

Chapter 7

UNIFORM LIMITED LIABILITY COMPANY ACT

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§7:10 Introduction

The Uniform Limited Liability Company Act [1996] was promulgated by the National Conference of Commissioners on Uniform State Laws at their San Antonio meeting in July 1996. The text and all amendments as of May, 2002 and their Official Comments are contained, with permission, on the CD.

The official comments to each section of the Uniform Act are very helpful. Obviously, for practitioners in states that have adopted the Uniform Limited Liability Company Act [1996], the comments provide invaluable data concerning the purpose and effect of the assorted provisions, but the usefulness of the Uniform Act's comments are not just for practitioners in adopted states. Rather, every American practitioner can make use of the comments, as they provide an interpretation of provisions that are contained in most non-Uniform states.

Several states and the Virgin Islands have adopted portions of the Uniform Limited Liability Company Act [1996]. Florida, Hawaii, Illinois, Montana, New York, South Carolina, Vermont, West Virginia and the Virgin Islands have all made use of Uniform Limited Liability Company Act [1996] provisions.

The National Conference of Commissioners on Uniform State Laws did not prepare sample, illustrative, forms for use with their Uniform Limited Liability Company Act [1996]. There are in the CD specific forms for use with the Uniform Act.

§7:15 LLC as Separate Entity

The Uniform Act specifically treats the LLC form as a separate entity apart and distinct from its owners. Uniform Act §201. By treating the LLC as a distinct entity apart from its owners, the Uniform Act has eliminated the old partnership issues concerning the ownership of partnership assets.

§7:30 Articles of Organization

The articles of organization in the Uniform Act are traditional, yet contain surprises for the careless. The Uniform articles must contain:

1. The name of the company;
2. The address of the initial designated office;
3. The name and address of the registered agent;
4. The name and address of each organizer;
5. Whether or not the LLC is a "term company;" and

6. Whether any member of the LLC is to be liable for the debts of the company.

Optional matters known as "opt-in" provisions are permitted.

It is significant that the articles of organization cannot modify §103[b] non-waivable provisions relating to:

1. Member access to records;
2. Duty of loyalty to the company;
3. Reducing the duty of care to the company;
4. Eliminating the obligation of good faith and fair dealing;
5. Varying the right to expel a member;
6. Varying the right to wind up the company under specified events; and,
7. Restricting a person's right to distributions.

There are two important default provisions that the drafter must be aware of when preparing articles of organization under the Uniform Act. The first is that the Uniform Act default rule is that a LLC will, unless otherwise stated, be an "at-will company." Uniform Act, §203 Comments.

The second key concept not to forget in drafting articles of organization is that the Uniform LLC, by default, will be member managed and not operated or run by managers. Uniform Act, §203 Comments.

§7:40 "Opt-in" Feature

The Uniform Act is premised on the drafting concept of "opt-in" features. The articles may contain provisions permitted to be set forth in the operating agreement or other matters not inconsistent with law. Uniform Act § 203(b). This provision permits the drafter with an opportunity to be creative by including notice of restrictions and limits in the articles of organization.

§7:50 Name

Under §105 of the Uniform Act, the LLC's name must contain the words "limited liability company" or "limited company" or abbreviations. No special requirement is made for the name for professional services such as "PLLC." The name must be "distinguishable upon the records of the state office." Uniform Act § 105. The name may be reserved for 120 days. Uniform Act § 106.

Practice Note: Failure to use the proper name in the commercial setting may result in the imposition of personal liability. It is good practice to advise clients, in writing, to always clearly disclose their association and position in an LLC when signing documents (e.g., “Sam Jones, Member, Sam’s Limited Liability Company.”)

§7:60 Purpose and Powers

A limited liability company may be organized under the Uniform Act “for any lawful purpose, subject to any law of this State governing or regulating business.” Uniform Act § 112(a). No additional provision is necessary for professional LLCs if the practice is for a lawful purpose. Under the Uniform Act, an LLC is not limited to specific powers; it has the same powers as an individual to do all things necessary and convenient to carry on its business. Uniform Act § 112 (b).

The Uniform Act takes the position that if the company is to have a limited purpose or powers, the articles of organization is the best place to give notice of the limits. The following language is illustrative:

Purpose: The purpose of this company is solely to own and operate an apartment building at 123 Whynott Street in Littleton, Massachusetts.

In addition, the Uniform Act fails to clarify whether the inclusion in the articles of the company’s limitations of purpose, agency and power is sufficient to provide notice of these limitations to third parties. Uniform Act § 102.

Pursuant to definitional §101[3] of the Uniform Act, LLC can be organized and used in non-profit settings. For an expanded discussion on the benefits of using non-profits and the necessary procedures see §§ 4:71, 4:72, and 4:73.

§7:70 Duration

When the first LLC act was adopted by Wyoming in 1977, the act made provision for a thirty-year company life. The purpose was to avoid the corporate characteristic of continuity of life. This maximum duration proved unnecessary. In 1988, the I.R.S. issued LLC revenue rulings that held that the inclusion of “events of dissociation” in a state’s LLC statute enabled LLCs in that state to avoid the corporate characteristic of continuity of life. These “events

of dissociation” are found in § 601 of the Uniform Act. Therefore, the state acts, and the Uniform Act, are no longer required by federal I.R.S. classification mandates to declare a specified term of years.

However, if a company elects to exist as a “term company,” the Uniform Act requires that the articles of organization specify the date of dissolution. Uniform Act §§ 203(5), 411.

§7:80 Term Company

The Uniform Act identifies a “term company” as one that expires on a date set in the articles, as opposed to a “at-will company” which means any LLC other than a term company. Uniform Act § 101. The at-will company is the default provision.

If the company is to have a specific date of dissolution, the articles shall set forth that date. Uniform Act § 203(5). If there is no specific date of dissolution, the company will continue until otherwise terminated.

PRACTICE NOTE: Practitioners beware! Even if the articles of organization state that the LLC is a “term company” but its operating agreement makes it an “at-will company” then, it is an “at-will company” as to the relationships between the members. Yet, as to innocent third parties, it would still operate as a “term company.” Uniform Act, §203 Comments. This legal “honey trap” will catch many unwary practitioners.

PRACTICE NOTE: Remember, under the Uniform Limited Liability Company Act, the democratic concept of “one man, one vote” controls management! The default rule is that in member managed LLCs, every member has equal rights in management decision-making issues regardless of the member’s ownership interest in the LLC. Uniform Act, §404.

§7:90 Management

The Uniform Act requires the company to designate in the articles whether it is to be “member-managed” or “manager-managed.” Uniform Act § 203.

Practice Note: Since most closely held companies are member-managed, this issue can be addressed by including the following provision in the articles:

Management: The Management of this company is by its members acting as a Board of Members, each voting according to their distributional interest.

If the company is manager-managed, §203 requires the articles of organization to declare the names and addresses of each initial manager. The names and addresses of each manager must also be listed in the company's annual reports. Uniform Act §211[a][4]. However, if the management is retained by members, the names and addresses of the members need not be included in either the articles or the annual report. Some states, e.g., Hawaii, have modified the Uniform Act to require that if the company is member-managed, the names and addresses of the members must be listed in the articles and annual reports.

Under the Uniform Act the default rule is that management of the business of the company is vested in the members. Uniform Act § 203(a)(6). If management is by managers, the articles must declare that the company is manager managed and list the names and addresses of each initial manager.

A manager need not be a member of the company and management need not include all members.

The Uniform Act also states that the articles must set forth "whether one or more members of the company are to be liable for its debts and obligations under section 303(c)." Uniform Act § 203(a)(7). This provision is without precedent in prior LLC acts which, by definition, are designed to overcome the limitations suffered by partnerships.

§7:95 One Member LLCs Permitted

One person LLCs are permitted by the Uniform Act. Uniform Act, §202[a]. For purposes of the Uniform Act, a "person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, or any other legal or commercial entity. Uniform Act, §101[14].

§7:100 Designated Office and Agent

The Uniform Act requires that the LLC maintain a Designated Agent and office for service of process.

Uniform Act, §107. In addition, the Uniform Act requires that the company have an "initial designated office" that need not be in the state or in the company's place of business. Uniform Act § 108(a)(1). A written statement accepting the appointment is not required.

Practice Note: Many states require that the articles be accompanied by a statement signed by the registered agent indicating that he or she consents to the appointment. This consent should state that the registered agent understands and accepts his or her duties.

The articles of organization and the annual report must contain the street address of the registered office where the registered agent can be found. Uniform Act §§ 108, 203 and 211. The Uniform Act does not specify any additional duties of the registered agent other than acceptance of service of process. The Uniform Act also does not specify where the company's records are to be maintained, yet the company is required to allow members access to the records. Uniform Act §§ 103(b), 408.

§7:110 Other matters

The articles of organization may contain such other matters as the members desire. Uniform Act § 203(b). If the company is created for a limited purpose, this is the best place to give notice of that limited purpose. Additional examples are contained in the list of default rules found at §7:150.

§7:120 Filing

One or more persons may form an LLC by signing and filing articles of organization with the secretary of state. Uniform Act § 202(a). The "organizer" need not be a member. The articles of organization need to be signed by an "organizer" and delivered to the office of the director for filing with the filing fee. Delayed dates are permitted. Uniform Act §§ 202 and 206.

§7:130 Amendment of Articles

The articles may be amended at any time for any purpose by filing an Articles of Amendment in the state office. Uniform Act § 204. The filing of Restated Articles of Organization is permitted. Uniform Act § 204(b). Absent other provisions in the operating agreement, the articles may only be amended with the

consent of all members of company. Uniform Act § 404(c)(3).

§7:140 The Operating Agreement

The operating agreement is the agreement of the members “concerning the relations among the members, managers, and limited liability company. The term includes amendments to the agreement.” Uniform Act § 101. Section 103 (a) of the Uniform Act provides that all of the members “may enter into an Operating Agreement, which need not be in writing, to regulate the affairs of the company and the conduct of its business, and to govern relations among the members, managers, and the company.”

While the Uniform Act permits oral operating agreements, they are not recommended. The better approach is to encourage drafting a written operating agreement, signed by all members. The written operating agreement should address each of the “day-one decisions” (the decisions concerning the operation and management of the company requiring unanimous consent of the members) and reflect whether the company has accepted, rejected or changed any of the Uniform Act’s default provisions.

The Uniform Act contains many default provisions which are not desirable in most cases, but which will govern “unless otherwise provided.” Section 103(a) supplies the key to the needed flexibility. It provides: “To the extent the Operating Agreement does not otherwise provide, this chapter governs relations among the members, managers, and Company.” The attorney has no better vehicle than the operating agreement in which to make a record of advice concerning the many critical default provisions. Section 103(b) provides that the operating agreement may not:

1. Unreasonably restrict a right to information or access to records;
2. Eliminate the duty of loyalty;
3. Unreasonably reduce the duty of care;
4. Eliminate the obligation of good faith and fair dealing;
5. Vary the right to expel a member by judicial determination;
6. Vary the requirement to wind up the LLC’s business in a case specified in section 801(4) or 801(5); or
7. Restrict the rights of third parties other than a manager, member or a transferee of a member’s distributional interest.

The operating agreement is the key to avoiding the unnecessary complication of many of the default provisions. Failure to execute a written operating agree-

ment on day-one, while the members still share the same vision, can prove difficult to overcome.

§7:150 Default Rules: A Uniform Act Checklist

The Uniform Act contains many “default rules” which govern if the draftsman does not “otherwise provide” in the operating agreement. Members may neither intend nor desire the course of action prescribed by a default rule, therefore, careful attention to the statute is required when drafting the articles and the operating agreement. Failure to address these matters in a written operating agreement may cause serious restrictions on the company. A detailed understanding of the operation and impact of these default rules is a great advantage in negotiating an operating agreement.

Practice Note: Since §103 is specific that the “opt-in” choices be in the operating agreement, it would be best to not rely on the exercise of such choices only in the articles without also including backing it up in the operating agreement.

Pursuant to the Uniform Act, unless otherwise provided in the articles or operating agreement, the following default rules govern the relations among the members, managers, and company:

- The company is organized for all lawful purposes and with all lawful powers.
- Each member is an agent of the company. §§ 301(a)(I), 301(c).
- The company shall indemnify a member and manager for liabilities incurred in the ordinary course of business or for the presentation of business property. § 403(a).
- A member is not entitled to remuneration for services performed for the company, except for services of winding up the company. § 403 (d).
- In a member-managed company, each member has equal rights in the management and conduct of the company’s business and most matters relating to the business of the company may be decided by a majority of the members. § 404(a).
- In a manager-managed company, the manager(s) have the exclusive authority to manage and conduct the company’s business and most matters relating to the business of the company may be exclusively decided by the manager or,

if there is more than one manager, by a majority of the managers. § 404(b).

- A manager shall: (1) be designated, appointed, elected, removed, or replaced by a vote, approval, or consent of a majority of members; (2) be qualified to transact business in this State if the manager is an entity, and (3) remain in office until a successor has been elected and qualified, unless the manager resigns or is removed sooner.
- Distributions and allocations are made in equal shares. §405.
- The members' fiduciary duty to the company and to other members is limited. §409.
- A vote of all remaining members is necessary to admit an assignee as a member. §503.
- A vote of all remaining members is required to continue after an event of dissolution. §802.
- There will be only one class of members.

The following matters, according to Uniform Act §404, require the consent of all members of the LLC:

1. Amending the operating agreement;
2. Authorizing or ratifying acts or transactions which would otherwise violate the duty of loyalty;
3. Amending the articles of organization;
4. Compromising an obligation of a member to make an agreed capital contribution;
5. Compromising, as among members, an obligation of a member to return money or other property paid in a wrongful distribution;
6. Making a distribution;
7. Admitting a new member;
8. Using the company's property to redeem an interest subject to a charging order;
9. Consenting to dissolve the company;
10. Waiving the right to have the company's business wound-up and the company terminated under section 802(b);
11. Merging the company with another entity; and,
12. Selling, leasing, exchanging, or otherwise disposing of all, or substantially all, of the company's property with or without good of owners.

§7:160 Events of Dissociation

The Uniform Act calls for the company to wind up or be continued upon the occurrence of specific events causing a member's dissociation. When one of these specific events occur, the company must decide to either continue or wind up its business. Uniform Act §§601 and 602. In addition, the Uniform Act allows

companies to "otherwise provide" specific dissociation events in their operating agreements. Uniform Act §103.

Upon an event of dissociation, §802(a) requires the company to wind up unless the members elect to continue as provided in §§411 and 802(b). Care should be taken in drafting the operating agreement and the articles under the Uniform Act to preserve the ability of the remaining members to elect to continue upon the withdrawal of a member. Unless otherwise provided in the operating agreement, after a dissociation of a member, continuation can be accomplished only by consent of all remaining members and the dissociated member who caused the dissolution. Uniform Act § 802. This default rule is much more restrictive than is necessary to avoid the corporate characteristics of continuity of life. *See*, Rev. Rul. 93-91, Rev. Proc. 95-1.

Practice Note: Without risking I.R.S. partnership tax treatment, the written operating agreement should contain the following provision:

Continuation: Upon an event of dissociation (or withdrawal) of a member, the company may be continued by majority in interest of the remaining owners.

The Uniform Act also introduces a unique complication in the area of member dissociation upon death (unless otherwise provided in the operating agreement). The comment to §601 provides:

Although a member is dissociated upon death, the effect of the dissociation where the company does not dissolve depends upon whether the company is at-will or term and whether manager-managed. Only the decedent's distributional interest transfers to the decedent's estate which does not acquire the decedent member's management rights. See §603(b)(1). Unless otherwise agreed, if the company was at-will, the estate's distributional interest must be purchased by the company at fair value determined at the date of death. However, if a term company, the estate and its transferees continue only as the owner of the distributional interest with no management rights until the expiration of the specified term that existed on the date of death. At the expiration of that term, the company must purchase the interest of a dissociated member if the company continues for an addi-

tional term by amending its articles or simply continues as an at-will company. See Sections 411 and 701(a)(2) and Comments. Before that time, the estate and its transferees have the right to make application for a judicial dissolution of the company under § 801[b][5] as successors in interest to a dissociated member. See Comments to §§801, 411 and 701. Where the members have allocated management rights on the basis of contributions rather than simply the number of members, a member's death will result in a transfer of management rights to the remaining members on a proportionate basis. This transfer of rights may be avoided by a provision in an operating agreement extending the § 701[a][1] at will purchase right to a decedent member of a term company.

§7:170 Assignment of Ownership Interest

An ownership interest in an LLC is assignable except as provided in the operating agreement or the articles of organization. Section 501(b) of the Uniform Act provides that “[a] distributional interest in a limited liability company is personal property and, subject to §§502 and 503, may be transferred in whole or in part.” Section 502 of the Uniform Act sets out the default rule that:

A transfer of a distributional interest does not entitle the transferee to become or to exercise any rights of a member. A transfer entitles the transferee to receive, to the extent transferred, only the distributions to which the transferor would be entitled. A member ceases to be a member upon transfer of all of the member's distributional interest, other than a transfer for security purposes, or a court order charging the member's distributional interest, which has not been foreclosed.

This provision was designed to avoid the old *Kintner* Classification Regulations concerning the corporate characteristic of free transferability of interest. However, the Uniform Act provision rule requires the consent of all other members in order for the transferee to become a member. Uniform Act §503(a). This requirement is unnecessarily restrictive. The threshold level of approval set by the I.R.S. to admit an assignee to membership is “majority in interest,” not “all.” See, Rev. Rul. 93-91, Rev. Proc. 94-46, Rev. Proc. 95-10.

The flexibility afforded by §103 should be used to adopt the more flexible “majority in interest” standard now allowed by the I.R.S.

Practice Note: The written operating agreement under the Uniform Act should contain the following provision:

Admission of Members: The transferee of a distributional interest may be admitted to membership by a majority vote by a majority interest of the members.

§7:180 Continuation

Even under the old *Kintner* Classification Regulations the IRS allowed the members to elect to continue the company by a majority interest vote of the remaining owners. Rev. Rul. 93-91. While this desired flexibility is not specifically provided in the Uniform Act, the option can be exercised in this “majority in interest” standard in the operating agreement. Uniform Act §103. If the company is not continued after an event of withdrawal, the company must wind up its affairs and liquidate the company's assets. Uniform Act §§ 801, 806.

Practice Note: Failure to properly and timely continue may result in a loss of limited liability. The operating agreement may include the following provision:

Continuation: After an event of dissolution the remaining owners may, by a majority in interest vote, elect to continue the company.

§7:190 Agency

Each manager (member or not) is an agent for the LLC for the purpose of its business of affairs. Uniform Act §§ 301, 302. However, the Uniform Act permits restriction of this authority. Generally, the company will not be bound by unauthorized acts of its agents made with persons having knowledge of the agency restrictions.

Practice Note: The articles might contain a provision as follows:

Agency: Management of this company is by the members acting as the Board of Members. Company action requires a written resolution of the Board.

§7:200 Party in Interest

The Uniform Act does not continue the “party in interest” provision contained in versions of the Model Act, the ABA Prototype Act and the state limited liability partnership acts. This provision (now contained in most states’ LLC acts) provides that a member is not a proper party to a proceeding by or against the LLC, except where the objective is to enforce either a member’s rights against the company or a member’s liability to the company.

However, while the Uniform Limited Liability Company Act reporters did not include a separate provision on the “Party in Interest” concept, they attempted to backdoor the provision via §201 of the Act. Section 201 states that the LLC is a separate and distinct entity from its owners. The reporters theorize that since owners are separate and apart from the LLC, they cannot be proper parties to a lawsuit.

§7:210 Limited Liability

The Uniform Act limits the potential personal liability of a company member. Sections 303(a) and 303(b) provide:

(a) Except as otherwise provided in subsection (c), the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, are solely the debts, obligations, and liabilities of the company. A member or manager is not personally liable for a debt, obligation, or liability of the company solely by reason of being or acting as a member or manager.

(b) The failure of a limited liability company to observe the usual company formalities or requirements relating to the exercise of its company powers or management of its business is not a ground for imposing personal liability on the members or managers for liabilities of the company.

§7:220 New Members

Section 202 of the Uniform Act requires that the company have “one or more members.” Unless otherwise provided in the articles or written operating agreement, a member is an owner of the business who has the right to equal participation in management and to share equally in distributions. Uniform Act §§301, 404 and 405.

Under the Uniform Act, members can control the admission of new members by using the operating agreement. Uniform Act §103. Unless otherwise provided, admission of a new member who either takes directly from the company or as an assignee requires the written consent of all members. Uniform Act § 404(c).

This standard is unnecessarily restrictive in that it allows one member to veto the admission of new members and prevent the otherwise desirable growth of the company. In addition, it is more stringent than is required by the Internal Revenue Service: the vote of a majority in interest of the remaining members satisfies I.R.S. standards. *See* Rev. Proc. 94-46 for a definition of “majority in interest.” Drafters should note that §103 permits the adoption of a less stringent standard in the operating agreement.

§7:230 Records

The Uniform Act does not specify what records are to be maintained or where they are to be found. In fact, in the comments to §408, the reporters state that the Uniform Act “does not require a company to maintain any records.” However, §103 forbids the operating agreement from unreasonably restricting a member’s right to information or access to records. The members’ right to information, as set out in §408, requires that:

(a) A limited liability company shall provide members and their agents and attorneys access to its records, if any, at the company’s principal office or other reasonable locations specified in the operating agreement. The company shall provide former members and their agents and attorneys access for proper purposes to records pertaining to the period during which they were members. The right of access includes the opportunity to inspect and copy records during ordinary business hours. The company may impose a reasonable charge, limited to the costs of labor and material, for copies of records furnished.