need to establish procedures to ensure notice that the partner amended returns have been filed, as it may be difficult to obtain that information by other means.

In the case of any adjustment that reallocates the distributive share of any item from one partner to another, this procedure is only available if returns are filed by all partners affected by such adjustment.

There are other differences between this procedure and that provided by Code Sec. 6226. First, these rules cause a return to be filed for the taxable year of the reviewed year partners which includes the end of the reviewed year and payment is made on that return – in the Code Sec. 6226 situation, the return is filed by the reviewed year partners for the taxable year which includes the date the required statement was furnished and payment is made with that filing. Under the Code Sec. 6225 mechanisms (except where Code Sec. 6225(b)(2) applies), both adjustments that increase and decrease tax are considered – under the Code Sec. 6226 mechanisms, only those adjustments in the subsequent intervening years that increase tax are considered.

But the selection is important and must be thoughtfully exercised because, as discussed below, the new rules restrict the rights of partners to notices and other participation in the examination or litigation that follows it. Further,
as stated above, the Partnership Representative has the sole authority to act on behalf of the partnership in these matters, and additionally, the “partnership and all partners shall be bound by actions taken … by the partnership.”

Drafting Points: The previous designation of a TMP should not be considered the designation of the Partnership Representative, given the change of duties and definitions.

The partnership agreement should provide for the selection of a Partnership Representative. In most cases, the partners would prefer that result to one in which the IRS selects the representative. It may be a person or entity that is not a partner – should the selection of a bank or trust company or other representative that will exist for a long time be considered? Besides substantial presence in the United States, what other characteristics would be important to consider?

Which partner or partners may make the selection? There are possible conflicts of interest inherent in the choices, e.g., selection of the partner with the largest profits interest as under present law. If the representative dies, resigns, is disqualified, or otherwise fails to act, who may choose a successor? At what time would this be permitted or required?

Are there other substantive rights to be conferred on the representative, or restrictions placed upon the representative? Should actions be taken only after a vote of the partners or would some other participatory mechanism be appropriate?

Under the TEFRA rules, the IRS generally has been required to give notice of the beginning of partnership-level administrative proceedings and of any resulting administrative adjustment to all partners whose names and addresses are furnished to the IRS. For partnerships with more than 100 partners, however, the IRS is generally not required under present rules to give notice to any partner whose profits interest is less than one percent. Further, under the present rules, partners have certain rights to participate in administrative proceedings at the partnership level and can request an administrative adjustment or a refund for the partner’s own separate tax liability. To the extent that a settlement is reached with respect to partnership items, all partners are entitled to consistent treatment.

The new BBA centralized system supersedes the current rules and provides new rules governing notices, and many aspects of the procedure controlling the examination and collection process, including time limitations, restrictions on assessment and the imposition of interest and penalties in the context of a partnership adjustment. A discussion of many of these rules, important as they may be, is beyond the scope of this column. It is critical to note, however, that the new rules eliminate most of the notice and participation rights previously afforded partners in the partnership by the TEFRA rules and provide instead for centralized representation in the Partnership Representative.
Drafting Points: TEFRA gave partners the right to be notified of various events. The Partnership Representative has no obligation under the statutes to take similar actions. Likewise, certain matters may have been decided at the partner level. The partnership agreement should be amended to provide either the same or perhaps more or less generous rights to the partners.

Should an agreement provide contractual rights similar to those provided under TEFRA, including, for example:

- notice of beginning of administrative proceeding and final partnership administrative adjustment (former Code Sec. 6223(a));
- partner to be kept informed of administrative and judicial proceedings of partnership items (former Code Sec. 6223(g));
- right to participate in the proceeding (former Code Sec. 6624);
- right to petition for judicial review (former Code Sec. 6626);
- right to petition for an administrative adjustment (former Code Sec. 6627).

Should some partners receive additional notices (e.g., of particular events like examination notices and IDR’s received, and the like)? Should the rights afforded be different depending on whether the partnership will pay the tax or the partners pay the tax under a 6226 or 6225(c)(2) election? Should the rights extend to former as well as current partners?

If this action is not taken, the Partnership Representative will not have the benefit of input from the partners before making decisions binding on the partnership, and the partners will have no binding avenue to participate in formulating necessary decisions and actions.

It is important to note that the BBA provides mechanisms that allow for the conduct of tax examinations and collections (by the IRS at the Federal level in the United States, and does not address those by state, local, and foreign jurisdictions). Further, issues have arisen in the past in operational tax matters (e.g., the making of a tax election on a tax return not under examination), and while many believed that TEFRA provided the TMP the necessary authority to make such elections or take other actions, that was not a matter free of controversy. While adapting the partnership agreement to the new BBA provisions, thought should be given to how such matters are decided, and by which partners or partner groups, and explicit authorities should be conferred and/or restrictions put in place.

Whose interests must the representative take into account in making particular decisions – the partnership interest or the partners (if so, which ones, e.g., the partner with the largest profits interest)? The simple answer – the interest of all the partners – is not necessarily the last word in all cases. There are significant possible conflicts of interests present in these matters. Indemnification provisions for the representative, and possibly for the governing or decision-making body, are needed. Effective disclosures of the ramifications of the choices should be made to all partners at the outset.

The Partnership Representative is likely in many cases to want direction from the partnership, and to want insulation from disgruntled partners who may not agree with decisions made in accordance with the mechanism placed in the partnership agreement.

The BBA provisions provide for three general types of notifications by the IRS to the partnership and the Partnership Representative in the course of an administrative proceeding with respect to that partnership. The notifications also apply to any proceeding with respect to an AAR filed by a partnership. These categories are (1) notice of any administrative proceeding initiated at the partnership level, (2) notice of a proposed partnership adjustment resulting from the proceeding and (3) notice of any final partnership adjustment resulting from the proceeding. Such notices are sufficient if mailed to the last known address of the Partnership Representative or the partnership, even if the partnership has terminated its existence. A notice of proposed adjustments informs the partnership of any adjustments tentatively determined by the IRS and the amount of any imputed underpayment resulting from such adjustments.

Further, it is important to note that any affirmative actions that partners may wish to take must be coordinated to be completed within the timeframes provided for particular actions in the statutes. The issuance of a notice of proposed partnership adjustment begins the running of a period of 270 days in which to supply all necessary information required by the
IRS in support of a request for modification. During that same period, the IRS may not issue a notice of final partnership adjustment. With the issuance of a notice of final partnership adjustment to the partnership, a 90-day period begins during which the partnership may seek judicial review of the partnership adjustment. The issuance of a notice of final partnership adjustment also marks the beginning of the 45-day period in which the partnership may elect the alternative payment procedures. Further notices of adjustment or assessments of tax against the partnership with respect to the partnership taxable year that is the subject of the notice of final partnership adjustment are prohibited during the period in which judicial review may be sought or during which a judicial proceeding is pending (absent a showing of fraud, malfeasance or misrepresentation of a material fact).

**Effective Date and Transition Period**

These new rules generally apply to returns filed for partnership taxable years beginning after December 31, 2017. However, a partnership may elect to have the new rules apply to partnership tax years beginning after the date of enactment and before January 1, 2018. It is also important to note that the statute does not “grandfather” existing partnerships governed by existing partnership agreements.

**In Conclusion**

These provisions are extremely complex and contain many new procedures and terms that are different from those currently employed. They are likely, especially given an expected increase in examinations of partnership returns by the IRS, to produce significant surprises, if not problems, for partners whose partnerships have not taken the changes into account. Existing agreements should be reviewed and modified where necessary, and new ones should be drafted with the provisions in mind. Such actions will make for a more effective experience when the IRS examines a partnership tax return, makes tax adjustments and/or requires payments of additional tax, penalties and/or interest.

**Fred F. Murray**, Managing Director, International Tax Services, Grant Thornton LLP, Washington, D.C. Grant Thornton LLP is the U.S. member firm of Grant Thornton International Ltd. He can be reached at fred.murray@us.gt.com.

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**Endnotes**

* The views expressed herein are those of the author and do not necessarily reflect the views of Grant Thornton LLP or any other person or entity with whom the author is or may have been associated. The author would like to acknowledge and thank Shamik Trivedi of Grant Thornton LLP for his helpful comments.


2 References in this column to a “section” or to “Code Sec.” are to a section of the U.S. Internal Revenue Code of 1986, as amended (“the Code”), unless otherwise indicated. References to regulations are to regulations promulgated by the U.S. Treasury under the Code.
Act Secs. 401-407 of the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248), 96 Stat. 324 (TEFRA), codified, at Code Secs. 6221–6234. TEFRA was effective for partnership tax years beginning after September 3, 1982 (the date of enactment). Id., at Code Sec. 407(a)(1). The original TEFRA audit rules have already been modified a number of times since enactment. The principal past legislative adjustments are: The Deficit Reduction Act of 1984 made certain technical corrections to TEFRA and extended TEFRA to nonpartnership entities that file partnership returns; the Tax Reform Act of 1986 coordinated the Tax Court deficiency procedures with respect to partner-level determinations arising from a partnership proceeding with the deficiency procedures applicable to the taxpayer from items unrelated to a partnership proceeding; the Technical Miscellaneous Revenue Act of 1988 provided for one or more extensions with respect to certain of the statutes of limitations if agreed to by the Treasury and the taxpayer; Act Secs. 1307(c)(1) and (c)(3)(B) of the Small Business Jobs Protection Act of 1996 (P.L. 104-88), 110 Stat. 1755, repealed all rules that caused TEFRA to apply to S corporations and made conforming amendments throughout the TEFRA provisions [Congress had extended the TEFRA partnership audit rules to S corporations later in 1992 shortly after TEFRA was enacted, but in a separate legislative act]; Act Secs. 1221–1243 of the Taxpayer Relief Act of 1997 (P.L. 105-34), 111 Stat. 788 (1997 Act), substantially modified the TEFRA partnership audit rules in 1997 by creating a third category under the administrative system for partnerships—the “electing large partnership” regime—and also by liberalizing the TEFRA partnership audit rules in general.

Small partnerships can elect to be subject to the TEFRA audit procedures for years beginning on or after January 1, 2004. Reg. §301.6231(a)(1)-(b)(2).

What follows is an overview only—to fully describe the rules and their interactions would require a lengthy dissertation.

TEFRA, at Code Sec. 402(a).

A taxpayer partner that takes a position inconsistent with the partnership return must file with the IRS Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (“AAR”).

In math or clerical error cases, the IRS may assess and send a notice of assessment of additional tax without using deficiency procedures. Code Sec. 6213(b) and IRM pt. 21.5.4 (Oct. 1, 2015).

For partnerships with more than 100 partners, however, the IRS generally is not required to give notice to any partner whose profits interest is less than one percent. Code Sec. 6223(b)(1), before amendment.

If there is no designation, the TMP is determined by the largest profits interest rule. Reg. §301.6231(a)(7)-(1m). The TMP may be designated by the IRS where the largest profits interest rule is impracticable to apply and may be a limited partner or an indirect partner [a partner (who is not a TMP) of a partnership that is itself a partner in a TEFRA partnership]. See IRM pt. 8.19.1.6.5.3 (Dec. 1, 2006).

The TMP acts as coordinator and liaison between the partners, the IRS and the courts in resolving the examination and disputes. The TMP provides the names, addresses, profits interests and TINs for each partner during the year for which an NBAP is issued; executes consents to extend the statutes of limitations; binds nonnotice partners to any settlement negotiated with the IRS unless that nonnotice partner intervenes; and files an AAR on behalf of the partnership and petitions the courts if the AAR is not allowed in whole or in part. Code Secs. 6227(c) and 6228(a)(1), before amendment.

Act Sec. 1226 of 1997 Act (P.L. 105-34).


The primary impact of the simplified flow-through regime was to reduce from “more than 40 items” to slightly more than 10 items reported to partners of ELPs. Importantly, Congress identified as sources of inefficiency and complexity to be (1) the assessment of any deficiency against a large number of partners, (2) the difficulty in locating a large number of partners (many of whom are no longer partners) and (3) the ability of individual partners to intervene in the audit. 1997 BLUEBOOK, at 363.

Act Sec. 1221 of 1997 Act (P.L. 105-34).

But if a partnership ceases to exist before a partnership adjustment takes effect, the former partners are required to take the adjustment into account, as provided in regulations. 1997 BLUEBOOK, at 364.

The IRS can give proper notice by mailing the notice to the last known address of the partnership, even if the partnership has since terminated its existence. 1997 BLUEBOOK, at 364.

1997 Bluebook, at 365.

The term "partnership" means any partnership required to file a return under Code Sec. 6031(a). Code Sec. 6241(1).

Code Sec. 6621(a).

Id. ("... any tax attributable thereto shall be assessed and collected ... at the partnership level pursuant to this subchapter.")

Staff of the Joint Committee on Taxation, JCS–1–16, GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN 2015, March 2016, at 57.

Code Sec. 6625(d)(1).

Code Sec. 6625(d)(2).

Code Sec. 6225(a).

Code Sec. 6225(b).

In the case of any adjustment that reallocates the distributive share of any item from one partner to another, such adjustment shall be taken into account by disregarding any decrease in any item of income or gain, and any increase in any item of deduction, loss or credit [Code Sec. 6225(b)(2)].

Regulations will provide for taking into account a lower rate of tax with respect to (a) ordinary income of a C corporation, (b) capital gain and qualified dividends of an individual and (c) tax exempt partners [Code Sec. 6225(c)(3),(4)].

Code Sec. 6225(c)(6),(7).

Code Sec. 6621(a)(2).

Code Sec. 6233.

Code Sec. 6235. One particularly notable change is found in Code Sec. 6235(a)(1)(C), which extends the statute of limitations on assessment by three years from the time an AAR is filed. This is in contrast to the long-standing notion of a three-year statute from the time the return is filed under Code Sec. 6501. Now, the filing of an AAR will extend the statute of limitations by an additional three years from that date. One may wonder if the change will affect the desirability of filing an AAR given the corresponding effects.

Code Sec. 6227.

Technically, the test is that “for such taxable year the partnership is required to furnish 100 or fewer statements under section 6031(b) with respect to its partners” [Schedule K-1s are used for this purpose]. Code Sec. 6621(b). See the special rules for S corporations noted in the next note.

Code Sec. 6221(b) provides specific eligibility requirements—the election is made if: (A) the partnership elects the application of this subsection for such taxable year; (B) for such taxable year the partnership is required to furnish 100 or fewer statements under Code Sec. 6031(b) with respect to its partners; (C) each of the partners of such partnership is an individual, a C corporation, any foreign entity that would be treated as a C corporation were it domestic, an S corporation or an estate of a deceased partner; (D) the election—(i) is made with a timely filed return for such taxable year and (ii) includes (in the manner prescribed by the Secretary) a disclosure of the name and taxpayer identification number of each partner of such partnership; and (E) the partnership notifies each such partner of such election in the manner prescribed by the Secretary. It is important to note that only partnerships comprised of partners who are individuals, certain C corporations and S corporations, and the estates of a deceased partner may make the election. If a partner is itself a partnership (or an entity that has elected to be treated as a partnership, like a limited liability company), that partnership is ineligible to make the election.

If one of the partners is an S corporation, the partnership shall only be treated as meeting the requirements of paragraph (C) above with respect to such partner if such partnership includes a disclosure of the name and taxpayer identification number of each person with respect to whom such S corporation is required to furnish a statement under Code Sec. 6037(b) [Schedule K-1] for the taxable year of the S corporation ending with or within the partnership taxable year for which the application of this subsection is elected.

Code Sec. 6221(b)(1). The rules of the subchapter do not apply if the election is made.
The partnership may make the election within 45 days from the notice of final partnership adjustment, and within 90 days from the notice of final partnership adjustment may file a petition for readjustment with the Tax Court, district court or Court of Federal Claims. Upon the final court decision, dismissal of the case or settlement, the partnership is to implement the election by furnishing statements (at the time and manner prescribed by the Secretary) to the reviewed-year partners showing each partner’s share of the adjustments as finally determined. As part of any settlement, for example, it is contemplated that the Secretary may permit revocation of a previously made election, and the partnership may pay at the partnership level. JCS-1-16, at 69.

Under Code Sec. 6226, if a partnership for which adjustments are made makes a Code Sec. 6226 election with respect to an imputed underpayment and furnishes to each partner of the partnership for the reviewed year and to the IRS a statement of the partner’s share of any adjustment to income, gain, loss, deduction or credit (as determined in the notice of final partnership adjustment), Code Sec. 6225 does not apply and each partner’s tax for the taxable year that includes the date the statement was furnished is increased by taking into account the aggregate of the “adjustment amounts.” The election so made is only revocable with IRS consent.

The “adjustment amounts” taken into account are: (A) in the case of the taxable year of the partner that includes the end of the reviewed year, the amount by which the tax would increase if the partner's share of the adjustments were taken into account for such taxable year, plus (B) in the case of intervening taxable years that include any taxable year subsequent to that taxable year but before the taxable year that includes the date the statement was furnished, the amount by which the tax would increase by reason of the required adjustment to tax attributes as summarized in the next sentence. Any tax attribute taken into account in a subsequent taxable year that would have been affected if the adjustments described in the statement of the partner’s share of any adjustment to income, gain, loss, deduction or credit (as determined in the notice of final partnership adjustment) were taken into account for the taxable year of the partner that includes the end of the reviewed year shall be appropriately adjusted. [Note that tax increases in subsequent intervening taxable years are taken into account, and not tax decreases.]

Any penalties, additions to tax or additional amount shall be determined as provided under Code Sec. 6221, and the partners of the partnership for the reviewed year shall be liable for any such penalty, addition to tax or additional amount. In the case of an imputed underpayment with respect to which the application of this section is elected, interest shall be determined—(A) at the partner level, (B) from the due date of the return for the taxable year to which the increase is attributable (determined by taking into account any increases attributable to a change in tax attributes for a taxable year) and (C) at the underpayment rate under Code Sec. 6621(a)(2), determined by substituting “5 percentage points” for “3 percentage points.” [Two-percentage-point increase in interest rate.]

Because the additional tax arises from an adjustment at the partnership level that is binding on the partner, the partner may not contest the merits of the partnership adjustment nor may the partner claim the IRS is time-barred with respect to such adjustment. JCS-1-16, at 76.

Code Sec. 6226(c)(2)(C).

Code Sec. 6225(c)(2) provides that if one or more partners file returns (notwithstanding Code Sec. 6511) for the taxable year of the partners that includes the end of the reviewed year of the partnership, and such returns take into account all adjustments by the IRS in the amount of any item of income, gain, loss, deduction or credit of the partnership, or any partner’s distributive share thereof properly allocable to such partners (and for any other taxable year with respect to which any tax attribute is affected by reason of such adjustments), and payment of any tax due is included with such returns, then the imputed underpayment amount shall be determined without regard to the portion of the adjustments so taken into account. If an adjustment reallocates the distributive share of any item from one partner to another, this provision only applies if returns are filed by all partners affected by such adjustment. [Note that the statutes of limitations under Code Sec. 6511 do not apply, and a return for a closed year is not barred by the statute.]

For example, it is no longer necessary to obtain the signature of each partner on a Form 870-PT, Agreement for Partnership Items and Partnership Level Determinations as to Penalties, Additions to Tax, and Additional Amounts, or a Form 906, Closing Agreement on Final Determination Covering Specific Matters, to implement and conclude the examination and settlement.

29
49 See, generally, JCS-1-16, at 71–78.
50 Code Secs. 6231(a) and Code Sec. 6227.
51 Code Sec. 6231(a).
52 See the discussion of the Code Sec. 6226 election above.
53 Code Sec. 6231(b).
54 Act Sec. 1101(g) of the Bipartisan Budget Act of 2015 (P.L. 114-74).
Proposed regulations released August 2, 2016 would permanently and profoundly change estate planning for families that own a controlling interest in a privately held corporation, partnership, or limited liability company. For these families, estate planning techniques often take advantage of valuation discounts to mitigate the estate and gift tax burden associated with transfers during life or at death. If adopted, the proposed regulations would restrict or eliminate available discounts, thus directly increasing the tax associated with certain transfers.

The Internal Revenue Service has requested comments on the proposed regulations by November 2, and will hold a hearing on December 1. Thus, taxpayers should have until at least year-end to complete transfers under the current rules. In addition, even if the regulations are finalized in something close to their current form, portions of the regulations likely will be subject to challenge on the grounds that they exceed the scope of the statute.

What Are Valuation Discounts?

Valuation discounts are downward adjustments to valuation. Broadly speaking, they account for features that render the property less appealing to a hypothetical buyer. There are many types of discounts, but the most common for estate planning purposes are “discounts for lack of marketability” and “discounts for lack of control.” Following is a hypothetical illustration of each:

Susan, John and Ted form a partnership. Their partnership agreement provides that no one can withdraw from the partnership nor sell his or her interest without the consent of the other two. Each of them has an equal vote in all matters relating to the partnership.

If John wanted to sell his interest, he cannot do so without the consent of both Susan and Ted. This means that he can’t easily convert his interest into cash. As a result, it is worth less than its pro rata share of the total value of the partnership. This is a discount for lack of marketability.

If John did get Susan and Ted’s consent to sell, he might have a hard time finding a buyer willing to pay him the full value of the underlying interests, even reduced by a marketability discount. This is because the prospective buyer would be only a minority interest holder and would not be able to control the direction of the entity. Therefore, the interest would be further discounted for lack of control.

These valuation principles are generally accepted in the law as reflective of business reality. Nonetheless, the IRS is wary of discounts in the intra-family context for two primary reasons. First, it is widely assumed that a senior generation would not exercise its rights in a manner that would harm the junior generation family members. Second, particularly with respect to non-operating investment entities, it is assumed that families place artificial restrictions on equity interests for the purpose of depressing the value, without affecting the value of the underlying assets. The impact of discounts is significant, with combined discounts for lack of marketability and lack of control often in the range of 25 percent to 50 percent off of the net value of the underlying assets.

What Do the Proposed Regulations Say?

On its face, the wording of the proposed regulations may obscure their plain impact. The Treasury Department’s summary indicates that the regulations “concern the treatment of lapsing rights and restrictions on liquidation” so as to prevent undervaluation of transferred interests. Although perhaps not obvious, the practical effect is to significantly curtail valuation discounts with respect to family held entities where those discounts rely on the normal inability of the owner of an interest in a private entity to quickly convert the interest to cash.
The regulations fall under section 2704 of the Internal Revenue Code. This section attempts to curb perceived valuation abuses associated with lapsing voting and liquidation rights. Even under current law, a transfer that results in a lapse of a voting or liquidation right is treated as a gift if it occurs during life, or is included in the gross estate if it occurs at death. Nonetheless, current law provides a number of exceptions that make planning with valuation discounts possible. The proposed regulations would eliminate almost all of these exceptions.

Briefly, each of the major categories of the proposed regulations is described below:

**Applicable Restrictions Redefined.** As noted above, present law targets valuation abuses with respect to liquidation rights. Thus in valuing a transfer of an interest in a controlled entity, “applicable restrictions” are disregarded. “Applicable restrictions” are restrictions on the entity’s ability to liquidate, which restrictions either lapse or can be removed by the transferor’s family. They do not, however, include restrictions imposed or required by state law.

Under current regulations, applicable restrictions are those that are more restrictive than state law. The proposed regulations expand the definition of an applicable restriction, such that even state law defaults would be “applicable restrictions” — unless the law provided that they could not be modified, which is rare in practice.

**Disregarded Restrictions.** Perhaps the most noteworthy section of the proposed regulations is the introduction of a class of “disregarded restrictions.” Like applicable restrictions, disregarded restrictions would be ignored in valuing an interest in an entity for estate and gift tax purposes. A disregarded restriction includes:

1. Any restriction or limitation on the ability of the holder to liquidate or have his or her interest redeemed;

2. Any restriction limiting the amount received by the holder to less than a minimum value, defined as a pro rata share of the entity value reduced by certain outstanding obligations;

3. Any provision permitting deferral of redemption proceeds for more than six months; and

4. Any provision that permits repayment in anything other than cash or property. Notably, a promissory note is not considered “property” unless the entity is engaged in an active trade or business, the proceeds are not attributable to passive assets, the note is adequately secured and the note is issued at a market interest rate.

**The Three Year Rule.** This rule is intended to capture deathbed transfers. If a transfer made within three years of death results in the lapse of a voting or liquidation right, the transferor’s gross estate will be increased by the value of that lost liquidation right. This would occur, for example, if parent held 60 percent of the vote, transferred 10 percent to each of her two children (leaving her 40 percent), and subsequently passed away. Under the proposed regulations, if she passes away within three years after making the transfer (and indeed, if she made the transfer last month and dies one year from now after the regulations are enacted), that “lost value” attributable to her liquidation power will be added to her taxable estate. This effectively creates a phantom asset in the estate — it will be taxed, but the tax must be paid from other assets of the estate.

**Who is Affected?**

Anyone with an interest in a family controlled entity may be affected. Roughly speaking, an entity is controlled if family members collectively own greater than 50 percent of the entity. In a complex set of rules, interests held in trust are attributed to the grantors and beneficiaries of the trust.

For purposes of determining control, the proposed regulations would ignore interests held by nonfamily unless:

1. The interest has been held by the nonfamily member for at least three years;

2. The interest is at least a 10 percent equity interest;
3. Nonfamily members in the aggregate hold at least 20 percent of the equity of the entity; and

4. Each nonfamily has the right to put his or her interests to the company and receive a share of the underlying value.

The stated purpose of this provision is to limit taxpayers’ ability to give “insignificant” interests to nonfamily members in order to escape being subject to the rules.

**When Would the Regulations Take Effect?**

At this point, the regulations are in proposed format. The Internal Revenue Service has requested comments by November 2, and will hold a hearing on December 1. Thus, even though exact timing is uncertain, the regulations could not take effect before December of this year.

More likely, the comments submitted to the IRS will result in modifications and clarifications to the proposed regulations, which can take time. The IRS has indicated, however, that this is a high priority. Thus, it is possible that regulations would be finalized and effective in early 2017.

For the most part, the regulations would apply to transfers that take place after the effective date of the final regulations. However, the proposed regulations would allow a 30 day grace period for transfers of interests subject to “disregarded restrictions.”

Even after the regulations are finalized, they likely will be subject to challenges in court. In addition to challenges to the scope of the IRS' regulatory authority under the statute, there will probably be litigation over what the appropriate level discount for lack of marketability is under these regulations. If the entity in question holds primarily non-marketable assets, such as real estate, can the valuation take into account that the property that hypothetically would be received by a liquidating owner is not liquid? What if the entity consists of both marketable and non-marketable assets?

**Is Current Action Recommended?**

Yes. Anyone considering a transfer of interests in a family controlled entity – whether an operating company or an investment company - might wish to do so now. For this purpose, “transfers” includes gifts, sales to grantor trusts and any other change in ownership. Even though proposed regulations indicate a 30 day grace period for transfers subject to disregarded restrictions, the provisions concerning applicable restrictions would take effect immediately. Notably, the estate tax inclusion associated with deathbed transfers would apply for those who die after the regulations are enacted – even if they had given away their interests before the regulations came out.
Is Entity Type Material?

By: Joshua Fershee
West Virginia University College of Law
Morgantown, West Virginia

Today I will pose a simple question: Is Entity Type Material?

Of course, context matters, so here’s where this is coming from: On July 1, 2016, Canterbury Park Holding Corporation filed an 8-K making the following announcement:

SHAKOPEE, Minnesota (July 1, 2016) - Canterbury Park Holding Corporation, a Minnesota corporation (Nasdaq Global Market: CPHC) (the “Company”), today announced that it has completed its previously announced reorganization of the Company’s business into a holding company structure (the “Reorganization”), pursuant to which a recently-formed Minnesota corporation with the same name, Canterbury Park Holding Company (“New Canterbury”), has replaced the Company as the publicly held corporation owned by the Company’s shareholders. At the market open today, July 1, 2016, the shares of common stock of New Canterbury will commence trading on the Nasdaq Global Market under the ticker symbol “CPHC,” the same ticker symbol previously used by the Company.

As a result of the Reorganization, the Company has been merged into a limited liability company subsidiary, Canterbury Park Entertainment LLC. In addition, the Company’s shareholders have automatically become shareholders of New Canterbury on a one-for-one basis, holding the same number of New Canterbury shares and the same ownership percentage after the Reorganization as they held immediately prior to the Reorganization. The business operations, directors and executive officers of the company will not change as a result of the Reorganization.

The exhibits list, though, provides:

<table>
<thead>
<tr>
<th>Exhibit Description</th>
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<tbody>
<tr>
<td>2.1 Agreement and Plan of Merger, dated March 1, 2016, among Canterbury Park Holding Corporation, a Minnesota corporation, New Canterbury Park Holding Corporation, a Minnesota corporation, Canterbury Park Entertainment LLC, a Minnesota limited liability corporation. (Incorporated by reference to Exhibit 2.1 to the Registration Statement on Form S-4 (File No. 333-210877) filed with the SEC on April 22, 2016.)</td>
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A what? You probably guessed it: a "Minnesota limited liability corporation." No, it’s a limited liability company, as properly noted in the press release.

Okay, so I suspect it’s not really material to the SEC or most other investors in the sense that this is a mistake, as long as the filing and exhibit are otherwise accurate. I looked at the May 27, 2016, DEF 14A, which did list the LLC correctly. However, in searching that document I found this was part of the 14A:

GGCP Holdings is a Delaware limited liability corporation having its principal business office at 140 Greenwich Avenue, Greenwich, CT 06830.

Sigh. Well, it may not matter to the SEC, but it’s material to me.

Reprinted with permission from the Business Law Professor Blog; originally posted on July 19, 2016.

Allen Sparkman
Allen Sparkman, along with is co-author Herrick Lidstone, were recognized in August by the Association of Continuing Legal Education for their book Limited Liability Companies and Partnerships in Colorado.
Minority Oppression in the LLC

By: Douglas Moll
University of Houston Law Center
Houston, Texas

The doctrine of shareholder oppression protects minority stockholders in closely held corporations from the improper exercise of majority control. When a minority shareholder claims abuse at the hands of a majority investor, courts applying the oppression doctrine will subject the majority’s conduct to a considerable amount of scrutiny. Approximately thirty-nine states have statutes providing for dissolution or other relief on the grounds of “oppressive actions” by “directors or those in control.” See Douglas K. Moll & Robert A. Ragazzo, Closely Held Corporations § 7.01[D][1][b], at 7-69 n.192 (LexisNexis 2015).

The factors that give rise to the oppression problem in the closely held corporation context are also present in the LLC setting. See, e.g., Douglas K. Moll, Minority Oppression & the Limited Liability Company: Learning (or Not) from Close Corporation History, 40 Wake Forest L. Rev. 883, 925-57 (2005). Indeed, the same combination of “no exit” and majority rule—a combination that has left minority shareholders vulnerable in the closely held corporation for decades—exists in the LLC. Despite these similarities, only nineteen states have LLC statutes providing for dissolution or other relief on the grounds of oppressive conduct or similar language.

Why the difference? Why do twice as many states provide oppression-related protection in the corporation setting (as compared to the LLC setting)? Some thoughts:

(1) Differences in default exit rights: In the corporation, state statutes do not provide default exit rights. In the LLC, the situation is similar, as the passage of the check-the-box regulations led to most states eliminating default exit rights for estate planning and related purposes. See id. at 925-40. Nevertheless, in a small handful of jurisdictions (5 states by my count), default exit rights still exist in LLCs. Such statutes usually indicate that the dissociation of a member leads to a buyout of the member’s ownership interest or dissolution of the company. When minority owners have a statutory mechanism for exiting the venture with the value of their investments, there is little need for an oppression doctrine, as the oppression doctrine typically seeks to provide the same outcome (i.e., exit and return of capital).

(2) The oppression doctrine is too vague and unpredictable: In many jurisdictions, oppressive conduct is defined as “burdensome, harsh, and wrongful conduct” by the majority, or a frustration of the minority’s “reasonable expectations” by the majority. These definitions have been criticized on the grounds that they are too vague and general to provide any meaningful guidance to litigants and courts. Importing the oppression doctrine with these definitions into the LLC setting may be viewed as compounding the problem. One could argue, however, that oppression is no more vague and open-ended than the concept of fiduciary duty, particularly in jurisdictions where the scope of manager and member fiduciary duties is not circumscribed by statute.

(3) Other dissolution grounds are broad enough to encompass oppressive conduct: Almost all LLC statutes provide for judicial dissolution on the ground that it is not reasonably practicable to carry on the business in conformity with the governing documents of the LLC. Such a ground is presumably broad enough to encompass certain types of oppressive behavior. For example, if the majority consistently deprives the minority of distributions to which the minority is entitled, such conduct would likely run afoul of the operating agreement and would show a pattern of the majority violating the governing documents. If this dissolution ground can handle oppressive conduct, the need for a dissolution statute explicitly tied to oppressive behavior is lessened.

On the other hand, some types of oppressive conduct fail to fit neatly within the “not reasonably practicable” language. In a classic freezeout where the minority is terminated from employment and denied any management role in the LLC, there may be no technical violation of the articles or the operating agreement. Cf. Dennis S. Karjala, Planning Problems in the Limited Liability Company, 73 Wash. U. L.Q. 455, 471 (1995) (“[I]n Arizona, Delaware, and Oregon, a court may order dissolution in an action by a member if it is established that it is ‘not reasonably practicable to carry on the business’ according to the articles or an operating agreement. Yet it is often possible to carry on the business while freezing a minority interest out of any return.”
Thus, a more explicit dissolution-for-oppression statute may still be useful.

(4) **Fiduciary duties to members exist in the LLC**: Perhaps the most compelling reason for the lack of LLC dissolution-for-oppression statutes is that minority members may already be protected from oppressive conduct by fiduciary duties owed to them by managers (and, possibly, other members). In the corporation setting, directors and officers traditionally owe fiduciary duties to the corporation itself, but not to individual shareholders. By contrast, in the LLC setting, many jurisdictions indicate (either by statute or judicial decision) that a manager owes a fiduciary duty to an individual member as well as to the LLC itself. See, e.g., RULLCA § 409 (2006). A member’s ability to bring a breach of fiduciary duty claim on his own behalf lessens the need for an oppression action, as the oppression action is also designed to allow a minority owner to assert, on his own behalf, that he has been unfairly treated.

That said, it is not clear that the scope of a manager’s fiduciary duty would be construed as broadly as the oppression doctrine has been construed, particularly with respect to protecting the minority’s participatory rights in the business (i.e., employment and management rights). In fact, in some jurisdictions, a manager’s fiduciary duty of loyalty is limited by statute to harm caused to the LLC itself (and not harm caused to an individual member). (Note: I discussed this in the partnership context in a prior post.) In addition, broad remedies for oppression, such as a buyout of the oppressed minority’s holdings, are already well-established in the case law. Although a court has significant remedial discretion in fiduciary duty actions as well, in many jurisdictions there is no precedent for a buyout as a remedy for breach of fiduciary duty.

What am I missing? Are there other explanations for significantly fewer oppression statutes in the LLC setting?

Some LLC statutes allow for dissolution when member conduct makes it not reasonably practicable to carry on the company’s business with that member. This ground seems even more tailored to oppressive conduct, but it is only present in seven jurisdictions.
The Delaware General Assembly recently passed legislation, which was signed into law on June 22, 2016 by Delaware Governor Jack Markell, amending the Delaware Limited Liability Company Act (the “LLC Act”), the Delaware Revised Uniform Limited Partnership Act (the “LP Act”) and the Delaware Revised Uniform Partnership Act (the “GP Act”) (collectively, the “LLC and Partnership Acts”). The amendments to the LLC and Partnership Acts are effective as of August 1, 2016.

The following is a brief summary of some of the more significant amendments that affect Delaware limited liability companies (“Delaware LLCs”), Delaware limited partnerships (“Delaware LPs”) and Delaware general partnerships.

**Automatic Admission of Assignees to Single Member Delaware LLCs**

[LLC Act § 18-704(a)(3)]

Under § 18-702(b)(3) of the LLC Act, unless otherwise provided in a limited liability company agreement, a member ceases to be a member of a Delaware LLC upon the assignment of all of such member’s limited liability company interests in the Delaware LLC. Under § 18-801(a)(4) of the LLC Act, as a default matter, a Delaware LLC dissolves at any time it has no members. Thus, prior to this year’s amendments to the LLC Act, if the sole member of a Delaware LLC assigned all of its limited liability company interests in the Delaware LLC to an assignee, and the assignee was not properly admitted as a substitute member of the Delaware LLC, the Delaware LLC would have dissolved.

The LLC Act has been amended to add a new subsection 18-704(a)(3) that provides that in connection with a voluntary assignment by the sole member of a Delaware LLC of all its limited liability company interests to a single assignee, the assignee will be admitted as a member of the Delaware LLC unless otherwise provided in connection with the assignment or unless otherwise provided in the limited liability company agreement of the Delaware LLC by a specific reference to § 18-704(a)(3) of the LLC Act. § 18-704(a)(3) of the LLC Act provides that an assignment will be voluntary for purposes of § 18-704(a)(3) of the LLC Act if it is consented to by the member at the time of the assignment and is not effected by foreclosure or other similar legal process.

The addition of § 18-704(a)(3) to the LLC Act will reduce the risk of triggering an inadvertent dissolution of a Delaware LLC that may have otherwise occurred if the admission of an assignee as a member was not otherwise provided for in connection with an assignment of all of a sole member’s limited liability company interests in the Delaware LLC.

**Default Rule Requiring Votes to be Affirmative or Approvals or Consents to Be in Writing Eliminated**


The LLC Act, the LP Act and the GP Act have been amended to change the default rule in certain instances that required affirmative votes or written approvals or consents to now only require votes, approvals or consents. This amendment will allow approvals or consents to be provided by means other than in writing. The amendment also brings certain provisions of the LLC Act and the LP Act, such as approving a transaction, dissolution of the entity, revocation of dissolution and admission of members or partners, in line with the merger and conversion provisions of the LLC Act and LP Act, which did not require approvals or consents to be written. Certain of these amendments confirm that the provisions of the applicable subsections are intended to be enabling and are not intended to restrict the way in which members and partners may vote on, consent to or approve any matter.

**Service of Process on a Series of a Delaware LLC or Delaware LP**

[LLC Act § 18-105; LP Act § 17-105]

The LLC Act and the LP Act have been amended to provide a manner for effecting service of process on a series of a Delaware
LLC or a series of a Delaware LP. Previously, the LLC Act and LP Act only specifically addressed service of process on the entity itself and not on a series of such entity. This amendment permits service of process on a series of a Delaware LLC or a series of a Delaware LP to be made in a manner similar to that for which service of process may be made under § 18-105 of the LLC Act and § 17-105 of the LP Act against the Delaware LLC or the Delaware LP, respectively.

Cross-Collateralization and Cross-Default by a Series of a Delaware LLC or Delaware LP

[LLC Act § 18-215; LP Act § 17-218]

The LLC Act and the LP Act have been amended to clarify and confirm that a series of a Delaware LLC or a series of a Delaware LP can agree to be liable for any or all of the debts, liabilities, obligations or expenses incurred, contracted for or otherwise existing with respect to the entity generally or another series of the entity, and that a Delaware LLC or Delaware LP can agree to be liable for any or all of the debts, liabilities, obligations or expenses incurred, contracted for or otherwise existing with respect to a series.
Pigs Get Fat and Hogs Get Slaughtered: Bankruptcy Remote Structures Declared Invalid

By: Thomas E. Rutledge
Stoll Keenon Ogden PLLC
Louisville, Kentucky

Jonathan M. Stemerman
Elliott Greenleaf, P.C.
Wilmington, Delaware

A pair of recent decisions have considered and rejected efforts by lenders to limit (prohibit) the ability of their creditors to seek bankruptcy laws. In the Illinois decision, a bankruptcy remote structure was declared void on the basis that the fiduciary duties of the person inserted by the lender were eliminated.\(^1\) A decision rendered by the United States Bankruptcy Court for Delaware invalidated certain requirements requested by a lender that had the effect of rendering its debtor incapable of filing bankruptcy.\(^2\)

In re: Lake Michigan Beach Pottawattamie Resort LLC

Lake Michigan Beach Pottawattamie Resort LLC (“LMBPR”) was a debtor to BCL-Bridge Funding, LLC (“BCL”). In the course of entering into certain forbearance and related agreements, at the request of BCL, LMBPR amended its operating agreement to provide for a “Special Member” to be appointed by BCL. The amended operating agreement would go on to provide that (i) the Special Member would owe no fiduciary duties to LMBPR or its constituents and (ii) no bankruptcy or similar filing could take place without the consent of the Special Member.

LMBPR was unable to perform on its various financing commitments. BCL filed a complaint against LMBPR, and published a notice of a non-judicial foreclosure sale. On the eve of that sale LMBPR filed a voluntary Chapter 11 bankruptcy, it having been approved by all members save and except the Special Member appointed by BCL. BCL challenged the filing on the basis that (1) it was done for an improper purpose and (2) was in violation of the blocking rights of the Special Member.

The court assessed the purpose of the Chapter 11 petition under the test set forth in In re Tekena USA, LLC\(^3\) and determined that BCL had not met its burden of showing it to have been in bad faith.

As for the lack of authority to make the bankruptcy filing, LMBPR (here described as the “Debtor”) asserted:

The Debtor argues, in response, that the provision in the Third Amendment requiring BCL’s consent for the filing of a bankruptcy petition by the Debtor, is void as against public policy because it amounts to a prohibition of the Debtor’s right to exercise its right to bankruptcy relief and, alternatively, is not valid under Michigan law.\(^4\)

The court then provided a review of the bankruptcy remote structure and the role of the independent director, noting that the format is permissible because the independent director has a fiduciary obligation to, on appropriate facts, vote in favor of the bankruptcy that would be against the interests of the creditor appointing that director. Specifically:

Even though the blocking director structure described above impairs or in operation denies a bankruptcy right, it adheres to that wisdom. It has built into it a saving grace: the blocking director must always adhere to his or her general fiduciary duties to the debtor in fulfilling the role. That means that, at least theoretically, there will be situations where the blocking director will vote in favor of a bankruptcy filing, even if in so doing he or she acts contrary to purpose of the secured creditor for whom he or she serves.\(^5\)

In contrast, the court here focused upon the fact that the operating agreement amendment that added the Special Member as

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\(^1\) In re: Lake Michigan Beach Pottawattamie Resort LLC, Case No. 15bk42427, 2016 WL 1359697 (N.D. Ill. April 5, 2016).
\(^3\) 419 B.R. 341, 346 (Bankr. N.D. Ill. 2009)
well eliminated any fiduciary obligations of that member. Specifically:

The Third Amendment limits BCL duties as the Special Member to those “rights and duties expressly set forth in this Agreement.” Third Amendment, Article 12.2(viii), p. 2. Those rights and duties are then limited by Article 12.4(iv):

Notwithstanding anything provided in the Agreement (or other provision of law or equity) to the contrary, in exercising its rights under this Section, the Special Member shall be entitled to consider only such interests and factors as it desires, including its own interests, and shall to the fullest extent permitted by applicable law, have no duty or obligation to give any consideration to any interests of or factors affecting the Company or the Members.

Id. at Article 12.4(iv), p. 2–3 (emphasis added). This language results in BCL as the Special Member having no duties to the Debtor, despite otherwise being a member of the Debtor.6

From there the court was able to determine that the provision requiring the consent of the Special Member appointed by BCL before LMBPR may seek bankruptcy protection is unenforceable. Hence the case may proceed.

In re: Intervention Energy Holdings, LLC

Intervention Energy Holdings, LLC and its wholly-owned subsidiary, Intervention Energy, LLC, were jointly indebted to EIG Energy Fund X V-A, L.P. EIG had purchased senior secured notes issued by Intervention; those notes were secured by various liens. Over time, various amendments have been made to the relevant note purchase agreements, including with respect to certain coverage covenants. Certain of those coverage covenants were ultimately violated. Those violations led to Intervention and EIG entering into a Forbearance Agreement and Contingent Waiver (the “Forbearance Agreement”) pursuant to which, assuming EIG would raise $30 million of equity capital to pay down the secured notes, the coverage violations would be waived. However, as a condition to the effectiveness of that Forbearance Agreement, EIG required Intervention to amend its operating agreements to provide:

- that a single unit would be issued to EIG, making it a member in Intervention; and
- requiring the unanimous approval of the members before any filing for bankruptcy could take place.7

Ultimately Intervention would file for bankruptcy protection notwithstanding that it did not have the consent of EIG to it doing so. That led to a motion to dismiss, brought by a EIG against Intervention, on the basis that Intervention lacked the authority to file for bankruptcy protection. In its decision, the Bankruptcy Court would reject that motion to dismiss. As such, the bankruptcy will proceed.

EIG, in support of its motion to dismiss, argued that, under the LLC Act, there is essentially full freedom of contract, including to set the requisite threshold for filing a petition in bankruptcy. Intervention relied upon the fact that a waiver of the capacity to file for bankruptcy is invalid and as well the recent decision rendered in In re Lake Michigan Beach Pottawatamie Resorts LLC in which a bankruptcy remote structure relying upon a “independent director” who lacked fiduciary duties was held to be unenforceable.

Obviously the arguments of Intervention would prevail. After string citing numerous decisions rejecting the notion that the right to file bankruptcy can be waived by contract, including a decision from the United States Supreme Court, it was observed:

A provision in a limited liability company governance documents obtained by contract, the sole purpose and effect of which is to place into the hands of a single, minority equity holder the ultimate authority to eviscerate the right of that entity to seek federal bankruptcy relief, and the nature and substance of whose primary


relationship with the debtor is that of creditor - not equity holder – and which owes no duty to anyone but itself in connection with an LLC’s decision to seek federal bankruptcy relief, is tantamount to an absolute waiver of that right, and, even if arguably permitted by state law, is void as contrary to federal public policy.8

From there, in light of the factual background of the mechanism by which EIG acquired its single interest in Intervention and the amendment of the LLC agreement requiring unanimity in order to file bankruptcy, it found those to be “the unequivocal intention of EIG to reserve for itself the decision of whether the LLC should seek federal bankruptcy relief.” Following other federal bankruptcy courts, it was the determination of the Intervention court that it would not enforce a waiver of the right to seek bankruptcy protection and, from there, it concluded that Intervention had the necessary authority to commence its Chapter 11 proceeding.

Decisions such as these identify outlier structures that will not be enforced with respect to bankruptcy remoteness. They do not stand for the proposition that bankruptcy remoteness is itself either improper or unattainable. The proper structuring of these relationships can be achieved, but that structuring should begin at the beginning of the debtor/creditor relationship.

Christina Houston Has Been Appointed to the TriBar Opinion Committee

Please congratulate Christina Houston on being named the newest member of the TriBar Opinion Committee. Christina’s dedicated work for the ABA Opinion Committee for the last 16 years has earned her this esteemed position.

The TriBar Opinion Committee is the standard-bearer for U.S. opinion practice. Originally formed nearly 40 years ago from members comprised of New York’s three largest bar associations, its membership is limited to 50 lawyers, most of whom are senior statesmen from white-shoe firms. Since its first report in 1979, the mission of the TriBar Opinion Committee has been to provide guidance on giving closing opinions to third parties in a manner that is fair to both the giver and the recipient. The Committee has promoted the standardization of both opinion language and diligence, thus facilitating the communication of complex ideas in a shorthand format. The Committee’s explication of customary practice has been a major contributor to the going national consensus on the meaning of standard opinion language and the work lawyers are expected to perform to support commonly given opinions. The Committee’s work continues as opinion change practice develops and evolves.

Christina joins long-time Committee leader Lou Hering on the TriBar.

8 Slip op. at 9, 2016 WL 3185576, * 6 (citations omitted).
ALJ Holds NYS Real Estate Transfer Tax Cannot Be Imposed on Sale of 45% Membership Interest in LLC

By: Kara M. Kraman
Morrison & Foerster LLP
New York, New York

In an issue of first impression under the New York State real estate transfer tax, a New York State Administrative Law Judge has held that the transfer tax cannot be imposed on a member’s sale to its comember of a 45% membership interest in a limited liability company (“LLC”) owning real property in New York State, where both members previously owned the real property as tenants-in-common. Matter of GKK 2 Herald LLC, DTA No. 826402 (N.Y.S. Div. of Tax App., May 26, 2016). At issue was the scope of the Department of Taxation and Finance’s authority to aggregate acquisitions of minority economic interests in real property.

Facts. The facts in the case were undisputed. In 2007, GKK 2 Herald LLC (“GKK”) and an unrelated party (“Co-Owner”) acquired an office building located in Herald Square (the “Office Building”). Upon acquisition, GKK and Co-Owner held undivided 45% and 55% tenant-in-common fee interests respectively in the Office Building. New York State real estate transfer tax (“RETT”) was paid on that acquisition.

On December 22, 2010, GKK contributed its 45% fee interest to Owner LLC, a newly formed Delaware LLC, and Co-Owner contributed its 55% fee interest to Owner LLC. In exchange, GKK received a corresponding 45% membership interest and Co-Owner received a corresponding 55% membership interest in Owner LLC. GKK and Co-Owner filed RETT returns, reporting the contribution of their fee interests in exchange for membership interests in Owner LLC as exempt “mere changes of identity or form of ownership” under Tax Law § 1405(b)(6).

On the same day, GKK then sold its 45% membership interest to Co-Owner. GKK and Co-Owner timely filed an RETT return, reporting Co-Owner’s purchase of GKK’s 45% membership interest in Owner LLC as a non-taxable transfer of less than a controlling interest in an entity that owns real property. As a result, Owner LLC became sole owner and operator of the real property, with Co-Owner as its sole member.

The Department claimed that the transaction was a transfer of a 100% controlling economic interest in real property, 55% of which was a nontaxable “mere change in form” of ownership, and 45% of which was a taxable change in beneficial ownership, and assessed RETT on that basis.

Applicable RETT law and positions of the parties. RETT is “imposed on each conveyance of real property or interest therein” located in New York State. Tax Law § 1402(a). A “conveyance” is defined to include the transfer or acquisition of a “controlling interest” in an entity that owns real property. Tax Law § 1401(e). In the case of a non-corporate entity, a “controlling interest” is defined as “fifty percent or more of the capital, profits or beneficial interest in such partnership, association, trust or other entity.” Tax Law § 1401(b)(ii). The regulations further provide that, “where there is a transfer or acquisition of a controlling interest in an entity . . . and the real estate transfer tax is paid on that transfer or acquisition and there is a subsequent transfer or acquisition of an additional interest in the same entity,” the transfers or acquisitions may be aggregated if they occur less than three years apart. 20 NYCRR § 575.6(d). RETT does not apply to “[c]onveyances to effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership.” Tax Law § 1405(b)(6).

The Department did not contest that the contributions by GKK and Co-Owner of their respective 45% and 55% fee interests in the Office Building, in exchange for corresponding membership interests in Owner LLC, were exempt from the RETT as “mere change[s] of identity or form of ownership.” The Department instead argued that the regulations permitting aggregation of certain acquisitions allowed it to aggregate Co-Owner’s purchase of GKK’s 45% interest in Owner LLC with Co-Owner’s 55% membership interest in Owner LLC, which it acquired in the preceding “mere change in form” transaction. GKK maintained that the sale of its 45% membership interest was a nontaxable transfer of a less-than-controlling interest in real property and that the Department could not aggregate exempt transfers with non-exempt transfers to reach a taxable result.

ALJ Decision. The ALJ held in favor of GKK that CoOwner’s purchase of GKK’s 45% interest in Owner LLC was not an acquisition of a
“controlling interest” in real property, and no transfer tax was due. She rejected the Department’s claim that an acquisition of a 55% interest in an entity that qualified for the “mere change in form” exemption could be aggregated with the acquirer’s subsequent purchase of a 45% interest in the same entity.

The ALJ held that the RETT regulation authorizing aggregation does not permit the aggregation of a nontaxable mere change in form transaction with a transfer of a minority interest. She found that the plain language of the regulation (20 NYCRR § 575.6(d)) permitting the aggregation of less than a controlling interest only applied to interests on which RETT was paid on the initial transaction. Therefore, the ALJ concluded that where, as here, no transfer tax was paid on the initial “mere change in form” transaction, the aggregation regulation did not apply. The ALJ also noted that it was not clear that the RETT statute authorized the regulation permitting aggregation of successive transfers at all but found it unnecessary to address that issue, because the regulation did not apply to the transaction at issue.

Although the Department argued that the ALJ should defer to its interpretation, the ALJ held that where, as here, the Department’s interpretation is inconsistent with the plain language of the statute and regulations, that interpretation is not entitled to any deference. The ALJ also rejected the Department’s reliance on precedent under the former real property transfer gains tax, noting that the gains tax statute was broader in scope than the RETT law with respect to aggregation. The Department has appealed the ALJ decision.

GKK was represented by Irwin M. Slomka, Thomas P. McGovern, and Kara M. Kraman of Morrison & Foerster LLP.

**Additional Insights**

The ALJ decision calls into question an earlier 2015 New York City ALJ decision that involved the same transaction. In **Matter of GKK 2 Herald LLC**, TAT(H) 13-25 (RP) (N.Y.C. Tax App. Trib., Admin. Law Judge Div., Apr. 1, 2015), a New York City ALJ reached the opposite result, upholding the City’s imposition of real property transfer tax (“RPTT”) on the transaction. The City ALJ upheld application of the federal income tax “step transaction doctrine” to, in effect, treat the transaction as if GKK sold its 45% fee interest directly to Co-Owner, even though Owner LLC, and not CoOwner, thereafter owned the fee interest. The City Tax Appeals Tribunal affirmed the decision of the ALJ, but treated the transaction as if GKK had sold its fee interest in the property directly to Owner LLC, rather than to Co-Owner.
Advancement Rights of Present and Future Officers Under LLC Agreement

By: Brett M. McCartney
Morris James LLP
Wilmington, Delaware

Advancement and indemnification rights are vital in attracting the best and brightest individuals to serve as managers of Delaware entities. Those rights are meant to provide managers of Delaware entities comfort when accepting positions that often lead to being named in litigation. In the limited liability company context, a manager’s advancement and indemnification rights are often derived from the entity’s operating agreement. And seeing as Delaware courts strive to enforce the express terms of an agreement, advancement and indemnification provisions must be drafted with precision. As discussed below, contractual limitations and qualifications on advancement and indemnification rights will be interpreted in a way that gives meaning to all terms in the agreement.

In Harrison v. Quivus Systems, C.A. 12084-VCMR, the Delaware Court of Chancery was confronted with a matter wherein the plaintiff sought advancement of expenses arising from litigation brought against him by Quivus Systems, for actions the plaintiff allegedly took while acting as CEO of Quivus. The Quivus operating agreement required the company, to the fullest extent allowed under Delaware law, to advance and indemnify expenses to its present and future CEO. John Harrison was removed as CEO of Quivus on July 1, 2014. Just over a year later, a derivative action was filed on behalf of Quivus in the Superior Court of the District of Columbia alleging a variety of claims against Harrison in his role as CEO, including that Harrison mismanaged and looted the assets of Quivus. Harrison filed an answer and counterclaim, alleging that Quivus’ financial condition was not the result of Harrison’s purported mismanagement. Subsequently, Harrison made a demand on the company for advancement of certain expenses incurred in the D.C. action, including his defense of all but one count of the derivative complaint and also the expenses incurred in prosecuting his counterclaims. Following Quivus’ rejection of his demand for advancement, Harrison filed a complaint in the Court of Chancery.

The Quivus operating agreement included an advancement provision providing: “Subject to any limitations set forth in the [Delaware LLC] Act, the company shall indemnify and advance expenses to each present and future member or manager of the company (and, in either case, his heirs, estate, personal representatives or administrators) to the full extent allowed by the laws of the state of Delaware, both as now in effect and as hereafter adopted. The company may indemnify and advance expenses to any employee or agent of the company who is not a member or manager (and his heirs, estate, personal representatives or administrators) to the same extent as to a member or manager, if the disinterested members determine that it is in the best interests of the company to do so. The company shall also have the power to contract with individual member, manager, employee, or agent for whatever additional indemnification the members shall deem appropriate.” The crux of the defendant’s argument was that the advancement provision qualifies the right to advancement and indemnification to present and future members or managers, not past members or managers. As a result, the defendant argued that Harrison was not entitled to advancement because he is neither a present nor a future manager.

The court noted that its task was to give legal effect to the unambiguous, plain language of the advancement provision in the Quivus operating agreement. In so doing, the court stated that while the operating agreement “does not define present or future managers, much less former managers” the operating agreement does define managers as “collectively, the chief executive officer, the secretary, and each other manager elected by the members.” It was undisputed that Harrison was the “present” manager when he was CEO of Quivus and it was during his time as CEO that the events giving rise to the D.C. action occurred. Nevertheless, the defendant argued that Harrison was not entitled to advancement as he was not a “present” or “future” manager of Quivus when the advancement action was filed. During oral argument on the parties’ cross motions for summary judgment, the defendant took the position that advancement rights vest at the time a claim is made against a present manager. The court found that position untenable, as it essentially eliminates “future” from the operating agreement. The court added color to the conundrum created by defendant’s
argument with a clever reference to the timeless Mel Brooks cinema classic, "Spaceballs." With an allusion to Dark Helmet’s struggle to comprehend when “then” will be “now,” the court interpreted the defendant’s argument to suggest that Harrison was a “present” manager in the past, and accordingly not a “present” manager in the present. The court held that defendant’s interpretation was unreasonable as it read “present” and “future” out of the operating agreement. Moreover, the defendant’s interpretation also rendered the phrase “his heirs, estate, personal representatives or administrators” meaningless.

In granting Harrison’s motion for summary judgment, the court stated that “Delaware law is clear that contracts must be read as a whole to give effect to each term, and the court will not adopt an interpretation that produces an unreasonable result.” The court held that at the time the Quivus operating agreement was adopted, the company “became bound to provide each then-present member or manager of the company with mandatory indemnification and advancement. Quivus also became bound to provide mandatory indemnification and advancement to anyone who became a member or manager of the company sometime thereafter—that is, in the future. Thus, the class covered by the advancement provision includes anyone who was a member or manager when the parties adopted the LLC agreement a present manager or member—or anyone who later became a manager or member a future member or manager.” In addition to granting Harrison’s claims for advancement, the court granted Harrison his fees in prosecuting his advancement claim, commonly known as “fees on fees.”

This decision illustrates the need for practitioners to advise their clients of the risks associated with advancement litigation, especially where a company is contesting the advancement of expenses. While companies may be leery of advancing thousands, if not millions, of dollars in expenses to managers, losing an advancement fight often leads to the company paying the manager’s fees in prosecuting the advancement claim, in addition to actually being required to advance the expenses subject to the dispute.
New Jersey Supreme Court Raises the Bar for Judicial Expulsion of LLC Members

By: Peter Mahler
New York Business Divorce
Posted on August 8, 2016

There are arguments pro and con when it comes to the power to expel a/k/a dissociate an LLC member. On the one hand, expulsion can be viewed as a necessary measure to preserve the LLC as a going concern when faced with persistent misconduct or failure to perform by one of its members. On the other hand, depending how broadly or narrowly the expulsion criteria are drawn, the power to expel can be a tool of oppression and abuse by those wielding it for their self-advantage.

Expulsion can occur in one of two ways. First, the operating agreement can authorize member expulsion under specified circumstances by self-executing action of the other members or managers. This is not a feature I regularly come across in operating agreements of LLCs, especially those whose membership consists of founding owners actively involved in the business.

Second, in states that have adopted the Revised Uniform LLC Act — to date numbering 16 plus the District of Columbia; New York is not one of them — courts are authorized to expel an LLC member on application by the company or a member on three specified grounds, two of which entail fault-based standards based on intentionally wrongful conduct or material breach, and the third of which dispenses with the notion of wrongful conduct by authorizing judicial expulsion of a member who

has engaged or is engaging in conduct relating to the company’s activities and affairs which makes it not reasonably practicable to carry on the activities and affairs with the person as a member.

Not surprisingly, the open-endedness of the above provision when utilized in LLC disputes has generated litigation, with New Jersey courts taking the lead. Last week, in IE Test, LLC v Carroll, 2016 WL 4086260 [NJ Sup Ct Aug. 2, 2016], that state’s Supreme Court handed down a major decision in which it reversed the lower courts’ summary judgment order expelling an LLC member and adopted a series of factors to assist trial courts in determining whether it is not reasonably practicable to operate an LLC in light of a subject member’s conduct.

Background. You can read here my full report on last year’s intermediate appellate court ruling that was reversed last week. Briefly, the case involves a three-member LLC that rose from the ashes of a prior venture that went bankrupt, leaving one of the three — Carroll — with a $2.5 million loss. After forming the new LLC, Carroll demanded that any operating agreement provide compensation for his loss. The others refused, consequently the LLC never adopted an operating agreement which, according to the other two members who held a combined 67% membership interest, led to irreconcilable discord with Carroll and made it impossible to obtain outside financing for their growing business.

The two others successfully brought suit to expel Carroll under the no-fault provision of New Jersey’s LLC Act, winning a summary judgment upheld by the intermediate appellate court including a $227,000 court-ordered buy-out of Carroll’s membership interest. In essence, the court held that the LLC’s continued operation with Carroll as a member was “not reasonably practicable” based on his intransigent insistence on being compensated for the prior venture’s debt to him, which he admitted was not legally enforceable, as a condition of entering into any operating agreement.

The Arguments on Appeal. In his appeal to the New Jersey Supreme Court, Carroll argued that there was no evidence that he interfered with the LLC’s business; that the other members sought his expulsion because it was financially advantageous for them to do so; that they used the impasse over an operating agreement as pretext; that he was willing to assist in financing the business should the lack of an operating agreement preclude bank financing; and that the LLC Act’s default rules resolve any concerns about disruption in the company’s management by providing for majority rule in management decisions in the absence of an operating agreement.

The other members countered that judicial expulsion under the “not reasonably practicable” standard requires the court to anticipate future conflicts that may make it impossible to conduct business with a dissenting LLC member; that the parties’ impasse already had created a significant impediment by rendering the LLC
unable to secure a line of credit or financing from a bank; that under the LLC Act certain decisions such as admission of new members or dissolution require unanimous consent; and that it was “inevitable” that Carroll’s dispute with the other members would undermine the LLC’s operations.

The Decision. The Supreme Court agreed with Carroll, holding that:

a disagreement among LLC members over the terms of an operating agreement does not necessarily compel the expulsion of a dissenting LLC member. If an LLC’s members can manage the LLC without an operating agreement, invoking as necessary the default majority-rule provision of the [LLC Act], then a conflict among LLC members may not warrant a member’s expulsion under the [LLC Act].

The court observed that, under the “not reasonably practicable” prong of the statute employed in IE Test, in contrast to the statute’s other, backward-looking, fault-based prongs, “the court prospectively analyzes the impact of [the subject LLC member’s] conduct on the LLC’s future.” It then explained:

Significantly, the Legislature did not authorize a court to premise expulsion under [the “not reasonably practicable” subsection] on a finding that it would be more challenging or complicated for other members to run the business with the LLC member than without him. Nor does the statute permit the LLC members to expel a member to avoid sharing the LLC’s profits with that member. Instead, the Legislature prescribed a stringent standard of prospective harm: the LLC member’s conduct must be so disruptive that it is “not reasonably practicable” to continue the business unless that member is expelled.

Underscoring the stringency of its newly adopted standard, the court added that LLC members seeking to expel a fellow member “are required to clear a high bar”; that the statute does not “authorize a court to disassociate an LLC member merely because there is a conflict”; and that the provision “require[s] the court to evaluate the LLC member’s conduct relating to the LLC, and assess whether the LLC can be managed notwithstanding that conduct, in accordance with the terms of an operating agreement or the default provisions of the statute.”

The court then laid out seven factors for trial courts to apply in evaluating the LLC member’s conduct, “among others that may be relevant to a particular case”:

1. the nature of the LLC member’s conduct relating to the LLC’s business;

2. whether, with the LLC member remaining a member, the entity may be managed so as to promote the purposes for which it was formed;

3. whether the dispute among the LLC members precludes them from working with one another to pursue the LLC’s goals;

4. whether there is a deadlock among the members;

5. whether despite that deadlock, members can make decisions on the management of the company, pursuant to the operating agreement or in accordance with applicable statutory provisions;

6. whether, due to the LLC’s financial position, there is still a business to operate; and

7. whether continuing the LLC, with the LLC member remaining a member, is financially feasible.

The inquiry, which the court acknowledged is borrowed in large part from the standard for
judicial dissolution of LLCs, requires a "case-specific analysis . . . with no requirement that all factors support expulsion, and no single factor determining the outcome."

Applying the first factor to Carroll's alleged conduct, the court concluded that, notwithstanding that he "provoked a distracting dispute among the LLC members that was never resolved" concerning his demand for compensation, there was no evidence that he "actively interfered with IE Test's business, or that he used the impasse over the compensation issue as an excuse to undermine the business by failing to cooperate when needed."

The court found that the remaining factors either did not support summary judgment or, at most, raised genuine issues of material fact for trial. There was conflicting evidence concerning the LLC's ability to obtain financing and whether Carroll's compensation demand stood in the way; there was no evidence of deadlock; and the business operated with increasing revenue despite the member discord and Carroll's continued involvement.

The court's decision accordingly reversed the grant of summary judgment and remanded the case to the trial court for proceedings consistent with its opinion.

Some Observations. Apart from IE Test and the All Saints University case which I wrote about previously, also decided by a New Jersey court, I'm not aware of any other reported decisions addressing judicial expulsion under the "not reasonably practicable" statutory provision. None is cited in IE Test. We'll have to wait and see whether courts in other states with the same statute follow the New Jersey Supreme Court's first-impression interpretation setting a "high bar."

I have a hunch that future cases involving the same statute will involve claims that blur the line between grounds for dissolution and expulsion. I can imagine, for instance, a 50% LLC member suing to expel the other 50% member primarily alleging a deadlock over important management decisions that is causing or likely will cause business paralysis. Absent wrongful conduct, one may ask, under those circumstances why should one member be forced out at the behest of the other, as opposed to dissolving the LLC and allowing the two members to bid against each other (and perhaps third parties) for the business assets?

Two final observations:
• The statute at issue is a default rule that can be eliminated in the LLC operating agreement or modified to specify different criteria for judicial (and non-judicial) member expulsion.

• IE Test is another in a seemingly endless stream of poster children for the proposition that, if you form and begin operating a multi-member LLC without first agreeing on an operating agreement, you're asking for trouble.
2016-2017 IRS Priority Guidance Plan

On August 15, 2016, the US Department of the Treasury/Internal Revenue Service Priority Guidance Plan for 2016-17 was released. Selected items of importance to those who practice partnership taxation are excerpted below.

GENERAL TAX ISSUES

37. Final regulations under § 7701 regarding series LLCs and cell companies. Proposed regulations were published on September 14, 2010.

INTERNATIONAL

H. Other

9. Regulations and other guidance under § 7701. Proposed regulations providing guidance under §§ 7701 and 6038A treating disregarded entities as corporations for purposes of reporting and recordkeeping obligations under § 6038A and related provisions were published on May 10, 2016.

PARTNERSHIPS

1. Final regulations under § 1.337(d)-3 relating to partnership transactions involving a corporate partner’s stock or other equity interests. Final and temporary and proposed regulations were published on June 12, 2015.

2. Final regulations under § 469(h)(2) concerning limited partners and material participation. Proposed regulations were published on November 28, 2011.

3. Regulations concerning the fractions rule under § 514(c)(9).

4. Guidance on targeted capital accounts under § 704(b).

5. Regulations to update the securities partnership aggregation rules under § 704(c).

6. Final regulations under §§ 704, 707, and 721 on management fee waivers. Proposed regulations were published on July 23, 2015.

7. Final regulations under §§ 704, 734, 743, and 755 arising from the American Jobs Creation Act of 2004, regarding the disallowance of certain partnership loss transfers and no reduction of basis in stock held by a partnership in a corporate partner. Proposed regulations were published on January 16, 2014.

8. Regulations under § 707 relating to disguised sales of property and regulations under § 752 regarding a partner’s share of liabilities. Proposed regulations were published on January 30, 2014.

9. Final regulations under § 732(f) regarding aggregation of basis for partnership distributions involving equity interests of a partner. Proposed regulations were published on June 12, 2015.

10. Final regulations under § 751(b) on unrealized receivables and inventory. Proposed regulations were published on November 3, 2014.

11. Final regulations under § 752 regarding related person rules. Proposed regulations were published on December 16, 2013.

12. Final regulations under §§ 761 and 1234 on the tax treatment of noncompensatory partnership options. Proposed regulations were published on February 5, 2013.

13. Final regulations under § 7704(d)(1)(E) regarding qualifying income for publicly traded partnerships. Proposed regulations were published on May 6, 2015.


TAX ADMINISTRATION


32. Regulations revising Circular 230 regarding proceedings before the IRS.
Treasury Department Proposes to Impose Additional Tax Reporting Obligations on Foreign Owned LLCs

By: Thomas E. Rutledge
Stoll Keenon Ogden PLLC
Louisville, Kentucky

The Treasury Department, on May 5, 2016, proposed regulations that would increase the reporting and record maintenance requirements of US organized disregarded entities (typically single member LLCs) owned by foreign persons.

In support of the objective of receiving additional information with respect to these foreign-owned disregarded entities, the Treasury began with a definitional sleight-of-hand; a domestic disregarded entity that is wholly owned by a foreign entity or person will be treated as if it is a domestic corporation. As a corporation, the disregarded entity will be treated as separate from its owner for the purpose of all reporting, record maintenance and other compliance requirements that are already apply with respect to domestic corporations that are owned 25% or more by foreign entities or persons. The proposed regulations require that, each foreign-owned disregarded entity ("FODE"):

- file a Form SS4 with the IRS, thereby obtaining a Federal Tax Identification Number and as well identifying to the IRS who is a “responsible party” with respect to the FODE;

- file, on behalf of the FODE, IRS Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in U.S. Trade or Business setting forth, irrespective of whether they are subject to federal income tax, reportable transactions between the FODE and its foreign owners or foreign related parties; and

- maintain records sufficient to establish the accuracy of any Form 5472 and in the US tax treatment of those transactions.

If finalized, and there is little reason to think they will not be, these regulations will constitute a significant change with respect to the treatment of FODEs. Currently, most FODEs do not file a Form SS-4 and are not subject to either tax reporting or record maintenance obligations under the Internal Revenue Code. These proposed regulations would affect a 180° change in that treatment. Further, as the IRS would have new information with respect to the US activities of FODEs, the IRS may share that information with foreign tax authorities pursuant to various information sharing agreements to which the US is a party.

Can Self-Employment Taxes and Net Investment Income Taxes Be Minimized?

By: Jennifer O’Leary
Pepper Hamilton LLP
Philadelphia, Pennsylvania

In certain situations, taxpayers may successfully thread the needle to not pay either net investment income tax or self-employment tax on some income from a pass-through entity that the taxpayer actively participates in.

Because of the increases in the Medicare tax, many taxpayers are interested in structuring to minimize self-employment tax. However, due to the introduction of the Medicare tax on net investment income, the Medicare tax also applies to passive income, such as interest, dividends, capital gains and income from passive activities. Traditionally, self-employment tax has not applied to distributions from limited partnerships (LPs) with respect to limited partnership interests because, in the past, limited partners were passive investors who did not provide services to the LP. Now, of course, to the extent that the income is from a passive activity or otherwise qualifies as net investment income, the Medicare tax on net investment income would apply to income from the LP.

Generally, partners in a limited liability partnership (LLP) who provide services to the LLP are subject to self-employment tax on all earnings from the LLP. As LLPs are traditionally used for service businesses, such as law firms and accounting firms, this outcome makes sense as self-employment taxes are supposed to apply to services income. This outcome is frequently carried over to limited liability companies (LLCs) where the members perform services for the LLC. However, in any business where capital is a significant factor in producing income, if an LLC member both produces services and provides capital, self-employment taxes should not apply to the income allocated to the capital. The Medicare tax on net investment income may apply, but it may not if the member actively participates. However, as the rules for self-employment taxes have not been updated to deal with the increased popularity of LLCs or limited partners who provide services to LPs, there are no controlling rules regarding self-employment and LLCs and LPs that reflect the new realities of how these entities operate.

The original rules regarding self-employment and LPs were designed to limit Social Security coverage to active employment and were written at a time when limited partners were passive investors in LPs. Thus, section 1402(a)(13) was originally enacted in 1976 to prevent passive investors from gaining coverage under the Social Security tax system. Proposed regulations regarding what a limited partner is were issued in 1994, and new proposed regulations were issued in 1997. However, Congress then issued a moratorium, saying that no regulations could be finalized on the issue for a year. Despite the expiration of the moratorium, no regulations on the point have been finalized.

The proposed regulations provide that an individual partner in a tax partnership (which would include an LLC taxed as a partnership) who has authority to bind the partnership is not a limited partner. Further, the preamble to the proposed regulations, in a discussion of the proposed regulations and their intent, states that “these rules [permitting bifurcation in certain limited circumstances] exclude from an individual’s net earnings from self-employment amounts that are demonstrably returns on capital invested in the partnership.” As the proposed regulations are not currently in effect, people generally have only relied on them if favorable. Increasingly, however, the IRS is taking the position that LLC members are not limited partners for purposes of section 1402(a)(13).

Although illogical, there now appears to be more support for limiting self-employment taxes when an LP is used because the original favorable rules, which limit the application of self-employment taxes to a limited partner’s interest in an LP, literally apply to LPs. Additionally, as noted above, there have been indications that the IRS is willing to be more aggressive with LLCs regarding self-employment issues. Ultimately, there should not be a difference between using an LLC and an LP, and taxpayers should not count on getting a more favorable outcome simply based on using an LP. However, right now based on IRS activity and the literal language of the statute, people are generally more comfortable with using LPs to minimize self-employment taxes. It is important to remember, though, that the original concept of a limited partner was of a passive investor. Thus, when a limited partner is actively
participating in the business of the LP, it is much more vulnerable to the argument that its income from the LP should be subject to self-employment taxes. Whichever entity is used, it makes sense to clearly delineate amounts paid for services as guaranteed payments. Any such guaranteed payments should be set at a reasonable amount for such services. Additionally, structuring to utilize a separate entity (which must be a separate entity for tax purposes, thus a disregarded entity cannot be used for this purpose) to provide services may make the delineation of payments cleaner.

Another approach to minimizing self-employment taxes is to use an S-corporation, as the law is clear that only amounts paid as salary to shareholders are subject to self-employment taxes. The salary has to be reasonable, but otherwise the law is clear on that point. S-corporations, however, have significant limitations on the number of shareholders and the type of shareholders permitted, as well as not allowing more than one class of stock. Thus, compensating employees with equity is more difficult in an S-corporation than in an LLC or LP. Another significant issue with utilizing an S-corporation is that, unlike a partnership, assets cannot be distributed without a tax cost. So, although an S-corporation may solve self-employment tax issues, it frequently creates other issues, particularly on sale. Further, eventually, the differences between S-corporations and partnerships with respect at least to self-employment should be removed. It seems likely that tax legislation will remove this S-corporation advantage in the future. In the interim, S-corporations can be used advantageously in certain situations. However, it must be recognized that there are costs to offset some of the advantages, and the advantages and disadvantages should be carefully evaluated.

Generally, individuals, trusts and estates with income above certain thresholds are subject to the 3.8 percent Medicare tax on net investment income, which includes interest, dividends, capital gains and passive income. The net investment income tax does not apply to amounts subject to self-employment tax. However, net investment income does not include income from an active trade or business conducted through a pass-through entity, including gains from the disposition of such activity, with certain exceptions for trading in financial instruments or commodities. Therefore, generally, income from a trade or business that the taxpayer actively participates in is not subject to net investment income. Thus, in certain situations, taxpayers may successfully thread the needle to not pay either net investment income tax or self-employment tax on some income from a pass-through entity that the taxpayer actively participates in. However, due to the increasingly all-encompassing nature of the IRS’s stance regarding what self-employment taxes apply to, the needle is getting harder to thread.

1. All section references herein are to the Internal Revenue Code of 1986, as amended, unless otherwise noted.

2. New York State Bar Association Tax Section Report, published in Tax Notes Today on November 15, 2011. Section 1402(a)(13) provides that net earnings from self-employment do not include “the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments described in section 707(c) to the partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services.”


4. For example, *Riether v. U.S.*, 919 F. Supp. 2d (D.N.M. 2012); CCA 201436049 (9/5/14) (finding that, as income of the LLC was for operational and investment management services performed by LLC members, all income of LLC members was subject to self-employment tax, even though members “paid more than a nominal amount” for their interests). Chief Counsel Advice does not have any precedential value but can provide an insight into the IRS’s thinking.

5. Generally, when given a choice between self-employment tax and net investment income tax, the self-employment tax is preferable, since half of it is deductible.

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Operating Agreement’s Two-Step Consent Provision Foils Assignment of LLC Member Interest

By Peter Mahler
New York Business Divorce
Originally posted August 1, 2016.

The pick-your-partner principle is universally embedded in the default rules of limited liability company enabling acts, including Sections 601 through 604 of the New York LLC Law which permit free assignment of distributional and other economic rights appurtenant to a membership interest but require the other members’ consent before an assignee is granted full member status with voting and other rights associated with membership in an LLC.

The distinction between a “mere” assignee versus a transferee with member status can become a battle ground when a putative LLC member who received his, her or its interest by assignment brings legal action against the LLC’s managers for dissolution, access to books and records, or asserting derivative claims on behalf of the LLC. That’s because by statute and/or common law, the suing party’s requisite legal standing to assert such claims depends on having member status.

A recent decision by Manhattan Commercial Division Justice Saliann Scarpulla in MFB Realty LLC v Eichner, 2016 NY Slip Op 31242(U) [Sup Ct NY County June 24, 2016], in which she dismissed derivative claims by a mere assignee of LLC interests, starkly illustrates the distinction and the importance of compliance with the LLC agreement’s provisions for bestowing member status on assignees.

The controversy in MFB Realty stemmed from a multi-member LLC formed in the mid-1990s for a timeshare residential condominium project at a Manhattan location. The LLC’s operating agreement defined “Member” as the original, named members and “persons hereafter admitted as Members.” In the article governing transfers of membership interests, Section 7.1 required prior written consent of 95% of the non-transferring members for any assignment by a member of “all or any portion of his, her or its interest in the Company.”

Section 7.2, captioned “Permitted Transfers,” allowed assignment to Permitted Transferees defined as lineal descendants of the parents of the members and the spouses of such descendants. It also included the following provision concerning member status that ultimately played a dispositive role in Justice Scarpulla’s decision:

“Notwithstanding anything contained in this Agreement to the contrary, no Permitted Transferee or any other transferee shall become a Member without the written consent of Members owning [95%] of the Membership Interests, which may be arbitrarily withheld.”

In December 2005, two non-managing members obtained the advance written consent of 95% of the other members for an assignment of their aggregate 10% membership interest to MFB Realty LLC which was owned by the two assigning members and certain lineal descendants of one of them. The written consent’s operative language stated that the consenting members “hereby consent . . . to any transfer . . . of any direct or indirect interests in the [LLC] to [MFB Realty].”

The assignment and assumption agreement with MFB Realty, a copy of which also was delivered to the other members in September 2006, stated that it was assigning “all of each Assignor’s interests” in the LLC “together with all such Assignor’s right, title and interest in and to the Company in respect of the Assigned Interest, including, without limitation, such Assignor’s capital account therein . . .”

You can view here copies of the written consent and the assignment. Notice that neither of them contain any explicit reference to voting rights or the admission of MFB Realty as a member of the LLC.

Which is exactly what Justice Scarpulla not only noticed, but found dispositive in MFB Realty’s lawsuit brought in 2014 against the LLC’s managing members asserting derivative claims accusing them of operating a competitive business utilizing the LLC’s resources and credit.

The judge began her analysis with recognition of the pick-your-partner principle reflected in the LLC Law’s default statute:
“The Limited Liability Company Law accords the members of an LLC the right to choose their fellow members, and provides that, “[e]xcept as provided in the operating agreement, an assignee of a membership interest may not become a member without the vote or written consent of at least a majority in interest of the members, other than the member who assigned or proposes to assign such membership interest.” Limited Liability Company Law§ 604 (a).”

Next, Justice Scarpulla summarized the pertinent provisions in Sections 7.1 and 7.2 of the operating agreement and found that they create a “two-step” process toward the admission of new members:

“In addition, the [LLC] operating agreement imposes certain restrictions on the transfer of membership interests, and distinguishes between assignees, or, transferees or permitted transferees, who hold only economic rights, and substituted members, who hold full rights under that agreement and applicable law. The [LLC] operating agreement provides that no member may transfer an interest without the prior written consent of members owning 95% of the [LLC] membership interests. The [LLC] operating agreement additionally provides that, “[n]otwithstanding anything contained in this Agreement to the contrary, no Permitted Transferee or any other transferee shall become a Member without the written consent of Members owning ... 95% ... of the Membership Interests, which may be arbitrarily withheld.” [Citations omitted]

Thus, under the [LLC] operating agreement two steps are required to obtain . . . member status. First, a [LLC] interest may be transferred only with the prior written consent of members owning at least 95% of the membership interests in [the LLC]. Second, member status in [the LLC] may be transferred only with the written consent of members owning at least 95% of [the LLC’s] membership interests.

Finally, Justice Scarpulla held that the written consent given by the other members in 2006 satisfied the first but not the second of the required two steps:

The documentary record submitted demonstrates that, while MFB obtained the necessary consent to become a transferee under section 7.1 of the [LLC] operating agreement, it never obtained the written consent required to become a substituted member under section 7.2 of that agreement. In the December 19, 2005 consent letter, the [other members] . . . consented to “any” transfer of [LLC] interests by [the assignors], who together hold a 10% interest. Significantly, however, the consent letter is completely devoid of any express (or implied) reference to the transfer of a membership interest in [the LLC], and nothing in that letter may be interpreted as a consent to the transfer of membership.

Justice Scarpulla accordingly dismissed all of MFB Realty’s derivative claims on the basis that, as a non-member, it lacked standing to assert them. MFB Realty has since filed a notice of appeal, the successful prosecution of which will be required if it is to have any say in the LLC’s business affairs or any role in monitoring the performance of the LLC’s controllers’ fiduciary obligations.

Some of you may be wondering, how could the controversy over MFB Realty’s member status first erupt almost 10 years after the assignment? Easily, at least in a case like this one involving a manager-managed LLC where the operating agreement excludes non-managing members from company management and has no other provisions requiring periodic member meetings or votes.

Finally, while the facts surrounding the consent or lack thereof in MFB Realty seem relatively clear cut precisely because of the formalities that were followed, that is not always the case, especially with LLCs — and even more so with family-owned LLCs — whose members ignore the formalities set forth in the operating agreement and whose course of conduct and representations in and out of court evidence the recognition of assignees as members.
More on Charging Orders: Devoll v. Demonbreun

By: Jay Adkisson
Riser Adkisson LLP
Las Vegas, Nevada

Rebecca Demonbreun and William Dowds ("Creditors") in 2010 obtained a judgment against Norris DeVoll ("Debtor"), who resided in Texas.

On March 8, 2011, the Creditors applied for a Turnover Order for the Debtor's assets. Texas is a community property state, which means that the community property of a husband and wife is available to the creditors of either or both; this also meant that the community property titled in the name of the Debtor's wife ("Paulette") was available to creditors. Paulette owned, as community property, an undivided one-half interest in a partnership known as "206 Camedia Partnership" ("Partnership"), with the other one-half being owned by the Debtor's brother, Gene DeVoll ("Gene").

Coincidence, coincidence, just two days after the Creditors made their application for the Turnover Order, on March 10, Gene suddenly decided that Paulette was in violation of the Partnership agreement, and sent to Paulette a "Notice of Default and Demand", by which he asserted his rights to her partnership interest for a nominal sum. Shortly thereafter, Gene purchased Paulette's interest for $5,000.

The Creditors' application for a Turnover Order was finally granted in August of 2011, and the Court ordered both the Debtor and Paulette not to dispose of their community property. The Debtor and Paulette both appealed the Turnover Order to the Texas Court of Appeals, and lost -- or "were poured out", to use the quaint Texas litigators' phrase -- in and opinion of that Court dated November 21, 2012.

Soon thereafter, in March of 2013, the Creditors brought a fraudulent transfer case against Gene, alleging that the "default" and subsequent $5,000 sale of Paulette's interest in the Partnership was simply a scam to transfer her partnership interest out of the Creditors' reach. The Creditors also sought a temporary injunction to keep Gene from disposing of the Partnership's principal asset, consisting of a parcel of real estate found at 466 Adrian Drive.

The Texas District Court agreed with the Creditors about their need for a temporary injunction, and granted it, but the temporary injunction was reversed on a technicality. The Creditors re-applied for a second temporary injunction, and this was granted on May 1, 2014. The temporary injunction forbid Gene from disposing of 466 Adrian Drive pending the outcome of the fraudulent transfer lawsuit. Gene appealed, and it resulted in the opinion of the Texas Court of Appeals that I shall next relate. Let's first set up the issue.

Texas partnership law, like pretty much the partnership law of every other state, restricts the creditor of a partner to but a single remedy, what is known as a Charging Order against the partner's interest. A Charging Order does little more than place a judgment lien against the partner's interest, but does not give the creditor any right to do anything with the partnership assets, or be involved in partnership interest. In fact, the historical purpose of a Charging Order is to keep a creditor from interfering with either the partnership's business or assets.

But Texas also follows the Uniform Fraudulent Transfer Act (here referred to as the "TUFTA"), which allows, among other things, a creditor to avoid a transfer made by the debtor with the intent of defeating creditors, as well as transfers that are made while the debtor is insolvent. Other Texas law allows a court to enjoin the transferee from further disposing of assets while the fraudulent transfer lawsuit is percolating towards trial.

The conflict in this case was between Texas partnership law and Texas fraudulent transfer law.

Gene argued that the temporary injunction violated the Texas partnership law, which provides that the Charging Order is the "exclusive remedy" available to a creditor of a partner in relation to that partner's interest in a partnership. Gene further argued that the temporary injunction keeps him from dealing with the partnership's property in the ordinary course of business, something the Texas partnership law expressly disallows. Finally, Gene argued that his $5,000 buyout of Paulette left her with no interest in the partnership.

The Creditors countered that Paulette
transferred her interest for $5,000 to Gene only to avoid her interest being subject to enforcement by the Creditors, and the TUFTA works to avoid such a transfer as a nullity. Avoidance of the $5,000 transfer would leave Paulette still holding her 50% interest in the partnership, which effectively means that she would still own through the partnership a one-half interest in 566 Adrian Drive.

Not finding any helpful precedent, the Court of Appeals considered the issue to be a case of first impression, and proceeded to analyze the relevant statutes. The Court first considered the Texas partnership law (technically, the Texas general partnership law, although if this case had involved a limited partnership, it probably would not have made any difference -- the same is also likely true if the partnership here had been organized as an LLC instead).

After reviewing the law's legislative history and purposes, the Court concluded that the purpose of its charging order provisions was (1) to allow a creditor to satisfy its judgment from the debtor's partnership interest (but not its assets), while (2) protecting the business of the partnership from interference by the creditor. The charging order provision accomplishes this by restricting a creditor's remedy against the debtor/partner by placing a lien on the debtor/partner's interest.

Very importantly, another benefit of the charging order is that a creditor has no rights against partnership property, but not against the partnership's property itself. The charging order provision does this by prohibiting other remedies, including equitable remedies such as an injunction, against the partnership property.

It was this last benefit of a charging order -- to exclude other remedies such as an injunction -- which created a conflict with the TUFTA, since the TUFTA expressly allows a creditor to obtain an injunction to prohibit a transferee from disposing of an asset. This can be necessary in a given case so that the creditor can obtain meaningful relief, and not just become the owner of yet another uncollectable judgment, this time against the transferee.

But was there really a conflict? The Court turned its attention to the two portions of the Texas partnership law that restricts a creditor's remedy to a charging order:

(d) The entry of a charging order is the exclusive remedy by which a judgment creditor of a partner or of any other owner of a partnership interest may satisfy a judgment out of the judgment debtor's partnership interest.

(f) A creditor of a partner or of any other owner of a partnership interest does not have the right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the partnership. [Tex.Bus.Orgs.Code sec. 152.308(d) and (f)]

The key takeaway here is that subparagraph (d) does not prohibit the court from using remedies other than the charging order in all circumstances, but only those which would allow the creditor to "satisfy the judgment" from partnership property. Thus, the Court:

[Subparagraph (f) of the charging order statute strips a creditor of the right to exercise an equitable remedy against partnership property. [ ]]

But we must read (f) not as an isolated provision but in conjunction with (d). [Subparagraph (d) makes the charging order an exclusive remedy, but it does not say the charging order is the exclusive remedy for all purposes; it says the charging order is "the exclusive remedy by which a judgment creditor ... may satisfy a judgment out of the judgment debtor's partnership interest." [ ] When we read (f) together with (d), we conclude (f) deprives a creditor of the right to an equitable remedy against partnership property to satisfy the judgment. [ ]]

In light of TUFTA's express remedies for creditors, we do not interpret section 152.308 to mean a judgment creditor has no right to any equitable remedy against any partnership property under any circumstance.

The Court added that this construction as also necessary to avoid an absurd result, which would be the clearly-incorrect conclusion that the Texas legislature intended to promote fraudulent transfers by carving out an exception to the TUFTA via the Texas partnership law.
Thus, the Court held that the Texas partnership law's restriction of a creditor's remedy to a charging order did not prevent the entry of an injunction against the dissipation of assets under the TUFTA, so long as the injunction was only as broad as strictly necessary to prevent the partnership interest from being dissipated. Applied to this case, since 566 Adrian Drive was essentially the only valuable asset of the partnership, the injunction was necessary to preserve Paulette's partnership interest pending resolution of the Creditors' fraudulent transfer lawsuit.

The panel of the Texas Court of Appeals which heard this matter had three justices. The majority opinion consisted of two of the justices; the third (Marion, S.B., who just happened to be the Chief Justice) filed a dissent.

Justice Marion was of the opinion that the Texas partnership law restricted remedies that may be employed by a creditor to the partnership interest itself, and not to partnership assets. Since the majority's opinion allowed the Creditors to enjoin the sale of 566 Adrian Drive and thus directly interfere with the partnership's business -- one of the primary purposes of so-called "charging order exclusivity" -- this violated the Texas partnership law, the TUFTA notwithstanding.

ANALYSIS

With the usual caveat that nobody has yet seen fitten to give me a black robe, it strikes me that Justice Marion had the better reasoning, but the Majority reached the correct result.

Justice Marion is exactly right when she points out that the Texas partnership law prohibits a creditor from taking some action that interferes with partnership property in the normal case.

But this wasn't a normal case. It is not as if Paulette owned a 10% interest in some hedge fund organized as a partnership, and creditors were attempting to freeze all the hedge fund's assets to protect the value of the 10%.

Instead, it seems to me that the better analysis would have been that the partnership dissolved by operation of law when Gene acquired Paulette's interest and thus became the sole partner (there is no such legal animal as a "single partner partnership"). Because the partnership no longer existed, then 566 Adrian Drive remained as the proceeds of the partnership, and thus would be available to the Creditors if their fraudulent transfer lawsuit was successful -- and that would justify the injunction against Gene's (as the transferee) attempt to sell away 566 Adrian Drive.

One should not lose focus, however, on the critical important holding in this case which is that a charging order isn't nearly as "exclusive" a remedy as it is often made out to be. Fundamentally, there has always been an unfortunate confusion between the charging order as a creditor's exclusive remedy, and the anticipated outcome that a creditor is stuck with a charging order and no more. But the former doesn't ipso facto lead to the latter, as this case points out.

To the contrary, there may be equitable remedies available to a creditor other than those which "satisfy the judgment". There may also be other theories of relief which technically are not considered "remedies" at all -- probably the best example being alter ego theories which manifest themselves in reverse veil-piercing cases -- and thus are not subject to the "exclusive" restriction of the charging order as a remedy. Other such theories would include those based on fraudulent transfers and constructive trusts. In fact, there are at least several things that a creditor might use to attempt to pry assets out of a partnership or LLC, despite that those entities having the statutory protection of the "exclusive" charging order remedy.

Here, my belief is that the Majority reached the correct conclusion of law, but misapplied it to the facts of the case. Justice Marion made the correct application of the law to the facts, but didn't consider an alternative theory of relief (most likely because the Creditors didn't make that argument). But none of this should overlook the very instructive Opinion that we are left to consider, and its implicit warning that charging order exclusivity, really isn't.

CITE AS

A Potpourri of Recent (Non-Delaware) LLP and LLC Cases

By: Elizabeth S. Miller
Baylor Law School
Waco, Texas

Limited Liability Partnerships


The court concluded that the disciplinary rule requiring an LLP law firm in New Jersey to maintain malpractice insurance does not apply during the firm's winding up if no legal services are being provided, and an LLP is not required to maintain tail coverage. Further, the failure to comply with the insurance requirement imposed by the disciplinary rule would provide grounds for the New Jersey Supreme Court to terminate the LLP's right to practice law or otherwise discipline the LLP but did not authorize the trial court to convert the LLP to a non-LLP general partnership. Conversion of the LLP to a non-LLP was not authorized by the New Jersey partnership statute either.

The plaintiff asserted a malpractice claim against an LLP law firm and its two partners. The LLP was winding up and no longer carried malpractice insurance although the firm carried insurance at the time the services were rendered. The plaintiff argued that the firm's failure to maintain insurance during winding up allowed the trial court to convert the firm from an LLP to a non-LLP general partnership so that the partner who did not commit malpractice would have vicarious liability.

The supreme court analyzed the disciplinary rule at issue, which required insurance against damages from the performance of "professional services." The court found no indication that the administrative activities in a winding up are included within that term. Because the disciplinary rule also requires compliance with New Jersey's UPA (which is based on the Revised Uniform Partnership Act (1997) or "RUPA"), the court proceeded to examine the statutory provisions addressing winding up. After examining the provisions of New Jersey's UPA, the court concluded that the administrative activities conducted during winding up are not the transacting of business for which an LLP law firm is created, and an LLP law firm that is winding up and has ceased to provide any legal services is not practicing law and could not commit malpractice during that period. Thus, the disciplinary rule does not require such a law firm to maintain professional liability insurance. Relying on a comment to Section 306 of RUPA, the court also found the date on which the firm incurred its obligation to the plaintiff to be dispositive. The comment states that partnership obligations under or relating to a contract generally are incurred when the contract is made, and obligations under or relating to a tort generally are incurred when the tortious conduct occurs as opposed to the time of the injury or harm. The court thus held that an LLP law firm incurs its obligation to a client on the date that the alleged malpractice occurs. In this case, the firm was a valid LLP with professional liability insurance coverage at the time of the alleged malpractice.

The court further concluded that neither the disciplinary rules nor the New Jersey UPA provided any basis for the trial court to convert the LLP in this case to a non-LLP general partnership. The disciplinary rule confers authority on the New Jersey Supreme Court to discipline an LLP law firm for failure to comply with the rules. The trial court had no such authority. As for the provisions of New Jersey's UPA, they provide that the status of an LLP remains effective until the LLP cancels its status under the statute or the State Treasurer revokes its status for failure to file an annual report when due or pay the required filing fee. The court noted that the statutory provisions are protective of the liability shield by providing cure provisions in the event of non-compliance with the annual filing requirements. Those provisions along with the absence of any language in the statute giving a court authority to convert a properly recognized LLP into a non-LLP general partnership led the court to conclude that the UPA provides no support for the trial court to convert the LLP to a non-LLP.

Next the court analyzed whether the disciplinary rule requires tail insurance after dissolution. The court noted that the insurance requirement for LLPs is a departure from the general rule that malpractice insurance is not required for attorneys in New Jersey. The rules do not require tail coverage for professional corporations or general partnerships that are not LLPs, nor are solo practitioners required to carry any insurance, including tail coverage. The court
decided against imposing a tail requirement on attorneys who choose to practice as LLPs, noting that a mandate to purchase tail coverage still would not fully protect the public from uninsured risks.

One justice wrote an opinion concurring in the judgment but dissenting from the majority's conclusion that an LLP does not have to maintain liability insurance during the LLP's winding up. This justice also urged amendment of the disciplinary rule to require lawyers engaging in the practice of law as an LLP to secure tail coverage for a six-year period after the LLP's dissolution, if such coverage is reasonably available.


Judge Scarpulla held that a provision in Dewey LeBouef's lease that provided the partners would have personal liability was not enforceable to hold the partners personally liable because the firm registered as a limited liability partnership after execution of the original lease, and the New York LLP statute provides that the partners are not personally liable for the obligations of the partnership unless otherwise agreed by a majority of the partners. The lease, which had been amended numerous times over the years, was not approved by a majority of the partners after the firm's registration as an LLP, and the court thus held that the landlord could not rely on the provision of the lease imposing personal liability on the partners.

Dewey Lebouef's landlord sued several hundred partners of Dewey LeBouef and its predecessor firms to hold the partners personally liable in the event of a breach. In 1997, Dewey Ballantine registered as a New York LLP. The lease was amended 12 times over the years, including 8 times after the firm registered as an LLP. The New York LLP statute provides that partners do not have personal liability for the debts of the partnership except to the extent that a majority of the partners agree otherwise or as provided in any agreement of the partners. According to the court, "While there may have been a reasonable time period following Dewey Ballantine’s conversion to a limited liability partnership in 1997, the contracting parties had ample opportunity to update the lease and comply with Partnership Law § 26 by securing a majority or other agreement among the partners to be personally liable." The court thus concluded that the lease was not enforceable to hold the partners personally liable due to failure to comply with the New York LLP statute.


The court of appeals held that the State of Texas did not establish that the manager and operator of an LLC was personally liable for civil money penalties under the Texas Water Code arising from the LLC's violations of rules promulgated by the Texas Commission on Environmental Quality. The State relied on the principle that an officer or other agent of a corporation is personally liable when he knowingly participates in a tortious or fraudulent act even though the act was performed as an agent; however, the State did not allege that the manager in this case engaged in a tortious or fraudulent act. The State argued that this principle of personal liability covers "wrongful acts" and that an individual corporate officer may be held liable for his own violations when a statute provides for individual liability as does the Water Code. The court concluded that the conduct in this case did not precisely align with the kind of statutory violation likened to an "environmental tort" by a sister court of appeals in another case and that the other case was not binding on the court in any event. Thus, the court held that the trial court erred in granting the State summary judgment against the individual manager.

The State of Texas filed suit against Morello and White Lion Holdings, L.L.C. ("White Lion"), an LLC formed and managed by Morello, alleging violations of rules promulgated by the Texas Commission on Environmental Quality and seeking injunctive relief and civil penalties. White Lion purchased property out of a bankruptcy estate and was transferred a hazardous-waste permit and compliance plan
associated with the property. A few years later, the State of Texas filed suit against White Lion alleging that it did not meet the requirements of the compliance plan, including requirements to continue corrective action to clean up contamination, monitor groundwater, file reports, and provide financial assurance for operation of corrective programs. Although the obligations that were imposed on the previous owner of the property were transferred to the LLC, the State amended its petition and named Morello in its suit, alleging that Morello was individually liable as well as the LLC. After the district court granted the State’s motion for summary judgment against White Lion and severed the claims against Morello, the State moved for summary judgment against Morello. The district court granted the State’s motion for summary judgment and ordered Morello to pay $367,250 in civil penalties. Morello appealed, arguing that he could not be held individually liable because the State was not attempting to pierce the veil of the LLC and did not allege the type of conduct for which an agent of an LLC may be held individually liable for actions taken on behalf of the company.

The court of appeals first explained that the Texas LLC statutes have always provided that a member or manager of an LLC is not liable for the debts, liabilities, or obligations of the LLC except to the extent the LLC agreement provides otherwise. Further, the statutes provide that a member may only be named as a party in an action by or against the LLC if the suit is brought to enforce the member’s right against or liability to the LLC. The court noted that the Texas LLC statutes at the time this suit was filed did not mention veil-piercing principles as an exception to the liability protection provided by an LLC or how such remedies might be applied in the LLC context. The court pointed out that it considered veil-piercing principles in a previous case without deciding whether veil-piercing concepts apply in the LLC context. In this case, the court stated that it was again not necessary to reach the question of whether veil-piercing concepts apply in the LLC context because the State did not assert that it was attempting to pierce White Lion’s veil.

The State acknowledged that the structure of an LLC is intended to shield its members from the liabilities and obligations of the LLC but argued that the statutory shield does not deflect liability for the conduct at issue. Rather than relying on veil-piercing principles to hold Morello personally liable, the State relied on the common-law principle that a corporate officer may be held individually liable when the officer knowingly participates in tortious or fraudulent acts even though the officer is acting on behalf of the corporation. However, the State did not allege that Morello engaged in any fraudulent or tortious activity. The State acknowledged that this was not a tort action but was “a statutory enforcement action brought against Morello as operator and sole decision maker of White Lion.” Instead of arguing that Morello engaged in fraudulent or tortious conduct, the State contended that this principle of law also covers “wrongful acts.” The State asserted that Morello could be held individually liable for the failure to adhere to the terms of the compliance agreement that was transferred to White Lion and for the failure to provide financial assurance because of Sections 7.101 and 7.102 of the Water Code. Section 7.101 of the Water Code provides that “[a] person may not cause, suffer, allow, or permit a violation of a statute within the commission’s jurisdiction or a rule adopted or an order or permit issued under such a statute,” and Section 7.102 of the Water Code authorizes the assessment of a penalty on “[a] person who causes, suffers, allows, or permits a violation of a statute, rule, order, or permit.” The State pointed to Morello’s control over the operations and decisions of White Lion as sole manager and officer and argued that he could be held individually liable for the “wrongful acts” which he directed, participated in, knew of, or assented to. Relatedly, the State argued that since Morello was the sole member, owner, and decision maker of White Lion, he was a person that caused, allowed, and/or permitted White Lion to violate the compliance agreement and administrative rules.

As it began its discussion of whether the State established as a matter of law that Morello could be held individually liable, the court noted that all of the cases that the State cited in its summary judgment motion recite the longstanding rule that a corporate employee maybe held liable for his “tortious” or his “fraudulent” acts when acting as an agent; the cases do not indicate that conduct falling outside of those types of misconduct may also serve as a basis for individual liability. Additionally, the court distinguished the cases relied on by the State as support for the proposition that the legislature intended to allow for individual liability
to be imposed on an agent of an LLC even in the absence of fraudulent or tortious conduct through the passage of Sections 7.101 and 7.102 of the Water Code. In *Miller v. Keyser*, 90 S.W.3d 712 (Tex. 2002), in which the Texas Supreme Court determined that an agent of a corporation may be held liable under the Deceptive Trade Practices Act, the court equated the claims brought under the Deceptive Trade Practices Act to “torts.” In the instant case, the court of appeals stated that there was no showing that the alleged failures to satisfy the terms of the compliance plan and failure to provide financial assurance were tortious or fraudulent conduct of Morello individually or that those failures to comply should be treated as if they were. Here, the State did not allege any fraudulent conduct and specifically stated that the violations at issue are not torts. The court of appeals was also unpersuaded by the decision of a sister court of appeals in *State v. Malone Service Co.*, 853 S.W.2d 82, 84–85 (Tex. App.–Houston [14th Dist.] 1993, writ denied). In Malone, the court of appeals concluded that the president of a company and the plant manager could be held individually liable under a former provision of the Water Code, which provided for civil money penalties to be imposed on a person who violated a provision of a permit. The court in Malone likened the conduct at issue in the case to “an environmental tort” for purposes of the rule that a corporate officer can be held individually liable for participating in or directing the commission of a tort. The court of appeals stated that the conduct at issue in Malone was consistent with what the legislature had described as an environmental tort in a former provision of the Civil Practice and Remedies Code relating to proportionate responsibility. That provision addressed injury, damage, or death “caused by depositing, discharge, or release into the environment of any hazardous or harmful substances.” The court stated that the conduct alleged by the State in the instant case did not align as easily with the description of an environmental tort because there was no allegation that Morello deposited or discharged any hazardous substances. In any event, the analysis from Malone did not bind the Austin Court of Appeals. Thus, the court concluded that the State failed to establish as a matter of law that Morello could be held individually liable for the alleged violations and that the district court thus erred by granting the State’s motion for summary judgment.

**LLC Veil Piercing**


The plaintiff sought to satisfy a judgment against an LLC by reaching the assets of the LLC’s member, the member’s spouse, and other entities owned or controlled by the member. The plaintiff relied on veil piercing (both traditional and reverse) and fraudulent conveyance claims. The Virginia Supreme Court made clear that the same standards that apply for veil piercing in the corporate context apply in the LLC context and held that the plaintiff had alleged sufficient facts to state its claims except for the veil-piercing claim against the member’s spouse.

With respect to the veil-piercing claims, the court first recognized the general rule that a person with a claim against an LLC may only pursue that claim against the LLC itself and not its members, but the court stated that an LLC’s “corporate veil” may be pierced “in rare instances” to hold a member personally liable. Under Virginia case law, the corporate veil may be pierced “when the unity of interest and ownership is such that the separate personalities of the corporation and the individual no longer exist and to adhere to that separateness would work an injustice.” However, “[a] corporate entity cannot be disregarded unless it is proved that the corporation is the alter ego, alias, stooge, or dummy of the individuals sought to be held personally accountable and that the corporation was a device or sham used to disguise wrongs, obscure fraud, or conceal crime.” The court stated that this same standard applies in the LLC context. The court acknowledged that it has recognized reverse veil piercing, in which a company is held liable for a shareholder’s personal liabilities, in addition to traditional veil piercing, in which a member may be held personally liable for a company’s liabilities. The court stated that courts generally should consider the same factors in deciding whether to apply either doctrine.

With respect to the plaintiff’s claim to pierce the LLC’s veil to reach its member, the complaint alleged that the LLC had no bank account, held no assets, and had been legally insolvent for several years. It alleged that the member had siphoned the LLC’s funds and that
the member owed the LLC more than $160,000, which the LLC made no effort to collect. The court said these allegations raised an implication that the LLC and its member were not separate personalities. Further, the complaint implicitly alleged that recognizing the separate existence of the LLC and its member would cause an injustice to the plaintiff in that the plaintiff would not receive the benefit of its judgment against the LLC. Thus, the plaintiff’s complaint stated a claim to pierce the LLC’s veil to reach the member.

Because the complaint alleged a claim to pierce the LLC’s veil to reach its member, the court turned to the question of whether the plaintiff alleged a claim to reverse pierce the veils of the related entity defendants through the member. Viewing the allegations in the light most favorable to the plaintiff, the complaint alleged that the LLC’s member was also a member of each of the related entity defendants. The complaint stated that the LLC and the related entity defendants did not operate as separate personalities because they advertised to the public as a single entity and the funds and employees of each entity were used as the funds and employees of every entity. Viewing these allegations in the light most favorable to the plaintiff, the complaint raised an implication that the LLC’s member, through his control over the LLC, also controlled the LLC’s entity alter egos, the related entity defendants. Thus, the plaintiff stated a claim to reach the assets of the related entity defendants by piercing the LLC’s veil to reach the member and then reverse piercing the related entity defendants’ veils through the member. In a footnote, the court pointed out that a court considering a reverse veil-piercing claim should consider the impact of reverse piercing on innocent investors and innocent creditors as well as the availability of other remedies the creditor may pursue. The complaint in this case did not have any allegations involving these issues, and the court did not consider them.

With regard to the member’s wife, the plaintiff did not allege that she had any relationship with the LLC other than indirectly through her husband. Therefore, the court concluded that her assets could not be reached by piercing the LLC’s veil.

The trial court dismissed the fraudulent conveyance claim on the basis that a claim for fraudulent conveyance must be pled with the same level of specificity as common law fraud. The supreme court stated that the plaintiff was not required to state its claim with specificity, and its general allegations of a fraudulent conveyance scheme were sufficient. The plaintiff alleged facts that, if true, would show that conveyances from the LLC to the LLC’s member and his wife and to the related entity defendants involved at least one badge of fraud.


The court held that an investor in a hedge fund alleged a plausible alter-ego claim against the individual who controlled the two Delaware LLCs that served as managing member and investment manager of the hedge fund. The court concluded that the investor’s allegations were sufficient to allege that the individual and the LLCs operated as a “single entity” and that there was an “overall element of injustice and unfairness.”

The plaintiff invested $5 million in a hedge fund, and the fund lost the entire investment within ten months. The plaintiff sued a Delaware LLC that served as the managing member of the fund and a Delaware LLC that served as investment manager. The plaintiff also sued Porges, the CEO and principal of these two LLCs. The plaintiff sought to hold Porges liable for breach of contract and breach of fiduciary duty by piercing the veil of the LLCs. Porges sought dismissal of the claims, but the court concluded that the plaintiff’s allegations were sufficient to allege an alter-ego claim against Porges under Delaware law.

In an alter-ego inquiry under Delaware law, the court must determine whether the relevant parties operated as a “single entity” by considering various factors (adequate capitalization, solvency, corporate formalities, siphoning of company funds, and whether the company functioned as a facade for the controlling owner). Additionally, a Delaware alter-ego claim requires an element of fraudulent intent. The Second Circuit has stated that the plaintiff need not prove actual fraud, but must show a mingling of the operations of the entity and its owner and an overall element of injustice and unfairness. The court noted that the pleading requirement under the federal rules is not one of particularity if the alter-ego claim does
not sound in fraud. Here, the plaintiff alleged that Porges created the LLCs “as a personal trading vehicle,” that Porges commingled personal and corporate assets, and that Porges and his entities shared the same office address. The plaintiff also alleged that the entities were grossly undercapitalized. The court said these allegations were sufficient to allege a “single entity” as well as “an overall element of unfairness or injustice.”

Fiduciary Duties in LLCs


The court examined the roles of two individuals with respect to two Kentucky LLCs, a Wyoming LLC, and a Kentucky corporation. The court concluded that one of the individuals did not owe the other individual any fiduciary duty arising out of any of the entities.

Jones and Griffin started a venture to buy and sell college textbooks. They formed Blackrock Investments, LLC (“Blackrock”), of which they were each 50% owners. Blackrock created a subsidiary, SE Book Company, LLC (“SE Book”). Jones and Griffin also formed College Book Rental Company, LLC (“College Book Rental”), which was owned by a trust of which Jones and Griffin were beneficiaries. Finally, Jones bought a 50% interest in Integrated Computer Solutions, Inc. (“ICS”), a corporation founded by Griffin. The business relationship of Jones and Griffin deteriorated, and they asserted various claims against each other in this lawsuit, including claims by Jones that Griffin breached his fiduciary duties to Jones. Griffin argued that he did not owe any fiduciary duties to Jones as a member.

Jones argued that the court had previously held that Griffin owed a fiduciary duty to Jones when the court stated that “a member of a limited liability company owes a duty of loyalty to fellow members.” The court said that it was speaking in the context of whether Jones, the manager-member of Blackrock, owed a fiduciary duty to a member, Griffin. The court characterized its language as “over-inclusive” and stated that other courts have made similarly overbroad statements, which would appear to support Jones’s position when taken out of context. As an example, the court pointed to a statement by the Kentucky Court of Appeals in Patmon v. Hobbs, 280 S.W.3d 589, 594 (Ky. Ct. App. 2009) as follows: “Kentucky limited liability companies, being similar to Kentucky partnerships and corporations, impose a common-law fiduciary duty on their officers and members in the absence of contrary provisions in the limited liability company operating agreement.” The court stated that the issue in Patmon was the fiduciary duties of a manager-member and that the statements should be viewed in that context.

Next, the court analyzed the relationship of Griffin and Jones with respect to SE Book, a Kentucky LLC. SE Book was owned by Blackrock, so neither Griffin nor Jones had an ownership interest in SE Books. SE Book was originally organized as a member-managed LLC but was changed to a manager-managed LLC. Jones was the manager. Under Kentucky law, the members of a member-managed LLC have fiduciary duties. In a manager-managed LLC, the managers owe fiduciary duties, but the members do not. Thus, the court held that Griffin, a member of a manager-managed LLC of which Jones was the manager, did not owe a fiduciary duty to Jones as a member.

Finally, the court analyzed the relationship of Griffin and Jones with respect to College
Book Rental, a Wyoming LLC. College Book Rental was manager-managed, and Jones was the manager. The Wyoming LLC statute imposes fiduciary duties of loyalty and care on a member of a member-managed LLC and a manager of a manager-managed LLC. Griffin was neither a member nor a manager of College Book Rental. Thus, the court held that Griffin did not owe Jones a fiduciary duty arising out of College Book Rental.

Griffin also argued that, even if he owed a fiduciary duty to Jones, none of his alleged conduct constituted a breach of fiduciary duty. Jones claimed Griffin breached his fiduciary duties by purchasing secured debt behind Jones's back and then suing Jones and his wife on their guarantees. Neither party cited Kentucky case law on whether the purchase of a shared debt by one of the debtors may constitute a breach of fiduciary duty, but the court discussed case law in the partnership context that provides support for the general proposition that the purchase of partnership debt by one partner may breach a fiduciary duty in certain circumstances. Whether Griffin actually breached a fiduciary duty required additional factual determinations. Similarly, additional factual findings were necessary before the court could address whether Griffin's initiation of litigation constituted a breach of fiduciary duties. Because the court had already found that Griffin did not owe a fiduciary duty to Jones, the court declined to make factual findings as to whether Griffin's actions violated a hypothetical fiduciary duty. The court concluded that Griffin was entitled to summary judgment on Jones's breach-of-fiduciary-duty claims because Griffin owed Jones no fiduciary duties.


The plaintiff invested $5 million in a hedge fund, and the fund lost the entire investment within ten months. The plaintiff sued a Delaware LLC that served as the managing member of the fund and a Delaware LLC that served as investment manager. The plaintiff also sued Porges, the CEO and principal of these two LLCs. The plaintiff's claims included claims for breach of contract and breach of fiduciary duty. The court held that the plaintiff's breach-of-fiduciary duty claims generally were not duplicative of the breach-of-contract claims, but were potentially duplicative in one respect. The court also concluded that the breach of fiduciary-duty claims were either direct claims or derivative claims that Delaware law might allow to be asserted directly under the particular circumstances of the case.

The defendants argued that the plaintiff's claims for breach of fiduciary duty should be dismissed as duplicative of the claims for breach of contract. The court acknowledged that both claims were based on the same underlying facts, but that is not the test. The test under Delaware law is whether there exists an independent basis for the fiduciary claims apart from the contractual claims. The court said that the breach-of-fiduciary duty claims were not generally duplicative under that standard. The court said that the offering memorandum contemplated suits alleging breach of fiduciary duty for gross negligence (based on an exculpatory clause that stated the managing member would not be liable "for mistakes of judgment or for losses due to such mistakes, unless caused by gross negligence, fraud, or willful misconduct") and that a fact finder could determine that the defendants made such mistakes, thereby breaching their fiduciary duties, while not necessarily breaching their contractual duties because of broad discretion afforded the defendants in the contract. In one respect, the court stated that the plaintiff's claim for breach of fiduciary duty appeared to be duplicative. To the extent that the plaintiff's allegation of breach of fiduciary duty based on concealment of information was based on a failure to provide the periodic reports that were required under the governing agreements, this claim would be duplicative of the claim for breach of contract.

The defendants also complained that the fiduciary-duty claims belonged to the fund and were derivative. The court stated that the plaintiff's claim that he would have withdrawn his money had he received adequate information from the defendants (other than from the reports that were covered by the contract claim) was direct rather than derivative. The court acknowledged that claims for fund mismanagement are ordinarily derivative under Delaware law, but here the fund had dissolved, and the only two members were adversaries. The court pointed out that there is case law in the partnership context where similar circumstances led a Delaware court to hold that "the justifications for requiring partners to bring
derivative claims—consolidation of lawsuits and a preference for intra-partnership dispute resolution—are inapplicable." It was somewhat unclear to the court whether Delaware courts would apply that holding in the LLC context, but the court was inclined to believe they would and was not prepared to hold otherwise based on the briefing to date. In a footnote, the court elaborated on arguments the defendants asserted under Delaware law to convince the court that the partnership case law mentioned by the court would not apply in this LLC context, but the court was not convinced by the defendants’ arguments. Unanswered questions raised by the court included whether and to what extent certain provisions of the Delaware LLC statute regarding defunct LLCs apply in a federal diversity case given that the provisions expressly refer to “the Court of Chancery,” and why a defunct LLC must be joined as a necessary party to an action between its only two members. Thus, the court declined to dismiss the claims for breach of fiduciary duty.


A judgment in favor of a member of an LLC against his co-member in a lawsuit in state court in which the judgment creditor sued for breach of fiduciary duty did not have preclusive effect for purposes of the judgment creditor’s objection to discharge of the debtor for a debt arising from fraud or defalcation in a fiduciary capacity where the state court made no findings of fact or conclusions of law. The bankruptcy court found it unnecessary to decide any issues of fraud or defalcation with respect to fiduciary duties owed by the debtor to the LLC since the LLC was not a plaintiff and the other member did not have standing to pursue the LLC’s claims. Assuming without deciding that the debtor owed his fellow member a fiduciary duty (which the debtor did not concede), there was insufficient evidence of moral turpitude, intentional wrongdoing, or willful blindness by the debtor with respect to the matters about which the other member complained to constitute fraud or defalcation.

Johnson and King formed Earl’s Deli, LLC, a Texas LLC, to operate a sandwich shop. The certificate of formation provided that the LLC was member-managed, and the company agreement likewise provided for management by the members, in proportion to the percentage interests of the members, which were 51% for Johnson and 49% for King. Notwithstanding the provision for management in proportion to their percentage interests, Johnson chose to be a passive owner, and King managed the LLC for the first year and a half until King informed Johnson that the LLC was out of money and would have to close. Johnson did not want to close the deli, so he took over the day-to-day operations. After doing so and reviewing the books, Johnson discovered alleged improprieties on the part of King. Johnson managed the deli for the next 3 1/2 years until the deli’s landlord, a corporation owned by Johnson, changed the locks and evicted the LLC for failure to pay the rent for the previous four years.

Johnson sued King in state court and obtained a judgment after a non-jury trial in which the court made no findings of fact or conclusions of law. King then filed a Chapter 7 petition, and Johnson filed this adversary proceeding objecting to discharge of King’s debt to him under Section 523(a)(4) (fraud or defalcation in a fiduciary capacity) and (a)(6) (willful and malicious injury to an entity or the property of an entity).

The bankruptcy court rejected the suggestion made by Johnson’s counsel at trial that both Johnson and the LLC were plaintiffs in the adversary proceeding. Based on the filings made in the bankruptcy, the court concluded that only Johnson was a plaintiff in the adversary proceeding. Johnson, even though he owned 51% of the LLC, did not have standing to assert injuries to the LLC. Thus, the court did not have to decide any issues of fraud or defalcation in a fiduciary capacity owed to the LLC under Section 523(a)(4) or willful or malicious injury to the LLC or its property under Section 523(a)(6). The court noted that the LLC would not have prevailed even if it had been a plaintiff for the reasons set forth below.

Johnson first argued that the judgment he obtained in state court established a breach of fiduciary duty within the meaning of Section 523(a)(4), but the court pointed out that Section 523(a)(4) requires more than a breach of fiduciary duty. Section 523(a)(4) requires fraud or defalcation while acting in a fiduciary capacity. Because the state court made no findings of fact or conclusions of law, the bankruptcy court did not have a sufficient record from the state court to give preclusive effect to
the judgment. Thus, the court proceeded to assess the evidence to determine whether to except King from discharge based on fraud or defalcation in a fiduciary capacity. The court stated in a footnote that King did not concede that he owed Johnson a fiduciary duty “as opposed to the unquestionable fiduciary duty he owed to the LLC.” Assuming, without deciding, that King owed a fiduciary duty to Johnson, the court went on to conclude that Johnson did not prove fraud or defalcation.

The court found that the evidence did not show that King committed “fraud” while acting in a fiduciary capacity because there was insufficient evidence of moral turpitude or intentional wrong. The court stated that allegedly unauthorized gas purchases made on the LLC credit card as well as $2,000 in distributions made to King during the time he managed the LLC were fully disclosed in the records of the LLC, to which Johnson always had access, and these transactions thus were not done “secretly” as alleged by Johnson. With respect to the gas purchases, it was necessary for the LLC to use the car of a member or employee since the LLC had no car. Although some of the gas purchases were for King’s personal use, there was no evidence that the LLC helped King pay a portion of his car insurance or maintenance, or that the total transaction—King’s providing a car and paying all maintenance and insurance in exchange for purchasing gas with the LLC’s credit card—was unfair to the LLC. With respect to the $2,000 in distributions, the company agreement provided that distributions of excess cash were to be made to the members in proportion to their percentage interests. While it was true that King made distributions only to himself and not to Johnson while King was managing and operating the deli, the court pointed out that Johnson chose not to share management responsibilities in proportion to their percentage interests as provided in their company agreement and that King’s calculation of excess-cash determinations appeared to have been proper. Furthermore, Johnson allowed similar distributions to be made to King even after Johnson took control of the day-to-day management and operation of the deli. Given provisions in the company agreement that allowed a member to exercise remedies against a defaulting member who has committed fraud or theft or gross negligence, the court found disingenuous Johnson’s claim that he did not want to “wrestle” with King over the distributions and did not know how to stop him. The court stated that the distributions did not suggest moral turpitude or intentional wrong by King, but instead both parties’ recognition that King was entitled to some type of return for his sweat equity or that King needed the distributions for living expenses.

The evidence did not show that King committed a “defalcation” while acting in a fiduciary capacity because a defalcation requires a culpable state of mind involving knowledge of, or gross recklessness with respect to, the improper behavior. The court found that King did not have actual knowledge of any wrongdoing with respect to use of the LLC credit card or distributions because there was none, and he was not willfully blind to breaches of fiduciary duty because there were no such breaches. The evidence also did not show that King committed embezzlement or larceny within the meaning of Section 523(a)(4).

See also In re Lake Michigan Beach Pottawattamie Resort LLC, 547 B.R. 899 (Bankr. N.D. Ill. 2016), summarized below under the heading “Interpretation and Enforcement of Operating Agreement ‘Blocking’ Provisions for Consent to Bankruptcy Filing.”

**Adoption of Operating Agreement After Formation of LLC**

Kilpatrick v. White Hall on MS River, LLC, 2016 WL 743667, __ So. 3d __ (Miss. 2016).

The court held that the plaintiff was not a member of an LLC despite having made an initial capital contribution of $186,500 and being listed as a member in an exhibit to the operating agreement and on tax returns. The operating agreement, which was executed by only three of the five men who made capital contributions, required payment of a $500,000 capital contribution in order to become a member. The plaintiff did not satisfy the $500,000 contribution obligation, and the court held that he thus did not become a member. The court also held that neither a constructive trust nor an equitable lien would be imposed to enable the plaintiff to recover his $186,500 contribution.

Five men reached an informal gentlemen’s agreement to form an LLC to purchase land and to contribute $500,000 each toward purchase of the land. A certificate of formation was filed, and
the land was purchased, but only three of the men made their agreed contributions. Kilpatrick paid only $100,000 at closing. Several months later, the three men who had made $500,000 contributions signed an operating agreement that recited that Kilpatrick contributed $100,000 and stated that he had zero membership shares and was not a member until meeting the $500,000 contribution obligation. Kilpatrick contributed a total of $84,500 for quarterly interest payments in addition to the initial $100,000 but never tendered his $400,000 balance owed toward the purchase price of the land. Tax records showed Kilpatrick as a member with varying percentages of ownership over three years. Kilpatrick alleged that he was a member and sought return of his capital contribution of $186,500 on the theory that the LLC was unjustly enriched by retaining his contribution. Kilpatrick claimed that the operating agreement was invalid because it was not signed by all members and that he was a member based on tax records and capital account ledgers. The court stated that Kilpatrick’s argument that the agreement was not valid because it was not signed by all members failed if Kilpatrick was never a member. The court stated that the records would have weight if the agreement was ambiguous, but the agreement unambiguously required a contribution of $500,000 to become a member. The court held that Kilpatrick was not a member and he was not entitled to the return of his $186,500 contribution because the members relied to their detriment on his unfulfilled promise to contribute the balance owed and “he who seeks equity must do equity.”

The Chief Justice dissented and would have held that Kilpatrick was a member and that the agreement was invalid. He would have thus remanded for determination of the fair value of Kilpatrick’s interest at the time of his dissociation from the LLC (based on statutory default rules that apply in the absence of an agreement). The Mississippi LLC statute provides that an operating agreement must initially be agreed to by all of the members and that a promise to make a contribution must be in a writing signed by the member. The statute also provides that a person becomes a member on the later of the date of filing of the certificate of formation or the date stated in the records of the LLC. In the Chief Justice’s view, three of the members could not decide sometime after formation what the rules of the LLC are, particularly that a contribution less than $500,000 would be forfeited.


Under the provisions of the New York LLC statute, the court held that two members of a three-member LLC were able to adopt an operating agreement permitting them to eliminate the salary of the third member, issue a capital call, and reduce the third member’s interest upon failure to satisfy the capital call notwithstanding the third member’s claim that they orally agreed when they formed the LLC to make all decisions by a unanimous vote and not to dilute a member’s interest in the event of a failure to contribute.

Three individuals filed articles of organization for a member-managed LLC with each member holding a 1/3 membership interest. The LLC had no written operating agreement for almost two years. Two of the members voted to amend the articles of organization designating the LLC as manager-managed, and they signed an operating agreement authorizing capital calls by approval of a majority interest of the members and adjustment to a member’s percentage interest in the event of a failure to make a requested contribution. The two members who signed the operating agreement voted to eliminate the third member’s salary and make a capital call, and the third member filed suit. The third member alleged that the members orally agreed when they formed the LLC to maintain the LLC as member-managed, to make all decisions by unanimous vote, and not to dilute the interest of any member in the event of a failure to contribute upon an authorized capital call. The New York LLC statute provides for member-management as a default rule, and the provisions addressing voting in a member-managed LLC state that, except as provided in the operating agreement, the articles of organization and operating agreement may be adopted or amended by vote of a majority interest of the members. The New York LLC statute defines the operating agreement as a written agreement of the members concerning the business of the LLC and the conduct of its affairs, and the statute states that the members “shall adopt a written operating agreement.” The statute also provides that an operating agreement may be entered into before, at the time of, or within ninety days after the filing of
the articles of organization. The court held that the operating agreement adopted by the two members was valid under the New York LLC statute. The court noted that the statute requires a written operating agreement but does not require "all" of the members to enter into an operating agreement. The court also stated that the statute permits an operating agreement to be entered into within ninety days after the filing of the articles of organization but does not mandate that it be entered into within that time. Even assuming that the operating agreement adopted by the majority was invalid so that there was no written operating agreement, the court stated that the default provisions of the LLC statute would apply, under which the LLC would be member-managed and a combined majority interest could reduce the third member's salary and issue the capital call.

**Amendment of LLC Operating Agreement Under Provision Permitting Amendment by Holder of Majority of Units**


The 55% member of an LLC amended the operating agreement in numerous respects including adding an arbitration clause to the operating agreement. The court held that the members could not be compelled to arbitrate their disputes under the arbitration clause added by the amendment adopted by the 55% member, even though the operating agreement provided that the operating agreement could be amended by a vote of members holding more than 50% of the LLC units. A party cannot be compelled to arbitrate unless the party agrees to arbitrate, and the court did not interpret the operating agreement to give the 55% member unfettered authority to amend the agreement amounts to an assumption that they members agreed ahead of time to be bound by any change the 55% member decided to make. The court held that there was no meeting of the minds regarding arbitration as the binding method of dispute resolution, and the clause was unenforceable. (The court did not address whether the other amendments were valid.)

**Interpretation and Enforcement of LLC Operating Agreement "Blocking" Provisions for Consent to Bankruptcy Filing**


The bankruptcy court held that a provision in a Delaware LLC’s operating agreement that required the LLC’s secured lender, as the holder of one unit of the LLC, to consent to a bankruptcy filing was void because the provision was against public policy as a matter of federal bankruptcy law. (This decision of a Delaware bankruptcy court is included in this survey of “non-Delaware cases” because the Delaware bar often confines its view of Delaware case law to the opinions of Delaware state courts.)

Pursuant to a forbearance agreement with its primary secured lender, the lender was issued one equity unit in the LLC, and the operating agreement was amended to require the consent of all equity holders for the LLC to
file a bankruptcy petition. The LLC filed for Chapter 11 bankruptcy, and the lender sought dismissal on the basis the filing was not authorized because the lender did not consent to the filing. The court noted conflicting decisions addressing the validity of these sort of “blocking” provisions under state law and stated that it was not necessary to determine whether state law allowed the provision in question because the provision was invalid under federal bankruptcy law as a disguised waiver of a debtor’s rights under the Bankruptcy Code. The court stated:

A provision in a limited liability company governance document obtained by contract, the sole purpose and effect of which is to place into the hands of a single, minority equity holder the ultimate authority to eviscerate the right of that entity to seek federal bankruptcy relief, and the nature and substance of whose primary relationship with the debtor is that of creditor—not equity holder—and which owes no duty to anyone but itself in connection with an LLC’s decision to seek federal bankruptcy relief, is tantamount to an absolute waiver of that right, and, even if arguably permitted by state law, is void as contrary to federal public policy.[footnote omitted] Under the undisputed facts before me, to characterize the Consent Provision here as anything but an absolute waiver of that right would directly contradict the unequivocal intention of [the lender] to reserve for itself the decision of whether the LLC should seek federal bankruptcy relief. Federal courts have consistently refused to enforce waivers of federal bankruptcy rights.

The court joined the other courts that have refused to enforce waivers of federal bankruptcy rights and held that the LLC had the authority to commence the Chapter 11 bankruptcy proceeding.


A Michigan LLC filed bankruptcy on the eve of foreclosure of the LLC’s principal asset. The LLC’s secured lender sought dismissal of the bankruptcy on the grounds that it was filed in bad faith or without the consent of the lender, whose consent was required as “special member” under the operating agreement. The court concluded that the bankruptcy was not filed in bad faith and that the provision of the operating agreement requiring consent of the “special member” was unenforceable. Thus, the court denied the creditor’s motion to dismiss the bankruptcy.

The LLC debtor in this case owned a vacation resort in Michigan. After the LLC defaulted on its loan, the lender agreed to forbear from pursuing its remedies in exchange for an amendment to the LLC operating agreement that established the lender as a member (the “special member”) whose approval was required to take “material action,” which included filing a bankruptcy petition. The lender, as special member of the LLC, had no interest in the profits or losses of the LLC, no right to distributions or tax consequences, and no obligation to make capital contributions to the LLC. In essence, the only relationship between the special member and the LLC was the special member’s authority to block the LLC from petitioning for bankruptcy relief. Further, when exercising its rights under the provision, the special member was not obligated to consider any interests or desires other than its own and had “no duty or obligation to give any consideration to any interest of or factors affecting the Company or the Members.” Shortly after the execution of this amendment to the LLC operating agreement, the LLC defaulted again, and the lender began foreclosure proceedings. The LLC filed a bankruptcy petition under Chapter 11. The members of the LLC other than the special member consented to the LLC’s bankruptcy filing, but the special member did not consent to the bankruptcy petition. The lender sought to dismiss the bankruptcy petition on the basis that it was filed in bad faith or that it was not authorized because the special member did not approve it. The court first analyzed whether the bankruptcy filing was made in bad faith and concluded that it was not. The court examined numerous factors relied on by the lender and found that those that were satisfied were not sufficient to establish bad faith. The court found that the case at hand was similar to a Georgia case in which the debtor’s single asset was real estate and the case was filed on the eve of foreclosure. The court did not dismiss the case because the presence of equity provided a sound basis for reorganization and substantial evidence of the debtor’s good faith intent to reorganize. Here, the lender did not dispute that there was equity in the LLC’s property.
The court then analyzed the lender’s argument that the bankruptcy was not authorized because the consent of the special lender was not obtained as required by the LLC operating agreement. The court analyzed the provision requiring consent of the special lender and concluded that it was unenforceable under Michigan LLC law and federal bankruptcy law. Because the LLC was formed in Michigan, the court looked to “Michigan corporate governance law” to determine whether the filing was a valid corporate action. Under the terms of the original operating agreement, the consent of members with a majority of the sharing ratios was required for all matters. Because the four members who approved the bankruptcy held 100% of the sharing ratios, their approval would have sufficed under the original voting provisions; however, the amendment adopted after the LLC’s default on its obligations to the lender superseded the other voting provisions and required the approval of the lender as special member for the LLC to file a bankruptcy petition. The Michigan LLC statute allows the operating agreement to override the default statutory voting requirement, and the bankruptcy petition was not approved by the special member; therefore, application of the requirement of the amendment to the operating agreement would result in the bankruptcy petition being infirm. The court stated that it must thus analyze whether the prohibition adopted in the amendment of the operating agreement was valid in order to determine the validity of the bankruptcy filing.

The court explained that the lender’s argument was based on “the well-established commercial practice of using ‘blocking directors.’” The court characterized the “blocking director” as the “lynchpin” of a bankruptcy-remote, special-purpose entity. The court described the typical structure of a special-purpose entity and concluded by stating that “[t]he import of such a structure is readily apparent. One specific director, chosen by the secured creditor, may withhold its vote and thus block, hence the name, a voluntary bankruptcy petition. Further, given the limited operations, an involuntary petition against the entity is highly unlikely.” The court further explained that this roundabout approach is required because a simple, absolute prohibition against filing for bankruptcy would likely violate public policy and be void. Just as individuals may not contract away their bankruptcy rights, corporations are similarly constrained. The court acknowledged, however, that “corporate formalities and state corporate law must also be satisfied in commencing a bankruptcy case.” Although the long-standing policy against contracting away bankruptcy rights is not necessarily controlling when a corporate control document defeats the right in question rather than a contract, the court stated that “common wisdom dictates that the corporate control documents should not include an absolute prohibition against bankruptcy filing.” According to the court, the “saving grace” of a blocking director is that the blocking director must always adhere to the director’s general fiduciary duties to the debtor in fulfilling the director’s role. Thus, at least theoretically, there will be situations where the blocking director will vote in favor of a bankruptcy filing, even if in so doing the director acts contrary to the purpose of the secured creditor at whose behest the director serves. The court cited In re General Growth Properties, Inc., 409 B.R. 43, 64 (Bankr. S.D.N.Y.2009) and In re Kingston Square Associates, 214 B.R. 713, 735–36 (Bankr. S.D.N.Y.1997) with regard to the fiduciary duties constraining blocking directors and concluded that “[t]he consideration of fiduciary duties and public policy concerns further extends to situations where the blocking position is a member of a limited liability company because the member of a limited liability company, such as the Debtor in this case, maintains the power to consent or block a bankruptcy petition.” According to the court, in order for a blocking structure to be valid, the blocking director must be subject to “normal director fiduciary duties” such that the director would in some circumstances vote in favor of a bankruptcy filing, even if the bankruptcy was not in the best interests of the creditor that chose the blocking director. This feature was missing from the structure in this case.

The amendment to the operating agreement in this case limited the lender’s duties as special member to the rights and duties expressly set forth in the agreement. The agreement limited the special member’s rights and duties as follows:

Notwithstanding anything provided in the Agreement (or other provision of law or equity) to the contrary, in exercising its rights under this Section, the Special Member shall be entitled to consider only such interests and factors as it desires, including its own interests, and
shall to the fullest extent permitted by applicable law, have no duty or obligation to give any consideration to any interests of or factors affecting the Company or the Members.

The court stated that this language resulted in the special member having no duties to the LLC, but the court stated that members of an LLC have a duty under Michigan law to consider the interests of the entity and not only their own interests. The court quoted the Michigan Limited Liability Company Act as requiring that:

(1) A manager shall discharge the duties of manager in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner the manager reasonably believes to be in the best interests of the limited liability company.

Based on this provision, the court concluded that the lender, as a member of a Michigan LLC, was required to consider the interests of the LLC, but the language of the amendment excluded the LLC’s interest from consideration and allowed the lender to consider only its own interests. In so doing, the language “expressly eliminates the only redeeming factor that permits the blocking director/member construct.” The court thus concluded that the blocking member provision in this case was unenforceable both as a matter of Michigan corporate governance and bankruptcy law. The court stated that the remaining corporate governance provisions governing the LLC resulted in a valid consent to bankruptcy when analyzed under Michigan law.

The court commented on the inclusion of the language “to the fullest extent permitted by applicable law” in the provision in question and referred to it as a “savings clause” that “might cure the invalidity of the prohibition, but only by rendering it meaningless.” The court stated that the “prohibition has no application other that which is impermissible under Michigan law.” By excluding the LLC’s interests from consideration when the lender acted as the special member and allowing the special member to consider only its own interests, the court stated that the provision expressly eliminated the “only redeeming factor that permits the blocking director member construct.” As a result, the court concluded that the provision requiring the special member’s consent was void, and the remaining governance provisions of the LLC resulted in a valid consent to bankruptcy in this case. In a footnote, the court noted that Michigan was one of the “rare states” that does not extend fiduciary duties to creditors of a corporation once the corporation is insolvent; however, the court stated that the duty that was important for purposes of the instant analysis was the duty to the debtor and its equity holders, and the court stated that Michigan law, like the law of other jurisdictions, imposes such a duty and that it “may not be forsworn.”

Access to Books and Records of LLC by Former Member


The court reversed a summary judgment in favor of an LLC on a former member’s claim to inspect the books and records created by the LLC during the former member’s time as a member because the absence of the governing documents in the summary judgment record precluded the LLC from establishing as a matter of law that the former member was not entitled to view the records. The court focused on the statutory definition of a member and noted that it includes “a person who has been admitted as a member in a limited liability company under its governing documents.” The court also addressed arguments made by the LLC based on the statute of limitations and a release agreement that was signed by the former member and the remaining member but did not identify the LLC as a party. Neither of these arguments entitled the LLC to judgment as a matter of law.

Davis was a former member of an LLC who relinquished his membership and later sought to inspect the books and records created or developed by the LLC during his time as a member. Because the LLC refused his request for access to the books and records, Davis sued the LLC and requested a declaration entitling him to inspect the desired documents. The trial court granted summary judgment in favor of the LLC, and Davis appealed, arguing that the trial court misconstrued the applicable statutes.

The court identified two relevant provisions in the Texas Business Organizations Code
BOC) under which an “owner or member” or a “member or an assignee of a membership interest” have a right of access to books and records of the LLC. The dispute between Davis and the LLC related to the words “member” and “owner.” Davis argued that these words encompass both present and former members and owners of the entity. The LLC apparently convinced the trial court that they referred to only current members and owners.

The court found it odd that neither party cited the statutory definitions to the trial court or in their respective appellate briefs. Nevertheless, the court stated that the definitions controlled the outcome. According to Section 1.002(53) of the BOC, a “member” of an LLC is “a person who is a member or has been admitted as a member in the limited liability company under its governing documents.” Tex. Bus. Orgs. Code § 1.002(53)(A) (emphasis added). In a different paragraph of that same section, “owner” of an LLC is defined as “a member.” Id. § 1.002(63). Thus, the definitions of “owner” and “member” contain at least two components, one of which depends on the verbiage of the LLC’s “governing documents,” but the summary judgment record did not contain the governing documents of the LLC. Without them, the court of appeals said that the trial court could not find that the LLC established, as a matter of law, that Davis was not entitled to view the LLC’s records. In other words, the trial court could not hold, as a matter of law, that Davis was not a member without knowing whether Davis “had” been admitted as a member under the LLC’s governing documents.

The court of appeals next addressed two other grounds asserted by the LLC: limitations and release. The LLC relied on the residual four-year statute of limitations. Based on Davis’s requests for documents, the LLC argued that Davis was required to sue no later than April of 2012, and he did not file until July of 2012. But the court of appeals concluded that the LLC’s analysis was flawed. Section 101.502(a) of the BOC provides that a member may review and copy records “on written request and for a proper purpose.” The court stated that this language led to the logical conclusion that any duty to disclose would not arise until such a written request was made and then refused. The summary judgment record revealed several written requests from Davis, the earliest being dated April 25, 2008, and sent by an attorney named Matheson. An affidavit attached to the motion for summary judgment stated that documents were sent to Mr. Matheson in response to that request and that copies of those documents had previously been provided to Davis. The court stated that the act of sending documents could hardly be interpreted as a refusal to comply with Section 101.502(a) in April of 2008, or, at the very least, a fact issue existed in that regard. The next written request appearing in the record was sent on behalf of Davis in February of 2012. Apparently, the LLC complied with that request in part. Assuming the partial failure to comply constituted a breach of the statutory duty in question, Davis filed suit for a declaration of his rights on July 25, 2012, less than four years from February 2012. Thus, the LLC failed to prove, as a matter of law, its entitlement to summary judgment on the affirmative defense of limitations.

As for its defense of release, the LLC argued that Davis executed an agreement releasing his causes of action against the LLC. The document relied upon by the LLC referred to a release and discharge of all claims by “the parties” and their “agents, employees and representatives,” but the document did not define the term “parties.” The document opened by stating that the agreement was by and between Davis and Byron Cook, but the LLC was not mentioned in that passage or in the paragraph referencing the release and discharge of claims. Also significant was the absence of conditioning language from the signatures of both Davis and Cook indicating that they intended to act individually and/or as a representative of the LLC. Although the record indicated that Cook was the sole remaining member of the LLC once Davis left, the LLC did not argue that it and Cook were one and the same. Because someone unnamed in a release (or otherwise omitted from the category of persons released) is not released, the summary judgment record failed to provide the trial court a basis to hold that the LLC was entitled to judgment as a matter of law on the affirmative defense of release.

Consequences of Assignment of LLC Membership Interest

A derivative action brought against the controlling members of an LLC was dismissed because the court held that the plaintiff was an assignee who had not been admitted as a member and thus lacked standing to bring the derivative action. Although the members had given consent to the assignment of the interest to the plaintiff as required by the operating agreement, the members had not consented to the admission of the assignee as a member as required by the operating agreement.

The plaintiff acquired a 10% interest in the LLC in 2006 from Furman and Birdoff, two of the original members of the LLC. The plaintiff was an entity owned by Furman and Birdoff and certain descendants of Furman and Birdoff. The plaintiff brought numerous claims for misuse and diversion of the LLC’s assets. Although the plaintiff asserted the claims individually and derivatively, the court stated that the claims belonged solely to the LLC and must be asserted derivatively. Under New York LLC law, only a member has standing to assert a derivative claim, and the court pointed out the distinction drawn between members and assignees under the New York LLC statute. Additionally, the operating agreement in this case contained provisions on assignments and admission of members. Article 7 of the operating agreement imposed certain restrictions on the transfer of membership interests and distinguished between transferees and permitted transferees, who held only economic rights, and substituted members, who held full rights under the agreement and applicable law. Section 7.1 of the operating agreement provided that no member may transfer an interest without the prior written consent of members owning 95% of the membership interests. Section 7.2 of the operating agreement provided that, “[n]otwithstanding anything contained in this Agreement to the contrary, no Permitted Transferee or any other transferee shall become a Member without the written consent of Members owning... 95% ... of the Membership Interests, which may be arbitrarily withheld.” The court pointed out that these provisions imposed a two-step process to obtain member status.

The plaintiff alleged that it became a member in 2006 when Furman and Birdoff assigned their combined 10% membership interest to the plaintiff pursuant to an agreement entitled “Assignment and Assumption of Limited Liability Company Interests Agreement.” The court stated that the record included written consent for the plaintiff to become a transferee but did not contain any evidence that the plaintiff ever obtained the written consent required by Section 7.2 of the operating agreement to become a substituted member. The consent letter consented to a transfer of the 10% interest held by the transferring members, but the letter did not reference consent to transfer of membership. Thus, the court held that the plaintiff did not become a substituted member and lacked standing to assert the derivative claims.


After the trial court determined that the assignee of a membership interest lacked standing to seek judicial dissolution and winding up of the LLC, the assignee argued on appeal that the LLC statute granted him standing to seek a winding up of the LLC even in the absence of dissolution. The court held that the statute does not confer standing on an assignee to seek winding up of the affairs of an LLC in the absence of a dissolution, and the statute displaced any equitable principle that would otherwise grant an assignee standing to seek winding up.

The plaintiff was assigned his wife’s membership interest in an LLC pursuant to a divorce settlement agreement. After the assignment, the plaintiff’s wife continued to be a member of the LLC. The plaintiff requested membership status, but the wife’s co-member did not consent. The plaintiff demanded distributions from the LLC, but no distributions were made to the plaintiff. The plaintiff brought an action against the LLC seeking judicial dissolution and winding up of the LLC, and the trial court dismissed the action on the basis that the Connecticut LLC statute does not confer standing on an assignee to obtain judicial dissolution and winding up. On appeal, the plaintiff no longer argued that he had standing to seek dissolution but that the Connecticut LLC statute conferred on him standing to seek a winding up of the LLC in the absence of dissolution.

The Connecticut Supreme Court generally discussed the nature of Connecticut LLCs and their governing law and then addressed provisions of the Connecticut LLC statute.
specifically relating to winding up. The court explained that the provisions on winding up were inextricably linked to dissolution and concluded that the only event triggering winding up under the statute is an event of dissolution. The statute provides for three events of dissolution: (1) any event of dissolution specified in the LLC’s articles of organization or operating agreement; (2) a vote to dissolve by the majority of the LLC’s members; or (3) the entry of a decree of judicial dissolution under the statute. Under the statute, only a member or someone on the member’s behalf may apply for a decree of dissolution, and a decree may be entered only if the court determines that “it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement.” Additionally, the provisions of the statute governing the process of winding up presuppose that the LLC has dissolved before winding up its affairs. Because an event of dissolution had not occurred, the plaintiff could not trigger a winding up of the LLC’s affairs. The plaintiff relied upon a statutory provision permitting a member or assignee to request a court to carry out the winding up process when the members or managers have engaged in wrongful conduct or for other cause shown. The court explained that this provision applies once a dissolution has occurred but does not permit an assignee to apply for a forced winding up absent a dissolution.

The court also discussed the relative rights, roles, and liabilities of members and assignees and concluded that allowing an assignee to force a winding up of affairs without a dissolution of the LLC would undermine the statutory scheme for LLCs. The court explained that an assignee is a passive recipient of the economic benefit of a membership interest who is barred by the statute from participating in the management of the LLC’s business or exercising any right of membership unless and until the assignee is admitted as a member. “Recognizing that assignees have no role to play in managing the LLC’s affairs, the act shields them from any liabilities that a member might have [citation omitted]; including, for example, for capital contributions.” The rights and duties of membership remain vested in the assignor until the assignee is admitted to membership, and “[t]he assignor member continues to hold the obligations of membership, including for capital contributions, and continues to owe a duty of good faith to the LLC.” The court stated that the plaintiff’s interpretation “would exalt rights of assignees to a level on par with those of members in the face of the act’s clear intention to the contrary.” The only provision of the statute that places assignees on a par with members is the provision allowing an assignee to request a court-supervised winding up once dissolution has occurred.

The court thus concluded that the LLC statute does not provide an assignee such as the plaintiff with standing to seek the winding up of the affairs of an LLC in the absence of a dissolution of the LLC. In a footnote, the court rejected the plaintiff’s argument that he was classically aggrieved under the common law or principles of equity. While the statute provides that “principles of law and equity supplement” the statute, those principles supplement the statute only to the extent that they are not “displaced” by provisions of the statute. Thus, assuming for the sake of argument that common law or equitable principles would otherwise grant an assignee standing to seek a winding up of an LLC’s affairs, the court concluded that these principles are displaced by the provisions of the statute that expressly limit an assignee’s role and prevent an assignee from forcing the dissolution or winding up of the LLC. The plaintiff cited the Delaware Chancery Court’s decision in In re Carlisle Etcetera LLC, 114 A.3d 592 (Del. Ch. 2015), but the court found that decision inapposite because of differences between Delaware law and Connecticut law concerning assignments of membership interests. The court pointed out that an assignment under Delaware law leaves both the member and the assignee without the power to exercise the rights of a member at issue unless and until the assignee is admitted as a member. “The court in In re Carlisle Etcetera LLC resolved this lacuna by granting equitable standing to the assignee.[citation omitted] Connecticut law, by contrast, does not result in a similar void because the assignor continues to hold the exclusive power to exercise the rights of membership until the assignee becomes a member.”


A divorcing member’s purported transfers to his wife of his 50% interests in three LLCs and a general partnership were ineffective because the documents were held by the wife’s
attorney and were never delivered to the LLCs and partnership. Because notice of the assignments was not provided to the LLCs and partnership, the court held that the wife did not have an ownership interest in the entities when she commenced this suit for judicial dissolution, and dismissal of the suit was proper because she did not have standing.

The plaintiff in this action sought judicial dissolution and winding up of three LLCs and a partnership in which her husband had transferred to her his entire interests during their divorce. The assignment instruments were never delivered to any representatives of the entities, and the plaintiff’s lawyer retained the instruments in her files. The entities’ representatives (the son and son-in-law of the transferor member/partner and the plaintiff) testified that the first time they learned of the assignments was when they were produced by the plaintiff as part of the discovery in this case. The trial court dismissed the plaintiff’s case on the basis that she could not prove a membership or partnership interest in any of the entities, and the court of appeals held that dismissal of the case was proper.

The court of appeals stated that the LLC and partnership statutes require that a party have some ownership interest in an LLC or partnership to have standing to bring an action to dissolve the entity. The operating agreements for two of the LLCs required that a transfer of interest was only effective when the LLC received notice. The third LLC had no operating agreement, but the court pointed out that, even if notice had been provided, the wife would not have become a member unless and until a majority in interest of the other members consented pursuant to the Connecticut LLC statute. The general partnership also did not have an agreement in effect, and the court pointed out that the partnership statute provides that a partnership need not give effect to a transferee’s rights under the statute until it has notice of the transfer. Relying on the operating agreements and these statutory provisions, the court concluded that the plaintiff did not have an ownership interest in any of the entities when she commenced the case. Thus, the court held that the trial court properly granted the motion to dismiss.


Under the District of Columbia LLC statute, the court had discretion to grant either judicial dissolution of the LLC or judicial expulsion of a member when the jury’s findings satisfied the grounds specified by statute for judicial dissolution as well as judicial expulsion. The court rejected the argument that the statutory language required the court to grant judicial expulsion when the grounds for judicial expulsion were present.

After disputes developed between Newman and Reese with regard to the management of their LLC, Newman provided written notice to Reese that Newman intended to withdraw from, dissolve, and wind up their business. Reese did not want to wind up the LLC and preferred that Newman simply be dissociated so that Reese could continue the business. Newman filed an action for judicial dissolution along with other claims, and Reese counterclaimed for Newman’s dissociation in addition to other claims. The jury awarded Newman damages on one of her claims and found grounds for both judicial dissolution of the LLC and judicial dissociation of Newman. The trial court ordered judicial dissolution of the LLC.

On appeal, Reese argued that the D.C. LLC statute required the court to order dissociation of Newman based on the jury’s findings. Section 29-806.02(5) of the D.C. LLC statute provides as follows:

A person shall be dissociated as a member from a limited liability company when: ...

(5) On application by the company, the person is expelled as a member by judicial order because the person has:

(A) Engaged, or is engaging, in wrongful conduct that has adversely and materially affected, or will adversely and materially affect, the company's activities and affairs;

(B) Willfully or persistently committed, or is willfully and persistently committing, a material breach of the operating agreement or the person's duties or obligations under § 29–804.09; or
(C) Engaged in, or is engaging, in conduct relating to the company’s activities which makes it not reasonably practicable to carry on the activities with the person as a member....

The court of appeals pointed out that Section 29-806.02 contains a list of fifteen different events on which a person shall be dissociated as a member. Although the statute states that a person “shall” be dissociated as a member on the occurrence on any of these events, the language does not require a trial judge to order dissociation under subsection (5) when the grounds for doing so are present, but instead provides that a member shall be dissociated when the judge has decided to expel a member for any of the reasons enumerated. Reese pointed out that the judicial dissolution provision expressly permits a court to order a remedy other than dissolution while there is no comparable provision in the judicial dissociation provision. The court did not view the absence of such a provision in the judicial dissociation provision as indicative that the court lacked discretion in judicially expelling a member. The court noted that the word “shall” does not appear in subsection (5) of Section 29-806.02. The word “shall” is only in the introductory language to the judicial dissociation provision, and the word “shall” is located in the same place in the dissolution section: Section 29-807(a)(1) provides that “[a] limited liability company is dissolved, and its activities and affairs shall be wound up, upon the occurrence of any of the following...."

The court found persuasive authority for its view in the comments to the Revised Uniform Limited Liability Company Act (2013) (RULLCA). The court pointed out that the D.C. law contains language almost identical to RULLCA § 602, and the comments to that section state that a court has discretion to choose between dissociation and dissolution where grounds for both exist.

In sum, the court concluded that a trial judge may (i.e., has discretion to) expel a member by judicial order when any of the events in Section 29-806.02(5)(A)-(C) have taken place, and when a judge does so, the member shall be dissociated. Additionally, when grounds for both dissociation of a member and dissolution of the LLC exist, the trial judge has discretion to choose either alternative. The court of appeals found no reason to disturb the trial court’s order dissolving the LLC where the jury found that both statutory bases for judicial dissolution were met (i.e., that Reese acted or is acting in a manner that is illegal or fraudulent, and that she was acting in a manner that was or would be directly harmful to Newman). Although the jury did make findings that would allow the trial judge to order the dissociation of Newman, the jury also found that Newman did not willfully or persistently commit a breach of the “partnership agreement” or of her duty of loyalty to the LLC. Thus, the trial court did not think it was appropriate to expel Newman and leave Reese (who was found to have been acting in a manner that was illegal or fraudulent) in control of winding up the LLC. The trial court found it more equitable to decline to expel Newman so that both parties would be on equal footing during the winding up of the LLC.


The court held that a member of two LLCs who filed a petition seeking dissolution of the LLCs did not cease to be a member in the LLCs under a provision of the LLC statute that provides that a member ceases to be a member upon the filing of a petition seeking “for the member” various types of relief including a dissolution. The statutory provision applies when the member seeks its own dissolution or similar relief, not when the member seeks dissolution or similar relief for the LLC.

A brother and sister inherited a mobile home park from their father, and two LLCs were formed in connection with the ownership and management of the park. The siblings did not get along, and the sister accused her brother of mismanaging the finances of the mobile home park. The sister filed this action against the LLCs and her brother, asking for equitable relief including dissolution. The brother alleged that his sister was interfering with the park manager that was appointed by the trial court pending resolution of the dispute. The brother submitted affidavits of tenants describing threatening and strange behavior of the sister, including that the sister “danc[ed] backward in a Michael Jackson moon-walking manner along the streets of [the mobile home park], wearing a belly dancer costume, in an inappropriate and bizarre manner.”
The brother argued, and the trial court agreed, that the petition for dissolution of the LLCs dissociated the sister as a member under the Georgia LLC statute, which provides as follows:

A person ceases to be a member of a limited liability company upon the occurrence of any of the following events:

... (4) Subject to contrary provision in the articles of organization or a written operating agreement, or written consent of all other members at the time, the member (A) makes an assignment for the benefit of creditors; (B) files a voluntary petition in bankruptcy; (C) is adjudicated a bankrupt or insolvent; (D) files a petition or answer seeking for the member any reorganization, arrangement, composition, readjustment, liquidation, dissolution, or similar relief under any statute, law, or regulation; (E) files an answer or other pleading admitting or failing to contest the material allegations of a petition filed against the member in any proceeding of this nature; or (F) seeks, consents to, or acquiesces in the appointment of a trustee, receiver, or liquidator of the member or of all or any substantial part of the member's properties.[.] (Emphasis added.)

The trial court concluded that the phrase “for the member” in subsection (b)(4)(D) applies whenever a member has filed a petition or answer seeking for the member any reorganization, arrangement, composition, readjustment, liquidation, dissolution, or similar relief under any statute, law, or regulation; or (F) seeks, consents to, or acquiesces in the appointment of a trustee, receiver, or liquidator of the member or of all or any substantial part of the member's properties. The trial court thus erred in determining that the sister's petition to dissolve the LLCs caused her to cease to be a member of those LLCs.

Charging Order


Based on a provision in the Revised Uniform Partnership Act (RUPA) that supplements the charging order provision in the Revised Uniform Limited Partnership Act (RULPA), the court concluded that the trial court had authority to issue certain ancillary orders against four limited partnerships in aid of enforcement of charging orders entered by the trial court. In contrast, the trial court did not have authority to issue any ancillary order against an LLC in aid of a charging order issued by the trial court against a membership interest in the LLC because the LLC statute does not contain any provision authorizing a court to issue ancillary orders.

The plaintiff obtained a judgment and asked the trial court to charge the interests of the defendant in four limited partnerships in which the defendant was a partner and an LLC in which the defendant was a member. The trial court entered an order directing the limited partnerships and LLC (collectively, “the companies”) to pay to the plaintiff “any and all distributions, credits, drawings, or payments due to” the defendant. In addition, the trial court's order imposed other obligations on the companies. The companies were prohibited from making any loans, and the companies and their members were prohibited from transferring, modifying, or encumbering any partnership or membership interest without approval from the court or from the plaintiff until the judgment was paid. The companies were also required to open their books and certain tax records for inspection by the plaintiff and to provide future financial statements to the plaintiff. The order also permitted the plaintiff to seek modification of the order to allow for the appointment of a receiver and the foreclosure on the defendant's interests in the companies.

On appeal, the companies argued that the trial court exceeded the scope of its statutory authority under the charging order statutes when it imposed the additional obligations on the companies. The court discussed the history of the charging order going back to the adoption of a provision by the British Parliament in 1891 and inclusion of provisions in the uniform partnership statutes promulgated by the National Conference of Commissioners on Uniform State Laws. The court then turned to the history of charging orders in Oregon, which adopted the Uniform Partnership Act in 1939, the Uniform Limited Partnership Act in 1971, the Revised Uniform Limited Partnership Act (RULPA) in 1985, and the Revised Uniform Partnership Act
(RUPA) in 1997. The Oregon Limited Liability Company Act (OLLCA) also contains charging order provisions. The companies argued that the provisions of RULPA and OLLCA that allow a court to charge the partnership or membership interests of a judgment debtor limit the scope of the judgment creditor’s rights to the rights of an assignee. Ultimately, the court of appeals held that the trial court was authorized to require the limited partnerships to disclose financial information to the plaintiff, but the trial court exceeded its authority by imposing the restrictions on loans and on the transfer or encumbrance of partnership interests. With respect to the charging order against the LLC, the court concluded that the trial court was not authorized to impose any of the additional obligations.

With respect to the trial court’s authority in the case of the limited partnership, the companies pointed out that RULPA does not state that a trial court may make additional orders in aid of enforcement of a charging order, in contrast to RUPA, which does so provide. According to the companies, the absence of that provision in RULPA indicated that the legislature did not confer upon a trial court the same authority to enforce a charging order against a limited partnership by ancillary orders that it conferred upon a trial court with respect to charging orders against general partnerships. The court relied on the gapfilling provision of RULPA (which provides that “[i]n any case governing limited partnerships that is not provided for in [Oregon’s version of RULPA], the provisions of [Oregon’s version of RUPA] govern”) and case law from other jurisdictions to conclude that the remedies provided in the charging order provisions of RUPA supplement the provisions of RULPA. Those remedy provisions confer on a court that issues a charging order the authority to “make all other orders, directions, accounts and inquiries the judgment debtor might have made or that the circumstances of the case may require.” The court found nothing in the partnership statutes or the record in this case that indicated the judgment debtor partner would have the authority to restrict the limited partnerships from making loans or restrict the limited partners from encumbering or transferring their interests. Furthermore, the trial court apparently did not determine that those provisions were required by the particular circumstances of this case. Those restrictions were thus beyond the court’s discretion, and the court vacated those provisions as to the limited partnerships. The court did not disturb the provisions granting access to information.

With respect to the trial court’s authority in the case of the LLC, the court pointed out that OLLCA does not itself provide any authority to enforce a charging order by issuing other ancillary orders, and OLLCA does not have a gapfilling provision directing the court to look to RUPA to supplement its provisions. The court also pointed out that OLLCA is not a uniform act, and the legislature has not instructed the courts to construe it to promote uniformity among the states, as it has with respect to the RUPA and the RULPA. The court thus concluded that the legislature did not authorize a trial court to enforce a charging order in the LLC context through ancillary orders like the ones the legislature authorized in the partnership context. Accordingly, the court vacated the challenged provisions as they applied to the LLC.


Fraudulent Transfer


The court of appeals held that a judgment creditor of members of several LLCs did not have standing to assert fraudulent transfer claims under the Georgia Uniform Fraudulent Transfer Act with respect to transfers made by the LLCs of the LLCs’ property because the LLCs were not “debtors” of the judgment creditor.

A judgment against the guarantors of a
bank loan was entered in Arizona in favor of an entity that had purchased the loan from the bank, and the judgment creditor domesticated the judgment in Georgia. The judgment creditor obtained charging orders against the membership interests of various judgment debtors in various LLCs, and the judgment creditor alleged fraudulent transfer claims with respect to transfers of property of by several of those LLCs. The trial court concluded that the judgment creditor lacked standing to assert the fraudulent transfer claims, and the court of appeals agreed.

The court of appeals quoted the actual-fraud provision of the Georgia Uniform Fraudulent Transfer Act (UFTA) at the relevant time, which provided that “[a] transfer made or obligation incurred by a debtor is fraudulent as to a creditor...if the debtor made the transfer or incurred the obligation: (1) With actual intent to hinder, delay, or defraud any creditor of the debtor.” The court pointed out that “a creditor is entitled to seek relief[footnote omitted] under the UFTA for transfers made, or obligations incurred, by a debtor with actual intent to hinder, delay, or defraud any creditor of the debtor.” Thus, a fraudulent transfer claim can only be brought by a “creditor” against a “debtor.” The UFTA defines the term “creditor” as “a person who has a claim” and a “debtor” as “a person who is liable on a claim.” “Claim” is broadly defined as “a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.” A “transfer” includes “every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset and includes payment of money, release, lease, and creation of a lien or other encumbrance,” and an “asset” is defined as “property of a debtor” with certain exceptions. The question was whether the judgment creditor was a creditor with standing to seek relief under the UFTA with respect to transfers made by non-judgment debtor LLCs.

According to the judgment creditor, it became a creditor of the non-judgment debtor LLC transferors by virtue of the charging orders against the judgment debtor members’ interests. The judgment creditor argued that the charging orders created a “right to payment” from, and thus a “claim” against, any LLC entity named in the charging orders. The court of appeals stated that the judgment creditor misunderstood the nature of a charging order, which is only a statutory mechanism to redirect to the judgment creditor any distributions from the LLC otherwise due to the judgment debtor member. The charging order does not create any direct remedy against the LLC’s property, and the court stated that a charging order clearly does not create a debtor-creditor relationship between the judgment creditor who obtained the charging order and the LLC whose member’s interest is being charged. “[W]here, as in this case, a creditor of a member of the LLC does not also have a debtor-creditor relationship with the LLC, the creditor does not also become a creditor of the LLC by obtaining a charging order against the LLC. Accordingly, the creditor does not have standing under the UFTA to set aside a transfer of assets made by the LLC solely by obtaining a charging order against the LLC.”

The judgment creditor also argued that it had standing under the UFTA to set aside a transfer by one of the LLCs because judgment debtors participated in the transfer by ordering the transfer to be made and executing the necessary documents. A transfer is broadly defined under the UFTA to include both direct and indirect transfers of an asset or an interest in an asset, but an “asset” is defined as property of the “debtor.” Thus, the court held that, under the plain language of the UFTA, participating in or directing a transfer of property has no consequence unless the asset was property of the debtor, which it was not in this case.

Additionally, the court stated that the judgment creditor, although it denied that it was proceeding under an “alter ego” theory, was essentially asking the court to disregard the corporate form and find that a creditor of a member of an LLC was also a creditor of the LLC for purposes of attaching the LLC’s assets and preventing their transfer. The court noted that the Georgia Supreme Court, in a somewhat different context, held that a creditor may not reach the assets of a corporation or LLC to satisfy a debt of one of its shareholders or members. The court also cited other case law rejecting reverse veil piercing.

As an additional basis to reject the judgment creditor’s standing to assert some of the fraudulent transfer claims, the court concluded that an assignee of a debt does not
under Georgia law have standing to assert fraudulent transfers occurring before the assignment of the debt. Thus, the judgment creditor did not have standing to assert fraudulent transfer claims that were based on transfers predating the judgment creditor’s purchase of the loan.


In a proceeding by a judgment creditor against the judgment debtor and his wholly owned LLC, the court of appeals held that the trial court did not abuse its discretion in issuing a temporary injunction prohibiting the LLC from transferring its assets pending trial. The judgment creditor asserted that assets had been fraudulently transferred to and by the LLC, and the Texas Uniform Fraudulent Transfer Act (TUFTA) provides for injunctive relief. The LLC argued that the court could not enjoin it under TUFTA because the plaintiff did not have a judgment against the LLC. The court held that the judgment creditor was a “creditor” of the LLC under TUFTA because he had a “claim,” which can be equitable and need not be matured or reduced to judgment. The court said the judgment creditor’s claim need not be against the debtor only, but may also be against the transferee or person for whose benefit the transfer was made.

Al Saleh obtained a $28 million judgment against Sargeant in Florida. BTB Refining LLC (“BTB”) was a Florida LLC wholly owned by Sargeant that was converted to a Texas LLC two days before entry of the judgment against Sargeant in Florida. In the Florida collection proceeding, Al Saleh asserted: (1) a claim for constructive trust over BTB’s primary asset, a $29 million note purchased with the proceeds of fuel contracts that were the subject of Al Saleh’s lawsuit against Sargeant in Florida; (2) a claim that BTB was the alter ego of Sargeant; and (3) a claim that BTB was fraudulently re-domiciled to Texas just before entry of the verdict and should be re-domiciled to Florida to allow foreclosure of Sargeant's interest under Florida law. Al Saleh's collection efforts in Florida were fruitless, and he domesticated the Florida judgment in Texas.

In the Texas collection proceeding, Al Saleh filed an agreed motion and obtained an agreed order charging Sargeant's member interest in BTB with the judgment debt. Al Saleh then filed an amended petition in which he stated that a sales transaction involving BTB was about to close in which Sargeant, as BTB’s alter ego, would ultimately receive approximately $52 million. Al Saleh requested the court’s assistance in ensuring that a portion of these funds was distributed to Al Saleh to satisfy the judgment against Sargeant. Al Saleh’s causes of action included claims relating to turnover, fraudulent transfer under TUFTA, and fraud, and Al Saleh also alleged theories of vicarious liability and disregard of the corporate form. The claims for disregard of the corporate form included allegations that BTB and a Bahamas corporation, Sargeant Marine, Ltd. ("Sargeant Marine"), were mere alter egos of Sargeant.

In support of his claims, Al Saleh alleged and provided evidence that Sargeant had settled litigation in which he released valuable claims but received no consideration under the settlement agreement. Instead, the settlement proceeds were paid solely to Sargeant’s entities, including over $52,000,000 to BTB. Al Saleh also alleged that BTB had entered into a “Zero Coupon Promissory Note” with Sargeant Marine obligating BTB to pay Sargeant Marine more than $55,000,000. In seeking the temporary injunction at issue in this appeal, Al Saleh urged that injunctive relief was necessary to prevent Sargeant, Sargeant Marine, and BTB from transferring or moving the settlement proceeds “beyond reach.” The trial court granted a temporary injunction ordering that “Sargeant, BTB, and the officers, agents, servants, employees, attorneys, principals, members, manager and other persons in active concert or participation with them, be and hereby are, commanded forthwith to desist and refrain from using or transferring to any person or entity $21,828,446.65 or transferring such amount out of the jurisdiction of this Court, from the date of this Order until further Order of this Court.”

The fundamental question on appeal was whether the trial court abused its discretion in entering an injunction freezing millions of dollars of assets of BTB until trial. BTB framed its argument as follows: Al Saleh, with no judgment against BTB, brought this lawsuit to attempt to hold BTB liable for Al Saleh's money judgment against Sargeant under theories of alter ego and fraudulent conveyance, and the district court abused its discretion in ruling that a temporary injunction was available to preserve BTB’s cash
as security for a potential money judgment against BTB in Al Saleh's favor.

Because Al Saleh alleged a fraudulent conveyance in violation of TUFTA, which provides for injunctive relief, the court analyzed the validity of the temporary injunction in this case under TUFTA. BTB argued that TUFTA requires the plaintiff to establish that he is a creditor of the transferor—here BTB. BTB reasoned that Al Saleh was not a creditor of BTB because Al Saleh did not have a judgment against that entity. The court distinguished cases relied on by BTB and concluded that Al Saleh was a "creditor" under the express terms of TUFTA because he "has a claim," which can be equitable and need not be matured or reduced to judgment. Further, the court said that a creditor's claim need not be against the debtor only, but can also be against the transferee of an asset or the person for whose benefit the transfer was made. The court said that TUFTA expressly provides for an injunction under the circumstances and facts alleged, and the trial court exercised its discretion to grant that injunction. The court rejected BTB's argument that the trial court lacked discretion to issue a temporary injunction based on cases that have disapproved of temporary injunctions freezing assets unrelated to the subject matter of the suit. But the court concluded that these cases did not control the analysis in this case because: (1) Al Saleh brought claims under TUFTA, which expressly provides that a plaintiff may obtain an injunction against further disposition of "the asset transferred or of other property"; and (2) Al Saleh presented evidence from which the trial court could have concluded that BTB's assets were related to the subject of the suit, i.e., Al Saleh's affidavit linking BTB's assets, including the promissory note with Sargeant Marine, to the funds at issue in the Florida dispute and the subject of the already-obtained Florida judgment. Thus, the court of appeals affirmed the temporary injunction.


The court of appeals discussed how the general partnership charging order provisions in Texas interact with TUFTA's remedies for a judgment creditor and whether the two statutes conflict. The court concluded that the charging order statute's prohibition against a creditor exercising legal or equitable remedies against partnership property to satisfy a judgment does not prevent a court from granting an injunction under TUFTA prohibiting transfer of partnership property in order to preserve the value of a partnership interest of a judgment debtor. In this case, the judgment creditor alleged that the purchase by a non-defaulting partner of a defaulting partner's interest in the partnership was a fraudulent transfer orchestrated to prevent the judgment creditor of the spouse of the defaulting partner from pursuing collection remedies against the community property interest of the judgment debtor in her spouse's partnership interest. The trial court issued a temporary injunction prohibiting the partnership (which at this point apparently had only one remaining partner) from transferring or encumbering its real property pending resolution of the fraudulent transfer claim. The court of appeals concluded that the injunction was proper.

To obtain injunctive relief against partnership property in a TUFTA suit, the court of appeals stated that the applicant must plead and prove all the required elements for injunctive relief, and the trial court must consider, at a minimum, the following factors: (1) the amount of the unpaid balance of the judgment; (2) the value of the partnership assets sought to be enjoined; and (3) the burden on the partnership's operations and management any relief granted would impose. "Exercising applicable principles of equity, the trial court may order relief to protect partnership assets from sale, transfer, encumbrance, etc., but must grant only the minimum reasonable restraint necessary to protect the partnership interest from being dissipated pending resolution of the TUFTA claim." A dissenting justice construed the plain language of the charging order statute as an absolute bar to a trial court's ability to grant injunctive relief to protect a judgment creditor's potential interest in an asset underlying a judgment debtor's partnership interest, but the majority concluded that the provisions of the charging order statute and TUFTA could be harmonized as described by the majority.


The court held that the trial court did not improperly apply veil-piercing principles to hold the owners of LLCs personally liable for a fraudulent transfer by one of the LLCs to the
other and that the evidence showed that the individuals were directly liable (i.e., separate and apart from veil-piercing principles) for their own role in the fraudulent transfer.

After Adams was unable to collect on a judgment that she obtained against Centex Freight Lines, L.L.C. (Centex) in a previous lawsuit, she and the court-appointed receiver for Centex filed this lawsuit alleging a fraudulent transfer of Centex's assets to a commonly controlled company, PJC Properties, LLC ("PJC Properties") for the unlawful purpose of evading payment of the judgment. The owners of Centex and PJC Properties were Steve Key and Pat Curry. The challenged transaction was a foreclosure and sale of Centex's assets to PJC Properties after default on a loan purportedly secured by all of Centex's assets. The jury found that PJC Properties did not have an enforceable security interest in Centex's assets and that the transfer was thus a fraudulent transfer under the Texas Uniform Fraudulent Transfer Act because Centex did not receive "reasonably equivalent value" in exchange for the assets. The jury also found that Key, Curry, and PJC Properties were "responsible" for the unfair conduct of Centex and PJC Properties and that holding only Centex responsible for liability on the Adams judgment would result in injustice. The trial court thus awarded Adams damages in the full amount of her prior judgment jointly and severally against Key, Curry, and PJC Properties, as well as attorney's fees, and awarded the receiver possession and title of all assets owned or held by Centex as of the date of the Adams judgment.

After finding that there was sufficient evidence to support the jury's finding that the transfer of Centex's assets was fraudulent due to the absence of an enforceable security interest, the court turned to the defendants' challenges to the application of veil-piercing principles to hold Key and Curry individually liable. The court began by noting the longstanding common law of Texas regarding corporate veil piercing and pointing out several cases noting statutory developments and applying corporate veil-piercing principles to LLCs. The court also noted the well-established rule that an entity's agent is personally liable for the agent's own fraudulent or tortious acts without the necessity of piercing the entity's veil.

The court rejected challenges to the jury questions and sufficiency of the evidence regarding the liability of Key and Curry based on veil piercing. The court stated that the court's instructions were derived from applicable case law and were accurate statements of the law regarding veil piercing, but the court also stated that it was not necessary for the trial court to employ the equitable doctrine of veil piercing to impose individual liability on Key and Curry in light of the jury's findings and the evidence because Key and Curry were individually liable for their own tortious conduct in participating and directing the fraudulent transfer.

In a concurring opinion, one member of the 3-judge panel disagreed with the majority that the issue of personal liability of Curry or Key for direct tort liability was properly before the court.

**Governing Law**


The plaintiff invested $5 million in a hedge fund, and the fund lost the entire investment within ten months. The plaintiff sued a Delaware LLC that served as the managing member of the fund and a Delaware LLC that served as investment manager. The plaintiff also sued Porges, the CEO and principal of these two LLCs. The plaintiff’s claims included claims for fraudulent and negligent misrepresentation, breach of contract, breach of fiduciary duty, and veil piercing. The LLC agreement for the fund and the subscription documents contained Delaware choice-of-law provisions, and the parties agreed that the contract claims and the breach-of-fiduciary duty claims were governed by Delaware law. (The court also applied Delaware law to the plaintiff’s claims to pierce the veil of the Delaware LLCs without any explicit choice-of-law analysis.) The parties disagreed as to whether the choice-of-law provisions in the LLC agreement and subscription documents governed the plaintiff’s misrepresentation claims. Applying New York choice-of-law rules, the court concluded that choice-of-law provisions did not cover the misrepresentation claims. Under New York law, ""for a choice-of-law provision to apply to claims for tort arising incident to the contract, the express language of the provision must be sufficiently broad as to encompass the entire relationship between the contracting parties."

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The LLC agreement provided that Delaware law “shall govern the validity of this Agreement, the construction of its terms and interpretation of the rights and duties of the Members,” and the subscription documents stated that they “shall be deemed to have been made under, and shall be governed by, and construed in accordance with, the internal laws of the State of Delaware (excluding the law thereof which requires the application of or reference to the law of any other jurisdiction).” The court concluded that these did not cover the plaintiff’s claims for fraudulent and negligent misrepresentation because the provisions did not “encompass the entire relationship between the contracting parties” and were similar to provisions that courts have held do not encompass such tort claims.

Applying New York law to the misrepresentation claims, the court concluded that the claims failed as a matter of law based on the non-reliance clause in the documents and the plaintiff’s sophistication.

**Diversity Jurisdiction**

**Grynberg v. Kinder Morgan Energy Partners, L.P.,** 805 F.3d 901 (10th Cir. 2015).

The plaintiffs, citizens of Colorado, sued Kinder Morgan Energy Partners, L.P. (“KMEP”) and Kinder Morgan CO2 Company, L.P. (“KMC02”) in federal district court to vacate an arbitration award. The plaintiffs invoked diversity jurisdiction, and the district court dismissed the action for lack of jurisdiction because KMEP, a Delaware master limited partnership, had unitholders who were citizens of Colorado. The plaintiffs argued that Carden v. Arkoma Associates, under which the citizenship of a limited partnership is determined by the citizenship of all of its partners, does not apply to master limited partnerships, but the court of appeals rejected that argument. Characterizing the issue as an “issue of first impression,” the court of appeals held that the citizenship of a MLP consists of its unitholders’ citizenship.” The court described KMEP as a Delaware master limited partnership and KMC02 as “a Texas limited partnership with one partner, KMEP. The court further noted that, “[b]ecause KMEP was the sole partner of KMC02, KMC02’s citizenship included KMEP’s citizenship.” The court provided the following explanation of MLPs:

MLPs are limited partnerships or limited liability companies whose ownership interests, called “common units,” are publicly traded. John Goodgame, New Developments in Master Limited Partnership Governance, 68 Bus. L. 81, 82 (2012); Wood v. Walton, No. WDO–09–3398, 2010 WL 458574, at *1 n. 3 (D.Md. Feb. 2, 2010) (unpublished). MLPs are similar to limited partnerships in that they have general partners who manage the partnership’s affairs and limited partners (called “unitholders”) who provide capital. Trafìgura AG v. Enter. Prods. Operating LLC, 995 F.Supp.2d 641, 643 n. 1 (S.D.Tex.2014). MLPs are classified as partnerships for federal taxation purposes, which allows them to benefit from “pass-through” taxation. Id. They are similar to corporations, however, in that MLPs are publicly traded. See id. Although MLPs are organized under state law, federal law permits federal pass-through taxation for MLPs engaged predominately in the “exploration, development, mining, or production, processing, refining, [or] transportation ... of any mineral or natural resource.” 26 U.S.C. § 7704(d)(1)(E).

The court explained that there are generally two types of business organizations for purposes of jurisdictional citizenship: corporations and unincorporated associations. The court discussed a long line of Supreme Court decisions, beginning with Chapman v. Barney, an 1889 opinion, in which the Supreme Court has held that an unincorporated entity’s citizenship is determined by its members’ citizenship. The court of appeals stated that this “rule applies to MLPs because they are unincorporated associations (1) formed under state law as limited partnerships or limited liability companies and (2) classified as partnerships for federal income tax purposes.” The plaintiff argued that MLPs qualify for an exception similar to that applied by the Supreme Court in Puerto Rico v. Russell & Co. In that case, the Supreme Court determined that a sociedad en comandita—an entity created under Puerto Rico law—was a citizen of Puerto Rico for diversity purposes. The plaintiffs argued that the corporate characteristics of an MLP warranted application of a similar analysis. The court of appeals disagreed because the Supreme Court has declined to extend the exception in Russell and has stated that it likely only applies to a sociedad en comandita. The court of appeals went on to state that the MLP’s
characteristics did not support treating an MLP like a corporation. The court stated that an MLP's similarities to a corporation are limited to being publicly traded, having centralized management, and having freely transferable units. The court pointed out that MLPs are formed as unincorporated entities under state law and that the partnership agreement can modify the fiduciary duties owed by partners whereas corporate law disallows modifying or restricting the fiduciary duties owed by the board of directors.

The court concluded by stating that the plaintiffs' policy argument should be addressed to Congress rather than the courts.


The court rejected the contention that the citizenship of a passive investor who was a member of a member of a member of the defendant LLC could be disregarded for purposes of the LLC's citizenship. The plaintiff argued that the standard established in Harvey v. Grey WolfDrilling Co., 542 F.3d 1077, 1079–80 (5th Cir.2008) (applying Carden v. Arkoma Associates to limited liability companies) would be stretched to an illogical absurdity in this case because the member whose citizenship would destroy diversity was in fact a member of a member of one of the plaintiff's members and was a limited partner who had no managerial responsibilities and was difficult to locate. The court found these arguments unpersuasive because the Supreme Court has explicitly rejected the contention that a court may consult the citizenship of less than all of an unincorporated entity's members to determine citizenship for diversity purposes. Additionally, there is no case law suggesting that an exception may be made when one of the LLC's members is an artificial entity whose members are also entities. To the contrary, the Fifth Circuit has observed that testing citizenship involves tracing the citizenship of entities through the various organizations and layers when necessary. Accordingly, the court rejected the plaintiff's contention that the court could consider less than all of the defendant LLC's members when determining its citizenship.
Election into the Partnership Audit Regime Under the Bipartisan Budget Act of 2015
T.D. 9780

[4830-01-p]

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Treasury Decision 9780

RIN 1545-BN34

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations pursuant to section 1101(g)(4) of the Bipartisan Budget Act of 2015 regarding an election to apply the new partnership audit regime enacted by that act to certain returns of a partnership. The regulations provide the time, form, and manner for making this election. The regulations affect any partnership that wishes to elect to have the new partnership audit regime apply to its returns filed for certain taxable years beginning before January 1, 2018.

DATES: Effective date: These regulations are effective August 5, 2016.

FOR FURTHER INFORMATION CONTACT: Jenni M. Black at (202) 317-6834 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Procedure and Administration Regulations (26 CFR part 301) to provide rules for the time, form, and manner of making the election under section 1101(g)(4) of the Bipartisan Budget Act of 2015, Public Law 114-74 (BBA) with respect to returns filed for partnership taxable years beginning after November 2, 2015 and before January 1, 2018.

The BBA was enacted on November 2, 2015, and was amended by the Protecting Americans from Tax Hikes Act of 2015, Public Law 114-113, div. Q (PATH Act) on December 18, 2015. Section 1101(a) of the BBA removes subchapter C of chapter 63 of the Internal Revenue Code (Code) effective for partnership taxable years beginning after December 31, 2017. Subchapter C of chapter 63 contains the unified partnership audit and litigation rules that were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97-248 (TEFRA). These partnership audit and litigation rules are commonly referred to as the TEFRA partnership procedures.

Section 1101(b) of the BBA also removes subchapter D of chapter 63 of the Code (containing audit rules for electing large partnerships) and part IV of subchapter K of chapter 1 of the Code (prescribing the income tax treatment for electing large partnerships), effective for partnership taxable years beginning after December 31, 2017.

Section 1101(c) of the BBA replaces the rules to be removed by sections 1101(a) and (b) with a new partnership audit regime. Section 1101(c) adds a new subchapter C to chapter 63 of the Code, including amended Code sections 6221-6241. The BBA also makes related and conforming amendments to other provisions of the Code.
On December 18, 2015, President Obama signed into law the PATH Act. Section 411 of the PATH Act corrects and clarifies certain amendments made by the BBA. The amendments under the PATH Act are effective as if included in section 1101 of the BBA, and therefore, subject to the effective dates in section 1101(g) of the BBA.

1. Overview of the New Partnership Audit Regime

Section 6221(a) as added by the BBA provides that, in general, any adjustment to items of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year (and any partner's distributive share thereof) shall be determined, and any tax attributable thereto shall be assessed and collected, at the partnership level. The applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to any such item or share shall also be determined at the partnership level. Section 6221(b) as added by the BBA provides rules for partnerships that are required to furnish 100 or fewer Schedules K-1, Partner's Share of Income, Deductions, Credits, etc., to elect out of this new regime. Generally, a partnership may elect out of the new regime only if each of its partners is an individual, corporation (including certain types of foreign entities), or estate. Special rules apply for purposes of determining the number of partners in the case of a partner that is an S corporation. Section 6221(b)(2)(C) provides that the Secretary by regulation or other guidance may prescribe rules for purposes of the 100-or-fewer-Schedule K-1 requirement similar to the rules for S corporations with respect to any partner that is not an individual, corporation, or estate.

Section 6223 as amended by the BBA provides that the partnership shall designate, in the manner prescribed by the Secretary, a partner or other person with a substantial presence in the United States as the partnership representative who shall have the sole authority to act on behalf of the partnership under subchapter C of chapter 63 of the Code, as amended by the BBA. In any case in which such a designation is not in effect, the Secretary may select any person as the partnership representative. A partnership and all partners of such partnership shall be bound by actions taken under subchapter C by the partnership and by any final decision in a proceeding brought under subchapter C with respect to the partnership.

Section 6225 as amended by the BBA generally addresses partnership adjustments made by the IRS and the calculation of any resulting imputed underpayment. Section 6225(a) generally provides that the amount of any imputed underpayment resulting from an adjustment must be paid by the partnership. Section 6225(b) describes how an imputed underpayment is determined, and section 6225(c) describes modifications that, if approved by the IRS, may reduce the amount of an imputed underpayment. The PATH Act added to section 6225(c) a special rule addressing certain passive losses of publicly traded partnerships.

Section 6226 as amended by the BBA provides an exception to the general rule under section 6225(a)(1) that the partnership must pay the imputed underpayment. Under section 6226, the partnership may elect to have the reviewed year partners take into account the adjustments made by the IRS and pay any tax due as a result of those adjustments. In this case, the partnership is not required to pay the imputed underpayment. Section 6225(d)(1) defines the reviewed year to mean the partnership taxable year to which the item(s) being adjusted relates.

Under section 6227 as amended by the BBA, the partnership may request an administrative adjustment, which is taken into account in the partnership taxable year the administrative adjustment request (AAR) is made. The partnership generally has three years from the date of filing the return to make an AAR for that year, but may not make an AAR for a partnership taxable year after the IRS has mailed the partnership a notice of an administrative proceeding initiated with respect to the taxable year.

Section 6231 as amended by the BBA describes notices of proceedings and adjustments, including certain time frames for mailing the notices and the authority to rescind any notice of adjustment with the partnership's consent. Section 6232(a) as amended by the BBA provides that any imputed underpayment is assessed and collected in the same manner as if it were a tax imposed for the adjustment year by subtitle A, except that in the case of an AAR that reports an underpayment that the partnership elects to
pay, the underpayment shall be paid when the request is filed.

Section 6234 as amended by the BBA generally provides that a partnership may seek judicial review of the adjustments within 90 days of the date the notice of final partnership adjustment is mailed. Section 6235 as amended by the BBA provides the period of limitations on making adjustments.

Section 6241 as amended by the BBA provides definitions and special rules, including rules addressing bankruptcy and treatment when a partnership ceases to exist. In particular, section 6241(4) as amended by the BBA provides that no deduction is allowed under subtitle A for any payment required to be made by a partnership under the new partnership audit regime.

2. Effective Dates

Pursuant to section 1101(g)(1) of the BBA, the amendments made by section 1101, which repeal the TEFRA partnership procedures and the rules applicable to electing large partnerships and which create the new partnership audit regime, generally apply to returns filed for partnership taxable years beginning after December 31, 2017. Section 1101(g)(2) of the BBA provides that, in the case of an AAR under section 6227 as amended by the BBA, the amendments made by section 1101 apply to requests with respect to returns filed for partnership taxable years beginning after December 31, 2017. Similarly, section 1101(g)(3) of the BBA provides that, in the case of an election to use the alternative to payment of the imputed underpayment by the partnership under section 6226 as amended by the BBA, the amendments made by section 1101 apply to elections with respect to returns filed for partnership taxable years beginning after December 31, 2017.

Section 1101(g)(4) of the BBA provides that a partnership may elect (at such time and in such form and manner as the Secretary may prescribe) for the amendments made under section 1101 (other than the election out of the new partnership audit regime under section 6221(b) as added by the BBA) to apply to any of its partnership returns filed for partnership taxable years beginning after November 2, 2015 and before January 1, 2018.

Explanation of Provisions

This Treasury decision adopts temporary regulations set forth in § 301.9100-22T to provide the time, form, and manner for a partnership to make an election pursuant to section 1101(g)(4) of the BBA to have the new partnership audit regime apply to any of its partnership returns filed for a partnership taxable year beginning after November 2, 2015 and before January 1, 2018. Section 301.9100-22T(a) provides the general rule that a partnership may elect at the time and in such form and manner as described in § 301.9100-22T for amendments made by section 1101 of the BBA, except section 6221(b) added by the BBA, to apply to any return of the partnership filed for an eligible taxable year (as defined in § 301.9100-22T(d)). Accordingly, a partnership that elects to apply the new partnership audit regime to a partnership return filed for an eligible taxable year may not elect out of the new rules under the small partnership exception under section 6221(b) as added by BBA, with respect to that return.

Section 301.9100-22T(a) further provides that an election made not in accordance with these temporary regulations is not valid, and an election, once made, may only be revoked with consent of the IRS. An election is also not valid if it frustrates the purposes of section 1101 of the BBA, which include the collection of any imputed underpayment that may be due by the partnership under section 6225(a) as amended by the BBA. In addition, partnerships may not request an extension of time for making an election described in § 301.9100-22T under § 301.9100-3.

Section 301.9100-22T(d)(1) generally provides that for purposes of the temporary regulations, an eligible taxable year is any partnership taxable year beginning after November 2, 2015 and before January 1, 2018. Section 301.9100-22T(d)(2) provides exceptions to the definition of an eligible taxable year to avoid proceedings under both the TEFRA partnership procedures and the new partnership audit regime for the same partnership taxable year. To avoid these multiple proceedings, an election under these temporary regulations does not apply if the partnership has taken the affirmative step to apply the TEFRA partnership procedures with respect to the partnership return for that taxable year. This occurs when the
tax matters partner has filed a request for an administrative adjustment for the partnership taxable year under section 6227(c) of the TEFRA partnership procedures with respect to a partnership taxable year. Similarly, an election under these temporary regulations also does not apply if a partnership that is not subject to the TEFRA partnership procedures has filed an amended return of partnership income for the partnership taxable year.

Under the general rule in § 301.9100-22T(b), an election to have the new partnership audit regime apply must be made when the IRS first notifies the partnership in writing that a partnership return for an eligible taxable year has been selected for examination (a "notice of selection for examination"). Section 301.9100-22T(b)(1) provides that a partnership that wishes to make an election must do so within 30 days of the date of the notice of selection for examination. The notice of selection for examination referred to in § 301.9100-22T(b) is a notice that precedes the notice of an administrative proceeding required under section 6231(a) as amended by the BBA. Section 301.9100-22T(b) provides that the IRS will not issue a notice of an administrative proceeding, which cuts off the partnership's time for filing an AAR under section 6227 as amended by the BBA, for at least 30 days after it receives a valid election filed in accordance with § 301.9100-22T(b). During the period of at least 30 days after the IRS receives a valid election and before the IRS mails the notice of an administrative proceeding, the partnership may file an AAR under section 6227 as amended by the BBA.

Section 301.9100-22T(b)(2) provides that an election must be in writing and include a statement that the partnership is electing to have the partnership audit regime enacted by the BBA apply to the partnership return identified in the IRS notification of selection for examination. The partnership must write "Election under Section 1101(g)(4)" at the top of the statement. The statement must be provided to the individual identified in the notice of selection for examination as the IRS contact for the examination. In addition, the statement must be dated and signed by the tax matters partner, as defined under section 6223 of the Code, and the regulations thereunder, and applicable forms and instructions. The statement must include the name, taxpayer identification number, address, and telephone number of the individual who signs the statement, as well as the partnership's name, taxpayer identification number, and tax year to which the statement applies. The statement must include representations that the partnership is not insolvent and does not reasonably anticipate becoming insolvent, the partnership is not currently and does not reasonably anticipate becoming subject to a bankruptcy petition under title 11 of the United States Code, and the partnership has sufficient assets, and reasonably anticipates having sufficient assets, to pay the potential imputed underpayment that may be determined during the partnership examination. The statement must also include a representation, signed under penalties of perjury, that the individual signing the statement is duly authorized to make the election under § 301.9100-22T(b) and that, to the best of the individual's knowledge and belief, the statement is true, correct, and complete.

A partnership electing into the new partnership audit regime under the BBA will also be required to designate the partnership representative, as defined in section 6223 as amended by the BBA, and provide the partnership representative's name, taxpayer identification number, address and daytime telephone number, and any other information as required in future guidance regarding the partnership representative. The Treasury Department and the IRS expect to issue additional guidance regarding designation of a partnership representative, including who is eligible to be a partnership representative, under section 6223 as amended by the BBA.

Section 301.9100-22T(c) provides an exception to the general rule in § 301.9100-22T(b) that a partnership may only elect into the new partnership audit regime after first receiving a notice of selection for examination. This exception provides that a partnership that has not received a notice of selection for examination described in § 301.9100-22T(b) may make an election to have the new partnership audit regime apply to a partnership return for an eligible taxable year if the partnership wishes to file an AAR under section 6227 as amended by the BBA. Once an election is made under § 301.9100-22T(c), all aspects of the new partnership audit regime, except section 6221(b) as added by the BBA, apply to the return filed for the eligible taxable year subject to the election. As with an election under § 301.9100-22T(b), an election under § 301.9100-22T(c) may not be revoked without consent of the IRS.
An election under § 301.9100-22T(c) must be made only in the manner prescribed by the IRS in accordance with the forms and instructions and other guidance issued by the IRS. In no case may an election under § 301.9100-22T(c) be made earlier than January 1, 2018. Consequently, an AAR under section 6227 as amended by the BBA may not be filed before January 1, 2018 (except by partnerships that have been issued a notice of selection for examination pursuant to the procedures discussed above). An AAR filed before that date (other than an AAR filed by a partnership that made a valid election under § 301.9100-22T(b)) will be treated as an AAR by the partnership under section 6227 of the TEFRA partnership procedures, or as an amended return of partnership income for partnerships not subject to the TEFRA partnership procedures, and will prevent the partnership taxable year for which the request, or return, is filed from being an eligible taxable year. See § 301.9100-22T(d)(2). The Treasury Department and the IRS intend to issue guidance regarding AARs under section 6227 as amended by the BBA before January 1, 2018.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation. These temporary regulations are published pursuant to section 7805(b)(2) of the Code to provide the time, form, and manner for a partnership to make an election pursuant to section 1101(g)(4) of the BBA to have the new partnership audit regime apply to any of its returns filed for a partnership taxable year beginning after November 2, 2015 and before January 1, 2018. Without this necessary guidance, a partnership would not be able to make a valid election pursuant to section 1101(g)(4) of the BBA. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), please refer to the Special Analyses section of the cross-reference notice of proposed rulemaking published in the Proposed Rules section of this issue of the Federal Register. Pursuant to section 7805(f) of the Code, these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these temporary regulations is Jenni M. Black of the Office of the Associate Chief Counsel (Procedure and Administration). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 301

Income taxes, Penalties, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301 -- PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Section 301.9100-22T is also issued under section 1101(g)(4) of Pub. L. 114-74. * * * *
Paragraph 2. Section 301.9100-22T is added to read as follows:

§ 301.9100-22T Time, form, and manner of making the election under section 1101(g)(4) of the Bipartisan Budget Act of 2015 for returns filed for partnership taxable years beginning after November 2, 2015 and before January 1, 2018 (temporary).

(a) Election. Pursuant to section 1101(g)(4) of the Bipartisan Budget Act of 2015, Public Law 114-74 (BBA), a partnership may elect at the time and in such form and manner as described in this section for amendments made by section 1101 of the BBA, except section 6221(b) as added by the BBA, to apply to any return of the partnership filed for an eligible taxable year as defined in paragraph (d) of this section. An election is valid only if made in accordance with this section. Once made, an election may only be revoked with the consent of the Internal Revenue Service (IRS). An election is not valid if it frustrates the purposes of section 1101 of the BBA. A partnership may not request an extension of time under § 301.9100-3 for an election described in this section.

(b) Election on notification by the IRS -- (1) Time for making the election. Except as described in paragraph (c) of this section, an election under this section must be made within 30 days of the date of notification to a partnership, in writing, that a return of the partnership for an eligible taxable year has been selected for examination (a notice of selection for examination).

(2) Form and manner of making the election -- (i) In general. The partnership makes an election under this section by providing a written statement with the words "Election under Section 1101(g)(4)" written at the top that satisfies the requirements of paragraph (b)(2) of this section to the individual identified in the notice of selection for examination as the IRS contact regarding the examination.

(ii) Statement requirements. A statement making an election under this section must be in writing and be dated and signed by the tax matters partner, as defined under section 6231(a)(7) (prior to amendment by the BBA), and the applicable regulations, or an individual who has the authority to sign the partnership return for the taxable year under examination under section 6063, the regulations thereunder, and applicable forms and instructions. The fact that an individual dates and signs the statement making the election described in this paragraph (b) shall be prima facie evidence that the individual is authorized to make the election on behalf of the partnership. A statement making an election must include –

(A) The partnership's name, taxpayer identification number, and the partnership taxable year for which the election described in this paragraph (b) is being made;

(B) The name, taxpayer identification number, address, and daytime telephone number of the individual who signs the statement;

(C) Language indicating that the partnership is electing application of section 1101(c) of the BBA for the partnership return for the eligible taxable year identified in the notice of selection for examination;

(D) The information required to properly designate the partnership representative as defined by section 6223 as amended by the BBA, which must include the name, taxpayer identification number, address, and daytime telephone number of the partnership representative and any additional information required by applicable regulations, forms and instructions, and other guidance issued by the IRS;

(E) The following representations –

(1) The partnership is not insolvent and does not reasonably anticipate becoming insolvent before resolution of any adjustment with respect to the partnership taxable year for which the election described in this paragraph (b) is being made;

(2) The partnership has not filed, and does not reasonably anticipate filing, voluntarily a petition for relief under title 11 of the United States Code;
(3) The partnership is not subject to, and does not reasonably anticipate becoming subject to, an involuntary petition for relief under title 11 of the United States Code; and

(4) The partnership has sufficient assets, and reasonably anticipates having sufficient assets, to pay a potential imputed underpayment with respect to the partnership taxable year that may be determined under subchapter C of chapter 63 of the Internal Revenue Code as amended by the BBA; and

(F) A representation, signed under penalties of perjury, that the individual signing the statement is duly authorized to make the election described in this paragraph (b) and that, to the best of the individual's knowledge and belief, all of the information contained in the statement is true, correct, and complete.

(iii) Notice of Administrative Proceeding. Upon receipt of the election described in this paragraph (b), the IRS will promptly mail a notice of administrative proceeding to the partnership and the partnership representative, as required under section 6231(a)(1) as amended by the BBA. Notwithstanding the preceding sentence, the IRS will not mail the notice of administrative proceeding before the date that is 30 days after receipt of the election described in paragraph (b) of this section.

(c) Election for the purpose of filing an administrative adjustment request (AAR) under section 6227 as amended by the BBA -- (1) In general. A partnership that has not been issued a notice of selection for examination as described in paragraph (b)(1) of this section may make an election with respect to a partnership return for an eligible taxable year for the purpose of filing an AAR under section 6227 as amended by the BBA. Once an election under this paragraph (c) is made, all of the amendments made by section 1101 of the BBA, except section 6221(b) as added by the BBA, apply with respect to the partnership taxable year for which such election is made.

(2) Time for making the election. No election under this paragraph (c) may be made before January 1, 2018.

(3) Form and manner of making an election. An election under this paragraph (c) must be made in the manner prescribed by the IRS for that purpose in accordance with applicable regulations, forms and instructions, and other guidance issued by the IRS.

(4) Effect of filing an AAR before January 1, 2018. Except in the case of an election made in accordance with paragraph (b) of this section, an AAR filed on behalf of a partnership before January 1, 2018, is deemed for purposes of paragraph (d)(2) of this section, to be an AAR filed under section 6227(c) (prior to amendment by the BBA) or an amended return of partnership income, as applicable.

(d) Eligible taxable year -- (1) In general. For purposes of this section, the term eligible taxable year means any partnership taxable year beginning after November 2, 2015 and before January 1, 2018, except as provided in paragraph (d)(2) of this section.

(2) Exception if AAR or amended return filed or deemed filed. Notwithstanding paragraph (d)(1) of this section, a partnership taxable year is not an eligible taxable year for purposes of this section if for the partnership taxable year –

(i) The tax matters partner has filed an AAR under section 6227(c) (prior to amendment by the BBA),

(ii) The partnership is deemed to have filed an AAR under section 6227(c) (prior to the amendment by the BBA) in accordance with paragraph (c)(4) of this section, or

(iii) An amended return of partnership income has been filed or has been deemed to be filed under paragraph (c)(4) of this section.

(e) Applicability date. These regulations are applicable to returns filed for partnership taxable years beginning after November 2, 2015 and before January 1, 2018.
(f) Expiration date. This section will expire on August 5, 2019.

John M. Dalrymple,
Deputy Commissioner for Services and Enforcement.

Approved: July 6, 2016

Mark J. Mazur
Assistant Secretary for Tax Policy
[FR Doc. 2016-18638 Filed: 8/4/2016 8:45 am; Publication Date: 8/5/2016]
The ideas and conclusions set forth in this draft, including the proposed statutory language and any comments or reporter=s notes, have not been passed upon by the National Conference of Commissioners on Uniform State Laws or the Drafting Committee. They do not necessarily reflect the views of the Conference and its Commissioners and the Drafting Committee and its Members and Reporter. Proposed statutory language may not be used to ascertain the intent or meaning of any promulgated final statutory proposal.

June 7, 2016
DRAFTING COMMITTEE ON LIMITED LIABILITY COMPANY
PROTECTED SERIES ACT

The Committee appointed by and representing the National Conference of Commissioners on Uniform State Laws in preparing this Act consists of the following individuals:

STEVE FROST, 111 W. Monroe St., Chicago, IL 60603-4080, Chair
JOHN FOX ARNOLD, 714 Locust St., St. Louis, MO 63101
DAVID J. CLARK, 353 Bel Marin Keys Blvd., Suite 1, Novato, CA 94949
WILLIAM H. CLARK, JR., One Logan Square, 18th and Cherry St., Philadelphia, PA 19103-6996
LOUIS T. M. CONTI, 100 N. Tampa St., Suite 4100, Tampa, FL 33602
HARRY J. HAYNSWORTH, IV, 108 Addingtons, Williamsburg, VA 23188
LISA R. JACOBS, One Liberty Place, 1650 Market St., Suite 4900, Philadelphia, PA, 19103-7300
STEVEN N. LEITESS, 10451 Mill Run Cir., Suite 1000, Baltimore, MD 21117
DAVID C. McBRIDE, 1000 King St., P.O. Box 391, Wilmington, DE 19899
JAMES C. MCKAY, JR., 441 4th St. NW, Suite 630 S., Washington, DC, 20001
THOMAS E. RUTLEDGE, 2000 PNC Plaza, 500 W. Jefferson St., Louisville, KY 40202-2874
EDWIN E. SMITH, 1 Federal St., 15th Floor, Boston, MA 02110-1726
DAVID S. WALKER, Drake University Law School, 2507 University Ave., Des Moines, IA 50311
DANIEL S. KLEINBERGER, 1818 Twin Circle Dr., Mendota Heights, MN 55118-4140

EX OFFICIO

RICHARD T. CASSIDY, 100 Main St., P.O. Box 1124, Burlington, VT 05402, President
H. LANE KNEEDLER, Office of the Attorney General of Virginia, 202 N. 9th St., Richmond, VA 23219, Division Chair

AMERICAN BAR ASSOCIATION ADVISORS

ALLAN G. DONN, Wells Fargo Center, 440 Monticello Ave., Suite 2200, Norfolk, VA 23510-2243, ABA Advisor
JAY ADKISSON, 2850 W. Horizon Ridge Pkwy., Suite 200, Henderson, NV 89052
MARJORIE R. BARDWELL, 601 Riverside Ave., Bldg. 5, Jacksonville, FL 32204-2901
CARTER G. BISHOP, Suffolk University Law School, 120 Tremont St., Boston, MA 02108-4977, ABA Section Advisor
J. LEIGHT GRIFFITH, 511 Union St., Suite 2700, Nashville, TN 37219, ABA Section Advisor
GREG LADNER, One Rodney Square, 920 N. King St., Wilmington, DE 19801, ABA Section Advisor
KYUNG S. LEE, Two Houston Center, 909 Fanin St., 15th Floor, Houston, TX 77010, ABA Section Advisor
ELIZABETH S. MILLER, Baylor Law School, 1114 S. University Parks Dr., One Bear Place #97288, Waco, TX 76798, ABA Section Advisor
SANDRA K. MILLER, Widener University, School of Business Administration, One University
EXECUTIVE DIRECTOR

LIZA KARSAI, 111 N. Wabash Ave., Suite 1010, Chicago, IL 60602, Executive Director

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# LIMITED LIABILITY COMPANY PROTECTED SERIES ACT

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<table>
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<th>Description</th>
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</tr>
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</table>
LIMITED LIABILITY COMPANY PROTECTED SERIES ACT

Prefatory Note – Preliminary

This preliminary prefatory note has 12 parts. Parts 1-8 address conceptual issues. Parts 9-11 explain how the act is structured. Part 12 compares the act to existing law.

Conceptual Issues

1. The Protected Series Construct
2. “Protected Series” as the Term of Art
3. The Import of the Protected Series Construct
4. Growing Popularity of Series Limited Liability Companies
5. The Two-Fold Nature of the Internal Shields: Non-Liability and Non-Recourse Rules
6. Non-Liability and Non-Recourse Rules: Contrasting the Traditional Corporate/LLC Liability Shield with the Internal Shield of a Protected Series
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Structural Issues

9. Structure of the Act – A Module to be Enacted as Part of a State’s Existing Limited Liability Company Statute
10. Extrapolation – Providing Default Rules at the Protected Series Level

The Act Compared to Existing Law

12. Clarity and Safeguards of this Act Compared to Current Protected Series Statutes

Conceptual Issues

1. The Protected Series Construct

As provided by statutes in 13 states, the District of Columbia, and Puerto Rico,¹ the protected series construct has the following aspects:²

- an identifiable set of assets segregated within a limited liability company (“a series

¹ As of May 11, 2016, the following statutes provide for protected series within a limited liability company: ALA. CODE §§ 10A-5A-11.01-16 (2015); DEL. CODE ANN. tit. 6, §§18-215 (West 2015); D.C. CODE ANN. §§29-802.06 (2015); 805 ILL. COMP. STAT. ANN. 180/37-40 (West 2014); 2016 Ind. Legis. Serv. P.L. 170-2016 (H.E.A. 1336) (West); IOWA CODE ANN. §§ 489.1201-1206 (West 2014); KAN. STAT. ANN. § 17-76, 143 (West 2014); MO. REV. STAT. § 347.186.1 (2014); MONTANA CODE ANN. § 35-8-304 (West 2013); NEV. REV. STAT. ANN. § 86.296 (West 2014); OKLA. ST. ANN. tit. 18, §§ 2005(B), 2054.4 (West 2014); TENN. CODE ANN. § 48-249-309 (West 2014); TEX. BUS. ORGS. CODE ANN. §§101.601-622 (West 2013); UTAH CODE ANN. §§ 48-3a-1201 to 1209 (West 2014); P.R. LAWS ANN. tit. 14, § 3967 (2011).

² Existing statutes refer to “series” rather than “protected series.” Prefatory Note, Part 2 explains why this act and its commentary use the latter label.
limited liability company”);³

- the assets:
  - comprise a protected series, empowered to conduct activities in its own name and right;
  - are obligated solely to persons asserting claims pertaining to those assets or activities; and
- are not available to persons asserting claims arising from the assets or activities of the series limited liability company or any other protected series of the company;
- one or more members of the series limited liability company may be associated with the protected series,⁴ but not necessarily; and
- distributions arising from the assets and activities go to:
  - the members associated with the protected series, if any; or
  - the series limited liability company, if the series has no associated members.

Thus, a series limited liability company contains “internal shields” – i.e., asset partitions confining the assets and liabilities of each protected series solely to creditors of that protected series. These “horizontal” shields are conceptually and practically quite different from the traditional, “vertical” shield that protects the owners of an organization from automatic, vicarious liability for the organization’s obligations.

2. “Protected Series” as the Term of Art

Following long-standing practice with statutory trusts and investment companies, existing protected series statutes use “series” as the term of art for the construct just described. However, outside the investment trust context, using “series” can be quite confusing. “Series” has an established and very different meaning with regard to bonds, corporate stock, etc.⁵ To avoid confusion, this act uses the term “protected series” – to signal the different meaning and to call attention to the internal, horizontal shields which are the construct’s defining characteristic.

3. The Import of the Protected Series Construct

The protected series:

- is one of the most significant developments in the law of business organizations since the advent of the limited liability company;
- pushes the conceptual envelope of entity law by providing for a quasi-distinct legal person existing within an overarching entity;

³ Delaware law authorizes protected series within a limited partnership, Del. Code Ann. tit. 6, §17-218 (2015), but very few Delaware limited partnerships provide for protected series.

⁴ Allowing a non-member of a series limited liability company to be associated with a protected series of the company would cause daunting complexity while producing very little (if any) benefit.

⁵ For example, lists of limited liability company statutes with “series” provisions often include the statutes of Minnesota, North Dakota, and Wisconsin. Although these acts do refer to “series,” the word has nothing to do with asset partitioning and internal shields. The three acts use “series” to describe a category of ownership interest analogous to a series of stock. See Minn. Stat. § 322B.03, subd. 44; ND Stat.§ 10-32.1-02(48); Wis. Stat. § 183.0504.
• establishes a new type of liability shield, the “internal shield” – rather than protecting the owners of an organization from vicarious liability for the organization’s debts, obligations, and other liabilities, the “internal shields” of a series protect the assets of one protected series from the creditors of the series limited liability company and of any other protected series of the series limited liability company.

4. Growing Popularity of Series Limited Liability Companies

It is not possible to determine the number of series limited liability companies and protected series in existence in the United States. Under most protected series provisions, a limited liability company can establish a protected series without making a public filing. The only item on the public record will be a statement that the company has the capacity to establish protected series. However, anecdotal evidence suggests heavy usage, especially under the Delaware statute.\(^6\)

Better data is available from Illinois, where the law requires a public filing to establish a protected series. As of January 26, 2016, more than 26,000 protected series were active under Illinois law.

The growing popularity is also reflected in the following chart, which shows the increasing number of U.S. jurisdictions that provide for the creation of protected series:

<table>
<thead>
<tr>
<th>year of enactment</th>
<th>name of enacting jurisdictions</th>
<th>total number of enactments in the year</th>
<th>cumulative total of jurisdictions with protected series provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>Delaware</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>2004</td>
<td>Oklahoma</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>2005</td>
<td>Illinois, Nevada, Tennessee</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>2008</td>
<td>Iowa</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>2009</td>
<td>Puerto Rico, Texas</td>
<td>2</td>
<td>8</td>
</tr>
<tr>
<td>2011</td>
<td>District of Columbia</td>
<td>1</td>
<td>9</td>
</tr>
<tr>
<td>2012</td>
<td>Kansas</td>
<td>1</td>
<td>10</td>
</tr>
<tr>
<td>2013</td>
<td>Missouri, Montana, Utah</td>
<td>3</td>
<td>13</td>
</tr>
<tr>
<td>2014</td>
<td>Alabama</td>
<td>1</td>
<td>14</td>
</tr>
<tr>
<td>2016</td>
<td>Indiana</td>
<td>1</td>
<td>15</td>
</tr>
</tbody>
</table>

Several other jurisdictions are reported as very interested in providing for protected series and awaiting the conclusion of this project.

Although the widespread use and growing popularity of protected series is undeniable, the reasons for this use and popularity are not well understood. For the most part, the legal and

---

\(^6\) An ABA advisor to the Drafting Committee reports having established between 1000 to 1500 protected series under Delaware law.
business relationships established through protected series can also be established with various structures involving several limited liability companies.

Some situations have been identified in which protected series provide a unique benefit, but these situations involve very specialized types of arrangements and cannot account for widespread use and popularity. Some proponents note the potential convenience for regulatory purposes: A series limited liability company holds a single license or makes one regulatory filing, and various protected series of the company function under the aegis of that license or filing.\(^7\)

Another explanation is that the series limited liability company provides the first ever, off-the-shelf template for establishing a structure of affiliated businesses. It is debatable whether such a template increases economic efficiency, provides traps for the unwary, or both. What is not in doubt is that the protected series construct is now an established part of U.S. business law.

Also not in doubt is that current statutes leave many very practical questions unanswered and, moreover, lack important safeguards to protect the public, in general, and creditors, in particular.

5. The Two-Fold Nature of the Internal Shields: Non-Liability and Non-Recourse Rules

Like the traditional “vertical shield,” a protected series’ horizontal shield has two separate but related aspects:

- **the non-liability rule**
  - a protected series is not liable for the debts of the series limited liability company or any other protected series of the company and *vice versa*

- **the non-recourse rule**
  - each *associated* asset of a protected series is shielded against collection efforts of judgment creditors of the series limited liability company or of any other protected series of the company;
  - *association* is accomplished by creating and maintaining required records\(^8\)

Current protected series statutes do not treat these two rules separately. This act does, and in doing so provides a novel, important protection for creditors and a novel, important inducement for good recordkeeping.

6. Non-Liability and Non-Recourse Rules: Contrasting the Traditional Corporate/LLC Liability Shield with the Internal Shields of a Series Limited Liability Company

With the traditional, vertical corporate/LLC liability shield, the non-liability provision

\(^7\) This benefit is all-important in the context of investment funds.

\(^8\) See Section 301.
implicitly (but ineluctably) protects the property of owners from being used to satisfy a judgment against the entity. Simply put, if an owner is not liable for the entity debt, the owner’s assets are not available to satisfy the debt.

In the context of a protected series and its horizontal shield, under this act the analysis is more complex. Establishing a protected series automatically invokes the non-liability rule, but to invoke the non-recourse rule it is necessary that assets owned by the protected series be associated assets of the protected series. Put another way, an asset owned by a protected series but not properly associated with the protected series is up for grabs not only to a person asserting claims against the protected series but also to a claimant against the series limited liability company and a claimant against any other protected series of the company.

EXAMPLE: Conference, LLC, a series limited liability company, has two protected series, Conference, LLC – Protected Series Alpha (“Alpha”) and Conference, LLC – Protected Series Beta (“Beta”). Each protected series owns assets, and each asset is an associated asset of the protected series that owns the asset. A judgment creditor of Alpha attempts to levy on an associated asset of Beta. The attempt will fail for two reasons: (i) the attempt is an effort to hold Beta liable for Alpha’s debts, which contravenes the non-liability rule; and (ii) the non-recourse rule protects Beta’s associated assets from claims except for claims asserted by Beta’s creditors.

EXAMPLE: Same facts, except that an asset owned by Beta is a “non-associated asset” – i.e., not associated with Beta (nor with Alpha or the series limited liability company). Although the asset remains Beta’s property, the asset is equally subject to levy by a judgment creditor of Alpha, Beta, or the series limited liability company.9

7. Overcoming the Shield

“Piercing the veil” is the foremost doctrine for overcoming the traditional, vertical shield separating an entity from its owners. “Conflation” is perhaps a more descriptive term, because the piercing doctrine ignores the formal separateness of entity and owner and treats them as if they were one. When a creditor succeeds with a piercing claim, the shield falls in toto. That is, all the owner’s non-exempt assets are available to the judgment creditor of the entity.10

9 If a judgment creditor of Alpha or the series limited liability company successfully levies on the asset, Beta may have an unjust enrichment claim against the judgment debtor and a damage action against the company for having failed to associate the item with Beta.

10 Piercing is based on a factor test. In the corporate context, two of the most prominent factors are the disregard of governance formalities and disregard of economic separateness between the entity and owners. “In the realm of LLCs, [the governance] factor is inappropriate, because informality of organization and operation is both common and desired.” ULLCA (2013) § 304(b), cmt. Some LLC statutes expressly negate governance informality as a piercing factor entirely, and some courts have discarded or downgraded the factor for LLC piercing claims. See, e.g., ULLCA (2013) § 304(b) (“The failure of a limited liability company to observe formalities relating to the exercise of its powers or management of its activities and affairs is not a ground for imposing liability on a member or manager for a debt, obligation, or other liability of the company.”); In re Packer, Bankruptcy No. 13–41304, 2014 WL 5100095 (Bankr. E.D. Tex. Oct. 10, 2014) (noting the informality of LLC governance, recognizing that “the disregard of corporate formalities … [is] one of the key factors in [corporate] veil-piercing determinations”; but holding that “it makes no sense to imperil the shield simply because the members do not undergo meaningless formalities such as formal meetings”) (citation and internal quotation marks omitted).
Doubtlessly, the piercing doctrine applies to the vertical shield between a series limited liability company and its owners. Presumably, the doctrine will also apply to the vertical shield between a protected series and its associated members. Likewise, the doctrine (or related theories of affiliate liability) will apply to the internal, horizontal shields — i.e., in the proper circumstances, a court will disregard the internal shields and negate the non-recourse rule as well as the non-liability rule.

This act’s association requirement creates an additional vulnerability for the internal shields. Even if a judgment debtor can easily defeat a piercing claim, a particular item of the protected series’ property might fail the association requirement and be up for grabs.

8. Traditional and Internal Shields Compared in Tabular Form

<table>
<thead>
<tr>
<th>type of shield</th>
<th>what the shield separates</th>
<th>non-liability rule</th>
<th>non-recourse rule</th>
<th>rules for overcoming the shield</th>
</tr>
</thead>
<tbody>
<tr>
<td>traditional, vertical corporate/LLC liability shield</td>
<td>an entity from its owners</td>
<td>stated expressly</td>
<td>unstated, but ineluctably implied</td>
<td>piercing – shield overcome in toto</td>
</tr>
<tr>
<td>internal, horizontal shields in a series limited liability company</td>
<td>one set of assets/operations from other sets of assets/operations</td>
<td>stated expressly</td>
<td>under this act only, stated expressly but only as to associated assets</td>
<td>piercing – shield overcome in toto under this act only, association requirement – non-recourse rule overcome item by item</td>
</tr>
</tbody>
</table>

**Structural Issues**

9. Structure of the Act – A Module to be Enacted as Part of a State’s Current Limited Liability Company Statute

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11 Courts have unanimously held that piercing applies to limited liability companies. See ULLCA (2013) § 304(b), cmt. (referring to “the equitable doctrine of ‘piercing the veil’” and stating that “courts regularly (and sometimes almost reflexively) apply that doctrine to limited liability companies”).
A protected series is inevitably connected with a limited liability company. Accordingly, protected series provisions are inserts into a jurisdiction’s existing limited liability company statute. This act takes the same approach, and is designed to work with any existing limited liability company statute.

10. Extrapolation – Providing Default Rules at the Protected Series Level

A protected series is a business organization, analogous in almost all respects to a limited liability company. Most limited liability company statutes provide default rules to address questions of internal affairs left unaddressed by a company’s operating agreement. See, e.g., ULLCA (2013), §105(b). The same need exists for a protected series.

This act meets that need by extrapolating the default rules of the limited liability company statute to address analogous issues at the protected series level. For example, suppose a protected series has four associated members but the operating agreement of the series limited liability company is silent on how the protected series is to be managed. The analogous question at the limited liability company level is how the company is to be managed. This act extrapolates the default rule at the limited liability company level to “fill the gap” and answer the question of how the protected series is to be managed. Under almost all limited liability company statutes, the default rule is management by members; hence, the associated members will manage the protected series.

Section 103 details the extrapolation paradigm:

- a protected series is treated as if it were a separate limited liability company;
- any associated member of the protected series is treated as if it were a member of the separate company;
- any protected series transforee of the protected series is treated as if it were a transforee of the separate company;
- any protected series transferable interest of the protected series is treated as if it were a transferable interest of the separate company;
- a series manager of the protected series is treated as if it were a person managing the separate company;
- any asset of the protected series is treated as if it were an asset of the separate company, whether or not the asset is an associated asset of the protected series; and
- any creditor or other obligee of the protected series is treated as if it were a creditor or obligee of the separate company.

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12 See Section 105(c)(1) (stating that “[a] protected series of a series limited liability company may not … continue to exist after the series limited liability company that established the protected series has completed its winding up).

13 A protected series does not have its own operating agreement. Rather, the operating agreement of a series limited liability company governs the internal affairs of a protected series of the company. See Section 107(tbd), cmt.

14 Merriam Webster defines “extrapolate” in relevant part to mean “to infer (values of a variable in an unobserved interval) [i.e., issues at the protected series level] from values within an already observed interval [i.e., default rules at the limited liability company level].” http://www.merriam-webster.com/dictionary/extrapolate, last visited 5/17/16.
When an operating agreement leaves unaddressed a question of internal affairs for a protected series, Section 107(c) invokes the Section 103 paradigm to fill the gap. See also Sections 103, cmt. and 107(c), cmt.

The extrapolation approach provides two significant advantages. First, the approach avoids burdening this act with lengthy provisions largely duplicative of provisions in the relevant limited liability company statute. Second, the approach imports to the protected series level the same policy choices on default rules reflected at the limited liability company level.

Not all issues at the protected series level are subject to extrapolation. This act contains four types of provisions:

- mandatory, non-variable provisions – e.g., Sections 105(c)(1) (providing that a protected series may not “continue to exist after the series limited liability company that established the protected series has completed its winding up”); 204(a)(1) (providing that a protected series may be served process by serving the series limited liability company that established the protected series); 15
- default, variable provisions, for situations in which extrapolation would be ineffective or produce an undesired result – e.g., Sections 303(b) (“If a protected series has no associated members when established, the series limited liability company owns the protected series transferable interests in the protected series.”); 304(b) (“Whenever a protected series has no associated members, the series limited liability company is the protected series manager.”);
- the extrapolation provision for internal affairs – i.e., Section 107(c); and
- extrapolation provisions crafted to address specific situations – e.g., Section 501(4)(a) (authorizing a court to dissolve a protected series “on application by … an associated member or protected series manager of the protected series: (i) in accord with the rules in Section 103; and (ii) to the same extent, in the same manner, and on the same grounds the court would enter an order dissolving a limited liability company on application by a member of or a person managing the company”).


Using the default rules of each state’s limited liability company statute facilitates enactment, as an enacting state need not revisit policy choices about the default rules for management structure, economic rights, information rights, etc.

This approach also produces parallelism in concept and terminology.

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15 Consistent with other uniform business organization acts, this act provides a single, centralized list of non-waivable and partially non-waivable provisions. See Section 109.
<table>
<thead>
<tr>
<th>concept</th>
<th>defined term pertaining to series limited liability company</th>
<th>defined term pertaining to a protected series</th>
</tr>
</thead>
<tbody>
<tr>
<td>person with both governance and economic rights</td>
<td>member</td>
<td>associated member</td>
</tr>
<tr>
<td>economic rights</td>
<td>transferable interest (rights to distributions from the series limited liability company)</td>
<td>protected series transferable interest (rights to distributions from a protected series)</td>
</tr>
<tr>
<td>owner of solely economic rights</td>
<td>transforee</td>
<td>protected series transferee</td>
</tr>
<tr>
<td>owned assets</td>
<td>property of (owned by) the series limited liability company</td>
<td>assets of (owned by) a protected series</td>
</tr>
<tr>
<td></td>
<td></td>
<td>associated asset/ non-associated asset of a protected series</td>
</tr>
</tbody>
</table>

12. Clarity and Safeguards of this Act Compared to Current Protected Series Statutes

This act seeks to provide greater “transparency” to the public and greater clarity as to the myriad legal questions raised by the protected series concept. The following chart identifies 21 key issues and compares this act with four statutes from across the non-uniform spectrum of current law.

16 A protected series can own an asset without the asset being associated with the protected series. This act labels this category of property as a “non-associated asset.” Only an associated asset is protected by the internal shields of a protected series. See Sections 301 and 402.
<table>
<thead>
<tr>
<th>Provisions Protecting Creditors or Providing Certainty</th>
<th>LLCPSA</th>
<th>Alabama</th>
<th>Delaware</th>
<th>Illinois</th>
<th>Texas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is a separate public filing necessary to establish each protected series?</td>
<td>Yes; § 201(b)</td>
<td>No</td>
<td>No</td>
<td>Yes; 805 ILL. COMP. STAT. 180/37-40(d)</td>
<td>No</td>
</tr>
<tr>
<td>Is protected series defined as a legal person?</td>
<td>Yes; § 102(7)</td>
<td>No</td>
<td>Yes; DEL. CODE ANN. tit. 6, § 18-101(12)</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Is the duration of protected series expressly limited to the duration of series limited liability company?</td>
<td>Yes; § 105(c)(1)</td>
<td>Yes; ALA. CODE § 10A-5A-11.09(a)</td>
<td>No</td>
<td>Yes; 805 ILL. COMP. STAT. 180/37-40(m)</td>
<td>Yes; TEX. BUS. ORGS. CODE § 101.616(1)</td>
</tr>
<tr>
<td>Must name of protected series include name of series limited liability company?</td>
<td>Yes; § 202</td>
<td>No</td>
<td>No</td>
<td>Yes; 805 ILL. COMP. STAT. 180/37-40(c)</td>
<td>No</td>
</tr>
<tr>
<td>Does each protected series have same registered agent as series limited liability company?</td>
<td>Yes; § 203</td>
<td>No</td>
<td>No</td>
<td>Yes; 805 ILL. COMP. STAT. 180/37-40(f)</td>
<td>No</td>
</tr>
<tr>
<td>Can service on protected series be made by serving series limited liability company?</td>
<td>Yes; § 204</td>
<td>No</td>
<td>No</td>
<td>Yes; 805 ILL. COMP. STAT. 180/37-40(f)</td>
<td>No</td>
</tr>
<tr>
<td>Provisions Protecting Creditors or Providing Certainty</td>
<td>LLCPSA</td>
<td>Alabama</td>
<td>Delaware</td>
<td>Illinois</td>
<td>Texas</td>
</tr>
<tr>
<td>-------------------------------------------------------</td>
<td>--------</td>
<td>---------</td>
<td>----------</td>
<td>----------</td>
<td>-------</td>
</tr>
<tr>
<td>Does the statute specify rules for disregarding the internal shields that protect the assets of one protected series from the creditors of another, other than a general recordkeeping requirement?</td>
<td>Yes; § 401</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Are there “asset by asset” consequences for assets not properly associated with a protected series, even if the internal shields remain in place?</td>
<td>Yes; § 402</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Does the statute preclude associating property after a claim against the property has been made?</td>
<td>Yes; § 402</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Provisions Protecting Creditors or Providing Certainty</td>
<td>LLCPSA</td>
<td>Alabama</td>
<td>Delaware</td>
<td>Illinois</td>
<td>Texas</td>
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</tr>
<tr>
<td>Do special recordkeeping requirements apply to transfers between a series limited liability company and a protected series of the company and between protected series of the company?</td>
<td>Yes; § 301(b)</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>If the statute expressly permits associated assets to be held by a nominee, etc., does the statute limit permission in any way?</td>
<td>Yes; § 301(c)</td>
<td>No</td>
<td>No; Del. Code Ann. tit. 6, § 18-215(b)</td>
<td>No; 805 Ill. Comp. Stat. 180/37-40(b)</td>
<td>No; Tex. Bus. Orgs. Code § 101.603(a)</td>
</tr>
<tr>
<td>Does the statute address specifically the rights of judgment creditors of associated members?</td>
<td>Yes; 403(1)</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
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</tr>
<tr>
<td>Does the statute expressly and directly require membership in the limited liability company as prerequisite to being associated member of protected series?</td>
<td>Yes; § 103(a)(2)</td>
<td>Yes; ALA. CODE § 10A-5A-11.01(c)</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Does the statute address how provisions in the limited liability company statute apply at the protected series level?</td>
<td>Yes; §§ 103, 107(c)</td>
<td>Yes</td>
<td>No</td>
<td>Yes; 805 ILL. COMP. STAT. 180/37-40(j)</td>
<td>Yes; TEX. BUS. ORGS. CODE §§ 101.609, 101.617</td>
</tr>
<tr>
<td>Does the statute address whether associated members of a protected series have veto rights to operating agreement amendments affecting the protected series?</td>
<td>Yes; § 304(d)</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Provisions Protecting Creditors or Providing Certainty</strong></td>
<td><strong>LLCPA</strong></td>
<td><strong>Alabama</strong></td>
<td><strong>Delaware</strong></td>
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<tr>
<td>Does the statute contain rules for protected series that the operating agreement cannot vary?</td>
<td>Yes; § 109</td>
<td>Yes, but limitation applies only to requirements for maintaining internal shields; ALA. CODE § 10A-5A-1.08(c)(15) (referring to ALA. CODE § 10A-5A-11.02(b)).</td>
<td>No</td>
<td>No</td>
<td>Yes, but limitation applies only to requirements for maintaining internal shields; TEX. BUS. ORGS. CODE § 101.054(a)(2) (referring to TEX. BUS. ORGS. CODE § 101.602(b))</td>
</tr>
<tr>
<td>Does the statute provide for registering foreign protected series to do business in the state?</td>
<td>Yes; § 604</td>
<td>No</td>
<td>No</td>
<td>Yes; 805 ILL. COMP. STAT. 180/37-40(o)</td>
<td>No</td>
</tr>
<tr>
<td>Does the statute require foreign protected series doing business in the state to comply with same name requirements as domestic protected series?</td>
<td>Yes; § 604(c)</td>
<td>No</td>
<td>No</td>
<td>Yes; 805 ILL. COMP. STAT. 180/37-40(c)</td>
<td>No</td>
</tr>
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<td>Provisions Protecting Creditors or Providing Certainty</td>
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<tr>
<td>Does the statute require a foreign protected series to disclose either (i) information regarding the foreign series limited liability company and other foreign protected series of the company comparable to the information available from the public record regarding a domestic protected series or (ii) the identity of an individual who has this information?</td>
<td>Yes; §§ 605, 604(b)(2)</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Does the statute permit a court to use enacting state’s piercing law on foreign protected series if foreign state’s law “repugnant” to the public policy of the enacting state?</td>
<td>Yes; § 601(b)</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
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</tr>
<tr>
<td>Does the statute expressly address whether the series limited liability company may own an interest in a protected series of the company?</td>
<td>Yes; § 303(a)</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>
LIMITED LIABILITY COMPANY PROTECTED SERIES ACT

[ARTICLE] 1

GENERAL PROVISIONS

SECTION 101. SHORT TITLE. This [act] may be cited as the Limited Liability Company Protected Series Act.

{{Note to Drafting Committee (“NTDC”) – Consultation is pending with the Committee on Style and the Executive Director as to how the name should reflect the act’s scope as a “plug in” to other acts.}}

SECTION 102. DEFINITIONS. In this [act]:

(1) “Asset” means property:

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

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

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

(3) “Associated member” means, with respect to a protected series, a member that meets the requirements stated in Section 302.

(4) “Foreign protected series” means a protected series established by a foreign limited liability company and having attributes comparable to a protected series established under this [act]. The term applies whether or not the law under which foreign company is organized refers to “protected series” or “series”.

(5) “Foreign series limited liability company” means a foreign limited liability company having at least one foreign protected series.

(6) “Non-associated asset” means an asset of a series limited liability company or protected series of the company which is not an associated asset of the company or protected series.
(7) “Person” has the meaning stated in [cite the limited liability company statute’s definition of “person” – see, e.g., Uniform Limited Liability Company Act (2013), Section 102(15)]. The term includes a protected series, whether referred to as a “protected series” or “series”.

(8) “Protected series”, except in the phrase “foreign protected series”, means a person established under Section 201.

(9) “Protected series manager” means a person under whose authority the powers of a protected series are exercised and under whose direction the activities and affairs of the protected series are managed pursuant to the operating agreement, this [act], and [the limited liability company statute].

(10) “Protected series transferable interest” means a right to receive a distribution from a protected series.

(11) “Protected series transferee” means a person to which all or part of a protected series transferable interest has been transferred. The term includes a person that owns a protected series transferable interest as a result of ceasing to be an associated member of a protected series.

(12) “Series limited liability company”, except in the phrase “foreign series limited liability company”, means a limited liability company having at least one protected series.

Legislative Note: Because this act is intended to be inserted into a state’s current limited liability company statute, this section does not define terms already defined in the Uniform Limited Liability Company Act (2006) (Last Amended 2013). This act presupposes the following definitions from that act:
Each enacting state should determine whether its limited liability company statute defines the terms listed in this Legislative Note. If a state’s limited liability company statute lacks a particular term entirely, the state should adopt the term as defined in the Uniform Limited Liability Company Act (2013), Section 102. If a state act defines a particular concept but uses a different label – e.g., limited liability company interest instead of transferable interest – the state should modify this act accordingly.

**Comment**

**“Asset” [1]** – This definition derives from Uniform Commercial Code (“UCC”) § 9-203(b)(2) and is intended to have the same meaning. The UCC provision states as a precondition to the enforceability of a security interest in collateral that “the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party.”

Property that is subject to a security interest, mortgage, or other lien is nonetheless an asset under this definition; the definition does not affect the rights of lienholders. An asset remains an asset even if “under water” (i.e., the amount owed and secured by the asset exceeds the value of the asset).

**“Associated asset” [2]** – This definition is key to establishing and delineating the “internal shields” provided by Section 401(a)(1)-(4). Even if a protected series is not liable for the debts of its series limited liability company or any other protected series of the company (i.e., no affiliate liability), an asset owned by a protected series is available for creditors of the company or another protected series of the company unless the asset is an associated asset of the protected series. See Section 301 for the recordkeeping required for an asset to obtain and maintain “associated asset” status. See also Section 402 (providing that only an associated asset of a protected series is shielded from claims from creditors of the series limited liability company and other protected series of the company). The same rules apply to assets owned by a series limited liability company.
“Associated member” [3] – Except for requiring that a person be a member of a series limited liability company in order to be an associated member of a protected series of the company, this act does not determine how a member becomes an associated member of a protected series. The operating agreement must address this important question. See Section 302(b).

“Foreign protected series” [4] – This definition is derived from ULLCA § 102(5), which defines “foreign limited liability company” as “an unincorporated entity formed under the law of a jurisdiction other than this state which would be a limited liability company if formed under the law of this state.”

This act characterizes a domestic protected series as a person, Section 104, but this definition omits that characterization. Most current statutes do not address the characterization issue.

“Person” [7] – The definition of “person” in ULLCA (2013) § 102(15) does not expressly include a protected series, although that definition’s catchall term – “other … commercial entity” – might apply. {{NFDC – trailing amendment might moot this point.}}


“Protected series transferee” [11] – A protected series transferee is analogous to a transferee of a membership interest, see ULLCA (2013) § 102(25), and the definition includes an associated member of a protected series to whom is transferred a protected series transferable interest owned by another person. In the analogous context of non-series limited liability companies, parties have contested whether a member who acquires a transferable interest from another person needs the consent of fellow members to acquire voting or consent rights corresponding to the acquired transferable interest. See, e.g., Achaian, Inc. v. Leemon Family L.L.C., 25 A.3d 800, 810 (Del. Ch. 2011) (Strine, Ch.); Blythe v. Bell, No. 11 CVS 933, 2012 WL 6163118 (N.C. Super. Dec. 10, 2012). Under ULLCA (2013), in the default mode the question is moot because members consent or vote per capita. See ULLCA (2013) §§ 501, cmt. and 502, cmt.

Where, however, the applicable limited liability company statute or operating agreement allocates voting or consent rights in terms of economic rights, the operating agreement should expressly resolve the question. The same is true with regard to a protected series and the acquisition by an associated member of another person’s protected series transferable interest.

In the latter case, if the operating agreement fails to address the issue, under Sections 103 and 107(c) the question will be resolved under the default rules of the applicable limited liability company statute. Because these provisions extrapolate from the applicable limited liability company statute and not the operating agreement, see Section 103(a), cmt., this result will obtain even if the operating agreement does address the question at the limited liability company level unless:

- the operating agreement contains a provision applying terms pertaining at the limited liability company level to analogous situations at the protected series level; or
a court determines as a matter of contract interpretation that the members of the series limited liability company intended the rule on this issue to be the same at both the limited liability company and protected series levels.

The second sentence of the definition contemplates rules such as ULLCA (2013) § 603(a)(3) (providing that “[i]f a person is dissociated as a member . . . any transferable interest owned by the person in the person’s capacity as a member immediately before dissociation is owned by the person solely as a transferee”), made applicable at the protected series level by Sections 103 and 107(c).

1. SECTION 103. RULES APPLICABLE WHEN APPLYING [LIMITED LIABILITY COMPANY STATUTE] TO [ACT].

   (a) Subject to subsection (b) and for the purposes of applying Sections 107(c), 108, 501(4)(A)(i), and 502(a), the following rules apply:

   (1) a protected series of a series limited liability company is deemed to be a limited liability company, organized separately from the series limited liability company that established the protected series and distinct from the company and any other protected series of the company;

   (2) any associated member of the protected series is deemed to be a member of the company deemed to exist under paragraph (1);

   (3) any protected series transferee of the protected series is deemed to be a transferee of the company deemed to exist under paragraph (1);

   (4) any protected series transferable interest of the protected series is deemed to be a transferable interest of the company deemed to exist under paragraph (1);

   (5) a series manager of the protected series is deemed to be a person managing the company deemed to exist under paragraph (1);

   (6) any asset of the protected series is deemed to be an asset of the company deemed to exist under paragraph (1), whether or not the asset is an associated asset of the
protected series;

(7) Any creditor or other obligee of the protected series is deemed to be a creditor or obligee of the company deemed to exist under paragraph (1).

(b) Subsection (a) does not apply if its application would:

(1) vary the effect of Sections 108 or [cite limited liability company statute provision limiting the power of an operating agreement – see, e.g., Uniform Limited Liability Company Act (2013), Section 105];

(2) require the [Secretary of State] to:

(A) accept for filing a type of record that neither this [act] nor [the limited liability company statute] authorizes or requires a person to deliver to the [Secretary of State] for filing; or

(B) make or deliver a record that that neither this [act] nor [the limited liability company statute] authorizes or requires the [Secretary of State] to make or deliver.

Comment

Subsection (a) – The provision provides the mechanics for the extrapolation approach which is at the core of this act. See Prefatory Note, Part 10. In effect, this provision “deems up” each construct at the protected series level to the analogous construct at the limited liability company level. This provision is not self-executing. It applies only when a provision of this act expressly invokes Section 103.

The provision does not “deem up” a protected series designation and does not refer to the operating agreement. A protected series designation has no analog at the limited liability company level. A certificate of formation would be the closest, but that certificate does far more than is done by a protected series designation. As for the operating agreement, again no analog exists. A protected series does not have its own operating agreement.

Subsection (b)(2) – This provision does not address the question of whether the filing office may, may not, or shall accept for filing a record that includes information beyond that specified by the statute that provides for the filing of the record.

SECTION 104. NATURE OF PROTECTED SERIES. A protected series of a series limited liability company is a person distinct from:
(1) the company, except as otherwise provided in Section 105(c)(1);

(2) another protected series of the company;

(3) a member of the company, whether or not the member is an associated member of the protected series;

(4) a protected series transferee of any protected series of the company;

(5) a transferee of a transferable interest of the company.

**Comment**

Section 105(c)(1) provides that a protected series cannot exist on its own; therefore, a protected series is not entirely distinct from the limited liability company whose existence is a precondition to the existence of the protected series.

2. **SECTION 105. POWERS AND DURATION OF PROTECTED SERIES.**

   (a) A protected series has the capacity to sue and be sued in its own name.

   (b) Except as otherwise provided in subsection (c), a protected series has the same powers that a limited liability company has under [cite the provision of the limited liability company statute specifying a limited liability company’s powers – see, e.g., Uniform Limited Liability Company Act (2013), Section 109].

   (c) A protected series of a series limited liability company may not:

      (1) continue to exist after the series limited liability company that established the protected series has completed its winding up;

      (2) be a member of the company;

      (3) establish a protected series;

      (4) have a protected series transferable interest, management or voting right, or any other right in another protected series of the company;

      (5) be a party to a merger, interest exchange, conversion, domestication, or
comparable transaction;

(6) except as permitted by law of this state, do anything or have any purpose that
the law of this state prohibits a limited liability company from doing or having[; or]

(7) ....

Legislative Note: Section 105(c)(7) is provided in case an enacting state decides that a power, a purpose, or conduct acceptable for a limited liability company is not acceptable for a protected series.

Comment

Subsection (a) – This subsection cannot be varied by the operating agreement. Section 109(3).

Subsection (b) – This act incorporates by reference the powers of a limited liability company under the relevant limited liability company statute. If that statute contains a detailed list of powers, the same list applies at the protected series level (subject to restriction by the operating agreement).

Beginning with ULPA (2001) § 105, the Uniform Law Commission has eschewed listing in detail the powers of a business organization. See, e.g., Uniform Limited Liability Company Act (2013), Section 109 (“A limited liability company has … the power to do all things necessary or convenient to carry on its activities and affairs.”) The approach has caused no problems to date, and for Uniform Limited Liability Company Act (2013) and comparable statutes, this subsection incorporates by reference a general grant of powers.

Those general powers certainly include the power to make contracts and own real and other property, which are key attributes to the concept of a legal person. Changes in the Model Business Corporation Act Relating to Domestication and Conversion—Final Adoption, 58 Bus. Law. 219, 223 (2002) (adding a new definition to the Model Business Corporation Act, Section 1.04(24A) (providing that “‘[u]nincorporated entity’ means an organization or artificial legal person that either has a separate legal existence or has the power to acquire an estate in real property in its own name …”). Cf. Katsuhito Iwai, “Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance, 47 Am. J. Comp. L. 583, 583 (1999) (“The law speaks of a business corporation as a ‘legal person,’ as a subject of rights and duties capable of owning real property, entering into contracts, and suing and being sued in its own name …”); Uniform Business Organizations Code, Section 1-102(A)(x)(II) (defining “entity” to include inter alia “any … person that has … the power to acquire an interest in real property in its own name”).

Pac Re 5-AT v. Amtrust N. Am., Inc., No. CV-14-131-BLG-CSO, 2015 WL 2383406, at *4 (D. Mont. May 13, 2015) is distinguishable, because the statute at issue there differs fundamentally from this act. Pac Re interpreted the Montana statute that provided for protected
cell captive insurance companies [PCC]). The decision noted that “the statute does not contemplate that the assets of a protected cell will be used to satisfy the liabilities of any other cell” but held that “[w]ithout a separate legal identity, and absent a statutory grant to the contrary, a protected cell does not have the capacity to sue and be sued independent of the larger PCC”). In contrast, Section 104 expressly states that a protected series is a legal person, and Section 105(a) specifically provides the capacity to sue and be sued.

Just as the operating agreement may limit the powers of a limited liability company, the operating agreement may limit the power of the protected series of a limited liability company. If the operating agreement restricts the company’s powers, the agreement will likely impose the same limits on the powers of any protected series of the company. If not, under this subsection a protected series will have broader powers than its series limited liability company.

**Subsection (c)(1)** – A protected series may not exist outside the context of the series limited liability company that established it. This provision is non-variable. Section 109(5) {{NTDC – revisit if mergers authorized}}

**Subsections (c)(2)-(4)** – These limitations, which the operating agreement cannot vary, Section 109(5), preclude structures that would be painfully Byzantine or would push the extrapolation construct beyond any understandable application. For a discussion of the extrapolation construct, see Prefatory Note, Part 10.

**Subsection (c)(4)** – This provision does not prevent one protected series from being a protected series manager of another protected series of the series limited liability company. A protected series manager is an agent of the protected series, and an agent does not “have rights” in its principal.

**Subsection (c)(5)** – {{NTDC – to be revisited after the committee re-visits whether to allow simple mergers}}.

**Subsection (c)(6)** – A limited liability company may not use a protected series to evade a requirement of other law. This provision’s introductory language – “[e]xcept as permitted by law of this state …” – refers to situations in which state law authorizes a protected series of a series limited liability company to operate under the auspices of a license obtained or regulatory filing made by the company in the company’s name.

This provision refers to permitted purposes as well as powers but does not otherwise prescribe the purpose of a protected series. If the operating agreement does not address the question, Sections 103 and 107(c) will extrapolate to the protected series level whatever purposes the limited liability company statute authorizes for a limited liability company. If an operating agreement restricts the purposes of a series limited liability company but does not accordingly restrict the purpose of the protected series of the company, the result may be anomalous. A protected series will have broader permitted purposes than the series limited liability company itself. A comparable issue exists with regard to powers. See Subsection (b), cmt. (last paragraph).
SECTION 106. GOVERNING LAW. The law of this state governs:

(1) the internal affairs of a protected series;

(2) the relations between a protected series and:

   (A) the series limited liability company that established the protected series;

   (B) another protected series of the company;

   (C) a member that is not an associated member of the protected series;

   (D) a protected series manager that is not a protected series manager of the
       protected series;

   (E) a protected series transferee that is not a protected series transferee of the
       protected series;

   (3) the liability of a person for a debt, obligation, or other liability of a protected series if
       the debt, obligation, or other liability is asserted solely by reason of the person being or acting as:

       (A) an associated member, protected series transferee, or protected series manager
           of the protected series;

       (B) a member of the limited liability company that established the protected series
           which is not an associated member of the protected series;

       (C) a protected series manager that is not a protected series manager of the
           protected series;

       (D) a protected series transferee that is not a protected series transferee of the
           protected series;

       (E) a person managing the company; or

       (F) a transferee of a transferable interest of the company;

   (4) the liability of a series limited liability company for a debt, obligation, or other
liability of a protected series established by the company if the debt, obligation, or other liability is asserted solely by reason of the company:

(A) having established the protected series;
(B) being or acting as a protected series manager of the protected series;
(C) having the protected series be or act as person managing the company; or
(D) owning a protected series transferable interest of the protected series;

(5) the liability of a protected series for a debt, obligation, or other liability of the series limited liability company that established the protected series or for a debt, obligation, or other liability of another protected series of the company if the debt, obligation, or other liability is asserted solely by reason of:

(A) the protected series:
   (i) being a protected series of the company or having as a protected series manager the company or another protected series of the company; or
   (ii) being or acting as a protected series manager of another protected series of the company or as a person managing the company; or
(B) the company owning a protected series transferable interest of the protected series.

Comment

**Paragraph (1)** – The concept of “internal affairs” presupposes an organization that is a legal person and thus applies to a protected series under this act. See Section 104 (stating that “[a] protected series … is a person”).

The internal affairs of a protected series include: (i) relations among associated members, if any, and between associated members, if any, and the protected series; (ii) relations between a protected series transferee and the protected series and any associated members; (iii) the rights and duties of a protected series manager; (iv) governance decisions affecting the activities and affairs of the protected series and the conduct of those activities and affairs; and (v) procedures and conditions for becoming an associated member. For a detailed discussion of “internal
Paragraph (2) – The listed relationships are not within the internal affairs of a protected series. Arguably, the relationships are part of the internal affairs of the series limited liability company, see Uniform Limited Liability Company Act (2013), Section 104(1) (stating that “[t]he law of this state governs … the internal affairs of a limited liability company”). This provision is included for the avoidance of doubt.

3. SECTION 107. RELATION OF OPERATING AGREEMENT, THIS [ACT], AND [LIMITED LIABILITY COMPANY STATUTE].

(a) Except as otherwise provided in this section and subject to Sections 108 and 109, the operating agreement of a series limited liability company governs:

(1) the internal affairs of a protected series;

(2) relations among the protected series, the company, and any other protected series of the company;

(3) relations between the protected series, its protected series manager, any associated member of the protected series, or any protected series transferee of the protected series and another person in the other person’s capacity as:

(A) a member of the company which is not an associated member of the protected series;

(B) a protected series transferee or protected series manager of another protected series; or

(C) a transferee of the company.

(b) If the operating agreement of a series limited liability company does not provide for a matter described in subsection (a), this [act] governs the matter.
(c) If neither the operating agreement nor this [act] provides for a matter described in subsection (a), [the limited liability company statute] governs the matter according to the rules stated in Section 103.

(d) Subsection (c) does not apply if its application would:

(1) vary the effect of Section 108 or 109; or

(2) require the [Secretary of State] to:

   (A) accept for filing a type of record that neither this [act] nor [the limited liability company statute] expressly authorizes or requires a person to deliver to the [Secretary of State] for filing; or

   (B) make or deliver a record that neither this [act] nor [the limited liability company statute] expressly authorizes or requires the [Secretary of State] to make or deliver.

Comment

A protected series does not have an operating agreement of its own, and the operating agreement of a series limited liability company should adequately address issues at the protected series level. Some operating agreements use exhibits or appendixes to address most, or all, of those issues. (If not all, presumably the other issues are addressed in the main body of the agreement.)

Unless prohibited by the operating agreement, associated members of a protected series may make contracts among themselves pertaining to the protected series. To the extent permitted by other law (principally the law of contracts), such contracts bind the parties but have no effect on the operating agreement or the rights and duties of members of the series limited liability company who are not party to the agreement (whether or not the non-party member is an associated member of the protected series).

Subsection (a)(1) – See Section 106(1), cmt.

Subsection (a)(3) – {{NTDC: Query – what about an associated member of the protected series in a different capacity (e.g., as a member simpliciter or as an associated member of a different protected series)?}}

Subsection (e) – Most limited liability company statutes provide default rules to address questions of internal affairs left unaddressed by a company’s operating agreement. See, e.g.,
Uniform Limited Liability Company Act (2013), Section 105(b). Comparable gaps can exist at the protected series level, but, unlike a limited liability company statute, this act does not provide a full set of “gap fillers.” Instead, this act assumes that, in most circumstances, the default rules in place at the limited liability company level are equally appropriate at the protected series level. This act does state some rules pertaining to the internal affairs of a protected series, but these rules are not comprehensive.

Thus, a question may arise pertaining to the internal affairs of a protected series to which neither the operating agreement nor this act provides an answer. In that situation, this provision and Section 103 invoke the limited liability company statute, and the answer is determined by extrapolating to the protected series level the rule for the analogous situation at the limited liability company level. Section 103 provides the extrapolation paradigm – i.e., using the default rules of the limited liability company statute while treating a protected series as if it were a limited liability company, an associated member of the protected series as if it were a member of that “as if” limited liability company, etc. See Prefatory Note, Part 10.

This subsection applies only to a protected series’ internal affairs and not, for example, to this act’s definitions. Of course, a provision of an operating agreement which violates Section 108 or 109 is ineffective to “provide for” a matter.

4. **SECTION 108. [LIMITED LIABILITY COMPANY STATUTE’S] LIMITS ON OPERATING AGREEMENT APPLICABLE TO MATTERS UNDER THIS ARTICLE.**

If [the limited liability company statute – see, e.g., Uniform Limited Liability Company Act (2013), Section 105(c), (d)(3), and (e)] prohibits an operating agreement from varying a provision of [the limited liability company statute], limits the extent to which the agreement may vary a provision, or restricts the agreement in any other way, the prohibition, limitation, or restriction applies to a matter under this [act] according to the rules stated in Section 103.

**Comment**

In concert with Section 103, this provision makes certain that restrictions stated in the limited liability company statute on the powers of an operating agreement apply to analogous situations at the protected series level. For example, Sections 103 and 107(c) extrapolate the concept of a derivative claim to the protected series level. Uniform Limited Liability Company Act (2013), Section 105(c)(11) prohibits an operating agreement from imposing unreasonable restrictions on *inter alia* a member’s right to bring a derivative claim. Under this section and Section 103, that prohibition applies to the right of an associated member of a protected series to bring a derivative claim pertaining to the protected series.
SECTION 109. ADDITIONAL LIMITATIONS ON OPERATING AGREEMENT.

An operating agreement may not vary:

(1) this section; 

(2) the nature of a protected series as stated in Section 104; 

(3) the capacity of a protected series under Section 105(a) to sue and be sued in its own name; 

(4) Section 105(b) to provide a protected series a power in addition to the powers provided to a limited liability company under [the limited liability company statute]; 

(5) the limitations stated in Section 105(c) on the powers of a protected series; 

(6) the law applicable under Section 106; 

(7) the application under Section 108 of prohibitions, limitations, and restrictions on the operating agreement; 

(8) the requirements and procedures under Section 201 for establishing a protected series, except that the operating agreement may vary the manner in which a limited liability company authorizes establishing a protected series; 

(9) the requirements in Section 202 for the name of a protected series; 

(10) the requirements and procedures in Section 301 for making an asset an associated asset; 

(11) the requirements under Section 302 that:

(A) a person be a member of a series limited liability company to be an associated member of a protected series of the company; and 

(B) a person’s dissociation as a member simultaneously causes the person to cease to be an associated member of any protected series of the company;
(12) the requirement under Section 303(a) that a protected series transferable interest must be owned initially by an associated member of the protected series or the series limited liability company that established the protected series;

(13) the principles identified in Section 401(b) as governing claims to disregard a limitation of liability stated in Section 401(a);

(14) the procedures and requirements under Section 402 to enforce claims against non-associated assets;

(15) the rights under Section 403 of a judgment creditor;

(16) the circumstances stated in Section 501(1) and (4) as causing dissolution of a protected series;

(17) Section 502, pertaining to winding up of a dissolved protected series, except to designate a different person to manage winding up;

(18) [Article] 6

(19) [Article] 7

(20) a provision of this [act] pertaining to:

   (A) registered agents; or

   (B) the [Secretary of State], including provisions pertaining to records authorized or required to be delivered to the [Secretary of State] for filing under this [act]; or

(21) the rights under this [act] of a person other than a series limited liability company, a protected series, a protected series manager, or a member, whether or not an associated member of a protected series, to the prejudice of the person, except to the extent that [the limited liability company statute] permits the operating agreement to vary the rights of a person not a member or manager of a limited liability company.
Comment

Sometimes—but not always—the comments to this act refer to a variable provision as a “default rule” and a mandatory provision as “non-variable.” These references are merely to draw attention to the default/mandatory distinction in particular contexts and have neither the intent nor the power to affect the default/mandatory status of provisions of this act whose comments lack a comparable reference.

Paragraph (4) (Section 105(b)) – A protected series can have no greater power than the limited liability company statute accords a limited liability company. However, nothing in this act precludes the operating agreement from reducing, restricting, or eliminating particular powers.

A restriction stated as to the powers of a series limited liability company does not automatically apply to a protected series of the company. To the contrary, if the operating agreement does not address the issue at the protected series level, Section 105(b) accords the protected series the full powers of a limited liability company. See also Section 105(b), cmt.

Paragraph (8) (Section 201) – For example, the operating agreement might decrease the quantum of member consent required to authorize establishing a protected series or grant the authority exclusively to the persons managing the limited liability company.

Paragraph (13) (Section 401) – Although the piercing principles may not be varied, the shields themselves – both vertical and horizontal – are variable. The same is true as to the vertical shields provided by the Uniform Limited Liability Company Act (2013), Uniform Limited Partnership Act (2013), and Uniform Partnership Act (2013). See ULLCA (2013) § 105(c) (not including the shield in the list of non-variable provisions); ULPA (2013) § 105(c) (same); UPA (2013) (same).

Paragraph (16) (Section 501(4)) – The operating agreement may not change the stated grounds for judicial dissolution but may determine the forum in which a claim for dissolution under Section 501(4) is determined. For example, arbitration and forum selection clauses are commonplace in business relationships in general and in operating agreements in particular.

Paragraph (21) – {{NTDC – Further analysis required to determine whether this provision can be re-phrased in terms of extrapolation.}}

[ARTICLE] 2

ESTABLISHING PROTECTED SERIES

5. SECTION 201. PROTECTED SERIES DESIGNATION; AMENDMENT OF DESIGNATION.

(a) With the affirmative vote or consent of all members of a limited liability company, the
company may establish a protected series.

(b) To establish a protected series, a limited liability company must deliver to the [Secretary of State] for filing a protected series designation, signed by the company, stating the name of the company and the name of the protected series to be established.

(c) A protected series is established when the protected series designation becomes effective under [cite to provision of limited liability company statute determining when a record delivered for filing becomes effective – see, e.g., Uniform Limited Liability Company Act (2013), Section 207].

(d) A series limited liability company may amend a protected series designation by delivering to the [Secretary of State] for filing a statement of designation change that changes the name of the company or the name of the protected series to which the designation applies or both. The change takes effect when the statement of designation change becomes effective under [cite to provision of limited liability company statute determining when a record delivered for filing becomes effective – see, e.g., Uniform Limited Liability Company Act (2013), Section 207].

**Legislative Note:** If the limited liability company statute of an enacting state requires the certificate of formation, however denominated, to identify a person with governance authority, the same requirement should appear in subsection (b).

Subsection (b) presupposes that an enacting state’s limited liability company statute will determine who may sign this record. See, e.g., Uniform Limited Liability Company Act (2013), Section 203(a)(1) (stating that in general “a record signed by a limited liability company must be signed by a person authorized by the company”). If no such “catch-all” provision exists, either this act or the limited liability company statute should be revised accordingly.

**Comment**

The operating agreement of a series limited liability company cannot vary this section, except to change the approval method stated in subsection (a). Section 109(8).

**Subsection (b)** – Because a protected series designation is a record created by a limited liability company, the limited liability company statute directly determines who has authority to
sign for the company and when the designation becomes effective, etc. See, e.g., Uniform Limited Liability Company Act (2013) §§ 203(a)(1) (stating that in general “a record signed by a limited liability company must be signed by a person authorized by the company”); Section 207 (pertaining to effective date and time).

Subsection (c) – A protected series may be established without associated members. Contrast Uniform Limited Liability Company Act (2013), Section 201(d) (“A limited liability company is formed when the certificate of organization becomes effective and at least one person has become a member.”) Likewise, a protected series may be established without any assets (whether or not associated).

If a protected series is established without associated members, the series limited liability company:

- owns all the protected series transferable interests, Section 303(b) (applicable only at establishment and subject to subsequent transfers by the company); and
- is the series manager of the protected series, Section 304(b) (applicable throughout the existence of the protected series – i.e., whenever a protected series has no associated members).

Subsection (d) – This provision uses “statement of designation change” to avoid confusion with statutes that use “statement of change” for a different purpose. See, e.g., Uniform Limited Liability Company Act (2013), Section 116 (Change of Registered Agent or Address for Registered Agent by Limited Liability Company).

The decision to file a statement of designation change will typically be within the ordinary course of the activities and affairs of a series limited liability company and essentially ministerial. For example, if a company changes its name, the company must change accordingly the name of each protected series of the company. See Section 202(b)(1), 202(c) cmt. In contrast, the decision to change the company’s name might be neither ministerial nor in the ordinary course.

For the reasons stated in the comment to subsection (b), the limited liability company statute governs who has authority to sign for the company a statement of designation change, etc.

SECTION 202. NAME.

(a) Except as otherwise provided in subsection (b), the name of a protected series must comply with [the provision of the limited liability company statute or other statute imposing name requirements on a limited liability company – see, e.g., Uniform Limited Liability Company Act (2013), Section 112].

(b) The name of a protected series of a series limited liability company must:

(1) begin or end with the name of the company, including any word or abbreviation required by [cite the “designator” provision of the limited liability company statute]
– see, e.g., Uniform Limited Liability Company Act (2013), Section 112(a)] [other statute imposing name requirements on a limited liability company – see, e.g., Uniform Business Organizations Code (2013) Section 1-302(d)] to designate that the company is a limited liability company; and

(2) contain the phrase “Protected Series” or “protected series” or the abbreviation “P.S.” or “PS”.

(c) If a series limited liability company changes its name, the company shall deliver to the [Secretary of State] for filing a statement of designation change for each of the company’s protected series, changing the name of each protected series to comply with this section.

Comment

Subsection (b)(1) – This provision, together with the filing requirement of Section 201(b) (statement of designation), provides substantial transparency, allowing a person to search the public record to determine:

- whether a limited liability company is a series limited liability company;
  - if so, the identity of all protected series of the company; and
- whether an organization is a protected series;
  - if so, the identity of the series limited liability company and any other protected series of the company.

For similar protections with regard to foreign protected series, see Sections 604(c) and 605. {{NTDC – Reporter will check with IACA for the views of the filing offices on “begin or end with” versus “begin with”;

Subsections (b)(1) and (c) – Due to these provisions, a series limited liability company that changes its name must change accordingly the name of each of the company’s protected series.

6. SECTION 203. REGISTERED AGENT.

(a) The registered agent in this state for a series limited liability company is the registered agent in this state for each protected series of the company.

(b) Before delivering a protected series designation to the [Secretary of State] for filing, a limited liability company shall contract with a registered agent for the agent to serve as the
registered agent in this state for both the company and the protected series.

(c) A person that signs a protected series designation delivered to the [Secretary of State] for filing affirms as a fact that the limited liability company on whose behalf the designation is delivered has complied with subsection (b).

(d) A person that ceases to be the registered agent for a series limited liability company ceases to be the registered agent for each protected series of the company.

(e) A person that ceases to be the registered agent for a protected series of a series limited liability company ceases to be the registered agent of the company and of any other protected series of the company.

(f) Except as otherwise agreed by a series limited liability company and its registered agent, the agent is not obligated to distinguish between a process, notice, demand, or other record concerning the company and a process, notice, demand, or other record concerning a protected series of the company.

**Comment**

**Subsection (a)** – It is not necessary for this act to state what happens when a protected series lacks an agent for service of process. In that situation: (i) under this subsection the company perforce also lacks an agent; (ii) under most limited liability company statutes that lack, if uncorrected, will lead to administrative dissolution; and (iii) under section 501(1), that dissolution causes the protected series to dissolve.

**Subsection (b)** – This provision refers to a limited liability company rather than a series limited liability company so as to encompass a limited liability company that is preparing to establish its first protected series.

**Subsection (c)** – This provision is derived from ULLCA (2013) § 203(c): “A person that signs a record as an agent or legal representative affirms as a fact that the person is authorized to sign the record.”

**Subsections (d) and (e)** – These provisions followed inevitably from subsection (a) but are included here for the avoidance of doubt.

**Subsection (f)** – Under this provision, unless otherwise agreed, the series limited liability
company rather than the registered agent must do the sorting.

7. **SECTION 204. SERVICE OF PROCESS, NOTICE, DEMAND, OR OTHER RECORD.**

   (a) A protected series may be served with any process, notice, demand, or other record required or permitted by law by:

   (1) serving the series limited liability company that established the protected series;

   (2) serving the registered agent of the protected series; or

   (3) other means authorized by law of this state other than this [act].

   (b) Service of a summons and complaint on a series limited liability company or foreign series limited liability company is notice to each protected series of the company or foreign protected series of the foreign company of service of the summons and complaint and the contents of the complaint. Service of a summons and complaint on a protected series of a series limited liability company or foreign protected series of a foreign series limited liability company is notice to the company and any other protected series of the company, or the foreign company and any other foreign protected series of the foreign company of service of the summons and complaint and the contents of the complaint.

   (c) Notice under subsection (b) is effective against a person whether or not the summons and complaint identify the person if the summons and complaint name as a party and identify:

   (1) the series limited liability company or a protected series of the company; or

   (2) the foreign series limited liability company or a foreign protected series of the foreign company.

Comment
**Subsection (a)** – Under this provision, serving a protected series by serving the series limited liability company that established the protected series has the same effect as serving the protected series’ registered agent. Subject to subsections (b) and (c), effective service requires that the protected series being served be adequately identified.

Service of a record on a protected series (however effected) does not affect the protected series if the record is inapposite. For example, serving a summons to a deposition on a series limited liability company has no effect on a protected series unless the summons names the protected series as the deponent. Likewise, serving a protected series with a charging order pertaining to a judgment debtor has no effect if the debtor is neither an associated member of the protected series nor a protected series transferee.

This act does not provide for substituted service if the registered agent of a protected series cannot be found, because, in concert with this subsection and Section 203(a), the limited liability company statute will provide adequate recourse, as follows:

- If the registered agent of a protected series cannot be found, perforce neither can the registered agent of the series limited liability company.

- However, the limited liability company statute (or some other state statute) will provide for substituted service on the series limited liability company – see, e.g., ULLCA (2013) § 119(b).

- Under this subsection, service on the company is service on the protected series.

- A person seeking to serve the protected series can do so by serving the company through the means provided for substitute service on the company.

**Subsections (b), (c)** – In a world of complex, multi-tiered, multipart organizations, it is not always easy to identify which part of such an organization is legally responsible for a particular claimed harm. This difficulty enhances statute of limitations risk. This subsection is intended to help mitigate that risk by addressing the “relating back” issue.

Both federal and state courts provide criteria for amending a complaint to name a new party and having the amendment relate back to the original complaint. See, e.g., F.R.C.P. 15(c), Minn.R.Civ.P. 15(h). While “relating back” solves the statute of limitations problem, the relating back rules require inter alia that “the party to be brought in by amendment … received such notice of the action that it will not be prejudiced in defending on the merits.” F.R.C.P. 15(c)(1)(C)(i).

In some jurisdictions, a plaintiff can also use “Doe” defendants to address the statute of limitations risk. See, e.g., Miss.R.C.P. 9(h) (“Fictitious Parties. When a party is ignorant of the name of an opposing party and so alleges in his [sic]pleading, the opposing party may be designated by any name, and when his [sic] true name is discovered the process and all pleadings and proceedings in the action may be amended by substituting the true name and giving proper notice to the opposing party.”).
However, using “Doe” defendants raises complex issues. See N.Y. C.P.L.R. 1024 (McKinney), Vincent C. Alexander, Practice Commentaries (explaining the complexities, noting that: (i) “the defendant whose name is unknown must be described in such a way as to fairly apprise the party that he or she is an intended defendant”; (ii) “an inadequate description renders the action jurisdictionally defective”; and (iii) “[i]n each case, of course, is fact-specific as to the sufficiency of the description of the intended defendant”).

Moreover, federal and some state courts disfavor the tactic. See, e.g., Barrow v. Wethersfield Police Dep't, 66 F.3d 466, 468 (2d Cir. 1995), modified, 74 F.3d 1366 (2d Cir. 1996) (“We have stated that it is familiar law that ‘John Doe’ pleadings cannot be used to circumvent statutes of limitations because replacing a ‘John Doe’ with a named party in effect constitutes a change in the party sued. Thus, such an amendment may only be accomplished when all of the specifications of Fed.R.Civ.P. 15(c) [relating back rule] are met.”) (quoting Aslanidis v. United States Lines, Inc., 7 F.3d 1067, 1075 (2d Cir.1993); internal quotation marks and brackets in original omitted); State ex rel. Holzum, 342 S.W.3d 313, 316 (Mo. 2011) (holding that naming Doe defendants is immaterial to a motion to relate back an amendment to the complaint and stating that the applicable rule “allows a change in parties but requires that the correct party defendant receive ‘notice’ of the original action”).

These subsections apply to series limited liability companies and protected series and also to foreign series limited liability companies and foreign protected series.

8. SECTION 205. CERTIFICATE OF GOOD STANDING FOR PROTECTED SERIES.

(a) On request of any person, the [Secretary of State] shall issue a certificate of good standing for a protected series. The certificate must state:

(1) the name of the protected series and the name of the series limited liability company that established the protected series;

(2) that a certificate of designation pertaining to the protected series has been filed and taken effect;

(3) the date the certificate took effect;

(4) if any statement of designation change pertaining to the protected series has taken effect, the effective date and contents of that statement;

(5) that no statement of termination of the protected series has been filed;
(6) that all fees, taxes, interest, and penalties owed to this state by the protected series and collected through the [Secretary of State] have been paid, if:

(A) payment is reflected in the records of the [Secretary of State]; and

(B) nonpayment affects the good standing of the protected series;

(7) that the most recent [annual] [biennial] report required by [the limited liability company statute] includes the name of the protected series and has been delivered to the [Secretary of State] for filing; and

(8) other facts reflected in the records of the [Secretary of State] pertaining to the protected series which the person requesting the certificate reasonably requests.

(b) Subject to any qualification stated in the certificate, a certificate issued by the [Secretary of State] under subsection (a) may be relied on as conclusive evidence of the facts stated in the certificate.

Legislative Note: This section parallels Uniform Limited Liability Company Act (2013), Section 211 (Certificate of Good Standing or Registration). An enacting state should revise this section as necessary to parallel the comparable provision in the state’s limited liability company statute.

Comment

This section applies only to protected series of a domestic series limited liability company. Under Section 604, each foreign protected series seeking registration is treated as if the foreign protected series were a foreign limited liability company. As a result, under Section 604, a foreign protected series may obtain a statement of registration under the appropriate provision of the limited liability company statute – see, e.g., Uniform Limited Liability Company Act (2013), Section 211.

Subsection (a) – This subsection parallels the provisions of ULLCA (2013) § 211, pertaining to domestic limited liability companies, with one exception. This provision has no parallel to ULLCA § 211(b)(2)(D)(ii) – that “the records of the [Secretary to State] do not otherwise reflect that the [limited liability] company has been dissolved or terminated.” To make that determination about a protected series, the filing office would have to determine whether its records disclose the dissolution of the series limited liability company. Requiring that determination for each certificate of good standing for a protected series would impose unnecessary costs. For example, suppose that a person seeks a certificate of good standing for 15 protected series of the same series limited liability company. The requestor needs only one
certification that the company is in good standing, not 15. See comment to subsection (a)(8).

**Subsection (a)(8)** – A person seeking to determine the good standing of a protected series of a series limited liability company should also determine whether the company is in good standing. Depending on the rules, procedures, or practices of the filing office, a requestor might use this provision to do so, or instead file a contemporaneous, separate request for a certificate of good standing for the company.

**SECTION 206. INFORMATION REQUIRED IN [ANNUAL] [BIENNIAL] REPORT.** The [annual][biennial] report that [the limited liability company statute] requires be delivered to the [Secretary of State] for filing must, in the case of a series limited liability company, also include the name of each protected series of the company. The failure of the company to include the name of a protected series does not dissolve or otherwise affect the protected series but does prevent issuance of a certificate of good standing pertaining to the protected series.

**[ARTICLE] 3**

**ASSOCIATED ASSETS; ASSOCIATED MEMBERS; PROTECTED SERIES**

**TRANSFERABLE INTEREST; MANAGEMENT**

9. **SECTION 301. ASSOCIATED ASSETS.**

(a) Only property that is an asset of a protected series may be an associated asset of the protected series. Only property that is an asset of a series limited liability company may be an associated asset of the company.

(b) An asset of a protected series is an associated asset of the protected series only if the series limited liability company that established the protected series creates and maintains a record or set of records that identifies the protected series and:

(1) describes the asset with sufficient specificity to permit a disinterested, reasonable individual to identify the asset and distinguish it from:
(A) other assets of the protected series, whether or not the other assets are associated assets of the protected series;

(B) assets of any other protected series of the series limited liability company, whether or not the assets are associated assets of the other protected series; and

(C) assets of the company, whether or not the assets are associated assets of the company;

(2) states when and from what person the protected series acquired the asset;

(3) if the protected series acquired the asset from the company or another protected series of the company, states the consideration paid, the payer, and the payee;

(4) if the protected series transfers the asset, or any part of the asset, states when and to what person the protected series made the transfer; and

(5) if the protected series transferred the asset to the company or another protected series of the company, states the consideration received, the payee, and the payer.

(c) To the extent permitted by law of this state other than this [act] and subject to subsections (a) and (b), a protected series may hold an associated asset directly or indirectly, through a representative, nominee, or otherwise, but may not hold the asset in the name of the series limited liability company or another protected series of the company.

(d) A series limited liability company may make an asset an associated asset of the company in accord with this section.

Comment

This section states the recordkeeping mechanics required to make an asset an associated asset of a protected series or series limited liability company. Section 402 states the consequences of non-compliance.

Section 402 also determines, albeit by implication, how long the records required by this section should be maintained. The statute of limitations applicable to voidable transactions is
also relevant. See comment to Section 402.

Subsection (a) – Only property that is an asset of a protected series may be an associated asset of the protected series. The same rule applies to the series limited liability company itself. Thus, associated assets are a subset of assets (although, if the recordkeeping is satisfactory, the subset will be co-extensive with the set).

Subsection (b) – This provision states the recordkeeping required for an asset to be an associated asset. ULLCA (2013) § 102(18) defines “record” as “information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.” The reference to “a record or set of records” indicates that the necessary information may be found in one record (e.g., one spreadsheet) or a combination of records.

A series limited liability company has the duty to maintain the records required for each protected series of the company and for the company itself. The duty is delegable, but delegation does not discharge the duty.

{{NTDC – Our liaison to the Committee on Style predicted that the Committee would not accept a statute that creates a duty but leaves open the question of who is responsible for discharging the duty.}}

The question of who, other than the series limited liability company, has access to these records depends in part on the status of the person requesting access. Section 107(c) and Section 103 determine the information rights of an associated member to information pertaining to a protected series, unless the operating agreement addresses the issue. Section 305 determines the rights of a member that is not an associated member of a protected series to information concerning that protected series, including the rights of a person previously associated with a protected series. {{NTDC – Need rule for access of a protected series manager.}}

As to an access request by an outsider – e.g., a third party creditor searching for non-associated (“up for grabs”) assets – the question is governed by other law, e.g., rules of discovery in civil procedure, including rules pertaining to post-judgment disclosures.

Subsection (b)(1) – In this context, a “reasonable individual” has at least a general familiarity with business records. However, the reasonable individual standard does not require familiarity with generally accepted accounting principles (GAAP) or any other particular set of accounting rules. It follows that records decipherable only by a forensic accountant do not meet the standard.

By the same token, this provision does not require that the recordkeeping comply with GAAP or any other particular set of accounting rules.

Subsection (b)(1)(A)-(C) – Under these provisions, each protected series has an interest in the specificity and accuracy of records maintained by the series limited liability company and any other protected series of the company. A record that would otherwise satisfy subsection (b) could fail to do so because another record maintained by the company, concerning another
protected series, renders the first record ambiguous (and likely the other record as well).

**Subsection (b)(2)-(5)** – These provisions impose substantial transparency requirements.

**Subsection (b)(3), (5)** – These provisions impose additional transparency requirements in transactions between a series limited liability company and one of its protected series or between two protected series of the company.

**Subsection (b)(3)** – In almost all instances, the protected series will pay the consideration. However, a protected series might acquire an asset through a third party beneficiary contract, including one in which the protected series is a donee beneficiary. Likewise, a protected series might make payment to an assignee of the transferor.

**Subsection (b)(5)** – See the comment to Subsection (b)(3).

{{NTDC – A comment will explain that, once an associated asset is transferred, the transferor faces no specific consequence for not creating or retaining this record – beyond voidable transaction statutes – but that a pattern of not conforming with this requirement could be a ground for piercing.}}

{{NTDC – Need to have a tracing provision, applicable once a claim is made against an asset.}}

**Subsection (c)** – Under this provision, stock could constitute an associated asset of a protected series, even though the stock is held in “street name” by a brokerage firm.

{{NTDC: Query – should the exception be replaced with permission provided the representative capacity and actual owner are disclosed? E.g., ABC LLC – Protected Series 1, as trustee for ABC LLC.}}

**Subsection (d)** – The horizontal liability shields that characterize a series limited liability company apply to the company as well as to each protected series. See Section 401(a)(1)-(4). As explained in Prefatory Note, Parts 5-6, the horizontal shields provide the non-liability rule. To have the protection of the non-recourse rule, a series limited liability company must comply with this section so that the company’s assets are associated assets.

10. **SECTION 302. MEMBERSHIP REQUIRED TO BE ASSOCIATED MEMBER; OPERATING AGREEMENT TO SPECIFY ASSOCIATED MEMBER.**

   (a) Only a member of a series limited liability company may be an associated member of a protected series of the company. If a person is dissociated from a series limited liability company, the person immediately ceases to be an associated member of any protected series of the company.
(b) A member of a series limited liability company becomes an associated member of a protected series of the company when the operating agreement or a procedure established by the agreement:

(1) identifies the member as an associated member of the protected series; and

(2) states what, if any, protected series transferable interest the associated member has in connection with becoming or being an associated member.

**Legislative Note:** Following Uniform Limited Liability Company Act (2013), Section 401(d), Section 302(b)(2) permits a member to be an associated member of a protected series without having an economic interest in the protected series. If a state’s limited liability company statute does not permit “non-economic members,” Section 302(b)(2) should omit the phrase “, if any,.”

**Comment**

**Subsection (a)** – The requirement stated here is fundamental to this act and corresponds with the definition of “associated member,” Section 102(3) (defining “associated member” as “a member that meets the requirements stated in Section 302) (emphasis added). The operating agreement can and typically will specify other events causing a member to cease being an associated member of a protected series.

**Subsection (b)** – Because this provision addresses the question of how a member becomes an associated member, extrapolation for internal affairs (Sections 103 and 107(c)) does not apply. In contrast, extrapolation will determine the consequences of a member ceasing to be an associated member of a protected series, unless the operating agreement addresses the matter. {{NTDC – Is the result stated in the first sentence of this comment the correct result? What happens if an operating agreement, with a merger provision, leaves gaps in the process for identifying associated members?}}

11. **SECTION 303. PROTECTED SERIES TRANSFERABLE INTERESTS.**

(a) A protected series transferable interest of a protected series must be owned initially by an associated member of the protected series or the series limited liability company that established the protected series.

(b) If a protected series has no associated members when established, the series limited liability company owns the protected series transferable interests in the protected series.

(c) A series limited liability company may acquire a series transferable interest through a
transfer from another person or as provided in the operating agreement.

Comment

Subject to subsection (b), this section and Section 302(b) leave to the operating agreement the initial allocation of protected series transferable interests.

Subsection (a) – A protected series transferable interest can be owned initially only by an associated member or the series limited liability company. Compare ULLCA (2013) § 102(24) (defining “[t]ransferable interest” as “the right, as initially owned by a person in the person’s capacity as a member, to receive distributions from a limited liability company”) (emphasis added).

Subsection (a) is not variable, Section 109(12), but does not restrict an initial owner’s rights to transfer. The operating agreement should delineate those rights. If it does not, sections 103 and 107(c) delineate the rights by extrapolation. See Section 107(c), cmt.

Subsection (b) – This subsection is not variable, because (i) subsection (a) is not variable, Section 109(12); and (ii) under subsection (a), the initial owner of a protected series transferable interest must be either an associated member or the series limited liability company. {NTDC – Should Section 109 specifically refer to this subsection?}

Subsection (c) – Under this provision, it is possible (albeit rarely, if ever, advisable) for a series limited liability company to have an economic interest in a protected series without having any governance rights.

EXAMPLE: Bird LLC (Bird) establishes Asha Protected Series of Bird LLC (Asha), with the protected series transferable interests in Asha allocated as follows: Andy (an associated member) – 40%; Gretchen (another associated member) – 40%; Bird – 20%. The operating agreement is silent on how Asha is to be managed. The limited liability company statute provides, as a default rule, for member-management of a limited liability company. Under Sections 103 and 107(c) (extrapolation for internal affairs), Asha is managed by Andy and Gretchen, its associated members (and thus also its protected series managers). (Section 304(b) makes the company the protected series manager only when a protected series has no associated members.)

SECTION 304. MANAGEMENT.

(a) A protected series manager in that capacity owes duties only to the protected series and any associated members of the protected series. A protected series may have simultaneously more than one protected series manager.

(b) Whenever a protected series has no associated members, the series limited liability
company is the protected series manager.

(c) An associated member of a protected series is by statute an agent for the protected series with statutory power to bind the protected series to the same extent, if any, that a member of a limited liability company is by statute an agent for the company with statutory power to bind the company.

(d) An associated member of a protected series of a series limited liability company has the same rights as any other member of the company to vote on or consent to an amendment to the company’s operating agreement or on any other matter being decided, whether or not the amendment or other matter affects the interests of the protected series or the associated member.

Comment

This act does not permit a series limited liability company to be an associated member of any of its protected series. In consequence, when the company acquires a series transferable interest it obtains no governance rights in the protected series except as provided in the operating agreement or under Subsection (b).

If a protected series has one or more associated members and the operating agreement does not specify how the protected series is to be managed:

- under Sections 103 and 107(c) and most limited liability company statutes the default rule is management by the associated members; therefore, by extrapolation the associated members are each a protected series manager; and
- extrapolation also provides the details for member management; e.g., how consent or voting rights are allocated and what quantum of consent is necessary to take particular actions.

However, extrapolation can never authorize a protected series to do anything in contravention of the operating agreement. Under most limited liability company statutes, amending the operating agreement requires the affirmative vote or consent of all members. See, e.g., ULLCA (2013) § 407(b)(4)(B), 407(c)(3)(B). The operating agreement may provide special voting rights to associated members of a protected series, but under this act the default rule is contrary. See Subsection (d).

Subsection (a) – “Duties” includes all duties, including fiduciary duties. The reference to duty to “any associated members of the protected series” does not override the distinction between direct and derivative claims. Under Sections 103 and 107(c), that distinction will apply
at the protected series level. *See, e.g.*, ULLCA (2013) § 801(b) and cmt.

The phrase “in that capacity” is crucially important. A person who is series manager of two protected series of a series limited liability company, or a manager of the company and a series manager of one of the protected series of the company is acting as an agent for two different principals. Absent an agreement with both principals after full disclosure, the agent is in a double bind:

The mere existence of a dual agency violates the duty of undivided loyalty. Moreover, the dual agent risks specific conflicts of duty as to a myriad of individual issues. The fact that these individual conflicts may be irreconcilable does not justify the agent ignoring one duty or the other. Rather, if any such specific conflict materializes, the agent is destined to be liable to one principal, the other, or both.


The following example shows one method of addressing the inevitable conflict.

EXAMPLE: A-Z LLC (“A-Z”) has five protected series – A-Z LLC – Protected Series 1, A-Z LLC Protected Series 2, etc. Per the operating agreement, A-Z is the series manager of each of A-Z’s protected series. To alleviate the “dual agent” problem, the operating agreement provides:

If this agreement, or [the applicable limited liability company statute] requires or authorizes A-Z to make a decision that has the potential to benefit one protected series of A-Z to the prejudice of another protected series of A-Z, or to benefit A-Z to the detriment of a protected series of A-Z, A-Z is not liable for damages under this agreement or [the limited liability company statute], whether the claim is in law or equity, if A-Z makes the decision with:

1. the honest belief that the decision serves the best interests of A-Z or one or more protected series of A-Z; and

2. the reasonable belief that the decision breaches no right under this agreement or [the limited liability company statute] of:

(i) A-Z;

(ii) a protected series of A-Z; or

(iii) a member of A-Z, whether in the capacity of a member of A-Z or an associated member of a protected series of A-Z.

**Subsection (b)** – This provision applies not only when a protected series is established but at any other time.
EXAMPLE: When established, Protected Series 1 of XYZ, LLC (“PS-1”) has four associated members. The operating agreement is silent on how PS-1 is to be managed, and the relevant limited liability company statute provides for member management as the default rule. Accordingly, PS-1 is member-managed and remains so as long as PS-1 has any associated members.

For various reasons, all four associated members eventually cease to be associated. Under this subsection, XYZ, LLC becomes the protected series manager. If later a member becomes an associated member, Subsection (b) no longer applies.

Subsection (c) – ULLCA (2006) § 301 eliminated “statutory apparent authority.” See ULLCA (2013), § 301(a), cmt. However, many limited liability company statutes retain the concept. This provision provides an associated member the same statutory apparent authority to bind a protected series that the limited liability company statute provides for a member to bind a limited liability company.

{{NTDC – The current language replaces the non-agent language from earlier drafts. Query whether the act should provide two alternatives: the current language for the majority of states; the non-agent language for states that have followed ULLCA (2006).}}

Subsection (d) – As a default rule, this provision precludes any claim to the protected-series equivalent of “class voting.”

12. SECTION 305. RIGHT OF PERSON NOT ASSOCIATED MEMBER OF PROTECTED SERIES TO INFORMATION CONCERNING PROTECTED SERIES.

(a) A member of a series limited liability company which is not an associated member of a protected series of the company has a right to information concerning the protected series to the same extent, in the same manner, and under the same conditions that a non-manager member of a manager-managed limited liability company has a right to information concerning the company under [the limited liability company statute – see, e.g., Uniform Limited Liability Company Act (2013), Section 410(b)(2)-(3)].

(b) A person formerly an associated member of a protected series has a right to information concerning the protected series to the same extent, in the same manner, and under the same conditions that a person dissociated as a member of a limited liability company has a
right to information concerning the company under [the limited liability company statute– see, e.g., Uniform Limited Liability Company Act (2013), Section 410(c)].

(c) If an associated member dies, the legal representative of the deceased associated member has a right to information concerning the protected series to the same extent, in the same manner, and under the same conditions that the legal representative of a deceased member has a right to information concerning the company under [the limited liability company statute – see, e.g., Uniform Limited Liability Company Act (2013), Section 504].

Comment
Sections 103 and 107(c) (extrapolation for internal affairs) provide the information rights for associated members of a protected series, to the extent the operating agreement does not address the matter.

[ARTICLE] 4
LIMITATION ON LIABILITY AND ENFORCEMENT OF CLAIMS

13. SECTION 401. LIMITATIONS ON LIABILITY.

(a) Subject to subsection (b) and Section 402:

(1) a debt, obligation, or other liability of a series limited liability company is solely the debt, obligation, or other liability of the company;

(2) a debt, obligation, or other liability of a protected series is solely the debt, obligation, or other liability of the protected series;

(3) a series limited liability company is not liable, directly or indirectly, by way of contribution or otherwise, for a debt, obligation, or other liability of a protected series of the company solely by reason of the company:

(A) having established the protected series;

(B) being or acting as a protected series manager of the protected series;
(C) having the protected series manage the company; or

(D) owning a protected series transferable interest in the protected series;

(4) a protected series is not liable, directly or indirectly, by way of contribution or otherwise, for a debt, obligation, or other liability of the series limited liability company that established the protected series or another protected series of the company solely by reason of:

(A) being a protected series of the company;

(B) being or acting as a person managing the company or a protected series manager of another protected series of the company;

(C) having the company or another protected series of the company be or act as a protected series manager of the protected series; and

(5) a person is not liable, directly or indirectly, by way of contribution or otherwise, for a debt, obligation, or other liability of:

(A) a protected series solely by reason of being or acting as an associated member of the protected series, a series manager of the protected series, a member of the series limited liability company that established the protected series, or a person managing the company or by having a series transferable interest in the protected series; or

(B) a series limited liability company solely by reason of being or acting as an associated member or protected series manager of a protected series of the company.

(b) A claim to disregard a limitation stated in subsection (a) is governed by the principles of law and equity, including principles providing rights to creditors or holding a person liable for a debt, obligation, or other liability of another person, which would apply if each protected series of the series limited liability company were a limited liability company, organized separately from the company that established the protected series and distinct from the company and any
Comment

This section provides two different types of liability shields:

- the traditional, vertical shields that protect owners and managers from vicarious liability for an organization’s obligations where the vicarious liability is asserted solely by reason of the status of owner or manager, Subsection (a)(5); and

- the novel, horizontal shields that protect a protected series of a series limited liability company from automatic, vicarious liability for the debts, obligations, or other liabilities of the company or another protected series of the company (and provide comparable protection for the company itself), Subsection (a)(1)-(4).

For further explanation, see Prefatory Note, Parts 5-6.

The horizontal shields do not affect the “asset by asset” analysis under Sections 301 and 402.

Subsection (a) – This subsection is subject to Section 402 because Section 402 interferes with the non-recourse aspect of the horizontal shields. See Prefatory Note, Parts 5-6.

Subsection (a)(1)-(4) – These provisions establish inter alia the “horizontal” shields which are the defining characteristic of a series limited liability company. See Prefatory Note, Part 1. {{NTDC: Query – combine paragraphs 1 and 3 and 2 and 4?}}

Subsections (a)(3)(B), (a)(4)(B) – These provisions shield only against vicarious liability for a debt, obligation, or other liability of a series limited liability company or a protected series where the vicarious liability is asserted solely by reason of a person’s role as a manager. The provisions do not protect against direct liability for tortious conduct. For a detailed discussion of this issue, see ULLCA (2013) § 304(a), cmt., Shield Inapposite for Claims Arising from a Member’s or Manager’s Own Conduct.

Subsection (a)(5) – This provision establishes the traditional, vertical liability shield.

Subsection (a)(5)(A) – This provision establishes the traditional, vertical liability shield with regard to protected series and is based on ULLCA (2013) § 304(a).

Subsection (a)(5)(B) – Every limited liability company statute protects a person from vicarious liability for a limited liability company’s obligations where the vicarious liability is asserted solely by reason of the person’s being or acting a member of the company. Most, if not all, limited liability company statutes extend the protection to a person’s status as a manager of a limited liability company. See, e.g., ULLCA (2013) § 304(a). This provision extends the protection to a person in the role of associated member or protected series manager.

In the context of non-series limited liability companies, some limited liability company statutes modify the traditional grounds for piercing (i.e., overcoming the shield) to the following
effect: “The failure of a limited liability company to observe formalities relating to the exercise of its powers or management of its activities and affairs is not a ground for imposing liability on a member or manager for a debt, obligation, or other liability of the company.” ULLCA (2013) § 304(b). This act contains no such language, because such language might be read as undercutting the strict formalities required to associate an asset with a protected series or series limited liability company. See Section 301. \{NTDC – Omitting such language creates an anomaly; for piercing purposes the status of member or manager is treated differently than the status of associated member or series manager.\}

**Subsection (b)** – This subsection encompasses outside reverse piercing claims (to the extent a state allows such claims) but by its terms does not address inside reverse piercing claims. A successful inside reverse pierce does not disregard a liability shield but rather permits an entity’s owner to enjoy and exercise a right belonging to the entity.

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

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

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

(b) Subject to subsection (c), the following rules apply:

(1) A claim against a series limited liability company may be enforced against an asset of a protected series of the company only if:

(A) when enforcement is first sought, the asset is a non-associated asset of the protected series; or

(B) when the liability giving rise to the claim was incurred, the protected series owned the asset but the asset was a non-associated asset of the protected series.

(2) A claim against a protected series may be enforced against an asset of the
series limited liability company only if:

(A) when enforcement is first sought, the asset is a non-associated asset of the company; or

(B) when the liability giving rise to the claim was incurred, the company owned the asset but the asset was a non-associated asset of the company.

(3) A claim against a protected series may be enforced against an asset of another protected series of the company only if:

(A) when enforcement is first sought, the asset is a non-associated asset of the other protected series; or

(B) when the liability giving rise to the claim was incurred, the other protected series owned the asset but the asset was a non-associated asset of the other protected series.

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

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

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

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

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

(3) the determination of ownership of property.
Comment

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

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

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

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

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

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

**Subsection (b)** – This subsection applies “asset by asset” and involves analysis at two points in time: when the claim against the asset is first made and when the liability giving rise to the claim was incurred.
When claim first made

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

When liability incurred

- if asset owned but not associated: asset available to claimant
- if asset not owned or owned and associated: availability depends on “when claim first made” analysis

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

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

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

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

SECTION 403. REMEDIES OF JUDGMENT CREDITOR. Any provision of [the limited liability company statute – see, e.g., Uniform Limited Liability Company Act (2013), Section 503] which provides or restricts remedies available to a judgment creditor of a member of a limited liability company or owner of a transferable interest of the company applies to a judgment creditor of:

1. an associated member or protected series transferee of a protected series; or
(2) the series limited liability company, to the extent it owns a protected series transferable interest of the protected series.

[ARTICLE] 5

DISSOLUTION AND WINDING UP OF PROTECTED SERIES

SECTION 501. EVENTS CAUSING DISSOLUTION OF PROTECTED SERIES.

A protected series is dissolved, and its activities and affairs must be wound up, upon the:

(1) dissolution of the series limited liability company that established the protected series;

(2) occurrence of an event or circumstance the operating agreement states causes dissolution of the protected series;

(3) affirmative vote or consent of all the members; or

(4) entry by the [the appropriate court] of an order dissolving the protected series on application by:

(A) an associated member or protected series manager of the protected series:

   (i) in accord with the rules in Section 103; and

   (ii) to the same extent, in the same manner, and on the same grounds the court would enter an order dissolving a limited liability company on application by a member of or a person managing the company; or

(B) the company or a member of the company on the grounds that the conduct of all or substantially all the activities and affairs of the protected series is illegal.

Legislative Note: The grounds for dissolution stated in Paragraphs 1 and 4 are non-waivable. Section 109(16). If the law of an enacting state permits the operating agreement to waive judicial dissolution, Section 109(16) should be revised accordingly.

Comment

This section states five grounds for dissolving a protected series, which group into three categories:
• a mandatory provision consistent with the nature of a protected series (Paragraph 1);

• two facilitative provisions, consistent with the contractual nature of a limited liability company (Paragraphs 2 and 3); and

• two provisions providing for dissolution by order of court (Paragraph 4(A) and (B)).

The section does not provide for dissolution when a protected series has no associated members, because the act allows a protected series to be established and function without associated members. The operating agreement can add such a provision, if desired, as well as sundry other grounds for dissolution.

**Paragraph (1)** – This provision has no analogy at the series limited liability company level, comports with Section 105(c)(1) (stating that a protected series of a series limited liability company may not continue when the company has terminated), and is non-waivable. This provision applies regardless of the cause of the company’s dissolution, including administrative dissolution. “**NTDC – Need to include provision “resurrecting” protected series if the company’s administrative dissolution is reversed.**”

**Paragraphs (2) and (3)** – Section 109 does not list these provisions as non-variable, but any variation would be nonsensical – e.g., an operating provision: (i) stating a cause of dissolution while providing that the stated cause does not cause dissolution; or (ii) providing that unanimous consent of the members does not cause dissolution, although unanimous consent suffices to delete the provision.

**Paragraph (3)** – This provision refers to “the affirmative vote or consent of all the members” (emphasis added). Except as provided in the operating agreement, associated members of a protected series have no special right to cause (or prevent) dissolution of the protected series. See Section 304(d).

**Paragraph (4)** – An operating agreement may not vary the grounds stated in this paragraph, but “may determine the forum in which a claim for dissolution … is determined.” Section 109(16), cmt.

**Paragraph (4)(A)** – This provision analogizes the grounds for court-ordered dissolution of a protected series to the grounds for court-ordered dissolution of a limited liability company.

**Paragraph (4)(B)** – When a protected series acts illegally, any member of a series limited liability company has reason to worry. Accordingly, a member has standing under this provision regardless of whether an associated member of the protected series. (This provision addresses a situation that by definition cannot exist at the limited liability company level and therefore is outside the scope of Paragraph 4(A).)

**15. SECTION 502. WINDING UP DISSOLVED PROTECTED SERIES.**

(a) Subject to subsection (b) and in accord with Section 103:
(1) a dissolved protected series shall wind up its activities and affairs in the same manner that a limited liability company winds up its affairs under [the limited liability company statute]; and

(2) judicial supervision or other judicial remedy is available in the winding up of the protected series to the same extent, in the same manner, and under the same conditions that apply under [the limited liability company statute] in the winding up of a limited liability company.

(b) When a protected series has completed winding up, the series limited liability company that established the protected series may deliver to the [Secretary of State] for filing a statement of designation cancellation stating the name of the protected series and that the protected series is terminated.

(c) A series limited liability company does not complete its winding up until each of its protected series has completed its winding up.

Comment

Subsection (a)(1) – If the limited liability company statute provides for a statement of dissolution when a limited liability company dissolves, see, e.g., ULLCA (2013) § 702(b)(2)(A), this paragraph extrapolates that provision to the protected series level. The exclusion from extrapolation stated in Section 107(d)(2) (precluding any extrapolation that authorizes or requires a new public filing) does not apply here. By its terms, that exclusion is limited to extrapolation under Section 107(c).

Subsection (c) – This subsection overlaps the limited liability company statute’s provisions on winding up a limited liability company, but only to the extent of treating the winding up of protected series as part of the winding up of the series limited liability company.

{{NTDC – Does filing a statement of designation cancellation give constructive notice? If so, we need further language in text, dovetailing with other constructive notice provisions in ULLCA (2013). We also need a Legislative Note recommending deletion if relevant LLC statute has no constructive notice provisions. Same issue re: statement of dissolution provided via extrapolation by Subsection (a)(1).}}
SECTION 601. GOVERNING LAW.

(a) The law of the jurisdiction of formation of a foreign series limited liability company governs:

(1) the internal affairs of a foreign protected series of the company;

(2) relations between the protected series and:

(A) the company;

(B) another protected series of the company;

(C) a member of the company which is not an associated member of the protected series;

(D) a protected series transferee of another protected series of the company;

(E) a transferee of a transferable interest of the company; and

(3) subject to subsection (b) and Section 603:

(A) the liability of a person for a debt, obligation, or other liability of a foreign protected series of a foreign series limited liability company if the debt, obligation, or other liability is asserted solely by reason of the person being or acting as:

(i) an associated member, series transferee, or protected series manager of the protected series;

(ii) a member of the company not an associated member of the protected series;

(iii) a series transferee of another protected series of the company;
(iv) a protected series manager of another protected series of the company;

(v) a person managing the company; or

(vi) a transferee of a transferable interest of the company;

(B) the liability of the company for a debt, obligation, or other liability of a protected series if the debt, obligation, or other liability is asserted solely by reason of the company:

(i) having established the protected series;

(ii) being or acting as a protected series manager of the protected series;

(iii) having the protected series manage the company; or

(iv) owning a protected series transferable interest in the protected series;

(C) the liability of a foreign protected series for a debt, obligation, or other liability of the company or another protected series of the company if the debt, obligation, or other liability is asserted solely by reason of the protected series:

(i) being a protected series of the company or having the company or another protected series of the company be or act as protected series manager of the protected series; or

(ii) managing the company or being or acting as a series manager of another protected series of the company.

(b) In determining a claim under subsection (a)(3)(B) or (C), a court may apply the law of this state instead of the law of the foreign jurisdiction of the foreign series limited liability
company if the court determines that applying the law of the foreign jurisdiction advances a policy or produces a result repugnant to the public policy of this state. In making the determination, the court shall consider:

(1) the specificity, clarity, and forcefulness with which the law of this state reflects a contrary public policy;

(2) whether the claimant is a resident of this state or for another reason reasonably might expect the law of this state to apply; and

(3) any relevant choice-of-law rule of law of this state.

Comment

Subsection (a)(3) – Each of the subparagraphs in paragraph (3) is subject to two very important exceptions: Subsection (b), which authorizes a court to choose the forum state’s law in certain exceptional circumstances; and Section 603, which makes Sections 301 and 402 applicable to a foreign series limited liability company and a foreign protected series.

Subsection (a)(3)(A) – This provision parallels Section 106(3) and, subject to the above noted exceptions, states the choice of law rule applicable to matters pertaining to the traditional shield, as that shield pertains to persons vis-à-vis a foreign protected series. The choice of law rule vis-à-vis the vertical shield of a foreign limited liability company appears in the main body of a state’s limited liability company statute. See, e.g., ULLCA (2013) § 901(a).

Subsection (a)(4)(B) and (C) – These provisions parallel respectively Section 106(4) and (5) and, subject to the above noted exceptions, state the choice of law rule for the horizontal shields within a foreign series limited liability company.

Subsection (b) – Virtually all, if not all, limited liability company statutes provide that the law of foreign limited liability company’s jurisdiction of formation governs piercing claims. See, e.g., ULLCA (2013) § 901(a)(2). This approach reflects the approach of the Uniform Limited Partnership Act in effect in most states when limited liability company statutes were first being enacted. See Uniform Limited Partnership Act (1976 with 1985 amendments) § 901(i) (stating that “the law of the state under which a foreign limited partnership is organized governs its organization and internal affairs and the liability of its limited partners”). According to the official comment, Section 901 “first appeared in the 1976 Act.”

However, the comment provides no explanation for this variation from the original Uniform Limited Partnership Act of 1916, which relied on common law choice of law principles for both the “internal affairs doctrine” and piercing claims. See Se. Texas Inns, Inc. v. Prime Hosp. Corp., 462 F.3d 666, 672-76 (6th Cir. 2006) (discussing at length which state law to apply
to a claim to pierce the veil of a limited partnership, making no reference to the limited partnership statute of the forum state (Tennessee), determining that “the choice-of-law question is not outcome-determinative in this case,” and therefore not deciding the issue).

In the corporate context, the choice of law has always been a matter of case law. See Dassault Falcon Jet Corp. v. Oberflex, Inc., 909 F. Supp. 345, 348-49 (M.D.N.C. 1995); Restatement (Second) of Conflict of Laws (1971) § 307 (“The local law of the state of incorporation will be applied to determine the existence and extent of a shareholder's liability to the corporation for assessments or contributions and to its creditors for corporate debts.”). Although the Restatement states the rule as invariable, venerable Supreme Court precedent allows for exceptions. Pinney v. Nelson, 183 U.S. 144, 150, 22 S. Ct. 52, 55, 46 L. Ed. 125 (1901) (“Contracting with reference to the laws of that state [not the state of incorporation] [the shareholders] …must be assumed to know the provisions of those laws; that by them a personal liability was cast upon the stockholders in corporations formed under the laws of the state, and that that same liability was also imposed upon the stockholders of corporations formed under the laws of other states and doing business within California.”).

In the context of such a novel concept as internal shields, the Drafting Committee determined to revert to common law flexibility rather than merely reiterating a codification that entered the law of unincorporated organizations without explanation and whose rationale has never been fully explored.

The stated standard – repugnancy – is a high one and consistent with case law from analogous contexts.

**SECTION 602. TRANSACTING OF BUSINESS IN STATE BY FOREIGN LIMITED LIABILITY COMPANY OR FOREIGN PROTECTED SERIES; JURISDICTION.** In determining whether a foreign limited liability company or foreign protected series of the company has transacted business in this state or is subject to the jurisdiction of the courts of this state:

1. the activities and affairs of the company are not attributable to a protected series of the company solely because the company established the protected series; and
2. the activities and affairs of a protected series are not attributable to the company or another protected series of the company solely because the company established the protected series or the other protected series.

{{NTDC – This section states a non-attribution rule that protects not only foreign protected}}
series but also foreign series limited liability companies. Query – does the latter protection belong in the limited liability company statute, with a Legislative Note to explain?}}

SECTION 603. APPLICATION OF SECTIONS 301 AND 402 TO FOREIGN SERIES LIMITED LIABILITY COMPANY AND FOREIGN PROTECTED SERIES.

Sections 301 and 402 apply to any asset located in this state owned by a foreign series limited liability company or foreign protected series subject to the personal jurisdiction of the courts of this state.

Comment

Other law determines whether an asset is located in this state.

16. SECTION 604. REGISTRATION OF FOREIGN PROTECTED SERIES.

(a) Except as otherwise provided in this section and subject to Section 602, the law of this state governing the registration of a foreign limited liability company to do business in this state applies to a foreign protected series as if the foreign protected series were a foreign limited liability company organized separately from the foreign series limited liability company that established the foreign protected series and distinct from the foreign company and any other foreign protected series of the foreign company.

(b) An application by a foreign protected series for registration to do business in this state must include:

(1) the name and jurisdiction of formation of the foreign series limited liability company that established the foreign protected series applying for registration; and

(2) if the company has other protected series, the name, street, mailing, and electronic mail address of an individual who knows the name, street, mailing and electronic mail address of each other foreign protected series and the protected series manager of and agent for process for each other foreign protected series.
(c) The name of a foreign protected series applying for registration or registered to do business in this state must comply with Section 202. A foreign protected series may comply with Section 202 pursuant to [fictitious name statute].

(d) The requirement in [cite to the relevant provision the limited liability company statute – see, e.g., Uniform Limited Liability Company Act (2013), Section 904] to amend a statement of registration to update information applies to the information required by subsection (b).

**Legislative Note:** Although business entity statutes typically do not provide a delayed effective date for foreign entities, an enacting state whose limited liability company statute has previously contemplated foreign protected series should consider delaying the effective date of subsection (a)(2). In such states, subsection (a)(2) imposes a significant new requirement on foreign protected series.

**Comment**

**Subsection (a)** – Among the provisions made applicable by this subsection are the process used and the information required for registration to do business, the law governing annual or biennial reports, and the law governing statements of good standing. Also made applicable is the “no greater powers” rule contained in many limited liability company statutes – e.g., ULLCA § 901(c) (“Registration of a foreign limited liability company to do business in this state does not authorize the foreign company to engage in any activities and affairs or exercise any power that a limited liability company may not engage in or exercise in this state.”).

Because this subsection treats each foreign protected series as if it were a separate foreign limited liability company, there is no requirement that all registered foreign protected series of a foreign series limited liability company have the same agent for service of process. **Contrast Section 203(a)** (providing that the registered agent of a series limited liability company is the registered agent for each protected series established by company). {{NTDC – open issue: how to address statutes which require a statement of good standing from the home jurisdiction of a registrant limited liability company when the home jurisdiction does not provide for a statement of good standing pertaining to a protected series.}}

Section 602 contains non-attribution rules applicable when determining whether a foreign series limited liability company or foreign protected series is doing business in this state.

**Subsection (b)(2)** – This provision is most easily understood with reference to Section 605(a), which requires substantial disclosures when a foreign series limited liability company or foreign protected series becomes party to an adjudicative proceeding. Registration to do business does not require the same disclosure but does require the applicant to identify an individual who knows the information contemplated by Section 605.

**Subsection (c)** – Section 202 requires that the name of a protected series either begin or
end with the name of the series limited liability company. Many limited liability company statutes have a provision addressing the problem of a noncomplying name of foreign limited liability company that is applying for registration – e.g., ULLCA § 906. Subsection (a) makes such provisions applicable to a foreign protected series. A foreign protected series can also use a state’s fictitious name statute.

If a foreign series limited liability company changes its name, the foreign company will have to change the name used in this state by any of the foreign company’s protected series registered in this state. See Section 202(c).

17. SECTION 605. DISCLOSURE REQUIRED WHEN FOREIGN SERIES LIMITED LIABILITY COMPANY OR FOREIGN PROTECTED SERIES SUBJECT TO PROCEEDING.

(a) Not later than [30] days after becoming a party to a proceeding before a civil, criminal, administrative, or other adjudicative tribunal of this state or a tribunal of the United States located in this state:

(1) a foreign series limited liability company shall disclose to each other party the name, street, mailing, and electronic mail address of:

(A) each foreign protected series of the company; and

(B) each protected series manager of and an agent for service of process for each foreign protected series of the company; and

(2) a foreign protected series shall disclose to each other party the name, street, mailing, and electronic mail address of:

(A) the foreign series limited liability company that established the foreign protected series, each person managing the company, and an agent for service of process for the company; and

(B) each other foreign protected series, if any, and the protected series manager of and an agent for service of process for each other protected series.

(b) The time to make disclosure under subsection (a) is tolled if the foreign series limited
liability company or foreign protected series challenges the personal jurisdiction of the tribunal. If the tribunal rules in favor of its jurisdiction, the tolling ends.

(c) If a foreign series limited liability company or foreign protected series does not comply with subsection (a), a party to the proceeding may:

(1) move the tribunal to treat the noncompliance as a failure to comply with the tribunal’s discovery rules; or

(2) bring a separate proceeding in [appropriate court] to enforce the requirements stated subsection (a).

Comment

In contrast to Section 604(b)(2), this section requires disclosure of information, not merely the identification of an individual who knows the information.

Subsection (a) – Arbitration is an adjudicative tribunal. {{NTDC – open issues: how to determine whether an arbitration proceeding is located in this state; whether, given that arbitration is consensual process, the protections of this section are unnecessary.}}

[ARTICLE] 7

MISCELLANEOUS PROVISIONS

SECTION 701. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

SECTION 702. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [act] modifies, limits, or supersedes the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., but does not modify, limit, or supersedes Section 101(c) of that act, 15 U.S.C. Section 7001(c), or authorize electronic delivery of any of the notices described in Section 103(b) of that act, 15 U.S.C. Section 7003(b).
Comment

This section responds to specific language of the Electronic Signatures in Global and National Commerce Act and is designed to avoid preemption of state law under that federal legislation.

18. **SECTION 703. APPLICATION TO EXISTING RELATIONSHIPS.**

Details TBD. As of October 14, 2015:

- long drag-in period – 2 years
- authorize an existing series LLC to opt in before the drag-in date
- authorize those with managerial authority to comply with this act’s recordkeeping and filing requirements without need for member approval (domestic only)

Comment

Article 5 of this act contains novel provisions affecting the internal shields of foreign protected series. See the Legislative Note to Section 604.

**SECTION 704. SAVINGS CLAUSE.** This [act] does not affect an action commenced, proceeding brought, or right accrued before [the effective date of this [act]].

**SECTION 705. SEVERABILITY CLAUSE.** If any provision of this [act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [act] which can be given effect without the invalid provision or application, and to this end the provisions of this [act] are severable.

*Legislative Note:* Include this section only if this state lacks a general severability statute or decision by the highest court of this state stating a general rule of severability.

**SECTION 706. REPEALS; CONFORMING AMENDMENT.**

(a) …

(b) …

(c) …
SECTION 707. EFFECTIVE DATE. This [act] takes effect . . . .


Philip Manns, Jr. and Timothy M. Todd, *Issues Arising Upon the Death of the Sole Member of the Single-Member LLC*, 99 MARQUETTE LAW REVIEW 725 (2016)

Peter Molk, *How Do LLC Owners Contract Around Default Statutory Protections?*, 42 JOURNAL OF CORPORATION LAW ___ (forthcoming), available on SSRN

Gianfranco A. Pietrafesa, *Avoiding Legal Malpractice in LLC Formations*, NEW JERSEY LAWYER 12 (June, 2016)


PLANNING AHEAD

The Committee on LLCs, Partnerships and Unincorporated Entities will meet three times in 2017: at the Spring Meeting of the Section on Business Law, at the Annual Meeting of the Section of Business Law, and at the 2017 LLC Institute. Looking forward:

<table>
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<tr>
<th>Event</th>
<th>Date</th>
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<tr>
<td>2017 ABA BLS Spring Meeting</td>
<td>April 6-8, 2017</td>
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<tr>
<td>New Orleans, Louisiana</td>
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<tr>
<td>2017 ABA BLS Annual Meeting</td>
<td>September 14-16, 2017</td>
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<td>Chicago, Illinois</td>
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<td>2017 LLC Institute</td>
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<tr>
<td>2018 ABA BLS Spring Meeting</td>
<td>April 12-14, 2018</td>
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The detailed schedules for Committee meetings and programs at these meetings will be announced in future issues of the LLC & Partnership Reporter.
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