

LLC Law Today & Beyond

2017

Seminar Reference Book

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PART I AN OVERVIEW OF LLC LAW

A. Introduction

The American limited liability company (LLC) is a relatively recent innovation. Although existing in Europe and South America for decades, the first LLC statute was not enacted in the United States until 1977. Furthermore, 40 of the 51 jurisdictions passed their first LLC statutes between the years of 1992 and 1997. Consequently, the LLC has really existed as a significant business entity in this country for only 20 to 30 years.

Since the states first enacted LLC laws they have gone through a great deal of change. “LLC law” – as that term is used in this webinar presentation booklet - consists of both LLC statutes and LLC case law. The LLC statutes we see today are different in many ways from the LLC statutes of the 1990s. Different as well is the body of case law – which is much larger and exhibits a much greater understanding of the unique needs of the LLC and its owners than seen in the past.

Now that the state legislatures have had sufficient time to reassess and amend the original LLC statutes, and the courts have had sufficient time to interpret the governing LLC statutes and agreements, it seems an appropriate time to review the current state of LLC law.

This booklet will present a general overview. It will not focus on the specific law of any particular state. However, it is important to remember that LLC law differs from state to state. Consequently, when presented with an LLC related matter, a legal professional should consult the LLC statute and case law governing that particular LLC.

B. What is an LLC?

An LLC is a statutory business entity that is formed by the filing of a document with the business entity filing office of one state. This document contains certain basic information

about the entity. The owners of an LLC are called members. An LLC may be managed by all or some of its members. Or, it may be managed by one or more managers who are not members.

The basic governing document of an LLC is a contract entered into by the members. This contract is referred to in most LLC statutes as an operating agreement. It is the operating agreement, and not the formation document or LLC statute, that typically governs the regulation of the affairs of the LLC, the conduct of its business, and the relations among its members, between its members and the LLC, and between its members and managers.

The governing LLC statutes consist mainly of default provisions. The members can opt out of these statutory provisions in their operating agreement. The statutes have few mandatory provisions other than requiring certain filings to be made and requiring the maintenance of an agent for service of process.

An LLC exists as an entity separate and apart from its owners. Thus, for example, an LLC can sue or be sued in its own name and buy, own, and use its own property. Parties doing business with an LLC must look to the company to satisfy any obligations owed to them. The members of an LLC have limited liability. Generally, their individual assets may not be used to satisfy the LLC's debts and obligations.

An LLC is a pass-through tax entity. The LLC itself does not have to pay federal income taxes. Instead, the LLC's income, losses, deductions, and credits pass-through to the members. An LLC may also elect to be taxed as a corporation and to be subject to an entity level income tax.

C. How is an LLC Used?

LLCs are being formed for a wide variety of purposes. LLCs are commonly used to own and hold real estate and personal property. They are also formed to operate commercial businesses. Almost any purpose that a person would have, in the past, used a corporation, a

partnership or a statutory trust for, an LLC may be, and is being, used for that purpose today. The main exception would be for persons who wish to take their business public. An LLC can be publicly traded – and the number of public LLCs is growing. But the entity of choice for those who wish to go public remains the corporation.

D. Five Key Features of the LLC

Certain features of the LLC have significantly influenced the LLC statutes and case law. They include the following:

1. **An LLC is a Hybrid Entity** – An LLC combines the features of a corporation and a partnership. In enacting and amending their LLC statutes, the legislatures were influenced by their states' corporation, limited partnership (LP), and general partnership (GP) laws. In addition, the courts, in interpreting provisions of the LLC statutes, have looked to the comparable provisions of the statutes governing corporations and partnerships. Furthermore, in deciding cases involving an LLC's internal affairs or the relations among LLC members, the courts have looked to previous decisions involving corporations and partnerships as a starting point for their analysis.

2. **An LLC is, in Most Cases, a Closely-Held Entity** – The vast majority of LLCs are closely-held. A closely-held entity is an entity: (1) where the ownership interests are not publicly traded and where there is no established market for those interests, (2) where there are relatively few owners, and (3) where the owners usually manage the business together and are often key employees as well.

The problems and concerns of closely-held entities and their owners are different from those of publicly-traded entities and large, widely-held private entities. Most legislatures and courts recognize this difference. Thus it impacts both the LLC acts and court rulings.

3. **An LLC is, in Most Cases, a “Pick Your Partner” Entity** – When the owners of a business are also the managers it is considered important that they have the ability to choose

who their fellow owners will be. It is particularly important when the business is their main source of income or represents a substantial investment. The legislatures and courts are aware of the importance of members being able to “pick their partner” and this influences both LLC statutes and judicial decisions.

4. **An LLC is a Contractual Entity** – An LLC is more of a contractual entity than a statutory entity. The legislatures anticipate that the members will provide for the governance of the LLC and for their own rights, duties and obligations in their operating agreement. This results in statutes with mainly default provisions governing many areas and no provisions at all governing others. It also results in court decisions applying contract law principles to decide many LLC cases.

5. **An LLC is a Flexible Entity** - The LLC was created, in part, because business people wanted an entity with the flexibility of a partnership but with the limited liability of a corporation. The desire to provide business people with flexibility has resulted in statutes with few restrictions on how the members can manage the LLC or allocate their financial rights.

E. Four Events That Influenced LLC Law

In order to understand today’s LLC law it is necessary to understand certain events in LLC history. The following four events, in particular, have significantly influenced the development of LLC law.

1. Hamilton Brothers Oil Company Lobbies for the Enactment of an LLC Law -

On March 4, 1977 the Wyoming Limited Liability Company Act was enacted. This was the first LLC act in the United States. Wyoming enacted this law in response to the lobbying efforts of Hamilton Brothers Oil Company.

Hamilton Brothers Oil Co. was involved in international oil and gas exploration. The company used LLCs created in foreign countries. Mainly, it used a Panamanian entity called

the limitada. Unlike the American entities available at that time, limitadas offered limited liability and partnership taxation. For various reasons Hamilton Brothers Oil Co. found that it could no longer use these foreign entities. It decided to have legislation drafted creating a domestic unincorporated entity that would provide limited liability and partnership taxation.

In 1975 Hamilton Brothers' representatives presented its LLC legislation to the Alaska legislature. The bill died. An identical LLC bill was then presented to Wyoming's legislature. It passed with little struggle.

2. **Revenue Ruling 88-76 is Issued; Kintner Rules Are Applied** - The LLC was intended to offer partnership taxation. However, for eleven years after Wyoming passed the first LLC act, the IRS failed to state how it would classify the LLC. Finally, in 1988 the IRS issued a ruling stating that a Wyoming LLC would be taxed as a partnership. This was Revenue Ruling 88-76.

In Revenue Ruling 88-76, the IRS applied the *Kintner* entity classification rules to determine whether the LLC should be taxed as a corporation or a partnership. The *Kintner* rules identified four corporate characteristics – limited liability, centralized management, free transferability of interests and continuity of life. Any unincorporated organization lacking two of the four characteristics was taxed as a partnership. An organization with at least three of the characteristics was taxed as a corporation.

The Wyoming LLC in Revenue Ruling 88-76 was characterized as a partnership because it lacked two of the four corporate characteristics. It lacked continuity of life because the withdrawal of a member caused dissolution unless all members voted to continue the business. It also lacked free transferability of interests because all members had to approve before a transferee could become a new member.

After this revenue ruling, the states rapidly began adopting LLC acts. During the next six years, 45 states enacted LLC laws. This is compared to just two states that passed LLC laws in the eleven years before the ruling.

3. Colorado Adopts a “Flexible” LLC Act - In 1990, Colorado became the first state to adopt a “flexible” LLC act. The previous LLC statutes had been what are called “bulletproof” acts. Bulletproof acts were intended to ensure partnership taxation. For example, they required unanimous consent to admit new members and to continue the business after an event of dissolution. This was to guarantee that the LLC would lack the corporate characteristics of free transferability of interests and continuity of life.

Under a flexible statute, on the other hand, the LLC had the option of requiring less than unanimous consent, by so providing in its operating agreement. The flexible statutes allowed the members to better tailor the LLC to meet their individual needs. As a result, the LLC became a more attractive entity choice.

4. “Check-The-Box” Rule is Enacted – Revenue Ruling 88-76 made it clear that an LLC could be taxable as a partnership. Nevertheless, the *Kintner* test still left a great deal of uncertainty. For example, it was not clear whether an LLC would lack the characteristic of continuity of life if it required a majority vote, rather than a unanimous vote, to continue after dissolution. Nor was it clear how a single member LLC would be taxed. In 1997, these questions were answered when the Treasury Department’s “check-the-box” rule went into effect.

The check-the-box rule radically changed how unincorporated entities would be classified for federal income tax purposes. The *Kintner* test was abandoned. Instead, an unincorporated organization with two or more owners would, by default, be treated as a partnership. Single owner entities would, by default, be disregarded as an entity.

The check-the-box rule, by clarifying the LLC’s tax status, spurred the formation of many LLCs. It also caused many states to amend their laws to repeal restrictive provisions that were intended to assist LLCs in being characterized as partnerships for tax purposes.

PART II LLC STATUTORY LAW TODAY

A. Three Generations of LLC Statutes

There are said to be three generations of LLC statutes. The first generation was the bulletproof LLC statute. This type of statute contained unalterable provisions. It was designed to ensure that two corporate characteristics would not be present so that the LLC would be taxed like a partnership.

The second generation was the flexible LLC statute. It had mainly default provisions. It allowed the members to decide which corporate characteristics would exist in their LLC. The current LLC statute is the third generation. It represents the first and second generation statutes amended for various reasons, including those discussed below.

B. Impetus for Amendments to LLC Statutes

The state LLC statutes have been significantly amended since they were first enacted in the 1980s and 1990s. The impetus for the changes made to the LLC statutes includes the following:

1. **The Check-the-Box Rule** - This rule made it unnecessary to have statutory provisions designed solely to avoid corporate taxation. It allowed the states to amend provisions governing such matters as dissolution, the period of duration, the number of members, and the transferability of interests.
2. **The Need to Fill in Gaps** - As time passed after the LLC statutes were originally enacted, it became apparent where the LLC statutes failed to address issues that needed to be addressed. Amendments were enacted to fill in those gaps.

3. **The Need to Clarify Provisions** – The passage of time also revealed that certain provisions of the LLC statutes that seemed clear when drafted, were not so clear when they actually had to be relied on by the LLC’s principals or legal advisers. The need to clarify ambiguous provisions resulted in amendments being made to the LLC statutes.

4. **Legislative Anticipation vs. Realities** - In enacting the original version of the LLC statutes the legislatures tried to anticipate how LLCs would be used and what the needs would be of the LLCs, their members and managers. Where the statutes proved inadequate to meet those actual needs, amendments were made.

5. **The Need for Consistency Among Business Entity Statutes** – The legislatures recognized that in some cases it was necessary to eliminate inconsistencies and conflicts between their LLC statutes and the statutes governing corporations and other unincorporated entities. This resulted in amendments to provisions governing issues such as mergers and name conflicts.

6. **Reactions to Court Decisions** – Sometimes the courts will interpret an LLC statute in a manner not intended by the legislature. Or a court case can reveal an ambiguity that the legislature did not realize existed. The legislatures may react to these cases by amending the LLC law.

C. Is There a “Typical” Third Generation LLC Statute?

The third generation LLC statutes are not uniform. Although the American Bar Association drafted Prototype LLC Acts and the National Conference of Commissioners on Uniform State Laws adopted Uniform Limited Liability Company Acts, none of these statutes have been widely adopted by the states.

Nevertheless, today’s LLC statutes are similar in a number of areas. However, they differ in some areas as well. Below is a brief discussion of what the current version of the LLC statutes typically provide in the areas of formation, members, management, mergers and

conversions, compliance requirements, foreign LLCs, and dissolution. It also discusses how the provisions governing these issues have changed over the years and how they may change in the future.

D. Formation

1. **Formation document** - The current LLC statutes provide that the formation of an LLC requires the delivery of a document with the state business entity filing office. This document is generally called articles of organization.

The main function of this document is to provide the public with notice that a limited liability entity has been formed. It is not intended to provide information on the entity's financial structure or the rights and responsibilities of its managers or owners. As such, the statutes generally require the formation document to set forth little more than the LLC's name, principal office address, and the name and address of its agent for service of process. Several states also require a statement as to whether the LLC will be managed by members or managers.

The earlier statutes required more information to be set forth. For example, they required a statement regarding the latest date the LLC could dissolve. This was to assist the LLC in avoiding the corporate characteristic of continuity of life. However, after the check-the-box rule it was no longer necessary to do so.

Most of the early laws also required a statement regarding whether the LLC would be member or manager managed. A number of states have retained this requirement. However, some states eliminated this requirement after the management structure became irrelevant for taxation purposes. The legislative intent behind that change was to allow an LLC to switch management structures without having to amend its formation document. It was also intended to let the members decide for themselves whether to make their management structure public.

2. **Organizers** - The current statutes typically provide that one or more persons may organize an LLC. Originally, the statutes required at least two persons to organize an LLC. This was for tax purposes - as at least two persons were required to form a partnership. The early laws also typically required initial members or managers to sign the formation document. Today, in general, any authorized person may sign.

3. **Purposes** – The LLC statutes today contain few restrictions on an LLC’s purposes. An LLC may be a for-profit entity or a not-for-profit entity. It may also practice a profession. Earlier statutes did not specifically provide for non-profit LLCs. Some did not allow an LLC to practice a profession. In addition, many of the original LLC statutes did not permit LLCs to engage in the businesses of insurance or banking. (Some still have this restriction.)

4. **Operating agreements** - The statutes today, like the statutes in the past, provide for member operating agreements. These operating agreements are required in many states. But they are optional in some. In recognition that the LLC is a contractual entity, the statutes impose few restrictions on what the members may set forth in their operating agreement in regards to how the LLC will be run and in regards to the members’ rights, duties, liabilities and responsibilities.

Amendments made to the original provisions dealing with operating agreements have tended to expand what the members may provide therein, rather than to impose restrictions. For example, several states amended their laws to provide that fiduciary duties may be eliminated in the operating agreement. Other amendments have clarified who is bound by the operating agreement. For example, some statutes now specify that the LLC itself, members admitted after formation, and certain third parties may be bound by the operating agreement.

E. Members

Members are the owners of an LLC. Almost all of the provisions of the LLC statutes dealing with members are default provisions. These provisions will apply only in the absence of a provision dealing with the matter in the operating agreement.

1. **Number of members** - The current statutes provide that an LLC may have one or more members. Under the original laws at least two members were required. This was because the legislatures anticipated that an LLC with only one member would be taxed like a corporation.

The statutory amendments that permitted the formation of single member LLCs were important events in LLC history. They greatly increased the usefulness of the LLC as an entity.

A significant percentage of the businesses in this country are solely owned. And there are many single member LLCs. They range from LLCs formed to operate simple home based businesses to LLCs formed to facilitate complex multi-million dollar financing transactions.

Single member LLCs are governed by the same provisions of the LLC acts as multi-member LLCs. However, the LLC acts contain a number of provisions designed to protect members from the actions of other members. These protections are not necessary in a single member LLC. Some courts have found that applying these provisions to single member LLCs leads to results the legislatures did not intend. As a result, the courts held that the provisions did not apply. Thus, in the future, the states may amend certain provisions of their LLC acts to clarify their applicability to single member LLCs.

2. **Membership interest** - A membership interest consists of financial rights and non-financial rights. The chief financial rights are the right to share in allocations of the company's profits and losses and the right to share in distributions of the LLC's assets during its existence and when it dissolves. The non-financial rights (sometimes called

management or governance rights) include the right to vote, to inspect books and records, and to bring a derivative suit.

The LLC statutes contain default rules for allocating the members' financial and voting rights. Some statutes give each member equal rights to vote and share in profits, losses and distributions. This default rule is borrowed from the general partnership laws. Others apportion voting and financial rights based on the amount of the investment. This default rule is also found in LP and corporation statutes. Amendments to make the default rules uniform could possibly occur in the future if the legislatures come to the conclusion that one of these approaches is preferable to the other.

3. Transferability of interests - The current LLC acts provide that the members may sell, assign or transfer their membership interest in whole or in part. However, unless the operating agreement provides otherwise, all the buyer, assignee or transferee receives is the member's financial rights. The buyer, assignee or transferee does not become a member or receive any management rights.

The LLC statutes as originally enacted also restricted the members' ability to sell, assign or transfer their management rights. These provisions were included in the LLC laws so that an LLC would lack the corporate characteristic of free transferability of interests.

After the check-the-box rule, the legislatures could have removed the default rule restricting transferability. They could have given members the same freedom to sell their ownership interests given to shareholders in the corporation acts. The legislatures did not do so however. They recognize that, in general, members will want to control transfers of membership interests. That way they can prevent unwanted outsiders from becoming participants in the management of their business.

4. Withdrawal of members - The early versions of the LLC statutes gave members the right to withdraw at any time and receive payment of the fair value of their membership

interests. By giving members withdrawal rights that could lead to the dissolution of the LLC, the legislatures hoped to avoid the corporate characteristic of continuity of life.

After the check-the-box rule many states amended their LLC statutes. Some now provide that a member may not withdraw from the LLC unless the operating agreement provides otherwise. Others provide that members may withdraw but treat the withdrawing members as assignees – which means they do not have a right to demand payment of the fair value of their membership interests. The reasons for this change were to provide the LLC with more liquidity and stability by locking in the members' capital investments and to give certain estate planning advantages to family owned LLCs.

5. Charging order - Most LLC statutes provide that a judgment creditor's rights against a debtor member's interest in an LLC are limited to a charging order. A charging order is a court order entitling the member's creditor to receive any distributions that the LLC would have otherwise made to the member. The member's creditor does not become a member and has no right to assume the member's management rights. The charging order provision is intended to protect a member from having a co-member not of his or her own choosing (i.e. the creditor).

Amendments to charging order provisions have been made over the years to specifically state that the charging order is the only remedy a judgment creditor has against a member's LLC interest, to clarify that the charging order constitutes a lien that may not be foreclosed upon, to limit a court's powers in the event of litigation to enforce the charging order and to clarify the applicability of charging order provisions to single member LLCs.

F. Management

1. Vested in members – The typical LLC act today has a default rule providing that the LLC will be managed by its members. The LLC acts in the early years had the same default rule. The original purpose of vesting management in members was to allow an LLC to avoid the corporate characteristic of centralized management. The check-the-box rule made that

purpose irrelevant. However, the legislatures chose not to change the default rule. They recognized that most LLCs will be managed by their members. In closely-held entities, the owners will often want a management role to monitor their investment.

The current statutes also provide that management of an LLC may be vested in one or more managers. Some statutes provide that manager-management must be set forth in the formation document. In others it is sufficient to provide for the management structure in the operating agreement.

2. **Management formalities** – In keeping with the legislative intent to provide a flexible entity, the LLC statutes impose few restrictions on the manner in which an LLC may be managed. Meetings of members or managers are not required. Nor, in general, are quorums, the setting of record dates, the keeping of minutes, and other management formalities found in corporation statutes. The members may decide what actions the LLC will take, and how these actions will be taken, in as formal or informal a manner as they wish.

3. **Fiduciary duties** – It is difficult to describe the “typical” provision dealing with the fiduciary duties owed by members and managers. This is an area in which the current LLC statutes lack uniformity.

Some statutes state that duties of loyalty and care are owed and then specify what those duties include. Some require members and managers to act in the LLC’s best interests. Some do not have any provisions at all dealing with fiduciary duties. Many LLC statutes do, however, provide that the members may expand or restrict the fiduciary duties that are imposed by statute or common law. Some state that fiduciary duties may be eliminated in the operating agreement.

G. Mergers and Conversions

1. **Mergers** - The LLC statutes today typically provide that a domestic LLC may merge with or into a domestic or foreign LLC, corporation, or any other type of business entity. These statutory provisions tend to be more expansive than the original merger provisions. Some early statutes provided for mergers with other LLCs only. Others provided for mergers with LLCs and only a few other business entity types. The merger provisions were expanded due to the desire of businesses to change forms through mergers and the desire to buy or sell businesses that were in other entity forms.

Amendments were also made to the merger provisions to make them more consistent with the merger provisions of the state's other business entity statutes. These amendments were made to facilitate inter-entity mergers. In addition, the early statutes tended to require a unanimous vote of members to approve a merger unless the operating agreement provided otherwise. In today's statutes a majority vote tends to be the default rule.

2. **Conversions** - The LLC statutes of today generally permit a domestic LLC to convert to any other form of domestic or foreign entity or to a foreign LLC. They also generally provide that any other form of domestic or foreign entity or a foreign LLC may convert to a domestic LLC. Many early statutes only authorized the conversion of an LP or GP to a domestic LLC. And many did not provide for the conversion of a domestic LLC to another entity.

Conversion provisions were added or expanded due to the desire of businesses to change forms without the need to create another entity to merge into. Amendments were also made to make the conversion provisions more consistent with the conversion provisions found in the state's other business entity statutes.

H. Compliance Requirements

LLC statutes do not contain many compliance requirements. Many of the compliance requirements found in other business entity acts are there to protect the investors. Thus, for

example, corporation statutes require an annual shareholders' meeting to be held. However, the legislatures generally believe that an LLC's members can provide for their own protections in their operating agreements.

The current version of the LLC acts do, however, contain a few compliance requirements. The two most common are the annual report and the registered agent requirements. Both of these compliance requirements further the legislative purpose of facilitating the public's and the state's ability to locate LLCs. In addition, a number of LLC acts contain a recordkeeping requirement.

1. Annual report requirement – Most state LLC statutes require the filing of an annual report. A few have a biennial report requirement. This report contains certain current information about the LLC such as its name, principal place of business, and name and address of its registered agent. Failure to file by the due date results in penalties. A continued failure to file is generally grounds for the administrative dissolution of a domestic LLC and the administrative revocation of a foreign LLC.

The provisions governing the annual report requirement have been amended in some states over the years. The filing fees can change depending on the state's budgetary needs. The due dates can also change. For example, some states that had a set due date for all LLCs switched to a due date based on the anniversary date of formation or qualification. This was to lessen the burden on the filing office and bring in a steadier flow of income from the filing fees. Statutes have also been amended to permit annual reports to be filed electronically.

2. Registered agent requirement - The state LLC statutes require LLCs to appoint and maintain a registered agent in the state. A registered agent is an agent appointed and maintained by an LLC for the purpose of receiving service of process and official notices and forwarding them on to the LLCs. A registered agent must have a location in that state where it may be served. The agent's name and location are "registered" and kept on file with the state business entity filing office.

The provisions governing the registered agent requirement have changed somewhat over the years. For example, a growing number of statutes now require the registered agent's consent to the appointment to be set forth on the document containing the appointment. Others now make a distinction between commercial registered agents (entities in the business of providing registered agent services) and non-commercial registered agents. Further amendments may occur as the states are seeking to make these provisions consistent among all of the entity types that they require to appoint and maintain a registered agent.

3. Recordkeeping requirement – Many LLC acts require an LLC to maintain various documents and records. The state laws vary. However, they generally require, at a minimum, maintenance of (1) a list of the names and addresses of the members and, if any, the managers, (2) a copy of the articles of organization and operating agreement and all amendments thereto, (3) copies of tax returns and reports and financial statements for the three most recent years, and (4) if not set forth in the operating agreement or articles of organization, details of the members' capital contributions.

I. Foreign LLCs

1. Statutory provisions in general – Every state has provisions dealing with foreign LLCs. A foreign LLC is an LLC formed in another state or jurisdiction.

Typically, the statutes will have provisions dealing with such issues as what law governs a foreign LLC, how a foreign LLC can obtain, maintain and cancel its authority to do business in the state, and what penalties are imposed for doing business without authority.

The states, in general, do not attempt to govern foreign LLCs. The purposes of the foreign LLC provisions are to make sure that foreign LLCs do not obtain an unfair competitive advantage over domestic LLCs and to facilitate the public's and state's ability to locate and communicate with foreign LLCs. In general, the provisions dealing with foreign LLCs have not changed much over the years.

2. **Governing law** – The LLC statutes provide that the law of the jurisdiction under which the foreign LLC was formed will govern its formation, its internal affairs, and the liability of its members and managers.

3. **Applying for authority to do business** – The LLC statutes generally provide that before a foreign LLC does business in the state it must apply for authority to do so. This is generally referred to as the “qualification” requirement.

To qualify, the foreign LLC must deliver a document to the state business entity filing office. The qualification document is generally called an application for authority or an application for registration. Like the formation document, the qualification document has a notice function. It is intended mainly to provide the state’s citizens and its tax and other government agencies with information necessary to contact the LLC or serve it with court papers or official communications.

Typically, the qualification document will set forth, at a minimum, the LLC’s legal name, any fictitious name it has to qualify and do business under because its legal name is not available for use in the state, its jurisdiction of formation, its principal office address, and the name and address of its agent for service of process in the state. Some states require additional information such as the LLC’s purposes and the date it began or will begin doing business. A certificate of existence from the home jurisdiction often has to accompany the application. (This document is also known as a certificate of good standing or a certificate of status.)

4. **Doing business without authority** – The LLC statutes provide that a foreign LLC doing business in the state may not maintain any suit, action or proceeding there until it has obtained authority to do business. In addition, many state LLC acts impose fines on a foreign LLC that does intrastate business without authority.

On the other hand, the statutes provide that the failure to qualify does not impair the validity of any of the foreign LLC’s contracts or acts. Nor does it prevent the LLC from defending

itself. In addition, the statutes provide that a member or manager is not liable for the foreign LLC's obligations solely by reason of the LLC having done business without authority.

5. What constitutes doing business? – A foreign LLC is only required to qualify if it is doing business in the state. However, not every activity engaged in by an LLC constitutes doing business for qualification purposes.

Few statutes try to define the term “doing business”. However, most contain a list of activities that do not constitute doing business. These lists generally include activities such as maintaining or defending lawsuits, holding meetings of members or managers, maintaining bank accounts, soliciting orders that require acceptance outside the state, and creating, acquiring or collecting debts, mortgages, or security interests.

Much of the law of “doing business” is found in court decisions. Because a foreign LLC doing business in a state may not maintain an action until it qualifies, it is not unusual for the defendant in a lawsuit brought by a nonqualified foreign LLC to seek dismissal on the grounds that the plaintiff was doing business without authority. It will then be up to the court to determine if the foreign LLC was in fact doing business in the state.

6. Compliance requirements – Foreign LLCs generally must file an annual report. They also must appoint and maintain a registered agent. However, LLCs are generally not subject to a recordkeeping requirement in foreign states.

J. Dissolution

Today's LLC statutes typically provide that an LLC is dissolved upon the consent of the members or upon the happening of an event set forth in its operating agreement or at a time set forth in the formation document. They also provide that unless the operating agreement provides otherwise a member's death, bankruptcy, incompetency, retirement, resignation, expulsion or withdrawal does not cause an LLC's dissolution.

The dissolution provisions of the original statutes were designed so that an LLC would not have the corporate characteristic of continuity of life. Early statutes provided that an LLC was dissolved upon a member's death, bankruptcy, incompetency, retirement, resignation or expulsion unless the members consented to continue. The voluntary withdrawal of a member also resulted in dissolution unless otherwise provided. The early statutes also required a specific date of dissolution to be set forth in the formation document. Some restricted an LLC's duration to 30 years.

After the check-the-box rule was enacted most states amended the dissolution provisions of their LLC acts. The legislatures recognized that most LLCs will want the advantage of continuity of life. Entities that are easily dissolved may be considered unstable. As a result they can have difficulty attracting business partners and funding.

K. Delaware's LLC Statute

1. **Is Delaware a popular LLC formation state?** – When Delaware enacted its LLC Act in 1992, people in the business, legal and academic communities wondered if Delaware would have the same success in attracting LLCs that it has had in attracting corporations.

Looking at Delaware today, it appears that the state has had similar success. Delaware is among the leaders in total number of LLCs and in annual LLC formations. In addition, studies have shown that of the LLCs formed in states other than where their business is located, the vast majority are formed in Delaware.

2. **Why is Delaware a popular LLC formation state?** - In general, Delaware is considered a good choice as a state of LLC formation for the same reasons it is considered a good choice as a state of incorporation. One reason is that Delaware's LLC Act, like the state's General Corporation Law, is considered one of the most flexible and non-restrictive of its kind in the country. Another is that litigation that involves an LLC's internal affairs or that requires an interpretation of its governing documents is heard in the Delaware Chancery

Court. This court has a national reputation for expertise in business entity matters. Delaware also has one of the larger bodies of LLC case law precedent. In addition, its filing office – the Division of Corporations – has a national reputation for efficiency and responsive service to business entities.

3. What does the Delaware LLC Act provide? – A Delaware LLC is formed by filing a certificate of formation with the Secretary of State. The only required content is the LLC’s name and the name and address of its registered agent. An LLC may carry on any lawful business, purposes or activity, whether for profit or not for profit, except banking.

A Delaware LLC must have at least one member. A member does not have to make a contribution and does not have to have a financial interest. The members must enter into an LLC agreement.

One of the key provisions of the Delaware LLC Act is Section 18-1101. This section states that it is the policy of the LLC Act to give the maximum effect to the principle of freedom of contract and to the enforceability of LLC agreements. Thus, freedom of contract is a statutory policy in Delaware. This section directs the courts to apply contract principles in cases where they might have otherwise applied traditional common law principles of corporate law or partnership law.

L. Series LLCs

Another difference between the early years of the LLC and today is that today it is possible to form a Series LLC in Delaware and a handful of other states.

1. What is a Series LLC? A Series LLC may be defined as an LLC, formed under the laws of a state that authorizes Series LLCs, that is divided into separate series, each of which functions like a separate LLC.

Each series of a Series LLC can have its own assets, liabilities, business purpose, members and managers. If certain statutory requirements are met – that mainly have to do with providing notice of the separate series and with keeping their assets separate – then the Series LLC laws provide that the liabilities of each particular series can be satisfied from the assets of that series only and not from the assets of any other series or the LLC itself.

4. The Delaware Series LLC law - Sec. 18–215 of the Delaware LLC Act is the main provision governing Delaware’s Series LLCs. Sec. 18-215(a) provides that an LLC agreement may establish or provide for the establishment of one or more designated series of members, managers, LLC interests or assets. A series may have separate rights, powers, or duties with respect to specified property or obligations of the LLC or profits and losses associated with specified property or obligations. A series may have a separate business purpose or investment objective.

Sec. 18-215(b) provides that the debts, liabilities, and obligations incurred, contracted, or otherwise existing with respect to a particular series of an LLC are enforceable against the assets of that series only, and not against the assets of the LLC generally or against the assets of a different series, if the following conditions are met: (1) notice of the limitation on liabilities of a series is set forth in the Certificate of Formation of the LLC, (2) the LLC agreement establishes or provides for the establishment of one or more series, and (3) the records maintained for the series account for the assets associated with that series separately from the other assets of the LLC or any other series.

3. Unanswered questions involving Series LLCs – The main drawback to the Series LLC is that there are a number of questions about its use that are currently difficult to answer. For example, how will a Series LLC be treated for federal income tax purposes or for state income and franchise tax purposes? Another question is what happens if a creditor of one series seeks to recover the assets of another series by bringing suit in a foreign state that does not authorize Series LLCs? Will that foreign state respect the separation of liabilities granted by the home state? Other questions include can it file for bankruptcy protection or register its own securities?

In the future, if more states authorize the formation of Series LLCs, and if the use of Series LLCs increases, the legislatures and courts will have an opportunity to clarify these issues.

PART III LLC CASE LAW TODAY

A. Some General Observations

“LLC law” is not only made by state legislators. It is also made by judges. By LLC case law we mean cases involving the internal governance of LLCs and cases adjudicating the rights, liabilities, and duties of members and managers.

There was not a substantial number of LLC cases decided in the 1990s. However, the number has been steadily increasing in the 21st century. The LLC cases deal with many issues. Among them are (1) cases requiring the court to interpret an LLC statute, (2) cases requiring the court to interpret an operating agreement, (3) cases involving attempts to impose liability on a member, (4) cases seeking to hold a manager liable for a breach of fiduciary duties, (5) cases questioning the authority of members or managers to act on an LLC’s behalf, (6) cases involving the treatment of LLCs under statutes that do not specifically apply to LLCs, and (7) cases involving single member LLCs.

B. Interpreting a State LLC Statute

Some cases require the courts to interpret an LLC statute. When interpreting a statute, a court’s primary goal is to evince the true intent and purpose of the legislature. The first step of statutory interpretation is to evaluate the plain language of the statute itself. The plain language of a statute is to be read as a whole, and its provisions interpreted in harmony with other provisions in the same statute and with other statutes under the same and related chapters.

C. Interpreting an Operating Agreement

Other LLC cases have required the courts to interpret an operating agreement. In these cases the courts apply the same principles of contractual interpretation that they apply to other kinds of contracts. In construing contracts, the function of the court is to ascertain the shared intentions of the contracting parties when they entered into their agreement. The first level of analysis is to give the words chosen by the parties their ordinary meaning. The courts go beyond the ordinary meaning when dealing with a situation that was not anticipated or provided for by the contracting parties or where the words, when fairly read and given their ordinary meaning, lead to a result that the court cannot believe is what reasonable parties would have intended.

D. Member Liability Cases

A large number of the LLC cases involve attempts to impose liability on a member. These attempts generally take one of the following forms: (1) an attempt by a third party to hold a member personally liable for the LLC's debts or obligations, (2) an attempt by a third party to hold a member liable based on the member's participation in the LLC's wrongful conduct, (3) an attempt by the LLC, a manager or member to hold a member liable for breaching a fiduciary duty, or (4) an attempt by a member to hold another member liable for breaching the operating agreement.

E. Manager Breach of Fiduciary Duty Cases

There is also a growing number of cases where a manager is sued by a member or an LLC for a breach of fiduciary duties. In some of the cases there was a provision in the operating agreement defining the managers' fiduciary duties that the court was called on to interpret. In others, the court had to apply the statutory standard or, if none, the common law.

F. Authority to Act Cases

The informal manner in which an LLC may be operated is considered one of the LLC's more desirable features. However, that informality, when combined with the few statutory

provisions dealing with management found in some LLC statutes, can lead to litigation over whether the person purporting to act on the LLC's behalf actually had the authority to do so.

G. Cases Involving the Treatment of LLCs under Statutes that Do Not Specifically Apply to LLCs

In the early years of the LLC, one of the main questions surrounding this new entity was how it would be treated under federal or state statutes that specifically dealt with corporations, partnerships, or both - but not LLCs because they did not exist when the statutes were written.

Over the years, many of these state and federal statutes have been amended to specifically deal with LLCs. Nevertheless this issue still arises as many other statutes have not yet been amended.

H. Cases Involving Single Member LLCs

All LLC statutes authorize the formation of LLCs that have only one member. However, the concept of the single member LLC does not fit neatly into all of the provisions of the typical LLC act. For example, the provisions designed to protect a member from the actions of a co-member have questionable relevance to the single member LLC. It therefore may not be surprising that the courts have decided some issues differently depending upon whether they were dealing with a single member LLC or a multi-member LLC.

PART IV LLC LAW BEYOND TODAY

A. The Uniformity Movement

Some of the changes to LLC law that we have already seen and may see more of in the future results from the states adopting some of the model and uniform laws that have been drafted in the last few years.

The movement to increase the uniformity of state laws began at the end of the 19th century. By that time, it had become apparent that having different and conflicting laws among the states was creating confusion and hindering trade.

The groups involved in the uniformity movement draft model and uniform acts covering a particular area where it is believed that eliminating the differences among the state laws will promote commerce. There are two main groups drafting model and uniform laws. One is the American Bar Association (ABA). The other is the National Conference of Commissioners on Uniform State Laws (NCCUSL).

The difference between a model act and a uniform act is not in the substance of the law. It is in the way the drafters expect it to be adopted by the state legislatures. A model act is a template that is expected to be modified by each state rather than adopted in whole. A model act is drafted when uniformity is considered desirable but not necessary. A uniform act is intended to be adopted without revision. It will be drafted where uniformity of state laws is the principal objective.

B. The Revised Uniform Limited Liability Company Act (RULLCA)

NCCUSL has been drafting uniform business entity laws for nearly 100 years. It approved the Uniform Limited Liability Company Act (ULLCA) in 1995. In 2006, the Revised Uniform Limited Liability Company Act (RULLCA) was approved.

RULLCA contains 11 articles, beginning with general provisions and including articles on formation, relations of members and managers to third parties, default rules for the members' relations with each other and with the LLC, restrictions on transfers, causes and consequences of dissolution, causes and consequences of dissociation, foreign LLCs, derivative suits, organic transactions and miscellaneous provisions.

C. Model Entity Transactions Act (META)

Multi-entity mergers and conversions can be difficult to deal with because they require compliance with at least two separate and often inconsistent statutes. The same is true of other restructuring transactions such as inter-entity exchanges and domestications.

In response to the problems caused by these inconsistencies, NCCUSL and the ABA drafted and approved the Model Entity Transactions Act (META) in 2005. The original version of META was then amended in 2007. META (2007) sets forth a single set of procedures for completing mergers and exchanges involving more than one type of business entity. It also has procedures for completing conversions and domestications.

D. Model Registered Agents Act (MoRAA)

The Model Registered Agents Act is another joint project undertaken by NCCUSL and the ABA. It was approved in 2006.

MoRAA deals with registered agent issues and applies to all forms of entities. It has provisions dealing with, among other matters, addresses in filings, the content of filings to

appoint a registered agent, the procedure for changing a registered agent, the resignation of a registered agent, and the duties of a registered agent.

MoRAA eliminates the function of the registered office address as the means of determining where venue or publication is appropriate. It also permits an individual or entity that is in the business of serving as a registered agent to file a statement to be listed as a commercial registered agent.

E. Uniform Business Organizations Code (UBOC)

The UBOC was drafted by NCCUSL. It is a “hub and spoke” law. It is intended to harmonize the language of all of the uniform unincorporated entity acts. Article 1 is the hub. In this article are provisions regarding definitions, filing requirements, names, registered agents, annual reports, foreign registration and administrative dissolution for LLCs and other unincorporated entities. MoRAA, META, and the RULLCA are all included in the UBOC.