October, 2018

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FROM THE CHAIR

Garth Jacobson
CT Corporation
Seattle, Washington

Greetings from the Chair,

A friend of my from law school once snarky observed that lawyers are word merchants. That is our clients pay us by the word for the documents we produce. That is assuming that the number of words translates to time for which we measure our billable hours. That cynical assessment may be true at times but it fails to capture the true art of wordsmithing documents. Those lawyers who truly “get it” take it beyond a craft to an art form. They are able to understand the desires and goals of their clients and translate it into truly beautiful written agreements that capture the intentions of the parties. They then “counsel” their clients as to the nuances of the agreement and how to abide by it. This then hopefully establishes rules of the game that in turn reduces the disputes along the way. Then hopefully the members of an LLC can play nice in a sandbox.

The evolution from word merchant to word artist often takes years to decades to achieve. It goes well beyond knowing the terms and phrases of agreements to understanding the subtleties and inferences. Every year Beth and Lou roll out the cases where the agreement words failed to prevent the disputes. Sometime it is because no one could dream up circumstances that lead to the dispute and other times it was merely a matter of poorly drafting the agreement. Sometimes it just amounted to the members not wanting to
play nice in the sandbox. But it is the “artists” of our committee who get it and teach us the techniques to become better lawyers for clients.

All of this waxing poetic leads to the point that our committee is made up of many word artists whose skills astound us. I am truly amazed at the incredible talented members of our committee. Every year we call out of these “artist” to receive the Lubaroff award in recognition of their contribution to our area of law. This year we honor Tom Rutledge for this award.

Tom’s list of contributions to our profession, area of law and our committee are amazing. He applies his skills as an outstanding lawyer, educator, legislation drafter and giver of immense amount of time to our committee and the ABA. While I could provide a long outline of his professionalism and advancements he makes to the improvement of our area of law and beyond, I think there is another aspect of Tom that deserves spotlighting.

Tom is one of the most caring people I know. He is quick to praise and provide encouragement to the large circle of friends around him. He is the first to deliver birthday greetings and encourages everyone else to do the same. Likewise he pays attention to the troubles and challenges we all face and is the first to offer kind words of support and condolences. He is truly one of those people who brightens a room and offers words of cheer to everyone. That is not to say he doesn't have a snarky side to him, but such comments are made without malice. I say these things because it demonstrates what professionalism and civility should be. We all have adversaries who test our patience and bring out our dark side. (This bitterness and lack of civility is seen every day in the legislative arena.) But Tom exemplifies what we should strive to overcome the nastiness associated with divisive conflict and find the common good. He reminds us there is a better way to do things through kindness and consideration. That’s not to say Tom is not competitive or a zealous advocate. But he does so as a true gentleman without meanness. We are all better for knowing him. In this trying time with the great rifts caused by conflicts in politics and cruelty of spirit we can learn to put down our differences and seek compromises through Tom’s attitude. I truly appreciate all Tom has done for us to make us all better.

On a totally different note the ABA invested much time and energy in improving the web pages we use. These improvements will make a webpage a better place to find the useful content our committee generates. Stay tuned for the updates that will be rolled out this fall. But if you want a preview click on this link and sign into our new webpage. Accept the invitation:

http://connect.americanbar.org/businesslawconnect/directory/members/profile/myaccount/inbox?CommunityKey=824de169-f11e-4c5f-bc35-568a3bbf5a08&ContactKey=15bbde4e-aed0-4978-923a-e67a997c1679&CommunityMemberKey=32813ab7-5b21-48ed-ba60-18a1ac44590e&Accept=True

You will not only find new content but also be able to add your own helpful information for the benefit of the rest of the committee members.

As most of you may know the state and federal governments have faced a lot of pressure to establish ways for law enforcement to obtain access to the names of the beneficial owner of business entities. Law enforcement seeks access to this information for the purpose of reducing money laundering that facilitates many nefarious activities and enable terrorist financing. In the past, the ABA has generally opposed all of that legislation. However that position may result in our not having a seat at the table to find a workable compromise between the interests of law enforcement and the business community. During the past months the LPUE Committee and the Corporations Committee combined their efforts to develop a whitepaper supporting a change in the ABA policy on beneficial ownership. Many of you have contributed to this document. The whitepaper outlines the principles and position we believe the ABA should take as it moves forward to lobby for the interests of attorneys and the business clients they represent. I ask you look at it and provide your thoughts. I will be asking
the Committee to grant Tom Rutledge and Scott Ludwig the authority to speak on behalf of our Committee as they finalize the document. At the LLC Institute we will have a program on beneficial ownership that will touch on the issues identified in this whitepaper. Then on Friday during our Committee meeting I will ask the committee to grant Tom and Scott the authority to speak on our behalf for the finalization of the whitepaper which supports the revision of the ABAs official policy. That paper will be distributed as part of the materials for the LLC Institute program on beneficial ownership.

Finally I look forward to seeing you at the LLC Institute. The Institute will experience life at a new venue. I am very excited about the agenda and know you will find it interesting, beneficial and fulfilling. But most importantly I look forward to seeing you at our event and catching up. You are what make this committee so interesting and fun. I look forward to seeing you there.

Thanks,
Garth

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Exhibits

PowerPoint: The Uniform Protected Series Act
By: Steven G. Frost, Daniel S. Kleinberger, Brian T. Lewis and Thomas E. Rutledge

Article: Uniform Law Conference Adopts a Uniform Protected Series Act
By: Steven G. Frost and Kelley Bender

Article: Uniform Protected Series Act – A Welcome Advance in Series LLC Legislation
By: Allen Sparkman

Nebraska Uniform Statutory Trust Act L.B. 1121

PowerPoint: Austin Program on Series
By: Daniel J. Sheridan, Adrienne Randle Bond, Melissa K. Stubenberg and John Legaré Williams
Thursday, October 11, 2018

7:20 a.m. - 8:00 a.m.  Breakfast (included in registration)
8:00 a.m. - 8:15 a.m.  Welcome; Housekeeping
8:15 a.m. - 10:15 a.m.  Program (2 hrs.)  Case Law Update (Non-Delaware)

Prof. Elizabeth “Beth” Miller (Baylor Law School, Waco, Texas); Kelley Bender (Chapman & Cutler, Chicago, Illinois); Sean Ducharme (Hunton & Williams LLP, Richmond, Virginia); and Dan Sheridan (Stark & Stark, Lawrenceville, New Jersey)

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.

10:15 a.m. - 10:30 a.m.  Break
10:30 a.m. - 12:00 p.m.  Program (1.5 hrs.)  Tax & Choice of Entity


This panel will discuss the impact of recent tax developments on the choice of form and structure of business organization for a new or existing firm. Among the topics considered will be the comparative tax efficiencies of partnerships, S corporations, C corporations, and sole proprietorships considering changes in rates, the new deduction for qualified business income, and other tax changes; the rules applicable to employment and self-employment income and the net investment income tax; the impact of the change in the taxation of profits interests; and the effect of the new rules on firms engaged in different types of activities such as investment, personal services, and capital intensive trades and businesses.

12:15 p.m. - 1:30 p.m.  Luncheon (included in registration)

Keynote address by Dana L. Trier (Davis Polk & Wardwell; Former Deputy Assistant Secretary for Tax Policy in the U.S. Treasury Department (2017-18))

1:30 p.m. - 3:30 p.m.  Program (2 hrs.)  Recent Tax Law Changes

Johnny Lyle (Adams and Reese LLP, Mobile, Alabama); Cristin Conley Keane (Carlton Fields P.A., Tampa, Florida); Sarah E. Ralph (Skadden, Arps, Slate, Meagher & Flom LLP, Chicago, Illinois)

This panel will discuss issues affecting LLC practitioners due to recent tax law changes. Among the topics addressed will be direct and indirect impacts of provisions found in the Tax Cuts and Jobs Act and other recent tax legislation and guidance including (1) changes to 1031 like/kind exchange rules,
partnership technical terminations, partnership basis rules, and nonshareholder contributions to capital, and (2) new provisions such as Qualified Opportunity Zones. The panel will also discuss drafting considerations created by the partnership income tax audit rules that went into effect January 1, 2018.

3:30 p.m. – 3:45 p.m. Break

3:45 p.m. - 5:30 p.m. **Program (1.75 hrs.) Beneficial Ownership Reporting**

Garth Jacobson (CT, a Wolters Kluwer business, Seattle, Washington); Cari Stinebower (Crowell & Moring LLP, Washington, DC); Kevin L. Shepherd (Venable LLP); US Senator Sheldon Whitehouse (invited); Sarah Runge, Credit Suisse, (recently retired Director, Office of Strategic Policy, Terrorist Financing and Financial Crimes US Dept. of Treasury) Howard Mendelsolm, Chief Client Officer Kharon  (Formerly with US Dept of Treasury 2001 - 2011)

This program will address the issues and latest legislative developments related to business entity beneficial ownership disclosure. This is a chance to learn the latest on this hot topic about anti-money laundering efforts and stopping terrorist financing while balancing the interests of entrepreneurs and business entities.

6:00 p.m. - 7:00 p.m. **Cocktail Hour – Cash Bar**

7:00 p.m. - 9:00 p.m. **Lubaroff Award Dinner** - (this event is a separately ticketed event - obtain through the registration process)

Friday, October 12, 2018

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

8:05 a.m. - 10:05 a.m. **Program (2 hrs.) Delaware and Bankruptcy Case Law Update**

Lou Hering (Morris, Nichols, Arskht & Tunnell LLP, Wilmington, Delaware); Tammy Mercer (Young Conaway Stargatt & Taylor, LLP, Wilmington, Delaware); James J. Wheaton (Boston University School of Law, Boston, Massachusetts)

This panel will discuss recent LLC and partnership cases from Delaware on various topics of significance, including cases dealing with fiduciary duties, the implied covenant, dissolution and cases illustrating pitfalls in drafting operating agreements. Jim Wheaton will provide an update on recent bankruptcy decisions of interest.

10:05 a.m. - 10:15 a.m. Break

10:15 a.m. – 12:15 p.m. **Program (2 hrs.) Derivative Actions**

Moderator: Warren Kean (Shumaker, Loop & Kendrick, LLP, Charlotte, North Carolina)

Panelist: Professor Deborah DeMott (Duke); Brock Czeschin (Richards Layton & Finger, Wilmington, Delaware)
This panel will discuss the history of derivative actions and their pre-emptive application in the context of limited liability companies and partnerships, particularly with respect to the legal standing of members to bring legal and equitable claims for the alleged breach of an LLC’s operating agreement (or the partnership agreement of a partnership). Another case of unmindful “corporification” of LLCs and partnerships? The panel will explore the fundamental differences between corporations and LLCs/partnerships particularly under Delaware law (and similar, contractarian law of LLCs of other states), how those fundamental differences may be being overlooked by lawyers and judges when determining the standing of members to seek redress for other members and those who manage LLCs, and how matters concerning direct and derivative claims should be addressed in operating and partnership agreements.

12:15 p.m. - 12:45 p.m.  
**Luncheon:** Working Committee Meeting (included in registration)

12:45 p.m. - 2:45 p.m.  
**Program (2.0 hrs.) Ethics: The Top 15 Things Your Ethics Counsel-Risk Manager Hope You Know (and Hopefully Remember)**

A.J. Singleton (Stoll Keenon Ogden PLLC, Lexington, Kentucky); Professor Nancy J. Moore (Boston University School of Law, Boston, Massachusetts)

*This panel will discuss “The Top 15 Things Your Ethics Counsel-Risk Manager Hope You Know (and Hopefully Remember)” No matter how long we’ve practiced, we all need reminders. This program will identify some of the recurring legal ethics issues that practicing attorneys face, and will provide some practical solutions along the way. It will also show how compliance with the Rules of Professional Conduct is also good risk management.*

2:45 p.m. – 3:00 p.m.  
**Break**

3:00 p.m. - 4:30 p.m.  
**Program (1.5 hrs.) Charging Orders**

Jay Adkisson (Las Vegas, Nevada)

Panelists: Lou Conti (Holland & Knight LLP, Tampa, Florida); Diana Espanola (Espanola Law, LLC, Cambridge, Massachusetts); John L. Williams (Williams Law Firm, Wilmington, Delaware); Thomas E. Rutledge (Stoll Keenon Ogden PLLC, Louisville, Kentucky); Lisa Jacobs (DLA Piper, Philadelphia, Pennsylvania)

*This panel will discuss hot-topics in LLC charging order law, including procedural issues, representing the LLC in charging order situations, the LLC member in bankruptcy, and tax issues arising from the charging order and foreclosure from the viewpoints of the debtor, the creditor, and the LLC.*

4:30 p.m. - 5:00 p.m.  
**Wrap-Up**
Thomas E. Rutledge to Receive the 2018 Martin I. Lubaroff Award

Thomas E. Rutledge is the 2018 recipient of the Martin I. Lubaroff Award.

Tom received his J.D. from the University of Kentucky College of Law (1990), having previously been with the Medieval Institute of the University of Notre Dame. Since graduating from law school, he has been with the firm that is today Stoll Keenon Ogden PLLC, where he is resident in the Louisville, Kentucky office. His practice has been devoted to the law of business organizations, with attendant tax and securities law considerations.

Tom first became involved with the Committee on LLCs, Partnerships and Unincorporated Entities (then the Committee on Partnerships and Unincorporated Business Organizations) around 1998. Since 2000, he has been the editor of what is today the LLC & Partnership Reporter. From 2013 through 2016 he served as the chair of the Committee. He as well serves on the section of Business Law’s Publications Board, and is currently on the Joint Editorial Board for Unincorporated Business Organizations. He has worked on numerous Committee projects including the Prototype Limited Liability Partnership Agreement, the Model LLC Membership Interest Redemption Agreement and various operating agreement forms that have been published by the Committee in the Business Lawyer.

In 2004 he was elected to membership in the American Law Institute, and in 2016 he was appointed to the Committee on Corporate Laws.

Tom has been involved in a significant number of the uniform law projects involving business entity law including having been an advisor from the Section of Business Law to the Model Entity Transactions Act, the Revised Uniform Limited Liability Company Act and, most recently, the Uniform Protected Series Act. In 2015, he was appointed a Commissioner to the Uniform Law Connection.

Tom is an adjunct professor at the University of Kentucky College of Law, where he has taught classes including the business planning seminar, the advanced business organizations seminar and the partnership law seminar. At the University of Louisville Brandeis School of Law he is the Gordon Davidson Fellow, lecturing on business organizations and securities regulation. He was a member of the drafting committee for the original 1994 Kentucky LLC Act, and has been the author of all of the amendments to that act since 2002. He has been involved as well in amendments to the Kentucky Business Corporation and Kentucky Nonprofit Corporation Acts. In addition, he served as the author of the Kentucky adoptions of the Revised Uniform Partnership Act, the Uniform Limited Partnership Act, the Uniform Unincorporated Nonprofit Association Act, the Uniform Limited Cooperative Association Act and the Uniform Statutory Trust Entity Act. He as well drafted the Kentucky Business Entity Filing Act. With Allan Vestal, he co-authored a book on Kentucky partnership and limited partnership law.


In his free time he entertains his Siberian Husky Hannibal Barca, studies Medieval and Renaissance history, wonders how it is he gets in so few hours on his bicycles and proudly recounts the latest exploits of his goddaughter Lilly, nieces Julia and Hannah, and nephew Eli.

From Professor Elizabeth “Beth” S. Miller:

Tom would have been deserving of this award with only a fraction of his accomplishments, and he shows no signs of slowing down! I have long marveled at how productive Tom is. It seems he has found a way to get more hours out of his day than the rest of us. Or maybe he is just superhuman, as I have suspected for some time. In any event, he somehow juggles a demanding law practice, adjunct teaching, state and national bar
activities, CLE speaking, legislative drafting, expert witnessing, and scholarly writing, all while still taking time to enjoy outdoor adventures, read varied genres of literature, and be a caring, attentive, and faithful friend to countless individuals in his far-ranging orbit. Tom does not just juggle all these roles; he is outstanding at fulfilling all of them. His contributions to the LPUE Committee and to the development and practice of law in the area of business entities are immense. I get tired just thinking about all the statutes (model, uniform, and “real”), journal and law review articles, model agreements, amicus briefs, CLE articles, and white papers Tom has authored or co-authored over the years, and his productivity in this area did not diminish—if anything, it seemed to increase—as he took on more and more administrative responsibility in the LPUE Committee. I doubt we will ever see another Committee chair serve as newsletter editor (single-handedly producing the newsletter) during (as well as before and after) his or her term as chair. Of course, during his years of yeoman’s service to the ABA Business Law Section, Tom has not missed a beat in his service to the Kentucky Bar (I think he basically comprises a one-man Business Law Section of the Kentucky Bar), Uniform Law Commission, and American Law Institute.

As if we all do not already owe Tom an immeasurable debt for his many years of dedicated service to the development of the law of unincorporated entities, many of us are further indebted to him for the countless personal acts of kindness he has shown us. Those fortunate enough to make Tom’s personal acquaintance have experienced his caring and abiding friendship. It would be understandable if Tom did not have time to stay in personal contact with the multitude of folks who cross his path in the course of all these endeavors I have described, but Tom has a knack for connecting with people and finding a way to show he cares about them (think handwritten notes and cards, phone calls, email birthday alerts, etc.). For all these reasons and more, Tom is richly deserving of this award.

From Scott E. Ludwig:

I first met Tom in the 90’s (the 1990’s not the 1890’s). We soon became close friends.

We were both fairly new to the Committee so we both volunteered as often as we could to work on projects. Normally we both volunteered at the same time so the leadership (George Coleman and Bob Keatinge) would assign us to the task. For whatever reason the leadership could never figure out our names and as a result Tom and I quickly learned to answer to either “Tom” or “Scott” which just added to the confusion.

Bob Keatinge decided to simplify matters and just referred to the two of us as “Rutwig.”

Over the years it has become quite apparent why Tom’s name came first. He is simply first class in everything he does.

When we decided to change the name of the Committee, Tom decided that we needed a “slogan,” and thus “The Best Damn Committee in the ABA” was born.

During Tom’s tenure as Committee Chair, Tom stabilized and expanded our programming and our LLC Institute.

He has worked tirelessly on numerous unincorporated entity acts, whether with our Committee, on behalf of the ULC, or on behalf of the Kentucky Bar.

He is a recognized author with over 100 publications, and he constantly is in the education mode, whether as an adjunct professor, as a CLE speaker, as a mentor to young lawyers, as a trial expert, or just as a friend. He never turns anyone away. At the same time, he is an amazing listener. He takes in volumes of information from others and condenses that information into easily digestible bite size morsels for the rest of us to be able to better understand the unincorporated world.

Tom’s body of work combined with his willingness to always help others makes him the perfect person to receive this year’s Martin I. Lubaroff Award. Like Marty, Tom is the quintessential lawyer—careful, thorough, exacting, engaging, insightful, precise, provocative, and persistent, while simultaneously being gentle, kind, and courteous. Tom, like Marty, is a good friend and mentor to scores of lawyers in Kentucky and throughout the United States.

On top of all that, I have the great privilege of counting him as one of those friends.
that sticks with you through thick and thin, so much so that I consider him a brother.

Congratulations Tom, you deserve and have earned this honor through a lifetime of work—and some play.

As to the name “Rutwig” I will have more comments on that term at the dinner!

See you then, brother!

From Robert “Bob” R. Keatinge:

Tom Rutledge¹ Receives the Luboff² Award³

Tom is one of those people who always seems to have been there—with a self-disparaging comment, a look of wonderment, or an action that seems to right an otherwise off-kilter world.⁴

My earliest recollection of Tom arose when in 2000, Tom who was a member of the executive committee of what was then known as

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¹ When a Chicago Probate Court Clerk who had amassed a fortune at his job—no doubt through parsimony and prudent investment strategies—died a note was found in his desk that read “I am dying intestate: this is my gift to the probate bar of Chicago.” In like manner, there is no way to celebrate Tom Rutledge (806 hits on americanbar.org) more effective than to shower him with footnotes and typos.

² Named for Martin I. Luboff, noted Delaware lawyer and scholar who once convinced a couple of foolish lawyers from square states, who will remain nameless, that one had to pay a toll to enter Delaware. See also https://www.delawareonline.com/story/news/local/2014/01/16/dialogue-delaware-sorry-folks-delaware-is-closed/4523785/

³ The Luboff Award was established in 2001 to honor the memory of Marty Luboff who untimely passed away on January 1, 2001. Marty was the quintessential lawyer—careful, thorough, exacting, engaging, insightful, precise, provocative and persistent, while gentle, kind and courteous. He was a good friend and mentor to scores of lawyers in Delaware and throughout the United States. Marty was a long-time member of, and key participant in, the LLCs, Partnerships and Unincorporated Entities Committee. He chaired the Limited Partnerships Subcommittee at the time of his death. The Luboff Award is to be given by the Committee to attorneys and others who have made material contributions to the development of alternative entity law. Richards Layton & Finger, P. A. of Wilmington, Delaware, with which Marty Luboff practiced, has generously assisted the Committee in establishing this Award.

⁴ Furthermore, on aiding and abetting the malicious purchase of wine at the Austin Four Seasons, the affiant sayeth not.

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¹⁶ As in demanding of time and demanding (in just the nicest possible way) of articles from committee members.


¹⁹ PUBOGRAM Volume XIX No. 1 (November 2001) available at https://www.americanbar.org/content/dam/aba/administrative/business_law/newsletters/CL590000/full-issue-200111.authcheckdam.pdf at page 20 (noting that the E-mail delivery system was preferential to having them hand delivered by your obedient servant).


spoke at the 2003 Symposium at the Widener University with Beth Miller on The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations, with the other Tom (Geu) explained Albright to all of us, and with Ellisa Opstbaum Habbart gave us a report on the Uniform Statutory Trust Act: Current Status. While all this was going on, Tom also getting uniform unincorporated acts adopted in Kentucky.

This only a small part of what Tom has contributed to the law of alternative entities and to each of use. His sense of history and context is always refreshing. Somehow the particular foolishness going on around in what seems the craziest of times is abated when Tom evokes the Diet of Worms, the anniversary of some medieval battle, or some abstruse reference to medieval scholarship. Like all true leaders, he has often ended up doing most of the worked needed and given credit to those around him when it turns out well. Many of us have written or spoken or taught together with Tom and his generosity, wisdom, and humor have made the experiences very both intellectually and spiritually enriching.

Whether it is at the podium, the computer or merely walking down an Austin street, Tom has made us wisher – and more importantly – more appreciative of the world in which we live and our extraordinary good fortune to be living now, practicing the law of relationships, and sharing all of this with wonderful people. In this respect Tom personifies everything we loved about Marty Lubaroff and still carry in our hearts.

From Professor Joan Heminway:

Tom Rutledge is so deserving of this prestigious award. I know that he understands its significance and values it.

Like Marty Lubaroff, Tom is a lawyer’s lawyer—he wants to get to the bottom of the question and does so with rigor and precision. And also like Marty, Tom is an excellent colleague, bridging gaps among practitioners of unincorporated business entity law from our many roles and vantage points. He is especially adept at connecting those of us in the legal academy with our allies in private practice. I am personally grateful for that. For example, his blog posts and messages with just-decided cases attached are so welcomed by those of us lucky enough to be on his mailing list. And his “birthday reminders” are strong evidence of the personal touch he adds to everything. In short, we could not have picked a better person for the Martin I. Lubaroff award this year. Kudos to Tom! He makes us all look good.

From Lauris G.L. Rall:

There is no one on the LLC/Partnerships Committee who has worked harder during the last decade on furthering the vision and work of the Committee than Tom Rutledge. Initially as part of the Rutwig team with Scott Ludwig, Tom worked closely with Scott to provide a workable structure to the Committee, including its Subcommittees and various project task forces. Scott and Tom (Batman and Robin, Bonny and Clyde) formed a dynamic duo to push forward publishable product and to expand inclusiveness by fostering online meetings and webinars. Creating the LLC Institute was brilliant and Tom has been in the middle of that from the beginning. Tom’s reign as Chair of the Committee while at the same time managing the PUBOGRAM (as it really should always be called) continued to underscore his magnificent dedication to the Committee’s work. Even with Garth at the helm now, Tom’s steady hand as First Mate and Editor in Chief makes his presence invaluable to the Committee’s work.
To top it all off, even though he comes from a questionable education background, and has spent too much time with dirt farmers, Tom is a joy to be with, and his intellect and charm make him a fine fellow at every party. A small group of golf nuts is headed to his home turf soon, and Tom has promised an audience with the Governor of Kentucky and a chance to ride the horses in a race at Keeneland. 17 What a guy!!!

From Louis T.M. Conti:

What can one say about Tom Rutledge, a Kentuckian sake drinker, being honored with the Marty Lubaroff Award for excellence in alternative entity laws and service to the ABA LPUE Committee? Well, quite a bit actually. Full disclosure, I knew Marty Lubaroff from my early days on the LPUE Committee, then called the PUBO Committee, because back then we were more focused on partnership law than LLC law. When one recalls Marty’s presence, dress, demeanor, and style, then considers Tom’s presence, dress, demeanor and style, one would never say they were mirror images. However, when one considers Marty’s thoughtfulness, wisdom and knowledge of the law on alternative entities, and Tom’s thoughtfulness, wisdom and knowledge of the law on alternative entities, one can immediately embrace Tom and Marty’s similarities. Obviously no one receives this recognition without exemplary legal knowledge and expertise. Tom has that in spades. Tom also is the most prolific (practicing lawyer) author on the Committee, and more importantly, he uses his love of Medieval History in his writings and keeps the Committee entertained constantly in our meetings and calls with historical references and stories. Tom somehow finds time to publish the Committee’s Newsletter, moonlights as an adjunct professor, serves as a Uniform Law Commissioner, ABA Advisor to ULC Drafting Committees, and does everything touching statutory entity laws in Kentucky. Of course, he will also unreservedly comment on LLC case law and statutory law across the country. Some would call him an over-achiever. I call him a friend and one of the most deserving recipients of the Marty Lubaroff Award since Marty Lubaroff, and I thank him every day (silently) for everything he has done, and continues to do, for the LLC, Partnership and Unincorporated Business Entities Committee. We are all better off for having known and benefitted from our time shared with Tom Rutledge. Congratulations Tom!

From Kelley M. Bender:

There hasn’t been a person on the Committee that has been more welcoming, inclusive and supportive than you, Tom. I might have stopped coming to Committee events long ago were it not for your willingness to bring me into the fold, and I am so grateful to you for it. This honor is very well deserved and I know it is also very well received by you, as I know you think quite a lot of the eccentric bunch of nerds we call friends on this Committee.

From J. William Callison:

It goes without saying that Tom is a dear friend and valued colleague. Through our Committee, LLC and partnership lawyers form a strong, vibrant and continuing community. Communities, like gardens (and Alabama’s plowed fields – looking at you, the other half of Rutwig), need to be tended in order to maintain strength and to grow. Tom is a community builder par excellence. Hats off to Tom Rutledge, who maintains and circulates the list of peoples’ birthdays and generally creates the ligaments and tendons that connect all of us. This recognition is extremely well deserved, and I am proud to have been Tom’s friend for these many years.

From Stuart L. Pachman:

With all the committees, programs, and bar association projects in which he participates and takes a leading role, and the numerous emails he sends boosting the LPUE, when does he practice?

From Professor Daniel S. Kleinberger:

The person who first used the phrase “like giving an Uzi to a two-year old” in reference to protected series. Need I say more?

Ok - a little more: intelligent, insightful, industrious, indefatigable, ineffable,— and that's just using one letter of the alphabet.

Possessed of both wit and wisdom. For example (he can reveal the contexts if he so

17 Editor’s Note – Lauris is delusional.
* "No, you wouldn't have. You would have just doubled your hourly rate."

* "Every day. We call them clients."

It will be an honor to be among those honoring him.

**From Christina M. Houston:**

It is wonderful to be celebrating Tom the same year that we enjoyed the documentary, RBG. How am I connecting RBG, Marty and Tom?

Each, a trailblazer. Each walked an independent path — not for any reason other than personal conviction, intense intellectual ambition and a determination to ensure the correctness of our laws.

Each, a visionary. Each invested in the future — every person matters; every project matters; every conversation matters. Passion is contagious — so is a delightful sense of humor. When a leader cares, we do too.

How many of us learn from Tom? How many of us are inspired by Tom? How many of count our blessings that Tom considers us a friend? Tom is one of the greats for reasons that we all know and enjoy. The opportunity to celebrate Tom? Nobody thinks twice.

He makes us smile. He is there for us for absolutely every professional matter and much more importantly for every personal moment. To have the opportunity to work with Tom is humbling. To get to spend personal time with him is priceless.

We are envious of Hannibal because nobody has a better life.

Thank you, Tom. We know how much you care, and we celebrate you.

**From Professor Mohsen Manesh:**

Impossibly productive, Tom is a better scholar than most full-time law professors. I can only imagine that he is also a scary-good lawyer. But there is nothing otherwise scary about Tom. He is jovial and unpretentious. He leads, encourages, connects, and enlightens. Perhaps no one is a more deserving or fitting recipient of the Martin I. Lubaroff Award than Tom Rutledge.

**From Professor Carter Bishop:**

I can’t make the LLC conference this year and likely not the Lubaroff dinner. However, you know how much I respect Tom. I met Scott Ludwig and Tom at the same time nearly before Margaret Ann and I were married (okay, not that long). He is a consummate professional with a sense of humor, something I appreciate. More specifically, Tom always makes time for those suffering. His notes to Margaret Ann since her accident have been comforting to her and hence to me.

**From James “Jim” Wheaton:**

I can’t remember when I first met Tom, but I’m sure that what struck me was his penchant for outdoor gear. At a time when I went around with a rolling briefcase, and Scott Ludwig traveled with two bankers boxes with mysterious papers and extra white shirts, Tom’s uniform was coat, tie, jeans and a backpack dripping with carabiners. The mountain climbing gear seemed overkill at meetings in Florida (highest peak, 345 feet) and DC (highest peak, the Washington Monument), but at least it reminded me that law was not the only source of fun. For Tom, that fun also included Coyote Uglies in Tampa and Nashville, but those are not stories I’m willing to tell unless forced to do so because of an FBI investigation. (He liked beer. He still likes beer. But I have no recollection of those events).18

Tom’s efforts on behalf of the LPUE community have been unflagging. He’s been involved on every drafting project, actively engaged much of the committee along with him, reinforced the community nature of our group with birthday reminders, and took the LLC Institute to great places. He writes, he speaks, and he teaches. He is a worthy recipient of the Lubaroff award, and I look forward to his formal recognition in Washington.

**From Lisa R. Jacobs:**

My heartiest congratulations to the most deserving Mr. Rutledge on his being the

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18 Editor’s Note. Tom hates beer.
recipient of the 2018 Martin I. Lubaroff Award. Tom is the perfect combination of so many characteristics: truly brilliant, supremely dedicated; thoughtful and caring lawyer; prolific writer; irreverent prankster; consummate professional and friend. Our fabulous section, the practice of law and humanity have all been blessed by Tom’s contributions. Kudos.

From Steven "Steve" G. Frost:

Tom Rutledge’s picture deserves to be in Wikipedia as part of the description of the Lubaroff Award. No one has done more than Tom to advance the law of unincorporated entities, and no one more consistently and frequently gives of himself to others. Examples of his professional accomplishments include that Tom has written an unusually large number of scholarly articles about the law of partnerships and LLCs, taught classes in law schools and in CLE programs, been an advisor to, and a commissioner of, the Uniform Law Conference in drafting unincorporated organization laws, been an officer of LPUE, edited the Pubogram (or whatever it is called today), and mentored young members of the Committee (always seeking to make them both active and, more importantly, feel welcome in the Committee). Anyone who has met Tom knows that he cares more about his friends than he does himself. It is not unusual for Tom to send you an overnight package with a gift he thinks you will enjoy, a book in the mail about a topic important to you, or stack of articles he has found about an activity or a place he knows you are going to visit. He is always thinking about how to enrich the lives of those around him. I am fortunate to have Tom as a friend and congratulate him for receiving this well-deserved award and recognition.

From Daniel J. Sheridan:

Tom’s unflagging dedication to the work of the LLC Committee is exceeded only by his sunny disposition and quick wit (which some may misconstrue as curmudgeonly and sarcastic – but they obviously don’t know Tom). During the eight years I have actively participated on the LLC Committee, I have benefitted from Tom’s support and guidance, enjoyed his company and humor, and marveled at his perseverance and tenacity. His scholarly contributions are of the same high caliber of many previous recipients of the Lubaroff Award, and his leadership continues to be one of the primary reasons the LLC Committee remains, as Tom would put it, “the best damn committee in the ABA”. Kudos to you Rutledge on this well-deserved honor.

From Allan G. Donn:

Each year when it is time to consider the award of the Lubaroff Award, we naturally consider the distinction between contributions to the law of unincorporated business organizations, on the one hand, and contributions to the Committee, on the other hand. In the case of Tom Rutledge, we don’t have to categorize his efforts because they are superlative in both categories. Stated differently, they are what Duke Ellington would describe as “beyond category.”

In addition to the many articles that have appeared in what many of us still refer to as the PUBOGRAM, Tom has written valuable articles for the bimonthly Journal of Passthrough Entities. All of us are indebted to whomever recruited Tom for that position.

I know that Tom will take it as a supreme complement when I say that his prodigious work reminds me of Beth Miller. I think of each of them that they must be twins because no one person could accomplish and produce what they do.

From Peter D. Hutcheon:

After 16 years of starting and editing The PUBOGRAM (as it always will be for me), I began looking for someone to take over. But as I discovered this was not just a “successor” in the sense of temporal sequence, but rather someone whose tireless enthusiasm and salesman-like personality fundamentally changed and upgraded our Committee newsletter into the authoritative source of information and analysis of all things related to alternative entities. And what you may ask was the key attribute of Mr. Rutledge? He is a medievalist! Truly something of a modern-day “knight-errant” (complete with his own set of armor). And how aptly coming from the Commonwealth of Kentucky - he bespeaks the essence and true meaning of “Bourbon” and he is surely one of Kentucky’s greatest “Kernals”, of wit, industry and friendship. Well-done, Brother Thomas!
From John “Johnny” F. Lyle III:

Tom Rutledge is an attorney’s attorney. Tom is brilliant, caring, intellectually curious, thoughtful, diligent and a good friend. He is very deserving of this award and a credit to our Committee.

From Gerald V. Niesar:

Those of us who had the honor and pleasure of working with Larry Ribstein over the years all remember his interjection, almost any time a new legal subject was introduced, to wit: “I wrote an article on that”. I believe I was not the only person skeptical of some of those claims. However, in the case of Tom Rutledge, even though I have never heard him make such a claim, I know it would be true if he did.
At its 2017 annual meeting in San Diego, the Uniform Laws Commission gave final approval to the Uniform Protected Series Act. A copy of this Act, **finalized as to style and with comments**, is enclosed.

There was a program on this Act at the 2017 BLS Annual Meeting in Chicago. A copy of the PowerPoint slide deck used at the presentation is enclosed.

The complete history of the project, including various memos on particular topics and drafts, including of the comments, are available on the ULC website at: http://www.uniformlaws.org/Committee.aspx?title=Protected Series Act.

Steve Frost and Kelley Bender wrote an article discussing this new act for the JOURNAL OF PASSTROUGH ENTITIES. A copy of that article is enclosed.

Allen Sparkman has authored an article on series, and the working draft is enclosed.

Nebraska is the first state to have adopted the Uniform Statutory Trust Act. L.B. 1121. It is effective January 1, 2021. A copy of this bill is enclosed.

At the recent BLS Annual Meeting a program on series was chaired by Dan Sheridan. The materials from that program are as well enclosed.

As you know, our Committee has been heavily involved in this project since its inception. Steve Frost served as the committee chair, and Dan Kleinberger as the reporter. Allan Donn served as the ABA advisor, and numerous committee members, either as commissioners or advisors from the Section of Business Law, were involved. At the risk of inadvertently leaving someone off, the contributions of Jay Adkisson, Carter Bishop, Bill Clark, Lou Conti, Harry Haynsworth, Peter Hutcheon, Leigh Griffith, Lisa Jacobs, Greg Ladner, Steve Leitess, Scott Ludwig, Beth Miller, Sandy Miller, Marla Norton, Allen Sparkman, Jim Wheaton and John Williams need to be recognized. On the crucial question of how (whether?) a series may grant a security interest, we relied upon the UCC expertise of Ed Smith and Norm Powell.
The Committee Presented the Professor Elizabeth “Beth” S. Miller
Content “Recognition” to Professor Beth Miller

At the 2017 LLC Institute, Professor Elizabeth Miller was recognized for her contributions to the Committee’s content efforts. The basis for this recognition is almost so obvious it is not worth reciting, but for those of you who are more new to our Committee, the various case law summaries prepared by Beth are a unique resource. Without editorializing, Beth for many years reviewed essentially every decision involving LLCs, and now provides a summary of the leading decisions. Although she does review decisions from Delaware, those decisions are often well covered by other resources. Beth reviews the decisions from other states, filling what would otherwise be a substantial void. All in all, these summaries are one of the greatest assets available to anyone doing research in the area of LLCs. But for Beth’s tireless efforts, this resource would not exist.

In addition to the preparation of these written materials, for in excess of 20 years Beth has chaired programs at our various meetings on these case law developments.

Otherwise widely published, including as the author of treatises on the Texas Business Organizations Code, Beth was chair of our Committee from 2004 to 2007, in 2011 received the Jean Allard “Glass Cutter” Award, and was the 2013 recipient of the Martin I. Lubaroff Award.

For some period of time, the Committee has been working on a “content award” as a means of recognizing those members of the committee who have made particular contributions to its efforts to create content useful to the membership. For reasons that would be obvious to any member of our Committee, we wanted this award to be named after and in recognition of Professor Beth Miller. As we worked the ABA process, we came to learn that the ABA has a rule to the effect that no award may be named after a living person. For that reason, for now we will simply “recognize” and grant “recognition” to those persons who have made significant contributions to the Committee’s content efforts.
2018 Amendments to Delaware’s General Corporation Law and Alternative Entity Statutes

By: Louis G. Hering & Melissa A. DiVincenzo
Morris, Nichols, Arsh & Tunnell LLP
Wilmington, Delaware

In its last session, the Delaware legislature passed a number of amendments to the Delaware General Corporation Law (the “DGCL”) and the Delaware “alternative entity” statutes—the Delaware Limited Liability Company Act (the “DLLCA”), the Delaware Revised Uniform Limited Partnership Act (the “DRULPA”), the Delaware Revised Uniform Partnership Act (the “DRUPA”) and the Delaware Statutory Trust Act (the “DSTA”). Except as noted below, all of the amendments became effective on August 1, 2018.

The amendments to the DGCL effected a number of substantive, technical and clarifying changes, including changes to the provisions governing the ratification of defective corporate acts and changes to the provisions governing the availability of appraisal rights in “medium-form” mergers.

The amendments to the alternative entity statutes include a number of significant substantive changes, the majority of which were made to the DLLCA and, as described below, (i) create a new type of limited liability company series known as registered series, (ii) permit registered series of the same limited liability company to merge or consolidate, (iii) permit a limited liability company to divide statutorily into two or more limited liability companies, (iv) create statutory public benefit limited liability companies, (v) provide jurisdiction to the Court of Chancery, upon a motion by the Attorney General, to cancel the certificate of formation of any limited liability company for misuse or abuse and (vi) provide protection from liability to delegates of a trustee acting pursuant to Section 3806(i) of the DSTA who rely in good faith on certain types of information obtained in performing their duties.

This article will first discuss the amendments to the DGCL and then the amendments to the alternative entity statutes.

Amendments to the DGCL

Distinguishing from a Registered Series of an LLC. [DGCL § 102]

Section 102 sets forth requirements for the contents of a certificate of incorporation and requires that the name of any corporation must be distinguishable from names of other entities on the records of the State of Delaware. Section 102(a)(1) has been amended to include a registered series of a limited liability company to the list of entities whose names must be distinguishable from the name of any newly created corporation.

Extension of 204 and 205 to Nonstock Corporations. [DGCL § 114]

Section 114 has been amended to permit nonstock corporations to ratify defective corporate acts pursuant to the provisions of Sections 204 and 205.

The 204 Amendments. [DGCL § 204]

Section 204, which allows for the ratification of defective corporate acts, has been amended to confirm and clarify certain provisions. Section 204(c)(2) has been added to confirm that ratification under Section 204 is available in circumstances where no valid stock is outstanding (regardless of the existence of any putative shares). Section 204(d), which requires notice to holders of valid and putative stock as of the time of the defective corporate act in ledgers, blockchain and other networks of databases were made to the DRULPA and the DSTA. The amendments also include several important changes to the DSTA that, as described below, (i) create default duties for trustees regarding the selection, supervision and actions of officers, employees, managers or delegates acting pursuant to Section 3806(b)(7) or Section 3806(i) of the DSTA, (ii) create default duties for agents and delegates of a trustee acting pursuant to Section 3806(b)(7) or Section 3806(i) of the DSTA, and (iii) provide protection from liability to delegates of a trustee acting pursuant to Section 3806(i) of the DSTA who rely in good faith on certain types of information obtained in performing their duties.

1 Mr. Hering and Ms. DiVincenzo are partners at the Wilmington, Del. firm of Morris, Nichols, Arsh & Tunnell LLP. Mr. Hering serves on the committees of the Delaware State Bar Association that have responsibility for the drafting and annual review of Delaware’s alternative entity statutes.
connection with any meeting of stockholders to vote on a ratification, has been amended to permit a corporation to satisfy the notice requirement by providing notice to such holders as of the original record date for the defective corporate act (to the extent applicable). Section 204(g) has been amended so that the notice requirement of Section 204(d) may be satisfied by disclosure in a document publicly filed with the Securities and Exchange Commission if the corporation is a public company.

The amendments to Section 204(h)(1) clarify that any acts that are within a corporation’s general powers may be ratified under Section 204 for any failure of authorization. This amendment is intended to confirm that corporate acts that were not authorized in accordance with the requirements of the DGCL are still “within the power of a corporation” for purposes of Section 204(h)(1) (other than acts that involve the exercise of a power expressly prohibited, such as the exercise of banking powers). This amendment is intended to negate the suggestion in *Nguyen v. View, Inc.*, C.A. No. 11138-VCS (Del. Ch. June 6, 2017) that an act authorized in violation of the DGCL is not a “defective corporate act.” Rather, such an act (that is within the power of the corporation) is a “defective corporate act” that involves a failure of authorization. These amendments do not limit, eliminate, modify or qualify any power granted to the Court of Chancery under Sections 204 or 205 of the DGCL.

Finally, Section 204(h)(2) was amended to clarify that the failure to authorize or effect an act or transaction in compliance a proxy or consent solicitation disclosure, if and to the extent such failure would render such act or transaction void or voidable, can be ratified pursuant to Section 204. The amendments to Section 204 are effective only with respect to defective corporate acts ratified or to be ratified pursuant to resolutions adopted by a board of directors on or after August 1, 2018.

**“Market Out” Exception to Appraisal Rights for 251(h) Mergers. [DGCL § 262]**

The amendments to Section 262 expand the “market out” exception to appraisal rights to mergers effected pursuant to Section 251(h), the “medium-form” merger provision (which allows for a merger following a tender offer without separate stockholder approval beyond the majority tender). In such mergers, appraisal rights generally will not be available to holders of shares of a target corporation if such shares were listed on a national securities exchange or held of record by more than 2,000 holders immediately prior to the execution of the merger agreement, so long as the holders of such shares are not required to accept anything other than any combination of shares of stock of the surviving corporation, shares of stock of a corporation that is listed on a national securities exchange or held of record by more than 2,000 holders, and cash in lieu of fractional shares of such corporations. The amendments to Section 262(e), a provision that requires notice to holders of shares who have demanded appraisal, clarify that in mergers effected pursuant to 251(h) the surviving corporation must provide notice of the aggregate number of shares that are not “tendered” for purchase or exchange and for which appraisal has been demanded. The amendments to Section 262 are effective for mergers or consolidations consummated pursuant to an agreement entered into on or after August 1, 2018.

**Amending the Revocation or Forfeiture of Charter Provisions. [DGCL § 284]**

The amendments Section 284 provide that the Attorney General has the exclusive authority to file for the revocation or forfeiture of a charter of a Delaware corporation. Additionally, the amendments allow the Delaware Court of Chancery to appoint a trustee to administer and wind up the affairs of a corporation whose charter has been revoked or forfeited.

**Simplifying Certificates of Revival. [DGCL § 313(b)]**

Section 313, which relates to the revival of exempt corporations, was amended so that the Delaware Secretary of State is no longer required by such provision to issue a certificate stating that the corporation’s certificate of incorporation has been revived.

**Amendment to Annual Franchise Tax Reports. [DGCL § 502(a)]**

Section 502, which includes the requirements for the annual franchise tax report, has been amended to provide that corporations exempt from taxation for any cause no longer have to list the specific facts entitling the corporation to exemption when filing their annual franchise tax reports.
Amendments Common to Multiple Alternative Entity Statutes

Distributed Ledgers and Blockchain. [DLLCA §§ 18-104(g); 18-302(d); 18-305(d); and 18-404(d); DRULPA §§ 17-104(g); 17-302(e); 17-305(c); and 17-405(d); DSTA §§ 3801(a); 3806(f)(2); 3806(g)(2); and 3819(d)]

The amendments amend numerous provisions of the DLLCA, the DRULPA and the DSTA to provide express statutory authority to use networks of electronic databases, including distributed ledgers and blockchain, to create or maintain records of the entity and for certain electronic transmissions. These amendments confirm that this rapidly advancing technology is available to be used with respect to limited liability companies, limited partnerships and statutory trusts.

Amendments to the DLLCA

Registered Series and Protected Series. [DLLCA §§ 18-101; 18-102(3); 18-103; 18-104; 18-105; 18-203; 18-206; 18-207; 18-208; 18-209(a); 18-215; 18-218; 18-219; 18-220; 18-221; 18-1105(a); 18-1107; 18-1108; 18-1109; and 18-1110]

The amendments amend numerous provisions of the DLLCA to create a new type of series known as registered series. Registered series will be addressed in new Section 18-218 of the DLLCA. Section 18-215 of the DLLCA, which currently addresses series, will be amended to provide that series formed under Section 18-215(b) of the DLLCA (either before or after the amendments) will be known as protected series. The provisions relating to registered series are similar to the provisions relating to protected series with several notable exceptions. First, in order to facilitate the use of registered series in secured financing transactions, registered series are designed to qualify as registered organizations under the Uniform Commercial Code. Thus, a certificate of registered series is required to be filed with the Delaware Secretary of State to form a registered series, and the name of a registered series must begin with the name of the limited liability company and be distinguishable from the names of other Delaware business entities or business entities qualified or registered to do business in Delaware. Second, one or more registered series of a limited liability company may merge or consolidate with or into one or more other registered series of the same limited liability company. Third, certificates of good standing and certificates of existence with respect to registered series will be issued by the Delaware Secretary of State. Fourth, a protected series of a limited liability company may convert to a registered series of the same limited liability company and a registered series of a limited liability company may convert to a protected series of the same limited liability company. Finally, an annual franchise tax in the amount of $100 per registered series will be required to be paid, but the aggregate amount of annual franchise tax for all registered series of a limited liability company will be capped at $5,000 if a limited liability company has more than fifty registered series. Because of the time necessary to implement the creation of registered series, including time needed to prepare for filings with, and the issuance of certificates by, the Delaware Secretary of State, the amendments regarding registered series and protected series will not be effective until August 1, 2019.

Division of a Limited Liability Company. [DLLCA §§ 18-203(a); 18-206; 18-209(a); 18-217; and 18-1105(a)]

New Section 18-217 of the DLLCA authorizes a limited liability company to divide into two or more newly formed limited liability companies, with the dividing limited liability company either continuing its existence or terminating as part of the division. A division of a limited liability company is effected by (i) the adoption of a plan of division setting forth the terms and conditions of the division including, among others, the allocation of assets, property, rights, series, debts, liabilities and duties of the dividing limited liability company among the resulting limited liability companies and, if it survives, the dividing limited liability company, and (ii) the filing with the Delaware Secretary of State of a certificate of division and a certificate of formation for each newly formed limited liability company. A plan of division will be given effect to divide the assets and liabilities of a limited liability company among the resulting limited liability companies and, if it survives, the dividing limited liability company so long as the plan of division does not constitute a fraudulent conveyance under...
Statutory Public Benefit Limited Liability Companies. [DLLCA Subchapter XII]

New subchapter XII of the DLLCA authorizes the creation of statutory public benefit limited liability companies, which are similar to public benefit corporations organized under subchapter XV of the DGCL. Subchapter XII of the DLLCA is intended to provide a simple and efficient “opt-in” procedure for forming a public benefit limited liability company. As with a public benefit corporation, a statutory public benefit limited liability company must be intended to produce a public benefit and to operate in a responsible and sustainable manner. New subchapter XII of the DLLCA does not limit the formation or operation of a limited liability company formed or operated for a public benefit (including a limited liability company designated as a public benefit limited liability company) that is not a statutory public benefit limited liability company.

Powers to Cancel a Certificate of Formation for Abuse or Misuse. [DLLCA §§ 18-112; and 18-203(a)]

Under new Section 18-112 of the DLLCA, upon motion by the Attorney General, the Court of Chancery may cancel the certificate of formation of any limited liability company for abuse or misuse of its limited liability company powers, privileges or existence. The Court of Chancery may appoint a trustee or receiver to administer such limited liability company’s winding up.

Amendments to DSTA

Duties and Liabilities of Trustee Regarding Officers, Employees, Managers and Delegates. [DSTA §§ 3806(b)(7); and 3806(m)]

The amendments add new subsection (m) to Section 3806 of the DSTA to provide default rules for a trustee’s duties and liabilities regarding the selection, supervision and actions of officers, employees, managers or delegates acting pursuant to Section 3806(b)(7) or Section 3806(i) of the DSTA. The default rule provides that, subject to the governing instrument, a trustee has no duties or liabilities with respect to the selection, supervision, or actions of, or to exercise or perform the rights, powers or duties of, an officer, employee, manager or delegate when such appointment, election, engagement or delegation is made, or is required to be made, pursuant to a provision of the governing instrument or another agreement contemplated therein. Additionally, when a trustee makes an irrevocable delegation under Section 3806(i) of the DSTA pursuant to the trustee’s discretionary authority, again subject to the governing instrument, the trustee must exercise the standard of care of a trustee required under the governing instrument or the DSTA in making, and establishing the scope and terms of, such selection or delegation, but is not otherwise responsible for the delegate’s activities. In all other cases, the trustee must exercise the standard of care of a trustee required under the governing instrument or the DSTA in making, and establishing the scope and terms of, such selection or delegation and monitoring such officer, agent or delegate. In connection with the new default rules enumerated in new subsection (m) of Section 3806 of the DSTA, Section 3806(b)(7) of the DSTA was amended to remove the current default rule providing that a trustee shall choose and supervise the officers, managers, employees or other agents or independent contractors of the trust.

Duties and Liabilities of Agents and Delegates. [DSTA § 3806(n)]

The amendments add new subsection (n) to Section 3806 of the DSTA, which provides that an officer, employee, manager or delegate acting pursuant to Sections 3806(b)(7) or 3806(i) of the DSTA shall comply with the scope and terms of the appointment, election, engagement or delegation including any standard of care and standard for liability for failure to adhere to such standard of care set forth therein, but if neither the governing instrument of the statutory trust nor the terms of such appointment, election, engagement or delegation address these issues, such officer, employee, manager or delegate shall exercise its rights, powers and duties subject to the standard of care required of a trustee under the governing instrument or the DSTA and be liable for the failure to do so.
Good Faith Reliance. [DSTA § 3806(k)]

The amendments amend Section 3806(k) of the DSTA to provide delegates of a trustee under Section 3806(i) of the DSTA full protection from liability when they rely in good faith on the records, information, opinions, reports or statements obtained in performing their duties, which is the same standard that applies to a trustee or beneficial owner or an officer, employee or manager acting pursuant to Section 3806(b)(7) of the DSTA.

Personal Liability Protection. [DSTA § 3803(c)]

The amendments amend Section 3803(c) of the DSTA to provide that any person to whom a trustee has delegated its rights, powers or duties to manage and control the business and affairs of the statutory trust under Section 3806(i) of the DSTA has protection from personal liability to the same extent, as an officer, employee or manager acting pursuant to Section 3806(b)(7) of the DSTA. In addition, Section 3803(c) of the DSTA has been amended to add trustees to the list of persons to whom, as a default rule, the protection from liability provided by that section does not apply.

Professor Daniel Kleinberg Recognized by the Uniform Law Commission

At its recently concluded 2018 Annual Meeting held in Louisville, Kentucky, the Uniform Laws Commission extended a special recognition to Prof. Daniel Kleinberger for all of his work as a reporter on the various Uniform Business Entity Acts. In her remarks, Anita Ramasastry, President of the ULC, particularly pointed out Dan’s tremendous service as the reporter on the Uniform Protected Series Act, which she described as “never-ending.”, a task which he executed superbly. She also mentioned his significant work as the research director for the Joint Editorial Board on Uniform Unincorporated Organization Acts.

In his remarks, Dan observed on the important role of the states in our Federal system. In summary, while there is a division of authority and capacity between and among the branches of the federal government, there is just as important a division between the federal and state governments. The ULC, through its uniform acts, assists the states in maintaining that division. Consistent, well reasoned, and comprehensive uniform act address issues that should be addressed at the state level, allowing the states to better fill their roles in the division of power and responsibility.
2018 Amendments to Delaware LLC & Partnership Acts

By: Joshua J. Novak
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Wilmington, Delaware

The Delaware General Assembly recently passed legislation, which has subsequently been signed into law by Delaware Governor John Carney, 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"). With the exception of amendments to the LLC and Partnership Acts addressing the requirements of registered agents (which became effective upon their signing by Delaware Governor John Carney), and amendments to the LLC and Partnership Acts relating to Delaware LLC series (which will not become effective until August 1, 2019), the amendments were effective as of August 1, 2018.

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 ("Delaware GPs").

Division of a Limited Liability Company
[LLC Act § 18-217]

Under a new Section 18-217 of the LLC Act, a single Delaware LLC will be allowed to divide into two or more Delaware LLCs. The original dividing Delaware LLC can continue its existence or terminate as part of the division as provided in a plan of division. In connection with a division, a dividing Delaware LLC must adopt a plan of division setting forth the terms and conditions of the division, including the allocation of assets, property, rights, series, debts, liabilities and duties of such dividing Delaware LLC among the "division Delaware LLCs" (which term means (i) the original dividing Delaware LLC effecting a division in the manner provided in new Section 18-217 of the LLC Act if it survives the division, and (ii) each resulting Delaware LLC formed as a consequence of the division), the name of each resulting Delaware LLC and, if the original dividing Delaware LLC will survive the division, the name of the surviving Delaware LLC. The surviving Delaware LLC, if applicable, or any resulting Delaware LLC must then file a certificate of division and a certificate of formation for each resulting Delaware LLC with the Delaware Secretary of State.

Following a division, each division Delaware LLC will be liable for the debts, liabilities and duties of the original dividing Delaware LLC as are allocated to it pursuant to the plan of division, and no other division Delaware LLC will be liable for such obligations unless the plan of division constitutes a fraudulent transfer under applicable law. If any allocation of assets or liabilities is determined by a court of competent jurisdiction to constitute a fraudulent transfer, each division Delaware LLC will be jointly and severally liable on account of such fraudulent transfer. Debts and liabilities of the original dividing Delaware LLC that are not allocated by the plan of division will be the joint and several debts and liabilities of all division Delaware LLCs.

Section 18-217 of the LLC Act provides that any terms of a written contract, indenture or other agreement that restrict, condition or prohibit a Delaware LLC from consummating a merger or consolidation or transferring assets will apply with equal force to a division if (i) the Delaware LLC was formed prior to August 1, 2018, and (ii) the Delaware LLC entered into such written contract, indenture or other agreement prior to August 1, 2018.

Statutory Public Benefit Limited Liability Companies
[LLC Act §§ 18-1201 - 18-1208]

The LLC Act has also been amended to add a new subchapter XII for purposes of enabling Delaware LLCs to elect to be formed as statutory public benefit limited liability companies ("Statutory Public Benefit LLCs"). Such Statutory Public Benefit LLCs would remain subject to all other applicable provisions of the LLC Act, except as modified or supplanted by the new subchapter XII of the LLC Act governing Statutory Public Benefit LLCs.

In general, a Statutory Public Benefit LLC is a for-profit Delaware LLC that is intended to produce a public benefit and to operate in a responsible and sustainable manner. To that end, a Statutory Public Benefit LLC is required to be operated in a way that balances the pecuniary interests of the members of such
Statutory Public Benefit LLC, the best interests of those materially affected by such Statutory Public Benefit LLC’s conduct, and the public benefit as set forth in such Statutory Public Benefit LLC’s certificate of formation.

Each Statutory Public Benefit LLC would be required, in its certificate of formation, to identify itself as a Statutory Public Benefit LLC and to state one or more specific public benefits to be promoted by such Statutory Public Benefit LLC. "Public benefit" is defined broadly as "a positive effect (or reduction of negative effects) on one or more categories of persons, entities, communities or interests (other than members in their capacities as members) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature."

New subchapter XII of the LLC Act also (i) sets forth specific duties of members, managers and other persons with authority to manage or direct the business and affairs of a Statutory Public Benefit LLC; (ii) imposes special notice requirements on Statutory Public Benefit LLCs, mandating periodic statements to members regarding the Delaware LLC's promotion of its public benefits and as to the best interests of those materially affected by the Delaware LLC's conduct; (iii) contains limitations on the power of Statutory Public Benefit LLCs to (a) adopt amendments to their certificates of formation or effect mergers, consolidations or divisions if the effect would be to abandon their public benefit, or (b) cease to be a Statutory Public Benefit LLC; (iv) establishes a means of enforcing the promotion of the public benefits of a Statutory Public Benefit LLC by granting certain derivative rights; (v) provides that the requirements imposed on Statutory Public Benefit LLCs may not be altered in a limited liability company agreement; and (vi) provides that such new subchapter XII is not to be construed to limit the accomplishment by any other means permitted by law of the formation or operation of a Delaware LLC that is formed or operated for a public benefit (including a Delaware LLC that is designated as a public benefit limited liability company) that is not a Statutory Public Benefit LLC.

Limited Liability Company Series
[LLC Act §§ 18-215, 18-218, 18-219, 18-220, 18-221, etc.]

The 2018 amendments to the LLC Act establish a new type of Delaware LLC series known as a "registered series." The registered series will be governed by a new Section 18-218 of the LLC Act. A registered series will qualify as a registered organization under the Uniform Commercial Code, which may facilitate the use of Delaware LLC series in secured financing transactions. To form a registered series, the certificate of formation of the Delaware LLC must contain a notice of the limitation on liabilities of a registered series, and a certificate of registered series must be filed with the Delaware Secretary of State. The name of a registered series must begin with the name of the Delaware LLC and be distinguishable upon the records of the Delaware Secretary of State from any entity or other registered series formed or qualified to do business in Delaware. Registered series will be able to merge or consolidate with or into one or more other registered series of the same Delaware LLC.

Series created under Section 18-215(b) of the LLC Act, both before and after the enactment of these amendments, will be known as "protected series." These amendments do not alter the features of protected series. An existing protected series will be able to convert to a registered series in accordance with the new Section 18-219 of the LLC Act.

The Delaware Secretary of State will be able to issue certificates of good standing and certificates of existence with respect to a registered series. Each registered series will be required to pay an annual franchise tax of $75.

The amendments regarding series of Delaware LLCs will not be effective until August 1, 2019, to provide the Delaware Secretary of State's office with the time necessary to prepare for the new filings to be made with, and certificates to be issued by, such office in connection with registered series.

Blockchain and Distributed Ledgers
[LLC Act § 18-305, LP Act § 17-305, etc.]

Several sections of the LLC Act and LP Act are being amended to provide express statutory authority for Delaware LLCs and Delaware LPs to use networks of electronic databases
(including blockchain and distributed ledgers) for the creation and maintenance of records of Delaware LLCs and Delaware LPs and for certain electronic transmissions. These amendments are expected to facilitate and accommodate the myriad of uses for these burgeoning technologies in the governance and activities of Delaware LLCs and Delaware LPs.

Registered Agents
[LLC Act § 18-104, LP Act § 17-104, GP Act § 15-111]

The LLC and Partnership Acts were all amended to require registered agents of Delaware LLCs, Delaware LPs and Delaware GPs to satisfy and adhere to regulations established by the Delaware Secretary of State regarding the verification of both the identity of the entity's contacts and individuals for which the registered agent maintains a record for the reduction of risk of unlawful business purposes. The amendments also authorize the Delaware Secretary of State to issue regulations to enforce the requirements applicable to registered agents.

Davis Walker Reappointed to Joint Editorial Board for Uniform Unincorporated Organization Acts

Our Committee, along with the Uniform Law Commission, has in place a Joint Editorial Board for the Uniform Unincorporated Organization Acts (the JEB). Dean David Walker (Drake Law, ret.) a representative of the ULC, has recently completed his first term on the JEB, and it was recently announced that he has been appointed for a second four-year term.

With this reappointment, the Commissioners from the ULC are Lisa R. Jacobs, Steven N. Leitess, Thomas Earl Geu and David S. Walker. From the Committee, the representatives to the JEB are Louis T.M. Conti, Scott E. Ludwig, Elizabeth S. Miller, and Thomas E. Rutledge. Scott is the current Chair of the JEB. There are also emeritus members Michael A. Bamberger, Allan G. Donn, Paul M. Altman and Steven G. Frost. James (“Jim”) J. Wheaton is the research director for the JEB.
Impact of Check-the-Box Conformity on State Tax Appeal Procedures – Alabama Department of Revenue v. Downing

By: Bruce P. Ely
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Birmingham, Alabama

In a case of first impression by an Alabama appellate court, the Alabama Court of Civil Appeals recently considered the appeal of the Alabama Department of Revenue (“ADOR”) of an adverse circuit court ruling that the taxpayer’s (and we use that term liberally as you will see) sales of prepaid authorization number cards for cell phone services were not subject to Alabama sales tax at the time the sales were made. Alabama Department of Revenue v. Downing, ___ So.3d ___, Dkt. 2170129, Ala. Civ. App. (July 7, 2018). That was the substantive issue on appeal; the more intriguing issue for us LLC aficionados was the procedural one – just who is “the taxpayer” on appeal?

Alabama is one of a handful of states that follows the Treasury Department’s check-the-box regulations not only for purposes of state income tax but for sales, use, rental, lodging, and several other state taxes, as well—but only with respect to LLCs. For other federally disregarded entities, such as Q-subs and disregarded limited partnerships, fed-state conformity stops at income tax. See Ala. Code §10A-5A-1.07; ADOR Revenue Procedure 98-001 (Mar. 16, 1998); see also Keatinge & Conaway on Choice of Business Entity §16.18 and Appendix 16A (Thomson Reuters 2018 ed.).

So, who is the proper taxpayer-plaintiff in an appeal of an ADOR assessment involving a single member LLC (“SMLLC”)? The sole member? The sole member doing business as the SMLLC? The SMLLC itself? Or maybe both?? The ADOR assessed Patrick Lee Downing as “the sole member of Downing Enterprises, LLC, a disregarded entity” for unpaid sales tax. He paid the assessment but soon filed a claim for refund with the ADOR, in his individual name “d/b/a Downing Enterprises, LLC”. The refund claim was denied and the SMLLC appealed to the Alabama Tax Tribunal, which affirmed the ADOR’s decision. Mr. Downing then appealed to the local circuit court as “sole member” of the SMLLC. The circuit court ruled his way and ordered the ADOR to honor his refund claim. The ADOR then appealed to the Alabama Court of Civil Appeals, contending for the first time that the SMLLC had lacked standing to appeal to the Tax Tribunal to begin with, and that “only Downing was the proper party”. Under Alabama and most other state’s law, of course, subject matter jurisdiction issues can be raised at any level of the appeal.

The taxpayer argued that for Alabama sales tax purposes, there’s no difference between himself and his SMLLC, citing Alabama’s broad-form version of check-the-box conformity and the above-referenced ADOR Revenue Procedure. Indeed, the Alabama Tax Tribunal’s predecessor, the ADOR Administrative Law Division, had long ago ruled that way in First American Holding, LLC v. ADOR, Admin. Law Div., Dkt. No. MISC. 07-773 (Dec. 20, 2007).

The Court of Civil Appeals saved the taxpayer’s (and maybe his attorney’s) bacon by confirming that Alabama indeed conforms to the check-the-box regs for almost all tax purposes with respect to LLCs, and regardless of whether the assessment was issued to the individual or to the SMLLC, both had standing to appeal.

As a disregarded entity, the LLC is not distinguishable from Mr. Downing for the purpose of appealing [to the Alabama Tax Tribunal], and the Department acknowledges that Mr. Downing would have had standing to appeal the denial of his petition for refund to the Tax Tribunal. We therefore conclude that the LLC also had standing to appeal to the Tax Tribunal.

Suffice to say, this is a cautionary tale to tax practitioners who handle state or local tax disputes involving single member LLCs or other forms of federally disregarded entities. Although the taxpayer won the procedural battle, he lost the substantive war, but this ruling is a teachable moment for all of us.

Bruce P. Ely is a partner with Bradley Arant Boult Cummings LLP, resident in its Birmingham, Alabama office and was a co-author of the original Alabama LLC Act of 1993, including (now with mixed emotions) its check-the-box conformity provision, which has survived through several major revisions and upgrades of the LLC statutes over the years and now resides in the Alabama LLC Law of 2014, of which his esteemed junior partner, Scott E. Ludwig, was a co-author.
Region Bank v. Kaplan: On Equivocation, Obfuscation, Evasion, and Duplicity

By: Jay D. Adkisson
Las Vegas, Nevada

Regions Bank won judgments against a number of companies owned by Marvin and Kathryn Kaplan. These companies and the approximate amounts of the judgments against them were RIA Palms for $4.3 million, Triple Net Exchange (called TNE) for $2.16 million, BNK Smith for $213,000 and MK Investing (MKI) for $1.5 million. Collectively, these companies are referred to as the "Kaplan entities".

While fighting Regions Bank, but before the bank won its judgments, the Kaplan entities "loaned" more than $700,000 to Kathryn, and MKI transferred $215,000 in cash and a $370,500 interest in another company (785 Holdings, LLC) to yet another Kaplan company, this one being MIK Advanta, LLC (MIKA), which, like MKI, was owned by Marvin's self-directed IRA and managed by Marvin. Not only were they "loans", but the Kaplans and MIKA "repaid" the "loans" by paying the Kaplan entities' legal fees and costs incurred in fighting Regions Bank.

We'll see how that excuse flies, as the next thing to happen was for Regions Bank to sue the Kaplans and their entities alleging fraudulent transfers under the Florida Uniform Fraudulent Transfers Act, upon which claim the U.S. District Court for the Middle District of Florida held a bench trial and then issued the following opinion.

The Court first took up the transfers by the Kaplan entities to Kathryn, which, again, the Kaplans attempted to characterize as "loans". It is here that the Court commented on something that happened at trial, which to me at least seems like a common experience in fraudulent transfer cases: namely, the debtors couldn't get their story straight.

While Kathryn alleged that she received "loans" from the Kaplan entities, Marvin wasn't so sure, and was not able to testify whether the payments to Kathryn were loans or not. Marvin thought that it was possible that the payments to Kathryn to loans, but when pressed on the subject finally said:

I made her a loan if it was a loan.

Further, Marvin testified that although the Kaplans has used the $700,000 paid to her by the Kaplan entities to pay those companies' legal fees, Marvin was unable to state that this amounted to a repayment of the loans, or even what the term of the loans were or their interest rate. The Court was less than impressed:

In sum, Marvin's cagey testimony and the Kaplan entities' conduct displays a protracted pattern of equivocation, obfuscation, evasion, and duplicity.

It didn't help that the Kaplans on their tax returns originally treated the money as "distributions" from the Kaplan entities, but then later went back and amended their returns to reflect the moneys received as loans. For his part, Marvin "blames his accountant for purportedly botching the original tax return", but this was offset somewhat by Marvin's admission that he signed the return without reading it.

Another problem with the loans characterization is that the Kaplans failed to document the loans, but instead simply passed money around and then tried to paint the transactions as loans and repayments later. A bigger problem was Marvin's story that the reason the moneys were distributed to Kathryn because the Kaplan entities themselves lacked bank accounts from which they could pay their attorneys directly. The obvious problem with this story was that the Kaplan entities paid the money from their own bank accounts.

Even the story that the money was to pay their existing legal bills fell flat, since $700,000 was paid to their attorneys, but their attorneys' fees by that time were only a little over $500,000. The excess amounts were kept in their lawyers' trust accounts for the benefit of Kathryn, and Marvin could not explain why Kathryn simply didn't keep this money in her own account in the first place. Thus, the court:

Rather than ease an observer's mind, the confusing and circuitous conveyances emit the unmistakable odor of fraud.

The Court further noted that a repayment of the loans would not mean that they were anything less of a fraudulent transfer under the Florida Uniform Fraudulent Transfers Act (FUFTA), although here the Court made a curious cite to
an 11th Circuit opinion that says that repayment of a fraudulent debt bars discharge.

At any rate, the effect of the "loans" was to deplete the Kaplan entities' bank accounts so that those moneys would not be available to Regions Bank, and thus effectively unable to pay their debts to bank at all. Thus, in addition to everything else, the payments to Kathryn were in the way of a constructive fraudulent transfer (an oxymoron if there ever was one), which is better understood as failing the insolvency test of the FUFTA.

Next, the court considered the transfer of about $74,000 from MK Investing (MKI) to MIK Advanta, LLC (MIKA). Here, Marvin conceded that in exchange for the $74,000, MKI received nothing of value from MIKA. Why was the money paid? According to Marvin:

"I'm sure [MIKA] had to buy something" or "[MIKA] had expenses, we had probably a lot of expenses."

At this point, an issue came up as to whether MKI was insolvent at the time that it made the transfer, insofar as at that time it had a cross-claims against the Smiths (who, apparently, were co-investors with the Kaplans) that eventually resulted in judgments against the Smiths for more than $7 million. This might have helped MKI, except that Marvin testified to the effect that the $7 million judgment wasn't worth the paper that it was printed on. It also didn't help that MKI didn't make any attempt to collect on the $7 million judgment, which was pretty good evidence that Marvin was right about the true value of the judgment.

The court held that because MIKA didn't give anything of value to MKI for the nearly $74,000 transferred to the former, the transfer violated the insolvency test of the FUFTA.

In this same line of transactions was the transfer to MIKA by MKI of MKI's interest in 785 Holdings. Prior to trial, the parties stipulated that MKI owned an interest in 785 Holdings, but then at trial Marvin called a reverse and denied that this was the true state of facts. At this point, Regions Bank showed Marvin a document, signed by Marvin, that MKI its interest in 785 Holdings to MIKA, but Marvin claimed that the document was inaccurate and that he had been forced by Advanta, the IRA administrator, to sign the document. The court was not impressed:

"I'm not sure [MKI] had to buy something" or "[MKI] had expenses, we had probably a lot of expenses."

According to the Kaplans, the "exclusive remedy" of the charging order operates to exclude Regions' access to MIKA's interest in 785 Holdings. Stated somewhat differently, the Kaplans argue that Delaware corporate law immunizes a fraudulent transfer from the Uniform Fraudulent Transfer Act so long as the judgment debtor transfers wealth through the vehicle of an interest in a Delaware LLC. If the Kaplans' argument were correct, every fraudster (and probably most debtors) would flock to the mechanism of an interest in a Delaware LLC. The more sensible view—adopted by the persuasive weight of authority in resolving either this issue or a similar question about the application of the Uniform Fraudulent Transfer Act to an LLC—is that no law (of Delaware or of any other state) permits fraudulently transferring with impunity an interest in an LLC. Although the charging order against a distribution is the "exclusive remedy" through which Regions can attempt to collect on an LLC interest owned by a judgment debtor, Regions is not yet a judgment creditor of MIKA (in other words, Section 18-703 lacks application at this moment). Actually and constructively fraudulent, MKI's transfer of the $370,500 interest in 785 Holdings entitles Regions to a money judgment (presumably convertible in Delaware to
a charging lien or another enforceable mechanism) against MIKA for $370,500.

The court then took up the approximately $215,000 transfer from Marvin's IRA to MIKA. Because the IRA was not a debtor (or a successor transferee), it could not fraudulently transfer money to anybody, and thus Regions Bank lost on this particular transfer.

Regions Bank also claimed that MIKA was subject to MKI's debt on an successor company theory, which is to say that MKI transferred the bulk of its assets to MIKA, and the latter continued the former's business while creditors of MKI were stiffed. The supporting evidence what that MKI and MIKA were both managed by Marvin and the two companies shared assets, office and pretty much everything else that matters. Based on this, the court held that MIKA was indeed a "mere continuation of MKI under a different name", and thus MIKA should be liable for MKI's debt to Regions Bank.

In addition to avoiding transfers and holding MIKA liable for MKI's debt to Regions Bank, the court found that there was sufficient evidence upon which to enter an injunction prohibiting any further disposition of the interest in 785 Holdings.

The court then concluded with:

At trial, Marvin blamed his accountant, his lawyers, and his IRA custodian for supposedly erroneous paperwork that largely supports Regions' claims. At times, Marvin faulted Advanta for the allegedly inaccurate documents and claimed that Advanta forced Marvin to create MIKA and that Advanta invented from whole cloth the valuations that Marvin verified, often under penalty of perjury. Based on Marvin's confusing, implausible, and often contradictory testimony and based on the contemporaneous papers, which were approved when the Kaplan parties faced no prospect of an adverse judgment for a fraudulent transfer and which largely refute the Kaplans' assertions, I reject the Kaplan parties' defenses and conclude that Regions proved the fraudulent-transfer claims (excepting the claim based on the IRA's transfer to MIKA of the $214,711.30 and excepting

the de facto merger claim in count fourteen).

The court then entered judgment for the same in favor of Regions Bank.

**ANALYSIS**

This is one of those opinions where the court's analysis was often shoddy, and sometimes simply wrong, but the court very likely ended up reaching the correct result anyway, so "no harm, no foul", the technical appellate term being "harmless error". There were many failures by the Kaplans here that caused their downfall, not the least of which being that the transactions were poorly planned and worse executed (with little or no documentation), and then Marvin apparently showed up for trial about as poorly prepared to testify on key issues as a witness might be. Which is to say that there is a decent chance that some of these transactions would have survived scrutiny in substantial part had they been contemporaneously and copiously documented and followed, and had the Kaplans been able to get their stories straight.

Subsumed in the court's analysis is the issue of whether the payment of attorneys' fees (or at least the $500,000 or so that was actually owed) would have been reasonable equivalent value ("REV", in fraudulent transfer speak) if they had been made by the Kaplan entities directly. This issue is important, because if those attorneys' fees would have been REV if paid by the Kaplan entities directly, then they should have been REV if paid by Kathryn in repayment of the moneys that were paid to her.

The problem is that the entire issue of REV is only relevant to a transferee's defense if the transferee was in "good faith", i.e., if the transferee was not in good faith, then it doesn't matter whether the debtor received REV for the transfer or not, since a transferee not in good faith will not get any credit whatsoever for whatever the transferee did actually return to the debtor.

This is where the fact of Kathryn controlling both the debtors (the Kaplan entities) and the transferee (since she personally received the money) slayed her on the issue of good faith, since she was essentially on both sides of the transactions, and the desire of the Kaplan entities to divest their assets so that they would not be subject to collection by Regions Bank
thus operated to negate any claim of good faith as to Kathryn individually. If, say, prior to the transfers Kathryn had been distanced from the Kaplan entities, then the outcome might have been different on this issue.

The issue of what happens when a transferee returns the money (which Kathryn claims she did when she paid the Kaplan entities' legal bills) has always been a difficult one for the courts. Instead of facing this issue directly, the court instead throws out a citation to an 11th Circuit opinion which says that repayment of a fraudulent transfer bars the debtor's discharge, which in the context of this non-bankruptcy case is about as relevant as the number of moons orbiting Jupiter. Which is to say that Kathryn might or might not have a valid appeal point on this issue depending on how Florida law on the subject shakes out (and as to which I don't even suggest a guess).

The transfers to MIKA were simply silly; they should never have been made. I attribute these to Marvin succumbing to panic and then simply moving things about and then trying to come up with a story later to justify it all, which works about never. That one can spin a yarn doesn't *ipso facto* mean that it is a *winning* yarn, and in fact what usually happens is exactly what happened here: The person spinning it is quickly caught up in their own web of lies and their credibility just as rapidly disintegrates. In the end, the court will not buy any of what they are selling, even if some of it is true.

And that's not a good position to be in.

**CITE AS**


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**Program Ideas?**

On what topics would you like to either organize a program or simply sit back and listen? We really want to organize programs that respond to the needs of Committee members. Remember, however, that none of us are mind readers, and we do not know what you want until you send us a note.

As for thinking any idea you might have is silly, remember that someone (who now is undoubtedly ridiculously rich) once said in a meeting, "Hey, let's make a movie about a tornado full of sharks."

Again, tell us what would be helpful, and we will see if we can deliver.
Wyoming’s Series Limited Liability Company Act: It’s (Virtually) All in the Operating Agreement

By: Gregory Taggart
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Seventeen states, the District of Columbia, and Puerto Rico allow for series limited liability companies. Wyoming took its position on that list during its 2018 legislative session. Wyoming’s Series Act became effective July 1, 2018. It makes clear—repeatedly—that the operating agreement rules the roost in a series LLC in Wyoming, beginning in the first subsection:

This section shall govern any matter with respect to a series to the extent not otherwise provided in the operating agreement.¹

(emphasis added)

The Series Act continues, “if an operating agreement establishes or provides for the establishment of a particular series,” the debts and obligations of a particular series can’t be enforced against the LLC itself or “any other series thereof.” Likewise, the debts and obligations of the LLC or “another series thereof” can’t be enforced against a particular series.²

The Act then warns members that such limitations only apply if 1. each series maintains separate records, 2. the “operating agreement specifically provides for the limitations on liabilities,” and 3. notice of the limitations “is included in the articles of organization.”³

(emphasis supplied)

The Act then makes clear that members can reverse all that via the operating agreement, so the debts of the LLC can be enforced against the series or the debts of the series against the LLC.⁴ In other words, members can use the operating agreement to impose liability wherever they want it imposed.

The Act also provides broad powers that any series established under it “shall have,” including the power to contract and hold title in real, personal, and tangible assets; to grant liens and security interests; and to sue or be sued.⁵ A series “may” also:

- Have separate rights, powers, or duties with respect to specified property or obligations of the LLC or profits or losses association with that property;
- Carry on any lawful purpose—banking and insurance excluded; and
- Hold assets directly or indirectly.⁶

Impliedly, those last three powers are made available to a series via the operating agreement. That agreement may also provide:

- For the relative rights, powers, and duties of classes or groups of members or managers;
- For the future creation of additional classes or groups;
- For the taking of an action—including amending the operating agreement—without the vote or approval of any member, manager, class, or group; and
- That any member or group shall have no voting rights.

The agreement, in fact, can be used to restrict or open voting to virtually any member, class, or group and base that voting power on a per capita, number, financial interest, or other basis.⁷

By default, management of a Wyoming series is vested in the members, in proportion to each member’s interest in the profits. If, however, the operating agreement provides for manager-management of a series, then one or more managers assume the responsibilities of that position.⁸

Subsections (h) and (j) of the Act outline the distribution rights liabilities of a member, including that 1. a member of a series entitled to a distribution has the status of and can use all the remedies available to a creditor of the series and 2. a member is personally liable to the series for the knowing receipt of a distribution in

¹ Wyo.Stat. 17-29-211(a)
² Wyo.Stat. 17-29-211(b)(i) and (ii)
³ Wyo.Stat. 17-29-211(c)(i)-(iii)
⁴ Wyo.Stat. 17-29-211(d)
⁵ Wyo.Stat. 17-29-211(e)
⁶ Wyo.Stat. 17-29-211(e)(i)-(iii)
⁷ Wyo.Stat. 17-29-211(f)(i)-(iii)
⁸ Wyo.Stat. 17-29-211(g)
violation of the Act. Finally, the operating agreement “may provide for the establishment of a record date” for allocations and distributions.\(^9\)

The Act makes clear that a series may be terminated and its affairs wound up “without causing the dissolution of the limited liability company” itself, nor will the termination “affect the limitations on liabilities” discussed above. It also explains that a series shall be terminated upon the occurrence of any one of the following:

- The dissolution of the LLC itself,
- An event specified in the operating agreement,
- The vote or consent of 2/3rds of the members, or
- On that application of a member that it’s not reasonably practicable to carry out the series’ purpose.\(^10\)

The Act also lists four categories of persons or entities that may wind up the affairs of a series and indemnifies those doing the wind up against liability so long as they act in accordance with the Act.\(^11\)

Finally, the Act provides that a foreign series LLC may operate in the state, but that it must state the following in its certificate of authority: \(^12\)

- That its operating agreement establishes or provides for a series and all that entails,
- Whether the debts and obligations of a series can be enforced against the foreign LLC or one of its series, and
- Whether the debts and obligations of the LLC or one of its series can be enforced against a particular series.

Wyoming’s new series act is simple and straightforward and should be appealing to those interested in using the series LLC in their practices.

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\(^9\) Wyo.Stat. 17-29-211(h)-(j)

\(^10\) Wyo.Stat. 17-29-211(k)

\(^11\) Wyo.Stat. 17-29-211(m)

\(^12\) Wyo.Stat. 17-29-211(n)
Judicial Dissolution and the Weaponized LLC

By: Peter A. Mahler
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Originally published in New York Business Divorce (Sept. 24, 2018)

What’s a weaponized LLC? It’s one whose operating agreement gives the controlling majority members the authority to dilute, remove from management, or expel a non-controlling minority member, typically for failing to satisfy a mandatory capital call or engaging in conduct the majority determines to be a breach of specified standards of conduct.

Weaponization can occur openly or stealthily. Openly, the dilution, removal, or expulsion powers are spelled out explicitly in the operating agreement signed by all the members. Stealthily, the operating agreement authorizes amendment of the operating agreement by the majority, i.e., without minority consent, effectively allowing such powers to be added at a later time of the majority’s choosing.

Few tears normally are shed when a minority member is diluted, removed from management, or expelled under the express provisions of an operating agreement to which the minority member knowingly subscribed. As the saying goes, you made your bed, now lie in it.

Does the minority member hit with the stealth variety via an amendment to which he or she never consented deserve any greater sympathy? More importantly for litigators, does the majority’s adoption and implementation of such measures for the purpose of squeezing out the minority member, or otherwise gaining leverage in a dispute not necessarily related to the LLC’s governance and business affairs, provide the minority member with grounds to seek judicial dissolution of the LLC?

Not according to Manhattan Commercial Division Justice Saliann Scarpulla whose decision last month in Yu v Guard Hill Estates, LLC, 2018 NY Slip Op 32008(U) [Sup Ct NY County Aug. 15, 2018], dismissed a minority member’s claim for judicial dissolution of two family-owned, realty-holding LLCs under Section 702 of New York’s LLC Law. The decision found insufficient as a matter of law the complaint’s allegations that the majority members — the plaintiffs’ siblings — were motivated by personal “vendetta” when they adopted and implemented amendments to the operating agreement removing the plaintiff as co-manager and authorizing a mandatory capital call leading to foreclosure of the membership interest of the financially strapped plaintiff.

Background

The complaint filed by Patrick Yu against his brother Raymond and sister Catherine centered on an LLC that owns a remainder interest in their parents’ residential property in Bedford, New York and another LLC that holds title to a Manhattan apartment building where the parents and the two sibling defendants also resided. Patrick held a one-third membership interest in the former LLC and a one-fifth interest in the latter LLC.

The complaint describes a series of intra-family squabbles commencing in 2013 pitting Patrick against his parents and siblings who, allegedly, “out of personal animus” toward Patrick, “use[d] every means at their disposal to marginalize Patrick’s role at the LLCs, to divest Patrick of his ownership stake in those entities, and to defeat Patrick’s reasonable expectation that he would realize some economic benefit from the ownership stake” in the LLCs’ two properties and in a third company that funds the family’s various real estate and business activities.

Patrick alleged in critical part that both LLCs “were created as entities wholly owned by the Yu children so that the Yu parents could transfer their interest in the Bedford and [Manhattan] properties to their children for tax and/or other reasons.” He further alleged that he “understood” that the LLCs “were to be passive entities meant solely as holding companies,” i.e., not generating revenue or incurring expenses, and not requiring funding by their members.

As family tensions ratcheted up, allegedly in “retaliation” for a books-and-records inspection demand made by Patrick, his siblings amended the LLCs’ 2-page, mirror-image operating agreements to remove Patrick as a managing member and by adding a provision authorizing the siblings as the remaining managing members to make a mandatory capital call at
their sole discretion, and if the demand is not met, foreclosing the membership interest of the non-contributing member.

The amendments were made without Patrick’s consent or signature in accordance with identical provisions in the original operating agreements — made many years before the outbreak of family friction — stating that “No amendment to this Agreement shall be effective unless made in a writing duly executed by the holders of not less than 51% of the membership interests of the Company.”

Soon afterward, the siblings made a $590,000 per member capital call to retire the mortgage and reimburse their parents for capital improvements to the Bedford residence. In his complaint, Patrick alleged that the capital call was made “to retaliate against and oppress Patrick” for exercising his statutory right to demand an inspection of books and records; that it was “out-of-step with [the LLC’s] purpose as an entity — which is to passively hold the Yu Family’s Bedford country estate”; and that his siblings knew Patrick did not have the funds to contribute.

Following the capital call and Patrick’s failure to make the demanded contribution, the siblings sent Patrick notices tracking the amended operating agreement’s remedial provisions authorizing the siblings to advance funds secured by a lien on Patrick’s membership interest subject to foreclosure.

Patrick then added to the growing menagerie of pending litigations with his family by filing for judicial dissolution of the two LLCs, principally contending that his siblings were unwilling or unable to permit the LLCs’ “stated purpose” to be achieved and that, instead, they were using the LLCs “as a weapon to exert pressure on and oppress a minority owner.” As further grounds for dissolution, Patrick alleged his siblings’ refusal to provide him with access to books and records, and he accused them of making inordinate payments for travel and entertainment expenses.

The Court’s Dismissal of the Lawsuit

The siblings filed a pre-answer motion to dismiss the complaint, arguing that its allegations failed to state a valid claim for judicial dissolution under LLC Law § 702’s not-reasonably-practicable standard as construed by the courts in the 1545 Ocean Avenue case and its progeny. They laid particular emphasis on the purpose of the LLCs as found in the operating agreements, the one stating that the LLC is formed “for the purpose of acquiring a remainder interest” in the Bedford property “and engaging in any and all activities necessary or incidental to the foregoing,” and the other using comparable language as concerns the Manhattan property. They also argued that the complaint’s allegations of oppressive conduct by the siblings, while relevant under the statute governing judicial dissolution of a closely held corporation, have no application under § 702 as per cases such as Doyle v Icon and Matter of Kassab.

Patrick opposed the motion, denying that his claim was one based solely if at all on “oppression”; insisting that both LLCs were designed as passive holding companies intended to serve as an “estate planning tool to transfer real property between generations of the Yu family”; asserting that his siblings were pursuing a “personal vendetta” against him while enriching themselves at his expense; and arguing that the complaint’s factual allegations met the pleading standard for judicial dissolution under § 702.

Patrick’s argument gained no traction with Justice Scarpulla who granted the siblings’ motion and ordered entry of judgment dismissing the complaint. Here’s what she wrote:

“Given the broad language in the operating agreements, Patrick has failed sufficiently to plead the requisite grounds for dissolution of the LLCs in his complaint. He does not adequately allege that the LLCs are not operating in a manner within the contemplation of their purposes and objectives as defined in their respective operating agreements, or that continuing their operation would be financially unfeasible. He provides no factual support or basis which would support an allegation that the individual defendants are unable or unwilling to promote the purpose of the LLCs or that it is not reasonably practicable to carry on the business of the LLCs in conformity with the operating agreements.

While Patrick complains that his family members have been engaged in certain activities to further their personal “vendetta” against him, his unflattering characterization of his family’s actions is not sufficient to support a cause of
action that his family has abandoned the
purpose of the LLCs and/or rendered the
operation of the LLCs financially unfeasible.”

Some Further Thoughts

I have no information and therefore no opinion
as to the reasons for, or the wisdom of, the
inclusion in the subject LLCs’ operating
agreements of a provision authorizing
amendment by majority rather than unanimous
consent. Was it deliberately inserted at the
parents’ insistence based on a belief that their
children would be unable to achieve consensus
to deal with unknown, future events
necessitating changes to the operating
agreement? We’ll never know. But I can say with
certainty that, absent the amendment provision,
under New York law Patrick would not have
faced a mandatory capital contribution or the
adverse consequences of his failure to
contribute.

The amendment provision typically is nestled
among the miscellaneous “boilerplate” found at
the tail end of the operating agreement. The Yu
case is a powerful reminder to pay careful
attention to every word when vetting a proposed
operating agreement. The price for not doing so
potentially is even higher when contemplating
taking a non-controlling interest in a
“weaponized” LLC.

The court’s summary dismissal of the complaint
in Yu draws an interesting comparison with the
Mace v. Tunick case also involving an action to
dissolve a real estate holding LLC in which the
appellate court reversed a summary dismissal
and ordered a trial to hear conflicting evidence
concerning the LLC’s purpose. In that case, the
operating agreement merely stated that the
LLC’s purpose was “any lawful business” which
the court said was tantamount to no purpose. In
Yu, in addition to the standard “any lawful
business” language, the purpose clauses in both
LLC agreements specifically referred to the
acquisition and holding of a specific real
property interest, thus avoiding the Mace
coundrum.
**Saadi v. Maroun: Sole Member?**

By: Jay D. Adkisson  
Las Vegas, Nevada

Saadi held a $90,000 judgment against Maroun, the latter who held an interest in Maroun's International, LLC (which I will refer to as MILLC), which held title to a condominium worth in excess of Saadi's judgment.

Saadi filed a motion for the judicial sale (auction) of Maroun's interest in MILLC, or in the alternative for a charging order against that interest. This dispute arose in Florida, the laws of which provide that if an LLC has only one member then the creditor may foreclose on that interest, but if there are multiple members in the LLC, then the creditor's remedy is exclusively that of a charging order.

A U.S. Magistrate Judge held a hearing on Saadi's motion, which resulted in a record that a third-party (Al-Qawasmi) held a 49% interest in MILLC, that MILLC was operating in the nation of Jordan under the fictitious business name of MI7USA, that MILLC received money and other consideration from Al-Qawasmi for his interest, and that MILLC had two other members, being Ahmad Kameh and Jean Maroun for 15% each. The U.S. Magistrate therefore concluded that Maroun was not the sole member of MILLC, and thus recommended that the judicial sale be denied but that Saadi be allowed a charging order against Maroun's interest in MILLC.

Saadi objected to the Magistrate's recommendation before the U.S. District Judge on the grounds that it was "speculation" whether Maroun was anything other than the sole member of MILLC, based on evidence that Maroun reported all of MILLC's taxable activities on his own return and never listed any other members, used MILLC's bank account for personal expenses, and lived in MILLC's condominium. Additionally, Saadi pointed out that all the Florida Department of State records made reference only to Maroun and nobody else.

But, after noting that the information required by the Florida Department of State for an LLC was minimal, the Court concluded:

> Considering only Plaintiff's evidence and disregarding all of Defendant's evidence, this Court concludes that Plaintiff has not shown that there are no other members of MILLC. Plaintiff's evidence simply showed that Defendant may have been improperly using MILLC's assets as his own, but that alone is not the same as showing that there are no other members of MILLC. Therefore, the Court overrules Plaintiff's objection to the Magistrate Judge's conclusion that Plaintiff has not shown that there are no other members of MILLC, and as such, a judicial sale is not an available remedy.

The U.S. District Judge thus denied Saadi's motion for a judicial sale, but allowed him to charge Maroun's interest in MILLC.

**ANALYSIS**

This case is a "pee wee" in the sense that it involves a relatively small amount of dollars and required only abbreviated analysis by the court. That should not, however, distract from the larger issue, which is how easy it is for a debtor to come up with just enough facts to defeat a determination that the debtor is the sole member of an LLC. Essentially, whatever the true facts, a debtor need only create a reasonable suspicion in the mind of the judge that the debtor might not be the single-member, so as to avoid foreclosure of the debtor's interest.

As a matter of creditor practice, what this case stands for is that a creditor needs to conduct extensive investigation outside of the legal process, and discovery within it, before seeking a determination that the debtor is the sole member of the LLC. This does not mean, however, that the creditor need wait to get the charging order until that evidence is developed; to the contrary, the creditor should seek the charging order as soon as the creditor has sufficient evidence that the debtor holds an interest in an LLC with value.

Here, Saadi should have immediately obtained the charging order upon the proof that Maroun held *any* interest in MILLC, and then waited until all the facts were in before seeking a determination that Maroun was the only member. It is a common, and perhaps excusable, mistake particularly in small-dollar cases where counsel are attempting to minimize their time and expenses so that they do not each up the judgment.
On another note, this case also illustrates the folly of one placing their residence into an LLC if the debtor's equity in the residence is below the applicable homestead exemption. Florida of course has an unlimited homestead exemption, in which event it is difficult to understand why a person living in Florida (or Texas, Oklahoma, etc.) would ever place their personal residence into an LLC unless they had significant other considerations such as to avoid estate taxes, etc.

CITE AS


Why Attend the LLC Institute

The LLC Institute is the most significant opportunity for ABA members to keep current on developments in alternative entity law. It brings together the best practical and academic minds and speakers from around the country, and is essential to anyone wants to stay at the cutting edge of this practice area.

Jim Wheaton
Clinical Associate Professor & Director,
Entrepreneurship & Intellectual Property Clinic
Boston University School of Law
**LLC’s Members Waived Limited Liability, Held Liable on LLC’s Debts and Obligations**

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

In a decision rendered last Friday, the Kentucky Court of Appeals affirmed a determination that, consequent to the wording of a particular operating agreement, the members in the LLC assumed and are liable to satisfy the LLC’s debts and obligations. *VanWinkle v. Walker*, No. 2016-CA-000097-MR, 2018 WL 4043388 (Ky. App. August 24, 2018).

VanWinkle, Walker and Crawford formed TLC Developers, LLC in 2004, executing an operating agreement in connection therewith. That operating agreement provided, in part: The profits and liabilities of the Company shall be divided as follows: Carl David Crawford = thirty-three and one third (33 1/3%), Lyle A. Walker = thirty-three and one third (33 1/3%) percent and Troy Van Winkle [sic] thirty-three and one third (33 1/3%).

When the company fell upon hard times, Walker and Crawford contributed additional amounts in order that the company could meet its business expenses. As recited by the court, “in their view, in the event TLC did not have the cash on hand to pay the liabilities itself, the operating agreement mandated that the three members would pay the liabilities of TLC equally.” VanWinkle did not make those contributions, apparently of the belief that the operating agreement did not require him to do so. He did, however, on two occasions contribute one-third of the amount necessary to satisfy TLC’s property taxes.

Ultimately, Walker and Crawford filed a complaint seeking a declaration of rights with respect to the obligation to satisfy TLC’s liabilities and the interpretation of the operating agreement. After a bench trial, the circuit court held that “the operating agreement unambiguously stated that the three members agreed to split the liabilities of the company in thirds,” and ultimately ordered VanWinkle to pay $87,300 has his share of the company’s liabilities. This appeal followed.

VanWinkle had essentially two arguments. First, the operating agreement, and the LLC Act, protected him from liability for the LLC’s debts and obligations. Second, he would argue that personal liability for the LLC’s debts and obligations is antithetical to the very notion of an LLC and for that reason could not be enforced. Both arguments would fail.

While the operating agreement recited that the members enjoyed limited liability from the debts and obligations of the LLC, essentially repeating the language of KRS § 275.150(1), the court went on to note, however, that while not recited in the operating agreement, the LLC Act continues with KRS § 275.150(2), which provides:

> Notwithstanding the provisions of subsection (1) of this section, under a written operating agreement or under another written agreement, a member or manager may agree to be obligated personally for any of the debts, obligations, and liabilities of the limited liability company.

Applying this language, the court found that “that is exactly what TLC’s members did when they agreed to split the liabilities of the company in the ‘Division of Profits and Liabilities’ provision” of the operating agreement.

As for the argument that imposition of liability for company obligations is antithetical to the very notion of an LLC, the court noted as well KRS § 275.003(1), it providing that it is the public policy to give maximum effective principle of freedom of contract and the enforcement of operating agreements. As to this point, the court wrote:

> While holding the members personally liable for the TLC’s liabilities may seem contrary to the very point of establishing an LLC, it adheres to the intent of the General Assembly: namely, to allow business partners the freedom to contract and establish an LLC that fits the needs of the respective members. Here, following a meeting of the minds, TLC’s three members each decided to split the liabilities of the company in equal shares.
State to Ask Court to Dissolve Backpage.com’s LLC Registration

By: Esteban Parra
Delaware News Journal

The state Department of Justice is planning to ask Chancery Court, under new legislation, to dissolve the Delaware registration of Backpage.com – once considered the "world's top online brothel."

The News Journal learned of the plan from a Department of Justice letter sent on Friday to the Delaware Coalition for Open Government, a group that believes the state is irresponsible when it allows companies like Backpage.com to remain in "good standing."

"When you have a company that is facilitating online sex trafficking registered in Delaware, that's an issue," Nick Wasileski, Delaware Coalition for Open Government president, told the newspaper earlier this month.

The state justice department confirmed its plan Friday afternoon and said it would act with caution on its approach.

"Because this first filing under the new statute may impact how the courts handle future filings, and because the federal government has already frozen the actual operations, DOJ attorneys will be acting deliberately in preparing and filing the dissolution petition," said Julia Lawes, a spokeswoman with the justice department.

Backpage.com, which was involved in nearly three-quarters of the 10,000 child-trafficking reports received annually by the National Center for Missing and Exploited Children, was seized by federal law enforcement in April.

Yet, the Delaware-registered limited liability company remained in "good standing."

State officials had said their hands were tied because the online company was meeting all requirements for a business entity outlined in Delaware law. But last month, when Delaware Gov. John Carney signed legislation that amended the state's code concerning limited liability companies, authorities were given the green light to go after bad actors.


BACKPAGE IN DELAWARE

Contained in his legislation was a section that allowed Chancery Court – upon petition from the state Department of Justice – to cancel the certificate of formation of any domestic limited liability companies for abuse or misuse of its limited liability company powers, privileges or existence.

The former CEO of Backpage.com pleaded guilty in April to a conspiracy charge involving facilitating prostitution and money laundering. Carl Ferrer's plea came nearly a week after the U.S. Department of Justice seized the controversial classified site.

Ferrer, 57, of Frisco, Texas, who is also a co-founder of the website, could spend up to five years in prison or pay a maximum fine of $250,000 at his sentencing hearing scheduled for early next year, according to the plea agreement, which requires him to cooperate with the government in shutting down the site.

The announcement of Ferrer's plea came three days after the government unsealed a sweeping federal indictment against Ferrer's former co-workers, the Arizona Republic reported. In that indictment, Backpage co-founders Michael Lacey and James Larkin, as well as five other executives, faced 93 charges involving facilitating prostitution through the Backpage site and money laundering.

"In terms of Backpage, I don't think anyone should believe that that kind of activity should be lawful or permitted," Townsend said. "So I'm very happy to hear that the Delaware Department of Justice is taking every step they can to participate in putting a stop to that activity."

Delaware hospitals' newest diagnosis: Human trafficking

In January, a multi-agency law enforcement operation in Delaware named Backpage as the primary mode of communication for initiating and arranging sexual encounters during a two-day crackdown on prostitution across New Castle County that produced more than 40 arrests.

Eight of the 11 men charged with patronizing a prostitute were from Delaware.
Last fall, a New Castle County resident, who advertised on the transsexual escort section of Backpage, was indicted on charges of attempted extortion and stalking.

In May 2017, Delaware State Police, FBI Wilmington office and the Delaware Department of Justice arrested five people in Dover and Smyrna in connection with prostituting two youth, ages 16 and 17, on Backpage.

And in the summer of 2013, two Delaware men charged with operating prostitution rings out of multiple motels in Sussex County posted ads on Backpage to negotiate prices with potential clients, police said at the time.

Yolanda Schlabach, who as founder of Greenwood-based nonprofit Zoë Ministries has spent nearly a decade trying to bring attention to the stigma of prostitution and sex trafficking of minors in Delaware, called the move by the state Department of Justice good news.

"I'm encouraged by the intention of the dissolving of Backpage as an LLC in the state of Delaware," Schlabach said in a statement. "It sends a message that trafficking is not welcomed in Delaware and it is a great step in the right direction."

Reprinted with permission from Delaware News Journal, where this article originally appeared on August 17, 2018. Here is a link to the original article:


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**Why Attend the LLC Institute**

Other Institutes are losing attendance, or are seeing their remote attendance increase. One of the many things that makes the LLC Institute great is building professional relationships and friendships face-to-face. The programs are always outstanding, thoughtful, yet practical, but some of the most valuable professional experiences I have had at past LLC Institutes stemmed from discussions at the bar, in restaurants or during breaks. There just are not that many LLC people in the world, much less in our respective law firms. Sometimes I am getting an answer to a question I have in those ad hoc discussions. More often, I am listening as someone else describes an issue I have not yet faced, or even thought about. I cannot tell you how many times now I have listened to one of those conversations, then had the same or a similar issue walk into my office. Attending the LLC Institute is a must for anyone serious about LLCs.

Johnny Lyle
Partner, Adams & Reece, LLP
SE Property Holdings, LLC v. The Rookery, LLC

By: Jay D. Adkisson
Las Vegas, Nevada


In 2013, the creditor, SE Property Holdings, LLC, obtained a charging order against the interest of the debtor, Richard Vail, in his company, Vail Construction, LLC, of which Vail was the sole member. The charging order had the effect of placing a lien in favor of SE Property against Vail's right to distributions from Vail Construction, meaning that if Vail Construction made distribution payments to Vail individually, those payments should instead be re-routed to SE Property and applied to the satisfaction of its judgment against Vail.

Fast forward to 2018, SE Property filed a motion to show cause why Vail should not be held in contempt for violation of the charging order. SE Property's motion listed ten ways that Vail had violated the charging order, such as transferring money from Vail Construction to his own account and paying his personal expenses, using money from the company to buy a boat, securing a loan on his residence, paying alimony to his ex-wife, and transferring money to another Vail-owned LLC. SE Property attached 300 pages of exhibits to support its motion.

In response, Vail ponied up his own affidavit, wherein he declared that although these events happened, all the transfers were for the ultimate benefit of Vail Construction and not himself. For instance, moneys transferred to his personal account reimbursed him for moneys paid to employees and for materials, the boat was used to construct piers for the company, payments to his ex-wife were to pay for real estate used by the company and to pay a mortgage on which she was liable, etc. Vail didn't attach any exhibits to his affidavit to support his statements, but simply asked the Court to take his word for it all. The Court noted that to hold somebody in contempt requires a high degree of proof, which is that SE Property had to show by "clear and convincing evidence" that Vail violated the charging order. The Court thought not. Although Vail did not support any of his denials with documentary evidence, his affidavit alone was enough to rebut the assertions of SE Property.

But more importantly, SE Property did not disprove Vail's denials, i.e., SE Property did not present the Court with sufficient evidence to show that Vail had lied about the transfers of the money from Vail Construction. Thus:

It appears to the Court that the plaintiff filed the instant motion prematurely. Default judgment was entered against Vail in September 2011, [] and the plaintiff has had over six years to invoke the process of post-judgment discovery to identify assets and uncover evidence that Vail is improperly avoiding payment on the judgment. A brief review of the docket sheet reveals that the plaintiff has repeatedly invoked these procedures. [] The plaintiff has not explained why it cannot now invoke those same procedures to obtain additional written discovery, Vail's deposition testimony, and/or any other evidence needed to elevate its suspicion of wrongdoing into clear and convincing evidence of same.

In other words, before moving to hold Vail in contempt, SE Property needed to first establish by evidence that Vail's denials were false. Because SE Property did not do so, the motion to hold Vail in contempt of court failed, but SE Property could go out and conduct discovery and come back to the Court with a renewed motion. Thus, the Court denied SE Property's contempt motion without prejudice to refiling.
Utah’s “Benefit Limited Liability Company Act”: A Bridge Too Far?

By: Gregory Taggart, Taggart Law, LLC
Cedar Hills, Utah

I agree with J. William Callison, the concept of the benefit, limited liability company “is oxymoronic.” Bill may have changed his mind since he wrote that in 2014. I haven’t. If a regular Utah “limited liability company may have any lawful purpose, regardless of whether for profit,” and if that lawful purpose could therefore include addressing any and all the general and specific public benefits listed in Utah’s Act, why subject an LLC to the following?

The operating agreement of a benefit company may not limit, be inconsistent with, or supersede a provision of [this act].

In other words, under Utah’s Benefit Limited Liability Company Act (effective 5/8/2018), the operating agreement no longer governs, at least with regard to the many requirements of that Act. By my count, those requirements include nine “shall”:

1. The certificate of organization “shall state that the limited liability company is a benefit company”;  
2. The benefit company “shall have a purpose of creating general public benefit”;
3. Each member of a member-managed benefit company “shall consider the effect any action on” a list of seven different items (more on this below);
4. Each manager of a manager-managed benefit company “shall” do the same;
5. So “shall” an officer of the benefit company if the officer “has discretion with respect to the matter; and it reasonably appears to the officer that the matter may have a material effect . . . “;
6. A benefit company “shall prepare an annual benefit report” that includes a variety of information;
7. A benefit company “shall send [that] benefit report . . . to each member”;
8. A benefit company “shall . . . post a copy of [that] report on a public portion of the benefit company’s website; and deliver a copy of [that] report to the division for filing;”
9. If the company has no website, it “shall provide a copy of [that] report, without charge, to any person who requests a copy.”

That’s a lot of new to-dos. To quote Callison again and in a similar context:

Limited liability companies are the multipurpose knives of the business organization world. They can be used well for many different tasks. It is this multiplicity of uses, all within one statutory form, that gives LLCs their value and their allure.

So is this new knife really necessary? I don’t think so, but the Utah Legislature disagrees. Thus, Utah business people can form either a corporation or an LLC and let their left hand, their next door neighbor, and the general public know what their right hand has been up to lately, maybe in the belief that virtue signaling has its own rewards.

2 U.C.A. 48-3a-104(2)
3 U.C.A. 48-4-102(4)
4 U.C.A. 48-4-104(1)
5 U.C.A. 48-4-201(1)
6 U.C.A. 48-4-301(1)(a)
7 U.C.A. 48-4-302(1)
8 U.C.A. 48-4-302(2)
9 U.C.A. 48-4-404(1)
10 U.C.A. 48-4-402(1)
11 U.C.A. 48-4-402(2)(a)
12 U.C.A. 48-4-402(2)(b)
14 Matthew 6:3-4
Apparently based on B Lab’s Model Benefit Corporation Legislation,15 Utah’s new Benefit Limited Liability Act allows Utah to join the ranks of Pennsylvania, Delaware, Maryland, and Oregon, states that have adopted some version of a benefit limited liability act. To my untrained eye, Pennsylvania, Maryland, and Oregon seem to have chosen B Lab’s model as their template. Delaware, of course, created its own.

I have three problems with Utah’s (and by extension, Pennsylvania’s, Maryland’s, and Oregon’s) approach: 1. Too easy access, 2. Too vague, and 3. Too many acronyms.

Too easy access. Becoming a benefit LLC is as easy as 1, 2, 3, 4: State that the company is one in its certificate of organization,16 place (if you wish) BLC or other approved words or letters after the company’s name,17 come up with “a purpose of creating a general public benefit,”18 and (if you wish) add one or more specific (and specifically defined) public benefit(s) into the mix of the company’s “any lawful purpose[s].”19 It’s more difficult to turn an existing LLC into a benefit LLC because the change requires the approval of 2/3rds of the members entitled to vote—a “minimum status vote.”20

Too vague. The defined and critical terms “general public benefit” and “specific public benefit” are loaded with vague terminology. Just what is a “Material positive impact on society and the environment taken as a whole”?21 How will you know if an individual or community is “underserved” or whether the “products or services” an LLC is delivering to them are “beneficial”?22 How might you measure the promotion of “economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business”?23 Attempting to live up to such standards is certainly laudatory, but at best they’re simply aspirational and almost impossible to measure. Unless, of course, there’s an independent third-party entity ready to put its stamp of approval on a benefit LLC’s efforts. (Un)fortunately, the Act has a handle on that, which will almost certainly lead to . . .

Too many acronyms. To make hay out of the ambiguity discussed above, both the Model and Utah’s Benefit Limited Liability Acts require a “third-party standard”24 developed by an entity “independent of the benefit company”25 that meets a variety of additional qualifications and has the “necessary expertise” and “uses a multistakeholder approach” etc. etc. etc.

These third-party entities can be “comprised of no more than 1/3rd of members of associations or businesses” in the relevant industry and can’t be “materially financed” by such entities. Some may read this and say, “Good. We need independent oversight.” I read it and say, why? Why would anyone voluntarily impose this structure on her business? Further, anybody familiar with the legal (JD, LLM, CTFA, CLA, CP), accounting (CPA, CIA, EA), finance, insurance, and investment (CFA, CFP, ChFC, LUTC, CPCU, CIC, CRM, ARM, AINS) worlds, should be able to foresee the loads of additional writing on the wall if benefit LLCs catch on. Then let the forum shopping begin.

I am not opposed to the objectives of benefit LLC or company movement. I see little wrong and lots of good in seeking to make a profit while otherwise benefitting society. For corporations, the idea makes some sense, given that corporations have historically been “primarily for the profit of the stockholders”26 and the law governing them more structured. That’s not the case with limited liability companies. Those who form LLCs in Utah and Wyoming, the states I’m licensed in, have the ability to move and shake under a typically more forgiving statutory framework and don’t need permission to pursue non-for-profit ends. Their limited liability company acts already grant that permission, as do the statutes of most other states. Benefit LLC regimes make much less sense in that context.

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16 U.C.A. 48-4-104(1)
17 U.C.A. 48-4-105(1)
18 U.C.A. 48-4-201(1)
19 U.C.A. 48-4-201(2)
20 U.C.A. 48-4-104((2), see also U.C.A. 48-4-103(6)
21 U.C.A. 48-4-103(3)
22 U.C.A. 48-4-103(8)(a)
23 U.C.A. 48-4-103(8)(b)
24 U.C.A. 48-4-103(10)
25 U.C.A. 48-4-103(10)(b)
LLCs – Read The Contract Before You Sign It

By: Herrick K. Lidstone, Jr. Burns, Figa & Will, P.C. Greenwood Village, Colorado

Miller v. HCP & Company (Del. Ch. Feb. 1, 2018)

"Parties have a right to enter into good and bad contracts; the law enforces both."

The limited liability company is the entity du jour in Colorado and elsewhere. According to the Colorado Secretary of State’s office, more than 88,000 limited liability companies ("LLCs") were formed in Colorado in 2017 as compared to fewer than 11,000 corporations. This continues the trend over the past several years. While a corporation is a statutory creature with some flexibility under the Colorado Business Corporation Act that can be included in the articles of incorporation, the LLC is a creature of contract and it is unlikely that the default provisions of the Colorado LLC Act would be acceptable to any LLC member who understood them.

Unlike Delaware law (see Del. Code Ann., title 6, § 18-201(d)), an LLC may be formed in Colorado without an operating agreement — whether written or oral. Oral agreements raise their own issues of substantiation and proof. As stated in Lidstone & Sparkman, Limited Liability Companies and Partnerships in Colorado (CLE in Colorado 2017) at § 3.2.5:

However, persons who enter into a business relationship with others without a written agreement risk future misunderstandings among the business owners and subject themselves to the default rules imposed by the applicable statutes. Sophisticated business people and the lawyers who advise them generally require that their understandings be documented in a written limited liability company operating agreement.

Scriven With Precision

Colorado statutes make clear that the members of an LLC can adopt the provisions of the LLC Act to their specific arrangement. C.R.S. § 7-80-108(4) states clearly: “It is the intent of this article to give the maximum effect to the principle of freedom of contract and to the enforceability of operating agreements.” However, this freedom of contract can be risky.

Where properly drafted, the operating agreement can serve as a contract that waives various duties of the LLC members and managers, although in substantially all cases the contractual obligation of good faith and fair dealing remains, subject to the ability (in Colorado) to “prescribe the standards by which the performance of the obligation is to be measured, if such standards are not unreasonable.” (C.R.S. § 7-80-108(2)(d).)

Colorado LLCs are easy to form by filing a simple document with the Secretary of State online and paying $50. It is my experience that many business people make their own filing and move forward as statutory member-managed LLCs either without an operating agreement or with a form operating agreement the business people have downloaded and likely have only changed the names.

Off-the-shelf and on-line operating agreements do not reflect the special needs and expectations of the LLC members forming the LLC, or who may become members thereafter. Operating agreements are complex contracts that need to be drafted to fit the expectations of the parties, including to achieve desired tax and business results. Too many LLCs move forward without a carefully considered operating agreement drafted to meet their business, tax, and management goals — if they have any written understanding at all.

As then Vice Chancellor Strine of the Delaware Court of Chancery stated in a manner also applicable to Colorado operating agreements: “With the contractual freedom granted by the LLC Act comes the duty to scriven with precision.” (Willie Gary LLC v. James & Jackson, LLC, 2006 Del. Ch. LEXIS 3, at *5 (Del. Ch. Jan. 10, 2006), aff’d, 906 A.2d 76 (Del. 2006).)

1 Available at SSRN: https://ssrn.com/abstract=3178385.

**Miller v. HCP & Company**

A recent case from the Delaware Chancery Court addressed issues where a group of members expected a different result from a sale of the LLC than the operating agreement (in Delaware the “limited liability company agreement” or “company agreement”) contemplated. One class of members thought that they had a priority to receive a 200 percent return before payment to the other members; the other members (the “complaining members”) thought that the approach taken by the first class was inconsistent with their duties. Unfortunately for the complaining members, the operating agreement was clear, and the Delaware Court applied the operating agreement as written.

This case also illustrates the difference between an LLC and a corporation, and the duties that the management (managers (in the case of the LLC) and directors (in the case of a corporation)) owe to the owners where, in the corporate context, common law fiduciary duties would apply and the stringent “entire fairness” standard of review would have to be considered. Where the parties elected to conduct business through an LLC and had a well-drafted waiver of duties, the complaining members had no avenues for relief in court.

**The HCP Operating Agreement Satisfied The New Investor’s Goals**

According to the complaint, Christopher Miller (“Miller”) co-founded Trumpet Search, LLC (“Trumpet”) in 2008 and was a member and manager until its sale. HCP & Company, a private equity firm (“HCP”), first invested in Trumpet in 2014 when it acquired a majority of Trumpet’s Class D units, becoming Trumpet’s largest member. In 2016, HCP purchased nearly all of Trumpet’s newly created Class E units and, in connection with that purchase, Trumpet’s second amended and restated operating agreement (the “amended agreement”) was signed by all of the members, including Miller.

Under the amended agreement, HCP (as holder of most of the Class E units) was entitled to a first-priority return of 200% of its Class E capital contribution. The amended agreement also set out a distribution waterfall for determining members’ returns on capital investment in the event of a sale that effectively would give HCP, which also held 90% of the next-in-line Class D units, the first $30 million before any sale proceeds would go to other members (including Miller). The amended agreement waived all fiduciary duties of Trumpet’s members and managers and provided HCP the right to appoint a majority of Trumpet’s seven-person board of managers. The amended agreement also gave the HCP-controlled board the right to approve a sale of Trumpet to an independent third party and provided that the board could determine in its sole discretion the manner in which a third-party sale would occur (whether as a sale of assets, merger, transfer of membership interests or otherwise). If the board approved a sale, the amended agreement obligated every member to consent to it.

Seven months after the amended agreement was adopted in connection with its purchase of Class E units, HCP allegedly pushed for a sale of Trumpet to MTS Health Partners, L.P., an unaffiliated third party, which initially offered $31 million. The non-HCP managers objected to the lack of an open-market process and low price. In response, the HCP managers allowed Trumpet to undertake an abbreviated sale process and contacted two entities who had previously expressed interest in Trumpet. This outreach led to competing indications of interest (including one valued between $50 million and $60 million). HCP nevertheless continued to pursue a sale to MTS, which threatened to revoke its offer or file suit for breach of an alleged exclusivity agreement as a result of Trumpet’s outreach to other prospective buyers. The competitive pressure, however, moved MTS to increase its bid to $41 million and then again to $43 million. According to plaintiff, the HCP managers exploited the lack of other firm offers on the table at the time (as well as MTS’s threat of litigation) to “wear down” two of the non-HCP managers into accepting MTS’s offer. As a result, HCP received its contracted 200 percent return, and the other members of HCP (including Miller) received little or no consideration for their interests.

**The Resulting Litigation**

Miller, as a member, then brought legal action against HCP and its board designees for breach of the implied covenant of good faith and fair dealing – a covenant also existing under the Colorado LLC Act in C.R.S. § 7-80-404(3). Miller alleged that the covenant of good faith and fair dealing required HCP to conduct an open-market auction that would likely have returned
funds to the other members. The defendants moved to dismiss the case based on Trumpet’s operating agreement, which Miller and the other minority members had signed, and the court granted the motion.

In granting the motion, the court noted that the implied covenant of good faith and fair dealing was (as in Colorado) intended to fill in gaps – not to create new obligations. The court found that Trumpet’s amended agreement did not contain any gap for the implied covenant to fill. The court observed that the amended agreement did not, by its terms, require the Trumpet board to conduct an auction but rather “explicitly vest[ed] the [b]oard with sole discretion as to the manner in which a sale is conducted, subject to the limitation that the company is ultimately sold to an unaffiliated third-party buyer.” According to the court, the Trumpet board had “unfettered discretion to determine both how the company will be marketed and how the sale will be structured, so long as the transaction does not involve insiders.”

The court next found inapplicable the principle that, when a contract confers discretion on one party, the implied covenant requires that the discretion be used reasonably and in good faith; the court reasoned that the amended agreement expressly defined the scope of the board’s discretion by requiring that any sale be to a third party and, thus, there was no gap in the contract or other reason for the court to look to the implied covenant to determine how the board’s discretion should be exercised. In the court’s view, the amended agreement indicated that the parties considered the implications of vesting discretion in a conflicted board, expressly addressed that situation with the third-party sale requirement, and thereby left no room for the implied covenant to operate.

The court held that, even if the amended agreement contained a gap regarding how Trumpet could be sold, the plaintiff’s implied covenant claim would fail because nothing suggested his reasonable expectations were frustrated. On the contrary, the express terms of the amended operating agreement indicated that the parties actually contemplated that Trumpet might be sold through private negotiation rather than an open-market process. Moreover, while the complaint alleged a process that was tilted in favor of the defendants’ interests, the court found that the defendants’ putative conduct during the sale process was not arbitrary, unreasonable, or unanticipated based on the plain terms of the operating agreement.

Importantly (and consider “scriven with precision”), the court noted that the parties easily could have anticipated this situation given that the defendants’ interest in a quick exit, whether or not beneficial to the other owners, was clear from the distribution waterfall itself. The court also observed that HCP did not use its control to consummate MTS’s initial $31 million offer, but rather allowed for some process to play out over several months and successfully obtained a substantial increase in MTS’s offer – the only one on the table when the deal was approved by the Trumpet board.

The court further recognized that, had the plaintiff wanted to avoid this result, he could have sought explicit contractual protections when they were negotiating the amended operating agreement. These protections might have included a minimum sale price, a majority-of-the-minority condition, or a period in which a sale was prohibited. Plaintiff bargained for none of these terms, and the court stated that it would not give plaintiff what he failed to get at the bargaining table, explaining that the implied covenant “is not an equitable remedy for rebalancing economic interests.” Accordingly, the court dismissed plaintiff’s complaint for failure to state a claim for breach of the implied covenant.

**What if Trumpet Had Been A Corporation?**

In a very interesting discussion, the Miller decision expressly contrasted the LLC result with the Delaware Chancery Court’s typical treatment of corporate cases involving similar facts. Under Delaware case law, a sale transaction such as the one described in Miller would have been subject to entire fairness review had Trumpet been a corporation. The entire fairness review (required because of the disproportionate interests of HCP as compared to the minority members) would have required that the defendants prove the fairness of the sale process and the price. Miller, in fact, is reminiscent of In re Trados Inc. Shareholder Litigation, Consol. C.A. No. 1512-VCL (Del. Ch. Aug. 16, 2013). In that case, a former common stockholder brought suit challenging a sale of the company wherein preferred stockholders received nearly all of the sale proceeds due to a
liquidation preference and common stockholders received no consideration at all. Following trial, the Court of Chancery found that a disinterested and independent majority of the board did not approve the transaction because, among other conflicts, directors affiliated with the preferred stockholders were focused on their firms’ desire to exit their investments in the company and not on the best interests of the company in general. The court further found that the company’s board did not deal fairly with the common stockholders, reasoning in part that the preferred stockholder-affiliated directors:

“did not make this decision after evaluating [the company] from the perspective of the common stockholders, but rather as holders of preferred stock with contractual cash flow rights that diverged materially from those of the common stock.”

The court held in *Trados* that the defendants did not breach their fiduciary duties because it was entirely fair for the common stockholders to receive nothing for their shares, which the court found to have no economic value. There were no competing bids or even indications of interest.

The *Trados* court summarized the duty of the directors of a Delaware corporation as including a duty to enhance shareholder value. Citing *Gantler v. Stephens*, 965 A.2d 695, 706 (Del. 2009) and other cases, the Chancery Court described the directors’ duty of loyalty as mandating that directors maximize the value of the corporation over the long-term for the benefit of the providers of equity capital, as warranted for an entity with perpetual life in which the residual claimants have locked in their investment. The Chancery Court also noted the “Revlon doctrine” based on *Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc.*, 506 A.2d 173, 182 (Del. 1986). *Revlon* held that once the directors determined to sell the company, the directors had an obligation to obtain the highest price possible.

Like Delaware General Corporation Law, the Colorado Business Corporation Act does not contemplate that the articles of incorporation or bylaws can waive the duties of directors to manage the business in the best interests of the shareholders. The directors’ duty of care is set forth in C.R.S. § 7-108-401(1) and their duty with respect to conflicting interest transactions in C.R.S. § 7-108-501. (Of course, directors of corporations that are formed as public benefit corporations under C.R.S. § 7-101-501 *et seq.* are not necessarily subject to the *Revlon* doctrine but also need to keep their public benefit purpose in mind.)

In summary, though, had Trumpet been organized as a corporation under Delaware law or Colorado law, waivers of fiduciary duties of care and loyalty would not have been enforceable and the court’s decision on the motion to dismiss likely would have been different.

**Implied Covenant of Good Faith and Fair Dealing: Ever-present, but Weak**

The *Miller* decision describes the Delaware courts’ unwillingness to use the contractual obligation of good faith and fair dealing where it would contradict otherwise clear contractual language and where the court found no arbitrary, unreasonable or unanticipated conduct. Where there is a clear waiver of fiduciary duties in an LLC operating agreement in a manner permitted by statute, a court will be “all the more hesitant to resort to the implied covenant.” A waiver of fiduciary duties “implies an agreement that losses should remain where they fall.” While the implied covenant inheres in every contract and cannot be eliminated by provisions of an LLC agreement, Delaware courts apply it “cautious[ly]” and it is “rarely invoked successfully.” Importantly, the implied covenant will not “override the express terms of the contract,” nor is it a “free-floating requirement that a party act in some morally commendable sense.” The implied covenant is not intended to be “an equitable remedy for rebalancing economic interests after events that could have been anticipated, but were not, that later adversely affected one party to a contract.”

As the Chancery Court stated, the contractual obligation of good faith and fair dealing is intended to be a narrow gap-filler that applies only when one party “proves that the other party has acted arbitrarily or unreasonably, thereby frustrating the fruits of the bargain that the asserting party reasonably expected” at the time of contracting, or where the contract actually contains “gaps” – that is, unaddressed issues.

The implied covenant is also intended to address circumstances where one party acts in an arbitrary, unreasonable, or unanticipated manner. This was the case in *New Design*
Constr. Co. v. Hamon Contractors, Inc., 215 P.3d 1172, 1182 (Colo. App. 2008), where Hamon attempted to control New Design’s work under a contract in what the court found to be an unreasonable manner. “As NDCC pointed out, if the implied covenant of good faith and fair dealing were not incorporated into the contract documents, Hamon could have required it ‘to perform its paving work at midnight using teaspoons.’” In response, the Court of Appeals said that the contractual obligation of good faith and fair dealing requires that “a party vested with contractual discretion exercise that discretion reasonably, not arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.” In Hamon, the court of appeals accepted evidence as to the custom in the industry for defining performance obligations.

The implied covenant is not intended to save a disappointed party from a bad deal. Where, as in Miller, the operating agreement provided the board the sole discretion to determine the manner of the company’s sale and addressed any risk of abuse of that discretion by restricting it solely to transactions with an unaffiliated third party, the court concluded that the parties “did consider the conditions under which a contractually permissible sale could take place” and left to the controlled board “the ability to structure a deal favorable to their interests.” This left no gap in the contract and no room for the implied covenant to work.

**Conclusion**

The stated statutory policy of the Delaware LLC Act, like the Colorado LLC Act, is to give maximum effect to the principle of freedom of contract and the enforceability of LLC contractual provisions as written – even though certain provisions may favor one party or another. This affords contracting parties great flexibility to privately order the affairs of the LLC and their respective rights and responsibilities. It also means that careful negotiation and drafting are essential to ensure that foreseeable scenarios are addressed and that the parties’ bargain is expressed in clear and unambiguous terms in the agreement.

Given the latitude provided by Colorado and Delaware law to organize LLCs, no two LLCs will be exactly alike.

- Founders and their attorneys should carefully organize the LLC as a manager-managed entity, and carefully draft the operating agreement to address the management, business, and tax goals expressed by the founder.

- Prospective LLC investors should review closely the operating agreement so that they are fully aware of the risks, rights, and remedies associated with an investment in the particular LLC.

- Equal attention and care should be paid to any material amendment to the operating agreement – which Miller and the other founders failed to do in the Miller case.

As the Miller court reminds us all by quoting Nemec v. Shrader, 991 A.2d 1120, 1126 (Del. 2010), “[p]arties have a right to enter into good and bad contracts[,] the law enforces both.”
Understanding the Uniform Protected Series Act: What Is A Protected Series?

By: Jay D. Adkisson
Las Vegas, Nevada

This is the first of a two-part article considering the Uniform Protected Series Act (UPSA), adopted by the Uniform Law Commission on July 19, 2017. Although I served as an ABA Business Law Section Adviser to the UPSA, the following musings are strictly my own.

The UPSA authorizes what is known as “Series LLC” (SeLLC). With little doubt, the Series LLC is the most complex legal entity yet created by humankind. The complexity of the Series LLC simply boggles the mind of even those who are familiar with, if not expert in, LLC law.

Think of the original LLC law passed by Wyoming in 1977 as the Wright Brothers’ Flyer 1 which first took to the air. Subsequent revisions to the LLC laws as embodied current in the Uniform Limited Liability Company Act (ULLCA), as repeatedly revised and amended, brought the LLC to the level of a Sopwith Camel, which now constitutes the ultimate state-of-the-art of LLC law.

If the simple LLC is a Sopwith Camel, with simple controls that anybody can learn to fly at a basic level in just a few hours, the Series LLC may be analogized to a modern 787 with literally dozens of major systems that interface in ways that create many thousands of potential issues. It is not an entity for the faint-of-heart, at least if significant assets are involved.

Protected Series LLCs

For these reasons, the Series LLC is not an entity for general consumption, for the do-it-yourselfer or even the average LLC planner who is inexperienced with Series LLCs. From time to time during the drafting process, there was talk of restricting the use of Series LLC only to those regulated industries which already have some experience with these entities and can be expected to use experienced counsel in forming them, those entities being primarily the hedge fund and insurance sectors. Releasing the Series LLC to the general public was feared to be, in the words of noted LLC expert Tom Rutledge, like “giving an Uzi to a three-year old”. In the end, however, it was decided that if users were willing to take the risks then the Series LLC should be available to them.

The drafters of the Uniform Protected Series Act (including me as an ABA Advisor) recognized early on that it would be utterly impossible to anticipate these myriad potential issues, and instead sought to build a basic statutory construct on which the planners creating Series LLC transactions (often referred to as “deals”) could themselves build their complex structures.

The basic idea behind a Series LLC is not particularly difficult. With an ordinary LLC, there is only one type of membership interest (or sometimes two, if there are managing or non-managing interests), and everybody has the same quality of rights. But with a Series LLC, there are many potentially many different tranches of equity. Each tranche of equity (a/k/a “protected series”) has its own assets and its own operations, and only the members who own a particular tranche share in the profit and loss distributions and increases or decreases in the value of equity from that particular tranche.

Structure of a Series Organization and Series Units

The "protected" part of a "protected series" comes from the statutory benefit that the assets and operations of each tranche of equity is protected from the liabilities of other tranches and their assets and operations -- in effect, each tranche is "walled off" from every other tranche (and the parent organization), and to a significant degree exists as its own entity.
The positive of this protection is that the owners of a particular tranche don't have to worry if another tranche is mismanaged or unlucky and thus suffers liability. The downside to this protection is that it can be easily misused to imbalance ordinary creditor-debtor relationships or to commit fraud.

Thus, the UPSA introduces the concept of the "associated asset" and the "non-associated asset", as well as important record-keeping requirements.

An asset is "associated" with a particular protected series only if the contemporaneous records denote the ownership of that asset by that protected series. An asset that has been properly associated with a series is available to the creditors of that series only, and not to creditor of any other series nor to the creditors of the parent organization.

If for whatever reason records do not exist or are not well-kept as to an asset, then the asset is deemed to be "non-associated" and is thus available to the creditors of any tranche or the parent organization, i.e., it is up for grabs for whichever creditor of any series or the parent organization gets to the asset first. Suffice it to say that for this reason Series LLCs are not for those who are not particularly good at keeping the books, and it is somewhat anticipated (based on, if nothing else, common sense) that a Series LLC will have its own professional accounting staff to make sure that the books are well kept.

The fraudulent transfer laws (now represented by the Uniform Voidable Transactions Act) are meant to and do apply to Series LLCs and their intra-series transfers. Concepts of alter ego/veil piercing and organizational liability also apply to Series LLCs. The application of these other bodies of law should substantially mitigate risks that a Series LLC could be used as a giant shell game by a financially-distressed or simply dishonest debtor.

This is the simple version of the UPSA. The statute itself is, of course, much more difficult to comprehend in all of its workings. What makes this comprehension somewhat easier are the sage comments by the Reporter to the UPSA, Prof. Dan Kleinberger, which are included with the Act. Although these comments do not themselves have the force of law, they are extremely enlightening into how the various pieces of the UPSA are supposed to work in concert and illuminating as to what the Drafting Committee was attempting to accomplish and why.

One more thing: The UPSA is not a standalone Act, but rather is in the nature of a "plug in" to a particular state’s own Uniform Limited Liability Company Act (ULLCA, or sometimes RULLCA in revised versions). The UPSA thus requires, sometimes expressly but often by implication, a process of "extrapolation" by which how things work or are defined under the ULLCA are applied to the UPSA. For instance, the UPSA does not speak directly to the concept of charging orders as a creditor remedy against a member’s particular interest in a protected series, but by extrapolation that concept does apply to protected series interests just as it would to any ordinary LLC membership interest.

But beware, however, that there is also "negative extrapolation" in the sense that sometimes the UPSA supersedes or overrides the ULLCA when a Series LLC is involved. Basic LLC law allows the members to "toggle on" or "toggle off" certain (but not all) features by way of the operating agreement, which concept the UPSA continues -- but the UPSA is more restrictive in what can be toggled on or off. Very simply, extrapolation is required in many areas and can be useful to planners, but it can also be a deadly trap for the unwary.

The obvious key to a successful Series LLC is a comprehensive and detailed Operating Agreement and ancillary documents that are carefully tailored to the specifics of the deal. Although a barebones or weak Operating Agreement might not cause too many problems with an ordinary LLC, that would be tantamount to suicide with a Series LLC. An off-the-shelf or do-it-yourself Operating Agreement for a Series LLC, or an Operating Agreement for an ordinary LLC with only slight modifications, will be little more than legal suicide should a significant issue arise.

For this reason, some members of the Drafting Committee only half-humorously suggested that the UPSA should instead be renamed the LFEA, for "Litigators Full Employment Act".

*Giving an Uzi to a three-year old, indeed.*
This article is the second in my series (pun unavoidable) on the new Uniform Protected Series Act ("UPSA") which was adopted by the Uniform Laws Commission in 2017. My article preceding this one is Understanding The Uniform Protected Series Act: What Is A Protected Series?

Article I of the UPSA recites the "General Provisions", which one may think of as the concrete slab that underlays the rest of the Act. While one might be tempted to skip over that and proceed to the meatier provisions, such would be a profound error. As a new Act, the UPSA does not have the benefit of anything like generations of widely-enacted statutes and volumes of court decisions upon which to fall back upon. In fact, as to court decisions there are either none or close to none, and although some states had already passed into law their own versions of a Series LLC, those acts have almost entirely escaped the attentions of the courts. The effect is that the UPSA is largely built from scratch, and thus to truly understand the UPSA one must start from the concrete slab of Article I and work upwards from there.

Why The UPSA? Section 101

Section 101 of the UPSA states simply that the Act may be entitled the Uniform Protected Series Act. If you think that choosing a name for the new Act would be easy, you'd be wrong. Simply choosing what to call this thing took up an inordinate amount of the drafting committee's time. By the time that I went to my first meeting on January 31, 2014 -- after it had already spent a year in a study committee and then a year in the drafting committee before I got there -- it was called the Series of Unincorporated Business Entities Act ("SUBEA"), in reflection that it was then to also apply to series partnerships and series limited partnerships, should some attorney drop too much LSD one night and attempt to create one of those.

At the January, 2016, meeting, it was decided to punt the idea of series partnerships and limited partnerships for now, and this then resulted in the Uniform Limited Liability Company Protected Series Act (ULLPSA), later shortened to the name finally adopted, the Uniform Protected Series Act (UPSA, phonetic "oops-sah", the "oops" part not meant to convey anything, at least consciously, though future generations may be left to wonder depending on how things turn out).

The Language Of The UPSA: Section 102

Section 102 sets out the definitions of the UPSA, which is to say the language of the Act. The UPSA is a very complicated Act, and to not understand the definitions very well will likely lead to utter confusion and error. Here it must be recalled that the UPSA is a "plug in" to the Uniform Limited Liability Company Act (ULLCA, or sometimes RULLCA in a revised form), and so the definitions of the UPSA must be read in context with the definitions of ULLCA through a process known as extrapolation.

The structure of the UPSA parses the components of a Series LLC into two types of entities.

First, the main company is the series limited liability company (a/k/a, though not defined, series organization), which means a series LLC that has formed at least one protected series. This is a screwy definition, because on the date of formation, the local Secretary of State (by whatever name) is going to issue a Certificate of Formation for a "series LLC", which will not have any protected series at that moment in time. What this definition really means is that until the company forms at least one protected series, the company will be...
Anecdotally, according to fellow ABA advisor (and buddy) John Williams who has formed literally hundreds of series LLCs, a considerable number of these companies never actually get around to forming even a single protected series, but operate simply as ordinary LLCs throughout their lifetime, but the owners of these companies merely wanted the option to be able to create protected series in the future should they then so desire. In this light, one wonders why somebody forming an LLC in a UPSA state would ever consider forming a non-series LLC for reasons other than additional cost, i.e., nothing compels the owner to form protected series but the future option is always open to them without having to later reorganize into a series LLC.

Second, a protected series under § 102(8) is defined as such a protected series as formed in a later provision of the UPSA (§ 201), but essentially means a tranche of equity in the series organization. An analogy frequently used in Drafting Committee meetings featured Dr. Evil as the series organization, and Mini Me as a protected series. My personal analogy is that the series organization is a large piece of honeycomb, and a protected series is an individual hex within the honeycomb.

A protected series manager under § 102(9) is a manager of the protected series, almost (but not quite) identical to a manager of an ordinary LLC.

A protected-series transferable interest under § 102(10) is basically the economic right to distributions from a protected series, and a protected series transferee is an assignee of that interest, which -- very importantly -- includes the interest (if any) of a former associated member of the protected series.

An asset under § 102(1) means that property in which either a protected series or the series organization either has rights or the power to transfer those rights. The definition of "asset" is specific to the UPSA, although as the Reporter's Comment notes, it is generally intended to have the same meaning as UCC § 9-203(b)(2). This definition is nothing like universal, however, even throughout the Uniform Acts, e.g., contrast with the definition of "asset" under the Uniform Voidable Transactions Act ("UVTA") which excludes property that is (1) exempt under applicable law, (2) held in tenancy by the entireties, or (3) to the extent that it is the subject of a bona fide security interest.

An associated asset under § 102(2) means an asset that has been "associated" with either a protected series or the series organization under the rules of a later provision (§ 301) that deals with the concept of association of assets. Arguably, the definitions of "associated asset" and "associated member" are the two most important definitions found in the UPSA. An "associated asset" is one that has been satisfactorily tied per § 301 to a particular protected series. If the asset has not been properly tied to a particular protected series, then it is an "unassociated asset" under § 102(6).

Conversely, a non-associated asset under § 102(6) refers to an asset that has not been "associated" with either a protected series or the series organization. The difference between an "associated asset" and a "non-associated asset" is this: An associated asset is only available to the creditors of a particular protected series, whereas a non-associated asset is available on a first-come, first-served basis to the creditors of any series or the series organization.

Section 102(7) tells us that a person includes a protected series. These five words may not sound like much, but they are one of the most important parts of the UPSA. For a protected series to be a "person", at least in legal terms, is meant to convey that a protected series has all the rights, privileges, responsibilities, liabilities, etc., as any other person under the law. In other words, each protected series of a series organization is its own person who stands alone and independent in the legal world.

Among other things, the declaration of personage is made in the hopes that a protected series would be treated in bankruptcy as a separate juridical entity and not simply an appendage of the series organization. The harder question, which generated much debate within the Drafting Committee, was whether it even should be a person (my own view is that a protected series is simply a tranche of equity and should not be, but those taking this position were simply outvoted).
Will a protected series be considered a "person" for federal bankruptcy law purposes? Suffice it to say that there was nobody on the Drafting Committee, including Yours Truly, who would have wagered $20 on the issue one way or another. Nobody knows, and nobody will know until somebody in a black robe gives their ruling. An **associated member** under § 102(3) means a member who has been "associated" with a protected series under another later provision (§ 302) that deals with the concept of association of members. Basically, an "associated member" is an owner of a particular tranche of equity which constitutes a particular protected series.

Here, there arises two terms that are not found in the UPSA, but likely will be part of any discussion of it. Although not statutorily defined, a **non-associated member** is a member of the series organization who, as it sounds, is not associated with the particular protected series being discussed, and in fact may not have ever been associated with any protected series. Similarly, a **disassociated member** is a member of the series organization who was once also associated as a member of the particular protected series being discussed, but has since ceased to be associated with that protected series.

There are also definitions for a **foreign series limited liability company** (§ 102(5)) and a **foreign protected series** (§ 102(4)) which basically refer to those forms when they are formed in another state, but doing business or something else in-state such as that they would be subjected to the in-state UPSA. More on this in a subsequent article.

The UPSA is not, of course, restricted to these particular terms, and where the definition of a term is missing, then through the process of extrapolation the corresponding term for the ULLCA is to be used. This is further explained at length in the Reporter's Comments to section 102.

**What Is A Protected Series? Section 103**

Section 103 is captioned "Nature Of Protected Series" and strives to tell us what a protected series is, and isn't. Whether section 103 accomplishes that task is a question best left to conjecture, since it is not at all difficult to envision somebody who is not familiar with the concept of a Series LLC using that section as a starting place and, after staring at it for 15 minutes, come away utterly baffled.

One the positive side, section 103 tells us that a protected series is a "person". This does not mean that a protected series will be coming over to anybody's house for beer and bar-b-que anytime soon, but instead is meant to affirm, as a matter of law, that a protected series is a juridical person entitled to all the rights, privileges and responsibilities of any other such "entity person" (such as corporations, partnerships and plain vanilla LLCs) under our laws. This could be quite important should a protected series attempt to file for bankruptcy protection independently from the series organization; or not, since as previously discussed nobody has a real inkling of how protected series might be treated in such a bankruptcy proceeding (and if one follows the "tranche of equity" description of a protected series, the thought that it could file for bankruptcy independently of the series organization makes utterly no sense whatsoever, but who knows, and in this regard section 103 might be viewed as authorizing the attempt).

Having told us that a protected series is a "person", section 103 then switches to the negative and goes on to tell us what a protected series is not: A protected series is not, and entirely distinct from, the series organization, any other protected series, a member of the series organization, and any transferee of an interest in either the protected series or the series obligation.

In other words, while the protected series is a component of the series organization, it is its own fellow. Well, sort of, since the Reporter's Comment states that "a protected series cannot exist on its own; therefore, a protected series is not entirely distinct from the series limited liability company on whose existence the protected series depends." Half bottle of aspirin, check, full bottle of scotch, check.

**The Powers And Duration Of A Protected Series: Section 104**

Section 104(a) tells us that a protected series has the capacity to sue in its own name and be sued in its own name. This subsection further emphasizes that a protected series is a separate juridical entity from the series organization, and effectively its own fellow for purposes of maintaining or defending legal actions.
Next, we find an extrapolation provision in subsection 104(b) which tells us that a protected series has basically the powers and purposes of the series organization itself, *i.e.*, if the series organization can do something, then presumably the protected series can do that too.

Can a protected series can exist on its own once the series organization has itself terminated? Section 104(c) answers this in the negative, by stating that a protected series can last no longer than the series organization. This subsection basically tells us that a protected series is an appendage of the series organization and cannot exist in the absence of the series organization. Thus, if the series organization terminates, all the protected series of that organization likewise terminate. Note that this provision significantly denigrates the concept of a protected series as an independent stand-on-its-own-two-feet separate juridical "person", and instead paints a protected series as simply an appendage of the series organization.

Note, however, that there is one situation where a protected series can survive the death of the series organization, which is where a merger of two series organizations has occurred, with a protected series from the one dying series organization becoming basically an appendage of the series organization that survives the merger. More about that when we get to section 604.

Moving on, subsection 104(d) tells us several important things, including that if the series organization is prohibited by law from doing something (say, holding a brothel license), then all the protected series of that company are likewise prohibited from that thing.

But probably more importantly, subsection 104(d) tells us that a protected series cannot be a member of the series organization, nor can one protected series establish another. This is in reflection that the concept of a series LLC where one series organization can create a bunch of protected series is difficult enough by itself. If you start trying to conceptualize structures where one protected series can create another like so many amoeba, then such things can only be understood after a healthy dose of tequila, peyote and mescaline. Which is to say that the Drafting Committee didn't want series LLCs to go down the rabbit hole into the surreal world where protected series can grow and multiply on their own or be an owner of the series organization and thus the father of its parent. Thus, the prohibition of § 104(d) which had near-unanimous support within the Drafting Committee for the aforementioned quite practical reasons.

**Whose Law Governs? Section 105**

Probably most of the time, disputes arising from the UPSA will involve only in-state parties, *i.e.*, the dispute will be confined to entities, members, and assets within a single state, and in which case that state's UPSA will apply to all aspects of the controversy and there will be utterly no reason to even think about choice-of-laws issues. Section 105 presumes that this will not be the case, and instead looks to situations where relationships involving a Series LLC have crossed state lines.

Subsection 105(1) relates only to "internal affairs", and basically says that for intra-Series LLC disputes, meaning those arising between members, the series organization, and protected series shall be determined by the laws of the state where the series organization was formed. Notably, the term "internal affairs" is a legal term of art, and denotes the legal affairs between the members, the managers, the series organization, and the protected series. However, the term does not include other third-persons to the arrangement, such as a creditor, even if their actions with the foregoing relationships, *e.g.*, that a creditor may foreclose on a member's interest in a protected series is not considered an "internal affair" even though that may dramatically impact not only the debtor member but the protected series and even the series organization.

The effect of subsection 105(2) is to enlarge the internal affairs doctrine to include relationships between not only the directly-affected members and managers of a protected series, but also to distant other members an managers of the same series organization even if not involved in a particular protected series.

Moving away from internal affairs, the effect of § 105(3) is to choose local law for liability issues that arise from the management, ownership or transfer of a protected series, which liability "is asserted solely by reason of the person being or acting" in the capacity as a manager, member or transferee. Similarly, subsections 105(4) and (5) apply local law to issues of liability arising from the filing of a designation of a protected series
with Secretary of State, acting as the manager of a protected series, situations where a protected series acts as the manager of the series organization, and the liability of a transferee of an interest in a protected series. Arguably, the effect of subsections 105(4) and (5) is to choose local law as to the question of whether a series organization may shield itself from the liabilities that are encapsulated and contained in a particular series organization, and those liabilities that may be subjected to what amounts to the "internal liability shields" of the individual protected series.

How The UPSA, The ULLCA And The Operating Agreement Work Together: Section 106

Section 106(a) sets out what the Operating Agreement for a series LLC will govern in terms of internal affairs, including defining the relationships between the series organizations and the various protected series, as well as manager and transferees.

As an aside, every LLC has an Operating Agreement, if simply verbal. The ULLCA operates such that if there is no written Operating Agreement, or if the written Operating Agreement fails for some reason or another, the ULLCA will provide the default operating rules for the LLC. But with a series LLC, the lack of a detailed, sophisticated, written Operating Agreement is nothing short of legal suicide, and akin to putting on a blindfold and then driving full-speed into rush hour traffic: It will not be very long before something very bad happens.

The Drafting Committee discussed, and came to the consensus, that no matter what the UPSA provides, there will still be folks who will form a series LLC and then simply adopt a standard-form Series LLC Operating Agreement with pedestrian provisions. This is one of those places in the discussion where the idea to name the UPSA the "LFEA" or "Litigators' Full Employment Act" went around.

In subsections 106(b) and (c), we find two extrapolation provisions that operate to bring the restrictions, etc., found in a state's ULLCA to apply as well to series organizations and protected series under the UPSA, and which restrictions, etc., override any contrary provisions in the Operating Agreement of a Series LLC.

Subsection 106(d) sets forth the hierarchy of governing authority in a Series LLC, which is:

1. The Operating Agreement, unless a provision is prohibited by other law or conflicts with the non-alterable provisions of the UPSA or ULLCA;
2. The UPSA, which trumps the ULLCA if the two conflict;
3. The ULLCA; and, finally;
4. Other law, e.g., common law as to breach of fiduciary duty, etc.

It cannot be overemphasized that the key to a successful series LLC is a sound, custom-drafted, sophisticated Operating Agreement. Can't say that enough.

What Can The Operating Agreement Toggle On And Toggle Off? Section 107

Section 107(a) sets forth the provisions of the UPSA that cannot be "toggled on or toggled off" by the Operating Agreement, and a provision in an Operating Agreement which attempts to do that should normally be unenforceable for that reason.

A note of caution: Most of the Section 107(a) restrictions are noted in the Reporter's Comment to the particular section restricted, but not always. The Drafting Committee discussed putting these restrictions not in a separate section (which became this § 107) but instead note these restrictions in the statutory language of the provisions to which they apply; that idea was discarded as unduly cumbersome, and thus this § 107 came about, but it essentially requires drafters to repeatedly reference this section to see whether or not they can do certain things in the Operating Agreement.
Understanding The Protected Series Act: Creating A Protected Series And Service Of Process

By: Jay D. Adkisson
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This is the third installment on my articles about the Protected Series Act, which was passed by the Uniform Law Commission in July, 2017, and on which I was an American Bar Association Adviser to the Drafting Committee. Previous installments were:

Understanding The Protected Series Act: What Is A Protected Series? (June 18, 2018), and Understanding the Protected Series Act: The Framework of UPSA (July 18, 2018).

Please read those previous articles first, or else you'll risk becoming disoriented very quickly as a protected series is a very advanced structure like nothing else in the law, and has its own discreet vernacular that must be understood. Shoot, this stuff is hard enough to understand even when you already know those other things well, so please don't try to wing it.

To briefly recap, a protected series is little more than a particular tranche of equity in a company (the series organization), which tranche has its own assets and operations that are effectively walled-off from all the other tranches and even the equity in the series organization itself. This third installment deals with how one creates a protected series organization and the individual protected series within it, the mechanics of which are found in Article 2, “Establishing Protected Series”.

Section 201. Protected Series Designation And Amendment

A protected series is created by a vote of the members of the series organization. Section 201(a) says that this vote must be unanimous, but then § 107(9) says that the series organization’s operating agreement may vary this to provide for some other percentage vote of the members. In other words, unanimity is the default toggle, but some smaller percentage (not even a majority) can be toggled instead.

Presumably, this also means that if the series organization has different classes of members, i.e., Orwell's different animals in the barnyard, the right to vote to create a protected series can be restricted to some members and not others. This would be the case where, for example, a series organization is set up as a hedge fund, and only the class of members with management rights could vote on whether to create a new protected series.

Protected Series LLCs JDA

Section 201(a) also presumes that the company has already filed and had accepted Articles of Formation with the Secretary of State’s office that authorizes it to be a Series LLC. This section does not -- repeat not -- state that somebody can take just any old ordinary LLC and convert it to a Series LLC with nothing more than a unanimous vote of the members (unless, of course, a particular state’s UPSA allows that, the point being that this § 201(a) doesn’t itself authorize that).

To create a protected series, there is a filing requirement, which is that the series organization will file a “protected series designation” with the Secretary of State where the LLC is formed which states the name of the protected series to be formed. In this regard, § 201(b) is one of the most singularly-important sections of the UPSA, since the filing with the Secretary of State to establish a protected series runs contrary to nearly every (if not every) series LLC statute already in effect as of the time that the UPSA was adopted.

The Drafting Committee spent a great deal of time on this issue before concluding that the filing of a designation would be a necessary predicate to establishing a protected series. There were two primary reasons for this:

First, there was little confidence among Drafting Committee members that a protected series could alone make a bankruptcy filing stick, i.e., be considered a “person” for purposes of the U.S. Bankruptcy Code, unless the protected series (and not just the series organization) held the imprimatur of the State, through the Secretary of State, by a filing. Or, if a bankruptcy filing did stick, then the filing would very likely drag the series organization (and thus all the other protected series) into the bankruptcy through substantive consolidation or some other theory. As for the other then-existing series LLC statutes, those were seen as simply creating what amounts to little more than a “contractual side-deal”, i.e., not an entity at all but merely an
amorphous contractual arrangement, which would likely not rise to the level of "person" for purposes of the Bankruptcy Code.

Second, the Drafting Committee thought that a filing for each protected series would help to protect against potential abuses of series LLCs, including attempts to negatively change normal creditor-debtor relationships through nefarious means, such as where some bad actor intentionally creates innumerable unregistered shells by which complicated shells games could be played with creditors.

As a practical matter, and having a good deal of experience with this myself with Nevada series LLCs, it is very difficult (if not impossible with some major banks) to even open a bank account for a protected series in the absence of some piece of paper regarding the protected series (and not just the series organization) from the Secretary of State's office showing that indeed the protected series does exist. So, the registration of protected series is a good thing, both theoretically and pragmatically.

Moving on, under § 201(c), the protected series comes into existence upon the filing of the designation with the Secretary of State. If one recalls the tranche characterization of protected series, the series organization creates a protected series by assigning a particular tranche of equity to the protected series. If there as yet no associated members, then the tranche of equity which has been assigned simply sits on the series organization's books as what amounts to "cabinet stock" until it is associated with a member.

Notably, the series organization can be — and is by default in the absence of another member — a member of the protected series, and also the only member of the protected series. This would be the cases where, for instance, the protected series are used to encapsulate various divisions of the series organization. For example, Big Oil LLC could be organized as a series organizations, with its divisions: exploration in Big Oil LLC Protected Series A, drilling in Big Oil LLC Protected Series B, refining in Big Oil LLC Protected Series C, etc. In such a scenario, Big Oil LLC as the series organization would be the member and manager of the protected series by default, although this arrangement could be modified by adding outside members, managers, etc.

Section 201(d) allows the protected series designation to be amended, also by filing the appropriate form with the Secretary of State. If there is a change to the series organization itself, such as a change-of-name, then there would have to be corresponding filings for each protected series. Section 201(d) is effectively another extrapolation provision of sorts which says that once a protected series has been registered with the Secretary of State, the registration may be amended to change similarly to the procedure for changing the same information for an ordinary LLC. This is effectively repeated in § 202(c).

Section 202. Name

What is in a name? "A rose by any other name would wither and die."* Section 202(a) lays out yet another extrapolation provision, which first requires that the name of a protected series complies with the requirements for an ordinary LLC. Section 202(b)(1) then says that the protected series must begin with the name of the series organization, while § 202(b)(2) says that the name of the protected series must contain either the words "protected series" or the designation PS (or P.S.).

The practical cumulative effect of § 202(b)(1) and (2) will be that a protected series will have a name like "Maxwell Taylor LLC Protected Series X" or "Courtney Hodges LLC PS-X". The purpose of this requirement is to largely let third parties know that they are dealing with a protected series which may have liability that is encapsulated away from the series organization or other series, and to deter the use of a protected series from being used to commit fraud.

Note that nothing in § 202 generally or specifically prohibits a properly-registered protected series from adopting a d/b/a designation, i.e., "Ambrose Burnside LLC Protected Series 14 d/b/a Army of the Potomac". Anecdotally, this seems to be a common practice to, inter alia, avoid confusion between one protected series and other protected series or the series organization itself. One can see, however, the potential misuse of a d/b/a designation for unsavory uses, but this is a problem with d/b/a designations generally anyway, and thought by the Drafting Committee to be of no special problem here.
Section 203. Registered Agent

The discussion of who should be the registered agent for a protected series took up a substantial amount of the Drafting Committee's discussion. There were suggestions that each protected series should have its own registered agent, but this idea was rejected as too cumbersome, confusing, and fraught with the possibility of fraud in the sense that a creditor might not be able to determine which registered agent should be served with papers.

The position finally settled upon is that of § 203(a) which basically says that the series organization (through its own registered agent) will act as the recipient for service for all of its protected series. This method was thought to have the additional benefit of alerting the series organization as to what was going on with a particular protected series organization that might be in some otherwise undisclosed (read: hidden from the series organization by the protected series) legal difficulty.

The practical difficulties of each protected series having its own registered agent also made that seem like a really bad idea, since such would have required the series organization to maintain a current list of all the registered agents for all the protected series in order to be able to answer potential third-party inquiries or otherwise respond when a plaintiff's lawyer can't figure out which protected series should be liable, and thus (inevitably) carpet-bombs the series organization and all the protected series process in the attempt to get the right one(s).

Section 203(b) says that a protected series must agree with a registered agent that the registered agent will act as the same for both the protected series and the series organization, and this must be done before the Statement of Designation (or whatever it will be called) is filed for the protected series with the Secretary of State. Section 203(c) then says that whoever signs the Statement of Designation for the protected series effectively certifies that § 203(b) was first accomplished.

What happens with the registered agent receives service of something, but it is not clear whether the service was made on the series organization or a protected series? Doesn't matter: The registered agent under § 203(f) must still accept the service, and then presumably forward the papers to somebody who might know where they go.

Effectively, § 203(f) places the burden on the series organization for getting the process to the correct protected series. Note that this creates potential liability for the series organization, since, for example, a protected series that is the object of process that is served on the series organization, but for whatever reason does not timely receive it from the series organization, may be able to assert a cause of action against the series organization for any injury suffered thereby. Whether such liability could be fully exculpated by a waiver or release of liability in the Operating Agreement, by the protected series to the series organization, seems doubtful.

Section 204. Service Of Process, Etc.

It is not difficult to imagine scenarios where a plaintiff knows that one of a number of protected series is liable for damages, but doesn't know which protected series is the one responsible.
So that the protected series cannot be used in a carnival shell game of "find the culpable series", § 204 sets out that a protected series may be served in one of three ways.

First, the protected series may be served by delivering process to the series organization under § 204(a)(1). More about this below in regard to § 203(b).

Second, the protected series may be served by delivery of process to its registered agent. As we have already seen, under § 203(a), the registered agent for every protected series is whoever is serving as the registered agent for the series organization, so this could have read "serving the registered agent of the series organization" and it would be about as correct.

Third, the protected series may be served by another means allowed by local law to serve an ordinary LLC with process, such as through service by publications, etc.

This brings us to arguably the most important provisions regarding service, which are found in § 204(b) and (c). These paragraphs say that any service of a summons and complaint that is made upon either the series organization or any protected series is notice to both the series organization and all the protected series (not just the named defendant) of both the fact of the service and notice of the contents of the complaint.

Issues involving service of process for a lawsuit took up many hours of the Drafting Committee's work. Ultimately, it was decided that, because of the potential for confusion between the series organization and probably numerous protected series, it made more sense to allow the plaintiff to serve the series organization and that would be "good service" on all of the protected series. The idea here is that even if the plaintiff doesn't know the right defendant, the series organization most likely will, and then the summons and complaint can be directed by the series organization to the target protected series to respond.

An additional consideration here was that this method of service also allowed the series organization to keep an eye on what was going on in its protected series, and not later be surprised by litigation or a judgment, etc., involving one of its protected series which had failed to advise (culpably or negligently) the series organization of its financial distress.

It is anticipated that if the plaintiff for whatever reason doesn't know which protected series is the one liable on a particular claim (such as is most likely to occur with a tort plaintiff), the plaintiff will likely "carpet bomb" both the series organization and each and every protected series other than the affected one may have to seek dismissal of the claims on the grounds that it was not the correct entity responsible.

Likewise, service made upon one protected series operates as service upon all protected series and the series organization, which is why requiring in § 203(c) that all of the protected series must use the same registered agent as the series organization makes such wonderfully good sense. The notice to the series organization and all the protected series is effective, under § 203(f), even if the wrong party was named in the summons and complaint. These rules likewise apply to foreign (out-of-state) series organizations and protected series under § 204(d) and (e).

Sections 205 and 206. Certificate of Good Standing for Protected Series And Information Required In Reports

A protected series can obtain a Certificate of Good Standing from the Secretary of State just like an ordinary LLC, and § 205 sets out what are basically instructions to the Secretary of State as to how to handle requests for such certificates.

Similarly, § 206 extrapolates a state's requirements for an LLC to file a periodic report (usually annually) to protected series.
Understanding The Protected Series Act: Assets, Members And Management

By: Jay D. Adkisson
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This is the fourth installment on my articles about the Protected Series Act, which was passed by the Uniform Law Commission in July, 2017, and on which I was an American Bar Association Adviser to the Drafting Committee.

Previous installments were:

Understanding The Protected Series Act: What Is A Protected Series? (June 18, 2018);
Understanding the Protected Series Act: The Framework of UPSA (July 18, 2018); and

Please take the time to read those other installments before reading this one, as otherwise you have about as much chance of understanding this stuff as if you entered in the middle of a Quentin Tarantino movie and from there tried to figure out the plot.

To briefly recap, a protected series is little more than a particular tranche of equity in a company (the series organization), which tranche has its own assets and operations that are effectively walled-off from all the other tranches and even the equity in the series organization itself. This fourth installment deals with Article 3 of the UPSA, which considers how the protected series gets its own assets, members and management, and the transfer of membership interests in a protected series.

Section 301. Associated Asset

We begin with what is quite possibly the single most important section of the UPSA, which is § 301 that relates to how assets are allocated between the series organization and the protected series. This is accomplished through a process of "association" — a concept that resonates throughout the UPSA. In the context of § 301, "association" basically means the placing of things somewhere, meaning either in the series organization or in a particular protected series -- but not both.

Under § 301(a), if an asset is associated with a protected series, then it is the asset of that protected series and that protected series only; it cannot also be the asset of the series organization or some other protected series. Similarly, if an asset is associated with the series organization, then it is the series organization's asset only, and not also the asset of some protected series or another. The underlying idea behind this rule is to prevent fraud on creditors by the series LLC claiming that particular assets are subject to ownership by various other protected series, or the series organization, such that the enforcement of judgments by creditors is thwarted.

An asset is "associated" with a protected series, or with the series organization, under § 301(b) and (c) if an only if adequate records have been kept would all a "reasonable individual" (the term used in those paragraphs) to do three things:

First, the records would identify the asset in particular and distinguish it from other assets of the protected series or the series organization. Thus, if the series LLC encompassed 40 liquor franchises, with each store in its own protected series, simply stating "48 bottles of premium Scotch" would not be enough; instead, the record would need to show something like "4 cases of Johnny Walker Gold Label Scotch, series nos. XXX through XXX".

Second, the records would answer "who", "when", and "how"; namely, from whom the asset was acquired, when the asset was
acquired, and how the asset was acquired. For example, "acquired from JDA Liquor Distributors on August 30, 2018, by cash purchase" would satisfy the records requirement, but "arrived sometimes in the summer of 2018 from vendors" would not.

Third, if the asset came from the series organization or another protected series, then additionally the records would have to reflect that the asset came from the series organization or a specifically-named protected series, and what consideration was paid for the transfer. Thus, "asset acquired in original formation of the protected series" would not be an adequate record, but "received asset from ABC Series LLC Protected Series 123 in exchange for a 16% membership interest in Protected Series 124" would be an adequate record.

The bottom line here is that a series LLC under the UPSA is all about the record keeping of assets. If the record keeping for a particular asset is sound, then the asset will be an associated asset and thus not available to any creditors other than those of the particular protected series (or the series organization) to which it is associated. If the record keeping is not sound, then the asset is an non-associated asset which is available on a first-come, first serve basis to the creditors of any protected series or the series organization. Subsection (b) defines what constitutes sound record keeping for protected series.

Notably, the UPSA doesn't mandate the form of the records to be kept, whether by database, spreadsheet, handwritten ledger, or otherwise, other than to say in § 301 (d) that they must be kept in a "reasonable manner". Suffice it to say that the best practice will be to do so in a fashion that the records can be easily understood and read by either a judge or jury, for somewhat obvious reasons.

Changing gears, the UPSA provides in section 301(e) that either the series organization or any of the protected series may have their assets held through a trustee, nominee, agent, etc., just like any other legal entity. What they cannot do, however, is to hold assets in such capacity for each other. The public policy reason behind this prohibition is to prevent a series LLC from being used as a giant shell game where assets which appear to be held by one protected series are actually owned by another, or at least the wrongdoer lies and says that such is the case. This keeps the creditor from having to play "asset whack-a-mole" among the protected series and the series organization.

Section 302. Associated Member

Having just seen how an asset becomes a part of a protected series, we now turn to see how one can become a member of a protected series, which is what § 302 is all about.

The first rule, as found in § 302(a), is that only the members of the series organization can be a member of a protected series. If one recalls the tranche characterization of protected series, this makes perfect sense. The holder of a tranche of equity is a holder of equity in the company generally, that equity being the particular tranche held. Thus, a member of a protected series must be a member of the series organization, but the converse is not true: A member of the series organization need not be a member of any protected series, i.e., that member can suffice to hold a general tranche of equity in the company but not a particularized tranche.

Again, however, note that there is no requirement that all the members of the series organization have the same rights and privileges, which is to say: Be equal members in the barnyard. The series organization's operating agreement can create membership interests of varying quality, and there is no statutory requirement at least that a particular quality of membership interest be held by a member to also be a member of a protected series.

One becomes a member of a protected series if the operating agreement, or other governing document of the series organization, says that they are a member, states the date of their membership association with the protected series, and describes the precise "transferable interest" in the protected series that the new member holds. Thus, to associate a member with Protected Series 123, the Operating Agreement or Ledger of Members, might read: "Tom Tanaka, 41% interest in ABC LLC, and joined ABC LLC Protected Series 123 on 8/30/2018 with a 18% interest."

Recall here that under LLC law generally, meaning the ULLCA in all its revisions, the term
"transferable interest" is defined as a member's right to distributions, i.e., the percentage of distributions that member will receive. Recall also that the Operating Agreement can restrict the right of a member to transfer their interest, so the term "transferable" is somewhat of a misnomer, if not an outright oxymoron.

Subsection 302(c) then states the logical conclusion of subsection (a), being that if a person is no longer a member of the series organization, then they immediately at that time cease to be a member of any protected series as well.

Section 303. Protected-Series Transferable Interest

We are told in § 303(a) that a transferable interest in a protected series must initially be owned either by the series organization or by an associated member of the protected series. This is a roundabout way of saying that the transferable interest cannot first be owned by a transferee of that interest.

For example, assume that Bill has been associated as a member of Protected Series 123 and will receive an 18% interest in exchange for Bill's contribution to PS-123 of $100,000. Bill borrows the money from non-member Sam, who takes the 18% interest to be issued as collateral for the loan. Bill contributes the $100,000 to PS-123. At that point in time, the 18% interest must first be issued to Bill, although then he can sign it over to Sam. The 18% interest cannot first be owned by non-member Sam under this rule.

But what if the protected series as yet has no members? In that case, the transferable interest in the protected series is deemed to be owned by the series organization under § 303(b). Similarly, under § 303(c), the series organization can itself acquire through whatever means, and from whoever, a transferable interest in one of its protected series. In such a case where the series organization ends up owning a transferable interest in a protected series, then the series organization is treated just like any other associated member of that protected series under § 303 (d).

Section 304. Management

There is sometimes made an analogy of a protected series to the series organization to being like Mini Me to Dr. Evil, i.e., an exact replica of original in all respects, just smaller and dependent on the original. This particular analogy probably works as well in regard to § 304, which deals with the management of a protected series, as any other analogy, since when it comes to management of the protected series what is permissible there largely (but not completely) mirrors what is permissible within the series organization.

Section 304(a) provides that a protected series can have multiple managers, just like an ordinary LLC. Also, just like an ordinary LLC, there is no statutory qualifications for who may act as the manager, i.e., the manager need not be an associated member of the protected series, or even a member of the series organization. To the contrary, a manager of a protected series can be a total outsider to the protected series and the series organization. This would be the case where, for instance, the series LLC is used as the framework for a hedge fund family, the protected series are individual hedge funds, and the managers of the protected series are non-investor outside financial advisors.

What if the protected series as yet has no associated members such as could vote on a manager? In that event, § 304(b) provides that the series organization acts as the manager of the protected series. You may also think of the series organization as the "default manager" for the protected series, although for clarity this should be written into the series organization's operating agreement.

The duties of a manager of a protected series are the same to the protected series and its members and transferees as the manager's duties would be to an ordinary LLC, per the extrapolation provision of § 304(c) which directs the reader to ULLCA § 108.

Section 304(d) says that the manager of a protected series owes in that capacity duties only to the protected series (but not the series organization or its members or transferees) and its own members (but not transferees), and does not owe any duties to any other protected series or their members or transferees -- but only to the
extent of the latter "in that person's capacity" as a member or transferee of the series organization or another protected series.

The problem here is one of overlapping memberships, since a member of a protected series must also be a member of the series organization, and a member might be associated with two or more protected series and not just the instant one where we are examining the manager's duties. Thus, the Reporter's Comment to § 304(d) notes:

"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.


Thus, at first glance, subsection (d) appears to be a broad exculpation of the duties of a series manager which might be owed to the series organization or other protected series, but a closer examination (and the Reporter's Comment) reveals that it is anything but that. The phrase beginning subsection (d), "Solely by reason of being or acting", implies that other circumstances may exist to impose such broader duties upon a manager of a protected series. For example, if a protected series is in severe financial distress, it could very well be the duty of the manager to notify the series organization if the latter could potentially be drawn into a bankruptcy of the protected series.

All of which is a nice way of saying that the statutory protections afforded by § 304(d) are nice, but in practice one acting as a protected series manager had better prudently collect conflict waivers in a booklet corresponding in size to the number of protected series and overall members in the series organization.

Members of a protected series are looped back into the series organization through § 304(e), which basically says that such a member doesn't have any different rights as a member of the series organization simply because the member is also a member of the protected series. This is true even if the member will be voting on matters that affects the protected series with which that member is associated.

But, and it is a really huge but, this is one of those provisions that can be "toggled off" in the Operating Agreement, such that an Associated Member in a protected series can be given either less or more rights in the series organization than ordinary members of the series organization. In other words, depending on how the Operating Agreement is drafted, not all the members in the series organization barnyard may end up being equal in terms of voting rights.

So, if there are duties, then there are obligations — and fiduciary obligations. Section 304(f) tells us that the derivative claim provisions of the ULLCA are applied to protected series so that there can be derivative claims within a protected series too. Suffice it to say that if you are having to actually analyze subsection (f) and the potential integration of derivative claim provisions in relation to a series LLC, it is strongly suggested that you have at the ready a half bottle of aspirin and a full bottle of Scotch, because that is going to get really gnarly with overlapping membership and management between the protected series and the series organization, and also in regard to how particular acts may affect other protected series as well. The phase "litigator's dream" comes to mind here.

An ordinary LLC doesn't need a manager, and in fact a good number of LLCs are simply managed by the members. Section 304(g) tells us that an associated member of a protected series has the same power to act as an agent and bind the protected series that the member would have with an ordinary LLC under the
ULLCA. With an ordinary LLC, these powers may, of course, be restricted if not eliminated entirely by the operating agreement, and the same would be true with a protected series — but what operating agreement? The operating agreement for the series organization could certainly take care of the issue, but here we get a whiff that perhaps each protected series needs its own operating agreement, consistent with the "Mini Me" characterization of a protected series.

Section 305. Rights Of Non-Associated Members To Information

We find a giant extrapolation provision in Section 305 which basically says that basically applies the rights to information about an ordinary LLC to a protected series, by restricting the information rights about a protected series to its associated members and managers to the exclusion of the members and managers of the series organization and other series to the extent that they are not also associated members and managers of the protected series. Of course, these rights may be further defined and varied in the operating agreement for the series organization (and the operating agreement for the protected series if one exists), and it probably makes good sense to vary those rights to that at least the managers of the series organization have the right to know what is going on in all the protected series.
Rethinking the Validly Issued Opinion on Equity Interests Issued by Alternative Entities

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A typical closing opinion addressing the issuance of capital stock reads as follows:

"The Shares [of capital stock] have been duly authorized and validly issued and are fully paid and nonassessable."


TriBar explains the elements of the “duly authorized” component of this opinion as follows:

“The opinion [duly authorized opinion] means that, under the corporation law of the state in which the Company was organized and the Company’s charter, the shares to which the opinion relates (the “Shares”) were (or will be) immediately prior to their issuance included within the shares that the Company had the power to issue. The opinion covers such matters as whether (i) the applicable state corporation law permits shares having the characteristics of the Shares, (ii) the provisions of the Company’s charter relating to the Shares comply with that law and (iii) sufficient authorized shares of the class of which the Shares are a part were available when the Shares were issued.”

TriBar Opinions Report § 6.2.1, 53 Bus. Law. at 648 (emphasis added) (footnote omitted).1

TriBar first addressed this opinion in the context of alternative entities in its Supplemental TriBar LLC Opinion Report: Opinions on LLC Membership Interests (“TriBar LLC Interests Report”), 66 Bus. Law. 1065 (2011). A typical “validly issued” opinion for an LLC reads as follows:

“The [LLC] [Membership] Interests issued by the Company [the LLC] to the purchasers thereof have been validly issued.”

The “duly authorized” component of the typical capital stock opinion is not included in this opinion for alternative entities because LLC statutes, unlike corporation statutes, do not provide for authorized capital or specify the requirements for creating it, and, unlike corporate charters, LLC operating agreements typically do not create a pool of “authorized” LLC interests. TriBar LLC Interests Report, 66 Bus. Law at 1068. Moreover, because an opinion that corporate shares have been “validly issued” could not be rendered if the shares were not “duly authorized,” TriBar Opinions Report, 53 Bus. Law. at 649, including a duly authorized opinion in an issuance opinion on alternative entity equity interests “would only cover matters already covered by the validly issued opinion and thus ordinarily would add nothing of value.” TriBar LLC Interests Report, 66 Bus. Law. at 1068.

On December 9, 2016, the Executive Committee of the Business Law Section of the State Bar of California approved the report entitled “Third-Party Closing Opinions: Limited Liability Companies and Partnerships” (the “CA Entities Opinions Report” or “CA Report”).2 The CA Report was prepared by a working group (the “CA Working Group”) comprised of representatives of the Partnerships and Limited Liability Companies Committee (the “Partnerships & LLCs Committee”) and the Opinions Committee of the Business Law Section, and is an update and restatement of the Partnerships & LLCs Committee’s 1998 and 2000 reports on legal opinions concerning California partnerships and LLCs.3 In the course

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1 A state’s corporation law, for purposes of the duly authorized opinion, includes the state constitution where it contains provisions relevant to the opinion. TriBar Opinions Report § 6.2.1 n. 126, 53 Bus. Law. at 648.

2 Effective January 1, 2018, the sections of the State Bar of California split off and became part of the California Lawyers Association (“CLA”), a voluntary bar association. 2017 Stats. ch. 422 (SB 36). See calawyers.org.

3 An exposure draft of the Alternative Entities Opinions Report was posted in April 2016 in the Legal Opinion Resource Center of the Legal Opinions Committee of the Business Law Section of the American Bar Association under “Meetings and Other Materials.” The comment period
of preparing the CA Report, the CA Working Group struggled with the scope of the validly issued opinion for LLC and limited partnership equity interests. In this article, the author, a co-chair of the CA Working Group and a past (2015-2017) co-chair of the California Opinions Committee, identifies these issues and how they are dealt with in the CA Report.  

The Scope of the Validly Issued Opinion for Alternative Entities

There is no controversy about three of the elements of the validly issued opinion on LLC or LP equity interests:

- It confirms that the creation and issuance of the LLC/LP interests satisfy the requirements of the applicable LLC/LP statute and the entity’s articles of organization (in Delaware, the certificate of formation) and operating/limited partnership agreement;

- It confirms that the issuance of the LLC/LP interests complied with any conditions on issuance in the resolution or other action, if any, adopted under the operating/limited partnership agreement approving the issuance; and

- It confirms receipt of the required kind and amount of consideration for the issuance of the LLC/LP interests.


What caused the CA Working Group concern is the next element of the validly issued opinion, which the CA Working Group refers to as the “substantive element.” As stated in the TriBar LLC Interests Report:

“As in the corporate context, this opinion [the validly issued opinion] requires that the LLC have the power under the applicable LLC statute, its certificate of formation, and its operating agreement to create interests in the LLC having the terms of the LLC Interests covered by the opinion. Thus, the opinion also confirms that the terms of the LLC Interests do not violate the applicable LLC statute, the LLC’s certificate of formation, or the operating agreement.” 66 Bus. Law. at 1067 (emphasis added).  

TriBar does not further define what “terms” of the LLC interests it refers to which should be examined against the applicable LLC statute, certificate of formation, and the LLC’s operating agreement. At the beginning of its LLC Report, TriBar defines “LLC Interests” by reference to Section 18-101(8) of Delaware’s LLC Act to mean a member’s share of profits and losses and the member’s right to receive distributions of the LLC’s assets. 66 Bus. Law. at 1066 n. 3. TriBar acknowledges that some states, such as New York, use the term “membership interest” in lieu of the term “limited liability company interest,” and that the term “membership interest” includes a member’s rights, if any, to vote and to participate in the management of the LLC. It notes that an “opinion on an LLC formed in a particular state normally uses the same terminology as is used in that state’s LLC statute.” Id. Accordingly, if an opinion giver addresses the valid issuance of “membership interests,” then the opinion giver should look to the governing statute of the covered law state for the elements or “terms” of those membership interests.


The views expressed in this article are those of the author and, otherwise than as stated, do not necessarily represent the views of the CA Working Group or the California Opinions Committee.

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5 In the more recent TriBar LP Opinions Report, TriBar’s emphasis is on “rights” rather than on “terms.” TriBar LP Opinions Report § 4.0.

6 Similarly, in its report addressing the substantive element of the valid issuance opinion for LP interests, TriBar acknowledges that limited partnerships formed in states other than Delaware may not have the broad discretion Delaware limited partnerships have to determine the rights of

History of the Substantive Element of the Validly Issued Opinion

An opinion that corporate stock has been validly issued cannot be given if issuance of the stock has not been “duly authorized.” The three elements of the duly authorized opinion on corporate stock are listed in the introduction to this article. See TriBar Opinions Report § 6.2.1, 53 Bus. Law. 591, 648.

Items (i) and (ii) of these elements are stated in terms of whether state corporation law permits shares having the characteristics of the shares addressed by the opinion, and whether the provisions of the company’s charter relating to the shares comply with that law. Thus, for example, a duly authorized opinion on preferred stock carrying special voting rights under Delaware law would address whether the DGCL permits preferred shares having such special voting rights and whether the company’s certificate of incorporation creates those special voting rights for the preferred shares in compliance with the DGCL.

The fullest treatment of the substantive element of the duly authorized/validly issued opinion is found in TriBar’s Preferred Stock Opinions Report. The focus of that report is on the duly authorized opinion, not the validly issued opinion, although, as noted above, the validly issued opinion cannot be given if the shares addressed by the opinion have not been duly authorized. Moreover, the elements of the duly authorized opinion have been engrafted onto the validly issued opinion in the TriBar LLC Interests Report because, as noted by TriBar, in the context of the issuance of LLC interests, the duly authorized opinion ordinarily adds nothing of value to the validly issued opinion. TriBar

LLC Interests Report § 1.0, 66 Bus. Law. at 1068.

As one of the elements of the duly authorized opinion on preferred stock, TriBar repeats, very closely, the substantive element of the duly authorized opinion from the TriBar Opinions Report:

“... the Company has the power under the applicable state corporation statute and its charter to create stock having the rights, powers and preferences of the stock in question.”

TriBar Preferred Stock Opinions Report, 63 Bus. Law. at 923.

In interpreting this element of the duly authorized opinion, TriBar, in its Preferred Stock Opinions Report, casts the inquiry in negative terms: because most corporation statutes contain broad statutory authority to create and issue stock with whatever economic and other terms a corporation chooses, “an opinion preparer’s inquiry regarding this [element] often will be limited to whether any of the specified rights, powers or preferences of the preferred stock violate provisions of the corporation statute or the company’s charter.” 63 Bus. Law. at 923-924 (emphasis added). 7

TriBar provides examples of what such a violation might be:

- The preferred stock purports to deny holders voting rights when the charter prohibits non-voting stock; or
- The preferred stock is granted priority in liquidation over an existing class or

7 In the context of corporate stock, California agrees with the substantive element of the duly authorized opinion: “...the ‘duly authorized’ opinion should not be given as to capital stock if the terms of that stock are prohibited by the [California General Corporation Law].” Corporations Committee, Business Law Section, State Bar of California, Legal Opinions in Business Transactions (Excluding the Remedies Opinion) 67 (October 2007 printing). The substantive element of the duly authorized opinion was affirmed by the California Opinions Committee in its report on venture capital financing opinions. Opinions Committee, Business Law Section of the State Bar of California, Report on Selected Legal Opinion Issues in Venture Capital Financing Transactions, 65 Bus. Law. 161, 171 and n. 21 (2009).

holders of their LP interests, and that, in those states, state bar association reports may provide guidance on which of those rights are covered by a validly issued opinion. TriBar LP Opinions Report § 4.0.
series whose terms prohibit creation of stock with a higher priority.

63 Bus. Law. at 924.

TriBar concludes its Preferred Stock Opinions Report with additional examples that might cause opinion preparers to qualify their duly authorized opinion on preferred stock:

- The charter establishes a procedure for declaring dividends that contravenes the corporation statute;
- The charter eliminates statutory appraisal rights either by expressly denying those rights or by requiring all holders to vote in favor of a matter if a majority of a class or series so votes ("drag-along rights") when under the applicable state corporation statute such a requirement constitutes an impermissible advance waiver of appraisal rights;
- The charter provides for a lower percentage vote for approval of certain matters than the vote required by the statute;
- The charter gives holders of a class of stock the right to designate a member of a committee of the board when the statute authorizes only the directors to appoint members of committees of the board; or
- The board pursuant to blank check authority creates a class of stock that is non-voting when a provision in the charter only permits the creation of voting stock.

63 Bus. Law. at 926.

Reading TriBar’s statements together, TriBar describes the substantive element of a duly authorized opinion on preferred stock as whether the company “has the power” under the applicable state corporation statute and its charter to create stock having the rights, powers and preferences of the stock in question, and then indicates that the opinion preparers’ inquiry regarding this element often will be limited to whether any of the specified rights, powers or preferences of the preferred stock violate provisions of the corporation statute or the company’s charter.\(^8\)

TriBar, for understandable reasons, does not use the phrase “rights, powers and preferences” from its Preferred Stock Report in its LLC Interests Report. Instead, it uses the phrase “terms,” without definition or explanation. The Delaware LLC Act does not use this word in describing the interests of members of a Delaware LLC, although it does use the phrase “rights, powers or duties” in describing the powers of a Delaware LLC to create classes or series of members and managers. Del. LLC Act, Del. Code, tit. 6, §§ 18-215, 18-302. Certainly a not unreasonable interpretation of “terms” is that it refers to all of the rights, powers, and duties associated with LLC interests.\(^9\)

The Delaware LP Act similarly does not use the phrase “terms” when discussing LP interests but, like the Delaware LLC Act, refers to “rights, powers and duties” in describing the powers of a Delaware LP to create classes or groups of limited partners. Del. LP Act, Del. Code, tit. 6, § 17302(a). In its recent report on LP opinions, TriBar focuses on “rights” as the focus of the validly issued opinion rather than on “terms.” See note 5.

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8 The potentially broader inquiry necessitated by the substantive element of the duly authorized opinion is illustrated by the one decision cited by TriBar in support of the substantive element of the duly authorized opinion on preferred stock: Waggoner v. Laster, 581 A.2d 1127 (Del. 1990). Preferred Stock Opinions Report, 63 Bus. Law. at 923 and note 10. In this decision, the Delaware Supreme Court affirmed the Chancery Court’s decision that the super-majority voting rights granted to the holders of the preferred stock were void because the issuer’s certificate of incorporation did not specifically authorize the board to establish special voting rights for the preferred. “In light of that omission,” concluded the Supreme Court, “and Delaware’s statutory requirement that such powers be enumerated in the certificate of incorporation, the Vice Chancellor found that the record was insufficient to establish that the company’s board was expressly authorized to grant preferential voting rights to certain classes of stock.” 581 A.2d at 1133-1134. The Supreme Court agreed with the Vice Chancellor.

9 As noted at the beginning of this article, TriBar does acknowledge, in its LLC Interests Report, that opinion preparers should look to the governing statute of the law covered by their opinion when addressing the elements of the equity interests addressed by the validly issued opinion. See TriBar LLC Interests Report, 66 Bus. Law. at 1066 note 3.
TriBar cites, in support of its application of the substantive element of the validly issued opinion to LLC interests, the Preferred Stock Opinions Report. It is also not unreasonable for opinion preparers to conclude that the “terms” referred to in the TriBar LLC Interest Report include the type of “terms” of preferred stock given as examples in the Preferred Stock Opinions Report as illustrative of the substantive element of the duly authorized opinion, cited in the bullet point paragraphs above. Such “terms” would include the voting rights granted to the members of the LLC, the economic terms of the LLC interests, the priorities or preferences granted to separate classes or series of interests, the dissenters’ rights, if any, granted to the holders of the LLC interests, and the governance provisions (e.g., the procedures to be followed for declaring distributions, the votes or consents for actions required to be approved by the members, and any rights given to a class of members to designate the manager(s) of the LLC) established by the LLC’s operating agreement affecting the membership interests.

The use of the word “terms” to describe LLC interests in the TriBar LLC Interests Report might be cabined by reference to the statutory definition of “LLC interests,” which are defined in that Report by reference to the Delaware LLC Act’s definition of “limited liability company interest”: a member’s share of profits and losses and right to receive distributions of assets. DE LLC Act § 18-101(8) Under this reading, the only “terms” of LLC interests that opinion preparers would need to confirm do not violate the Delaware LLC Act, the LLC’s certificate of formation, or its operating agreement would be the rights to distributions and profits and losses associated with the LLC interests, what are referred to under California’s LLC Act as “transferable interests.” (See note 19 below.) However, this narrow usage of LLC interests is not repeated or highlighted in TriBar’s discussion of the validly issued opinion on LLC interests in the TriBar LLC Interests Report or in its recent TriBar LP Opinions Report and, were this the scope of the substantive element of the validly issued opinion, then the citation to the Preferred Stock Opinions Report would not be necessary. Moreover, were this the appropriate reading of TriBar’s reference to “terms” in its LLC Membership Interests Report, then it would be reasonable to expect this interpretation of terms to be stated explicitly in the Report.

What “Terms” and “Rights” are Addressed by the Substantive Element of the Validly Issued Opinion?

As part of its CA Alternative Entities Opinions Report, the CA Working Group prepared a sample closing opinion illustrating the opinions addressed by the CA Report. The form of the CA Working Group’s sample opinion on the validly issued opinion reads as follows:

“The Membership Interests issued by the Company to the purchasers thereof have been validly issued.”

California’s LLC Act defines “membership interest” to mean “a member’s rights in the limited liability company, including the member’s transferable interest, any right to vote or participate in management, and any right to information concerning the business and affairs of the limited liability company provided by this title.” California Revised Uniform Limited Liability Company Act (“CRULLCA”), Cal. Corp. Code § 17701.02(r). The issue that the CA Working Group grappled with is what “terms” of LLC “membership interests” (or, for limited partnerships, its LP interests) are properly understood to be addressed by the validly issued opinion? Do the terms addressed by the validly issued opinion include all of the “rights” granted to the members (or limited partners) by the membership or partnership agreement? Does it include all “duties” imposed upon the members or limited partners by the membership or partnership agreement (e.g., the obligation to respond to capital calls)? Does the opinion subsume whether any of those “terms,” as defined, violate the applicable provisions of the governing statute, for California LLCs, the CRULLCA or, for limited partnerships, the California LP Act (the Uniform Limited Partnership Act of 2008, Cal. Corp. Code § 5900 et seq.)?

TriBar also refers to the Preferred Stock Opinions Report at the beginning of its discussion of the validly issued opinion on LP interests in the TriBar LP Opinions Report § 4.0.

“Transferable interest” is, in turn, defined as the right to receive distributions from an LLC in accordance with the operating agreement. Cal. Corp. Code § 17701.02(aa).
TriBar uses the broadly enabling Delaware statutes as its model in describing the substantive element of the validly issued opinion to be whether the terms of the interests violate the relevant provisions of the statute or the company's governing documents. But what if the enabling statute is not broadly "enabling," but contains numerous prohibitions on the permissible "terms" that the members or partners of an LLC or LP may adopt? California provides an example of this category of statutes.


While California's LLC statute professes fealty to the principle of freedom of contract and to the enforceability of operating agreements, e.g., CRULLCA, Cal. Corp. Code § 17701.07(a), CRULLCA contains extensive restrictions on the freedom of members to craft operating agreement terms of their choosing. Thus, Cal. Corp. Code § 17701.10, contains at least 19 restrictions on the freedom of members to modify the default provisions of CRULLCA, many with subparts and most with extensive cross references to the operative provisions of CRULLCA, many of which are themselves complex. Many of the restrictive provisions require judgments to be made as to what is "unreasonable" or what constitutes "informed consent."

For example, the operating agreement of a California LLC may not:12

- Eliminate the duty of loyalty, the duty of care, or any other fiduciary duty, but the operating agreement may narrow fiduciary duties in specified ways, Cal. Corp. Code §§17701.10(c)(4), 17701.10(c)(14),(15), 17701.10(d), 17701.10(g);

- Eliminate the obligation of good faith and fair dealing between a member or manager and the members, but the operating agreement "may prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable ..." (Cal. Corp. Code §17701.10(c)(5));

- Vary the duties of an LLC to maintain and provide copies of the information, returns, and reports required by CRULLCA, Cal. Corp. Code §§17701.10(d)(2), 17704.10(h);

- Except as permitted by CRULLCA, vary the rules on winding up and dissolution of an LLC stated in Cal. Corp. Code §17707.01 – 17707.09 (Cal. Corp. Code §17701.10(c)(8));

- Unreasonably restrict the right of a member to maintain a class action or derivative action against the LLC, Cal. Corp. Code §17701.10(c)(9);

- Vary any of the merger or conversion rules of Article 10 of CRULLCA (§17710.01 – 17710.18), Cal. Corp. Code §17701.10(c)(10), (12);

- Unreasonably reduce the duty of care of a member or manager to the members, Cal. Corp. Code §17701.10(c)(15);

- Vary the agency rules applicable to members and managers, Cal. Corp. Code §17701.10(d); and

- Eliminate or limit a member's or manager's liability to an LLC for money damages, except in one of five specified ways set out in Cal. Corp. Code § 17701.10(g).

In addition, CRULLCA requires that any modification of the fiduciary duties of the manager to an LLC and its members must be with the "informed consent" of the members of the LLC, Cal. Corp. Code § 17701.10(e).


While California’s list of restrictions on the freedom of members to craft an operating agreement of their choice is extensive, it is not unique. Section 110 of the Revised Uniform Limited Liability Company Act (2006) prepared by the National Conference of Commissioners on Uniform State Laws (derived from Section 103 of the 1996 version of the Uniform LLC Act)

contains eleven separate prohibitions on what may be included in an operating agreement (§ 110(c)), five separate categories of provisions that may be included in an operating agreement if “not manifestly unreasonable” (§ 110(d)), and additional restrictions on the power of members to select operating agreement provisions of their choice (§ 110(e)-(g)). Versions of NCCUSL’s model act had been enacted in 15 states and are pending in four more.

3. Delaware’s LLC Act.

California’s and the Uniform Act’s approach should be contrasted with Delaware’s, whose LLC Act contains no such provisions. Section 18-1101 of Delaware’s LLC Act articulates Delaware’s policy “to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements” and permits drafters of Delaware LLC operating agreements wide latitude in the provisions they may include in a Delaware LLC agreement, including provisions that restrict or eliminate fiduciary duties. The only restriction in Section 18-1101 is that a Delaware operating agreement “may not eliminate the implied contractual covenant of good faith and fair dealing.” Del. Code, tit. 6, § 18-1101(c), (e).

While the freedom granted by Delaware’s LLC Act to the drafters of Delaware LLC operating agreements is wide, it is not unbounded, as illustrated by Vice Chancellor Laster’s opinion in In re Carlisle Etcetera LLC, 114 A.3d 592 (2015). In this decision on a motion to dismiss, the Vice Chancellor ruled that, notwithstanding that the petitioner assignee of a two-member Delaware LLC had no contractual right under the LLC’s operating agreement to seek dissolution under the applicable provisions of the Delaware LLC Act per R & R Capital. Should an opinion giver, in delivering a validly issued opinion on membership interests issued by such an LLC, take a qualification in view of Vice Chancellor Laster’s opinion in Carlisle? Can the opinion giver conclude that the “terms” of the membership interests for purposes of the validly issued opinion do not extend to waivers of the right to seek dissolution of the LLC? Can the opinion giver rely upon the equitable principles limitation in concluding that no express qualification is necessary, even if the validly issued opinion extends to the waiver of the right to seek dissolution of the LLC? Such are the challenges opinion preparers confront in addressing the substantive element of the validly issued opinion for alternative entities, even in a jurisdiction as accommodating to the drafters’ choices as Delaware.

13 Similar freedom, with the same limitation, is granted to the partners of a Delaware limited partnership. See Del. Code, tit. 6, § 17-1101(c), (d)

14 In so concluding, the Vice Chancellor distinguished Chancellor Chandler’s unpublished decision in R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, 2008 WL 3846318 (Del. Ch. 2008), in which the Chancellor squarely held that members of a Delaware LLC could waive their rights to seek dissolution and the appointment of a receiver under the Delaware LLC Act.

15 Based upon the listing of preferred stock “rights, powers and preferences” that might cause opinion preparers to qualify their duly authorized opinion on preferred stock, an opinion giver probably could not reach this conclusion. See, e.g., the example from the TriBar Preferred Stock Opinions Report of a charter provision eliminating statutory appraisal rights when under the applicable state corporation statute such a provision would constitute an impermissible advance waiver of appraisal rights. TriBar Preferred Stock Opinions Report, 63 Bus. Law. at 923.

16 If a provision would in all circumstances be held unlawful, the equitable principles limitation would not apply. The equitable principles limitation is contextual, and includes those principles that courts apply when, in light of the particular facts occurring after the effectiveness of an agreement, the courts decline in the interest of equity to give effect to a particular provision of the agreement. See TriBar Opinions Report § 3.3.4, 53 Bus. Law. at 625.

The variation in states’ alternative entity statutes is crucial to a determination of the usage and diligence associated with the validly issued opinion on equity interests of alternative entities. As TriBar acknowledges, the elements (or “terms”) of the “interests” of an LLC or LP addressed by the validly issued opinion is a function of the covered state’s (i.e., the state whose law is covered by the opinion letter, which usually would be the state of organization) alternative entity statute. Whether those elements or terms, as articulated in the LLC’s or LP’s governing documents, violate the governing statute is heavily dependent upon whether and how that statute restricts the freedom of the members and partners of the LLC or LP to craft terms of their choosing. The more restrictions on that freedom imposed by the governing statute, the more complex the opinion preparers’ task is in addressing the substantive element of the validly issued opinion. Because of this variation, and in the absence of definitive guidance, there can be no national common understanding of the scope of the substantive element of the validly issued opinion or the diligence required to render the opinion — this usage and these tasks are to be determined state-by-state.

**Addressing the Ambiguity in the Scope of the Substantive Element of the Validly Issued Opinion in the Context of LLCs and LPs**

One obvious solution to the challenges posed by the validly issued opinion on LLC and LP interests is to include an explicit limitation to the scope of the opinion. The limitation would define those “terms” or “rights” of the interests being addressed by the opinion. For example, the opinion giver may expressly define the terms being addressed by the opinion as only those terms governing the members’ (or limited partners’) rights to distributions and rights to vote, two clearly core “terms” or “rights” of equity interests in LLCs and LPs. By such a limitation the opinion giver would make clear that it is addressing whether the distribution and voting rights provisions of the operating or limited partnership agreement violate the applicable governing statute or certificate of formation of the entity, but is not addressing in a similar fashion any other rights or duties of the members or limited partners set out in the membership or partnership agreement.17 The scope of the opinion would be determined by the opinion giver, based upon the context in which the opinion is to be delivered and the expectations of the opinion recipient (and might include, for example, in addition to the rights to distributions and voting rights, information rights).

In its treatment of the validly issued opinion on LLC and LP interests, the California Alternative Entities Opinions Report recommends that opinion preparers consider two alternative forms of an express limitation to the opinion. The first follows the alternative mentioned in the previous paragraph, and limits the substantive element of the opinion to whether the members’ (or limited partners’) rights to distributions and rights to vote violate the applicable statute or the governing documents of the entity:

“Our opinion in paragraph __ above [the valid issuance opinion] confirms that the issuance of the Membership [LP] Interests satisfies the requirements of RULLCA [the LP Act] and the Company’s Articles of Organization [Certificate of Limited Partnership] and Operating [Limited Partnership] Agreement, including any necessary approvals by the manager[s] and members [general partner[s] and limited partners] of the Company and the receipt of the amount and kind of consideration, if any, required

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17 Any limitation on the validly issued opinion would likely not be accepted in an Exhibit 5 opinion required in connection with the issuance of LLC or LP interests in an SEC-registered offering of the same. See Securities and Exchange Commission, *Legality and Tax Opinions in Registered Offerings* (Staff Legal Bulletin No. 19) (October 14, 2011), 2011 WL 4957889 at **2, 11. Historically alternative entities that have registered their offerings of equity interests have been Delaware alternative entities. As noted above, satisfying the substantive element of the validly issued opinion for Delaware alternative entities does not pose the challenges confronted under California’s and other states’ alternative entity statutes following the uniform act model. Moreover, given the amounts inevitably involved in an SEC-registered offering, the necessary diligence required to give an Exhibit 5 opinion for a registered offering may very well be cost-justified even if the relevant “terms” to be addressed by the opinion are given the broadest interpretation under the Delaware alternative entity statutes.
thereunder. The opinion also confirms that the provisions of the Company’s Operating [Limited Partnership] Agreement governing distributions do not violate RULLCA [the LP Act] or the Company’s Articles of Organization [Certificate of Limited Partnership], and that the Company’s Operating [Limited Partnership] Agreement does not purport to deny the manager[s] and members [general partner[s] and limited partners] of the Company any of those non-waivable voting [approval] rights mandated by RULLCA [the LP Act]. The opinion does not otherwise address, and we express no opinion on, whether any of the other provisions of the Operating [Limited Partnership] Agreement violate RULLCA [the LP Act] or the Articles of Organization [Certificate of Limited Partnership].


In crafting this limitation, the CA Working Group sought to balance the interests of opinion givers for a sensible limitation on the scope of the substantive element of the validly issued opinion and the interests of opinion recipients in receiving, at a minimum, assurance that the validly issued opinion on LLC or LP interests addresses whether the governing documents’ treatment of distributions and voting rights violate the statute governing the entity or its charter.

Furthermore, expressly limiting the scope of the substantive element of the validly issued opinion on alternative entity equity interests also responds to the belief of several members of the CA Working Group that the substantive element of the validly issued opinion should only focus on those terms which, if found violative of the governing statute, would permit the purchasers of the equity interests to rescind their purchases. Conversely, terms of the interests that would not permit purchasers to rescind their purchases should not be addressed by the substantive element of the validly issued opinion. The law of rescission supports this bifurcation. See, e.g., CA Civil Code § 689(b)(4) (permitting rescission of a contract if, inter alia, the consideration for the obligation of the rescinding party fails in a “material” respect); Wyler v. Feuer, 85 Cal.App.3d 392, 403-404, 149 Cal. Rptr. 66, 633-634 (2d Dist. 1978) ("[c]ase law has uniformly held that a failure of consideration must be ‘material,’ or go to the ‘essence’ of the contract before rescission is appropriate."). Limiting the scope of the substantive element of the validly issued opinion to those terms of the interests that are of the “essence” of the interests responds to this principle.

There was also considerable sentiment among the partnership and LLC practitioners who served on the CA Working Group that the substantive element of the validly issued opinion is a trap for the unwary and should not be subsumed in the validly issued opinion at all, but rather should be separately stated and negotiated with opinion recipients. To address this concern, the Alternative Entities Opinion Report recommends an alternative form of limitation to the validly issued opinion for opinion preparers who hold this view, as follows:

“Our opinion in paragraph _____ above confirms that the issuance of the Membership [LP] Interests satisfies the requirements of RULLCA [the LP Act] and the Company’s [LP’s] Articles of Organization [Certificate of Limited Partnership] and Operating [Limited Partnership] Agreement, including any necessary approvals by the manager[s] and members [general partners[s] and limited partners] of the Company and the receipt of the amount and kind of consideration, if any, required thereunder. The opinion does not address, and we express no opinion on, whether any of the provisions of the Operating [Limited Partnership] Agreement violate RULLCA [the LP Act] or the Articles of Organization [Certificate of Limited Partnership]."

18 This principle also finds support in Delaware. See Loew’s Theatres, Inc. v. Commercial Credit Company, 243 A.2d 78, 81 (Del. Ch. 1968) ("... a charter provision which seeks to waive a statutory right or requirement is unenforceable"). In Loew’s Theatres, Commercial Credit defended its refusal to grant a shareholder list request by pointing to its 1912 Certificate of Incorporation permitting only shareholders holding in the aggregate 25% or more of its outstanding capital stock the right to inspect the corporation’s stock ledger, contrary to § 220 of the Delaware General Corporation Law, which grants that right to "any" stockholder for any proper purpose. While Loew’s Theatres was not a case addressing the valid issuance of stock, it demonstrates that one permissible remedy for an invalid charter restriction of statutory rights is for a court to ignore the restriction and grant the rights.
Alternative Entities Opinions Report at 46.

This form of limitation would serve to highlight the issues addressed in this article, thereby focusing the attention of opinion preparers and recipients on the issues posed by the validly issued opinion. If the opinion recipient objects to the limitation, then the parties can address the issue with a view to reaching a satisfactory resolution of the scope of the opinion, as understood by both opinion giver and opinion recipient.

TriBar acknowledges the practice of providing a separate statement of the substantive element of the validly issued opinion in its Preferred Stock Opinions Report. As TriBar notes, some opinion recipients request that the substantive element of the duly authorized opinion be separately stated, and TriBar includes in its report one formulation opinion preparers sometimes use for this separate assurance:

“The rights, powers and preferences of the preferred stock set forth in the [charter] do not violate [the applicable corporation statute] or the [charter].”

TriBar Preferred Stock Opinions Report, 63 Bus. Law at 924.

For LLC and LP validly issued opinions, this “alternative” identified by TriBar might become the preferred form of the opinion. If so, then the validly issued opinion would be limited to the elements identified by TriBar (quoted under “The Scope of the Validly Issued Opinion for Alternative Entities” at the beginning of this article) but would not include the substantive element of the validly issued opinion: that element would be addressed in a separately stated opinion.

This article originally appeared in the Winter 2017-2018 issue of In Our Opinion, the quarterly newsletter of the BLS’s Legal Opinions Committee, and is reprinted with permission of that Committee.

Why Attend the LLC Institute

There are a lot of smart people practicing law and in the ABA. So, the fact that there are smart people who attend the LLC Institute is neither a surprise nor a source of distinction from other ABA programs.

What does distinguish the LLC Institute is the degree of devotion to their craft that the participants have and express. So, if you learn nothing about LLCs and related entities, you will still learn what it means to have the ethos of a lawyer.

Stuart Levine
Baltimore, Maryland
We Survived Austin, and It Is Entirely Possible Austin Survived Us

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

For those of you not in attendance at the just completed BLS Annual Meeting in Austin, you were missed, and you missed a great meeting. The following notes are in the nature of one person’s recap; if you were there you will have your own memories. If you have not attended one of our meetings, hopefully the following will entice you to come to a future meeting.

As always a note of thanks needs to go out to the BLS staff for their (it must be beyond exhausting) efforts in advance of and at the meeting, all making a very complicated undertaking (e.g., for each meeting, there should be assigned to it no more and no less than one room) come off seamlessly.

Thursday morning began with a program chaired by Dan Sheridan reviewing the law of, and how to write agreements under, the titled Drafting Series LLC Provisions Under the Delaware, Texas and the Uniform Protected Series Acts. Guidance was provided as well as to the Delaware Registered Series added in 2018 but not effective until August 1, 2019. As Steve Frost was not there to maintain discipline, the term “mothership” was employed. Dan Kleinberger, Reporter on the Uniform Protected Series Act, let it slide.

Next on Thursday we held our Open Committee Meeting. It began with a presentation by Erica Gaylon and Megan Walton, both from the Secretary of State’s Office of the (great) Commonwealth of Kentucky, on remote electronic notarization. We were led through the requirements and effect of a remote notarization and the data trail that is preserved in connection therewith. Garth Jacobson discussed how the identity verification protocols that are part of the various apps may assist in beneficial ownership reporting and more generally how greater use of notarization may increase confidence in documents generally. Thanks to Erica and Megan for that presentation.

We as well reviewed the status of the joint project with Corporate Laws Committee on beneficial ownership reporting. Following from the appointment of a task force at the Spring Meeting in Orlando, over the course of numerous calls and e-mail exchanges, significant revision of the initial proposal has taken place. It is nearly completed, and will be reviewed at the LLC Institute.

Another review was of where we stand on drafting projects. First, the Charging Order Practice Guide is doing very well with over 200 sales, and Jay Adkisson was recognized for his work on that project. Second on the list is the Delaware Law based Model Series LLC Agreement. In the course of the morning program Melissa Stubenberg said it was about done, so it must be about done. Once Johnny Lyle completes (no pressure) (actually, lots of pressure) a few revisions to the tax provisions, we will be handing off to the Committee’s Editorial Board, and then send it out for publication as a book or in the Business Lawyer (to be determined). Once the series agreement is done we will complete (it has the same tax issues) the long awaited FLP for an ULPA (2001) LLLP Agreement. The Security Interests in LLC Interests Agreement, a joint project of three committees for which Dan Sheridan has served as the co-chair from our Committee, is at the stage of editorial nits. Whether it will be a book or go to the Business Lawyer remains to be determined. More below on the Austin meeting of that task force.

As for new projects, we discussed the need to update and re-release both the Model LLP Agreement and the Model LLC Interest Redemption Agreement. Another “it’s ready for being refreshed” project is the Model Real Estate Development Operating Agreement.

We discussed as well writing a Series LLC Practice Guide.

We traded ideas for programs in Vancouver and subsequent meetings. What would you like to hear about, and on what would you like to lead a program? Send your ideas, notions, offers and requests to Garth (garth.jacobson@wolterskluwer.com) and Christina (christina.houston@dlapiper.com).

Last but in no manner least, we welcomed Elizabeth M. Reeder, a new BLS Fellow, to our Committee. Elizabeth (“Liz”) is with Strauss Troy Co. LPA and is located in the Covington
Kentucky office. She is a graduate of the University of Kentucky College of Law.

Also, we were joined for the day by Beth Miller. If you don’t already know why that is a big deal, I can’t explain it.

Unfortunately overlapping with the time slot for Open Committee Meeting on Thursday, there was that day co-sponsored a program *A Family Affair: Representing the Family-owned Business (Ethically)*. This program, initiated by Middle Market and Small Business, was co-sponsored by our Committee, the Private Equity and Venture Capital Committee and also the Professional Responsibility Committee.

The next event on Thursday was a program co-sponsored with the Professional Responsibility Committee, it (both that committee and this program) chaired by our own Bob Keatinge, titled *Law Firm Breakups - the Unfinished Doctrine and Other Current Developments*. Bob, Allan Diamond and Susan Saab Fortney shared insights as to issues (ethical and fiduciary) involved in law firm Breakups ranging from a single attorney departing to an entire firm collapsing/exploding. While we had anticipated a report from Allan on last Wednesday’s oral argument in *Heller Ehrman*, it was delayed consequent to Hurricane Florence’s then approach to the East coast.

Also on Thursday afternoon was a meeting of the *Security Interest in LLC Interests Agreement Task Force*. In Dan’s words:

The Joint Task Force on Security Interests in LLCs Membership and other Unincorporated Entity Interests reviewed and discussed final edits to the draft Model Security Agreement based upon feedback and comments received from Professor Dan Kleinberger and Robert Schwartz, both of whom were in attendance. All of the Task Force Co-Chairs were also present, as were Professor Stephen Sepinuck and Lynn Soukup, both of whom have been significant contributors to the efforts of the Task Force since its inception. General consensus was reached on final changes to the document The Task Force Co-Chairs will finalize and proceed to obtain approval of the form by their respective committees, which hopefully will be soon followed by publication through the Section.

Thursday was brought to a close with our Committee dinner at Moonshine. As usual we had the opportunity to make new acquaintances, to renew old friendships, and to strengthen the bonds that are the strength of our Committee. We were fortunate to have Annie Wheaton join us at the dinner.

On Friday various of us attended meetings and programs sponsored by other committees.

At the meeting of the Opinions Committee it was announced that the Opinion Standards for limited partnerships are in process at the Business Lawyer and are forthcoming. Christina Houston and Lou Hering were participants in that project.

On Friday, the Committee co-sponsored a program *Healthcare Joint Ventures: Basic Issues and Trends*. This program, organized by the Nonprofit Organizations Committee, was also co-sponsored by the Health Law and Life Sciences Committee.

Also on Friday, the Committee co-sponsored a program *Should Venture Capital Take Another Look at the Use of Alternative Entities*. This program, organized by the Private Equity and Venture Capital Committee, was also co-sponsored by Federal Regulation of Securities and the Middle-Market and Small-Business Committees.

The program materials are all posted on the BLS website.

Friday evening some of us descend on the hospitality suite. Ms. Pac Man, Space Invaders and similar arcade games were an instant hit, as was a photo booth. The center of attention was a giant Jenga (the blocks were sections of 2x4). Johnny Lyle and AJ Singleton (each circa 6’4”) had a significant advantage over mere mortals. RutWig never had a chance.

Throughout the days we were there a number of side trips to sample local restaurants, especially barbeque, were made. I know of at least one case where a cooler was brought to Austin in order that Franklins barbecue could be brought home. Keep Austin Weird and SXSW shirts were bought to take home as souvenirs and gifts. While others may have been more fortunate, a Friday excursion to watch the bats emerge from beneath the “Bat Bridge” was for
naught - seems they either took a night off or decided to not leave until well later than their normal time (insert bad joke about flying rodents not wanting to associate with lawyers).

On Saturday morning several of us started the day with the walk/run event sponsored each day of the meeting. We walked, and Johnny Lyle brought a towel. You know, in case of Vogons (some of you might need to Google the reference).

See you in DC for the 2018 LLC Institute, and in the meantime thank you for your contributions to the Best Damn Committee in the ABA.
WORTH READING


Bob G. Kilpatrick and Dennis R. Lassila, Compensation vs. Qualified Dividends for Shareholder-Employees After the TCJA, 129 JOURNAL OF TAXATION (July 2018).


PLANNING AHEAD

The Committee on LLCs, Partnerships and Unincorporated Entities will meet three times in 2019: at the Spring Meeting of the Section on Business Law, at the Annual Meeting of the Section of Business Law, and at the 2019 LLC Institute. Looking forward:

<table>
<thead>
<tr>
<th>Event</th>
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<tr>
<td>2019 ABA BLS Spring Meeting Vancouver, BC</td>
<td>March 28-30, 2019</td>
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<tr>
<td>2019 ABA BLS Annual Meeting Washington, DC</td>
<td>September 12-14, 2019</td>
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<td>2019 LLC Institute</td>
<td>TBD</td>
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<tr>
<td>2020 ABA BLS Spring Meeting Boston Marriott Copley and Westin Copley Place Boston, MA</td>
<td>March 26-28, 2020</td>
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<tr>
<td>2020 ABA BLS Annual Meeting Sheraton Chicago Hotel &amp; Towers</td>
<td>September 10-12, 2020</td>
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<tr>
<td>2020 LLC Institute</td>
<td>TBD</td>
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<tr>
<td>2021 ABA BLS Spring Meeting Sheraton Dallas, TX</td>
<td>April 22-24, 2021</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.
Case Law Reviews

As this issue of the LLC & Partnership Reporter goes to press, the final case law summaries to be presented at the 2018 LLC Institute are not yet available. Those documents will be posted to the Committee’s page on the ABA’s website, no later than shortly after the Institute. Look there for those resources.
1. PowerPoint: The Uniform Protected Series Act by Steve Frost, Lisa Jacobs, Dan Kleinberger, Brian Lewis and Tom Rutledge

2. Article: Uniform Law Conference Adopts a Uniform Protected Series Act by Steve Frost and Kelley Bender

3. Article: Uniform Protected Series Act – A Welcome Advance in Series LLC Legislation by Allen Sparkman

4. Nebraska Uniform Protected Series Act (L.B. 1121)

5. PowerPoint: Austin Series Program
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