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The Next Generation: The Revised Uniform Limited Liability Company Act

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I. Introduction

On July 13th, 2006, the National Conference of Commissioners on Uniform State Laws ("NCCUSL" or "the Conference") "approved and recommended for enactment in all the States"[1] the Revised Uniform Limited Liability Company Act ("Re-ULLCA"). This approval came ten years after the Conference approved the original Uniform Limited Liability Company Act ("ULLCA") and ended a drafting process that had itself spanned three years.[2]

The new Act brings major innovations to the law of limited liability companies, and NCCUSL has begun actively seeking enactments around the country. This article seeks to introduce the new Act to business lawyers across the country,[3] by: (i) explaining why NCCUSL decided to draft a new LLC statute, reviewing the process through which the Conference produced and approved the new Act, and describing the Act's basic architecture; (ii) highlighting the Act's major innovations; and (iii) providing a roadmap through the Act's intricate and all-important provisions concerning the operating agreement.

II. Why a New LLC Act Now, By Whom and How Was the New Act Drafted, and What Does the New Act Look Like?

A. Why a New LLC Act Now?

The new Act's Prefatory Note contains the most succinct explanation for "Why a new LLC Act Now?"

1. Re-ULLCA, Cover. Re-ULLCA *is available at* http://www.law.upenn.edu/bll/ulc/ullca/2006act_final.htm.

2. Prefatory Note to Re-ULLCA. *See also* ULLCA drafting committee website, *Welcome from the Chair, available at* http://www.llcproject.org/ULLCA/DesktopDefault.aspx.

3. As will be seen, the Act is already well known to leading practitioners and academics who have served as ABA Advisors to the Drafting Committee. *See infra* notes 5–12 and accompanying text (Part II-B).

> Eighteen years have passed since the IRS issued its gate-opening Revenue Ruling 88-76, declaring that a Wyoming LLC would be taxed as a partnership despite the entity's corporate-like liability shield. More than eight years have passed since the IRS opened the gate still further with the "check the box" regulations. It is an opportune moment to identify the best elements of the myriad "first generation" LLC statutes and to infuse those elements into a new, "second generation" uniform act.[4]

B. By Whom and How Was the New Act Drafted?

The Drafting Committee for Re-ULLCA was chaired by David Walker, Dean of the Drake Law School, included eight other commissioners, and benefited from the active participation of 13 advisors appointed by the ABA.[5] In addition to the ABA Advisor,[6] the Committee had eight advisors from the Business Law Section,[7] three from the Real Property, Probate and Trust Law Section,[8] and one from the Section on Taxation.[9] The current chair of the PUBO Committee was one of the Business Law Section's Advisors,[10] and the immediate past chair of that Committee was the ABA Advisor.[11]

As explained in March 2006 newsletter of the ABA Committee on Partnerships and Unincorporated Business Organizations:

> ABA advisors actually outnumbered NCCUSL commissioners on the committee, and on most votes the committee's chair counted commissioners and ABA advisors together as one group. On the rare occasions when the committee seemed significantly divided, the chair took a formal vote of commissioners (as NCCUSL procedures require) but then also made note of a vote of the ABA advisors.[12]

The Drafting Committee also benefited from a scholarly perspective. As is usual, the co-reporters are law professors. In addition, the chair of the Committee

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4. Re-ULLCA, Prefatory Note, *available at* http://www.law.upenn.edu/bll/ulc/ullca/2006act_final.htm#_Toc147562675.

5. The members of the drafting committee are listed at http://www.llcproject.org/ULLCA/DesktopDefault.aspx?tabindex=1&tabid=49.

6. Robert Keatinge.

7. William J. Callison (from the Committee on Partnerships and Unincorporated Business Organizations ["PUBO"]), William H. Clark, Jr. (from the Committee on Corporate Laws), Jon T. Hirschoff (from the Committee on Negotiated Acquisitions), Paul L. Lion, III (from PUBO; also representing the California State Bar), Scott E. Ludwig (from PUBO), Professor Elizabeth Stone Miller (from PUBO), Professor Sandra K. Miller (from PUBO), and Thomas E. Rutledge (from PUBO).

8. Professor Thomas Earl Geu, Barry B. Nekritz and Robert Krapf.

9. John R. Maxfield.

10. Professor Elizabeth Stone Miller.

11. Robert Keatinge.

12. Daniel S. Kleinberger, *Progress Report on the Revised Uniform Limited Liability Company Act ("ULLCA") and the Issue of "Corpufuscation,"* Vol. XXII, no. 2, PUBOGRAM, at 7 (March 2006) [hereinafter "*Progress Report*"]. ABA influence was also strong among the commissioners. One was the original ABA Advisor to the Drafting Committee for RUPA and the first recipient of the PUBO Committee's Martin I. Lubaroff Award for contributions to law of unincorporated business organizations (Harry J. Haynsworth). Another had been the Tax Section's Advisor to ULLCA and ULPA (2001) (Steven G. Frost). The ABA's influence was felt most strongly on the question of "shelf LLCs." *See infra* notes 73–84 and accompanying text (Part III-F).

is a law school dean,[13] one of the members is a dean emeritus,[14] and another is a law professor.[15] One of the ABA advisors is a business school professor,[16] and two others are law professors.[17] Several of the ABA Advisors who are full-time practitioners have also published several articles on LLC law.[18] All and all, authors from the three leading LLC treatises were part of this working group.[19]

The drafting process spanned three years and included ten drafting committee meetings,[20] six drafts,[21] and consideration by the entire Conference at four consecutive annual meetings. Each committee meeting lasted two and a half days, and many key issues were debated, re-debated and re-debated.[22] The Act was on the annual meeting agenda in 2003 (concept discussion, based on drafting committee's briefing memo); 2004 (partial first reading), 2005 (first reading), and 2006 (final reading).[23]

13. David Walker is Dean of the Drake Law School.

14. Harry Haynsworth is Dean Emeritus of the William Mitchell College of Law.

15. Ann Anker is Professor of Law at Widener University School of Law.

16. Sandra Miller is Professor of Accounting and Taxation at Widener University School of Business Administration.

17. Tom Geu is Professor of Law at University of South Dakota School of Law, and Elizabeth Miller is Professor of Law at Baylor Law School.

18. William J. Callison, *"The Law Does Not Perfectly Comprehend. . . .": The Inadequacy of the Gross Negligence Duty of Care Standard in Unincorporated Business Organizations,* 94 KY. L.J. 451 (2005–06); William J. Callison, *Blind Men and Elephants: Fiduciary Duties Under the Revised Uniform Partnership Act, Uniform Limited Liability Company Act, and Beyond,* 1 J. SMALL & EMERGING BUS. L. 109 (1997); Robert R. Keatinge, *The Implications of Fiduciary Relationship in Representing Limited Liability Companies and Other Unincorporated Associations and Their Partners or Members,* 25 STETSON L. REV 389 (1995); Robert R. Keatinge, *New Gang in Town Limited Liability Companies: An Introduction,* 4 BUS. L. TODAY 5 (1995); Thomas E. Rutledge, *To Boldly Go Where You Have Not Been Told You May Go: LLCs, LLPs, and LLLPs in Interstate Transactions,* 58 BAYLOR L. REV. 205 (2006); and Thomas E. Rutledge, *The Lost Distinction Between Agency and Decisional Authority: Unfortunate Consequences of the Member-Managed Versus Manager-Managed Distinction in the Limited Liability Company,* 93 KY. L.J. 737 (2004–2005).

19. In alphabetical order by author: CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW (1994 and Supp. 2006-2); [hereinafter "BISHOP AND KLEINBERGER"]; WILLIAM J. CALLISON & MAUREEN A. SULLIVAN, LIMITED LIABILITY COMPANIES: A STATE-BY-STATE GUIDE TO LAW AND PRACTICE (2006); and LARRY A. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES (2d ed. 2003).

20. The drafting committee met during May 2003 in Atlanta, Georgia; June 2003 via teleconference; November 2003 in Chicago, Illinois; April 2004 in Chicago, Illinois; June 2004 via teleconference; October 2004 in Chicago, Illinois; February 2005 at Phoenix, Arizona; May 2005 via teleconference; October 2005 via teleconference; and February 2006 via teleconference. *See* http://www.llcproject.org/ULLCA/DesktopDefault.aspx?tabindex=4&tabid=52.

21. http://www.nccusl.org/Update/CommitteeSearchResults.aspx?committee = 224.

22. *See, e.g.,* Re-ULLCA, 2006 Annual Meeting Draft [hereinafter "2006 Annual Meeting Draft"], § 409, cmt. (discussing the drafting committee's many-splendored approaches to the duty of care issue) and § 401, cmt. (discussing the committee's internal debates over the "shelf LLC" issue), *available at* http://www.law.upenn.edu/bll/ulc/ullca/2006amdraft.htm.

23. It was highly unusual for the Conference to devote part of an annual meeting to a briefing memo. However, the chair of the Drafting Committee persuaded the Conference's leadership that it was appropriate for the Conference to understand several fundamental conceptual innovations the Committee planned to make before the Committee (and its co-reporters) began the intensive labor of drafting statutory language.

C. What Does the New Act Look Like?

Re-ULLCA's architecture derives from and resembles that of RUPA, ULLCA, and ULPA (2001).

Article 1	contains	general provisions, including definitions; sections on a limited liability company's duration, purposes, powers, name, and agent for service of process; and three key provisions concerning the operating agreement
Article 2	provides	for the formation of limited liability companies and for the public filing of records pertaining to an LLC
Article 3	governs	the relations of members and managers to third parties—i.e. with non-members dealing with or affected by the limited liability company
Article 4	states	the default rules for the members' relationship inter se and with the limited liability company and provides templates for member-management and manager-management
Article 5	implements	the "pick your partner" principle, which is at the core of the law of unincorporated business organizations, and delimits the rights of transferees
Article 6	states	the causes and consequences of a person's dissociation as a member of a limited liability company
Article 7	delineates	the causes and consequences of the dissolution of a limited liability company
Article 8	governs	foreign limited liability companies
Article 9	provides	for direct and derivative claims by members and for the establishment, conduct, and judicial review of special litigation committees
Article 10	governs	organic transactions—mergers, conversions, and domestications
Article 11	contains	miscellaneous provisions, including a section providing transition rules for pre-existing limited liability companies

The only significant nomenclature change from ULLCA is the use of "certificate of organization" rather than "articles of organization" to refer to the publicly filed document used to create a limited liability company. The change is intended "to signal that: (i) the certificate merely reflects the existence of an LLC (rather than being the locus for important governance rules); and (ii) this document is significantly different from articles of *incorporation,* which have a substantially greater power to affect *inter se* rules for the corporate entity and its owners."[24]

III. Major Innovations in the New Act

The new Act's major innovations concern:

a. the operating agreement;
b. the "un-cabining" of fiduciary duty;
c. the obligation of good faith and fair dealing;
d. an owner's legitimate self-interest;
e. a reformulation of the duty of care;
f. the "shelf LLC" issue;
g. the question of "statutory apparent authority";
h. statements of authority by position;
i. default rules on management structure;
j. charging orders;
k. a remedy for oppressive conduct;
l. derivative claims and special litigation committees; and
m. organic transactions—mergers, conversions, and domestications.

Also noteworthy are (i) the Act's eschewal of the notion of a "series LLC," and (ii) the situation faced under the Act by transferees.

A. The Operating Agreement

The new Act defines the operating agreement very broadly: " 'Operating agreement' means the agreement, whether or not referred to as an operating agreement and whether oral, in a record, implied, or in any combination thereof, of all the members of a limited liability company, including a sole member, concerning the matters described in Section 110(a)."[25] Following the modern statutory trend[26] (although not the axioms of contract law),[27] this definition encompasses an "agreement" of the sole member of a single member LLC. Following partnership law, the definition extends to the most informal of agreements.[28]

The operating agreement is an LLC's foundational accord,[29] even though formation of an LLC requires the filing of a document with a specified public official.[30]

24. Re-ULLCA § 102(1) cmt. (emphasis in original). Most LLC statutes use the term "articles of organization." *See, e.g.,* Ariz. Rev. Stat. Ann. § 29-601 (Supp. 2006); Fla. Stat. Ann. § 608.402 (West Supp. 2007); *see generally* Bishop and Kleinberger, *supra* note 19, at ¶ 5.05. Delaware uses the term "certificate of formation." Del Code Ann. tit. 6, § 18-101 (2007).

25. Re-ULLCA § 102(13).

26. Bishop and Kleinberger, *supra* note 19, ¶ 5.06 [3] [d].

27. As a matter of common law, a contract presupposes at least two parties. Richard A. Lord, 1 Williston On Contracts § 3:2 (4th ed. 2006).

28. *See* RUPA § 101(7) (defining "partnership agreement") and ULPA (2001) § 102 (13) (same). *Compare* Revised Model Business Corporations Act § 7.32(b)(1) (2005) (requiring shareholder agreements to be in writing).

29. See the discussion *infra* at notes 30–35 and accompanying text.

30. Re-ULLCA § 201.

The operating agreement's domain is very broad,[31] and the agreement is the first place to look for the "deal" among the members.[32]

It is not required for an LLC to have an operating agreement,[33] but it is inevitable:

> [T]he Act's very broad definition of "operating agreement" means that, as soon as a limited liability company has any members, the limited liability company has an operating agreement. For example, suppose: (i) two persons orally and informally agree to join their activities in some way through the mechanism of an LLC, (ii) they form the LLC or cause it to be formed, and (iii) without further ado or agreement, they become the LLC's initial members. The LLC has an operating agreement; "all the members" have agreed on who the members are, and that agreement—no matter how informal or rudimentary—is an agreement "concerning the matters described in Section 110(a)."[34]

Continuing the tradition of RUPA, ULLCA, and ULPA (2001), the new Act centralizes all provisions dealing with the power and effect of the operating agreement.[35] "However, because an operating agreement raises issues too numerous and complex to include easily in a single section, the new Act uses three related sections to address the operating agreement."[36] Section 110 delineates the scope and general power of operating agreement and states an important and specific set of limitations on that power. Sections 111 and 112 deal with operating agreement mechanics and with the effect of the operating agreement on specified third persons and on the LLC itself.

Recognizing that "[o]ne of the most complex questions in the law of unincorporated business organizations is the extent to which an agreement among the organization's owners can affect the law of fiduciary duty,"[37] Section 110 considers in detail the extent to which the operating agreement can define, alter, or eliminate aspects of fiduciary duty; expressly authorizes the operating agreement to relieve members and managers from liability for money damages arising from breach of duty (subject to specified limitations), and provides specific guidance for courts asked to invalidate an operating agreement provision on the grounds

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31. According to Re-ULLCA § 110(a):

> The operating agreement governs: (1) relations among the members as members and between the members and the limited liability company; (2) the rights and duties under this [act] of a person in the capacity of manager; (3) the activities of the company and the conduct of those activities; and (4) the means and conditions for amending the operating agreement.

32. "*To the extent the operating agreement does not otherwise provide for a matter described in subsection (a),* this [act] governs the matter." Re-ULLCA § 110(b) (emphasis added).

33. *Compare* CAL. CORP. CODE § 17050(a) (West 2006) which provides: "In order to form a limited liability company, one or more persons shall execute and file articles of organization with, and on a form prescribed by, the Secretary of State and, either before or after the filing of articles of organization, the members shall have entered into an operating agreement." *Id.*

34. Re-ULLCA § 102(13) cmt.

35. Of course, under RUPA and ULPA (2001), the owners' foundational document is called the partnership agreement rather than the operating agreement. *See* RUPA § 103(a); ULPA (2001) § 110(a).

36. Re-ULLCA, Prefatory Note, Noteworthy Provisions of the New Act.

37. Re-ULLCA § 110 cmt.

that the provision is "manifestly unreasonable."[38] These provisions are especially important, given the Drafting Committee's decision to "un-cabin" fiduciary duty.

B. "Un-cabining" Fiduciary Duty

For almost a century, Justice Cardozo's opinion in *Meinhard v. Salmon* has been the touchstone of the law of fiduciary duty among "[j]oint adventurers [and] co-partners,"[39] and before RUPA, fiduciary duty in unincorporated business organizations was mostly a matter of case law.[40] According to the Comments to RUPA, "the UPA . . . touches only sparingly on a partner's duty of loyalty and leaves any further development of the fiduciary duties of partners to the common law of agency."[41]

RUPA took a radically different approach and sought to codify exhaustively all fiduciary duties relevant to a RUPA partnership and its partners.[42] The underlying idea was to "cabin in" fiduciary duty so as to protect partnership agreements from judicial second-guessing.[43]

38. See the discussion *infra* at notes 39–52 and accompanying text (Section IV- B).

39. 164 N.E. 545, 546 (N.Y. 1928).

40. Re-ULLCA § 409(a) and (b) cmt. (stating that "[u]ntil the promulgation of RUPA, it was almost axiomatic that . . . fiduciary duties reflect judge-made law").

41. RUPA § 404 cmt. 1. The reference to the common law of agency was perhaps too narrow. Partnership law had (and has) its own case law of fiduciary duty. *E.g.,* Peskin v. Deutsch, 479 N.E.2d 1034, 1038 (Ill. App. Ct. 1985) ("the fiduciary duty owed by one partner to another includes a duty to make full and fair disclosure"); Klotz v. Klotz, 117 S.E.2d 650, 656 (Va. 1961) ("[t]he relationship of partners is of a fiduciary character and imposes upon them the obligation to exercise good faith and integrity in their dealings with one another in the partnership affairs"). Cases discussing the duty of loyalty often sound in equity. *E.g.,* Gotham Partners, L.P. v. Hallwood Realty Partners, L.P. 817 A.2d 160, 175 (Del. 2002) (stating, "breach of the duty of loyalty . . . permits broad, discretionary, and equitable remedies"); Cantor Fitzgerald, L.P. v. Cantor, No 16297, 2000 WL 307370, at *1 (Del. Ch. Mar. 13, 2000) (holding breach of duty of loyalty did not permit an injunction in this case but did result in "other equitable relief").

42. RUPA § 404 cmt. 1 ("Section 404 is both comprehensive and exclusive."). RUPA § 404(a) provides that "The *only* fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subsections (b) and (c)." (emphasis added). Those subsections characterize a partner's duty of loyalty (subsection (b)) and care (subsection (c)) as "*limited to*" the obligations stated therein. (emphasis added).

43. *See* William J. Callison, *Blind Men and Elephants: Fiduciary Duties Under the Revised Uniform Partnership Act, Uniform Limited Liability Company Act, and Beyond,* 1 J. Small & Emerging Bus. L. 109, 115 (1997) ("RUPA attempts to displace common law rules that coexisted with the UPA, including common law fiduciary duty rules."); J. Dennis Hynes, *Freedom of Contract, Fiduciary Duties, and Partnerships: The Bargain Principle and the Law of Agency,* 54 Wash. & Lee L. Rev. 439, 451 (1997) ("In [Section 404] [RUPA] constricts the ability of courts to expand the concept of fiduciary duties. [T]he evident purpose of this constriction is to increase the certainty and reliability of partnership agreements. . . ."). *See also* Transcript of 2006 NCCUSL Annual Meeting, Saturday Morning Session, July 8, 2006, at 44 (on file with *The Business Lawyer*) (remarks of Co-Reporter Kleinberger: "Just for those people who may not be in touch with the lingo, when we are talking about cabining in, that was RUPA's contribution to say it was going to codify all those fiduciary duties, and that is what we have undone here."); Re-ULLCA § 409(a) and (b), cmt. ("In an effort to respect freedom of contract, bolster predictability, and protect partnership agreements from second-guessing, the Conference decided that RUPA should fence or "cabin in" all fiduciary duties within a statutory formulation.").

Both ULLCA and ULPA (2001) followed RUPA,[44] but from the outset Re-ULLCA's Drafting Committee was skeptical of this "cabin in" approach.[45] Eventually, the Committee and the Conference decided that, at least in the realm of limited liability companies, progress may be retrograde and "the 'cabin in' approach creates more problems than it solves."[46] The "cabin in" approach ignores the implicit fiduciary or fiduciary-like duty of members to avoid oppressing fellow members,[47] produces great difficulty in dealing with member-to-member disclosure obligations in member-to-member buy-sell transactions,[48] and puts inordinate pressure on the concept of "good faith and fair dealing."[49]

As explained in the new Act's Prefatory Note:

> the better way to protect the operating agreement from judicial second-guessing is to:
>
> * increase and clarify the power of the operating agreement to define or re-shape fiduciary duties (including the power to eliminate aspects of fiduciary duties); and
>
> * provide some guidance to courts when a person seeks to escape an agreement by claiming its provisions are "manifestly unreasonable."[50]

44. ULPA (2001), § 408 ("[t]he only fiduciary duties that a general partner has to the limited partnership and the other partners are the duties of loyalty and care. . . . A general partner's duty of loyalty to the limited partnership and the other partners is limited to. . . . A general partner's duty of care to the limited partnership and the other partners . . . is limited to. . . .") and ULLCA § 409 ("[t]he only fiduciary duties a member owes . . . are the duty of loyalty and the duty of care. . . . A member's duty of loyalty . . . is limited to. . . . A member's duty of care . . . is limited to. . . .").

45. Revision of Uniform Limited Liability Company Act, Preliminary Report, 2003 NCCUSL Annual Meeting, August, 2003, at 9, *available at* http://www.law.upenn.edu/bll/ulc/ullca/ann-meet-draft03.pdf.

46. Re-ULLCA, Prefatory Note, Noteworthy Provisions of the New Act. *See also* Transcript of the 2006 NCCUSL Annual Meeting, *supra* note 43, at 5 (remarks of Chairman David Walker "We have, we say, 'uncabined' fiduciary duty.").

47. *See infra* notes 111–32 and accompanying text (Part III-K).

48. *See* Daniel S. Kleinberger, *A User's Guide to the New Uniform Limited Partnership Act*, 37 SUFFOLK U. L. REV. 583, 636–39 (2004) [hereinafter "*User's Guide*"] (explaining the difficulty of relying on the obligation of good faith and fair dealing, because that obligation must be tied to some duty or right under the statute or the partnership agreement). *See also* Transcript of 2006 Annual Meeting, *supra* note 43, at 44 (Remarks of Co-Reporter Kleinberger: "Tremendous difficulty [exists if we try] to deal with disclosure duties inter se members by statute. We tried it several times, Carter [Bishop, co-reporter] and I. Every time we wrote something, the committee looked at it and said, you're writing a miniature securities act here. We don't want it. So, the fiduciary duty of disclosure is an important aspect of this.").

49. *User's Guide, supra* note 48. *See also* Transcript of 2006 Annual Meeting, *supra* note 43, at 44 (Remarks of Co-Reporter Kleinberger: "[W]e are already seeing pressure in the courts on the duty of good faith and fair dealing. When you say there are no other fiduciary duties and courts for hundreds of years have looked to fiduciary duties as a policing mechanism that they can develop, if you say you can't have fiduciary duties, they will go to good faith. And, in fact, I had a conversation with . . . [t]he judge of North Carolina's business court [who] said, if you stop us on fiduciary duty, we will just go to good faith."). For further discussion of pressure on the duty of good faith, in an analogous context, see Carter G. Bishop, *A Good Faith Revival of Duty of Care Liability In Business Organization Law,* 41 TULSA L. REV. 477 (2006).

50. Re-ULLCA, Prefatory Note, Noteworthy Provisions of the New Act.

As further explained by the chair of the Drafting Committee:

> T]he efforts of the [drafting] committee [to uncabin fiduciary duty] resulted in further articulation, clarification, elaboration, expansion of the freedom under Section 110 [powers of the operating agreement] to define the standards by which performance was to be measured. Particularly, [ABA] advisors . . . were concerned that the operating agreement be permitted to define the standards of performance. So the net effect . . . is to give further impetus to the members to define their obligations through the contract.[51]

Accordingly, Section 409 of the new Act *partially* codifies the duties of loyalty and care:

> (a) A member of a member-managed limited liability company owes to the company and, subject to Section 901(b), the other members the fiduciary duties of loyalty and care stated in subsections (b) and (c).
>
> (b) The duty of loyalty of a member in a member-managed limited liability company *includes* the duties:
>
> (1) to account to the company and to hold as trustee for it any property, profit, or benefit derived by the member:
>
> (A) in the conduct or winding up of the company's activities;
>
> (B) from a use by the member of the company's property; or
>
> (C) from the appropriation of a limited liability company opportunity;
>
> (2) to refrain from dealing with the company in the conduct or winding up of the company's activities as or on behalf of a person having an interest adverse to the company; and
>
> (3) to refrain from competing with the company in the conduct of the company's activities before the dissolution of the company.
>
> (c) Subject to the business judgment rule, the duty of care of a member of a member-managed limited liability company in the conduct and winding up of the company's activities *is* to act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member reasonably believes to be in the best interests of the company. In discharging this duty, a member may rely in good faith upon opinions, reports, statements, or other information provided by another person that the member reasonably believes is a competent and reliable source for the information.
>
> . . . .
>
> (g) In a manager-managed limited liability company, the following rules apply:
>
> (1) Subsections (a), (b), [and] (c), . . . apply to the manager or managers and not the members.[52]

C. Returning Good Faith and Fair Dealing to the Concept's Contract Law Moorings

Consistent with the new Act's focus on the operating agreement, Section 409 returns the "the obligation of good faith and fair dealing" to that concept's contract law moorings.

51. Transcript of 2006 Annual Meeting, *supra* note 43, at 44 (Remarks of Chairman Walker).

52. Re-ULLCA § 409(a), (b), (c), and (g) (emphasis added). Note the absence of "only" and "limited to."

It was RUPA that first codified the obligation as part of a business entity statute,[53] but that codification did not mention the obligation's contract law nature. RUPA § 404(d) states simply: "A partner shall discharge the duties to the partnership and the other partners under this [Act] or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing." RUPA's Comments, while recognizing the concept's contract law origin,[54] took a very broad, open-ended view of the obligation:

> The meaning of "good faith and fair dealing" is not firmly fixed under present law. "Good faith" clearly suggests a subjective element, while "fair dealing" implies an objective component. It was decided to leave the terms undefined in the Act and allow the courts to develop their meaning based on the experience of real cases.[55]

ULLCA and ULPA (2001) each adopted the RUPA formulation essentially verbatim,[56] but the new Act does not. Instead, Section 409(d) includes the word "contractual" to modify the "obligation of good faith and fair dealing."[57]

The difference is intended to signal a more conservative view of the obligation—i.e., "to emphasize that the obligation is not an invitation to re-write agreements among the members."[58] As the Comment to Section 409(d) explains:

> [T]he obligation should be used only to protect agreed-upon arrangements from conduct that is manifestly beyond what a reasonable person could have contemplated when the arrangements were made . . . . In sum, the purpose of the obligation of good faith and fair dealing is to protect the arrangement the partners have chosen for themselves, not to restructure that arrangement under the guise of safeguarding it.[59]

D. The Question of an Owner's Legitimate Self-Interest

The new Act also differs from RUPA on how to approach the "schizoid" nature of owner-to-owner relations in a closely held business.[60] Despite Cardozo's admonition in *Meinhard* that "[a] trustee is held to something stricter than the morals of

53. The obligation is implied by the common law (Restatement (Second) of Contracts § 205 (1981)) and had been previously codified in, *inter alia,* the Uniform Commercial Code (U.C.C. §§ 1-304 (2001), 2-103(j) (2003)).

54. RUPA § 404 cmt. 4 notes: "The obligation of good faith and fair dealing is a contract concept, imposed on the partners because of the consensual nature of a partnership."

55. RUPA § 404 cmt. 4.

56. ULLCA § 409(d) and ULPA (2001) § 408(d). However, ULPA's Comments took a decidedly narrower view of the obligation, stating: "Courts should not use the obligation to change *ex post facto* the parties' or this Act's allocation of risk and power. To the contrary, in light of the nature of a limited partnership, the obligation should be used only to protect agreed-upon arrangements from conduct that is manifestly beyond what a reasonable person could have contemplated when the arrangements were made." ULPA (2001) § 305(b) cmt.

57. Re-ULLCA § 409(d) states: "A member in a member-managed limited liability company or a manager-managed limited liability company shall discharge the duties under this [act] or under the operating agreement and exercise any rights consistently with the *contractual* obligation of good faith and fair dealing." (Emphasis added).

58. *Id.* § 409(d) cmt.

59. *Id.* (quoting ULPA (2001), § 305(b) cmt.).

60. Daniel S. Kleinberger, Agency, Partnerships, and LLCs 199 (2d ed., Aspen Publishers 2002) ("UPA's schizoid approach").

the market place,"[61] owners of a closely held business have "certain rights to what has been termed 'selfish ownership. . . .' "[62]

RUPA tried to express this concept by stating: "[a] partner does not violate a duty or obligation under this [Act] or under the partnership agreement merely because the partner's conduct furthers the partner's own interest."[63] ULLCA and ULPA (2001) each incorporate this language,[64] but the new Act does not. As explained in the Comments to Re-ULLCA, Section 409: "This language is inappropriate in the complex and variegated world of LLCs. As a proposition of contract law, the language is axiomatic and therefore unnecessary. In the context of fiduciary duty, the language is at best incomplete, at worst wrong, and in any event confusing."[65]

There is no simple, concise way to explicate the "schizoid" fiduciary duty of an LLC member. Part III-K of this Article does, however, explain how this Act approaches member-to-member fiduciary duty.[66]

E. Reformulating the Duty of Care

The UPA states no standard of care, and RUPA sets a low standard: "[a] partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law."[67] ULLCA and ULPA (2001) both copy RUPA.[68]

After much debate, the Drafting Committee and the Conference decided that, in a post-Enron era, gross negligence sets the bar too low.[69] The Committee and

61. Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

62. Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 663 (Mass. 1976).

63. RUPA § 404(e).

64. ULPA (2001) § 408(e) and ULLCA § 409(e).

65. Re-ULLCA § 409(e), cmt. In place of the omitted language, subsection 409(e) makes an important point about the duty of loyalty: "It is a defense to a claim under subsection (b)(2) [conflict of interest; adverse dealings] and any comparable claim in equity or at common law that the transaction was fair to the limited liability company." Re-ULLCA § 409(e). Although the subsection states "a well-established principle of judge-made law," the statement is useful: "Given this Act's very detailed treatment of fiduciary duties and especially the Act's very detailed treatment of the power of the operating agreement to modify fiduciary duties, the statement is important because its absence might be confusing." Re-ULLCA § 409(e) cmt.

66. *See infra* at notes 111–32 and accompanying text.

67. RUPA § 404(c).

68. ULPA (2001) § 408(c) and ULLCA § 409(c).

69. The 2006 Annual Meeting Draft contains the following history of the Drafting Committee's discussions of this issue:

> This section's history was conceptually tumultuous. For some time, the uncertainty pertained to the appropriate standard for the duty of care. At its November, 2003 meeting, at the urging of Commissioner Blackburn, the Drafting Committee decided to try to (i) eschew the "gross negligence" standard of care first promulgated in RUPA and afterwards followed in ULLCA and ULPA (2001); and (ii) incorporate something like the standard of care/standard of liability dichotomy recently adopted in MBCA §§ 8.30 and 8.31. Under the MBCA, that dichotomy exists principally for directors and not for officers, cf. MBCA 8.42(c) (stating that director standard of

Conference were also influenced by the fact that many LLC statutes state an ordinary care standard.[70]

The new Act's standard is a hybrid—ordinary care expressly subject to the business judgment rule:

> (c) Subject to the business judgment rule, the duty of care of a member of a member-managed limited liability company in the conduct and winding up of the company's activities is to act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member reasonably believes to be in the best interests of the company.
>
> . . . .
>
> (g) In a manager-managed limited liability company, . . . [subsection] (c). . .appl[ies] to the manager or managers and not the members.[71]

A detailed Comment explains the rationale:

> In some circumstances, an unadorned standard of ordinary care is appropriate for those in charge of a business organization or similar, non-business enterprise. In

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liability principles apply to officers if they "have relevance), and those positions reflect categorically different kinds of responsibilities.

In response, the co-reporters drafted and the Committee considered a version of this section and a companion section, Section 410, that together attempted to parallel functionally the MBCA's positional distinction by using the defined terms "governance responsibility" and "operational responsibilities." (The draft also differed from the MBCA approach by leaving unaffected the traditional rules for duty of loyalty violations.)

At its April 2004 meeting, the Drafting Committee discussed the proposal at length and with good-natured intensity. When the dust cleared, no one had moved to change any language. However, there was considerable sentiment expressed in favor of collapsing the two sections into one provision and somehow reinstating the gross negligence standard in combination with a business judgment rule formulation.

The chair of the Committee then directed the co-reporters to draft a single section, which was presented to and adopted by the Committee during a teleconference. That single section was distributed to the 2004 Annual Meeting as a supplement to the Act and was read in place of the Sections 409 and 410 included in the Annual Meeting draft. At its October, 2004 meeting, the Drafting Committee again vigorously debated the topic of fiduciary duty, but no changes were moved.

. . . .

At its February, 2006 meeting, the Committee returned again to the vexing question of the appropriate standard of care and reached a compromise—maintaining an ordinary negligence standard but expressly superimposing the business judgment rule.

2006 Annual Meeting Draft § 409 cmt. At the 2006 Annual Meeting, the Conference considered and defeated a motion from the floor to return to the gross negligence standard. Transcript of 2006 Annual Meeting, supra note 43, at 47–51.

70. Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom With the Need For Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC,* 152 U. Pa. L. Rev 1609, 1658 (2004) (article has two tables in the appendix summarizing state LLC statutes standard of care: 21 states with "good faith prudent person" language and 19 states using "gross negligence or willful misconduct" language); Elizabeth S. Miller and Thomas E. Rutledge, *The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations?,* 30 Del. J. Corp. L. 343, 366–68 (2005) ("Approximately eighteen state LLC statutes parallel language formerly used in the MBCA and require managers and managing members to act in good faith and exercise the care of an ordinarily prudent person in a like position under similar circumstances.").

71. Re-ULLCA § 409(c) and (g)(1).

others, the proper application of the duty of care must take into account the difficulties inherent in establishing an enterprise's most fundamental policies, supervising the enterprise's overall activities, or making complex business judgments. Corporate law subdivides circumstances somewhat according to the formal role exercised by the person whose conduct is later challenged (e.g., distinguishing the duties of directors from the duties of officers). LLC law cannot follow that approach, because a hallmark of the LLC entity is its structural flexibility.

This subsection, therefore, seeks "the best of both worlds"—stating a standard of ordinary care but subjecting that standard to the business judgment rule to the extent circumstances warrant. The content and force of the business judgment rule vary across jurisdictions, and therefore the meaning of this subsection may vary from jurisdiction to jurisdiction.

That result is intended. In any jurisdiction, the business judgment rule's application will vary depending on the nature of the challenged conduct. There is, for example, very little (if any) judgment involved when a person with managerial power acts (or fails to act) on an essentially ministerial matter. Moreover, under the law of many jurisdictions, the business judgment rule applies similarly across the range of business organizations. That is, the doctrine is sufficiently broad and conceptual so that the formality of organizational choice is less important in shaping the application of the rule than are the nature of the challenged conduct and the responsibilities and authority of the person whose conduct is being challenged.

This Act seeks therefore to invoke rather than unsettle whatever may be each jurisdiction's approach to the business judgment rule.[72]

F. The Question of the "Shelf LLC"

In practice, many attorneys (and their clients) wish to have a limited liability company formed and on the public record while the relevant deal coalesces—i.e., before the precise identity and relationship of the members has been finally determined. In theory, according to some advisors to the Drafting Committee, a member-less LLC is an oxymoron and having an LLC waiting "on the shelf" for the members to be identified is an example of the "corpufuscation" of partnership law.[73]

"No issue roiled the drafting process to this Act more than the question of 'shelf LLCs,'"[74] and a compromise was reached at the Drafting Committee's final meeting

72. Re-ULLCA § 409(c) cmt. The new Act also approaches this subject from the other direction—i.e., by expressly authorizing the operating agreement to exculpate a member or manager from liability for breach of the duty of care. Re-ULLCA § 110(g). *See infra* notes 172–75 and accompanying text.

73. Daniel S. Kleinberger, *The Closely Held Business Through the Entity-Aggregate Prism,* 40 Wake Forest L. Rev. 827, 872–73 (2005) [hereinafter "*Prism*"] and *Progress Report, supra* note 12, at 11 (2006). Other "theorists" point out that the LLC departed from its partnership moorings when LLC statutes recognized the single member LLC. *Id.*

74. Re-ULLCA, 2006 Annual Meeting Draft, § 401 cmt. The Comment to the final statutory text has a less dramatic tone: "No topic received more attention or generated more debate in the drafting process for this Act than the question of the 'shelf LLC'—i.e., an LLC formed without having at least one member upon formation. Reasonable minds differed (occasionally intensely) as to whether the 'shelf' approach (i) is necessary to accommodate current business practices; and (ii) somehow does conceptual violence to the partnership antecedents of the limited liability company." Re-ULLCA § 201 cmt.

(during the 2006 annual meeting).[75] Most LLCs will be formed with at least one person becoming a member upon formation,[76] but the new Act "permits an organizer to file a certificate of organization without a person 'waiting in the wings.'"[77]

For the latter situation, the Act requires two filings to form the LLC. The organizer must first deliver the certificate of organization for filing,[78] and, "if the company will have no members when the [Secretary of State] files the certificate, [the certificate must contain] a statement to that effect."[79]

The first filing is a just a precursor. Section 201 "provides that the LLC is not formed until and unless at least one person becomes a member and the organizer makes a second filing stating that the LLC has at least one member."[80] The second filing must state "the date on which a person or persons became the company's initial member or members."[81]

The Act suggests a deadline of 90 days for the second filing.[82] If the deadline is not met, the original filing "lapses and is void."[83] If the deadline is met, the limited liability company is "deemed formed as of the date of initial membership stated" in the required second filing.[84]

75. Transcript of 2006 Annual Meeting, *supra* note 43, at 23 (Remarks of Chairman Walker stating that the committee's amendment to the annual meeting draft "does reveal a compromise").

76. Re-ULLCA § 201(b)(3) and (d)(1) (providing that, unless the certificate of organization states that "the company will have no members when the [Secretary of State] files the certificate," a "limited liability company is formed when the [Secretary of State] has filed the certificate of organization and the company has at least one member, unless the certificate states a delayed effective date").

77. Re-ULLCA, Prefatory Note, Noteworthy Provisions of the New Act. Re-ULLCA § 201(b)(3).

78. Re-ULLCA § 201(a).

79. *Id.* § 201(b)(3).

80. *Id.* Prefatory Note, Noteworthy Provisions of the New Act.

81. *Id.* § 201(e)(1)(B).

82. *Id.* § 201(e)(1) (placing the number 90 within brackets). *See* NCCUSL Drafting Rule 406, cmt. (characterizing bracketed material as suggested).

83. Re-ULLCA § 201(e)(1).

84. Re-ULLCA § 201(e)(2). As a practical matter, the complexity inherent in the Act's compromise will be of greatest interest to lawyers asked to provide third party opinion letters. A detailed treatment of that subject is beyond the scope of this article, but the following summary may be helpful.

(1) The principal purpose of a third party opinion letter is to indicate that a business organization has the legal capacity to bind itself to a particular, significant transaction.

(2) To have that capacity, the organization must, of course, exist as a legal entity. In this connection, third party opinion letters traditionally consider both whether a business organization was "duly formed" and is "validly existing."

(3) Under Re-ULLCA, due formation involves the limited liability company having at least one member upon formation—either: (i) when the filing officer files the certificate of organization, Re-ULLCA § 201(d)(1), or (ii) when, subsequent to that filing, the organizer admits a person as an initial member, delivers to the filing officer a statement so indicating, and the filing officer files the statement. Re-ULLCA §§ 201(e)(2) and 401(c).

(4) The filing officer's act of filing the certificate under § 201(d)(1) or the statement under § 201(e)(2) is, as a statutory matter, "conclusive proof that the organizer satisfied all conditions to the formation of a limited liability company." Re-ULLCA § 201(d)(3) and (e)(3).

(5) As for the opinion letter concept of "validly existing," it may be appropriate to ascertain that at the moment of formation the limited liability company did indeed have at least one member.

For a more detailed discussion of opinion issues concerning limited liability companies, see Robert R. Keatinge, *Shelf LLCs and Opinion Letter Issues: Exegesis and Eisegesis of LLC Statutes,* Vol. XXIII, No. 2, PUBOGRAM 15 (March 2006). *See also* TriBar Opinion Committee, *Third-Party Closing Opinions: Limited Liability Companies,* 61 Bus. Law. 679 (2006).

G. Statutory Apparent Authority

The power of a member or manager of a business organization to bind the organization to third parties is in essence a question of agency law, and in this context one of the most important rules of agency law is *apparent authority by position.*[85] Most LLC statutes codify this concept, providing "what might be termed 'statutory apparent authority' for members in a member-managed limited liability company and managers in a manager-managed limited liability company."[86]

This approach traces back to the original Uniform Partnership Act[87] and has been copied by RUPA, ULLCA, ULPA (2001)[88] and myriad state LLC statutes.[89] Nevertheless, the Drafting Committee determined that statutory apparent authority is inappropriate for limited liability companies, because:

- codifying power to bind according to position makes sense only for organizations that have well-defined, well-known, and almost paradigmatic management structures; and
- limited liability companies feature almost infinite flexibility of management structure and an LLC's name provides no clue as to the LLC's management structure.

As explained in a March 2006 "Progress Report on the Revised Uniform Limited Liability Company Act":

> The concept [of statutory apparent authority] still makes sense both for general and limited partnerships. A third party dealing with either type of partnership can know by the formal name of the entity and by a person's status as general or limited partner whether the person has the power to bind the entity.

85. Restatement (Third) of Agency, Introduction (2006) [hereinafter "R.3d Agency"] ("This Restatement . . . discusses at length the application of agency doctrine to organizations. Many agents hold positions in organizations. This Restatement thus covers applications of agency doctrine to persons who act as representatives of corporations, partnerships, other business organizations, and private not-for-profit entities. In that context, the focal point for the application of agency doctrine is determining either the duties owed the organization by those holding positions within it or the consequences of interactions between actors in positions defined by one organization with individuals external to the organization or with actors who hold positions in another organization."); *id.* § 1.03 cmt. b ("If the principal places a person in a position or office with specific functions or responsibilities, from which third parties will infer that the principal assents to acts by the person requisite to fulfilling the specific functions or responsibilities, the principal has manifested such assent to third parties."); *id.* § 3.03 cmt. b ("A principal may also make a manifestation by placing an agent in a defined position in an organization. . . . Third parties who interact with the principal through the agent will naturally and reasonably assume that the agent has authority to do acts consistent with the agent's position . . . unless they have notice of facts suggesting that this may not be so."); *id.* § 3.03 cmt. c ("Apparent authority in an organizational setting may also arise from the fact that a person occupies a type of position that customarily carries specific authority although the organization has withheld such authority from that agent.").

86. Re-ULLCA § 301(a) cmt.

87. Uniform Partnership Act § 9(1) (1914) [hereinafter "UPA"] (providing) that "the act of every partner . . . for apparently carrying on in the usual way the business of the partnership . . . binds the partnership").

88. RUPA § 301; ULLCA § 301; ULPA (2001) § 402.

89. For a discussion of this approach in LLC statutes, see Bishop and Kleinberger, *supra* note 19, ¶ 7.05 [3].

Most LLC statues have attempted to use the same approach but with a fundamentally important (and problematic) distinction. An LLC's status as member-managed or manager-managed determines whether members or managers have the statutory power to bind. But an LLC's status as member- or manager-managed is *not* apparent from the LLC's name. A third party must check the public record, which may reveal that the LLC is manager-managed, which in turn means a member as member has no power to bind the LLC. As a result, a provision that originated in 1914 as a protection for third parties can, in the LLC context, easily function as a trap for the unwary. The problem is exacerbated by the almost infinite variety of management structures permissible in and used by LLCs.[90]

Thus, "it makes no sense to require each LLC to publicly select between two statutorily preordained structures (i.e., manager-managed/member-managed) and . . . link a 'statutory power to bind' to each of those two structures."[91] Accordingly, Section 301 of the new Act states simply that: "A member is not an agent of a limited liability company solely by reason of being a member. A person's status as a member does not prevent or restrict law other than this [act] from imposing liability on a limited liability company because of the person's conduct."[92]

Under the new Act, the question of a member or manager's power to bind becomes a matter of agency law:

[Section 301] expressly preserves the power of other law to hold an LLC directly or vicariously liable on account of conduct by a person who happens to be a member. For example, given the proper set of circumstances: (i) a member might have actual or apparent authority to bind an LLC to a contract; (ii) the doctrine of *respondeat superior* might make an LLC liable for the tortuous conduct of a member (i.e., in some circumstances a member acts as a "servant" of the LLC); and (iii) an LLC might be liable for negligently supervising a member who is acting on behalf of the LLC. A person's status as a member does not weigh against any of these or any other relevant theories of law.

Moreover, subsection (a) does not prevent member status from being relevant to one or more elements of an "other law" theory. The most categorical example concerns the authority of a non-manager member of a manager-managed LLC.

EXAMPLE: A vendor knows that an LLC is manager-managed but chooses to accept the signature of a person whom the vendor knows is merely a member of the LLC. Assuring the vendor that the LLC will stand by the member's commitment, the member states, "It's such a simple matter; no one will mind." The member genuinely believes the statement, and the vendor accepts the assurance.

90. *Progress Report, supra* note 12, at 10 (emphasis in original).

91. Re-ULLCA § 301(a) cmt. *See also* R.3d Agency, *supra* note 85, §3.03 cmt. c ("Moreover, the fact that any given organization has a particular legal form does not mean that its actual operational practices conform perfectly to legal form. Organizations vary widely in the degree to which they operate informally or formally in making decisions and in interacting with third parties external to the organization. Organizations also vary in the degree to which authority is associated solely with a position within an organizational hierarchy or is personalized to a particular individual regardless of the organization's formal association of authority with defined positions.").

92. Re-ULLCA § 301(a) and (b).

The person's status as a mere member will undermine a claim of apparent authority. Restatement (Third) of Agency § 2.03, cmt. d (2006) (explaining the "reasonable belief" element of a claim of apparent authority, and role played by context, custom, and the supposed agent's position in an organization). Likewise, the member will have no actual authority. Absent additional facts, section 407(c)(1) (vesting all management authority in the managers) renders the member's belief unreasonable. Restatement (Third) of Agency § 2.01, cmt. c (2006) (explaining the "reasonable belief" element of a claim of actual authority).[93]

Although "under section 301(a), . . . the mere fact that a person is a member of a member-managed limited liability company cannot by itself establish apparent authority by position. . . . [a] course of dealing . . . may easily change the analysis."[94] Another example from the Comments illustrates this point:

EXAMPLE: David is a one of two members of DS, LLC, a member-managed LLC. David orders paper clips on behalf of the LLC, signing the purchase agreement, "David, as a member of DS, LLC." The vendor accepts the order, sends an invoice to the LLC's address, and in due course receives a check drawn on the LLC's bank account. When David next places an order with the vendor, the LLC's payment of the first order is a manifestation that the vendor may use in establishing David's apparent authority to place the second order.[95]

The Comments to Sections 301 and 407 analyze in detail how agency law will function in the absence of statutory apparent authority. The results will be acceptable even for pre-existing LLCs, formed under a statute that provided for statutory apparent authority, because "the notion of 'lingering apparent authority' will protect any third party that has previously relied on the statutory apparent authority of a member of a particular member-managed LLC or a manager of a particular manager-managed LLC."[96]

H. Statements of Authority by Position

Eliminating statutory apparent authority eliminates the need to have an LLC's certificate of organization indicate the LLC's management structure. However, the members of an LLC might want to make public their management structure in order to facilitate transactions and to avoid "having to disclose to third parties the entirety of the operating agreement."[97]

The new Act addresses this issue by authorizing a statement of authority pertaining to a position. RUPA pioneered the notion of a publicly-filed statement

93. Re-ULLCA § 301(b) cmt.
94. *Id.*
95. *Id.*
96. Re-ULLCA § 1104 (citing Restatement (Third) of Agency § 3.11 cmt. c (2006)) (Application to Existing Relationships), Legislative Note (stating that "[s]ection 301 (de-codifying statutory apparent authority) does not require any special transition provisions").
97. Re-ULLCA § 302(a)(2) cmt.

of authority pertaining to particular partners,[98] and Re-ULLCA takes that concept a step further. Under Re-ULLCA, § 302(a)(2), a statement of authority:

> with respect to any position that exists in or with respect to the company, may state the authority, or limitations on the authority, of all persons holding the position to:
>
> (A) execute an instrument transferring real property held in the name of the company; or
>
> (B) enter into other transactions on behalf of, or otherwise act for or bind, the company . . . .[99]

As with RUPA, statements of authority concerning real property can give constructive notice if properly filed in the real estate records, while other statements of authority affect only third parties with knowledge. As explained by the Comment to Re-ULLCA Section 302:

> This section is derived from and builds on RUPA, § 303, and, like that provision is conceptually divided into two realms: statements pertaining to the power to transfer interests in the LLC's real property and statements pertaining to other matters. In the latter realm, statements are filed only in the records of the [Secretary of State], operate only to the extent the statements are actually known. Section 302(d) and (e).
>
> As to interests in real property, in contrast, this section: (i) requires double-filing—with the [Secretary of State] and in the appropriate land records; and (ii) provides for constructive knowledge of statements limiting authority. Thus, a properly filed and recorded statement can protect the limited liability company, Section 302(g), and, in order for a statement pertaining to real property to be a sword in the hands of a third party, the statement must have been both filed and properly recorded. Section 302(f).[100]

I. Templates for Management Structure

Most LLC statutes provide for default rules for two types of management structure—member-management and manager-management.[101] The new Act continues these templates but innovates in two significant ways.

First, the Act permits the operating agreement rather than the certificate of organization to establish an LLC's management structure.[102] This approach is made possible by the Act's eschewal of statutory apparent authority.

98. RUPA § 303.

99. Re-ULLCA § 302(a)(2). The section also permits statements of authority as to "a specific person." *Id.* § 302(a)(3).

100. *Id.* § 302 cmt.

101. Bishop and Kleinberger, *supra* note 19, ¶ 7.02 [2] and [3].

102. Re-ULLCA § 407(a). If the operating agreement does not specify manager-management, for purposes of the Act's operative provision the LLC will be member-managed. That is, "member-managed" is the default setting. *Id.* § 102(10) ("'Manager-managed limited liability company' means a limited liability company that qualifies under Section 407(a)."); *id.* §102(12) ("'Member-managed limited liability company' means a limited liability company that is not a manager-managed limited liability company.").

Second, the Act recognizes that the statutory templates are just that. Some LLCs use neither of the templates for management structure, and many LLCs start with one of the templates but (via the operating agreement) alter significantly the allocation of power among the members or between members and managers. Accordingly, the Act carefully contemplates how managerial duties might shift to correspond with the particular management relationships chosen by the members.[103]

J. Charging Orders

The charging order is a venerable part of the law of unincorporated business organizations[104] and is an essential buttress to the "pick your partner" principle that is central to the law of limited liability companies.[105] The new Act reinforces the principle by modernizing the statutory language on charging orders. The goal is "that the language (and its protections against outside interference in an LLC's activities) can be readily understood."[106]

The charging order is a lien in favor of the judgment creditor of a member or transferee which applies against the transferable interest of the judgment debtor. Once in effect and duly served on the limited liability company, a charging order "requires the limited liability company to pay over to the person to which the charging order was issued any distribution that would otherwise be paid to the judgment debtor."[107]

The order functions analogously to a garnishment, and the court has the power to deal with efforts to evade the lien:

> To the extent necessary to effectuate the collection of distributions pursuant to a charging order, the court may:
> (1) appoint a receiver of the distributions subject to the charging order, with the power to make all inquiries the judgment debtor might have made; and
> (2) make all other orders necessary to give effect to the charging order.[108]

The court's power is limited to evasive conduct and does not extend to interfering in the legitimate activities of the LLC. A court enforcing a charging order has no more right to affect the LLC's obligations to the judgment debtor than the court would have to compel a wage garnishee to increase the wages of the debtor employee. Thus, a receiver appointed under Re-ULLCA, § 503(b) is emphatically

103. *See, e.g.,* Re-ULLCA § 110(f) ("To the extent the operating agreement of a member-managed limited liability company expressly relieves a member of a responsibility that the member would otherwise have under this [act] and imposes the responsibility on one or more other members, the operating agreement may, to the benefit of the member that the operating agreement relieves of the responsibility, also eliminate or limit any fiduciary duty that would have pertained to the responsibility.").

104. Daniel S. Kleinberger, Carter G. Bishop, Thomas Earl Geu, *Charging Orders and the New Uniform Limited Partnership Act—Dispelling Rumors Of Disaster,* 18 Probate and Property 30, 30 (July/August 2004).

105. Bishop and Kleinberger, *supra* note 19, ¶ 8.06 [2][a][iv].

106. Re-ULLCA, Prefatory Note, Noteworthy Provisions of the New Act.

107. Re-ULLCA § 503(a).

108. *Id.* § 503(b).

not a receiver for the LLC; the receiver's powers are limited solely to seeking information to which the judgment debtor is entitled.[109]

As for the court's power "to make all other orders," that power is limited to those orders "necessary to give effect to the charging order." The Comment to Section 503(b)(2) provides two very important examples:

> **Example:** A judgment creditor with a charging order believes that the limited liability company should invest less of its surplus in operations, leaving more funds for distributions. The creditor moves the court for an order directing the limited liability company to restrict re-investment. Subsection (b)(2) does not authorize the court to grant the motion.
> **Example:** A judgment creditor with a judgment for $10,000 against a member obtains a charging order against the member's transferable interest. Having been properly served with the order, the limited liability company nonetheless fails to comply and makes a $3000 distribution to the member. The court has the power to order the limited liability company to pay $3000 to the judgment creditor to "give effect to the charging order."[110]

K. A Remedy for Oppressive Conduct

In 2003, when the Drafting Committee first reported to a NCCUSL annual meeting, the question of a statute-based remedy for oppressive conduct was one of nine major topics discussed in the Committee's briefing memo.[111] The memo acknowledged that, as of that moment, "[t]he Drafting Committee has had almost no discussion of this topic, other than to acknowledge that the topic is of great importance and will require careful and repeated discussion."[112] The memo then described the question before the Committee (and eventually the Conference) as follows:

> LLCs may be destined eventually to supplant the corporation as the entity of choice for closely held businesses. If so, omitting an oppression remedy from the new Act (i) could be interpreted as rejecting the past five decades of legal developments regarding oppression, and (ii) would, at minimum, force courts to consider re-inventing the corporate oppression wheel in the LLC context.
>
> On the other hand, the limited liability company is essentially a contract-based arrangement—at least *inter se* the members (which is relevant focal point for discussions of oppression). The contracting parties may protect themselves to the extent they consider necessary. Moreover, the paucity of LLC statutes with oppression remedies might mean something about proper public policy and certainly has implications for the prospects of uniform enactment.

109. If the judgment debtor is a mere transferee, the entitlement is nil until dissolution. *See id.* § 502(a)(3)(B) and (c) (stating that a mere transferee is not entitled to "have access to records or other information concerning the company's activities . . . [except that] [i]n a dissolution and winding up of a limited liability company, a transferee is entitled to an account of the company's transactions only from the date of dissolution").

110. *Id.* § 503(b)(2) cmt.

111. 2003 NCCUSL Annual Meeting Briefing Memo, at 64–72, *available at* http://www.law.upenn.edu/bll/ulc/ullca/ann-meet-draft03.pdf.

112. *Id.* at 70.

> Yet close corporation law developed its protections for minority shareholders by analogizing to general partnerships, which are at least as much creatures of contract as are limited liability companies (and arguably more so; no public filing is necessary to create a general partnership). Moreover, in most limited liability companies the contractual arrangement is a "relational contract"—i.e., of long duration, with parts of the bargain necessarily left open or subject to discretion, and with the parties to the bargain significantly interdependent. Although the concept of relational contracts has had little impact on the courts, the circumstances described by the concept have occasioned legislative intervention at both federal and state levels. Statutes designed to protect dealers provide the most notable examples. Whether such intervention is good policy is a separate question, but the examples show that on occasion this society chooses to have the government intervene "for the sake of fairness" in arrangements that are primarily contractual.[113]

By 2006, when the Conference gave final approval to the new Act, the inclusion of a statute-based remedy was a non-issue; the decision to include a remedy went without discussion, let alone debate.[114]

The new Act's oppression remedy appears in the section concerning dissolution. Section 701(a)(5) authorizes a court to dissolve a limited liability company:

> on application by a member, . . . on the grounds that the managers or those members in control of the company:
>
> (A) have acted, are acting, or will act in a manner that is illegal or fraudulent; or
>
> (B) have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant.[115]

Section 701(b) authorizes a court to "order a remedy other than dissolution."[116] The operating agreement cannot alter Section 701(a)(5) but may limit or even eliminate subsection (b).[117]

Providing a remedy for oppression makes good sense. "Like most close corporations, most limited liability companies face the 'lock in' problem and the corresponding susceptibility of minority owners to oppression by those in control."[118] Moreover, "courts have begun to apply close corporation 'oppression' doctrine to LLCs."[119]

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113. *Id.* at 71–72 (citations omitted).

114. Transcript of 2006 Annual Meeting, *supra* note 43, at 62–64.

115. Re-ULLCA § 701(a)(5).

116. *Id.* § 701(b).

117. *Id.* § 110(c)(7) (stating that an operating agreement may not "vary the power of a court to decree dissolution in the circumstances specified in Section 701(a). . . (5)). Section 110(c) does not mention section 701(b). Therefore, the operating agreement has plenary power over that provision. *Id.* § 110(a) (stating that ("[e]xcept as otherwise provided in subsections (b) and (c), the operating agreement governs: (1) relations among the members as members and between the members and the limited liability company; . . . [and] (3) the activities of the company and the conduct of those activities").

118. Daniel S. Kleinberger, *Direct Versus Derivative and the Law of Limited Liability Companies,* 58 BAYLOR L. REV. 63, 120 (2006) [hereinafter "*Direct v. Derivative*"]. *See generally* BISHOP AND KLEINBERGER, *supra* note 19, ¶ 10.09.

119. Re-ULLCA, 2005 Annual Meeting Draft, § 701, Reporters' Notes, *available at* http://www.law.upenn.edu/bll/ulc/ullca/2005annmtgdraft.htm. *See also* Harvey Gelb, *Fiduciary Duties and Dissolution in*

The Act's approach to this question is nuanced, although the nuances are latent and reflect a mixture of reliance on judicial good sense and deference to the members' foresight (i.e., their operating agreement). The Drafting Committee selected as the applicable term of art the word "oppressive" rather than the perhaps looser phrase "unfairly prejudicial" but then chose not to specify in detail the factors to be considered in determining whether conduct is "oppressive."[120] These choices reflect respect for judicial good sense. Deference for the operating agreement includes the members' power under Section 110 to clearly delineate members' discretionary authority. As is stated in the Comment to the section codifying the obligation of good faith and fair dealing:

> Courts should not use the obligation to change ex post facto the parties' or this Act's allocation of risk and power. To the contrary, . . . the obligation should be used only to protect agreed-upon arrangements from conduct that is manifestly beyond what a reasonable person could have contemplated when the arrangements were made. . . . In sum, the purpose of the obligation of good faith and fair dealing is to protect the arrangement the [members] have chosen for themselves, not to restructure that arrangement under the guise of safeguarding it.[121]

It is noteworthy that the oppression remedy is phrased initially as court-ordered dissolution and that the operating agreement can limit the court to that remedy. Dissolution is the "nuclear option" in any dispute among members of a closely held business, and a separate provision of the Act authorizes a court to fashion a less draconian remedy.[122]

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the Closely Held Business, 3 WYO. L. REV. 547 (2003); Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC,* 152 U. PA. L. REV. 1609 (2004); Douglas K. Moll, *Minority Oppression and the Limited Liability Company: Learning (or Not) from Close Corporation History,* 40 WAKE FOREST L. REV. 883 (2005); Pinnacle Data Serv., Inc. v. Gillen, 104 S.W.3d 188, 196 (Tex. App. 2003) (expressly applying close corporation doctrine); Wyoming.com, LLC v. Lieberman, 109 P.3d 883, 886 (Wyo. 2005) (Kite, J., concurring) ("We have not had the occasion to address Mr. Lieberman's rights as a minority owner in the LLC nor the obligations of the LLC to him as a minority interest owner. Those rights and responsibilities in the context of other forms of business organizations are well developed and may provide guidance in the realm of the LLC.").

120. See 2005 Annual Meeting Draft, § 701(a)(5), Reporters' Notes, which explain:

> At its April, 2004 meeting, the Drafting Committee deleted language that would have cabined somewhat the vague term "oppressive." The deleted language provided that:
> oppressive conduct has occurred only if the conduct complained of has directly harmed the applicant and:
> (1) constitutes a material, uncured breach of the operating agreement or of the obligation of good faith and fair dealing stated in Section 409(d); or
> (2) although not constituting a material, uncured breach under paragraph (1), has substantially defeated an expectation of the applicant which is entitled to protection because the expectation:
> (A) is not contradicted by any term of the operating agreement nor by the reasonable implication of any term of that agreement;
> (B) was central to the applicant's decision to become a member of the limited liability company or for a substantial time has been centrally important in the member's continuing membership;
> (C) was known to other members, which expressly or impliedly acquiesced in it;
> (D) is consistent with the reasonable expectations of all the members; and
> (E) is otherwise reasonable under the circumstances.

121. Re-ULLCA § 409(d) cmt. (quoting the Comment to ULPA (2001), § 305(b); brackets and first ellipsis added).

122. Re-ULLCA § 701(b).

The Act includes the lesser remedy because: "In the close corporation context, many courts have reached this position without express statutory authority, most often with regard to court-ordered buyouts of oppressed shareholders. The Drafting Committee preferred to save courts and litigants the trouble of re-inventing that wheel in the LLC context."[123] However, the members through their operating agreement may override subsection (b), in effect limiting the court (and themselves) to the all-or-nothing remedy of dissolution.[124]

It is also noteworthy that the new Act does not directly address the question of member-to-member fiduciary duties. The modern law of close corporations makes clear that shareholders owe each other fiduciary duties,[125] and some recent LLC cases have ruled likewise as to members.[126]

The new Act takes a different approach. The Act's partial codification of fiduciary duty of loyalty pertains only to duties that protect the entity,[127] and the obligation of good faith and fair dealing is purposefully referred to as "contractual" in order to "emphasize that the obligation is not an invitation to re-write agreements among the members."[128]

There is space, however, for courts to find a fiduciary duty among members. The codification in Section 409 is not exhaustive,[129] and, indeed, Section 701(a)(5)(B)

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123. Re-ULLCA, 2005 Annual Meeting Draft, § 701(b), Reporters' Notes.

124. *Compare* ULPA (2001), § 1206(c)(5) (providing that, for limited partnerships "dragged into" the new limited partnership act, "Section 603(5) [authorizing a court to expel a general partner without dissolving the limited partnership] does not apply and a court has the same power to expel a general partner as the court had immediately before [the effective date of this [Act]]") (first set of brackets added). The pre-ULPA (2001) case law was divided as to whether—absent an authorizing provision in the partnership agreement—a court had the power to expel a general partner without dissolving the limited partnership. *See e.g.,* Miltland Raleigh-Durham v. Myers, 807 F. Supp. 1025,1059–60 (S.D.N.Y 1992) ("[t]his Court has the power to remove . . . general partners of the Limited Partnerships in issue and elevate a limited partner to the position of managing partner in order to preserve the partnership . . . ."); Heikel v. 268 Ltd., No. 87-2464, 1989 WL 123632, at *1 (9th Cir. Oct. 2, 1989), ("to be legitimate, the expulsion must be 'bona fide under the partnership agreement'" and regardless of legitimate expulsion, the "ouster" from the partnership dissolved the limited partnership).

125. *Donahue v. Rodd Electrotype Co. of New England, Inc.,* 328 N.E.2d 505, 515 (Mass. 1975) is perhaps the seminal case, but other examples abound. *See generally* 2 F. HODGE O'NEAL AND ROBERT B. THOMPSON, O'NEAL AND THOMPSON'S CLOSE CORPORATION & LLCS: LAW AND PRACTICE § 9:27 (Rev. 3d ed. 2006); Daniel S. Kleinberger, *Why Not Good Faith—The Foibles of Fairness in Closely Held Corporations,* 16 WM. MITCHELL L. REV. 1143 (1990); Douglas K. Moll, *Minority Oppression & the Limited Liability Company: Learning (or Not) From Close Corporation History,* 40 WAKE FOREST L. REV. 883 (2005).

126. Credentials Plus, LLC v. Calderone, 230 F. Supp. 2d 890, 899 (N.D. Ind. 2002) ("Indiana LLCs, being similar to Indiana partnerships and corporations impose a common law fiduciary duty on their officers and members in the absence of contrary provisions in LLC operating agreements."); Anderson v. Wilder, No. E2003-00460-COA-R3-CV, 2003 WL 22768666, at *3 (Tenn. Ct. App. Nov. 21, 2003) ("[s]ince it is also well established as a fundamental rule of partnerships, that *all* partners, not just the majority, owe each other fiduciary duties (Lightfoot v. Hardaway, 751 S.W.2d 844, 849 (Tenn.Ct.App.1988)), it logically follows that a majority of the members of an "LLC" should owe a fiduciary duty to the minority members just like the duty a majority of the shareholders of an "Inc." owe the minority shareholders.") (citations and emphasis in original).

127. Re-ULLCA § 409(b)(1)-(3) ("to account to the company . . . [for usurped company opportunities]; to refrain from dealing with the company in the conduct or winding up of the company's activities as or on behalf of a person having an interest adverse to the company; and . . . to refrain from competing with the company . . . .").

128. *Id.* § 409(d) and cmt.

129. *See supra* text accompanying notes 45–49.

inescapably implies that "those members in control of the company" have a duty to avoid acting "in a manner that is oppressive and was, is, or will be directly harmful" to another member.[130]

However, while articulating member-to-member fiduciary duty would put the Act squarely within the modern law of closely held business,[131] the question is largely semantic. The oppression remedy exists, and conduct by "those members in control of the company" will trigger it.[132]

L. Derivative Claims and Special Litigation Committees

The distinction between direct and derivative claims follows from the status of a business organization as a legal person distinct from its owners.[133] Following the majority view in the case law of closely held businesses,[134] the new Act requires a member who brings a direct action to "plead and prove an actual or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the limited liability company."[135]

The Act recognizes the direct/derivative distinction as an important safeguard to the members' agreed-upon arrangements.[136] The Act's provisions on derivative claims are modern, based on the provisions of ULPA (2001), which improved on the provisions of ULLCA, which in turn had improved on the provisions of the Revised Uniform Limited Partnership Act (1976/1985).

The Act innovates by expressly providing for special litigation committees. As explained by the Comment to Section 905:

> Although special litigation committees are best known in the corporate field, they are no more inherently corporate than derivative litigation or the notion that an organization is a person distinct from its owners. An "SLC" can serve as an ADR mechanism,

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130. Re-ULLCA § 701(a)(5)(B).

131. *See supra* note 119.

132. Fiduciary duty is, in its origins, an equitable concept. *See* D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty,* 55 Vand. L. Rev. 1399, 1493 (2002) (citing L.S. Sealy, *Fiduciary Relationships,* 1962 Cambridge L.J. 69, 69–72). It has been stated that "[t]he maxim of the common law that wherever there is a right there is a remedy for its infraction has never been adopted by courts of equity." Powers v. Bald Eagle Boom Co., 17 A. 254, 255 (Pa. 1889). But here the situation is opposite. The Act creates the remedy and a right to pursue it. Articulating a duty correlative with the right may be of conceptual interest, but as a practical matter the Act's protection is sufficient as is.

133. See Bishop and Kleinberger, *supra* note 19, ¶ 10.01 [2][b][i] for a general treatment of this topic and *Direct v. Derivative, supra* note 118, for a detailed analysis.

134. *Direct v. Derivative, supra* note 118, at 118–19.

135. Re-ULLCA § 901(b). *See also id.* §§ 409(a) (formulating the duties of loyalty and care as "owe[d] to the company and, *subject to Section 901(b),* the other members"), 701(a)(5)(B) (permitting a member to seek dissolution on account of conduct that "was, is, or will be *directly harmful to the applicant*") (emphasis added).

136. *See e.g.,* Landstrom v. Shaver, 561 N.W.2d 1, 14 n.16 (S.D. 1997) ("Those who operate and manage these [small, corporate] farms and businesses, often the majority shareholders, should not be subject to the demands of minority shareholders whose concern may be solely that of dividends and not the farm or business itself. Many of these small corporations and their management are ill-prepared to invest the time and money required to fend off a minority shareholder suit and are therefore influenced by the mere threat of such litigation.").

> help protect an agreed upon arrangement from strike suits, protect the interests of members who are neither plaintiffs nor defendants (if any), and bring to any judicial decision the benefits of a specially tailored business judgment.[137]

The Act adopts the *Auerbach* approach to judicial review of SLC decisions.[138] The SLC has the burden of proving "that the members of the committee were disinterested and independent and that the committee acted in good faith, independently, and with reasonable care,"[139] but—if the SLC meets this burden—the court may not substitute its judgment for the SLC's.[140]

To allow an SLC to do its work, and to blunt one of the weapons of a strike suit, "on motion by the committee made in the name of the company . . . the court shall stay discovery for the time reasonably necessary to permit the committee to make its investigation."[141] However, the court may refuse or limit the stay "for good cause shown" by the plaintiffs, and the SLC provision "does not prevent the court from enforcing a person's right to information under Section 410 [providing extensive information rights to members] or, for good cause shown, granting extraordinary relief in the form of a temporary restraining order or preliminary injunction."[142]

M. Organic Transactions—Mergers, Conversions, and Domestications

Modern LLC statutes provide for a panoply of entity-transformative transactions, ranging from intra-species/intra-jurisdiction (i.e., a merger of domestic LLCs) to cross-species/cross-jurisdiction (e.g. a domestic LLC converting into another type of organization under the law of a different jurisdiction).[143] Article 10 of the new Act provides for an LLC's participation in the three generally recognized "organic" transactions: mergers, conversions, and domestications.[144]

For Article 10 to apply, a domestic limited liability company must be involved either as "input" or "output." For example, Article 10 applies to a merger in which a domestic LLC and two foreign LLCs merge into a foreign limited partnership and also to a conversion in which a foreign limited partnership becomes a domestic LLC. The Act does not include interest exchanges (the unincorporated analog to the corporate "share exchange"), because that type of transaction would

137. Re-ULLCA § 905 cmt.
138. Auerbach v. Bennett, 47 N.Y.2d 619 (N.Y. 1979).
139. Re-ULLCA § 905(e).
140. *See id.* § 905(d) cmt. ("The standard stated for judicial review of the SLC determination follows *Auerbach v. Bennett,* 47 N.Y.2d 619, 419 N.Y.S.2d 920 (N.Y. 1979) rather than *Zapata Corp. v. Maldonado,* 430 A.2d 779 (Del. 1981), because the latter's reference to a court's business judgment has generally not been followed in other states.") (citations in original).
141. Re-ULLCA § 905(a).
142. *Id.*
143. Bishop and Kleinberger, *supra* note 19, ¶¶ 12.09, 12.11.
144. Re-ULLCA Article 10. The Re-ULLCA provisions are based closely on comparable provisions in ULPA (2001), except that Re-ULLCA treats domestications and conversations as separate types of transactions. ULPA (2001) treats domestications as a subset of conversions. Re-ULLCA § 1001 cmt.

be novel in the unincorporated context and is far from universally accepted in corporate law.[145]

The following matrix shows the range of possibilities under Article 10:

	intra-jurisdiction	**inter-jurisdiction**
intra-species	• merger involving only domestic LLCs	• merger involving both domestic and foreign LLCs but no other "species" of entity • domestication
inter-species	• merger involving a domestic LLC and at least one other domestic "species" • conversion in which a domestic LLC becomes another species of domestic entity, or vice versa	• merger involving a domestic LLC and at least one other foreign "species" (and perhaps other domestic organizations as well) • conversion in which a domestic LLC becomes another species of foreign entity, or vice versa

N. The Decision to Eschew the Series LLC

A series LLC "authorizes an extraordinary type of membership interest—one that neither pertains to nor partakes of an entire LLC but rather is associated with and segregated to a compartmentalized set of assets, profits, losses, and liabilities."[146] An LLC statute that authorizes series LLCs permits "an LLC to compartmentalize its operations and create 'internal' shields to protect assets associated with one aspect of the business from claims pertaining to others. Under [a series provision], an LLC may associate specified assets and operations with a particular series of membership interests and limit claims and obligations pertaining to those interests and operations to the specified assets."[147]

States ranging from Delaware to Iowa have authorized series LLCs,[148] and the Drafting Committee considered following those states. Indeed, at its February,

145. For example, the Delaware corporate statute does not provide for share exchanges (Del. Code Ann. tit. 8, §§ 251–66 (2007)), and neither does California (Cal. Corp. Code §§ 1100–1113 (West Supp. 2006)). *But see* N.Y. Bus. Corp. Law § 913(a)(1) (McKinney 2003) ("[t]wo domestic corporations may, as provided in this section, participate in the consummation of a plan for binding share exchanges"); *id.* §913(f)(1) ("[a] foreign corporation and a domestic corporation may participate in a share exchange, but, if the subject corporation is a foreign corporation, only if such exchange is permitted by the laws of the jurisdiction under which such foreign corporation is incorporated.").

146. Bishop and Kleinberger, *supra* note 19, ¶ 14.06[1][c].

147. *Id.* ¶ 6.01[5].

148. Del. Code Ann. tit. 6, § 18-215 (2007) and Iowa Code Ann. § 490A.305 (West 1999). For an example of an ULLCA-based statute that permits series, see 805 Ill. Comp. Stat. Ann. 180/37-40 (West Supp. 2006).

2006 meeting, the Committee considered a series provision that would have significantly advanced the concept.[149]

Ultimately, however, the Drafting Committee declined to accept the series concept. A March 2006 "Progress Report" on the new Act contained the following explanation for this decision:

> Originally devised by sophisticated Delaware lawyers for their "funds" clients, series are now being (mis)used to subdivide assets of operating businesses and to provide unwarranted hopes of low cost "asset protection." No one quite knows what will happen under bankruptcy law when a series becomes insolvent. Nor does anyone know whether the courts of a non-series state will respect the "internal shields" of a series LLC. Most LLC statutes provide that "foreign law governs" the liability of members of a foreign LLC. However, those provisions are irrelevant [to a foreign series LLC] because they pertain to the liability of a member for the obligations of the LLC. For a series LLC, the pivotal question is entirely different—namely, whether some assets of an LLC should be immune from some of the creditors of the LLC.
>
> What's good for Delaware and highly sophisticated deals is not necessarily good for the LLC law of other states. A philosophy that works wonders for "high end" transactions may be bad medicine for the thousands of more prosaic but nonetheless important closely held businesses that choose to house themselves within LLCs.[150]

A recent posting to LNET-LLC (a list serve focusing on limited liability companies) contained a more picturesque (but equally emphatic) description of the foibles of the series concept. Sent by a practitioner who had been one of the ABA Business Law Section Advisors to the Re-ULLCA Drafting Committee, the posting stated:

> Series, as I understand them, originated in the mutual fund and structured finance realms. Asset/liability partitioning is there not a significant issue as the possibility of tort liability is low and insurance is available. That statement would not true is a series of a fund defaulted on lets say a significant derivative contract, but I have not seen that case.
>
> But let's step away from that realm. What is the reason that series are being considered/adopted outside of Delaware? What need is filled in the practical world (you know, the one in which Larry Curly and Moe open a factory at 1 Blackacre Lane to make widgets) by the series? In light of the at best significant (overwhelming?) issues of indefinite federal and state taxation, securities compliance (please raise your hand if you are willing to issue a clean non-consolidation opinion between offerings of series), drafting complexity, the issue of whether the internal liability shield will be respected in states that do not have series provisions, and the ultimate possibility that the bankruptcy is going to consolidate all of the series into the parent, why would you use a series LLC/LP in the practical world?

149. The draft provided, *inter alia,* that: "The articles of organization may provide that a designated series shall be treated as a separate entity distinct from the limited liability company, other series of the limited liability company, and members. . . . A designated series has the capacity to sue and be sued in its own name and the power to do all things necessary or convenient to carry on its activities." ULLCA II Series Draft, § 210(i) and (k), *available at* http://www.law.upenn.edu/bll/ulc/ullca/2006FebSerDraft.htm (last visited 11/26/2006).

150. *Progress Report, supra* note 12, at 9 (citations omitted).

> For me it is not enough (sorry, it is not even on the radar screen) that I can avoid needing to form multiple SMLLCs [single member limited liability companies] to segregate liabilities and assets. That cost is de minimus and I am pretty sure I know the requirements and effect of doing so.
>
> Sorry, I just have not seen a compelling case for series outside of the mutual fund and structured finance area.[151]

A subsequently posted suggestion that administrative costs might be lower with a series LLC than with a set of single-member LLCs drew the following response from the practitioner who had served as the principal ABA Advisor to the Re-ULLCA Drafting Committee:

> While I have mixed feelings about series, ... I would be surprised if the savings in filing fees in any but the most regressively taxed of states would approach the marginal costs in terms of legal and record-keeping of series. I understand that people have found significant benefits of series in some specialized circumstances such as securitization and international contexts, and those benefits in some highly lawyered deals may be worthwhile, but the cost of setting up or maintaining series would not seem an appropriate consideration. If the client is spending less on keeping track of the series interests that he/she/it would on maintaining separate SMLLCS, the client is probably doing it wrong.[152]

Certainly the debate over series LLCs will continue.

O. The Lot of "Mere" Transferees

Under the new Act, absent a contrary agreement:

- a person who ceases to be a member of an LLC, for any reason, has no "pay out" right and becomes solely a transferee of the person's own transferable interest;[153]
- the transferee of a transferable interest does not become a member, has no governance rights and virtually no information rights, regardless of whether the transfer was voluntary, involuntary, gratuitous, or for consideration;[154]
- members may alter the operating agreement and affect a transferee's rights, without the consent of the transferee;[155]
- the LLC's duration is perpetual[156] and a transferee has no right to seek dissolution,[157] which means that the transferee is "locked in" to its status in perpetuity, or until the members decide otherwise.

151. Posted by Thomas E. Rutledge, Sat. Oct 21, 2006 5:39 am (PDT) (copy on file with *The Business Lawyer*). This posting occurred after and outside of the Re-ULLCA drafting process.

152. Robert E. Keatinge (sent to lnet-llc@yahoogroups.com; Monday, October 23, 2006 at 3:22 p.m., on file with *The Business Lawyer*). Lin Hanson, who helped devise the series provisions of the Illinois statute, subsequently stated: "That would surely be true in Illinois." (sent to lnet-llc@yahoogroups.com; Friday, October 27, 2006 1:52 p.m., on file with *The Business Lawyer*). These postings also occurred after and outside of the Re-ULLCA drafting process.

153. Re-ULLCA § 603(a)(3).

154. *Id.* §§ 502 and 410(f).

155. *Id.* § 112(b).

156. *Id.* § 104(c).

157. *Id.* § 701.

Extreme as this situation may appear, it is consistent with partnership law precedent[158] and the "pick your partner" principle that is at the core of LLC law.[159] The Drafting Committee struggled with the issue of transferee vulnerability, and under several "meeting" drafts transferees had standing to seek dissolution in circumstances of egregious misconduct.[160] However, the Committee was unable to determine how to avoid transferee vulnerability without giving transferees the power to "freeze the deal" and interfere in governance via threat of litigation.[161]

In its final regularly scheduled meeting, the Drafting Committee excised the provision giving transferees standing.[162] A Comment acknowledges that the Act itself will not be the final word on this issue:

> The law of unincorporated business organizations is only beginning to grapple in a modern way with the tension between the rights of an organization's owners to carry on their activities as they see fit (or have agreed) and the rights of transferees of the organization's economic interests. (Such transferees can include the heirs of business founders as well as former owners who are "locked in" as transferees of their own interests). . . . This Act does not address the question of whether, in extreme circumstances, transferees might be able to claim some type of duty or obligation to protect against expropriation.[163]

158. Re-ULLCA § 112(b) cmt. (discussing Bauer v. Blomfield Co./Holden Joint Venture, 849 P2d 1365 (Alaska 1993). *See* Bishop and Kleinberger, *supra* note 19, ¶ 8.06 [2][e]. However, until ULPA (2001), § 104(c) provided a perpetual term for limited partnerships, partnership law did not have to take into account the problem of perpetual lock-in. *See* UPA § 32(2) (permitting an assignee to seek judicial dissolution of an at-will general partnership at any time and of a partnership for a term or undertaking if partnership continues in existence after the completion of the term or undertaking); RUPA § 801(6) (same except adding the requirement that the court determine that dissolution is equitable); ULLCA § 801(5) (same as RUPA). Moreover, the partnership cases are few in number and may not hold in the context of a business entity that has become the vehicle of choice not only for sophisticated entrepreneurs but also for mom, pop, and the neighbors down the street.

159. Re-ULLCA § 502 cmt. *See* Bishop and Kleinberger, *supra* note 19, ¶ 8.06 [2][a][iv] and Kleinberger, *Prism, supra* note 73, at 842, 863.

160. For example, the February 2006 Meeting Draft § 701(a)(5) provided for court ordered dissolution "on application by a member, *a dissociated member that has retained a transferable interest, or a transferee,* . . .on the grounds that the managers or those members in control of the limited liability company: (A) have acted, are acting, or will act in a manner that is illegal or fraudulent; or (B) have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant." (emphasis added). The February 2006 Meeting Draft is *available at* http://www.law.upenn.edu/bll/ulc/ullca/2006febmtg.htm.

161. *See* Re-ULLCA § 112(b) cmt. ("If the law categorically favors the owners, there is a serious risk of expropriation and other abuse. On the other hand, if the law grants former owners and other transferees the right to seek judicial protection, that specter can "freeze the deal" as of the moment an owner leaves the enterprise or a third party obtains an economic interest.").

162. *Compare* the February 2006 Meeting Draft, § 701(a)(5) *with* the 2006 Annual Meeting Draft, § 701(a)(5).

163. Re-ULLCA § 112(b) cmt. The reference to "heirs of business founders" recalls the seminal close corporation case of *Donahue v. Rodd Electrotype Co. of New England, Inc.,* 328 N.E.2d 505, 515 (Mass. 1975). If the entity in *Donahue* had been an LLC formed under the new Act, it would have been necessary for the court to go outside to Act to find a cause of action for the widow of one of the company's two founders.

IV. A Roadmap through Intricacy—The Operating Agreement

A. The Broad Scope and Unfettered Sources of the Operating Agreement

Jurisdictions from coast to coast and from border to border agree that the operating agreement is foundational to any LLC.[164] "A limited liability company is as much a creature of contract as of statute,"[165] and, accordingly, the new Act devotes a definition and three major operational sections to the operating agreement.[166]

The Act defines the operating agreement in very broad terms:

> "Operating agreement" means the agreement, whether or not referred to as an operating agreement and whether oral, in a record, implied, or in any combination thereof, of all the members of a limited liability company, including a sole member, concerning the matters described in Section 110(a). The term includes the agreement as amended or restated.[167]

This definition contains no "statute of frauds."[168] To the contrary, the phrase "whether oral, in a record, implied, or in any combination thereof" means that—at least so far as the Act is concerned—the contents of the operating agreement

164. Denevi v. Green Valley Corp., No. CV784721, 2005 WL 236386, at *2 (Cal. Ct. App. Jan. 21, 2005) ("[i]n general, relations among members and between the members and a limited liability company are governed by articles of organization and an operating agreement"); Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 291 (Del. 1999) ("'[i]t is the policy of [the Act] to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.'") (quoting Del. Code Ann. tit. 6, § 18-1101(b)); Kinke v. R.D.C., LLC, 889 So.2d 405, 409 (La. Ct. App. 2004) ("An operating agreement, whether written or oral, governs the operation of the LLC . . . [a]n operating agreement is contractual in nature; thus, it binds the members of the LLC as written and is interpreted pursuant to contract law"); Lentricular Eur., LLC v. Cunnally, 693 N.W.2d 302, 307 (Wis. Ct. App. 2005) ("[t]he numerous opportunities for members of an LLC to choose to be governed by terms that differ from those in the statute plainly express the legislature's intent to provide LLC members with the flexibility to define many aspects of their relationship by contract," but holding when operating agreement is ambiguous as to whether it intended to override statutory provisions, the statutory provisions govern). *See generally* Bishop and Kleinberger, *supra* note 19, ¶ 5.06 [1] [b].

165. Re-ULLCA § 110 cmt.

166. *Id.* §§ 110–12. In addition, "An operating agreement is a contract, and therefore all statutory language pertaining to the operating agreement must be understood in the context of the law of contracts." *Id.* § 102(13) cmt.

167. *Id.* § 102(13).

168. As to whether other statutes of fraud might apply, see Re-ULLCA § 102(13) cmt. ("This Act states no rule as to whether the statute of frauds applies to an oral operating agreement. Case law suggests that an oral agreement to form a partnership or joint venture with a term exceeding one year is within the statute. *See, e.g.,* Abbott v. Hurst, 643 So.2d 589, 592 (Ala. 1994) ("Partnership agreements, like other contracts, are subject to the Statute of Frauds. A contract of partnership for a term exceeding one year is within the Statute of Frauds and is void unless it is in writing; however, a contract establishing a partnership terminable at the will of any partner is generally held to be capable of performance by its terms within one year of its making and, therefore, to be outside the Statute of Frauds.") (citations omitted); Pemberton v. Ladue Realty & Const. Co., 244 S.W.2d 62, 64 (Mo. 1951) (rejecting plaintiff's contention that mere part performance sufficed to take the oral agreement outside the statute and holding that partnership was therefore at will); Ebker v. Tan Jay Int'l, Ltd., 739 F.2d 812, 827–28 (2d Cir.1984) (same analysis with regard to a joint venture). However, it is not possible to form an LLC without signing and delivering to the filing officer a certificate of organization in record form, Re-ULLCA § 201(a), and the Act itself then establishes the LLC's duration. Subject to the operating agreement, that duration is perpetual. *Id.* § 104(c). An oral provision of an operating agreement

can be established by words, written or spoken, conduct, or some combination of these. The one mechanical requirement is assent: "Absent a contrary provision in the operating agreement, a threshold qualification for status as part of the 'operating agreement' is the assent of all the persons then members."[169]

The Act does not specifically empower the operating agreement to impose a private statute of frauds—i.e., to provide that amendments must be in writing.[170] However, Section 110(a)(4) empowers the operating agreement to determine "the means and conditions for amending the operating agreement." According to the Comment to that provision, "Paragraph (a)(4) could be read to encompass such authorization."[171] Moreover, "under Section 107 [supplemental principles of law] the parol evidence rule will apply to a written operating agreement containing an appropriate merger provision."[172]

B. The Structure and Function of Section 110

Section 110 is the most intricate of the sections dealing with the operating agreement, and most of its intricacy concerns the "complex question[] . . . [of] the

calling for performance that extends beyond a year might be within the one-year provision—e.g., an oral agreement that a particular member will serve (and be permitted to serve) as manager for three years. An oral provision of an operating agreement which involves the transfer of land, whether by or to the LLC, might come within the land provision of the statute of frauds. Froiseth v. Nowlin, 287 P. 55, 56 (Wash. 1930) ("[The land provision] applies to an oral contract to transfer or convey partnership real property, and the interest of the other partners therein, to one partner as an individual, as well as to a parol contract by one of the parties to convey certain land owned by him individually to the partnership, or to another partner, or to put it into the partnership stock.") (quoting 27 Corpus Juris 220)."). In contrast, the fact that a limited liability company owns or deals in real property does not bring within the land provision agreements pertaining to the LLC's membership interests. Interests in a limited liability company are personal property and reflect no direct interest in the entity's assets. Re-ULLCA §§ 501 & 102(21). Thus, the real property issues pertaining to the LLC's ownership of land do not "flow through" to the members and membership interests. *See, e.g.*, Wooten v. Marshall, 153 F. Supp. 759, 763–64 (S.D. N.Y. 1957) (involving an "oral agreement for a joint venture concerning the purchase, exploitation and eventual disposition of this 160 acre tract" and stating "[t]he real property acquired and dealt with by the venturers takes on the character of personal property as between the partners in the enterprise, and hence is not covered by [the Statute of Frauds]."). For other land-related consequences of the LLC's status as a separate entity, see Bishop and Kleinberger, *supra* note 19, ¶ 5.05 [1][e] ("An LLC's separate legal status also affects property rights. A member's contribution of property to an LLC constitutes 'more than a change in the form of ownership; it is a transfer from one entity to another.' This change means that contributed property is out of the reach of the contributor's creditors, unless that creditor can make a case of fraudulent transfer or persuade the court to do a reverse pierce, treating the LLC as if it were the member. Where real property is involved, the change in ownership implicates real estate transfer taxes and means that the former owner of property contributed to an LLC lacks standing to contest zoning activities pertaining to the property. Similarly, members deadlocked over the use of an LLC's real property have no right to a partition of that property and evidence of unjust enrichment as to the property of an LLC is not, by itself, evidence of unjust enrichment as to the sole owner of the LLC.").

169. Re-ULLCA § 102(13) cmt. *See id.* § 407(b)(5) ("The operating agreement may be amended only with the consent of all members.") (member-managed LLC) and *id.* § 407(c)(4)(D) ("The consent of all members is required to . . . amend the operating agreement.") (manager-managed LLC).

170. *Compare* U.C.C. § 2-209(2) (permitting a written contract for the sale of goods to preclude modifications except through a writing signed by the parties).

171. Re-ULLCA § 110(a)(4) cmt.

172. *Id.*

extent to which an agreement among the organization's owners can affect the law of fiduciary duty."[173] The Comment to Section 110 provides the following "road-map" to the section:

Subsection (a)	grants broad, *general* authority to the operating agreement
Subsection (b)	establishes this Act as comprising the "default rules" ("gap fillers") for matters within the purview of the operating agreement but not addressed by the operating agreement
Subsection (c)	states restrictions on the power of the operating agreement, especially but not exclusively with regard to fiduciary duties and the contractual obligation of good faith
Subsection (d)	contains specific grants of authority for the operating agreement with regard to fiduciary duty and the contractual obligation of good faith; expressed so as to state restrictions on those specific grants—including the "if not manifestly unreasonable" standard
Subsection (e)	specifically grants the operating agreement the power to provide mechanisms for approving or ratifying conduct that would otherwise violate the duty of loyalty; expressed so as to state restrictions on those mechanism—full disclosure and disinterested and independent decision makers
Subsection (f)	specifically authorizes the operating agreement to divest a member of fiduciary duty with regard to a matter if the operating agreement is also divesting the person of responsibility for the matter (and imposing that responsibility on one or more other members)
Subsection (g)	contains specific grants of authority for the operating agreement with regard to indemnification and exculpatory provisions; expressed so as to state restrictions on those specific grants
Subsection (h)	provides rules for applying the "not manifestly unreasonable" standard established by subsection (d)

It is important to remember that Section 110(a) states the most important general principle regarding the operating agreement. Except as specifically and expressly limited by other provisions of the Act, it is the operating agreement—not the Act—which provides for the members the "rules of the game."[174]

C. The Operating Agreement and Fiduciary Duty

The Act's most important and intricate limitations apply when the operating agreement eliminates, limits, or delineate some aspect of fiduciary duty. Section 110 expressly authorizes such provisions—other than the wholesale elimination of all fiduciary duty—and establishes a two-layered approach for dealing with challenges.

173. Re-ULLCA § 110 cmt.

174. The operating agreement also governs a small set of non-members. Re-ULLCA § 110(a)(2) (stating that the operating agreement governs "the rights and duties under this [act] of a person in the capacity of manager"), *id.* § 112(b) (providing that the operating agreement controls the rights of transferees and dissociated members).

The first layer involves the reach of the challenged provision. The following chart appears in the Comment to Section 110(d)(3):

duty	**extent of operating agreement's power to restrict the duty(subject to the "manifestly unreasonable" standard)Section 110(d)(1), (3) and (4)**	**power of the operating agreement to provide indemnity or exculpation w/r/t breach of the dutySection 110(g)**
loyalty	restrict or completely eliminate	none
care	alter, but not eliminate; specifically may not authorize intentional misconduct or knowing violation of law	complete
other fiduciary duties, not codified in the statute	restrict or completely eliminate	complete

The second layer involves the "not manifestly unreasonable" standard, which Section 110(d) imposes and Section 110(h) explicates. Subsection (h) is protective of the operating agreement and provides: "The court shall decide any claim under subsection (d) that a term of an operating agreement is manifestly unreasonable."

The "manifestly unreasonable" standard has been part of the law of unincorporated business organizations since the adoption of RUPA,[175] but subsection (h) is entirely new. The Comment to subsection (h) explains the subsection's rationale and purpose:

> The "not manifestly unreasonable standard" became part of uniform business entity statutes when RUPA imported the concept from the Uniform Commercial Code. This subsection provides rules for applying that standard, which are necessary because:
>
> - Determining unreasonableness *inter se* owners of an organization is a different task than doing so in a commercial context, where concepts like "usages of trade" are available to inform the analysis. Each business organization must be understood in its own terms and context.
> - If loosely applied, the standard would permit a court to rewrite the members' agreement, which would destroy the balance this Act seeks to establish between freedom of contract and fiduciary duty.
> - Case law research indicates that courts have tended to disregard the significance of the word "manifestly."

175. RUPA § 103(b)(3)(i), (b)(5).

- Some decisions have considered reasonableness as of the time of the complaint, which means that a prospectively reasonable allocation of risk could be overturned because it functioned as agreed.[176]

An example illustrates the importance of the "as of when" issue.

EXAMPLE: When a particular manager-managed LLC comes into existence, its business plan is quite unusual and its success depends on the willingness of a particular individual to serve as the LLC's sole manager. This individual has a rare combination of skills, experiences, and contacts, which are particularly appropriate for the LLC's start-up. In order to induce the individual to accept the position of sole manager, the members are willing to have the operating agreement significantly limit the manager's fiduciary duties. Several years later, when the LLC's operations have turned prosaic and the manager's talents and background are not nearly so crucial, a member challenges the fiduciary duty limitations as manifestly unreasonable. The relevant time under subsection (h)(1) is when the LLC began. Subsequent developments are not relevant, except as they might inferentially bear on the circumstances in existence at the relevant time.[177]

D. The Expansive Reach of the Operating Agreement—To Transferees, Dissociated Members, Incoming Members, Managers, and the Limited Liability Company Itself

Under the new Act, an operating agreement is both a contract[178] and more than a contract. The Act defines "operating agreement" to include a contract with only one party[179] and, in Sections 111 and 112, provides that the operating controls the rights of specified non-parties.

In some respects, giving the operating agreement's "extraterritorial" power is sensible and even traditional. For example, Section 112(b) provides: "The obligations of a limited liability company and its members to a person in the person's capacity as a transferee or dissociated member are governed by the operating agreement."[180] A transferee is, in effect, the assignee of the transferor's economic rights, and a person dissociated as a member relates to the LLC as if the transferee of the person's own transferable interest.[181] It is hornbook contract law that an assignee "stands in the shoes" of the assignor and is governed by the contract.[182]

Likewise it makes sense for Section 111(b) to provide: "A person that becomes a member of a limited liability company is deemed to assent to the operating agreement."[183] Because "[a] limited liability company is as much a creature of

176. Re-ULLCA § 110(h) cmt. The Comment also notes: "If a person claims that a term of the operating agreement in manifestly unreasonable under subsections (d) and (h), as a matter of ordinary procedural law the burden is on the person making the claim." *Id.*

177. *Id.* § 110(h)(1) cmt.

178. See the discussion *supra* at notes 28–34, 165 and accompanying text.

179. See the discussion *supra* at notes 26–28 and accompanying text.

180. Re-ULLCA § 112(b).

181. *Id.* § 603(a)(3).

182. E. Allen Farnsworth, Contracts § 11.8 (4th ed. 2004).

183. Re-ULLCA § 111(b).

contract as of statute,"[184] membership in an LLC is inextricably and inevitably connected with being party to the operating agreement.

Other aspects of the operating agreement's reach are not so traditional or self-evidently sensible. Most remarkably, the Act breaks with the common law of contracts and provides that transferee rights are subject to changes in the operating agreement that occur after the transfer. Section 112(b) states:

> Subject only to any court order issued under Section 503(b)(2) to effectuate a charging order, an amendment to the operating agreement made after a person becomes a transferee or dissociated member is effective with regard to any debt, obligation, or other liability of the limited liability company or its members to the person in the person's capacity as a transferee or dissociated member.[185]

The Drafting Committee adopted this provision to avoid the "specter" of "former owners and other transferees" being able to "'freeze the deal' as of the moment an owner leaves the enterprise or a third party obtains an economic interest" in the LLC.[186] Contract law is to the contrary,[187] and the danger is that "[i]f the law categorically favors the owners, there is a serious risk of expropriation and other abuse."[188]

The operating agreement also governs "the rights and duties under this [act] of a person in the capacity of manager,"[189] even though a non-member manager might not be party to the operating agreement.[190] A non-member manager has at least two methods of self-protection: entering into a separate agreement with the LLC, the breach of which (through changes in the operating agreement) would provide the manager remedies; or insisting that the operating agreement include provisions that (i) specify the manager's rights and duties, and (ii) give the manager veto power over any amendments pertaining to those rights and duties.

Section 112(a) expressly authorizes veto rights for non-members (following Delaware law),[191] and the Comment to that subsection provides an example involving a manager's self-protection:

> EXAMPLE: A non-member manager enters into a management contract with the LLC, and that agreement provides in part that the LLC may remove the manager without cause only with the consent of members holding 2/3 of the profits interests. The operating agreement contains a parallel provision, but the non-member manager is not a party to the operating agreement. Later the LLC members amend the operating agreement to change the quantum to a simple majority and thereafter purport to

184. *Id.* § 110 cmt.
185. *Id.* § 112(b).
186. *Id.* § 112(b) cmt. For a more detailed discussion of this issue, see *supra* notes 153–63 and accompanying text (Section III-O).
187. Bishop and Kleinberger, *supra* note 19, ¶ 8.06 [2][e].
188. Re-ULLCA § 112(b) cmt.
189. *Id.* § 110(a)(2).
190. The Act defines the operating agreement as "the agreement, whether or not referred to as an operating agreement and whether oral, in a record, implied, or in any combination thereof, of all the members," Re-ULLCA § 102(13), but does not expressly rule out a non-member being a party. Re-ULLCA § 407(c)(6) recognizes that "[a] person need not be a member to be a manager."
191. *See* Del. Code Ann. tit. 6, § 18-302(e) (2007).

remove the manager without cause. Although the LLC has undoubtedly breached its contract with the manager and subjected itself to a damage claim, the LLC has the power under Section 110(a)(2) to effect the removal—unless the operating agreement provided the non-member manager a veto right over changes in the quantum provision.[192]

The new Act also provides a special rule for the relationship of the operating agreement to the limited liability company. Section 111(a) states: "A limited liability company is bound by and may enforce the operating agreement, whether or not the company has itself manifested assent to the operating agreement."[193] As a theoretical matter, the Act seems again at odds with the basic constructs of contract law.[194] As a practical matter, however, the rule is certainly desirable.

V. Conclusion

Statute drafting is a craft, in many ways analogous to designing and building by hand an intricate and beautiful cabinet. The authors of this article (co-reporters for the Drafting Committee) hope that business lawyers and legislators will find Re-ULLCA well designed, well crafted, and ready for use.

192. Re-ULLCA § 112(a) cmt.

193. *Id.* § 111(a).

194. In general, only parties to a contract are fully entitled to enforce it and fully subject to its provisions. For example, an assignee's claims are subject to the contract, but the assignee itself is not directly liable for any breach of the contract. Cont'l Cas. Co. v. Campbell Design Group, Inc., 914 S.W.2d 43, 44 (Mo. Ct. App. 1996) ("What is not discussed by [the company] is the basic legal premise that a contract generally binds no one but the parties thereto, and it cannot impose any contractual obligation or liability on one not a party to it. The record does not establish that either of the individual defendants was a party to the contract. Language in a contract to which they were not parties cannot bind them.") (citations omitted.) *See generally* Daniel S. Kleinberger, *A Crack in the Shield? Malpractice Coverage At Risk,* 63 Bench & B. of Minn. 26 (September 2006). For a hypothesis of why the new Act (and other LLC statutes) avoid deeming the LLC a party to the operating agreement, see *Prism, supra* note 73, at 870–71.