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UTAH SHOULD ADOPT A MODIFIED VERSION OF THE REVISED UNIFORM LIMITED LIABILITY COMPANY ACT

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I. INTRODUCTION

On March 28, 2011, Governor Gary R. Herbert signed into law S.B. 131, the Unincorporated Business Entity Uniform Acts, which included a modified version of the Revised Uniform Limited Liability Company Act (RULLCA). The modified version of RULLCA included in S.B. 131 has been further modified in S.B. 21[1] to make certain corrective and harmonized changes (the Proposed Act). It is the basic premise of this Article that the Proposed Act will provide a number of valuable improvements for businesses formed as limited liability companies (LLCs) in Utah.

This Article begins with a brief history of the evolution of LLC acts. Next, it reviews the current state of law relative to Utah LLCs, with a particular focus on potentially problematic provisions in our existing LLC Act. It then provides a general overview of certain provisions of the Proposed Act, paying particular attention to problematic issues associated with Utah's existing LLC Act.

II. EVOLUTION OF LLC ACTS

Since Wyoming passed the first LLC Act in 1977, the LLC has grown to be a favored form of business entity, not only in Utah, but throughout the nation. By the end of 1996, all of the states, Puerto Rico, and the U.S. Virgin Islands adopted LLC acts.

During the LLC "explosion" of the early 1990s, a working group of the American Bar Association's Committee on LLCs, Partnerships, and Unincorporated Entities (LPUE) drafted and in 1992 published the Prototype Limited Liability Company Act (the Prototype Act) to provide guidance for the analysis and resolution of issues involved in crafting LLC legislation. Shortly thereafter, the National Conference of Commissioners on Uniform State Laws (NCCUSL) began working on a Uniform Limited Liability Company Act (ULLCA) and finalized an initial version in 1994. Both the Prototype Act and the ULLCA were influential as various states drafted and modified their LLC acts, but neither fully occupied the field. In addition to the Prototype Act and the ULLCA, state legislative bodies have looked to NCCUSL's Uniform Partnership Act and the Uniform Limited Partnership Act for guidance in connection with adopting and amending their LLC acts. As a result, LLC acts vary considerably in both form and substance from state to state.

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1 S.B. 21, 60th Leg., Gen. Sess. (Utah 2012), *available at* http://le.utah.gov/~2013/bills/static/SB0021.html (sponsored by L. Hillyard).

On January 1, 1997, the Internal Revenue Service repealed its *Kintner* regulations,[2] which provided for classification of business entities as partnerships or corporations for tax purposes based on the existence or lack thereof of certain corporate characteristics (i.e., limited liability, centralized management, free transferability of interest, and continuity of life), and replaced them with the "check-the-box" regulations.[3] Prior to the repeal of the *Kintner* regulations, many LLC acts were drafted as so-called bulletproof statutes. Such bulletproof LLC acts ensured that LLCs formed under them would always be classified as partnerships for federal tax purposes, because any such LLC would always lack the corporate characteristics of continuity of life and free transferability of interests.

In response to the adoption of the check-the-box regulations, the ULLCA was revised and many states amended their LLC acts to remove the outdated provisions relating to the *Kintner* regulations. In addition, as the LLC structure has grown to become the favored form of business and investment entity, states have further amended their LLC acts to deal with emerging issues such as single-member LLCs, series within an LLC, shelf LLCs, subsidiary-style LLCs, and conversions and domestications. For example, single-member LLCs, once suspect because of their novelty and uncertain tax status, are now popular both for sole proprietorships and as corporate subsidiaries.

As a result of the changing legal landscape, in the early 2000s, LPUE undertook to update the Prototype Act and NCCUSL initiated a project to amend and update the ULLCA. LPUE published the Revised Prototype Limited Liability Company Act (the Revised Prototype Act) in the November 2011 issue of *The Business Lawyer*.[4] In 2006, NCCUSL approved and recommended the RULLCA for enactment in all states. The members of the drafting committees of the RULLCA and the Revised Prototype Act include practicing lawyers, judges, legislators, and law professors who are some of the nation's most knowledgeable and well-versed experts in LLC issues and drafting legislation. Since the approval of the RULLCA, NCCUSL has undertaken to harmonize the RULLCA and the other unincorporated business entities statutes (i.e., the Revised Uniform Partnership Act (RUPA) and the Uniform Limited Partnership Act (2001) (ULPA (2001))). In 2011, NCCUSL approved and recommended for enactment in all states the harmonized versions of RULLCA (HRULLCA), RUPA (HRUPA) and ULPA (2001) (HULPA).

[2] Simplification of Entity Classification Rules, 61 Fed. Reg. 66,584 (Dec. 18, 1996) (codified at Treas. Reg. § 301.7701-2(a)(1) (2012)).

[3] Treas. Reg. §§ 301.7701-1 to -3. Widely known as the "check-the-box" regulations, these regulations provide that most multiowner unincorporated business forms (including multimember LLCs) will be taxed as partnerships, and single-owner unincorporated business forms (including single-member LLCs) will be disregarded for tax purposes, unless a specific election is made to have them taxed as corporations. *Id.*

[4] Revised Prototype Ltd. Liab. Co. Act Editorial Bd., LLCs, P'ships & Unincorporated Entities Comm., Am. Bar. Ass'n Section of Bus. Law, *Revised Prototype Limited Liability Company Act*, 67 BUS. LAW. 117 (2011).

III. UTAH'S LLC ACT

Utah enacted its first LLC statute in 1991 and, after several revisions, the entire statute was replaced in 2001 with the Utah Revised Limited Liability Company Act (the Current Act). The Current Act consists of provisions taken from a variety of sources including the Utah Revised Business Corporation Act, the Utah Revised Uniform Limited Partnership Act (the Utah LP Act), the Utah Professional Corporation Act, the Utah Revised Nonprofit Corporation Act, the Prototype Act, the ULLCA, and the LLC statutes of California, Colorado, Connecticut, Delaware, Mississippi, North Carolina, New York, Virginia, and Washington. As a result, the Current Act is a hodge-podge statute unlike any other LLC statute—indeed, one member of the ABA's drafting committee for the Revised Prototype Act has referred to it as a "Frankenstein" statute.[5]

In what is supposed to be a business-friendly state, Utah has an LLC statute that has certain outdated and antibusiness features including: (1) limited life (i.e., no perpetual life), (2) a one-of-a-kind liquidation proceeds waterfall that penalizes member-creditors and winding-up creditors by subordinating their claims to the claims of other creditors, (3) statutory reformation of the members' business deal if not in a signed writing, which disproportionately disadvantages the unsophisticated and unrepresented, (4) inflexible management structure and delegation of authority, (5) limited member asset protection features, (6) default profit/loss allocation and distribution rules that do not take into account "profits interests" and which, in certain circumstances, will conflict with federal tax rules, and (7) a default requirement for a unanimous vote on all matters to be decided by the vote of the managers.

For purposes of this Article, whether an LLC statute is business friendly is taken from the perspective of the LLC and its members and management, as opposed to third parties doing business with the LLC (e.g., creditors). The business-friendly definition includes such things as ease of formation, ongoing compliance obligations, and giving maximum effect to the concept of freedom of contract (i.e., the ability of individuals to make a legally binding agreement without governmental interference).

A. LLC Duration Is Unnecessarily Limited to a Maximum of Ninety-Nine Years

While almost all LLC statutes now permit LLCs to have a perpetual existence similar to that of corporations, the Current Act explicitly limits the duration of an LLC formed under the Current Act to ninety-nine years from the date when the LLC's articles of organization were filed or the later of any amendments to the articles of organization effecting a change in the duration.[6] This durational limit is an outdated remnant of the old *Kintner* regulations, and its sole function was

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[5] PROPOSED REVISIONS TO THE UTAH LLC ACT (2011), *available at* http://www.utahbar.org/cle/springconvention/materials/H_outline.pdf.

[6] UTAH CODE ANN. § 48-2c-403(4)(c) (West Supp. 2012).

intended to ensure that an LLC qualified for partnership tax treatment. In response to the check-the-box regulations, most state LLC statutes were amended to permit perpetual-duration LLCs. Utah has not modified its statute to reflect the evolution in tax classification by the check-the-box regulations. In contrast, the Utah LP Act was amended post-check-the-box regulations to remove this outdated limit on duration and permit perpetual duration of limited partnerships.[7] While the members of an LLC may choose to have an LLC of limited duration, no sound policy reason exists to statutorily limit the duration of LLCs.

B. Utah's One-of-a-Kind Liquidation Proceeds Waterfall Penalizes Member-Creditors and Winding-Up Creditors by Subordinating Their Claims

Unlike any other LLC act, the Current Act penalizes member-creditors and winding-up creditors by subordinating their claims to the claims of other creditors during the liquidation and winding-up process. Such subordination is neither warranted nor justified and runs contrary to other Utah creditor-rights statutes.

The Current Act, like other LLC acts, provides that a member of an LLC may transact business with the LLC and, subject to such laws as may be applicable, "shall have the rights and obligations with respect to any such matter as a person who is not a member."[8] These provisions recognize not only that members of LLCs often wear many different hats (e.g., creditor, lessor, guarantor, employee, etc.), but also that members of LLCs frequently transact business with the LLCs, and the members of the LLC should not be penalized for engaging in such transactions.

A member may become a creditor of an LLC in a variety of ways. In practice, members often (i) lend money (either secured or unsecured) to the LLC, (ii) provide services to the LLC for which the member is to receive remuneration, (iii) sell goods to the LLC on credit, (iv) receive indemnification payments from the LLC, (v) pay LLC expenses on behalf of the LLC for which the member will be reimbursed, and (vi) lease real or personal property to the LLC.

Each LLC statute establishes a priority of asset distribution in connection with the winding up of an LLC's business. Typically, an LLC's assets are first applied or set aside to satisfy an LLC's obligations to creditors in the order of priority as provided by law (i.e., first to secured creditors based on priority and then to unsecured creditors based on priority). It is only after creditors have been paid or otherwise provided for that any remaining assets are distributed to the members in respect of their LLC interests.

Business-friendly LLC acts do not distinguish between nonmember-creditors and member-creditors with respect to priority of liquidating distributions. The fact that a person is a member does not alter any rights that such person may have as a creditor. For example, the Delaware LLC Act provides that upon the winding up of

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[7] *Id.* § 48-2a-201(1)(d)(i).
[8] *Id.* § 48-2c-119.

a Delaware LLC, the LLC's assets are to be distributed as follows: (1) to creditors, *including members and managers who are creditors*, to the extent otherwise permitted by law, in satisfaction of liabilities of the LLC, other than liabilities for which reasonable provision for payment has been made and liabilities for interim and resignation distributions to members and former members; (2) unless otherwise provided in the LLC agreement, to members and former members in satisfaction of liabilities for interim and resignation distributions; and (3) thereafter, to the members.[9]

In contrast, the Current Act penalizes member-creditors by subordinating their creditor interests behind nonmember-creditors in liquidation. Under the Current Act, the assets of an LLC are to be applied or distributed as follows: (1) to pay or satisfy the liabilities of creditors *other than members*, in the order of priority as provided by law; (2) to pay or satisfy the liabilities to members in their capacity as creditors, in the order of priority as provided by law; (3) to pay or satisfy the expenses and costs of winding up the LLC; and (4) thereafter, to the members.[10] This member-creditor subordination penalty, based solely on the grounds that the creditor is a member, is neither warranted nor justified. In fact, this provision is inconsistent with other Utah creditor-rights statutes including the Utah Uniform Commercial Code[11] and the Utah Real Estate Act,[12] which provide for different payment priorities.

The Current Act further confuses creditor rights with respect to expenses and costs incurred as part of winding up an LLC. The Current Act creates a separate class of creditors (the so-called winding-up creditors)—those to whom the company owes the costs and expenses of winding up the LLC—and places this class of creditors behind, rather than on par with or ahead of, all other creditors (both nonmember- and member-creditors).[13] Accordingly, nonmember-creditors such as attorneys, accountants, and employees who assist in the winding up of the LLC and suppliers and other consultants who provide goods and services during the winding up period of an LLC may have their claims subordinated to all other creditors. This provision of the Current Act is a disincentive to persons who might otherwise provide goods and services to an LLC that is or might be winding up its business. This is especially true in circumstances where the LLC may have insufficient assets to pay all of its creditors. Furthermore, such subordination is inconsistent with other Utah creditor-rights statutes.[14]

The Current Act has the dubious distinction of being the only LLC statute that creates such an inequitable asset distribution waterfall. In contrast, the Utah LP Act does not subordinate partner-creditor or winding-up-creditor claims.[15] Rather, the

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[9] DEL. CODE ANN. tit. 6, § 18-804(a) (2005).
[10] UTAH CODE ANN. § 48-2c-1308.
[11] *Id.* §§ 70A-9a-101 to -709 (West 2004 & Supp. 2012).
[12] *Id.* § 57-1-29 (West Supp. 2012).
[13] *Id.* § 48-2c-1308(1).
[14] *See id.* §§ 70A-9a-101 to -709 (West 2004 & Supp. 2012); *id.* § 57-1-29 (West Supp. 2012).
[15] *Id.* § 48-2a-804 (West Supp. 2012).

Utah LP Act uses the same basic liquidating distribution provision (i.e., first to creditors including partner-creditors)[16] used in states that have business-friendly LLC acts such as Delaware,[17] Texas,[18] Nevada,[19] and Virginia.[20]

As a word of caution, some practitioners have mistakenly attempted to opt-out of the problematic statutory distribution provisions of the Current Act by including alternative liquidation distribution provisions in a written operating agreement. In fact, many Utah LLC operating agreements, either intentionally or inadvertently, contain asset liquidation distribution provisions that purport to remove or alter the statutory subordination of member-creditor and winding-up-creditor claims. In spite of such proactive drafting, the Current Act nullifies any such modification of the statutory distribution provisions without the consent of the nonmember-creditors. The Current Act specifically provides that a Utah LLC's articles of organization or operating agreement may not "restrict rights of . . . persons other than the members, their assignees and transferees, the managers, and the [LLC], without the consent of those persons."[21] Accordingly, the superior priority rights granted to nonmember-creditors under the Current Act may not be restricted without such nonmember-creditors' consent. Therefore, an operating agreement that purports to remove or alter the statutory subordination of member-creditor and winding-up-creditor claims would be of no force or effect as to nonconsenting, nonmember-creditors.

C. The Current Act Abandons Nearly a Century of Legislative History and Disproportionately Disadvantages the Unsophisticated and Unrepresented by Prohibiting Oral Operating Agreements

Unlike a majority of LLC acts, the Current Act superimposes a one-size-fits-all statutory set of business terms in place of informally agreed to business terms that have not been memorialized in a written operating agreement. Not only does this written requirement abandon nearly a century of legislative history during which Utah has recognized both oral partnership agreements and oral operating agreements, but it also leads to greater uncertainty and disproportionately disadvantages the unsophisticated and unrepresented who are less likely to have formal written operating agreements.

The requirement that an operating agreement be in writing is one of the most potentially troublesome provisions of the Current Act. Ironically, it is also one of the most misunderstood. The Current Act defines an "operating agreement" as "a *written* agreement of the members . . . concerning the business or purpose of the company and the conduct of its affairs."[22] The problem with the written

[16] *Id.*
[17] DEL. CODE ANN. tit. 6, § 18-804(a) (2005).
[18] TEX. BUS. ORGS. CODE ANN. § 11.053 (West 2011).
[19] NEV. REV. STAT. ANN. § 86.521 (LexisNexis 2010).
[20] VA. CODE ANN. § 13.1-1049 (2011).
[21] UTAH CODE ANN. § 48-2c-120(1)(h).
[22] *Id.* § 48-2c-102(16) (emphasis added).

requirement is that it attempts to legislate a best practice while ignoring certain realities. Stated differently, the issue is not whether oral agreements are appropriate or whether operating agreements *should* be in writing—indeed, it seems clear that the best practice is to always have members of an LLC memorialize their business agreement in writing. Rather, the issue is whether an operating agreement *must* be in writing.

Recognizing the reality of informal oral agreements, a significant majority of jurisdictions,[23] as well as the RULLCA[24] and the Revised Prototype Act,[25] permit oral operating agreements. Like many of the jurisdictions that permit oral operating

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[23] The following jurisdictions permit oral operating agreements (either explicitly or by not requiring a written operating agreement): Alaska, ALASKA STAT. § 10.50.095 (2010) (silent—no written requirement); Arizona, ARIZ. REV. STAT. ANN. § 29-601(14) (Supp. 2011); California, CAL. CORP. CODE § 17001(ab) (West 2006); Colorado, COLO. REV. STAT. § 7-80-102(11) (2012); Connecticut, CONN. GEN. STAT. ANN. § 34-101(17) (West Supp. 2012); Delaware, DEL. CODE ANN. tit. 6, § 18-101(7) (Supp. 2010); District of Columbia, D.C. CODE § 29-801.02(10) (LexisNexis Supp. 2012); Florida, FLA. STAT. ANN. § 608.402(24) (West 2007); Georgia, GA. CODE ANN. § 14-11-101(18) (Supp. 2012); Hawaii, HAW. REV. STAT. ANN. § 428-101 (LexisNexis 2008) (silent—no written requirement); Idaho, IDAHO CODE ANN. § 30-6-102(15) (Supp. 2012); Illinois, 805 ILL. COMP. STAT. ANN. 180/15-5 (West 2010) (silent, except for single-member LLCs, which must have written operating agreements unless they are managed by a person other than the member); Indiana, IND. CODE ANN. § 23-18-1-16 (LexisNexis 2010); Kansas, KAN. STAT. ANN. § 17-7663(g) (2007); Kentucky, KY. REV. STAT. ANN. § 275.015(20) (West Supp. 2011) (except certain single-member LLCs); Louisiana, LA. REV. STAT. ANN. § 12:1301(16) (Supp. 2012) (except single-member LLCs); Maine, ME. REV. STAT. tit. 31, § 1502(15) (2011); Maryland, MD. CODE ANN., CORPS. & ASS'NS § 4A-402(b)(2) (West Supp. 2012); Massachusetts, MASS. ANN. LAWS ch. 156C, § 2(9) (LexisNexis 2005); Minnesota, MINN. STAT. ANN. § 322B.03(6) (West 2011) (silent—no written requirement); Mississippi, MISS. CODE ANN. § 79-29-105(t) (Supp. 2011); Missouri, MO. ANN. STAT. § 347.015(13) (West 2001) (except single-member LLCs); Montana, MONT. CODE ANN. § 35-8-102(23) (2011) (silent—no written requirement); Nebraska, NEB. REV. STAT. ANN. § 21-102(14) (LexisNexis Supp. 2011); Nevada, NEV. REV. STAT. ANN. § 86.101 (LexisNexis Supp. 2011) (no written requirement, but must be evidenced in tangible or electronic format); North Carolina, N.C. GEN. STAT. § 57C-1-03(16) (2011); North Dakota, N.D. CENT. CODE § 10-32-02(8) (2012) (silent—no written requirement); Ohio, OHIO REV. CODE ANN. § 1705.01(J) (LexisNexis Supp. 2012) (except single-member LLCs); Oklahoma, OKLA. STAT. ANN. tit. 18, § 2001(16) (West 2012); Oregon, OR. REV. STAT. § 63.001(25) (2011); Pennsylvania, 15 PA. CONS. STAT. ANN. § 8916 (West Supp. 2012); Rhode Island, R.I. GEN. LAWS § 7-16-2(21) (Supp. 2011); South Carolina, S.C. CODE ANN. § 33-44-103(a) (2006); South Dakota, S.D. CODIFIED LAWS § 47-34A-101(12) (2007); Texas, TEX. BUS. ORGS. CODE ANN. § 101.001(1) (West Supp. 2012); Vermont, VT. STAT. ANN. tit. 11, § 3001(15) (2012) (no written requirement, but must be evidenced in tangible or electronic format); Virginia, VA. CODE ANN. § 13.1-1023 (Supp. 2012); West Virginia, W. VA. CODE ANN. § 31B-1-103 (LexisNexis 2009); and Wyoming, WYO. STAT. ANN. § 17-29-102(xiv) (2011).

[24] REVISED UNIF. LTD. LIAB. CO. ACT § 102(13) (2006).

[25] REVISED PROTOTYPE LTD. LIAB. CO. ACT § 102(14) (2011).

agreements, Utah has a long history of recognizing oral agreements for both partnerships and limited liability companies. Ever since Utah codified the then-common law with respect to general partnerships by its adoption of the Uniform Partnership Act (1917) in 1921,[26] Utah has permitted oral partnership agreements.[27] Utah's recognition of oral partnership agreements was expanded to limited partnerships in 1990 with the adoption of the Utah Revised Uniform Limited Partnership Act,[28] which explicitly states that a partnership agreement may be "written or oral."[29] Utah then permitted oral operating agreements for LLCs[30] when it enacted its first LLC statute, the Utah Limited Liability Company Act, in 1991.[31] It was not until 2001 with the adoption of the Current Act[32] that operating agreements were first required to be in writing.[33] Given the broad acceptance of oral agreements as well as Utah's present and historical recognition of such agreements, there is no legitimate reason for the now-disparate treatment with respect to Utah LLCs.

The writing requirement disproportionately disadvantages unsophisticated individuals and persons who are not represented by legal counsel. A large percentage of LLCs (roughly estimated to be between 50–60%)[34] are formed by nonlawyers, including accountants, filing services, and unsophisticated individuals. The LLCs these parties form are less likely to have a written operating agreement. Sophisticated or well-advised parties, on the other hand, are much more likely to have a written operating agreement. Accordingly, the class of persons who need the most protection will benefit most by permitting oral operating agreements.

The Current Act replaces often integral and essential business terms that have not been memorialized in a written operating agreement with a one-size-fits-all statutory set of business terms. This replacement of informally agreed-to business terms with completely unrelated business terms runs the risk of distorting or even destroying the original intent of the parties. An example of such distortion or destruction is readily apparent in LLCs with no written operating agreement and so-called service members. Service members are persons who are granted equity in exchange for services to or for the benefit of the LLC. A popular method of

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[26] Uniform Partnership Act, ch. 89, 1921 Utah Laws 253 (codified at UTAH CODE ANN. §§ 48-1-1 to -48).

[27] UTAH CODE ANN. §§ 48-1-3, -4, -13 (silent—no written requirement).

[28] Revised Uniform Limited Partnership Act, ch. 233, 1990 Utah Laws 1126 (codified at UTAH CODE ANN. §§ 48-2a-101 to -1107).

[29] UTAH CODE ANN. § 48-2a-101(10).

[30] UTAH CODE ANN. § 48-2b-126 (LexisNexis Supp. 2000) (repealed 2001) (silent—no written requirement).

[31] Utah Limited Liability Company Act, ch. 258, 1991 Utah Laws 991 (repealed 2001).

[32] Utah Revised Limited Liability Company Act, ch. 260, 2001 Utah Laws 1213 (codified at UTAH CODE ANN. §§ 48-2c-101 to -1902).

[33] UTAH CODE ANN. § 48-2c-102(16).

[34] Percentage range is based on NCCUSL's anecdotal, nonscientific survey of filing officers in the various states that have enacted or are studying the RULLCA.

providing equity-based compensation to LLC service members, including founders, is the granting of a "profits interest."[35] However, a member who receives a profits interest in exchange for services to or for the benefit of the LLC *does not* receive credit to his capital account for the value of such services. Since the Current Act's default rules for current distributions,[36] voting,[37] profit/loss allocations,[38] and liquidating distributions[39] are all based upon the members' capital account balances, a service member under such default rules would have *nothing*—no right to current distributions, no voting percentage interest, no receipt of allocation of profits or losses, and no participation in a liquidating distribution. Therefore, if not memorialized in a written operating agreement, the default rules of the Current Act would override every business deal involving a service member receiving a profits interest, thereby distorting or destroying the original intent of the parties.

Given the potential for extreme inequity resulting from the parties' distorted or destroyed intent, it is likely that a court faced with such a dilemma would use its equitable powers based on either a theory of unjust enrichment or detrimental reliance to try to achieve some sort of equitable solution. The court's exercise of its equitable powers may result in an outcome still different from the original intent of the parties and could therefore lead to even greater uncertainty for the parties involved.

Permitting oral agreements will result in greater certainty. Businesses want certainty that the business deal to which the parties have agreed will be followed—whether that deal is oral, written, or otherwise. Certainty as to a particular outcome, while important, is not as important as certainty that the right or correct outcome will occur (i.e., the terms accurately reflect the parties' intentions). In contrast, the writing requirement actually results in *less* certainty in that the intended business terms are irrelevant in the absence of a written agreement and, subject to the court's equitable gerrymandering, are replaced with statutory default

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[35] A profits interest is an equity-based form of compensation that allows a member to share in the future economic appreciation of the value of an LLC but does not provide the member with an interest in the current value of an LLC. If the profits interest is structured to meet certain Internal Revenue Service requirements, the granting of the profits interest will not be a taxable event. *See, e.g.*, Rev. Proc. 93-27, 1993-2 C.B. 343.

[36] UTAH CODE ANN. § 48-2c-1001 ("[C]urrent distributions shall be allocated among the members in proportion to the members' capital account balance as of the beginning of the company's current fiscal year.").

[37] *Id.* § 48-2c-704(10) ("[V]oting at a meeting [of the members] shall be determined by percentage interests in the profits of the company . . . .").

[38] *Id.* § 48-2c-906 ("[P]rofits and losses shall be allocated in proportion to the members' capital account balances as of the beginning of the company's current fiscal year.").

[39] *Id.* § 48-2c-1308(2) ("Company assets remaining . . . shall be allocated and distributed . . . in accordance with the members' final capital account balances after allocation of all profits and losses including profits and losses accrued or incurred during winding up.").

terms which may be completely different (for all parties) from the intended business deal.

Also, permitting oral operating agreements is not likely to result in more litigation. Anecdotally, in the almost one hundred years that Utah has had a codified partnership statute that has permitted oral agreements, Utah's courts have not been overwhelmed with oral partnership litigation matters. Therefore, why should permitting oral operating agreements result in significantly more litigation? The argument that litigation will increase is based solely on the assumption that the party alleging oral terms, when apprised of the statutory requirement that the operating agreement must be in writing, will pack up and go home or otherwise be dissuaded from bringing suit. This is not a reasonable assumption, especially, as noted above, if the party alleging oral terms can bring action under theories of unjust enrichment and detrimental reliance.

Finally, from a public policy perspective, in a business-friendly state, the policy should be to defer to the business deal agreed upon by the parties, whether that agreement is in writing or not. A business-friendly state should fall back to default statutory terms only as a last resort when the parties have either not considered or not agreed upon a specific term. If a party can prove the existence of agreed-upon terms, the State should not interfere or interject statutory business terms wholly unrelated to a business deal. A policy of deferring to the actual business deal not only adds much needed certainty, but also does not disproportionately disadvantage unsophisticated or unrepresented parties who are more likely to have oral agreements.

D. The Current Act's Outdated Application of Statutory Apparent Authority Unnecessarily Decreases Management Flexibility

The Current Act unnecessarily restricts the often-touted advantage of LLCs having a potentially infinite variety of management structures to two statutorily predetermined structures (i.e., manager-managed or member-managed).[40] Furthermore, the Current Act statutorily confers actual and apparent authority to members and managers in the above two paradigms regardless of the intentions of the parties.[41]

As stated above, one of the benefits of the LLC structure is its flexible management structure. An LLC's management (i.e., those who have the authority to manage the affairs of the LLC and the legal power to bind the LLC) can be structured in any way the members choose. In contrast, the management structures of general partnerships, limited partnerships, and corporations are statutorily dictated and less flexible. For example, an LLC's management structure can be made to resemble the management structure of other entities.[42] An LLC's

[40] *Id.* § 48-2c-403(1)(f)–(g).

[41] *Id.* § 48-2c-802.

[42] For LLCs with a general partnership-type management structure, all of the members have the right to participate in managing the LLC and are agents with the power

management structure is not, however, just limited to those resembling other entities' management structures; it can be custom-tailored to meet the needs and desires of the LLC's members.

Notwithstanding this supposed flexibility, the Current Act requires that the LLC publicly select between two statutorily preordained structures (i.e., manager-managed or member-managed)[43] and then links statutory power to bind to the selected structures.[44] This concept of statutory apparent authority by position (i.e., each member in a member-managed LLC, and each manager in a manager-managed LLC has apparent authority to act on behalf of and bind the LLC in the ordinary course of business) dates back at least to the original 1914 Uniform Partnership Act.[45] Since then, the concept of statutory apparent authority based on position has found its way into the various uniform partnership and limited liability company acts.

The "position" concept of statutory apparent authority makes sense for both general and limited partnerships, but not for LLCs. Both types of partnerships have well-defined, well-known, predictable, and almost paradigmatic management structures. A third party dealing with either type of partnership can know by the formal name of the partnership and by the person's status as general or limited partner whether the person has power to bind the partnership. The concept of statutory apparent authority does not, however, make sense with respect to LLCs because an LLC's name gives no indication as to its management structure and, more importantly, because an LLC may use an almost infinite variety of management structures.

Statutory apparent authority causes problems when the members of an LLC do not extend actual authority to every manager in a manager-managed LLC or every member in a member-managed LLC. For example, the members may want a corporate, board-style management structure where the board of managers is intended to operate as a group, and no single manager acting alone has actual authority to act on behalf of the LLC. In such instances, the Current Act frustrates the intended management structure by providing that each manager has statutory apparent authority to act on behalf of and bind the LLC in the ordinary course of the LLC's business. Even if an LLC has a written operating agreement that provides for a board-style management structure, a manager may, without actual authority, bind the LLC in the ordinary course of business if a third party does not know or does not otherwise have actual or constructive notice that the manager lacks authority.[46] Under the Current Act, limitations on a manager's or member's

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to bind the LLC. Alternatively, for LLCs with a limited partnership-type management structures, fewer than all of the members participate in managing the LLC and are agents with the power to bind the LLC. Finally, for LLCs with a corporation-type management structure, a board and officers manage the LLC, with no board member acting alone having the power to bind the LLC.

[43] UTAH CODE ANN. § 48-2c-403(1)(f)–(g).

[44] *Id.* § 48-2c-802.

[45] UNIF. P'SHIP ACT § 9 (amended 1997).

[46] UTAH CODE ANN. § 48-2c-802.

statutory apparent authority must be set forth in an LLC's articles of organization.[47] In contrast, the Delaware LLC Act,[48] the RULLCA,[49] and the Revised Prototype Act[50] each depart from the statutory apparent authority model found under the legacy LLC statutes, including the Current Act.

The Delaware LLC Act provides in part: "Unless otherwise provided in [an operating] agreement, each member and manager has the authority to bind the [LLC]."[51] As such, the Delaware LLC Act does not vest statutory apparent authority in a person or persons based on the type of management structure adopted by the LLC (i.e., member-managed or manager-managed); instead, it puts all third parties on notice that no member or manager has statutory apparent authority to bind the LLC. One commentator summarized the practical application of this section with the following anecdote: "[W]hen the man says, 'I can do anything unless my wife says I may not,' I question anyone's ability to rely upon him without her there to confirm he may act."[52] Just as a third-party would check with the man's wife in the anecdote, so must third parties look to a Delaware LLC's operating agreement to determine whether a person purporting to have authority has authority to engage in the particular act.

RULLCA section 301(a) expressly provides that members have no statutory apparent authority.[53] Furthermore, by its silence (i.e., no specific statutory authority granted), managers of a manager-managed LLC also do not have statutory apparent authority. The Revised Prototype Act goes even further and provides that no person shall have the power to bind the LLC except to the extent that such person is authorized in the LLC operating agreement, by the members in a duly filed statement of authority, or as provided by law.[54] The following introductory comment to the Revised Prototype Act describes the ABA's reason for the elimination of the manager-managed and member-managed dichotomy and statutory actual and apparent authority:

> The [Revised Prototype] Act changes significantly the original Prototype Act in that it eliminates the member-managed and manager-managed bifurcation of management structures and the statutorily conferred actual and apparent authority of members and managers in those paradigms. Instead, the [Revised Prototype] Act provides that a person's actual or apparent authority to bind the limited liability company will be

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[47] *Id.*

[48] DEL. CODE ANN. tit. 6, § 18-402 (2005).

[49] REVISED UNIF. LTD. LIAB. CO. ACT § 301(a) (2006).

[50] REVISED PROTOTYPE LTD. LIAB. CO. ACT § 301 (2011).

[51] DEL. CODE ANN. tit. 6, § 18-402.

[52] Thomas E. Rutledge & Steven G. Frost, *RULLCA Section 301—The Fortunate Consequences (and Continuing Questions) of Distinguishing Apparent Agency and Decisional Authority*, 64 BUS. LAW. 37, 46 n.48 (2008) (citation omitted).

[53] REVISED UNIF. LTD. LIAB. CO. ACT § 301(a) ("A member is not an agent of [an LLC] solely by reason of being a member.").

[54] REVISED PROTOTYPE LTD. LIAB. CO. ACT § 301.

> determined with reference to the limited liability company agreement, decisions of the members in accordance with the limited liability company agreement or the default rules of the [Revised Prototype] Act, a statement of authority, or law other than the [Revised Prototype] Act such as the common law of agency. This approach allows drafters to provide for managers, officers, boards of directors, and other forms of governance that were difficult if not impossible to accomplish under the original Prototype Act [or other legacy LLC Acts].[55]

LLC acts that do not base statutory apparent authority on position do not impose a significantly greater burden on third parties—contracting or otherwise—doing business with LLCs (e.g., banks and title insurance companies) to make sure that the person with whom they are dealing has authority. Under the Current Act, third parties without knowledge to the contrary are entitled to rely on a Utah LLC's filings with the Division of Corporations and Commercial Code (i.e., articles of organization and annual report) for purposes of determining authority. While checking applicable filings has the benefits of speed and simplicity, it also runs the risk of inaccuracy. In the absence of statutory apparent authority, however, the due diligence of a third party doing business with an LLC is not substantially different from what third parties must do when conducting business with a corporation (i.e., review charter documents and obtain secretary and incumbency certificates). In addition, some state LLC acts that do not have statutory apparent authority provide for the filing of statements of authority as a means of providing evidence of authority of a position, office, or person to enter into transactions.[56] Such statements of authority serve as notice of who does or does not have authority to act for and bind the LLC. In addition, such statements of authority provide the same benefits of speed and simplicity found under the Current Act. Therefore, because the necessary due diligence performed in the absence of statutory apparent authority is substantially the same as what is already performed for corporations, and since filed statements of authority provide evidence of actual authority, LLC acts without statutory apparent authority do not impose a significantly greater burden on third parties.

The increasingly outdated concept of statutory apparent authority by position in LLCs decreases management flexibility and is therefore less business-friendly. The elimination of statutory apparent authority will provide greater management flexibility, and therefore a more pro-business statute, by permitting LLCs to (i) adopt an almost infinite variety of management structures (as opposed to the two statutorily predetermined structures set forth in the Current Act), and (ii) determine which persons, positions, or offices have actual authority to bind the

[55] Revised Prototype Ltd. Liab. Co. Act Editorial Bd., *supra* note 4, at 119–20.

[56] *E.g.*, D.C. CODE § 29-803.02 (LexisNexis Supp. 2012); COLO. REV. STAT. § 38-30-172(d) (2012); IDAHO CODE ANN. § 30-6-302 (Supp. 2012); IOWA CODE ANN. § 489.302(3) (West Supp. 2012); ME. REV. STAT. tit. 31, § 1542 (2011); NEB. REV. STAT. ANN. § 21-127 (LexisNexis 2008); WYO. STAT. ANN. § 17-29-302 (2011).

LLC without authority being statutorily endowed. Furthermore, this greater flexibility is achieved without imposing a significantly greater burden on third parties doing business with the LLC.

E. Members Have Limited Asset Protection Because Foreclosures on LLC Interests Are Permitted

Unlike many LLC statutes that limit a creditor's right against a debtor-member's LLC interest to a charging order, the Current Act permits foreclosure thereby depriving members of Utah LLCs of a potentially valuable asset protection tool.[57] Furthermore, the Current Act requires, as a condition precedent to ordering foreclosure, that a creditor make a showing that distributions under the charging order will not pay the judgment debt within a reasonable time, thus inadequately balancing the rights of both creditors and debtors.

An important aspect of the law of unincorporated business organizations (i.e., partnerships and LLCs) is the "pick your partner" principle. Most, if not all, LLC statutes provide that, subject to certain limited exceptions, a transferee of an LLC interest is not automatically admitted as a member of the LLC. LLC statutes often require express consent of the existing members for admission of a new member.

An extension of the "pick your partner" principle is the use of charging orders, in lieu of foreclosure and liquidation, as a creditor remedy to satisfy a member's personal debts. Charging orders operate much like garnishments and require an LLC to pay to a debtor-member's creditor amounts that otherwise would be distributed to the debtor-member until the debt is satisfied or otherwise discharged. A charging order constitutes a lien on a debtor-member's LLC interest. Once the liability has been satisfied, either with distributions from the LLC or otherwise, the charging order terminates, and the rights to receive distributions with respect to the LLC interest are fully restored to the debtor-member. Importantly, a creditor with a charging order does not become a member of the LLC and, accordingly, has no voting or management rights in the LLC.

Many LLC acts limit a creditor's right against a debtor-member's LLC interest to a charging order.[58] Such states are viewed as friendly toward LLC

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[57] UTAH CODE ANN. § 48-2c-1103(2)(b) (West Supp. 2012).

[58] In several states a charging order is the exclusive remedy by which a member's judgment creditor may satisfy a judgment out of the member's LLC interest. *See, e.g.*, ALA. CODE § 10A-5-6.05 (2009); ALASKA STAT. § 10.50.380 (2010); ARIZ. REV. STAT. ANN. § 29-655 (1998); DEL. CODE ANN. tit. 6, § 18-703 (2005); FLA. STAT. ANN. § 608.433 (West Supp. 2012) (excluding single-member LLCs); GA. CODE ANN. § 14-11-504 (Supp. 2012) (except as otherwise provided in the articles of organization or a written operating agreement); KAN. STAT. ANN. § 17-76,113 (2007); ME. REV. STAT. ANN. tit. 31, § 1573; MICH. COMP. LAWS SERV. § 450.4507 (LexisNexis Supp. 2012); MINN. STAT. ANN. § 322B.32 (West 2004); MISS. CODE ANN. § 79-29-703 (West 1999); NEV. REV. STAT. ANN. § 86-401 (LexisNexis Supp. 2011); N.J. STAT. ANN. § 42:2B-45 (West 2004); OKLA. STAT. ANN. tit. 18, § 2034 (West 2012); S.D. CODIFIED LAWS § 47-34A-504 (2007);

members because they preclude a creditor from foreclosing on a debtor-member's LLC interest. For example, the Delaware Limited Liability Company Act provides, "The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or of a member's assignee may satisfy a judgment out of the judgment debtor's limited liability company interest."[59] Some states, in addition to providing that a charging order is the exclusive remedy, expressly preclude foreclosure.[60] Nevada, for example, states that:

> [A charging order is] the exclusive remedy by which a judgment creditor of a member or an assignee of a member may satisfy a judgment out of the member's interest of the judgment debtor, whether the limited-liability company has one member or more than one member. *No other remedy, including*, without limitation, *foreclosure* on the member's interest or a court order for directions, accounts and inquiries that the debtor or member might have made, is available to the judgment creditor attempting to satisfy the judgment out of the judgment debtor's interest in the limited-liability company, and no other remedy *may be ordered by a court*.[61]

In contrast, the Current Act takes a "liquidation approach" pursuant to which a creditor can foreclose on the debtor-member's LLC interest and receive permanent economic rights in the LLC interest, including rights to distributions from the LLC after the member's debt has been satisfied.[62] Under the Current Act, a court may order foreclosure of an interest in a Utah LLC subject to a charging order at any time.[63] Unlike certain other states that expressly permit foreclosure on a debtor-member's interest, the Current Act does not require a showing by the creditor that the distributions under the charging order will fail to pay the judgment debt within a reasonable time before ordering foreclosure.[64] While the most pro-

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TENN. CODE ANN. § 48-249-509 (Supp. 2011); TEX. BUS. ORGS. CODE ANN. § 101.112 (West Supp. 2012); WYO. STAT. ANN. § 17-29-503.

[59] DEL. CODE ANN. tit. 6, § 18-703(d).

[60] The following states expressly preclude foreclosure: Alaska, ALASKA STAT. § 10.50.380(c); Georgia, GA. CODE ANN. § 14-11-504(b) (except as otherwise provided in the articles of organization or a written operating agreement); Maine, ME. REV. STAT. ANN. tit. 31, § 1573(7); Michigan, MICH. COMP. LAWS SERV. § 450.4507(5)–(6); Nevada, NEV. REV. STAT. ANN. § 86.401(2)(a); New Jersey, N.J. STAT. ANN. § 42:2B-45; Oklahoma, OKLA. STAT. ANN. tit. 18 § 2034; South Dakota, S.D. CODIFIED LAWS § 47-34A-504(e); Texas, TEX. BUS. ORGS. CODE ANN. § 101.112(c); Virginia, VA. CODE ANN. § 13.1-1041.1(E) (2011); and Wyoming, WYO. STAT. ANN. § 17-29-503(g).

[61] NEV. REV. STAT. ANN. § 86-401(2)(a) (emphasis added). Almost identical language is found in the Wyoming LLC Act. *See* WYO. STAT. ANN. § 17-29-503(g).

[62] *See* UTAH CODE ANN. § 48-2c-1103(2)(b).

[63] *Id.*

[64] The following jurisdictions permit foreclosure only after a showing that the distributions under a charging order will not pay the judgment debt within a reasonable time: District of Columbia, D.C. CODE § 29-805.03(c) (LexisNexis Supp. 2012); Florida,

business approach would be to expressly prohibit foreclosure altogether, permitted foreclosure—only upon a showing that distributions will not pay the judgment debt within a reasonable time—at least requires the court to balance the rights of the member and the creditor and is more pro-business than permitted foreclosure at any time without any such showing.

The liquidation approach set forth in the Current Act (i.e., permitting foreclosure without any showing) not only deprives members of Utah LLCs of a potentially valuable asset protection tool, but, without such a showing requirement, it also lacks a condition precedent that is intended to balance the rights of both creditors and debtors. Accordingly, legal practitioners and entrepreneurs often cite Utah's liquidation approach as a factor in favor of choosing to form an LLC outside Utah.[65]

F. Default Economic Rules Conflict with Federal Tax Law and Do Not Account for "Profits Interest"

The Current Act's default rules for profit and loss allocations and distributions may result in profit and loss allocations that do not comply with applicable federal tax rules. In addition, these same default rules when combined with the default rule for voting do not allow for profits-interest members.

The default rules in the Current Act for current distributions,[66] profit/loss allocations,[67] liquidating distributions,[68] and voting[69] are each based upon the members' capital account balances. However, a member's capital account is defined in the Current Act as follows:

> "Capital account," unless otherwise provided in the operating agreement, means the account, as adjusted from time to time, maintained by the company for each member to reflect:

FLA. STAT. ANN. § 608.433(6) (West Supp. 2012) (with respect to single-member LLCs); Idaho, IDAHO CODE ANN. § 30-6-503(3) (Supp. 2012); Iowa, IOWA CODE ANN. § 489.503(3) (West 2009); and Nebraska, NEB. REV. STAT. ANN. § 21-2654(4) (LexisNexis Supp. 2011).

[65] For example, sophisticated estate planning and asset protection attorneys will often elect to form LLCs for their Utah clients in neighboring Nevada or Wyoming.

[66] UTAH CODE ANN. § 48-2c-1001 ("[C]urrent distributions shall be allocated among the members in proportion to the members' capital account balance as of the beginning of the company's current fiscal year.").

[67] *Id.* § 48-2c-906 ("[P]rofits and losses shall be allocated in proportion to the members' capital account balances as of the beginning of the company's current fiscal year.").

[68] *Id.* § 48-2c-1308(2) ("Company assets remaining after [dissolution and winding up] . . . shall be allocated and distributed . . . in accordance with the members' final capital account balances after allocation of all profits and losses including profits and losses accrued or incurred during winding up.").

[69] *Id.* § 48-2c-704(10) ("[V]oting at a meeting [of the members] shall be determined by percentage interest in the profits of the company . . . .").

> (a) the value of all contributions by that member;
> (b) the amount of all distributions to that member or the member's assignee;
> (c) the member's share of profits, gains, and losses of the company; and
> (d) the member's share of the net assets of the company upon dissolution and winding up that are distributable to the member or the member's assignee.[70]

In addition, the Current Act provides that, except as otherwise provided in the articles of organization or operating agreement, the capital accounts of the members shall be adjusted to reflect the revaluation of the company assets upon the occurrence of certain events (i.e., greater than *de minimis* capital contribution or distribution, dissolution and winding up of the company, a merger of the company, or the grant of a greater than *de minimis* profits interest).[71]

It seems clear from the language of sections 48-2c-102(3) and 48-2c-903 that the authors of the Current Act were trying to incorporate the federal income tax concept of a capital account. The Treasury regulations, however, take several pages to define a capital account and describe its maintenance while the Current Act takes fewer than 350 words. Accordingly, there are scenarios where a capital account for federal income tax purposes will be *different* than a capital account determined under the default rules of the Current Act.

When such differences do occur, what allocation rules (i.e., federal tax or Current Act) should LLCs follow? To try and resolve this question, it is important to remember that the Internal Revenue Service may alter the members' allocations if such allocations do not have substantial economic effect and if the term "capital account" (as defined in the Treasury regulations) is used to make that determination.

Since federal law (i.e., the Internal Revenue Code and the Treasury regulations) will ultimately determine a member's share of profits and losses for tax purposes, why then is it necessary to have a default rule in the Current Act for allocating profits and losses? The ULLCA, the ULPA (2001), the RULLCA, and the Revised Prototype Act omit any default rule for allocation of profits and losses. The Comment to section 503 of the ULPA (2001) explains the rationale for the omission as follows:

> This Act has no provision allocating profits and losses among the partners. Instead, the Act directly apportions the right to receive distributions. Nearly all limited partnerships will choose to allocate profits and losses in order to comply with applicable tax, accounting and

[70] *Id.* § 48-2c-102(3).
[71] *Id.* § 48-2c-903(1)(c).

> other regulatory requirements. Those requirements, rather than the Act, are the proper source for guidance for the profit and loss allocation.[72]

Furthermore, basing default rules for profit and loss allocations, distributions, and voting percentage interests on capital account balances does not provide allowance for profits-interest members. As noted above, a member who receives a profits interest in exchange for services to or for the benefit of the LLC *does not* receive credit to his capital account for the value of such services. Accordingly, under the black-letter law reading of the default rules in the Current Act, a profits-interest member would have no capital account, no right to current distributions, no voting percentage interest, would receive no allocation of profits or losses, and would not participate in a liquidating distribution. To allow for the recognition of profits-interest members, the default rules should be based on something other than the members' capital accounts (regardless of whether defined as set forth in the Treasury regulations or in the Current Act) or the members' capital contributions.[73]

Therefore, the application of the Current Act's default rules for profit and loss allocations, distributions, and voting percentage interests (a) do not provide allowance for profits-interest members and (b) may result in profit and loss allocations that do not comply with applicable federal tax rules.

G. The Current Act Fails to Set a Default Rule for How a Vote of the Managers Decides Matters

The Current Act fails to have a default rule for how a vote of managers decides matters in a multi-manager, manager-managed LLC. Having to apply a unanimous voting standard in the absence of a contrary standard is antibusiness because inherent in such standard is the potential for deadlock and abuse.

The Current Act only contains a default rule for deciding matters without a meeting, without prior notice, and without a vote.[74] Absent from the Current Act is how a vote of the managers is to decide matters. Because there is no default rule for deciding matters by a vote, to be safe, unless a written operating agreement or articles of organization provide for an alternative voting standard, any matter to be decided by a vote of the managers should be decided by a unanimous vote. Failure

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[72] UNIF. LTD. P'SHIP ACT § 503 cmt. (2001); *see also* REV. UNIF. LTD. LIAB. CO. ACT § 404 cmt. (2006).

[73] The default rules of RULLCA provide that (a) with respect to nonliquidating distributions, such distributions are to be made in equal shares, *see* REV. UNIF. LTD. LIAB. CORP. ACT § 404(a); (b) with respect to liquidating distributions, such distributions are to be made first to return capital and then in equal shares, *see id.* § 708(b); and (c) with respect to management, decisions are either made unanimously or by a majority (in number) of the members, *see id.* § 407(b)(3)–(5), (c)(4)–(5).

[74] UTAH CODE ANN. § 48-2c-808 provides that "on any matter that is to be voted on by the managers . . . [they] may take action without a meeting, without prior notice, and without a vote, if a consent in writing, setting forth the action so taken, is signed by all of the managers . . . ."

to obtain the unanimous vote of the managers as to a particular matter—when the LLC's articles of organization or operating agreement provide no alternative voting standard—would leave the particular matter subject to a potential challenge for not having been properly or duly authorized.

Once again Utah is in the minority; a large majority of states provide complete default rules for how managers decide matters, whether by vote or consent.[75] For example, the California LLC Act provides, "Except as otherwise provided in the articles of organization or the operating agreement, . . . decisions of the managers shall be made by majority vote of the managers if at a meeting, or by unanimous written consent."[76]

Furthermore, a unanimous vote standard, which as noted above should be used in the absence of a default rule, is an antagonistic business standard. Unanimity inherently has the potential for deadlock, wherein the managers cannot all agree and thus the LLC's business is prevented from moving forward without judicial or third-party intervention. Unanimity also provides fertile ground for more nefarious conduct. For example, one or more managers could hold an LLC, the other managers, and even the members hostage to extort some unmerited

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[75] The following states have a manager voting default rule: Alaska, ALASKA STAT. § 10.50.150(b) (2010); Arizona, ARIZ. REV. STAT. ANN. § 29-681(B), (D), (E) (Supp. 2012); Arkansas, ARK. CODE ANN. § 4-32-403(a) (2001); California, CAL. CORP. CODE § 17156 (West 2006); Colorado, COLO. REV. STAT. § 7-80-401(1) (2012); Connecticut, CONN. GEN. STAT. ANN. § 34-142(a) (West 2005); Florida, FLA. STAT. ANN. § 608.4231(6) (West 2007); Georgia, GA. CODE. ANN. § 14-11-308(a)(2) (2003); Hawaii, HAW. REV. STAT. ANN. § 428-404(b)(2) (LexisNexis 2008); Idaho, IDAHO CODE ANN. § 30-6-407(3)(c) (Supp. 2012); Illinois, 805 ILL. COMP. STAT. ANN. 180/15-1(b)(2) (West 2010); Indiana, IND. CODE ANN. § 23-18-4-3(b) (West 2010); Iowa, IOWA CODE ANN. § 489.407.3(c) (West Supp. 2012); Kentucky, KY. REV. STAT. ANN. § 275.175(1) (West 2006); Louisiana, LA. REV. STAT. ANN. § 12:1316 (2010); Massachusetts, MASS. ANN. LAWS ch. 156C, § 26(d) (LexisNexis 2012); Michigan, MICH. COMP. LAWS SERV. § 450.4405(2) (LexisNexis Supp. 2012); Minnesota, MINN. STAT. ANN. § 322B.653 (West 2004); Mississippi, MISS. CODE ANN. § 79-29-401(7) (2011); Missouri, MO. ANN. STAT. § 347.079(4) (West 2012); Montana, MONT. CODE. ANN. § 35-8-307(2)(b) (2011); New Hampshire, N.H. REV. STAT. ANN. § 304-C:33(V) (2005); New Mexico, N.M. STAT. ANN. § 53-19-17(B)(3) (2012); New York, N.Y. LTD. LIAB. CO. LAW § 408(b) (McKinney Supp. 2012); North Carolina, N.C. GEN. STAT. § 57C-3-20(b) (2011); North Dakota, N.D. CENT. CODE § 10-32-83 (2012); Oklahoma, OKLA. STAT. ANN. 18 § 2018 (West 2012); Oregon, OR. REV. STAT. § 63.130(2)(b) (2011); Pennsylvania, 15 PA. CONS. STAT. ANN. § 8942(a) (West Supp. 2012); Rhode Island, R.I. GEN. LAWS § 7-16-19 (Supp. 2011); South Carolina, S.C. CODE ANN. § 33-44-404(b)(2) (2006); South Dakota, S.D. CODIFIED LAWS § 47-34A-404.1(b)(2) (2007)); Tennessee, TENN. CODE ANN. § 48-239-112(c) (West 2010); Texas, TEX. BUS. ORGS. CODE ANN. § 101.355 (West Supp. 2012); Vermont, VT. STAT. ANN. tit. 11 § 3054(b)(2) (West 2010); Virginia, VA. CODE. ANN. § 13.1-1024(G) (2011); Washington, WASH. REV. CODE ANN. § 25.15.165(1) (West Supp. 2011); West Virginia, W. VA. CODE ANN. § 31B-4-404(b)(2) (LexisNexis 2009); Wisconsin, WIS. STAT. ANN. § 183.0404(1)(b) (West 2002); and Wyoming, WYO. STAT. ANN. § 17-29-407(c)(iii) (2011).

[76] CAL. CORP. CODE § 17156.

benefit. Accordingly, the application of the unanimous vote standard as a default rule is decidedly antibusiness. In contrast, recognizing the potential for deadlock and abuse as well as the resulting negative effects on business, all of the state LLC acts that have a manager voting default rule employ the "majority vote"[77] standard.[78]

The failure of the Current Act to include a default rule for how matters are decided by the vote of managers results in the application of the antagonistic business standard of a unanimous vote of the managers. Such a standard is higher than the standard all states that have a manager voting default rule apply and exposes LLCs to potential manager deadlock and abuse.

IV. UTAH'S REVISED UNIFORM LLC ACT

Since NCCUSL adopted the ULLCA in 1994, there have been significant developments related to LLCs, which were noted in the introduction. The RULLCA was drafted with these developments in mind. The members of the drafting committees of the RULLCA included practicing lawyers, judges, legislators, and law professors who are some of the nation's most knowledgeable and well-versed experts in LLC issues and drafting legislation. In addition to the members of NCCUSL's drafting committee, ABA members nationally recognized as experts with respect to LLCs and representing several different ABA sections[79] served as advisors to the RULLCA drafting committee. The RULLCA was drafted in terms that are consistent with other commercial law statutes, such as RUPA and ULPA (2001). In fact, the harmonized versions of these acts have a similar look and feel. To date, Iowa,[80] Nebraska,[81] Wyoming,[82] Idaho,[83] Utah,[84] District of Columbia,[85] and California[86] have adopted the RULLCA, and Kansas,[87] Minnesota,[88] and New Jersey[89] have introduced legislation to adopt the RULLCA.

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[77] The "majority vote" standard is the vote of a majority of the managers on a per capita basis.

[78] *See* statutes cited *supra* note 75.

[79] The ABA sections represented included (i) ABA Business Law Section, (ii) ABA Real Property, Probate and Trust Law Section, and (iii) ABA Tax Section.

[80] IOWA CODE ANN. §§ 489.101–.1304.

[81] NEB. REV. STAT. ANN. §§ 21-101 to -197 (LexisNexis Supp. 2011).

[82] WYO. STAT. ANN. §§ 17-29-101 to -1105 (Supp. 2012).

[83] IDAHO CODE ANN. §§ 30-6-101 to -1104 (Supp. 2012).

[84] UTAH CODE ANN. §§ 48-3-101 to -1405 (West Supp. 2012) (effective July 1, 2013).

[85] D.C. CODE §§ 29-801.01 to -810.01 (LexisNexis Supp. 2012).

[86] Revised Uniform Limited Liability Company Act, 2012 Cal. Legis. Serv. ch. 419, at 3967–4055 (West).

[87] H.B. 2261, 2011 Sess. (Kan. 2011) (sponsored by Lance Kinzer). H.B. 2261 died in the Committee on Judiciary on June 1, 2012.

[88] H.B. 1274, 87th Sess. (Minn. 2011) (sponsored by Doug Wardlow).

[89] S.B. 742, 215th Leg. (N.J. 2012) (sponsored by Paul A. Sarlo).

The Proposed Act,[90] while based on the HRULLCA, incorporates certain Utah-specific provisions: (a) the existing election to purchase in lieu of dissolution provision in the Current Act[91] that permits an LLC or its members to purchase the interest of the member who has sought judicial dissolution of the LLC for oppressive, harmful, illegal, or fraudulent conduct by the managers or control members;[92] (b) an updated version of the existing professional LLC provisions of the Current Act;[93] (c) an updated version of the Current Act's series LLC provisions;[94] (d) the existing low-profit limited liability company provisions;[95] and (e) a change to the standard courts apply when considering whether to invalidate operating agreement provisions that address fiduciary duty and other sensitive matters from "manifestly unreasonable"[96] to a more predictable and business-friendly "unconscionable or against public policy" standard.[97]

In very general terms, the Proposed Act is more detailed, more up-to-date, and more business friendly than the Current Act. The following sections will note significant provisions of the Proposed Act, paying particular attention to how the Proposed Act addresses the previously identified problems in the Current Act.

A. The Proposed Act's Structure Has the Same Look and Feel as Other Uniform Statutes

The structure of the Proposed Act closely resembles that of the RUPA, the ULLCA, and the ULPA (2001).[98] Using a common and familiar structure has many advantages over Utah's existing one-of-a-kind LLC Act. These advantages include (a) consistency and uniformity with Utah's and other states' uniform business statutes, (b) similar terminology and concepts that appear in other modern business and commercial statutes, (c) ease in finding and locating provisions, and (d) ease in identifying differences between similar statutes.

With the adoption of the Proposed Act as well as the Utah-specific versions of the HRUPA and HULPA, each of Utah's unincorporated business statutes will have uniform provisions with a similar look and feel. For example, formation, charging order, derivative proceedings, foreign admission, and organic change provisions (e.g., mergers) in the Proposed Act mirror similar provisions in the Utah versions of the HRUPA and HULPA. This uniformity will result in greater

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[90] S.B. 21, 60th Leg., Gen. Sess. (Utah 2012).

[91] UTAH CODE ANN. § 48-2c-1214 (West Supp. 2012).

[92] S.B. 21 § 48-3a-702.

[93] UTAH CODE ANN. §§ 48-2c-1501 to -1513; S.B. 21 §§ 48-3a-1101 to -1112.

[94] UTAH CODE ANN. §§ 48-2c-606 to -616; S.B. 21 §§ 48-3a-1201 to -1209.

[95] UTAH CODE ANN. § 48-2c-412; S.B. 21 §§ 48-3a-1301 to -1304.

[96] HARMONIZED REVISED UNIF. LTD. LIAB. CO. ACT § 105(c)(6), (d)(3), (e) (2011).

[97] S.B. 21 § 48-3a-112(3)(f), (4)(c), (5).

[98] Daniel S. Kleinberger & Carter G. Bishop, *The Next Generation: The Revised Uniform Limited Liability Company Act*, 62 BUS. LAW. 515, 519 (2007) (discussing RULLCA upon which the structure of the HRULLCA and the Proposed Act are based).

predictability as to what these statutes say and as to how Utah's courts will interpret them.

B. The Proposed Act Permits Perpetual Life LLCs

The Proposed Act removes the long-outdated provision of the Current Act that explicitly limits the duration of LLCs.[99] Instead, the Proposed Act specifically provides that an LLC has perpetual life[100] unless another duration is set forth in the LLC's operating agreement.[101]

C. Operating Agreements Become the Foundational Document and May Be Oral

The Proposed Act defines "operating agreement" very broadly: "[An] agreement, whether or not referred to as an operating agreement and whether *oral, implied, in a record, or in any combination thereof*, of all the members of a limited liability company, including a sole member, concerning the matters described in Subsection 48-3a-112(1)."[102] The operating agreement may consist of a number of separate documents (or records), however denominated, unless the operating agreement itself provides otherwise.[103] Under the Proposed Act, the operating agreement is the LLC's foundational document[104] even though formation of a Utah LLC pursuant to this statute will require the filing of a certificate of organization with the Division of Corporations and Commercial Code.[105] As such, a conflict between an LLC's operating agreement and its certificate of organization is generally resolved in favor of the LLC's operating agreement.[106] This is a shift toward those states, including Delaware, which have certificates of organization or formation that only evidence the formation or existence of the LLC and contain only minimal information.[107] For example, the Proposed Act requires that only the name of the LLC, address of the principal office of the LLC, and registered agent information be set forth in the certificate of organization.[108] The Proposed Act requires neither a statement as to how the LLC is managed nor the names and addresses of the members or managers. Therefore, instead of spreading management and other business provisions among an LLC's articles of organization and operating agreement as required by the Current Act, under the Proposed Act, all such provisions will be located in the operating agreement.

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[99] *See supra* Part III.A.
[100] S.B. 21 § 48-3a-104(3).
[101] *Id.* § 48-3a-112(1).
[102] *Id.* § 48-3a-102(16) (emphasis added).
[103] *Id.* § 48-3a-112(1)(d).
[104] *Id.* § 48-3a-112(1).
[105] *Id.* § 48-3a-201.
[106] *Id.* § 48-3a-114(4).
[107] DEL. CODE ANN. tit. 6, § 18-201 (2005 & Supp. 2010).
[108] S.B. 21 § 48-3a-201(2).

Having all of the business terms in one document will lead to greater consistency and efficiencies.

As noted above, the Proposed Act's definition of an operating agreement specifically permits oral agreements, thus avoiding the problems inherent in the Current Act's writing requirement.[109] This does not mean written agreements are not advisable. It merely recognizes the reality of informal business relationships and does not impose a statutory formality, where the failure to comply may result in a statutorily imposed business deal entirely unrelated to the actual business deal the members agreed upon.

While the Proposed Act would permit the contents of an operating agreement to be established by written or spoken words, conduct, or some combination thereof, written operating agreements with integrated contract and written amendment provisions would minimize the potential that prior oral agreements or conduct and oral amendments to written operating agreements would be upheld.[110] The purpose of an integrated contract provision is to prevent the parties to a written agreement from later claiming that they had an agreement that was different from their written agreement, that the written agreement does not reflect their entire understanding, or that the written agreement is not consistent with prior agreements or conduct of the parties. With respect to an operating agreement with an integrated contract provision, any previous negotiations or agreements in which the members had considered different terms will be deemed superseded by the final written operating agreement. Such integration provisions are enforceable under Utah contract law.[111] A written amendment provision is language included in a contract that provides that amendments to the contract must be in writing.[112]

[109] *See supra* Part III.C.

[110] An integrated contract provision is language included in a contract that declares the contract to be the complete and final agreement between the parties. The following is an example of an integrated contract provision: "This Agreement, along with any exhibits, appendices, addendums, schedules, and amendments hereto, encompasses the entire agreement of the parties, and supersedes all previous understandings and agreements between the parties, whether oral or written. The parties hereby acknowledge and represent that said parties have not relied on any representation, assertion, guarantee, warranty, collateral contract, or other assurance, except those set out in this Agreement, made by or on behalf of any other party or any other person or entity whatsoever, prior to the execution of this Agreement. The parties hereby waive all rights and remedies, at law or in equity, arising or which may arise as the result of a party's reliance on such representation, assertion, guarantee, warranty, collateral contract, or other assurance, provided that nothing herein contained shall be construed as a restriction or limitation of said party's right to remedies associated with the gross negligence, willful misconduct, or fraud of any person or party taking place prior to, or contemporaneously with, the execution of this Agreement."

[111] *See* Tangren Family Trust v. Tangren, 182 P.3d 326, 332 (Utah 2008) ("[I]n the face of a clear integration clause, extrinsic evidence of a separate oral agreement is not admissible on the question of integration.")

[112] The following is an example of a written amendment provision: "This Agreement may only be amended by a written document duly executed by all parties."

While the Proposed Act does not specifically authorize an operating agreement to limit the means by which it may be amended (e.g., modifications must be in a signed writing), section 48-3a-112(1)(d) does provide that the operating agreement governs "the means and conditions for amending the operating agreement."[113] Furthermore, the comments to the RULLCA with respect to this section specifically state that this section "could be read to encompass such authorization."[114] Therefore, oral agreements are permitted, thereby avoiding the problems inherent in the Current Act's writing requirements. But given the broad number of potential sources from which the contents of an operating agreement can be established, written operating agreements with both an integrated contract provision and a written amendment provision should be used to maximize certainty.

D. Members Are Permitted Greater Latitude in Defining, Altering, and Eliminating Fiduciary Duties—Increased Freedom of Contract

As compared to the Current Act, the Proposed Act provides greater latitude to owners in structuring their business deals (i.e., freedom of contract) and is therefore more business friendly. In doing so, the Proposed Act fairly balances public policy concerns regarding the contractual obligation of good faith and fair dealing with the extent to which owners may alter and eliminate fiduciary duties.

Historically, the law of "fiduciary duty in unincorporated business organizations was mostly a matter of case law."[115] As stated in the comments to the RULLCA, "Until the promulgation of RUPA, it was almost axiomatic that: (i) fiduciary duties reflect judge-made law; and (ii) statutory formulations can express some of that law but do not exhaustively codify it."[116] While the original UPA followed this approach, RUPA took a radically different approach and sought to exhaustively codify all fiduciary duties relevant to a RUPA partnership and its partners.[117] The principal reason for this new approach was to "'cabin in' fiduciary duties so as to protect partnership agreements from judicial second guessing."[118] This cabin-in approach was followed by both the ULLCA and the ULPA (2001).[119]

The RULLCA and the Proposed Act take a different approach. The RULLCA drafting committee determined, after careful consideration, that "the 'cabin in'

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[113] S.B. 21 § 48-3a-112(1)(d).

[114] REVISED UNIF. LTD. LIAB. CO. ACT § 110(a)(4) cmt (2006).

[115] Kleinberger & Bishop, *supra* note 98, at 522.

[116] REVISED UNIF. LTD. LIAB. CO. ACT § 409 cmt.

[117] REVISED UNIF. P'SHIP ACT § 404 cmt. 1 (1997) ("Section 404 is both comprehensive and exhaustive."). Section 404(a) provides, "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)." *Id.* § 404(a).

[118] Kleinberger & Bishop, *supra* note 98, at 522 .

[119] UNIF. LTD. P'SHIP ACT § 408 (2001); UNIF. LTD. LIAB. CO. ACT § 409(a) (1996).

approach creates more problems than it solves."[120] The cabin-in approach ignores the implicit fiduciary or fiduciary-like duties such as the duty of controlling members to not oppress fellow members, and puts an inordinate amount of pressure on the concept of "good faith and fair dealing."[121] The RULLCA drafting committee also determined a better way to protect the operating agreement from judicial second-guessing: (i) "[I]ncrease and clarify the power of the operating agreement to define and re-shape fiduciary duties (including the power to eliminate aspects of fiduciary duties),"[122] and (ii) "provide some guidance to the courts when a person seeks to" invalidate a provision of an operating agreement on the grounds that the provision is, under the RULLCA, "manifestly unreasonable."[123] Accordingly, RULLCA incorporated into its provisions such powers and guidance.[124]

The Proposed Act continues the Current Act's "uncabined" approach, but with some improvements. The Current Act codifies both the duty of care[125] and the duty of loyalty,[126] but it does not contain language limiting or cabining the fiduciary duties to just these codified duties. The Proposed Act improves upon the Current Act's approach by (a) providing in detail the extent to which the operating agreement can define, alter, or eliminate aspects of fiduciary duty;[127] (b) expressly limiting the ability to "relieve or exonerate a person from liability for conduct involving bad faith, willful misconduct, or recklessness;"[128] and (c) providing

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[120] REVISED UNIF. LTD. LIAB. CO. ACT , prefatory note; *see also* David Walker, Chair of Drafting Comm., Remarks at the Third Session of Proceedings in the Committee of the Whole Revised Uniform Limited Liability Company Act of the National Conference of Commissioners on Uniform State Laws (July 8, 2006) (transcript available at National Conference of Commissioners on Uniform State Laws) ("We have, we say, 'uncabined' fiduciary duties.").

[121] REVISED UNIF. LTD. LIAB. CO. ACT prefatory note; *see also* Daniel Kleinberger, Co-Reporter of Drafting Comm. Remarks at the Fourth Session of Proceedings in the Committee of the Whole Revised Uniform Limited Liability Company Act of the National Conference of Commissioners on Uniform State Laws (July 8, 2006) (transcript available at National Conference of Commissioners on Uniform State Laws) ("[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 [a] judge in . . . North Carolina . . . . The judge of North Carolina's business courts said, if you stop us on fiduciary duty, we will just go to good faith.").

[122] REVISED UNIF. LTD. LIAB. CO. ACT prefatory note.

[123] *Id.* However, in lieu of the "manifestly unreasonable" standard used in the RULLCA, the Proposed Act has the more judicially predictable "unconscionable or against public policy" standard. S.B. 21, 60th Leg., Gen. Sess. § 48-3a-112(3)(f) (Utah 2012).

[124] REVISED UNIF. LTD. LIAB. CO. ACT § 110; S.B. 21 § 48-3a-112.

[125] UTAH CODE ANN. § 48-2c-807(1) (West Supp. 2012).

[126] UTAH CODE ANN. § 48-2c-807(2).

[127] S.B. 21 § 48-3a-112(4)(c)(i).

[128] *Id.* § 48-3a-112(3)(g).

specific guidance to courts asked to invalidate an operating agreement provision on the grounds that the provision is "unconscionable or against public policy."[129] These provisions are more business-friendly than the Current Act, in that it grants greater latitude to owners in structuring their business deals while balancing public policy concerns regarding the contractual obligation of good faith and fair dealing and the alteration or elimination of fiduciary duties.

E. Members Have Greater Flexibility in Determining an LLC's Management Structure with the Elimination of Statutory Apparent Authority

The Proposed Act recognizes that "statutory apparent authority" is an attribute of partnership formality that does not belong in an LLC statute.[130] Accordingly, the Proposed Act has eliminated the statutory link between the management structure and apparent authority. Thus, whether a member, manager, or some other person has power to bind an LLC becomes a matter of agency law.

The Proposed Act expressly provides that members have no statutory apparent authority.[131] Furthermore, by its silence (i.e., no specific statutory authority granted), managers of a manager-managed LLC also do not have statutory apparent authority. The following commentary, under the RULLCA, will apply to the Proposed Act:

> The actual authority of an LLC's manager or managers is a question of agency law and depends on the contents of the operating agreement and any separate management contract between the LLC and its manager or managers. These agreements are the primary source of the manifestations of the LLC (as principal) from which a manager (as agent) will form the reasonable beliefs that delimit the scope of the manager's actual authority.[132]

The comments to sections 301 and 407 of the RULLCA provide additional guidance analyzing in detail how agency law will function in the absence of statutory apparent authority.[133]

Eliminating statutory apparent authority also eliminates the need to have an LLC publicly indicate in its certificate of organization the LLC's management

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[129] *Id.* § 48-3a-112(5).

[130] REVISED UNIF. LTD. LIAB. CO. ACT prefatory note (2006); *see supra* Part III.D.

[131] S.B. 21 § 48-3a-301(1) ("A member is not an agent of [an LLC] solely by reason of being a member.").

[132] REVISED UNIF. LTD. LIAB. CO. ACT § 407(c) cmt.; *see also* RESTATEMENT (THIRD) OF AGENCY § 3.01 (2006); RESTATEMENT (SECOND) OF AGENCY §§ 15, 26 (1958).

[133] REVISED UNIF. LTD. LIAB. CO. ACT §§ 301 cmt., 407 cmt. (analyzing in detail how agency law will function in the absence of statutory apparent authority, including, in the context of a multimember, member-managed, or multimanager, manager-managed LLC with an operating agreement that is silent as to how management responsibility is to be allocated between or among them).

structure. However, an LLC might want to make, or a third-party may require, as a condition to the business relationship or transaction, that the LLC make a public filing of its management structure. The Proposed Act addresses this issue by providing for the filing of statements of authority.[134] Section 48-3a-302(1) of the Proposed Act permits such a statement of authority to designate authority of a specific person or by position or office (e.g., president, chief executive officer, etc.). A filed statement of authority will enable an LLC "to provide evidence of ongoing authority to enter into transactions without having to disclose to third parties the entirety of the operating agreement."[135]

By removing the outdated concept of statutory apparent authority by position, the Proposed Act provides greater management flexibility to adopt an almost infinite variety of management structures and determine which persons, positions, or offices have actual authority to bind the LLC. In addition, by providing for the filing of statements of authority, third parties will continue to have the convenience and ability to rely on filing evidence of authority.

F. The Proposed Act Contains a Default Governance Rule for Managers Missing from the Current Act

The Proposed Act includes a default rule for how a vote of the managers decides matters. The Proposed Act provides that "any matter relating to the activities and affairs of the limited liability company is decided exclusively by the manager, or, if there is more than one manager, by a majority of the managers."[136] This important default rule is conspicuously missing from the Current Act.[137]

G. The Proposed Act Contains Foreclosure Provisions That Better Balance the Rights of Debtor-Members and Judgment Creditors

Like the Current Act, the Proposed Act does not limit the remedy available to a member's judgment creditor to only a charging order.[138] Both the Current Act and the Proposed Act permit a court to foreclose on a charging order and sell the charged LLC interest.[139] Accordingly, both statutes are more pro-creditor than those state LLC statutes that provide a charging order as the exclusive remedy. However, because the Proposed Act contains both a showing requirement[140] and grants limited power to the court to make other orders giving effect to a charging order, the Proposed Act is more pro-business than the Current Act and better balances the rights of both debtor-members and judgment creditors.

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[134] S.B. 21 § 48-3a-302(1); *see supra* Part III.D.
[135] REVISED UNIF. LTD. LIAB. CO. ACT § 302(a)(2) cmt.
[136] S.B. 21 § 48-3a-407(3)(a).
[137] *See supra* Part III.G.
[138] S.B. 21 § 48-3a-503(3); *see supra* Part III.E.
[139] UTAH CODE ANN. § 48-2c-1103(2)(b) (West Supp. 2012); S.B. 21 § 48-3a-503(3).
[140] *See supra* Part III.E.

While the Current Act permits a court to foreclose at any time,[141] the Proposed Act requires a showing by the judgment creditor "that distributions under a charging order will not pay the judgment debt within a reasonable time" before a court may foreclose and order the sale of the LLC interest.[142] As noted above, requiring such a showing is a way for the court to balance the rights of the debtor-member and the creditor and is more pro-business. Also, the Current Act grants the court broad discretionary powers to "make all other orders, directions, accounts, and inquiries a judgment debtor might make *or that the circumstances of the case may require*."[143] Such a broad grant of unfettered authority is an unwelcome invitation for the courts to meddle in the internal affairs of an LLC. In contrast, the Proposed Act's grant of power to the court to make other orders is limited to "giv[ing] effect to the charging order."[144] This limited grant prevents the court from interfering in the internal affairs of the LLC. For example, if a judgment creditor who believes the LLC should invest less of its surplus in operations in order to leave more funds available for distributions has a charging order and makes a motion for a court order directing the LLC to restrict reinvestment, section 48-3-503(2)(b) of the Proposed Act does *not* authorize the court to grant such a motion.[145]

Even though foreclosure is permitted under both the Proposed Act and the Current Act, because of the showing requirement and the limited grant of power to the court to make other orders to give effect to a charging order, the Proposed Act is more pro-business and better balances the rights of both the debtor-member and the judgment creditor.

H. The Proposed Act Does Not Penalize Member-Creditors and Winding-Up Creditors in Liquidation

The Proposed Act eliminates both the member-creditor penalty and the winding-up-creditor penalty imposed by the Current Act wherein such creditors' claims are subordinated.[146] Instead, the Proposed Act simply provides that "[i]n winding up its activities, [an LLC] shall apply its assets to discharge its obligations to creditors, including members that are creditors."[147] The Proposed Act recognizes that no ordering or priority of the payment of creditor claims is necessary since such ordering and priority is already determined pursuant to other applicable law.[148]

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141 UTAH CODE ANN. § 48-2c-1103(2)(b).
142 S.B. 21 § 48-3a-503(3); *see supra* Part III.E.
143 UTAH CODE ANN. § 48-2c-1103(1)(d) (emphasis added).
144 S.B. 21 § 48-3a-503(2)(b).
145 REVISED UNIF. LTD. LIAB. CO. ACT § 503(b)(2) cmt (2006).
146 UTAH CODE ANN. § 48-2c-1308(1); *see supra* Part III.B.
147 S.B. 21 § 48-3a-711(1).
148 *See* DEL. CODE ANN. tit. 6, § 18-804(a) (2005); UTAH CODE ANN. § 48-2c-1308(1).

I. The Proposed Act Contains Comprehensive Provisions for Mergers, Interest Exchanges, Conversions, and Domestications

Unlike the Current Act, which deals only with conversions and mergers,[149] the Proposed Act includes comprehensive provisions for mergers, interest exchanges, conversions, and domestications.[150] Under the Proposed Act, a set of provisions governs each type of organic change. These provisions are not only internally consistent with one another, but are also consistent with the organic change provisions of the Utah-specific versions of the HRUPA and HULPA.[151]

Also, the Proposed Act corrects a problem in the Current Act with respect to conversions. The Current Act inadequately deals with "outbound" conversions (i.e., the conversion of the Utah LLC into a foreign entity) in that it is unclear what, if anything, the LLC must file in Utah in connection with such a conversion.[152] The confusion arises from the wording of section 48-2c-1406(4) of the Current Act, which states:

> (4) A conversion of a domestic [LLC] into a foreign subject entity must be:
>
> (a) permitted by the statutes governing the foreign subject entity;
>
> (b) approved in the manner required by the statutes described in Subsection (4)(a); and
>
> (c) *accompanied by any filing in the foreign jurisdiction required by the statutes described in Subsection (4)(a).*[153]

Nowhere in section 48-2c-1406(4) is a filing with a Utah governmental entity explicitly required. Instead, the wording provides that an outbound conversion must be "accompanied" by a filing in the foreign jurisdiction. Not only is the wording confusing, but it also seems to imply that the conversion only needs to have the filing required in the foreign jurisdiction and not in Utah. If this is the case, how is Utah to be informed of an outbound conversion when the only filing is the filing in the foreign jurisdiction? The author, when confronted with this exact issue involving the conversion of a Utah LLC into a Delaware LLC, raised the issue with Kathy Berg, the Director of the Utah Division of Corporations and Uniform Commercial Code. As a result of that meeting, Ms. Berg agreed to accept for filing a letter indicating that an outbound conversion had taken place when accompanied by a copy of the conversion filing from the foreign jurisdiction.[154]

The organic transaction provisions of the Proposed Act not only eliminate the confusion found in the Current Act, but also provide clear and comprehensive

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[149] UTAH CODE ANN. §§ 48-2c-1401 to -1411.

[150] S.B. 21 §§ 48-3a-1001 to -1056.

[151] *See supra* Part IV.A.

[152] UTAH CODE ANN. § 48-2c-1406(4).

[153] *Id.* (emphasis added).

[154] Telephone Interview with Kathy Berg, Director, Div. of Corps. & Unif. Commercial Code, Utah Dep't of Commerce (Oct. 13, 2009).

statutory guidance with respect to effecting such organic transactions and the resulting consequences thereof.

J. The Proposed Act Includes Enhanced Series LLC Provisions, Which Increase the Likelihood that Bankruptcy Courts and Nonseries Jurisdictions Will Respect a Series

Given the uncertainty surrounding series LLCs ("SLLCs"), the Proposed Act contains specific provisions not found in the Current Act that increase the likelihood that bankruptcy courts and nonseries jurisdictions will respect the existence of a series separate from the master LLC and each of the other series.[155]

The SLLC is a form of LLC that partitions its assets and members into one or more separate "series" or "cells," each of which can have separately designated members and managers and can own its own assets separately from the assets of the LLC or any other series. The liabilities of each series will be enforceable only against the assets of that series. Delaware enacted the first SLLC statute in 1996.[156] Since that time, Iowa,[157] Oklahoma,[158] Illinois,[159] Nevada,[160] Tennessee,[161] Utah,[162] Texas,[163] and Kansas[164] have passed SLLC legislation. At least three other states (Minnesota,[165] North Dakota,[166] and Wisconsin[167]) provide for a "series" of ownership interests but do not provide creditor protection as between each series. It is important to note that the drafters of the RULLCA considered but ultimately rejected the idea of including SLLC provisions in the RULLCA.[168] The drafters noted conceptual concerns, bankruptcy issues, series treatment in states without SLLCs, tax treatment, and securities law issues.[169]

Given the lack of judicial, statutory, and administrative guidance, several open issues continue to plague SLLCs, including uncertainties surrounding the

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155 S.B. 21, 60th Leg., Gen. Sess. §§ 48-3a-1201 to -1209 (Utah 2012).

156 Act of June 10, 1996, ch. 360, 70 Del. Laws 360 (1996) (codified at DEL. CODE ANN. tit. 6, § 18-215 (2005)).

157 IOWA CODE ANN. § 490A.305 (West 1999) (superseded by IOWA CODE ANN. § 489.1201 (West 2009) (effective Jan. 1, 2009)).

158 OKLA. STAT. ANN. tit. 18, § 2054.4 (West 2012).

159 805 ILL. COMP. STAT. ANN. 180/37-40 (West 2010).

160 NEV. REV. STAT. ANN. § 86.296 (Lexis-Nexis 2010).

161 TENN. CODE ANN. § 48-249-309 (Supp. 2011).

162 UTAH CODE ANN. § 48-2c-606 to -616 (West Supp. 2012).

163 TEX. BUS. ORGS. CODE ANN. § 101.601 to .621 (West 2012).

164 Substitute for H.R. 2207, 84th Leg., Reg. Sess. (Kan. 2011) (to be codified at KAN. STAT. ANN. §§ 17-7663, -7682) (effective July 1, 2012).

165 MINN. STAT. ANN. § 322B.41 (West 2004).

166 N.D. CENT. CODE § 10-32-02(57) (2012).

167 WIS. STAT. ANN. § 183.0504 (West 2002).

168 REVISED UNIF. LTD. LIAB. CO. ACT prefatory note (2006).

169 *Id.*

interaction of the series structure with tax,[170] securities,[171] and bankruptcy[172] laws and the laws of nonseries jurisdictions.[173] Most of the uncertainty surrounds whether bankruptcy courts and nonseries jurisdictions will respect the "separateness" of each series. In other words, will a series be treated as separate from the master LLC and each of the other series as to liabilities, purpose, power to sue or be sued, ownership of property, and otherwise, or will the existence of a series be disregarded?

While the merits of having an SLLC statute in Utah are debatable, because the Current Act already has SLLC provisions,[174] omitting SLLC provisions in the Proposed Act is not a viable option (i.e., the proverbial genie cannot be put back in the bottle). In light of the continuing uncertainty regarding SLLC, however, the Proposed Act's SLLC provisions substantially improve those in the Current Act. Certain aspects of these provisions should be favorable factors in determining the "separateness" of each series and whether bankruptcy courts and non-SLLC states will respect liability protection of each series.

The SLLC provisions in the Current Act,[175] like those of Nevada, Oklahoma, and Kansas, closely follow the original Delaware statute. In contrast, the Illinois and Iowa[176] SLLC provisions, while clearly influenced by the original Delaware statute, contain additional provisions that are designed to further the separateness of each series. It is these additional provisions that have been incorporated into the Proposed Act.

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[170] One of the key uncertainties involves the classification and treatment of SLLCs under U.S. federal tax law. On September 14, 2010, the Internal Revenue Service attempted to address this particular area of uncertainty by issuing Proposed Treasury Regulation §§ 301.6011-6, 301.6071-2 and 301.7701-1(a)(5) (the Proposed Regulations) which address some, but not all, of these tax issues. Series LLCs and Cell Companies, 75 Fed. Reg. 44699 (proposed Sept. 13, 2010). Basically, the Proposed Regulations provide that each series of an SLLC will be evaluated under the so-called check-the-box entity classification regulations as a separate entity and may make any federal tax election it is otherwise eligible to make independently of the SLLC or any other series. *Id.*

[171] The uncertainty is whether the issuer of securities is only one particular series or instead the entire SLLC for purposes of registration, exemptions from registration, offering integration, and disclosure requirements of federal securities laws.

[172] The uncertainty is how the bankruptcy courts will react to an SLLC when faced with the following issues: (i) whether a series may be a debtor for bankruptcy purposes and make a separate bankruptcy filing, and (ii) whether a bankruptcy court will uphold series liability shields.

[173] The uncertainty is whether nonseries jurisdictions will recognize the series concept.

[174] UTAH CODE ANN. §§ 48-2c-606 to -616 (West Supp. 2012).

[175] *See* S.B. 21, 60th Leg., Gen. Sess. § 48-3-a-112(3)(g) (Utah 2012).

[176] IOWA CODE ANN. § 489.1201 (West 2009) (effective January 1, 2009, incorporated as part of Iowa's adoption of the RULLCA).

For example, unlike the other states, Illinois and Iowa explicitly define a series within an SLLC as a "separate [legal] entity."[177] This language separates Illinois and Iowa from the previous Delaware statute and its progenitors, including the Current Act, because the Illinois and Iowa LLC acts do not provide that each series is its own legal entity that is distinct from the original LLC. The Proposed Act includes a similar provision.[178]

In addition, Illinois and Iowa provide that "the provisions of this [LLC] Act which are generally applicable to limited liability companies, their managers, members and transferees *shall be applicable to each particular series*."[179] This phrase is significant, and although absent from the original Delaware statute and the Current Act, it has been included in the Proposed Act.[180] A court in a state without a series LLC statute may be more apt to treat the series like a simple LLC where, as in the Illinois and Iowa statutes and under the Proposed Act, the statute explicitly commands it.

Also absent from the original Delaware statute and the Current Act is a provision similar to that found in the Illinois statute and the Proposed Act, which provides that each series is to be treated as a separate entity that may "contract, hold title to assets, grant security interests, sue and be sued and otherwise conduct business and exercise the powers of a limited liability company."[181] This omission from the Delaware statute led one commentator to believe that the statute simply provides a way to segregate assets, not to separately own them.[182]

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[177] 805 ILL. COMP. STAT. ANN. 180/37-40(b) (West 2010) ("A series . . . [is] treated as a separate entity to the extent set forth in the articles of organization."); IOWA CODE ANN. § 489.1201(3) ("A series meeting all of the conditions of subsection 2 shall be treated as a separate entity to the extent set forth in the certificate of organization.").

[178] S.B. 21 § 48-3a-1201(3)(a) (proposing that a series that meets all of the conditions of subsection (2) shall "be treated as a separate entity to the extent set forth in the certificate of organization").

[179] 805 ILL. COMP. STAT. ANN. 180/37-40(j) (emphasis added); IOWA CODE ANN. § 489.1201(7) ("Except to the extent modified by this article, the provisions of this chapter which are generally applicable to a limited liability company, and its managers, members and transferees, *shall be applicable to each series with respect to the operations of such series*." (emphasis added)).

[180] S.B. 21 § 48-3a-1201(6) ("Except to the extent modified by this part, the provisions of this chapter which are generally applicable to a limited liability company, and its managers, members and transferees, *shall be applicable to each series with respect to the operations of such series*." (emphasis added)).

[181] 805 ILL. COMP. STAT. ANN. 180/37-40(b); S.B. 21 § 48-3a-1201(3) ("A series meeting all of the conditions of Subsection (2) shall . . . *have the power and capacity to, in its own name, contract, hold title to property, grant liens and security interests, and sue and be sued*." (emphasis added)).

[182] John C. Murray, *A Real Estate Practitioner's Guide to Delaware Series LLCs (With Form)* (2007), *available at* http://local.firstam.com/ekcms/uploadedFiles/firstam_com/References/Reference_Articles/John_C_Murray_Reference/Limited_Liability_Companies/jm-delaware.pdf.

In *GxG Management LLC v. Young Brothers and Co.*[183]—the first reported decision involving a Delaware SLLC—the court held that the statute did "not indicate what capacity an LLC has to pursue litigation on behalf of its series, . . . what capacity a series of an LLC has, if any, to pursue litigation on its own behalf, or . . . whether it should be regarded as an entity distinct from the LLC from which it is carved."[184] The court further noted, when denying a motion to amend judgment, that the relationship between a Delaware LLC and its series "merely [creates] a 'series of interest' maintained by the LLC."[185]

Following *GxG Management*, the Delaware legislature amended the LLC statute to rectify the belief that a series LLC only has an interest in (not ownership of) its assets.[186] The new provision explicitly states that a series can hold title to assets in its own name.[187] Furthermore, the capacity to sue and be sued, questioned by the court in *GxG Management* and other commentators, was clearly granted in the amended Delaware statute. Explicitly defining a series as a separate legal entity was not, however, added to the Delaware statute.

Another significant addition in the Illinois LLC Act and Proposed Act is a provision providing for better notice to third parties that they are dealing with an SLLC. For example, the Illinois statute and the Proposed Act require the name of the series to contain the name of the SLLC and that it be distinguishable from the names of the other series.[188] The Current Act has no such requirement. Therefore, if an SLLC includes the company name with the particular series behind it, a potential creditor performing reasonable due diligence should be on notice to inquire about a series and what makes a series different or separate from the main company name.

While Delaware amended its statute to deal with some of the issues that commentators and the court in *GxG Management* exposed, Utah has not amended the Current Act. Accordingly, SLLCs under the Current Act are at a *greater risk* of losing series liability protection in bankruptcy and by non-SLLC states than SLLCs formed under or governed by the Proposed Act.

The following Illinois-type provisions, which are absent in the Current Act, have been incorporated into the Proposed Act: (a) a series is to be treated as a "separate entity";[189] (b) a series has "the power and capacity, in its own name, to

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[183] No. 05-162-B-K, 2007 WL 551761 (D. Me. Feb. 21, 2007).

[184] *Id.* at *7 (citation omitted).

[185] GxG Mgmt. LLC v. Young Bros. & Co., No. 05-162-B-K, 2007 WL 1702872, at *1 (D. Me. June 11, 2007) (order denying motion to amend judgment).

[186] The Delaware series provisions were amended in 2007 (effective August 1, 2007). Act of July 10, 2007, ch. 105, 76 Del. Laws 124 (codified at DEL. CODE ANN. tit. 6, § 18-215 (West Supp. 2010)).

[187] DEL. CODE ANN. tit. 6, § 18-215(b) ("Assets associated with a series may be held directly or indirectly, including in the name of such series, in the name of the limited liability company, through a nominee or otherwise.").

[188] 805 ILL. COMP. STAT. ANN. 180/37-40(c) (West 2010); S.B. 21, 60th Leg., Gen. Sess. § 48-3a-1201(1) (Utah 2012).

[189] S.B. 21 § 48-3a-1201(3)(a).

hold property and sue and be sued";[190] (c) "the provisions of [the Proposed Act] which are generally applicable to [LLCs], and its managers, members and transferees, shall be applicable to each series";[191] and (d) a requirement that "[t]he name of each series must contain the name of the [SLLC] and be distinguishable from the name of any other series."[192] Even with these clarifying provisions in the Proposed Act, significant uncertainty will continue regarding SLLCs for the foreseeable future. However, the incorporation of these Illinois-type provisions into the Proposed Act should assist bankruptcy courts and non-SLLC states in determining whether to respect the separate existence, including liability protection, of each series.

K. The Proposed Act Includes Low-Profit LLCs

The low-profit LLC provisions from the Current Act[193] are incorporated into the Proposed Act as Part 13, *Low-Profit Limited Liability Companies*.[194]

L. The Proposed Act Eliminates Default Rules for Profit and Loss Allocations

The Proposed Act eliminates the use of the tax term "capital account" and the default rules regarding profit and loss allocations used in the Current Act.[195] The Proposed Act recognizes that there are scenarios where a capital account for federal income tax purposes will be different than a capital account determined under the default rules of the Current Act. The Proposed Act also recognizes that federal tax laws will ultimately determine a member's share of profits and losses for tax purposes.

V. CONCLUSION

The Proposed Act offers a number of advantages over the Current Act. The Current Act is an outdated one-of-a-kind statute that is a patchwork of other commercial statutes that do not mesh well. It has significant inconsistencies and is decidedly less business-friendly than the Proposed Act. It is time for the Utah legislature to enact an LLC statute that (1) represents the best thinking of some of the nation's foremost experts on LLCs and LLC legislation, (2) is drafted while taking into account recent developments and national trends, (3) offers the benefits of uniformity and consistency with Utah's other unincorporated business entity statutes as well as with other states' unincorporated business entity statutes, and (4) conveys the message that Utah is a pro-business state.

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190 *See id.* § 48-3a-1201(3)(b).
191 *See id.* § 48-3a-1201(6).
192 *See id.* § 48-3a-1201(1).
193 UTAH CODE ANN. § 48-2c-412 (West Supp. 2012).
194 S.B. 21 §§ 48-3a-1301 to -1304.
195 *See supra* Part III.E.