

## **I. OVERVIEW OF LLC'S AND OTHER ENTITY OPTIONS**

### **A. History and Types of Limited Liability Companies:**

The concept of the limited liability company did not begin to develop until the 1970's. In 1977 the state of Wyoming enacted the first limited liability company act in an effort to attract franchise revenue to the state. Five years later, in 1982, Florida followed with its own act which was patterned upon the Wyoming act. Questions were immediately raised as to whether this entity would be treated for federal income taxes purposes as a partnership and thus have the desired pass-through status or whether it would be treated as an association taxed as a corporation. In 1988, eleven years after Wyoming adopted its limited liability company act, the IRS published Revenue Ruling 88-76 which classified a Wyoming LLC which met certain factual criteria as a partnership for federal income tax purposes. In response to 88-76, the other states which had not already adopted LLC acts began adopting their own limited liability company acts. In 1991 Delaware adopted its first Limited Liability Company Act. The Delaware Act underwent major revisions in 1995 and 1997, thereafter it has been amended in small proportions almost every year in an effort to keep Delaware's Act as the leading and most cutting edge Act in the nation.

A limited liability company is a non-corporate business form which provides its members with limited liability and also allows the members to participate actively in the entity's management without becoming personally liable for the entity's obligations. At its most basic level, a limited liability company may be viewed as a partnership whose partners have limited liability. The limited liability company has all of the best features of partnerships and corporations with none of the corporate rigidity and with the limited liability which the partnership form lacks. As with a partnership, the relationship between the members, and the members with the company, is determined by contract. That contract is called a company agreement or operating agreement. The company agreement may be either written or oral. In the absence of any agreement or where the agreement is otherwise silent, the Delaware Act becomes the default company agreement.

The company may be managed by all or just some of its members or by one or more non-members. If it is managed by less than all of its members, the person(s) who manage the business is then called the manager. Some drafters of company agreements refer to a manager who is also a member as the managing member. There is no legal significance in the differing titles. A company may have one or more managers. The manager need not be a member. We speak about either member-managed companies or manager-managed companies. Managers are similar to officers and directors in the corporate sense. A manager may have a title such as president, however, such titles are optional. The manager may also delegate management to a non-manager. The non-manager may also have a title such as president.

The first Delaware Limited Liability Company Act in 1991 has been substantially amended. The Delaware Act in its current form provides substance and guidance to the practitioner, and provides that the relationship between the members of the limited liability company will be governed by the principles of contract. Section 18-1104 provides that "In any case not provided for in this chapter, the rules of law and equity, including the law merchant,

shall govern.” The Delaware Act built upon its predecessors and continues to evolve. The Delaware Act gives limited liability companies the same flexibility as a general partnership, however, each member of the limited liability company has the same, identical, limited liability as a stockholder of a Delaware corporation under the GCL. Income, expense and any loss of the limited liability company are recognized for income tax purposes by its members, and no income taxes are paid by the LLC unless it elects to be treated as a corporation. There is no requirement that an LLC publish a legal notice of its formation, nor are there any minimum capital requirements, nor any requirements that it file annual financial reports, and there is no requirement that it publicly file the names of its members or managers.

The genesis of the limited liability company was in tax law. Investors in real property had traditionally held such assets in their individual name or in pass-through entities such as a general partnership or a limited partnership. Investors seek to limit their liability to third parties, however, if they used a corporation as the vehicle to provide limited liability, the loss generated from passive sources, such as depreciation and other losses, was trapped at the corporate level in a C corporation and the investor could not enjoy the shelter from their investment on their personal return. S corporations were at one time popular, however following the imposition of the passive activity regulation under tax laws, the S corporation became less attractive.

The Delaware Act is considered to be the most modern and most flexible in the nation. Delaware places almost no limitation on the ingenuity of attorneys and business persons in drafting company agreements to meet the needs of business transactions. Unlike corporations, where the business transaction must be structured to meet the requirements of the GCL, the company agreement is structured to meet the needs of the business transaction.

Delaware has adopted only one statutory form of limited liability company, however, as will be explored in depth later in this article, limited liability company’s may be either managed by its members or by a manager. Under Section 18-215, a limited liability company agreement may establish or provide for the establishment of one or more series of members, managers or limited liability company interests having separate rights, powers or duties with respect to specified property or obligations of the limited liability company or profits or losses associates with specified property or obligations, and any such series may have a separate business purpose or investment objection. These limited liability companies are referred to as “series limited liability companies.” Series limited liability companies will be discussed in depth later.

## **B. The LLC as a Legal Entity:**

In accordance with §18-201(b), a limited liability company is formed at the time of the filing of the initial Certificate of Formation with the Delaware Secretary of State, or at such later date and time as may be specified in the Certificate of Formation. Section 18-201(a) specifies those matters which must be set forth in the Certificate of Formation. Under Subsection (b), the company is formed if there has been substantial compliance with the requirements of §18-201. The Subsection goes on to provide:

A limited liability company formed under this chapter shall be a separate legal entity, the existence of which as a separate legal entity shall continue until the cancellation of the limited liability company's certificate of formation.

The existence of the company is terminated either by an order of the Delaware Court of Chancery or the filing of a Certificate of Cancellation under §18-203. The Court of Chancery, under §18-802 has the right, on application by or for a member or manager of the company, to enter a decree of dissolution of a limited liability company "whenever it is not reasonably practical to carry on the business in conformity with a limited liability company agreement.

### **C. Overview of Other Potential Business Entities:**

#### **1. Limited Liability Partnerships:**

Limited liability partnerships are a species of the general partnership. Prior to the 2005 amendments to the Delaware Uniform Partnership Act ("RUPA"), the partners first had to enter into a general partnership and file a Statement of Partnership Existence with the Delaware Secretary of State. Thereafter, the partnership could elect, pursuant to Section 15-001, to become a limited liability partnership. As a result of the 2005 amendments, a partnership now may be formed as a limited liability partnership, bypassing the need to first establish the general partnership.

Section 15-306(c) provides:

Any obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort or otherwise, is solely the obligation of the partnership. A partner is not personally liable, directly or indirectly, by way of indemnification, contribution, assessment or otherwise, for such an obligation solely by reason of being or so acting as a partner.

Therefore, while under general partnership law, Section 15-306(a) provides:

Except as otherwise provided in Subsections (b) and (c), all partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law.

A partner acting within his or her authority on behalf of the limited liability partnership is personally liable for their own actions. They are thus, by virtue of the limitations contained in Section 15-306(c), not liable for the debts or obligations of the partnership or the tortious acts of their fellow partners. In the context of a professional practice, the limited liability partnership shields the partners from the liabilities created by the actions or inactions of their fellow partners.

The limited liability partnership is generally developed in connection with professional practices. The limited liability partnership became effective on August 1, 1993 at the behest of accountants. While Delaware had by that time adopted its first Limited Liability Company Act, the tax laws with respect to limited liability companies were in flux, and it was unlikely that a large accounting practice with hundreds of partners could have qualified under the tax laws to be treated as a partnership rather than an association taxed as a corporation. Therefore, the accountants sought to create the limited liability partnership under the Partnership Act.

The RUPA has, however, several non-waivable provisions which make the limited liability partnership less desirable than the limited liability company for practices other than professional practices. Until recently, Delaware attorneys could not practice as a limited liability company and were limited to practicing within the limited liability partnership. Within recent years, that too has changed.

## **2. General and Limited Partnerships:**

Under the General Partnership Act, a partnership not electing to be a limited liability partnership suffers from the problem that all of the partners are personally liable for the debts and obligations of the partnership. While the creditors must first look to the assets of the partnership to satisfy the debt, once the assets of the partnership are exhausted, then the creditor is free to collect its judgment against the individual partners. Before the advent of limited liability companies, the general and limited partnerships were the only entities available to parties who wished to have the benefits, under the tax laws, of the entity being classified for tax purposes as a partnership (we will deal with Subchapter S elections later in this article).

Historically, the limited partnership suffered from one of the same problems as the general partnership, the general partner of the limited partnership must be generally liable for the debts of the partnership, while the limited partners have the same limitation from liability as the stockholders of a Delaware corporation. Recently, Delaware has engrafted upon the Delaware Revised Limited Partnership Act, Section 17-214. Section 17-214(c) provides:

If a limited partnership is a limited liability limited partnership, (i) its partners who are liable for the debts, liabilities and other obligations of the limited partnership shall have the limitation on liability afforded to partners of a limited liability partnership under the Delaware Revised Uniform Partnership Act. . .

A limited partnership which has elected to be a limited liability limited partnership is required under Section 17-214(a)(2) to have the last words or letters of its name the words "limited liability limited partnership," or the abbreviation "L.L.L.P.," or the designation "LLLP."

### **3. C Corporations:**

Corporations designated as “C corporations” or “S corporations” are classifications which exist solely under the Internal Revenue Code and not the Delaware General Corporation Law (“DGCL”). Under the DGCL, there are general corporations and close corporations. Generally speaking, under the Internal Revenue Code, a C corporation is an entity separate from its owners and is a taxpayer. The income and expense of the corporation is reported on the corporation’s income tax return, and unless there has been a distribution by way of dividend to the stockholders, the profits of the corporation are not separately taxable to the stockholder.

Historically, the general corporation has been business entity most often selected by parties entering into business and business transactions. Under the DGCL, the stockholders of a Delaware corporation are not liable for the debts or other obligations of the corporation unless they have agreed in writing to be liable for those debts. This concept is known as limited liability. The stockholders, when investing in the corporation, purchase the stock for cash or other consideration. The consideration which is agreed to be paid to the corporation for the stock represents the liability of the stockholder. The stockholder’s investment in the company is always at risk and, unless the stockholder has in fact not paid for the stock, the stock being considered partially paid, the stockholder is not required to make up any of the debts of the corporation. If the stock is partially paid, the stockholder remains liable for the unpaid portion of the subscription price. With the exception of an unpaid subscription, generally the only time that the stockholder is liable for a debt of the corporation under the DGCL are those cases generally referred to as “piercing the corporate veil,” that is, cases where the stockholder has used the corporation to commit fraud or has used the corporation in a generally inequitable manner to injure another party.

The DGCL provides strict ground rules for the operation of the corporation and the relationship between the stockholders and the corporation. The management of the business of the corporation is in the hands of the corporation’s board of directors. The directors are elected by the stockholders. Vacancies within the board of directors are filled by the remaining directors, and in the absence of any continuing directors, by the stockholders. The day-to-day operations of the corporation are managed by the officers, who are elected by the directors. This relationship of the stockholders electing directors and directors electing the officers is set out in the DGCL. The relationship between the stockholders and the directors and the directors and the officers are somewhat rigid and do not allow for a free interplay needed in private transactions. The provisions of the DGCL require the drafter to fit the transaction within the strictures of the DGCL, while under the Limited Liability Company Act, and to a lesser extent, the Revised Uniform Partnership Act, those laws allow for much more flexibility in the drafting of the structure of the entity.

### **4. S Corporations:**

S corporations are a function of the Internal Revenue Code. Under the Internal Revenue Code there are limits on the number of stockholders in a Subchapter S corporation. Additionally, there are limitations on who may become a stockholder in an electing Subchapter S

corporation. A person who is not a citizen of the United States is prohibited from being a stockholder in an electing Subchapter S corporation. The rules dealing with the pass-through of income and loss limit the amount of loss which a stockholder may take on their personal tax return.

Under the DGCL, the by-laws of the corporation or a stockholder agreement may provide for limitations on the number of stockholders and the qualifications of persons who are stockholders so as to avoid the possibility of an inadvertent loss of qualification as an electing Subchapter S corporation.

Generally, the tax rules dealing with Subchapter S corporations limit the losses which the stockholder may recognize on their personal returns to the stockholder's basis in their stock. The result of these limitations has been that Subchapter S is not an appropriate vehicle for the ownership of real property where the owner anticipates that the losses created by depreciation and other non-cash expenses will be greater than income. Currently, given the tax treatment given to limited liability companies, there are few reasons to use Subchapter S.

## **5. Other Entities:**

There remains one additional primary form of business entity under Delaware law, the statutory trust. The statutory trust was previously called the Delaware business trust. Both the trustee and the beneficiaries of the statutory trust have the same limited liability afforded to stockholders under the DGCL. Under the other forms of business entity in Delaware, there is no good reason for a non-resident to have a place of business in Delaware unless they are in fact transacting business in this state, as having an office in Delaware will make the company susceptible to Delaware income taxes. The statutory trust, on the other hand, must have a Delaware presence by having at least one trustee which has an office in the State of Delaware. Statutory trusts are generally used to hold assets rather than actually transacting an active business. The trustee holds the assets, collects the income and loss, and distributes the income and loss to the beneficiaries in accordance with the trust document. The statutory limitation of liability has made the Delaware statutory trust an effective entity for holding assets such as cruise ships, oil tankers jumbo jets, as well as income-producing properties such as shopping centers and office buildings. In each case, the asset is generally leased by the trustee to a third party who operates the asset and remits rental payments to the trustee. In most cases, the trustee is not involved in the day-to-day operation of the asset, and the asset is generally net leased to the operator.

### **D. State Law Governing Limited Liability Companies:**

The Delaware law governing limited liability companies is codified under Title 6 of the Delaware Code, Section 1801, *et seq.* Under Section 18-1102, the official name of the law is the "Delaware Limited Liability Company Act." Delaware has only the single law governing limited liability companies.

**E. Multi-State Operation:**

In any case where a Delaware limited liability company is transacting business in a state other than Delaware, the law of that state governs what acts are necessary before the Delaware limited liability company may transact business within that state. Generally, states require a “foreign limited liability company” to qualify in some manner. Generally qualification requires that the limited liability company file a form of application with the Secretary of State, and in some cases, with the state taxing authorities. The form of qualification varies from state to state. Before the limited liability company commences its operations in the state, it first must determine whether it is doing business, as that term is defined under that state’s law. Unless the company is involved in a matter which constitutes “doing business” under that state’s law, generally, the foreign limited liability company is not required to qualify. In Part 4 we will discuss the requirements under Delaware law for qualification.

**F. Protection of Liability:**

Unlike the requirements of the DGCL where a company must maintain records of the meetings of the shareholders and the directors, the Limited Liability Company Act does not contain such requirements. Good business, however, militates in favor of the members and managers holding meetings and maintaining minutes of those meetings. Section 18-303(a) provides as follows:

Except as otherwise provided in this Chapter, the debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company, and no member or manager of the limited liability company shall be obligated personally for such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.

Under Subsection (b), members and managers may assume personal liability for such debts or obligations, however, in the absence of an assumption under Subsection (b), there is no liability. The members and managers have “limited liability” in the same manner as a stockholder of a Delaware business corporation under the DGCL.

## **IV. COMPLIANCE UNDER STATE AND FEDERAL LAW**

### **A. Formation of a Limited Liability Company**

#### **Name Reservation:**

Any person may, upon paying the specified fee to the Secretary, obtain the exclusive right to form a company under a specified name for a period of 120 days. The period of the reservation may be renewed for successive terms of 120 days upon payment of an additional fee, and the reservation is transferable. The reservation is made in accordance with Section 18-103(a) and (b) by filing a Certificate stating (a) the name to be reserved, and (b) the name and address of the applicant. The Certificate must be signed by the applicant as defined in 18-103(a), and not by an "authorized person" as permitted for most other filings under the Act (Section 63 below).

#### **Nature of Business, Purpose:**

The Act provides in Section 18-106 that a company "may carry on any lawful business, purpose or activity, whether or not for profit" but may not issue policies of insurance, assume insurance risks or conduct banking. In subsection (c) the Act clarifies that a company may enter into contracts of guarantee and that certain financial risks, such as issuing swaps and hedges are permitted. This last caveat was intended to confirm that the activities listed in the subsection are not the assumption of insurance risks.

#### **Certificate of Formation:**

Consistent with the Delaware view that ease of formation is the hallmark of any Delaware limited liability entity, a limited liability company may be formed by filing a Certificate of Formation which meets the statutory minimum requirements. The statute requires only the filing with the Delaware Secretary of State of a written "Certificate of Formation" which must contain (a) the name of the company, and (b) the name and address of the registered agent and the registered office. The address must include the name of the county in which the registered agent's office is situate. (§18-201) The current filing fee is \$100.00 (§18-206) The Certificate of Formation, as is the case with most other Certificates filed with the Secretary of State, is "executed by one or more authorized persons" who need not be either a member or manager of the company. (§18-204(a)).

#### **§ 18-204. Execution:**

(a) Each Certificate required by this subchapter to be filed in the office of the Secretary of State shall be executed by 1 or more authorized persons.

(b) Unless otherwise provided in a limited liability company agreement, any person may sign any Certificate or amendment thereof or enter into a limited liability company agreement or amendment thereof by an agent, including an attorney-in-fact. An authorization, including a power of

attorney, to sign any Certificate or amendment thereof or to enter into a limited liability company agreement or amendment thereof need not be in writing, need not be sworn to, verified or acknowledged, and need not be filed in the office of the Secretary of State, but if in writing, must be retained by the limited liability company.

(c) The execution of a Certificate by an authorized person constitutes an oath or affirmation, under the penalties of perjury in the third degree, that, to the best of the authorized person's knowledge and belief, the facts stated therein are true.

Execution of any Certificate under §18-204(c) constitutes an oath or affirmation, under penalties of perjury, that to the best of the person's knowledge and belief, the facts in the Certificate are true and correct.

The parties may, at their option, add to the Certificate of Formation such other matters as they may determine to include (18-201(a)(3))

**Name:**

The name of the company must contain one of the following designations that it is a limited liability company: "Limited Liability Company," "LLC" or "L.L.C." The name may contain the name of a member or manager and must be such as to distinguish it upon the records of the Secretary of State from the name on the Secretary's records of any other corporation, partnership, limited partnership, statutory trust or limited liability company reserved, registered, formed or organized under the laws of the State of Delaware or qualified to do business or registered as a foreign corporation, foreign limited partnership, foreign statutory trust, foreign partnership or foreign limited liability company so reserved or registered. (§18-102(3)) The name may contain the words "Company," "Association," "Club," "Foundation," "Fund," "Institute," "Society," "Union," "Syndicate," "Limited," or "Trust" (or any abbreviation of like import). (§18-102(4))

**Registered Agent:**

The address of the registered office in the Certificate of Formation need not be the company's principal place of business or even its business address in Delaware. In most cases, the registered office is the office of the registered agent, however, this is not a requirement. The Certificate includes the name and address of the registered agent for service of process in the State of Delaware.

**Filing:**

The Certificate is "filed" with the Secretary of State by delivering the "original signed copy of the Certificate ... to the Secretary of State," and paying the required fee to the State of Delaware. A person who executes a Certificate as an agent or fiduciary is not required to exhibit evidence of that person's authority as a prerequisite to filing. Any signature on a

Certificate authorized to be filed under the Act may be a facsimile, a conformed signature or an electronically transmitted signature (18-206(a))

**Sui Juris:**

The company is *sui juris*, that is, it is a separate legal entity which can sue or be sued in its own name and has legal existence separate from its members, upon the filing of the Certificate with the Delaware Secretary of State, or such later date as may be stated in the Certificate and shall continue until a Certificate of Cancellation is filed (Section 18-201(b))

**Notice:**

The filing of the Certificate of Formation constitutes notice that the entity formed in connection with the filing is a limited liability company formed under the Act and notice of the all other facts set forth in the Certificate which are either required or permitted under the Act. No publication or additional notice must be given. (18-207)

**Term:**

The term of the company commences upon the filing of the Certificate with the Secretary of state or such later date as may be specified in the Certificate. The duration of the company may be provided or it continues until a Certificate of Cancellation is filed. (18-201) Under Section 18-801(b), a company which does not specify a term in its company agreement, has a perpetual duration.

**Certificate of Amendment:**

Once filed, a Certificate of Formation may be amended by an authorized person executing and filing a Certificate of Amendment with the office of the Secretary of State pursuant to Section 18-202.

Section 18-201

(a) In order to form a limited liability company, 1 or more authorized persons must execute a Certificate of Formation. The Certificate of Formation shall be filed in the office of the Secretary of State and set forth:

- (1) The name of the limited liability company;
- (2) The address of the registered office and the name and address of the registered agent for service of process required to be maintained by § 18-104 of this title; and
- (3) Any other matters the members determine to include therein.

(b) A limited liability company is formed at the time of the filing of the initial Certificate of Formation in the office of the Secretary of State or at any later date or time specified in the Certificate of Formation if, in either case, there has been substantial compliance with the requirements of this section. A limited liability company formed under this chapter shall be a separate legal entity, the existence of which as a separate legal entity shall continue until cancellation of the limited liability company's Certificate of Formation.

(c) The filing of the Certificate of Formation in the office of the Secretary of State shall make it unnecessary to file any other documents under Chapter 31 of this title.

(d) A limited liability company agreement may be entered into either before, after or at the time of the filing of a Certificate of Formation and, whether entered into before, after or at the time of such filing, may be made effective as of the formation of the limited liability company or at such other time or date as provided in the limited liability company agreement.

#### **Restated Certificate:**

A company may at any time integrate into one instrument all provisions of its Certificate of Formation then in effect as a result of amendments or other instruments having been filed. The Restated Certificate may further amend the Certificate of Formation. Upon the filing of the Restated Certificate, the Restated Certificate supersedes all previously filed instruments, however the original effective date of formation will remain unchanged. (18-208) If the Restated Certificate of Formation merely restates and integrates, but does not further amend the initial Certificate as amended by any subsequent Certificate, it must be designated in the heading a "Restated Certificate of Formation." However, if the Restated Certificate further amends the initial Certificate as amended by any subsequent Certificate, it must state in the heading of the Certificate that it is an "Amended and Restated Certificate of Formation." (18-208(b)) The Restated Certificate is executed by one or more authorized persons and filed as provided in Section 18-206.

In either the heading or the introductory paragraph the Restated Certificate must state the company's present name, and if the name of the company has been changed, the name under which the company was originally formed, the date of its original formation, the future effective date and time of the Certificate if it is not to be effective upon filing, and a statement that the Certificate was duly executed and is being filed under Section 18-208. If the Certificate does not amend or supplement the previously filed Certificate or any previous amendment, and there is no discrepancy between the previous provisions and the Restated Certificate, the Restated Certificate must state that fact as well.

## **Certificate of Cancellation:**

The existence of the company continues until a Certificate of Cancellation is executed and filed with the Secretary of State. The Certificate of Cancellation is filed once the company has dissolved and has completed winding up its affairs. (18-203) In the case of a Merger or Consolidation, any domestic limited liability company which is not the surviving entity is not required to file a Certificate of Cancellation, as the Certificate of Merger or Consolidation serves as a Certificate of Cancellation for that company. (18-209(e)) Unlike the provisions of the GCL where, following the filing of a Certificate of Dissolution, the corporation proceeds within three years to wind up its affairs, when a LLC files its Certificate of Cancellation, it must have already concluded its winding up. Once the Certificate of Cancellation is filed, the company is without power to take any further action. Thus, if the company fails to convey a parcel of land held by the company prior to the filing of the Certificate of Cancellation, the company is wholly unable to subsequently convey the property. Delaware does not have a statutory procedure to revoke the cancellation. The commonly accepted practice is, however, to file a Certificate of Correction (18-211(a)) to the Certificate of Cancellation. That Section provides as follows:

(a) Whenever any certificate authorized to be filed with the office of the Secretary of State under any provision of this chapter has been so filed and is an inaccurate record of the action therein referred to, or was defectively or erroneously executed, such certificate may be corrected by filing with the office of the Secretary of State a certificate of correction of such certificate. The certificate of correction shall specify the inaccuracy or defect to be corrected, shall set forth the portion of the certificate in corrected form, and shall be executed and filed as required by this chapter. The certificate of correction shall be effective as of the date the original certificate was filed, except as to those persons who are substantially and adversely affected by the correction, and as to those persons the certificate of correction shall be effective from the filing date.

Under Section 18-211(b) the company may file in lieu of the Certificate of Correction a Corrected Certificate. The Corrected Certificate must be designated as such in its heading, shall specify the defect or inaccuracy to be corrected and shall set forth the entire Certificate in corrected form.

In our example, if the company had not in fact wound up its affairs at the time the Certificate of Cancellation became effective, the filing would, therefore, be "an inaccurate record of the action therein referred to." It is then appropriate to file a Certificate of Correction. Again, however, after the company has completed the new winding up, it must again file a Certificate of Cancellation.

### **Execution, Amendment or Cancellation by Judicial Order:**

In the event that a person who is, under the Act, required to execute a Certificate which is required to be filed under the Act, either fails or refuses to do so, then in such case any other person who is adversely affected by the inaction may petition the Court of Chancery to direct the execution of the Certificate. If the court finds that the execution of the Certificate is proper, it is required to order the Secretary of State to record an "appropriate Certificate." 18-205(a) In the case of a person who is required to execute a company agreement or an amendment to a company agreement and who fails or refuses to execute the company agreement or an amendment, any person who is adversely affected may petition the Court of Chancery to direct the execution of the agreement. If the Court finds that the company agreement or an amendment should be executed, it is required to enter an order granting appropriate relief which would be in the form of a mandatory injunction. If a party continues to refuse to obey the injunction, the court has the power to direct that a person execute the agreement in the name of the person who has refused to execute the agreement. 18-205(b)

## **B. Mergers, Conversions and Series LLC**

### **Merger**

#### **Merger Process:**

A Delaware LLC may, pursuant to an agreement of Merger or Consolidation, merge or consolidate with or into one or more domestic (Delaware) limited liability companies or "other business entities" formed under the laws of Delaware, another state, foreign country or foreign jurisdiction. (18-206(b)) "Other business entity" means a corporation, statutory trust (formerly known as business trusts), or a business trust (i.e., commercial law business trust) or association, a real estate investment trust, a common-law trust, or any other unincorporated business, including a partnership, whether general (including a limited liability partnership) or limited (including a limited liability limited partnership) and a foreign limited liability company. (18-206(a)) In a merger, one of the constituent companies is the survivor and the other constituent companies merge with and into the survivor, in a consolidation the constituent companies come together and form a resulting company which will be the survivor, no one company is the survivor.

A Delaware limited liability company which is a party to the merger may be the surviving entity or the other business entity may be the survivor. Unless the company agreement provides to the contrary, the Agreement of Merger or Consolidation must be approved by members holding more than 50% of the current percentages or other interests in the profits of the domestic limited liability company owned by all members. If the company agreement has established classes or groups of members, members holding more than 50% of each class or group, as appropriate, must separately approve the merger. In connection with the merger or consolidation the rights or securities or interests in the constituent parties may be exchanged for or converted into cash, property, right or securities of, or interests in, the surviving or resulting domestic limited liability company or other business entity. In addition to or in lieu of a conversion to cash, or other rights, the securities or interests may be exchanged for or converted into cash, property, right or securities of or interests in a domestic limited liability company or

other business entity which is not the surviving or resulting limited liability company or other business entity in the Merger or Consolidation. In this manner a Merger or Consolidation may be structured so that certain member of a limited liability company or interest holders in another business entity can be "cashed out" in the Merger or Consolidation in the same manner as this can be accomplished under the GCL, however, the last proviso which allows for conversion into interests in a third party entity grants additional options in transactions. (18-206(b))

The Merger or Consolidation is effected by filing a Certificate of Merger or Consolidation which meets the requirements of Section 18-209(c). In lieu of filing a Certificate of Merger, the Agreement of Merger or Consolidation containing the information required by Section 18-209(c) may be filed. The merger or consolidation is effective either at the time it is filed or such future effective date as provided in the Certificate. The Certificate of Merger or Consolidation serves as a Certificate of Cancellation when the domestic LLC is not the surviving or resulting entity. Notwithstanding that the merger has been approved by all constituent parties, the merger may be amended or terminated pursuant to the terms of the Agreement of Merger or Consolidation. A Certificate of Merger or Consolidation with a future effective date may be terminated by filing a Certificate of Termination prior to the effective date. The Certificate of Merger or Consolidation may also effect any amendment to the company agreement or may effect the adoption of a new company agreement when the domestic limited liability company is the surviving or resulting entity.

#### **Requirements for a Certificate of Merger or Consolidation.**

The Certificate of Merger or Consolidation must state:

- The name and jurisdiction of formation or organization of each constituent party to the Merger or Consolidation.
- That an agreement of Merger or Consolidation has been approved and executed by each constituent party to the Merger or Consolidation.
- The name of the surviving business entity.
- The future effective date and time of the Merger or Consolidation if the Merger or Consolidation is not to be effective upon the filing of the Certificate.
- That the agreement of Merger or Consolidation is on file at a place of business of the surviving or resulting entity and the address of such office.
- That a copy of the agreement of Merger or Consolidation will be furnished by the surviving or resulting domestic limited liability company or other business entity, on request and without cost, to any member of any domestic limited liability company or other business entity which is to merge or consolidate.

- If the surviving or resulting company is not a domestic business entity, a statement that such business entity may be served with process in the State of Delaware in any action, suit or proceeding for the enforcement of any obligation of any domestic limited liability company which is to merge or consolidate, irrevocably appointing the Secretary of State as its agent to accept service of process in any such action, suit or proceeding and specifying the address to which a copy of such process shall be mailed to it by the Secretary of State.
- The Certificate of Merger or Consolidation is executed pursuant to Section 18-204 by the surviving domestic limited liability company by an authorized person, or if the domestic limited liability company is not the surviving entity, the Certificate is executed on behalf of the limited liability company by the surviving business entity.

Upon the accomplishment of the Merger or Consolidation, all rights, privileges and powers of each merged or consolidated entity, and all property, real, person and mixed, and all debts due to any such entity, as well as all other things and causes of action belonging to each such entity, shall be vested in the surviving or resulting entity.

### **Conversion:**

#### **Process of Conversion:**

The Delaware Act permits any "other entity" to convert to a Delaware limited liability company or a Delaware limited liability company to convert to an "other entity" formed under Delaware law. (18-214) Or under section 18-216 to an other entity existing under the laws of any other state or nation The Act defines "other entity" as: "... a corporation, statutory trust, business trust or association, a real estate investment trust, a common-law trust or any other unincorporated business, including a partnership (whether general (including a limited liability partnership) or limited (including a limited liability limited partnership)) or a foreign limited liability company." The conversion to a Delaware limited liability company is accomplished by filing a Certificate of Formation to create the converted entity under Section 18-214(b), followed by the filing of a Certificate of Conversion with the Secretary of State which meets the requirements of Section 18-214(c). The existence of the converted entity relates back to the effective date of the formation of the "other entity" under the Act. The converted entity succeeds to all rights, privileges, powers, properties and benefits of the "other entity" and holds its property subject to the debts, liabilities and duties of the "other entity."

#### Section 18-214:

(d) Upon the filing in the office of the Secretary of State of the Certificate of Conversion to limited liability company and the Certificate of Formation or upon the future effective date or time of the Certificate of Conversion to limited liability company and the Certificate of Formation, the other entity shall be converted into a domestic limited liability

company and the limited liability company shall thereafter be subject to all of the provisions of this chapter, except that notwithstanding § 18-201 of this title, the existence of the limited liability company shall be deemed to have commenced on the date the other entity commenced its existence in the jurisdiction in which the other entity was first created, formed, incorporated or otherwise came into being.

(e) The conversion of any other entity into a domestic limited liability company shall not be deemed to affect any obligations or liabilities of the other entity incurred prior to its conversion to a domestic limited liability company or the personal liability of any person incurred prior to such conversion.

(f) When any conversion shall have become effective under this section, for all purposes of the laws of the State of Delaware, all of the rights, privileges and powers of the other entity that has converted, and all property, real, personal and mixed, and all debts due to such other entity, as well as all other things and causes of action belonging to such other entity, shall remain vested in the domestic limited liability company to which such other entity has converted and shall be the property of such domestic limited liability company, and the title to any real property vested by deed or otherwise in such other entity shall not revert or be in any way impaired by reason of this chapter; but all rights of creditors and all liens upon any property of such other entity shall be preserved unimpaired, and all debts, liabilities and duties of the other entity that has converted shall remain attached to the domestic limited liability company to which such other entity has converted, and may be enforced against it to the same extent as if said debts, liabilities and duties had originally been incurred or contracted by it in its capacity as a domestic limited liability company. The rights, privileges, powers and interests in property of the other entity, as well as the debts, liabilities and duties of the other entity, shall not be deemed, as a consequence of the conversion, to have been transferred to the domestic limited liability company to which such other entity has converted for any purpose of the laws of the State of Delaware.

The 2003 amendments to the Act now permit a LLC to convert out of Delaware. The approval process for a conversion out is the same as any other conversion, however under section 18-216 (e) the Company must file a Certificate which states:

- The name of the Company, and if the name has been changed, the name in its original Certificate of Formation.
- The date of the filing of the original Certificate of formation.
- The jurisdiction in which the other entity, into which the Company will convert, was formed.

- The future effective date and time (which must be a date or time certain) of the conversion if the Certificate is not to be effective upon filing.
- That the conversion has been approved in accordance with 18-216.
- The agreement of the company to be served with process in Delaware and the irrevocable appointment of the Secretary of State as its agent for the service of process.
- The address to which the Secretary shall send any service of process.

### **Approval of the Conversion of an LLC to Another Entity:**

A limited liability company formed under the Act may convert to an "other entity" formed under the Act or under the laws of another jurisdiction. If the company agreement specifies the manner for authorizing the conversion, the conversion must be authorized in accordance with the agreement. If the agreement does not provide the method for authorizing the conversion and does not prohibit a conversion, the conversion must be authorized by the members. If the company has more than one class or group of members, the conversion must be approved by the members of each such group or class holding more than 50% of the then current percentage or other interest in the profits of the company owned by all members in each class or group. The conversion does not require that the company file a Certificate of Cancellation, wind up its affairs or pay its debts and distribute its assets. In connection with the conversion, the interests in the company may be converted into cash, property rights or securities or interests in the business form into which the company is to be converted. In addition or in lieu of conversion of the company interests into interests in the surviving entity, the company interests may be converted into rights or securities or interests in another business form. The options granted to the company in connection with the conversion of company interests are the same as under a merger and permits the "cash out" of some of the members in connection with the conversion to the other entity. 18-216.

### **C. Property Transfers:**

A limited liability company is a separate legal entity from its owners. As such, a limited liability company can own real property, lease, mortgage and convey such property. A limited liability company, because it is governed by a limited liability company agreement which is not a public record, presents unique problems in connection with the conveyance of real property. Generally, the title insurance company which is issuing title insurance in connection with the transaction, as well as the purchaser's attorney, will require the following from the limited liability company:

1. A copy of its company agreement and any amendments certified as a true copy by the member of manager;
2. A certified copy of its Certificate of Formation and any amendments;
3. A current Certificate of Good Standing issued by the Secretary of State;
4. A copy of a resolution by the members or managers in accordance with the company agreement authorizing the transaction and the execution, acknowledgment and delivery of the instruments to be recorded;
5. Proper identification of the person executing the documents; and
6. Any other documents which may be identified as a result of the review of the company agreement, the Certificate of Formation or the authorizing resolutions.

If the limited liability company is a manager managed company, the deed or other instrument is signed by the manager in the following format:

XYZ LLC

By: \_\_\_\_\_  
 , Manager

If, however, the company is not managed by a manager but by its members, or it has designated a managing member, the instrument is executed by all of the members either identified in the company agreement or by such lesser number as provided in the resolution of the members authorizing the transaction. Once again, the execution would appear as follows:

XYZ LLC

By: \_\_\_\_\_  
 Member [or Managing Member]

**D. Dissolution And Winding Up:**

**Dissolution:**

A company dissolves and its affairs under Section 18-801 are wound up (a) at the time provided in the company agreement, (b) upon the occurrence of an event or events specified in the company agreement, (c) unless otherwise specified in the company agreement, with the affirmative vote or written consent of the holders of 2/3 of the then current percentage of company interests of all classes and group of members, (d) at such time as the company no longer has any members, or (e) by the entry of a judicial order of dissolution under Section 18-

802. If the company agreement does not provide for a time when the company will dissolve, then the company has perpetual existence. (18-801(a))

At such time as the company no longer has any members, the company must dissolve unless within 90 days of the event which gave rise to the termination of the membership of the last member, or such other period as may be provided in the company agreement, the personal representative (a term defined in § 18-101(B) as "the executor, administrator, guardian, conservator or other legal representative of a natural person or the legal representative or successor thereof of a person other than a natural person") of the last member, its designee or nominee becomes admitted as a member. The company agreement may provide that the personal representative, its nominee or designee shall be obligated to become admitted as a member so as to continue the existence of the company. (18-801(a)(4)) This latter provision becomes important in finance transactions where the lender requires that the borrower be a special purpose entity, this provision will preclude the dissolution of the borrower as a result of the death of a human member or the dissolution of an entity member.

Section 18-801(b) clarifies that the "death, retirement, resignation, expulsion, bankruptcy or dissolution" of a member does not cause the dissolution and winding up of the company unless the company agreement requires the dissolution and winding up on such an occurrence.

#### **Judicial Dissolution:**

The Delaware Court of Chancery has exclusive jurisdiction to hear applications by or on behalf of a member or manager to dissolve a company because "it is not reasonably practicable to carry on the business in conformity with a ..." company agreement. (18-802)

#### **Winding Up:**

Unless the manager of the company has wrongfully dissolved the company, the manager winds up the affairs of the company. If the company does not have a manager the member or members may wind up the affairs of the company. Upon the application of a member, manager or the personal representative of a member or manager, the Court of Chancery may appoint a liquidating trustee. (18-803(a))

When a corporation dissolves a Certificate of Dissolution is filed pursuant to 8 Del. C. §275, thereafter and for a period of 3 years the company continues for the purpose of winding up its affairs, unless the time to wind up its affairs is extended by order of the Court of Chancery. When a LLC dissolves, no document is filed with the Secretary of State, the party responsible for the winding up proceeds with the winding up process, and once that process has been completed a Certificate of Cancellation is filed. Once the Certificate of Cancellation is filed, the winding up must have been completed as the party performing the winding up is thereafter wholly without any power to act on behalf of the company, even in the case where the company continues to hold title to land. Section 18-803 does not contain a time limitation to complete the winding up process. (18-803) The Act does not contain any provision which permits the cancellation of the Certificate of Cancellation. However, under Section 18-211, when

a document filed with the Secretary of State is an inaccurate record of the actions reflected therein, the member or manager may file a Certificate of Correction. If the company continues to hold an asset or it is otherwise a necessity for the company to do a specific act after the Certificate of Cancellation has been filed, a Certificate of Correction may be filed to "undo" the cancellation. Any party which acted upon reliance on the Certificate of Cancellation is fully protected.

### **Distribution of Assets:**

Section 18-804(a) provides the statutory priority for distribution of assets. Under Subsection 804(b), the company must make provision for the payment of claims and obligations including unmatured and contingent claims known to the company, make provisions sufficient to provide for claims currently the subject of litigation or based upon known facts, claims which are likely to arise or become known to the company within 10 years following the date of dissolution. If there are sufficient assets, the claims and obligation are required to be paid in full, if there are insufficient assets, claims are paid in order of priority as set forth in Subsection 804(a). After making provision for all such claims, then and only then, may assets be distributed to the members. A member who receives a distribution in violation of the section which the member knows to be in violation of this section is liable to the company, not creditors, for the amount of the distribution. "Reasonable compensation" is not included in the concept of a wrongful distribution. Subsection 804(d) provides a 3 year statute of limitation upon any such claim against a member under Section 18-804.

### **E. One Person Limited Liability Companies:**

Delaware permits the formation of a limited liability company with a single member. The Act permits the single member may adopt a company agreement. The company agreement is an agreement of the members. A contract represents an agreement of two or more persons, and under contract law, a person may not enter into a contract with themselves. In the case of a limited liability company agreement, a company agreement is not void by virtue of it being executed by only the single member. (See 18-101(7)).

Though the limited liability company may have just one member, the company still needs to have a limited liability company agreement. The company agreement may, under Section 18-101(7), be an oral agreement which the member conscientiously adopts or a written agreement. A single member would be ill-advised to claim to have an oral agreement, as there is generally no other party to attest to the terms of that agreement should that ever become important.

### **F. Foreign Limited Liability Companies:**

#### **Law Governing:**

The internal affairs and the liability of a foreign limited liability company to its members and managers is governed, subject to the Delaware Constitution, by the laws of the state, country or other jurisdiction under which the foreign limited liability company is formed, govern its internal affairs and the liability of its members and managers. A foreign company may

not be denied registration in Delaware solely by reason of differences between the laws of its jurisdiction of organization and the laws of Delaware. A foreign company is, however, subject to Section 18-106 which describes the nature of the business of a limited liability company.

### **Registration of a Foreign Limited Liability Company:**

Before a foreign company may begin "doing business" in Delaware, the company must register with the Secretary of State. The company must submit an Application for Registration signed by an authorized person meeting the requirements of Section 18-902(a)(1) and pay the fee set forth in Section 18-1105(a)(6). The Application is executed by an authorized person in accordance with Section 18-204. A foreign company is not "doing business" in Delaware solely by reason of being a member or manager of a domestic or foreign limited liability company. (18-902)

If any statement in the Application for Registration was false when made, or any fact described changed making the application false in any respect, the company is required to cause an authorized person to file an amendment to the Application accompanied with the payment of the appropriate fee. (18-905)

### **Issuance of Registration:**

In each case where a company which has complied with Section 18-902, the Act requires that the Secretary certify that the application has been filed by endorsing upon the original Application the word "Filed" and the date and hour of filing. The endorsed Application is then indexed within the Secretary of State's records system. The Secretary then prepares and returns to the person filing the Application a copy of the original Application indorsed as "Filed" with the date and time of filing, and the Secretary of State is required to certify the copy as a true copy of the original. The filing of the Application with the Secretary makes it unnecessary to file any other document. (18-903)

A registered foreign limited liability company may cancel its registration by filing with the Secretary a Certificate of Cancellation under Section 18-203 accompanied by the appropriate fee. The filing of a Certificate of Cancellation does not terminate the authority of the Secretary to accept service of process with respect to causes of action arising out of the company doing business in Delaware. (18-906)

### **Name, Registered Office, Registered Agent:**

The name which the foreign company registers with the Secretary of State need not be the name under which it is formed in its jurisdiction of formation. The name registered must contain the words "Limited Liability Company," "LLC" or "L.L.C." and must be a name under which a domestic company could have been formed, i.e., may not contain the word "bank" or "trust company" or imply that it is an insurance company. The name, unless first consented to by an entity having the same or similar name, must distinguish the foreign company upon the records of the Secretary from the name of any domestic or foreign corporation, partnership, statutory trust, limited liability company or limited partnership reserved, registered, formed or

organized under Delaware law. The foreign limited liability company must maintain a registered office in this State as well as have a registered agent. (18-904)

### **Doing Business in Delaware Without Registration:**

A company which has failed to register may not maintain any action, suit or proceeding in Delaware until it has registered and paid all fees and penalties for the years or parts of a year during which it did business without having registered and a fine of \$200 for each year or part thereof during which it failed to register. A company which commences an action may register and pay all fees without having to dismiss the previously filed action. The failure of a company to register does not impair the validity of any contract entered into without registration, the right of a third party to maintain an action against the company or prevent the company from defending any action, suit or proceeding in a Delaware court. The failure of the company to register does not result in the personal liability of a member or manager for the obligations of the company solely as a result of the failure to register. (18-907)

The Attorney General has the power to seek an injunction from the Court of Chancery to enjoin any foreign limited liability company or any agent thereof from doing business in Delaware if it had not registered or if it had filed an Application on the basis of false or misleading representations. (18-906)

### **Service of Process Upon Registered and Unregistered Foreign Limited Liability Companies:**

Service of process upon a registered foreign company is similar to service of process upon a domestic company. In the case of a registered foreign company, in addition to serving the manager or registered agent, service of process can be made personally upon "any managing or general agent." (18-810) In the case of an unregistered foreign company, by virtue of doing business in the State the company has appointed the Secretary of State as its agent for the service of process. The Secretary, upon receipt of the process, is required to send the summons to the company, by certified mail, return receipt requested, at the address supplied by the plaintiff. (18-911)

### **G. Securities Laws Considerations:**

A limited liability company interest may qualify as a security under both state and federal securities laws. Consequently, great care must be taken before a member or a manager or other party enters into agreements to sell membership interests to persons not involved in the business of the company.

Both state and federal securities laws contain exemptions from registration under limited circumstances. The scope and breadth of federal and state securities laws are much too complicated for a complete review in an article of this length. For that reason, you are urged to consult a securities lawyer prior to selling membership interests to any party.

Generally, however, in those cases where individuals join together in a business venture where there is participation by the members in the venture, such ventures are generally not considered to be the sale of investment securities. However, in many cases the sale remains subject to the anti-fraud rules under the securities acts.

#### **H. Special Rules For Regulated Professionals:**

The Delaware Constitution places the responsibility for the regulation of the profession of law under the jurisdiction of the Delaware Supreme Court. Under Supreme court Rule 67 the court has permitted attorneys to practice in several forms including LLP's or LLC's subject to the following limitations in subsection (h):

(i) Individual Acts. "Each shareholder, partner or member of a Professional Organization shall be liable to the extent provided by law for his or her own negligence, wrongful acts or misconduct in rendering legal services."

(ii) Joint and several liability. Each shareholder, partner or member of a Professional Organization is jointly and severally liable for any liability of the Professional Organization based upon a claim arising from acts by shareholders, partners or members of and other persons employed or otherwise retained by the Professional Organization in rendering of legal services while such person was a shareholder, partner, or member of the Professional Organization, subject to limitations contained in the rule with respect to safe harbor amounts of professional liability insurance maintained by the Professional Organization.

#### **I. Exceptions To Limited Liability:**

As pointed out before, the Limited Liability Company Act provides for limited liability of members to managers and further provides that a member or manager may in writing agree to be liable for the debts or other obligations of the company.

In limited circumstances, the courts have applied to limited liability companies the corporate concept of "piercing the corporate veil." Under this concept, the court allows a creditor to reach the personal assets of the members of the limited liability company where the person has used the limited liability company to commit fraud or the person has used the limited liability company to take or omit to take action which makes it generally inequitable to permit the members or managers to use the limited liability company's limited liability shield to shield them from personal liability for their own act or omission.

Courts are reluctant to pierce the corporate veil. It is seldom that the courts take such radical action, and generally speaking, the courts only take such action in cases where the facts are particularly egregious, where the court finds the actions of the members or managers to shock the court's conscious.

#### **J. The Company Agreement:**

##### **Background:**

In some jurisdictions, the company agreement must be filed in a public office and becomes a public document, not so in Delaware. The company agreement is a private agreement among the members of the company.

Under the GCL, there are provisions which require the corporation to have at least one director and officer. The GCL requires the shareholders and the board of directors must meet on a regular basis, at least annually. The Limited Liability Company Act is devoid of any such requirements unless, of course, the parties place such a requirement in the company agreement. There are few absolute requirements for a limited liability company. One of the few requirements is the payment of the annual franchise fee to the State of Delaware currently set at \$200.00 and to maintain a registered office and registered agent within the State of Delaware.

The Limited Liability Company Agreement, sometimes referred to as an "operating agreement," is defined in Section 18-101(7) and is the agreement of the members as to the affairs of the company and the conduct of its business. The manager, if the manager is not a member, is not a party to the Agreement. The Agreement may be entered into either before or after the company is formed. The Agreement may be written or oral and is not unenforceable, in the case of a company with only one member, as a result of there having only been one party to the Agreement. In the case where the company has either not adopted a company agreement, or the company agreement does not include matters addressed under the Act, the Act serves as the "default" provision for the Agreement. Most sections in the Act include a phrase similar to "except as provided in a limited liability company agreement ..."

It goes without saying that it would be unwise for a company with two or more members either not to have a company agreement or to have an oral agreement.

The Agreement is executed by the members, and, if the managers are members of the company, by the members/managers. The Agreement need not be executed by the company or a non-member manager. The company is bound by the company agreement whether or not it executes the Agreement. If the manager is not a member, it would be wise for the company to enter into an agreement with the manager binding the manager to perform the obligations of the manager under the Agreement.

#### Section 18-101(7)

"Limited liability company agreement" means any agreement (whether referred to as a limited liability company agreement, operating agreement or otherwise), written or oral, of the member or members as to the affairs of a limited liability company and the conduct of its business. A limited liability company is not required to execute its limited liability company agreement. A limited liability company is bound by its limited liability company agreement whether or not the limited liability company executes the limited liability company agreement. A limited liability company agreement of a limited liability company having only 1

member shall not be unenforceable by reason of there being only 1 person who is a party to the limited liability company agreement. A written limited liability company agreement or another written agreement or writing:

a. May provide that a person shall be admitted as a member of a limited liability company, or shall become an assignee of a limited liability company interest or other rights or powers of a member to the extent assigned, and shall become bound by the limited liability company agreement:

1. If such person (or a representative authorized by such person orally, in writing or by other action such as payment for a limited liability company interest) executes the limited liability company agreement or any other writing evidencing the intent of such person to become a member or assignee; or

2. Without such execution, if such person (or a representative authorized by such person orally, in writing or by other action such as payment for a limited liability company interest) complies with the conditions for becoming a member or assignee as set forth in the limited liability company agreement or any other writing; and

b. Shall not be unenforceable by reason of its not having been signed by a person being admitted as a member or becoming an assignee as provided in subparagraph a. of this paragraph, or by reason of its having been signed by a representative as provided in this chapter.

The Delaware Act does not have a provision which specifically requires, in so many words, that the company adopt an agreement. Delaware practitioners have interpreted Section 18-101(7), however, to require that a company adopt either a written or oral company agreement.

### **Indemnification:**

The company agreement may provide for the indemnification of members, managers or other persons from and against any and all claims and demands whatsoever. (18-108) Section 18-107 permits members and managers to deal with the company in the same manner as a person who is neither a manager or member:

Except as provided in a limited liability company agreement, a member or manager may lend money to, borrow money from, act as a surety, guarantor or endorser for, guarantee or assume 1 or more obligations of, provide collateral for, and transact other

business with, a limited liability company and, subject to other applicable law, has the same rights and obligations with respect to any such matter as a person who is not a member or manager.

### **Contractual Appraisal Rights:**

Unlike the rights granted to shareholders under the GCL, a member of a limited liability company does not have any statutory appraisal rights in the event of a merger, consolidation, amendment of the Certificate of Formation, conversion to another business form, transfer to any other jurisdiction, or the sale of substantially all of the Company's assets. Under Section 18-201 a company agreement (or an agreement of Merger or Consolidation) may grant contractual appraisal rights to any group or class of members or other company interests

"... in connection with any amendment of a limited liability company agreement, any Merger or Consolidation in which the limited liability company is a constituent party to the Merger or Consolidation, any conversion of the limited liability company to another business form, any transfer to or domestication in any jurisdiction by the limited liability company, or the sale of all or substantially all of the limited liability company's assets. The Court of Chancery shall have jurisdiction to hear and determine any matter relating to any such appraisal rights." (18-210)

### **Members and Managers Not Responsible for Company Debts:**

Members and managers of a LLC are not personally liable for the debts, obligation and liabilities of the company, irrespective of how they arise, solely by reason of being a member or acting as a manager of the company. Under the terms of a company agreement or an other agreement, a member or manager may agree to be obligated personally for any or all of the debts, obligations and liabilities of the company. (18-303)

(a) Except as otherwise provided by this chapter, the debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company, and no member or manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.

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

### **Admission of Members:**

The company agreement provides for the admission of members. (18-301) The interests of the members of the company may be represented by a Certificate in the same manner that a share of stock evidences the ownership by the stockholder of his shares. (18-702(c)) The company agreement may permit a person to be admitted as a member without making a capital contribution or being obligated to make a contribution to the company. The Agreement may also provide that a member may hold a company interest or a person may become a member without holding any economic interest in the company. (18-301(d)) A person is admitted as a member upon the later of the formation of the company or at the time provided in the company agreement and upon compliance with the terms or requirements contained in the company agreement. If the Agreement does not provide for the time of admission, a member is deemed to have been admitted at the time when the member's admission is reflected in the records of the company.

Following the organization of the company, additional members may be admitted, either as an assignee of a company interest from an existing member or by acquiring the interest directly from the company. In the case of a person acquiring the interest directly from the company or a person being admitted as a member without an economic interest, that person is admitted at the time provided in, and upon compliance with, the company agreement. A person admitted directly by the company becomes a member by complying with the company agreement, which may include making a capital contribution. If the company agreement does not provide for the procedure to admit new members, a member may be admitted upon first obtaining the consent of all of the members and the person is officially admitted on the date when the person's admission is reflected upon the records of the company. Generally, the new member will be required to sign a counterpart of the company agreement or a separate agreement, or joinder, making that person a party to the company agreement.

### **Members Have No Interest in Company Property:**

The company interest in a limited liability company is personal property, (18-701) however, no member has an interest in specific company property (Id.) Likewise, no creditor of a member has any right to obtain possession of or otherwise exercise any legal or equitable remedies with respect to the property of the company. (18-703(f)) This latter provision is important to lenders lending to a company. As in the case of a limited partnership, a judgment creditor of a member, or of an assignee, has the right to obtain a charging order to satisfy the judgment. See Section 13.4, infra.

### **Assignee of a Member's Interest:**

A company agreement may provide that a member may not assign or otherwise transfer their company interests. Unless otherwise provided in the company agreement, all of the members must approve the assignment or transfer of a company interest. The right to receive a distribution of income and expenses is separate from membership and may be assigned separately in the absence of a prohibition in the company agreement. An assignee of a company interest may become a member as provided in the company agreement, or if the agreement does not so provide, at the time that such person's admission is approved by all members and the new member's admission is reflected on the records of the company. Until the assignee becomes a member, the assignee shall have no liability as a member solely as a result of the assignment.

(18-702(d)) Likewise, the assignee has no right to participate in management of the business affairs of the company. (18-702(a)) The company agreement may place limitations upon the right of an assignee to become a member and may in fact prohibit any assignee from becoming a member. (18-702(b)(1)) Under Section 18-704(a), unless otherwise provided in the company agreement, an assignee becomes a member upon:

- (1) The approval of all of the members of the limited liability company other than the member assigning limited liability company interest; or
- (2) Compliance with any procedure provided for in the limited liability Company Agreement.

(b) An assignee who has become a member has, to the extent assigned, the rights and powers, and is subject to the restrictions and liabilities, of a member under a limited liability company agreement and this chapter. Notwithstanding the foregoing, unless otherwise provided in a limited liability company agreement, an assignee who becomes a member is liable for the obligations of the assignor to make contributions as provided in § 18-502 of this title, but shall not be liable for the obligations of the assignor under subchapter VI of this chapter. However, the assignee is not obligated for liabilities, including the obligations of the assignor to make contributions as provided in § 18-502 of this title, unknown to the assignee at the time the assignee became a member and which could not be ascertained from a limited liability company agreement.

(18-704)

### **Repurchase of Interests:**

Unless the company agreement prohibits or limits the rights of the Company to acquire company interests, the company may acquire, by purchase, redemption or otherwise, any company interest or other interest in the company from a member or manager. Unless otherwise provided in the agreement, the interest so acquired is deemed to be cancelled upon acquisition. (18-702(e)) The company agreement may require that a member or manager wishing to sell or assign their company interest or other interest sell the interest to the company or offer the interest to the company for sale prior to any transfer to a third party.

### **Death of Members:**

A company does not terminate or dissolve upon the death of a member unless required to do so under the company agreement. Upon the death of a member who is an individual, or upon a court determining that the member is incompetent, the "personal representative" of the member has the right to exercise all rights of a member to settle the member's estate or administer the member's property, including any power under a company agreement of an assignee to become a member. (18-705) Under Section 18-801(a)(4) a company dissolves upon the death of the last member or upon a court finding that the member is not capable of managing his affairs. Under that subsection, however, a company agreement may

make it mandatory for the personal representative or his designee to be admitted as a member within 90 days following the event which led to there being no member, and thus continue the company.

### **Resignation of Members:**

In the absence of terms in the company agreement to the contrary, a member may resign only at the time or upon the happening of events specified in the Agreement and as provided in the Agreement. Notwithstanding anything to the contrary under applicable law, the Agreement may provide that a member may not resign from the company nor may he assign his interest in the company prior to the dissolution and winding up of the company. It is not uncommon to provide in company agreements that because of the trust among the members, their business relationship or the nature of the company's investment, that a member may neither resign or transfer his company interest until the company has dissolved and its affairs wound up. (18-603)

Unless otherwise provided in the company agreement, upon the resignation of a member or manager, the company must pay that member, under Section 18-604, any unpaid distributions and the fair value of his company interest.

### **Business Transactions of Member/Manager with the Limited Liability Company:**

Under the Act, a member or manager may lend money to the company, borrow money from the company, act as a surety, guarantor or endorser for an obligation of the company, or guarantee or assume one or more obligations of the company, and may transact other business with the company. The Section further provides that such member or manager has the same rights and obligations with respect to any such matter as a person who is not a member or manager. The company agreement may limit or in fact prohibit any such transactions. Generally, a company agreement contains a provision which requires that if a company is to do business with a member/manager, the terms of the transaction must be fair to the company and must at least be on terms as generous as the company could have obtained from a non-member or manager.

### **Delegation of Rights and Powers to Manage:**

Generally, the limited liability company agreement provides either for a delegation of rights and powers to manage or requires that the company must be managed by the manager or by all or a group of the members. In the absence of such a provision, Section 18-407 permits the manager or one or more of the members the right to delegate to agents, officers and employees of a member/manager or to delegate by management agreement or another agreement with, or otherwise to, other persons. Unless the company agreement provides to the contrary, the delegation to such person does not cause the member or manager to cease to be a member or manager or cause the person to whom management has been delegated to become a member or manager.

### **Contribution by a Member or Manager:**

The Delaware Act does not require that a member or manager make a contribution to the company in exchange for a company interest. If a contribution is made under Section 18-501, the contribution may be in cash, property or services rendered, or a promissory note or other obligation to contribute cash or property or to perform services in the future. Unless it is otherwise provided in the company agreement, if a member is obligated to the company to perform any promise to contribute cash or property or to perform services, even if the member is unable to perform because of death, disability or any other reason, the provision goes on to provide that if the member does not make the required contribution of property or services, the member continues to be obligated at the option of the company to contribute cash equal to that portion of the agreed value, as provided in the records of the company, of the contribution that has not been made. That right is statutorily in addition to and not in lieu of any other rights, including the right of specific performance that the company may have against the member under the company agreement or applicable law. This Section does not provide any rights in favor of creditors, however, to enforce this obligation.

### **Division of Profits and Losses:**

The company agreement will allocate income and expenses amongst the members, and if there are classes or series of members, in accordance with the terms of the agreement. If the company agreement is silent on the division of income and expenses, income and expenses are by default allocated on the basis of the agreed value, again as stated in the records of the company, of the contributions made by each member to the extent they have been received by the company and have not been returned. This would mean that, unless otherwise provided in the company agreement, income and expenses are distributed in accordance with the ratio of the capital accounts. To the extent that there are to be distributions, distributions of cash and other assets are allocated amongst the members and among classes or groups of members as provided in the company agreement. Again, if the company agreement is silent, the cash and other assets are distributed based on capital accounts (Sections 18-503 and 18-504).

### **Remedies for Breach of a Company Agreement by a Member:**

A company agreement may provide that in the case of a member who fails to perform in accordance with the Agreement or fails to comply with the terms and conditions of the agreement, that member will be subject to specified penalties or consequences. The Agreement may also specify that upon the happening of specified events a member will be subject to specified penalties or consequences. (18-306) The penalties may include reducing or eliminating a member's company interest, subordinating the member's interest to that of the non-defaulting members, a forced sale of the interest, forfeiture of the interest, the loan by another member to meet the requirements of the defaulting member, the fixing of the value of the interest by appraisal or formula and redemption or sale of the interest at that value or other penalty or consequence provided in the agreement. 18-502(c) If a member fails to make a capital contribution required under an Agreement, under Section 18-502(c) the Agreement may provide that the member is subject to any of the same penalties.

### **Series of Members, Managers or Company Interests:**

A company agreement may establish or provide for the establishment of separate series of membership, managers or company interests. A series differs substantially from a group or class of members or managers. Each series when established is similar to a company within the company. As set forth in Section 18-215 members of a series have rights within the series similar to the rights of a member of a company without classes or series. The series when established may provide for and may have separate rights, powers and duties with respect to specific company property, or obligations of the company, or profits or losses associated with specified property, or obligations which may be different from any other series. The Agreement may provide that one or more series may have a separate or different business purpose or objective. An Agreement could be drafted to provide that one series may be entitled to all of the income or expense associated with a specific investment held by the company or a series could be entitled to a preferred return on distributions of income or a preference upon the sale of capital assets or a preference on dissolution. As in the case of a mutual fund, each series could have a separate investment objective and hold specified assets for the benefit of the members holding company interests in that series.

If the Certificate of Formation contains language placing parties on notice that the company is authorized to create the series of members, managers or company interests, and the company meets the record keeping requirements of Section 18-215(b), then the debts, liabilities and obligations of that series may only be enforced against the assets of that series. A member or manager may agree to be obligated personally for any or all of the debts, obligations and liabilities of one or more series (18-245(c))

The agreement may also provide and make provision for the future creation of additional classes or groups of members or managers associated with the series having such relative rights, powers and duties as may from time to time be established, including rights, powers and duties senior to existing classes and groups of members or managers associated with the series. This provision is similar to the so-called blank check preferred stock under the GCL. The agreement may provide that any member or class or group of members associated with a series may have no voting rights, may be entitled to vote separately or with all or any class or group of members or managers associated with the series on any matter and voting may be on a per capita, number, financial interest, class, group or any other basis. (18-215(d), (e)).

### **Classes and Voting:**

In the corporate context, a corporation may issue common and preferred stock, as well as series of shares within each category, which each have relative rights and privileges which are distinct to that series of stock. As discussed above under Section 18-215, a company may have series of members, managers or company interests with respect to specified property or obligations. Under Section 18-302 a company agreement may create classes or groups of members, similar to preferred stock, which shall have such relative rights, powers, and duties as the agreement may provide and may provide for the future creation of additional classes or groups of members which may be senior to existing classes and groups or members. The

members of a class or group differ from a series in that a class or group have interests in all of the company's property. Members of a class or group under this Section may be given the right to vote separately or with all or any class or group of members or managers on any matter. Voting may be on a per capita, number, financial interest, class, group or any other basis. Unlike the GCL where a Certificate of Designation must be filed in the case where a class or series of stock is authorized, no similar instrument need be filed by a limited liability company.

Similar to series of members, the company agreement may provide for the future creation of classes or groups of members having relative rights, powers and duties which may be senior to existing classes or groups of members. (18-302(a)).

### **Disputes Among Members, Managers:**

In the case of a dispute regarding the admission, election, appointment, removal or resignation of a manager, the Delaware Court of Chancery has jurisdiction to hear and determine such matters. In any such disputed matter, the company must be made a party and service of process must be made upon the company and any person whose right to serve as manager is the subject of such action. Such persons may be served through the company's registered agent. (18-110) Any action to interpret, apply or enforce the agreement or the duties, obligation or liabilities of a company to the members or managers or the company or the duties, obligations or liabilities among members or managers or the rights or powers of, or restrictions on the company, members or managers, may be brought in the Court of Chancery. (18-111)

Section 18-109(d) reads as follows:

In a written limited liability company agreement or other writing, a manager or member may consent to be subject to the nonexclusive jurisdiction of the courts of, or arbitration in, a specified jurisdiction, or the exclusive jurisdiction of the courts of the State of Delaware, or the exclusivity of arbitration in a specified jurisdiction or the State of Delaware, and to be served with legal process in the manner prescribed in such limited liability company agreement or other writing. Except by agreeing to arbitrate any arbitrable matter in a specified jurisdiction or in the State of Delaware, a member who is not a manager may not waive its right to maintain a legal action or proceeding in the courts of the State of Delaware with respect to matters relating to the organization or internal affairs of a limited liability company.

Thus, while the company and a manager may agree to have all disputes tried or arbitrated in a forum outside of the State of Delaware, a member cannot waive his right to maintain the Section 18-110 or 18-111 actions in Delaware. The right is personal to the member, and the member, therefore, has the right to waive that right and bring an action in another appropriate jurisdiction unless the company agreement provides that Delaware shall have exclusive jurisdiction.

### **Bankruptcy of a Member:**

The filing of bankruptcy against a member does not cause the company to dissolve or terminate unless required under the company agreement. (18-304)

Unless the company agreement provides otherwise, or with the written consent of all of the other members, a member ceases to be a member when a member files a voluntary petition in bankruptcy, is adjudged a bankrupt or insolvent, files a petition or answer seeking relief under any similar creditor relief law, files an answer admitting to being bankrupt or insolvent, or seeks or consents to the appointment of a receiver or liquidator.

A member likewise ceases to be a member, unless otherwise provided in the company agreement or with the written consent of all members, 120 days after the commencement of any involuntary proceeding against the member seeking relief under any creditors rights act which is not dismissed, or if within 90 days after the appointment of a trustee, receiver or liquidator without the member's consent the appointment is not stayed or vacated, or if within 90 days after the expiration of any such stay, the appointment is not vacated.

#### **§ 18-304. Events of bankruptcy:**

A person ceases to be a member of a limited liability company upon the happening of any of the following events:

(1) Unless otherwise provided in a limited liability company agreement, or with the written consent of all members, a member:

- a. Makes an assignment for the benefit of creditors;
- b. Files a voluntary petition in bankruptcy;
- c. Is adjudged a bankrupt or insolvent, or has entered against the member an order for relief, in any bankruptcy or insolvency proceeding;
- d. Files a petition or answer seeking for the member any reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief under any statute, law or regulation;
- e. Files an answer or other pleading admitting or failing to contest the material allegations of a petition filed against the member in any proceeding of this nature;
- f. Seeks, consents to or acquiesces in the appointment of a trustee, receiver or liquidator of the member or of all or any substantial part of the member's properties; or

(2) Unless otherwise provided in a limited liability company agreement, or with the written consent of all members, 120 days after the commencement of any proceeding against the member seeking reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief under any statute, law or regulation, if the proceeding has not been dismissed, or if within 90 days after the appointment without the member's consent or acquiescence of a trustee, receiver or liquidator of the member or of all or any substantial part of the member's properties, the appointment is not vacated or stayed, or within 90 days after the expiration of any such stay, the appointment is not vacated.

**Access to and Confidentiality of Information; Records:**

Section 18-305 grants to each member of a limited liability company the right, subject to such reasonable standards as may be set forth in a company agreement or otherwise established by the manager or, if there is no manager, then by the members, to obtain from the company from time to time upon reasonable demand for any purpose reasonably related to the member's interest as a member of the limited liability company:

(1) True and full information regarding the status of the business and financial condition of the limited liability company;

(2) Promptly after becoming available, a copy of the limited liability company's federal, state and local income tax returns for each year;

(3) A current list of the name and last known business, residence or mailing address of each member and manager;

(4) A copy of any written limited liability company agreement and Certificate of Formation and all amendments thereto, together with executed copies of any written powers of attorney pursuant to which the limited liability company agreement and any Certificate and all amendments thereto have been executed;

(5) True and full information regarding the amount of cash and a description and statement of the agreed value of any other property or services contributed by each member and which each member has agreed to contribute in the future, and the date on which each became a member; and

(6) Other information regarding the affairs of the limited liability company as is just and reasonable.

Each manager shall have the right to examine all of the information described in (1) to (6) above for a purpose reasonably related to the position of manager. Any action to enforce the rights of a member or manager under Section 18-305 shall be brought in the Court of Chancery.

(b) The manager, under Section 18-305(b), has the right to examine all information described in (a), again for "a purpose reasonably related to the position of manager."

It is often important that a company maintain confidentiality regarding all or some of its company information from some of its members. Under Section 18-305(c), the manager has the right to keep confidential from the members, for such period of time as the manager deems reasonable, any information that the manager reasonably believes to be in the nature of trade secrets or other information the disclosure of which the manager in good faith believes is not in the best interest of the limited liability company, or could damage the limited liability company or its business, or which the limited liability company is either required by law or by agreement with a third party to keep confidential.

### **Fiduciary Duties:**

Delaware courts have implied that there exists in a company agreement a covenant of good faith and fair dealing (*Wilmington Leasing, Inc. v. Parrish Leasing, Co., L.P.*, C.A. No. 15202, Jacobs, V.C. (Del.Ch. Sept. 25, 1966)). While the case to which we cite is a case involving a limited partnership, the provisions of the Delaware Revised Uniform Limited Partnership Act (the LP Act) 17-1101, relied upon by the Vice Chancellor is identical to the provisions of the LLC Act, 18-1101. In another case decided by the Court of Chancery, again under the same provision of the LP Act, the court found that the agreement may limit the fiduciary duties of the general partner (manager) to the limited partners (members) and also inferred that in the proper case, no doubt where the parties are sophisticated, those duties may be entirely eliminated with the exception of the contractual obligation of good faith and fair dealing. Subsequent to these case the LLC Act and the similar provision in the LP Act have been amended so as to permit the parties to limit or eliminate fiduciary duties in their LLC or LP Agreement (18-1101(c))

### **Registered Agent:**

The company is required to maintain a registered agent for service of process in this state in accordance with Section 18-104. The Section requires that the company have a registered office, which need not be its place of business, and a registered agent to accept service of process at that address. The office must be open during normal business hours to accept service of process and "otherwise perform the functions of a registered agent." A company cannot use a post office box as its registered office, as a post office box does not meet the requirements of the Act. The company may serve as its own registered agent. The registered agent may be an individual resident in the state or a domestic corporation, limited partnership, limited liability company, statutory trust or such foreign entity qualified to do business in Delaware.

### **Communications Contact:**

Under Section 18-104(g) every company shall provide its Registered Agent with the name and business address and business telephone number of a natural person who is a "member, manager, officer, employee or designated agent" of the company who is authorized to

receive communications from the Registered Agent. If the company does not provide the Registered Agent with such Communications Contact the Registered Agent may resign as registered agent for such company.

### **Service of Process:**

Service of process upon the company is made by physically delivering one copy of the process to the manager or to the registered agent in Delaware, or by leaving it at the "dwelling house or usual place of abode in the State of Delaware" of the manager or registered agent, or to the manager at the registered office or to the Company's other place of business in Delaware, or otherwise in the manner prescribed by the Act or any applicable rule of court. 18-105

### **Registered Office:**

The Certificate of Formation must include the address of the company's registered office in Delaware, as well as identify its registered agent for service of process. In most cases, both the registered agent and the registered office are located at the same address. There is no requirement under Delaware law which would mandate that the company itself have any physical presence in Delaware. There is no requirement for either a Delaware office, bank account or a Delaware secretary; there is no requirement that any member or manager be a Delaware resident, or even a legal resident or citizen of the United States; there is no requirement for public filing of accounts. It is not uncommon for all of the members and managers of a limited liability company or, for that matter, a Delaware corporation, to all be non-residents and non-citizens of the United States. The Company is free to establish its bank accounts in any jurisdiction which it may select and similarly to establish its primary place of business where it may elect. There is no requirement under Delaware law that anyone associated with a Delaware limited liability company or corporation ever set foot in the State of Delaware or the United States.

### **Domestication of Non-United States Entities.**

#### **Background:**

Responding to international concerns in the 1980's, Delaware amended the GCL to permit non-United States business entities to either permanently (§388) or temporarily (§389) change their domicile to Delaware. Concerns regarding revolution or other temporary political upheaval created the perceived need to provide a temporary home for those companies in Delaware resulting in the enactment of Section 389. With the subsequent enactment of the LLC Act the permanent domestication provisions were incorporated into the Act in Section 18-212. Entities Permitted to Domesticate.

A "non-United States Entity" means a entity formed, incorporated, created or which came into being under the laws of any foreign county or foreign jurisdiction, other than any state within the United States. These entities include without limitation limited liability companies, corporations, business trusts or associations, real estate investment trusts, common

law trusts or any other unincorporated business, including both limited and general partnerships, including limited liability partnerships.

**Procedure to Domesticate:**

The non-United States Entity may domesticate by filing a Certificate of Limited Liability Company Domestication meeting the requirements of the section and accompanied with a Certificate of Formation. The domestication may become effective upon filing with the Secretary of State or may provide for a future effective date. The section permits the non-United States Entity to continue its existence in the foreign jurisdiction, however for the purposes of Delaware law, it shall constitute a single entity formed under the laws of Delaware as well as the foreign jurisdiction.

**Effect Upon Existing Obligations And Vesting Of Assets:**

Domestication does not affect any of the obligations of the non-United States Entity which existed prior to the domestication or any personal liability of any person thereunder. The domestication does not affect the choice of law applicable to the non-United States Entity except that from and after the domestication the law of the State of Delaware shall apply to the same extent as if the non-United States Entity had been formed in Delaware on that date. All property, real and personal, and all debts vest in the domesticated company without the need to convey the property by deed or otherwise. For all purposes of Delaware law the domesticated company shall be the same entity as the previous non-United States Entity having a date of formation as of the date that the original non-United States Entity was formed. Unless required by applicable non-Delaware law, the non-United States Entity need not wind up its affairs in the original jurisdiction of formation.

**Transfer or Continuance of Domestic Limited Liability Company:**

**Transfer or Continuance:**

A domestic limited liability company may, under Section 18-213, transfer its existence to another state or jurisdiction which permits the transfer to or domestication in such state or jurisdiction as a limited liability company or may in the alternative transfer its existence to such state or jurisdiction but also continue its existence as a limited liability company under Delaware law.

**Procedure:**

Unless otherwise provided in the company agreement, the transfer or transfer and continuance must be approved in writing by all managers and members. Once the requisite approval has been obtained, the company files a Certificate of Transfer or a Certificate of Transfer and Continuance which contains the provisions enumerated in the section.

**Effect of Transfer or Transfer and Continuance:**

At the effective date of the Certificate of Transfer and upon payment of all required fees, the company ceases to exist as a limited liability company in Delaware. The cessation of existence in Delaware and the transfer to another jurisdiction shall not affect the obligations and liabilities of the company which existed prior to the transfer or domestication in another jurisdiction or the personal liability of any person incurred prior to the transfer. Such transfer or domestication shall not affect choice of law rules applicable to any liability which existed prior to the transfer or domestication. The Delaware company shall not be required to wind up its affairs under Delaware law. If the company files a Certificate of Continuance, the company shall continue to exist as a limited liability company under Delaware law to the same extent as prior to that time. The continuing domestic limited liability company and the entity formed as a consequence of the transfer or its domestication shall for all purposes of the laws of Delaware constitute a single entity created or having come into being and existing under Delaware law and the laws of the other jurisdiction.

### **Remedies for Breach of a Company Agreement by a Member:**

A company agreement may provide that in the case of a member who fails to perform in accordance with the Agreement or fails to comply with the terms and conditions of the agreement, that member will be subject to specified penalties or consequences. The Agreement may also specify that upon the happening of specified events a member will be subject to specified penalties or consequences. (18-306) The penalties may include reducing or eliminating a member's company interest, subordinating the member's interest to that of the non-defaulting members, a forced sale of the interest, forfeiture of the interest, the loan by another member to meet the requirements of the defaulting member, the fixing of the value of the interest by appraisal or formula and redemption or sale of the interest at that value or other penalty or consequence provided in the agreement. 18-502(c) If a member fails to make a capital contribution required under an Agreement, under Section 18-502(c) the Agreement may provide that the member is subject to any of the same penalties.

## **V. PRACTICAL OPERATING PROCEDURES:**

### **A. Managers:**

#### **Management of the Company:**

Management of a limited liability company is governed by Section 18-402. Under Section 8-101(7), the company agreement is the agreement of the members. Consequently, if the manager is not a member, then the manager is not a party to the agreement. In that case, the company and the manager need to enter into an agreement under which the manager agrees to serve as manager.

Unless otherwise provided in a company agreement, a company is managed by its members in proportion to the then current percentage or other interest of members in the profits of the company owned by all of the members. A company agreement may provide that the limited liability company interests held by the members is not related to capital accounts. Therefore, one member who has a nominal or no capital account may have a greater company

interest in the profits and losses of the company than would otherwise be allocated to him based upon his percentage interest based upon the company's capital.

A company agreement may provide that the company is managed by all or less than all of its members. One or more members may be designated in the agreement to manage the company; such a designation has the same legal effect of naming the member(s) as manager(s), notwithstanding a designation such as "managing member." The company agreement may provide that the company is to be managed by one or more managers. If the Agreement calls for more than one manager, unless otherwise provided in the Agreement, all managers have the right to bind the company. The manager or managers need not be members of the company. However under Section 18-403 a manager may make contributions to the company, or may receive an interest in the income and loss without making a contribution, and share in the income and expense of, and distributions from the company as a member. If the manager is also a member, the person retains the rights and powers of a member and is subject to the restrictions of a manager. Subject to the terms of the Agreement, the manager also has the rights, powers and is subject to the restrictions of a member, except when the member is acting as a manager.

Unlike a limited partner in a limited partnership, the members of a member-managed limited liability company may, subject to the terms of the company agreement, actively participate in the management of the company, and the active participation in management does not subject the member to unlimited liability. Because members of an LLC may actively participate in management without losing their limited liability, an LLC is a preferable entity over a limited partnership or limited liability limited partnership for an active business as opposed to a company which is primarily holding an investment asset.

#### **Admission and Resignation of Managers:**

A person is admitted as a manager under Section 18-401 if they are named in a company agreement or similar agreement under which the company is formed. (18-101(10)) A manager may resign as a manager of a company at any time, or upon the occurrence of events specified in the agreement and in accordance with the company agreement. However, the agreement may provide that a manager may not resign. Notwithstanding such provision, the manager may nevertheless resign at any time by giving written notice to the company. If such resignation results in damages to the company, the company may recover from the resigning manager damages for breach of the agreement and may off set the damages from any amounts distributable to the resigning manager.

#### **Classes or Groups of Managers:**

A company agreement may provide for classes or groups of managers having such relative rights, powers and duties as set forth in the Agreement. (18-404) As in the case of members, the agreement may provide for the future creation of additional classes or groups of managers having such relative rights, powers and duties as may from time to time be established, including rights, powers and duties senior to existing classes or groups of managers. Section 18-404 contains provisions similar to Section 18-302, which is applicable to members. If a manager

fails to perform in accordance with or to comply with the terms of the company agreement, the agreement may provide under Section 18-405 that the manager shall be subject to specified penalties or specified consequences and may provide that at the time or upon the happening of events specified in the agreement the manager shall be subject to specified penalties or consequences.

### **Reliance Upon Company Records:**

Managers and members are fully protected under the Act if they rely in good faith upon the records of the company as well as upon information, opinions, reports or statements presented to the company by its other members, managers, officer, employees or committees or by any other person as to matters the member or manager believe in good faith to be within that persons professional or expert competence. The member or manager may rely upon such persons in determining the existence and amount of assets from which distributions to members might properly be paid. (18-406) This latter provision is particularly important in light of the discussion, *infra*, regarding the liability of a member for distributions under Section 18-607.

### **Delegation of Rights and Powers to Manage:**

The manager of a manager-managed company or a member of a member managed company has the power and authority to delegate to one or more persons the management power and authority held by the manager or member. Delegation of authority does not strip the member or manager of the authority granted to him or her under the company agreement or the Act. Likewise, the acceptance of the delegated authority does not cause the person to whom power and authority has been delegated to become a member or manager. (18-407) Section 18-407 also creates the basis upon which the company may appoint "officers," such as a President, who likewise need not be a member or manager.

## **B. Powers and Duties of Members:**

In the absence of terms to the contrary in the company agreement, the management of a limited liability company is vested in its members. (§18-402). Additionally, each member, unless otherwise provided in the company agreement, has the authority to bind the company. (§18-402). In the case of a member-managed company, the decision by the members owning more than fifty percent (50%) of the then current percentage or other interest of the members in the profits of the limited liability company owned by all of the members shall be the decision of the company. Thus, Section 18-402 would permit any member to bind the company, however, in order for the company to make a decision, the vote of the members holding more than fifty percent (50%) of the interests is required. In the absence of a provision in the company agreement, there is the potential for a conflict between the actions of a single member and the decision of the majority, nevertheless, the act of the single member will bind the company. Under Section 18-306, the company has a remedy against the member who breaches the company agreement, however, if the company agreement is silent, the company would lack a remedy. For these reasons, as well as

other business considerations, a limited liability company agreement generally provides that one person or a specified group of persons have the power and authority to manage the company, and that those members who are not designated as managers lack any authority to bind the company.

A member or an assignee of a limited liability company interest has the right under §18-1001 to bring a derivative action in the Court of Chancery in the right of the limited liability company to recover a judgment in favor of the company if the managers or members with authority to do so have refused to bring the action or if it is unlikely that an effort to cause those managers or members to bring the action would be successful. Derivative actions are brought in the name of the company and not in the name of the member. Any recovery in a derivative action is the property of the company and not the member bringing the action.

Under general equitable standards, a member or manager has duties, including fiduciary duties, to the company and to the other members or managers and any other party that is bound by the company agreement. Under Section 18-1101(c), the company agreement may expand or restrict or eliminate those duties, including fiduciary duties. Section 18-1101(c) contains that caveat:

. . . provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.

Section 18-1101(d) provides a default rule which eliminates the liability of a member or manager or other person to another party that is bound by the company agreement for a “breach of fiduciary duty for the member’s or manager’s or other person’s good faith reliance on the provision of the limited liability company agreement.” The agreement may, however, vary that exculpation.

Finally, Section 18-1101(e) provides that the company agreement may provide for the limitation or elimination of any and all liability of a member or manager or other party bound by a company agreement for breach of contract and breach of duties (including fiduciary duties), again with the proviso that “a limited liability company agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith and violation of the implied contractual covenant of good faith and fair dealing.”

Section 18-1101(c) provides for the elimination of duties subject to the provision that the agreement may not eliminate the implied contractual covenant of good faith and fair dealing, while Subsection (e) provides that the agreement may provide for the limitation or elimination of liability for breach of contract and breach of duties, which would include an act or omission that is a good faith violation of the implied covenant of good faith and fair dealing.

### **C. Records and Reports:**

Section 18-305 provides for access to information by a member. Section 18-305(a) provides that the company agreement may establish reasonable standards governing what information and documents are to be furnished and at what time and location and at whose

expense such documents will be provided to the members. Subject to those reasonable restrictions, the member has the right to receive from the company:

(1) True and full information regarding the status of the business and financial condition of the limited liability company;

(2) Promptly after becoming available, a copy of the limited liability company's federal, state and local income tax returns for each year;

(3) A current list of the name and last known business, residence or mailing address of each member and manager;

(4) A copy of any written limited liability company agreement and Certificate of Formation and all amendments thereto, together with executed copies of any written powers of attorney pursuant to which the limited liability company agreement and any Certificate and all amendments thereto have been executed;

(5) True and full information regarding the amount of cash and a description and statement of the agreed value of any other property or services contributed by each member and which each member has agreed to contribute in the future, and the date on which each became a member; and

(6) Other information regarding the affairs of the limited liability company as is just and reasonable.

Section 18-305(c) grants to the manager of the company the right to keep confidential from the members, for such period of time as the manager deems reasonable, any information which the manager reasonable believes to be in the nature of trade secrets or other information, the disclosure of which the manager in good faith believes is not in the best interest of the company, or which could damage the company or its business, or which the company is required by law or by agreement with a third party to keep confidential. Any action to enforce the rights of the members under Section 18-305 must be brought in the Court of Chancery of the State of Delaware.

#### **D. Transfer of Membership Interests:**

The interests of a member in a limited liability company is made up of two parts. First, the right to participate in the management of the company, and second, the right to receive an allocation of income, gain, loss, deduction or credit, or similar items.

A limited liability company interest, with the consent of all other members, is assignable in whole or in part except as provided in the company agreement. The company agreement, therefore, may provide that the interest is not-assignable at all. The company agreement may allow for the bifurcation of the interest and allow for the assignment of the income stream and prohibit the assignment of the right to become a member and to participate in management.

Under Section 18-702(a), the assignee of a member's company interest will have no right to participate in the management of the business and affairs of the company agreement unless provided in the company agreement. In the absence of a provision in the company agreement dealing with the assignment, the assignment requires the approval of all of the members of the company, other than the member assigning the company interest, before the interest may be assigned.

Unless the company agreement grants to the assignee the right to exercise the rights and powers of a member, under Section 18-702(b)(1), the assignee is not entitled to do so. An assignee of a company interest has the right to share in the profits and losses of the company and to receive such distributions as the assignor was entitled. The company agreement may, however, limit or eliminate this right.

A member of a limited liability company ceases to be a member and to have the power to exercise the rights and powers of a member upon the assignment of all of the member's limited liability company interest. Therefore, under Section 18-702, a member continues to be a member if that member retains the right to participate in the management of the company but assigns to an assignee the member's entitlement to share in profits and losses. The company agreement may, however, provide otherwise.

Provided that the company agreement permits an assignee to become a member, the assignee does not have any of the liability to the company of being a member until such time as the assignee becomes a member under the terms and conditions of the company agreement. (§18-702(d)).

A company may acquire by purchase, redemption or otherwise any limited liability company interest or other interest of a manager or member in a limited liability company. The limited liability company agreement may eliminate that right or may provide for the terms and conditions under which the interest of the member or manager or other party is acquired by the company. Unless otherwise provided in the agreement, upon the company acquiring the interest of a member, that interest is "deemed cancelled."