TOO MANY COOKS SPOIL THE CAKE, AND TOO MANY STATUTES SPOIL THE LLC:

A PLEA FOR UNIFORMITY

Carol Goforth*

There is widespread agreement that closely held enterprises play a critical role in this country. Even if some economists are questioning whether all closely-held businesses offer the same long term benefits for the economy in terms of job-production or innovation, the reality that so many American businesses are in fact closely held means that such enterprises are significant to a very large number of individuals. In the past thirty years, we have seen dramatic and unparalleled growth in the range of operational structures available to such businesses. Regrettably, in the rush to try and offer entrepreneurs "new" and "better" statutory options, we have lost the benefits of uniform, predictable and well-understood operational structures. We continue to modify, adapt, and innovate so rapidly that the ideal business form is a constantly shifting and moving target, which serves no one well. This article suggests that it is time to stop offering "new" alternatives and "new" rules, and to attempt to find common ground and move towards a more uniform understanding of how LLCs, in particular, should be structured and operated to maximize efficiency for the closely held, multi-owner business. The current ULLCA, promulgated by the Uniform Law Commission, seems the most likely alternative to achieve this result.

* University Professor and Clayton N. Little Professor of Law, University of Arkansas School of Law. Special thanks to Professor Will Foster of the University of Arkansas School of Law for his comments and insights. It should go without saying that any errors that appear here are due to my ignorance and not any failure in his commentary.

INTRODUCTION

For most of the 20th century, American entrepreneurs looking to start a new business were quite limited in their choice of organizational structures. For single-owner enterprises, the founder could operate as a sole proprietorship or a corporation.[1] At the same time, there were three prevalent business models for multi-owner, for-profit enterprises: the general partnership, the limited partnership, and the traditional corporation.[2] Of all of these options, only the corporation gave all business owners limited liability. It is therefore completely unsurprising that the corporation was the preferred choice for most multi-owner businesses, regardless of whether they were closely held or publicly owned.

Today, there are a number of newer options for closely held businesses. The first of the new alternatives to the traditional corporation was the statutory close corporation, although even today fewer than half the states have this as an option.[3] Two of the newer choices are explicitly and

1. The sole proprietorship was simple to form and operate but carried the price of unlimited personal liability for the owner and inability to transfer ownership interests in the business to anyone, while the single-shareholder corporation resulted in a significantly higher level of formality and structural requirements that were originally established with larger groups of owners in mind, as well as more complicated tax requirements. Because this option was not, and is not, based on statutes, it has not been subject to substantial modification over the years, and continues to operate under the same rules as it did in the past. *See generally* J. CARY BARTON, TEXAS PRACTICE GUIDE BUSINESS ENTITIES §§ 1:1-1:10, Westlaw (database updated December 2015) (outlining advantages and disadvantages to various business entities); Gerald A. Cassioppi, *Decisions, Decisions . . . The Business Entity Dilemma for the Business Owner*, 20 DCBA BRIEF 26 (2008).

2. In addition to these main-stream business alternatives, there have long been several additional statutory options for specialized business enterprises. State statutes often authorized the formation of such specialized business forms as real estate investment trusts (REITs), cooperatives, non-profit and professional corporations, although those statutes have limited applicability and are relatively rarely utilized. In addition, it has been possible for many decades for corporations organized under state law to elect different tax status under either subchapter C or (assuming the statutory requirements are satisfied) subchapter S of the Internal Revenue Code. 26 U.S.C. §§ 301-391, 1361-79 (2016).

3. Sixteen states offer separate, specialized legislation for the closely held business. ALA. CODE § 10A-30-2.02 (LexisNexis 2009); ARIZ. REV. STAT. ANN. § 10-1801 (2013); DEL. CODE ANN. tit. 8, § 341 (2011); GA. CODE ANN. § 14-2-950 (2003); 805 ILL. COMP. STAT. ANN. 5 / 2A.05 (West 2010); KAN. STAT. ANN. § 17-7201 (2007); MD. CODE ANN., CORPS. & ASS'NS § 4-101 (LexisNexis 2014); MO. ANN. STAT. § 351.750 (West 2015); MONT. CODE ANN. § 35-9-101 (2013); NEV. REV. STAT. ANN. § 78A.010 (LexisNexis Supp. 2013); 15 PA. STAT. AND CONS. STAT. ANN. § 2301 (West 2011); S.C. CODE ANN. § 33-18-103 (2006); TEX. BUS. ORGS. CODE ANN. art. 21.702 (West 2012); VT. STAT. ANN. tit. 11A, § 20.01 (2010); WIS. STAT. ANN. § 180.1801 (West 2002); WYO. STAT. ANN. § 17-17-103 (2013) (each containing language identifying the possibility of electing statutory close corporation status or specifying how to elect such status). This list does not appear to have changed over the past few decades. *See* Tara J. Wortman, *Unlocking Lock-in: Limited Liability Companies and the Key to Underutilization of Close Corporation Statutes*, 70 N.Y.U. L. REV. 1362, 1363-64 (1995) (listing Alabama, Arizona, Delaware, Georgia, Illinois, Kansas,

universally based on partnership statutes: the limited liability partnership or LLP[4] (which is based on the general partnership) and the limited liability limited partnership or LLLP[5] (which is based on the limited partnership). The other addition to the menu of enterprise options is the limited liability company (LLC),[6] a version of which is now available in every American

Maryland, Missouri, Montana, Nevada, Pennsylvania, South Carolina, Texas, Vermont, Wisconsin, and Wyoming, along with the District of Columbia as having such statutes, and also noting that there are other statutes that have "scattered provisions for close corporations throughout the general corporation laws").

4. For a description of the genesis of the LLP, see Robert Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065 (1995) (describing the genesis of the LLP). The LLP is best thought of as a traditional general partnership modified so as to give the general partners the protections of limited liability, in much the same way that shareholders in a corporation are protected against personal liability for the debts of the corporation. *Id.* at 1073, 1075.

5. *See* Hamilton, *supra* note 4. This form of business is based on the traditional limited partnership. The benefit of LLLP status is that the general partners in such an enterprise will also obtain limited liability. The following states have statutes authorizing the formation of LLLPs: Alabama, Arizona, Arkansas, Colorado, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Kentucky, Maine, Maryland, Minnesota, Missouri, Montana, Nevada, New Mexico, North Carolina, North Dakota, Oklahoma, Pennsylvania, South Dakota, Tennessee, Texas, Utah, Virginia, and Washington. ALA. CODE §§ 10A-9-1.01 to 10A-9-12.04 (LexisNexis 2009); ARIZ. REV. STAT. ANN. §§ 29-367, 29-1001(7), 29-1101, 1102, 1026(D) (West. Supp. 2015); ARK. CODE ANN. §§ 4-47-101 to 4-47-1302 (2011 & Supp. 2016); COLO. REV. STAT. §§ 7-64-306(3)-(4), 1001(1), 1002; 7-90-301 (2015); DEL. CODE ANN. tit. 6, § 17-214 (2011); FLA. STAT. ANN. §§ 620.1101 to 620.2205 (West 2007); GA. CODE ANN. §§ 14-8-62(g), 14-9-403 (2003); HAW. REV. STAT. §§ 425E-101 to 425E-1206 (2004 & Supp. 2011); IDAHO CODE §§ 53-2-101 to 53-2-1205 (2009 & Supp. 2016); 805 ILL. COMP. STAT. ANN. 215 / 0.01 to 215 / 1402 (West 2010); IOWA CODE ANN. §§ 488.101-488.1207 (West 2009 & Supp. 2016); KY. REV. STAT. ANN. §§ 362.2-102 to 362.2-1207 (LexisNexis 2008); ME. REV. STAT. ANN. tit. 31, §§ 1301-1461 (2011); MD. CODE ANN., CORPS. & ASSNS. §§ 10-805, 9A-1006 (LexisNexis 2014); MINN. STAT. ANN. §§ 321.0101-321.1208 (West 2011 & Supp. 2016); MO. ANN. STAT. § 358.510 (West 2015); MONT. CODE ANN. §§ 35-12-501 to 35-12-1522 (2013); NEV. REV. STAT. ANN. §§ 87A.010-87A.700 (LexisNexis 2010 & Supp. 2013); N.M. STAT. ANN. §§ 54-2A-101 to 54-2A-1206 (2013); N.C. GEN. STAT. § 59-210 (2013); N.D. CENT. CODE §§ 45-10.2-01 to 45-10.2-117 (2013); 54 OKLA. STAT. ANN. tit. 54, §§ 500-101A to 500-1207A (West 2011); 15 PA. STAT. AND CONS. STAT. ANN. § 8201 (West, Westlaw through 2016 Legis. Sess.); S.D. CODIFIED LAWS § 48-7-1106 (2004); TENN. CODE ANN. § 61-1-1001 (2013); TEX. REV. CIV. STAT. ANN. art. 6132a-1, § 2.14, art. 6132b, § 3.08(e) (West 2010) (Repealed 2010); UTAH CODE ANN. §§ 48-2e-101 to 48-2e-1205 (LexisNexis Supp. 2013); VA. CODE ANN. § 50-73.142 (2013); WASH. REV. CODE ANN. §§ 25.10.006 to 25.10.926 (West Sup. 2016). The District of Columbia does as well. DC CODE §§ 29.701.01 to 29.711.01 (2013).

6. *See, e.g.,* Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1475-78 (1998); *see generally* Carol Goforth, *The Rise of the Limited Liability Company: Evidence of a Race Between the States, but Heading Where?*, 45 SYRACUSE L. REV. 1193 (1995). There are also other new business forms in many states, such as the series LLC. Sandra Mertens, *Series Limited Liability Companies: A Possible Solution to Multiple LLCs*, 84 CHI.-KENT L. REV. 271 (2009) ("Series Limited Liability Companies (LLC) are now over a decade old."). These are not as widely known or used as the alternatives addressed in this article. For example, there are only a dozen statutes authorizing series LLCs to date, although the Uniform Law Commission is studying how to approach this option. *See* ALA. CODE 1975 § 10A-5A-11.01

jurisdiction. The LLC offers a blending of the rules applicable to general and limited partnerships and corporations,[7] with different states offering different default rules.[8] These changes represent explosive growth in the statutory options available to businesses.[9]

(effective January 1, 2015); D.C. CODE § 29-802.06 (2013); DEL. CODE ANN. tit. 6, § 18-215 (2013); 805 ILL. COMP. STAT. ANN. 180 / 37-40 (West 2010); IOWA CODE ANN. § 489.1201(West 2009); KAN. STAT. ANN. §17-76,143 (Supp. 2013); MO. ANN. STAT. § 347.186 (West 2015); MONT. CODE ANN. § 35-8-304(4) (2013); NEV. REV. STAT. ANN. § 86.296 (LexisNexis 2014); OKLA. STAT. ANN. tit. 18, § 2054.4 (2012); P.R. LAWS ANN. tit. 14, § 3967 (2011); TENN. CODE ANN. § 48-249-309 (2012); TEX. BUS. ORGS. CODE ANN. art. 101.601 (West 2012); UTAH CODE ANN. § 48-3-1202 (LexisNexis Supp. 2013) (repealed 2013) (state statutes not authorizing this type of business).

7. "LLC statutes contain little that is truly new. Almost entirely, they reflect a combination of partnership and corporate law and, in some instances, the derivation has been virtually verbatim." CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 5.02 (2016).

8. "Prior to 1996, nearly every state had its own LLC statute, resulting in significant variation in the applicability and enforcement of LLC law throughout the country. Unfortunately, the promulgation of ULLCA did not solve the problem of variability in LLC law, in large part because it was introduced after most jurisdictions had already legislatively addressed LLCs." Joseph M. Dylla, *A Case for the Adoption of the Revised Uniform Limited Liability Company Act in South Dakota*, 56 S.D. L. REV. 285, 286 (2011) (footnote omitted). For a detailed description of how current LLC Acts treat various issues differently, see infra Part IV of this article.

9. In 2005, Thomas Rutledge wrote:

> On a national and state basis, the law of unincorporated business organizations is evolving at a frenzied pace. At the national level, the last decade has seen NCCUSL draft and release RUPA (which went through several released versions before settling on the 1997 version), the Uniform Limited Liability Company Act (ULLCA) (which had to be reopened and revised to address Check-the-Box) and Re-RULPA. . . . The ABA is working on a new Prototype Limited Liability Company Act, and NCCUSL is working on a complete rewrite of ULLCA. . . . At the state level, every state has adopted, and many states have entirely revised an earlier adoption of, an LLC act. A majority of the states have adopted RUPA, many with non-uniform provisions. Re-RULPA is moving forward.

Thomas E. Rutledge, *The Alphabet Soup of Unincorporated Business Law: Using LPS, LLPS, GPS, LLLPS, & BTS and Dealing with RUPA, RERULPA, UNETA, MITA, & META,* ALI-ABA VIDEO L. REV. 143, 156 (2005).

The National Conference of Commissioners on Uniform State Laws, or NCCUSL as referred to in the Rutledge article, has now began calling itself the Uniform Law Commission (or ULC). *See* Unif. Law Comm'n, *About the ULC*, ULC, http://www.uniformlaws.org/Narrative.aspx?title=About%20the%20ULC (last visited Sept. 24, 2016).

Nor are the forms of business discussed in this article the only options. For example, about a dozen states have recently adopted legislation authorizing the formation of Series LLCs, and the Uniform Law Commission is studying how to approach this option. *See* ALA. 1975 § 10A-5A to 11.01 (LexisNexis 2016) (effective Jan. 1, 2015); D.C. CODE § 29-802.06 (2001 & Supp. 2012); DEL. CODE ANN. tit. 6, § 18-215 (2013); 805 ILL. COMP. STAT. ANN. 180 / 37-40 (West Supp. 2010); IOWA CODE § 489.1201 (2009); KAN. STAT. ANN. § 17-76, 143 (Supp. 2013); MO. ANN. STAT. § 347.186 (West 2015); MONT. CODE ANN. § 35-8-304(4) (2013); NEV. REV. STAT. ANN. § 86.296 (LexisNexis 2010); OKLA. STAT. ANN. tit. 18, § 2054.4 (West 2012); P.R. LAWS ANN. tit. 14, § 3967 (2011); TENN. CODE ANN. § 48-249-309 (2012); TEX. BUS. ORGS. CODE ANN. art. 101.601 (West 2012); UTAH CODE ANN. § 48-3-1202 (LexisNexis Supp. 2012) (repealed 2013) (list of statutes authorizing this form of business).

Since most of these statutes were drafted to conform to the prevailing tax rules, the remarkable and rapid changes in the tax regime that occurred during this time frame are also critically important to understanding the current legislative landscape.[10] Today, the income tax status of most domestic unincorporated entities that have at least two owners but are not publicly traded is elective,[11] although incorporated businesses are still limited to being taxed as corporations under either subchapter C or S of the Internal Revenue Code.[12] The default rule is that most of such closely held unincorporated entities are taxed as partnerships, although some businesses elect corporate tax status because certain investors find it difficult to work with the mandatory pass-through of income that happens with tax partnerships.[13]

Once the tax rules were modified to react to the myriad changes in state organizational options and an elective tax regime was established, legislators were theoretically freed from trying to fit the state organizational options into narrow categories dictated by federal tax rules. Unfortunately, rather than focusing on considering the structures that might best meet the needs of closely held businesses (for whom the new business forms were primarily intended), the statutes generally continued to be based on a hodge-podge of rules picked from historical options. The fact that the default rules were not drafted with the goal of setting out rules that were most likely to work well for closely held enterprises has meant that businesses organized under those rules could be and certainly have been structured in sub-optimal ways from

10. In 1997, the IRS changed the test used to determine tax status of business entities operated for profit from the corporate resemblance test to the current check-the-box approach. *Compare* Treas. Reg. § 301.7701-2(a)(1) (as amended in 1997) *with* Treas. Reg. §§ 301.7701-1 to -3 (as amended in 2012).

11. *Id.*

12. In order for a domestic business entity to elect subchapter S treatment, which is available only if the business meets certain requirements not imposed on other forms of businesses: (1) there must be an affirmative election agreed to by all owners made and filed in a timely fashion; (2) the corporation may never have more than 100 shareholders (although certain family groups, including a husband and wife, may be counted as a single shareholder); (3) only individual citizens or residents of the United States, certain domestic estates and qualified trusts may own shares; (4) there may be only a single class of stock in the corporation; and (5) its debt must be secured in writing, with specific interest and payment terms, owed to creditors who are permitted shareholders and not convertible into stock. For a list and explanation of the eligibility requirements for subchapter S current through 2016, see WILLIAM R. CHRISTIAN & IRVING M. GRANT, SUBCHAPTER S TAXATION ¶ 3.03 (2015), 1999 WL 630521, at 1.

13. *See, e.g.,* Karl P. Fryzel & Richard N. Kimball, *Venture Capital Financing, in* FINANCING A BUSINESS IN MASSACHUSETTS § 2.1-2.10 (2010) (noting that "[t]he typical concerns of a venture capital fund in structuring an investment include . . . minimizing taxes to the investor, which may require the company to adopt the corporate form to avoid taxes.").

an operational standpoint.[14] In many instances, the presence of default rules that do not accord with prevailing business owner preferences does not mean that the business is locked into undesirable choices, but the cost of legal representation in drafting around the default rules is certainly less than ideal. The problems are exacerbated by the reality that not all lawyers give good advice about drafting alternatives or actually follow through with effective language even if they properly ascertain what their client would like to achieve. Sometimes there are rules that preclude organizational efficiency. Finally, the continuing "innovation" and experimentation with new business options and forms is actively preventing operational efficiency for closely held businesses and their attorneys.

The thesis of this article is that it is time for us to stop drafting additional alternative business structures and developing "better" statutory frameworks,[15] and to instead focus on moving towards a more unified and predictable form of business for closely held enterprises. Since the statutory close corporation option has proved problematic, and LLPs and LLLPs have achieved uniformity without having widespread appeal, this article suggests that we focus on making our treatment and understanding of LLCs more uniform and predictable. We should learn from the failed statutory close corporation experiment, and work towards a cohesive business structure that works for most multi-owner closely held businesses. Legislative changes should be made with the goal of increasing uniformity and clarity, not with

14. Other commentators have also observed that business organization statutes have not been optimally designed for efficiency. The late Professor Larry E. Ribstein once noted that

> [b]usiness association statutes rarely are analyzed as ways to minimize transaction costs. Economists have focused on the choice between organizing transactions within a firm or between firms, and have paid no attention to questions concerning how these contracts are supplied. Lawyers tend to assume that statutory business forms are artifacts of tax law, and often fail to acknowledge transaction cost justifications for statutory standard forms.

Larry E. Ribstein, *Statutory Forms for Closely Held Firms: Theories and Evidence from LLCs*, 73 WASH. U. L.Q. 369, 371 (1995) (footnote omitted); *see also* Laurel Wheeling Farrar & Susan Pace Hamill, *Dissociation from Alabama Limited Liability Companies in the Post Check-the-Box Era*, 49 ALA. L. REV. 909, 932 (1998) ("The policy behind drafting statutory default provisions should seek to provide a set of rules addressing the needs of the intended users of the business form who are least likely to plan ahead of time.").

15. Even outspoken proponents of the various innovations produced by ULC have noted that "[t]he current proliferation of the number of business forms has become a source of increasing confusion." Harry J. Haynsworth, *The Unified Business Organizations Code: The Next Generation*, 29 DEL. J. CORP. L. 83, 83 (2004). While Dean Haynsworth concludes that even additional experimentation and movement towards a unified business organization statute organized with a "hub and spokes" approach is justified, he does note that current variation among state business organization statutes has created a number of "traps for the unwary." *Id.* Not surprisingly, commentators generally opposed to the efforts of the ULC have been highly critical of this kind of effort at rationalization. Larry E. Ribstein, *Making Sense of Entity Rationalization*, 58 BUS. LAW. 1023, 1041 (2003) ("NCCUSL [now known as the ULC], however, is far more likely to be a source of additional problems than a solution. . . .").

an eye to additional innovation and experimentation in legislative options. Standardized language, accepted forms and language would be ideal, while new approaches to business statutes are probably not.

This article is organized as follows. After this introduction, the second section of this article discusses definitions and provides background information to give context for the issues that are raised in subsequent sections. The third section examines in some detail why the close corporation statutes failed as a means of addressing the special needs of closely held enterprises. The fourth section focuses on ways in which the current generation of LLC statutes and current tax regulations applicable to such enterprises have similarly failed to respond to the operational needs of the closely held enterprises by failing to focus on the benefits of uniformity. The final section focuses on the potential importance of focusing on developing a cohesive and unified view of the LLC, and on developing model forms and language, rather than on proposing additional substantive and structural changes to business organization law. The primary suggestion here is to turn to the ULLCA (2013) as the most likely source of a workable framework for state LLC Acts. That recommendation assumes that the Uniform Law Commission stops tinkering with its statute for at least a few years.

II. TERMINOLOGY AND HISTORY

A. *The "Closely Held" Enterprise*

As a matter of terminology, "closely held" can mean a number of different things in the context of business organizations. As used in this article, the focus is on the traditional "closely held" business, as defined in cases looking at the general law applicable to smaller corporations. Generally, these cases look at whether there are a limited number of owners and no ready market for ownership interests, although some courts also ask whether there is substantial participation by owners in the management of the enterprise and whether the owners are widely dispersed.[16] Companies that

16. One of the leading cases to utilize this formation of the closely held corporation was *Donahue v. Rodd Electrotype*, 328 N.E.2d 505, 585-86 (Mass. 1975) (listing characteristics of a close corporation as "(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation"). The court in *Donahue* noted that it needed to develop its own approach because it could find "no single, generally accepted definition." *Id.* at 585. In deciding on this tripartite test, the *Donahue* court first cited authorities that emphasized participation of control shareholders in management in close corporation. Note, *Statutory Assistance for Closely Held Corporations*, 71 HARV. L. REV. 1498 (1958) (talking about close corporations such as those in which the stockholders occupy most management positions); Kruger v. Gerth, 210 N.E.2d 355 (1965) (Fuld, J., dissenting); Robert Kramer, *Foreword*, 18 L. & CONTEMP. PROBS. 433 (1953);

have not yet "gone public" in the sense of registering any of their equity interests with the Securities Exchange Commission may still be owned by such a widely diverse group of investors that they are not "closely held" under this definition. For example, in the relatively recent past, a company was only required to be publicly registered when it had at least 500 shareholders.[17] The JOBS Act of 2012 increased the number of shareholders that an enterprise could have before it is required to register as a public company to the lesser of 2000 total or 500 "unaccredited" investors.[18] Thus, it is possible to have a company with a very large number of widely dispersed, passive investors that is still not a registered "public" company.

In addition to ignoring single-owner enterprises (on the grounds that they are unlikely to run into serious problems with LLC statutes, even as written), this article presumes that either existing default and gap-filler rules in the

Helms v. Duckworth, 249 F.2d 482, 486 (1957). The court then cited other authorities that suggest focusing on the number of shareholders and market for shares. Galler v. Galler, 203 N.E.2d 577 (1965); F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 1.02 (3d ed. 2003). Modern jurisprudence has embraced the *Donahue* definition, and it is general accepted that a corporation with a limited number of shareholders, no ready market for shares, and typically some substantial participation in management by shareholders, will have the special needs general associated with closely held businesses. Sometimes additional considerations are included, such as the geographic dispersion of shareholders. "Common law recognizes close (closely-held) corporations as a special type of corporation. Courts generally look for some or all of the following attributes in order to define a corporation as a close corporation: a small number of stockholders, no ready market for its stock, participation of a substantial majority of the stockholders in the management, direction and operations of the corporation, and concentration of the stockholders in a limited geographical location." Baruch Gitlin, *When is a Corporation Close, or Closely-Held, Corporation under Common or Statutory Law*, 111 A.L.R.5th 207 (2003). This source also notes that a number of cases have not focused on the question of whether there is substantial shareholder participation in management as part of the analysis. *Id.* Every jurisdiction apparently has some authority defining "close corporation." Gary D. Justis, *Avoiding A Minority Shareholder Oppression Claim in A Close Corporation in Missouri: The Impact of the New Close Corporation Statutes*, 56 MO. L. REV. 257, 263 (1991) ("A close corporation also is defined judicially in all jurisdictions."). Other sources have also identified other factors that could be used in defining what is meant by "closely held" in this context. For example, Professor O'Neal listed the following factors as being the ones most commonly used by various authorities, albeit not all in the same way or all at the same time: (1) a relatively small number of shareholders; (2) shares that are not readily traded on the market; (3) shareholders who tend to treat each other as partners; and (4) management and ownership that are substantially identical. F. HODGE O'NEAL & ROBERT B. THOMPSON, *supra* at § 1.02. This source concludes that the most important factor of a closely held corporation is that its "shares are not generally traded in the securities markets." *Id.*

17. Until legislative reform in 2012, section 12(g) of the Securities Exchange Act of 1934 required a company with a class of equity securities held by 500 or more shareholders of record and having more than $10 million in assets to register with the SEC and become a reporting company. 17 C.F.R. § 240.12g-1 (2013).

18. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 § 501 (2012). For a discussion of the history of the Security and Exchange Commission's approach to and definition of "accredited investors," see Michael L. Monson, *The Evolution and Future of the Accredited Investor Standard for Individuals*, 23 UTAH B.J., Nov./Dec. 2010, at 36.

corporate statutes work well for the publicly traded company, or at least that such enterprises are generally run or advised by professionals with sufficient resources and sophistication so that they understand and can operate well within those rules. Similar assumptions are made for companies that have large numbers of sophisticated, widely dispersed passive investors even if the company is not technically publicly held because it has never had a public offering and has no securities registered under the federal securities laws. A business characterized by widely dispersed, passive ownership and an available market for shares, even if that market is not a national exchange, is probably well suited to or at least very used to the traditional corporate structure.[19] In addition, to the extent that traditional corporate laws do not work well for such a company, those kinds of businesses are all likely to have sufficient resources to draft around default rules with the assistance of experienced counsel. Instead, this article addresses the concerns of the smaller business that is more likely to be dependent on statutory default rules and gap-filler provisions embodied in the statutes, where less sophisticated (and less wealthy) entrepreneurs might not have the time, inclination, or resources to retain experienced counsel to assist with structuring the business in an optimal format.

Complicating matters somewhat is the fact that at various points, this article also talks about "statutory close corporations"[20] as well as closely held businesses. A statutory close corporation is a corporation that has elected to be subject to specific rules available only to qualifying corporations that have specifically elected to be subject to the special provisions.[21] States have taken different approaches to determining which corporations are eligible for

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19. "Broadly-shared management power becomes impractical as the number of owners of a business increases. Thus, most businesses that have, or expect to have, large numbers of investors choose the corporate form, where management authority is centralized in the board of directors." 5 MATTHEW G. DORE, BUSINESS ORGANIZATIONS § 2:5 (2015).

20. *See infra* Part III of this article.

21. For example, in Delaware, a corporation must elect close corporate status in its articles. Mary Siegel, *Fiduciary Duty Myths in Close Corporate Law*, 29 DEL. J. CORP. L. 377, 409 (2004) ("[T]he Delaware Supreme Court requires corporations to elect close corporate status in order to obtain the benefits of that subchapter.") (citing Nixon v. Blackwell, 626 A.2d 1366, 1380 (Del 1992); Chapin v. Benwood Found., Inc. 402 A.2d 1205 (Del. Ch. 1979), *aff'd sub nom on other grounds*; Harrison v. Chapin, 415 A.2d 1068 (Del. 1980) (holding that the close corporate subchapter rules are "unavailable to noncomplying corporations").

statutory close corporation status,[22] which reflects the fact that state close corporation statutes vary widely in many respects.[23]

Why the focus on smaller, closely held businesses? First, there is the undisputable fact that such enterprises play a tremendous role in this country. It is clearly true that most economic reports concerning the impact of small businesses use a different definition of small business than does this article. In fact, even in the legal arena, small businesses are defined differently depending on the area of law in question.[24] From an economic point of view, the number of employees is often regarded as being of primary importance, but even there, widely differing definitions can be found. The Small Business Administration ("SBA"), for example, defines "a small business as an independent business having fewer than 500 employees."[25] A 2011 Working Paper sponsored by the National Bureau of Economic Research used a different definition in analyzing the economic impact of small businesses, "primarily" referring to "firms with between 1 and 19 employees."[26] Of these, the second definition is far likelier to involve the kind of "closely held" business discussed in this article.

That Working Paper therefore provides significant insights into the importance of such businesses. First, in 2007 (the year studied), there were roughly 6 million firms with at least some employees, and of those, 90% had fewer than 20 employees.[27] Taken together, these firms accounted for about 20% of all aggregate paid employment in this country, despite the fact that they were each quite small. The relative importance of small and closely held businesses is only magnified by the fact that most American businesses do not have paid employees. "In 2007, for example, there were 21.7 million

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22. States have taken at least four distinct approaches to determining what corporations are eligible for close corporation status: (1) some states are simply self-selective, allowing a corporation to declare itself to be a close corporation in its charter, although these often provide that the status is lost if there is ever a public offering of shares; (2) some states allow corporations with certain characteristics to use special statutory provisions available to close corporations; (3) some states define close corporations by the number of shareholders, often 35 or 50; and (4) some states require the corporation to have share transfer restrictions in order to utilize close corporation provisions. Krishnan S. Chittur, *Resolving Close Corporation Conflicts: A Fresh Approach*, 10 HARV. J. L. & PUB. POL'Y 129, 145-46 (1987).

23. *See infra* Part III of this article.

24. Mirit Eyal-Cohen, *Down-Sizing the "Little Guy" Myth in Legal Definitions*, 98 IOWA L. REV. 1041, 1065-86 (2013) (surveying and noting differences in how "small business" is defined in securities law, health law, labor and employment law, patent law, government contracting law, and tax law).

25. *Frequently Asked Questions*, SMALL BUS. ADMIN, https://www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf (Mar. 2014).

26. Erik Hurst & Benjamin Wild Pugsley, *What Do Small Businesses Do?* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 729, 2011), http://www.nber.org/papers/w17041.pdf.

27. *Id.* at 6.

zero employee firms which represented roughly 78% of all firms," although many of these were second businesses or independent consultants.[28] The majority of these "small" businesses were and presumably still are owned by persons who do not aspire to have their businesses become large or publicly traded.[29] Instead, such firms appear to be concentrated among a very few industries, including "skilled craftsmen, lawyers, real estate agents, doctors, small shopkeepers, and restaurateurs."[30] Moreover, that paper collects and analyzes data suggesting that there is less innovation[31] or growth in the job market[32] because of these smaller businesses than policy makers might be assuming.[33]

Despite its economics focus and ultimate conclusion that small firms may not be as critical to innovation and job creation in the American economy as sometimes presumed, the Working Paper provides substantial support for the notion that most small firms in this country are not started out of necessity but because the owners want to be working in a closely held enterprise.[34] In other words, in this country, people do not go to work in a small, closely held business because they have to; they do so because they choose to.[35] Non-pecuniary factors like scheduling flexibility and the ability "to be one's own boss" predominate.[36] This perspective is backed up with a wide number of reports about how critical small business formation is to

28. *Id.* at 10.

29. *Id.* at 4. "When asked at the time of their business formation, most business owners report having no desire to grow big. . . ." *Id.* at 3.

30. *Id.* at Abstract, 1-2.

31. *Id.* at 20 ("Most small firms to not seem to innovate. . . .").

32. *Id.* at 13 (noting that throughout their lifecycle "the overwhelming majority of firms remain small").

33. *Id.* at 39 (criticizing the choice to subsidize small firms because "[w]hen small business activity is directly subsidized, the economy as a whole becomes less productive given the response of individuals to work in small (subsidized) self-owned firms as opposed to establishing larger firms which can produce at lower average costs by taking advantage of the returns to scale").

34. Fewer than 4% of small business owners in the U.S. "report starting a business because of a lack of employment options." *Id.* at 36.

35. In contrast to the reasons why so many individuals start small businesses in developing economies, data collected by Hurst & Pugsley shows that "it does not appear that the U.S. small business owners are 'reluctant' entrepreneurs." *Id.* (contrasting results in this country with data from developing countries as reported by ABHIJIT V. BANERJEE & ESTER DUFLO, POOR ECONOMICS: A RADICAL RETHINKING OF THE WAY TO FIGHT GLOBAL POVERTY (2011)).

36. Hurst & Pugsley, *supra* note 26, at 3.

Americans and the American dream,[37] sometimes despite the lack of pecuniary or economic benefit.[38]

Regardless of whether one believes small, closely held enterprises are valuable for the boost they can provide to the economy, or because they promote happiness among millions of business owners who do not seem to want to be part of "big business," it is clear that such enterprises are an essential component of our current economic landscape. It therefore makes sense not to ignore them when considering statutory options for business structures, even if one wishes to criticize outright subsidies.[39]

B. Historical Organizational Alternatives for Multi-Owner Businesses

The current legislative landscape offers a large and seemingly ever-growing list of organizational alternatives available to businesses, many of them still structured with the requirements of outdated tax regulations in mind. To understand how this came about, the logical starting point is the general statutory regime that was in place prior to the advent of the LLC and LLP in this country. At the time the first American LLC statute was enacted

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37. *See* Orrin K. (Skip) Ames III, *Closely Held Corporations: An Intersection of Business, Law, and Ethics*, 43 CUMB. L. REV. 171, 171 (2013) ("The concept of entrepreneurship is an important part of our current national conversation. Entrepreneurs and those who start small businesses, many of which are family owned, are essential elements of economic growth and examples of what a free market economy can produce."). For a political perspective on these issues, see 128 CONG. REC. 9177 (1982) (statement of Sen. Samuel A. Nunn, Jr.) ("Small business is the heart of the free enterprise system, that sector most likely to take the steps necessary to get this Nation back of [sic] the road to economic recovery."); 124 CONG. REC. 35217 (1978) (statement of Sen. Gaylord A. Nelson) ("[S]mall businesses . . . are the heart and soul of the competitive free enterprise system."); *see also* Frank T. Carlton, *What Is Free Enterprise?*, 3 AM. J. ECON. & SOC. 655, 656 (1944) (discussing the importance of free enterprise to the American dream).

38. Richard J. Pierce, Jr., *Small Is Not Beautiful: The Case Against Special Regulatory Treatment of Small Firms,* 50 ADMIN. L. REV. 537, 538 (1998) (noting that the myth that small is good and big is bad is deeply rooted in our cultural beliefs); *accord* Mirit Eyal-Cohen, *Legal Mirrors of Entrepreneurship*, 55 B.C. L. REV. 719, 719-20 (2014) (criticizing the results of the fact that small businesses "have come to represent the essence of the American dream and the free enterprise economic system.").

Despite general acknowledgement that small businesses are important to this country, some commentators worry that they are "underappreciated." Regina F. Burch, *Financial Regulatory Reform Post-Financial Crisis: Unintended Consequences for Small Businesses*, 115 PENN ST. L. REV. 409, 410 (2010) (arguing that "small businesses play an underappreciated role in the United States economy. For example, most business news stories involve large, publicly traded companies. However, the number of small businesses vastly overshadows the number of large businesses. In addition, small businesses' contribution to the United States economy is overshadowed by media reports of ethical conflicts and potentially unlawful conduct at larger businesses.").

39. For some criticism of the role that direct subsidization of small business can have, see Hurst & Pugsley, s*upra* note 26, at 36-41; *accord* Eyal-Cohen, *supra* note 38, at 730. The desirability of offering economic subsidies to small business is outside the scope of this article.

in 1977,[40] all states authorized multi-owner businesses to organize as general partnerships, limited partnerships, or corporations. While there was some variation among the states with regard to how each of these forms of enterprise were to operate, there was also a great deal of similarity in the way these businesses were set up.

The predominate statutory model for the general partnership was the Uniform Partnership Act (UPA);[41] limited partnerships in most states were governed by the Revised Uniform Limited Partnership Act (RULPA);[42] and, although there was somewhat wider divergence among the states when it came to corporations, the prevalent model for corporate statutes was the Model Business Corporation Act (MBCA).[43] Even in jurisdictions possessing corporate statutes not directly modeled on the MBCA, there was a great deal of similarity in the way that they required corporations to be set up. Pursuant to these statutes, three substantially different forms of multi-owner business organizations could be formed and operated in any American

40. Goforth, *supra* note 6, at 1198 ("LLCs were first authorized in this country in Wyoming, pursuant to legislation adopted in 1977.").

41. According to the Prefatory Note to the Revised Uniform Partnership Act, "The UPA ha[d] been adopted in every state other than Louisiana and ha[d] been the subject of remarkably few amendments in those states over the past 80 years." UNIF. P'SHIP ACT Prefatory Note (1914), 6 U.L.A. 5 (2015) (speaking of the 80-year period prior to adoption of the Revised Uniform Partnership Act).

42. RULPA was also adopted in every state except for Louisiana. REVISED UNIF. LTD. P'SHIP ACT Table of Jurisdictions Wherein the Act Has Been Adopted (1976), 6B U.L.A. 1-2 (2008); UNIF. LTD. P'SHIP ACT Table of Jurisdictions Wherein Act Has Been Adopted (1976), 6A U.L.A. 325 (2008) (together listing 49 states plus the District of Columbia with a version of the uniform limited partnership act as of 1989). There were actually two different versions of RULPA in 1989—the original 1976 version which was widely prevalent when LLCs were first being discussed and an amended version that was promulgated in 1985. Many of the 1985 amendments were quite influential, but few of the changes made material differences to the particular issues discussed in this Article. The citations to RULPA in this Article will general be to the version with the 1985 amendments included, although the volumes do show changes so that the language that appeared in the 1976 version can also be determined.

43. According to the American Bar Association, "[t]he Model Act serves as a model for corporate statutes throughout the United States. It has been adopted in whole or substantial part as the corporation statute of 30 states, while selected provisions of the Act have been adopted by many other states." MODEL BUS. CORP. ACT, ANN. at v (AM. BAR ASS'N 2011).

The Model Business Corporation Act (MBCA) has never been the law in all 50 states, but the rules discussed in this article were, and in many cases continue to be, prevalent in the United States. The MBCA was the work product of the Committee on Corporate Laws (Section of Corporation, Banking and Business Law) of the American Bar Association, and was originally modeled on the Illinois Business Corporation Act of 1933. It was first published as a complete act in 1950 and is not the same as the Model Business Corporation Act that was promulgated in 1928 by NCCUSL (now ULC) (an effort that was withdrawn in 1957). While the MBCA has been highly influential, there is variation in the language used in the various state statutes both because of individual tailoring that occurred when the acts were initially enacted in various jurisdictions and because of modifications over time, even where the principles are basically the same.

jurisdiction. This exhausted the options for most multi-owner for-profit businesses unless a more complicated structure was created, typically with the assistance of counsel. This might have involved arrangements such as single-shareholder corporations being formed to act as general partners in a limited partnership where the individual owners of the corporations were also the only limited partners in the limited partnership.[44]

A general partnership possessed a rather odd combination of attributes, some of which allowed the partnership to act as an entity and some of which made the partnership look like nothing more than an association of persons acting in concert.[45] For example, a partnership could hold property,[46] but the UPA was originally silent on the question of whether a partnership could sue and be sued in its own name.[47] General partners were not allowed to protect their personal assets from being vulnerable in the event that the partnership failed to pay its debts;[48] they all had statutory management authority,[49] and they could not be divested of apparent authority to conduct partnership business that appeared to be carrying on the ordinary business of the partnership.[50] No new partners could be admitted to the partnership without the unanimous consent of all partners,[51] and without that consent only the economic rights in the partnership would be transferred,[52] leaving the uncomfortable possibility that a person with no economic stake in the business could continue to be called a partner and have a direct say in how

44. This might have been done to avoid risking personal assets of the individual owners, while at the same time avoiding the double taxation associated with the corporate form, for the majority of the limited partnership's income. The structure, however, was not without risks. *See generally* Frigidaire Sales Corporation v. Union Properties, Inc., 562 P.2d 244 (Wash. 1977) (en banc).

45. The somewhat uneasy tension between the partnership as an association of persons and as an entity in its own rights has been explicitly recognized as a result of the differing preferences and influence of the two principle reporters for the project. *See* UNIF. P'SHIP ACT Prefatory Note (1914), 6 pt. III U.L.A. 1-3 (2015). Despite some characteristics that made the partnership operate as a legal entity, it was actually statutorily defined as an association of persons. UNIF. P'SHIP ACT § 6(1) (1914), 6 pt. III U.L.A. 93 (2015).

46. UNIF. P'SHIP ACT § 10 (1914), 6 pt. III U.L.A. 306 (2015).

47. For a more detailed discussion of the problems presented by this silence, see II ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIPS § 5.01(b) at 5:5–5:10 (2014 Supp.).

48. UNIF. P'SHIP ACT § 15 (1914), 6 pt. III U.L.A. 331-32 (2015).

49. UNIF. P'SHIP ACT § 18(e) (1914), 6 pt. III U.L.A. 410 (2015) (specifying that "[a]ll partners have equal rights in the management and conduct of the partnership business").

50. UNIF. P'SHIP ACT § 9(1) (1914), 6 pt. III U.L.A. 268 (2015).

51. UNIF. P'SHIP ACT § 27 (1914), 6 pt. IV U.L.A. 235 (2015).

52. UNIF. P'SHIP ACT § 26 (1914), 6 pt. IV U.L.A. 228 (2015).

the business was to be run.[53] Finally, if any partner died, became incapacitated, or withdrew from the partnership for any reason, that triggered at least a technical dissolution of the partnership,[54] even if the withdrawal was in violation of an agreement between the partners.[55]

Limited partnerships offered at least some owners protection against personal liability for enterprise-level debts, but they obtained that protection at the cost of any right to participate in management or control of the business.[56] Management authority over the operations of the limited partnership was vested in the general partners,[57] and their personal assets were at risk if the business itself could not or did not pay all of its debts.[58] Death or incapacity of the partners could affect the continued existence of the business as the limited partnership depended on the continued participation of at least one limited partner and at least one general partner.[59] General

53. UNIF. P'SHIP ACT § 27(2) (1914), 6 pt. IV U.L.A. 235 (2015); *see, e.g.*, Wester & Co. v. Nestle, 669 P.2d 1046 (Colo. App. 1983) (distinguishing between mere assignment of interests and withdrawal).

54. UNIF. P'SHIP ACT § 29 (1914), 6 pt. IV U.L.A. 253 (2015) (stating that "[t]he dissolution of a partnership is the change in relation of the partners caused by any partner ceasing to be associated in the carrying on . . . of the business").

55. UNIF. P'SHIP ACT § 31(2) (1914), 6 pt. IV U.L.A. 277 (2015) (specifying that dissolution would be caused even "[i]n contravention of the agreement between the partners . . . by the express will of any partner at any time").

56. The issue of the rights of limited partners to participate in control of a limited partnership has been particularly contentious over time. The original ULPA, as promulgated in 1916, specified in section 7 that a limited partner would "not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business." UNIF. LTD. P'SHIP ACT § 7 (1916). RULPA (1976) modified this language considerably, by providing in section 303 that "a limited partner is not liable for the obligations of a limited partnership unless he [or she] is also a general partner or, in addition to the exercise of his [or her] rights and powers as a limited partner, he [or she] takes part in the control of the business. However, if the limited partner's participation in the control of the business is not substantially the same as the exercise of the powers of a general partner, he [or she] is liable on the persons who transact business with the limited partnership with actual knowledge of his participation in control," and this language was modified again with the 1986 amendments to RULPA. REVISED UNIF. LTD. P'SHIP ACT § 303 (1976), 6B U.L.A. 180-81 (2008) (marked to show both versions). The current uniform limited partnership act (ULPA (2001)) has gone even further, now providing that "[a] limited partner is not personally liable . . . for an obligation of the limited partnership solely by reason of being a limited partner, even if the limited partner participates in the management and control of the limited partnership." UNIF. LTD. P'SHIP ACT § 303 (2010), 6A U.L.A. 418 (2008).

57. REVISED UNIF. LTD. P'SHIP ACT § 403 (1976), 6B U.L.A. 222 (2008).

58. *Compare* REVISED UNIF. LTD. P'SHIP ACT § 303(a) (1976), 6B U.L.A. 180 (2008) (stating that limited partners ordinarily have no personal liability for debts of the limited partners, with some exceptions), *with* REVISED UNIF. LTD. P'SHIP ACT § 403(b) (1976), 6B U.L.A. 222 (2008) (stating that general partners in a limited partnership have the same liability as general partners in a general partnership).

59. While withdrawal of a limited partner would only affect the continued existence of the limited partnership if the partnership agreement so provided, withdrawal of a general partner would

partners also retained the absolute power to withdraw at any time,[60] although the right of limited partners to do so was constrained.[61] Admission of new partners required the consent of all partners, and a sale of an interest in the limited partnership without such consent resulted in the transfer only of economic rights.[62] The rules governing operation of this business provided for some degree of formality,[63] albeit less than for the corporation.

Corporations offered all owners limited personal liability,[64] and provided for centralized management in the hands of a board of directors,[65] who often did have some degree of ownership in the company but were not required to by statute.[66] This management structure was generally mandatory,[67] and

normally trigger dissolution. REVISED UNIF. LTD. P'SHIP ACT § 801 (1976), 6B U.L.A. 321 (2008); REVISED UNIF. LTD. P'SHIP ACT § 801(4) (1976), 6B U.L.A. 321 (2008); *see also* REVISED UNIF. LTD. P'SHIP ACT § 602 (1976), 6B U.L.A. 284 (2008) (giving general partners the power to withdraw at any time, even in contravention of an agreement among the partners).

60. REVISED UNIF. LTD. P'SHIP ACT §§ 402(1), 602 (1976), 6B U.L.A. 216, 286 (2008).

61. REVISED UNIF. LTD. P'SHIP ACT § 603 (1976), 6B U.L.A. 286 (2008).

62. REVISED UNIF. LTD. P'SHIP ACT § 301 (1976), 6B U.L.A. 173 (2008) (admission of limited partners); REVISED UNIF. LTD. P'SHIP ACT § 401 (1976), 6B U.L.A. 213 (2008) (admission of general partners). Note that under RULPA a partner who assigned all of his or her interests would cease to be a partner. REVISED UNIF. LTD. P'SHIP ACT § 702, 6B U.L.A. 306 (2008). This is not the same rule as applied to partners in a general partnership. *See supra* note 53 and accompanying text.

63. RULPA required certain records to be kept, including a list of general and limited partners and their business addresses, a copy of the certificate of limited partnership and any amendments, the past three years' worth of tax records, any written partnership agreement, three years of financial records, a written analysis of the value of each partner's total contribution to the partnership, any provisions for additional contributions, provisions for mandatory distributions, and events of dissolution. REVISED UNIF. LTD. P'SHIP ACT § 105 (1976), 6B U.L.A. 117-18 (2008). Limited partners had the right to inspect and copy this information, and any other "information regarding the affairs of the limited partnership as is just and reasonable." REVISED UNIF. LTD. P'SHIP ACT § 305 (1976), 6B U.L.A. 206 (2008).

64. MODEL BUS. CORP. ACT § 6.22(b) (AM. BAR ASS'N 2010).

65. MODEL BUS. CORP. ACT § 8.01(b) (AM. BAR ASS'N 2008).

66. Most statutes allow corporate bylaws to require share ownership, and many public corporations do have such requirements. Consistent with statutes authorizing bylaws that require share ownership as a qualification to serve as a director, many public corporations have adopted share ownership guidelines for their directors. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(b) (2013); Seamus O'Toole & David Outlaw, *Director Stock Ownership Options*, EQUILAR (Mar. 9, 2016), http://www.equilar.com/reports/33-director-stock-ownership-guidelines.html (stating that "companies often implement director stock ownership guidelines to ensure that board members are invested in the company's current and future performance. These guidelines typically require that directors own at least some specified amount of company equity and that they hold equity granted as compensation for a minimum period. . . ."). This source conducted a study suggesting that nearly 90% of Fortune 100 companies have ownership guidelines for directors. *Id.*; *see also Director Nominations*, 39 DEL. J. CORP. L. 117, 143 n.125 (2014) ("Typically, a director's ownership target will be a multiple of the annual retainer.").

67. MODEL BUS. CORP. ACT § 8.01(a) (AM. BAR ASS'N, 2008) (specifying that with limited exceptions "each corporation must have a board of directors.").

there were specific meeting and record-keeping requirements for corporations in order to make sure that shareholders had at least some minimal right to information even if they did not serve on the board.[68] The death or incapacity of one or more shareholders had no effect on the continuing existence of the corporation,[69] which for all intents and purposes was a legal entity independent of the persons who technically "owned" it. The residual power of the shareholders as owners was essentially their power to replace directors, rather than to participate directly in management of the business.[70] On the other hand, if the shares were sold, under universally applicable default rules the purchaser became the shareholder with no need for additional approval by either the directors or other shareholders. With limited exceptions, these rules and the built-in formality, including the necessity for annual "meetings" and votes to re-elect directors each year, applied even if the corporation was owned by a single individual or very small group of persons. Many of these rules were mandatory.

Although there were three options for multi-owner business organizations under state law, federal tax regulations essentially required that all of these forms of enterprise be classified either as tax partnerships or associations taxable as corporations. The way in which this classification worked was somewhat convoluted.

C. The Corporate Resemblance Test

Although businesses are organized under the laws of individual states, the tax status of those enterprises, at least for purposes of federal income taxes, depends on federal law.[71] In general terms, prior to the last two decades, this meant that the question of how American businesses were classified for tax purposes depended on the corporate resemblance test, which required that companies be evaluated to determine whether or not they

68. MODEL BUS. CORP. ACT §§ 7.01-7.08, 8.20-8.25, 16.01-16.06, 16.2-16.21 (AM. BAR ASS'N, 2008) (detailing shareholder meetings, directors' meetings, and record keeping requirements, respectively).

69. MODEL BUS. CORP. ACT § 14.02 (AM. BAR ASS'N, 2008) (stating that both the board of directors and shareholders must normally vote as a group to trigger voluntary corporate dissolution; death or incapacity of individual shareholders is not listed as affecting corporate existence).

70. MODEL BUS. CORP. ACT § 8.01(b) (AM. BAR. ASS'N, 2008) (stating that "[a]ll corporate powers shall be exercised by or under the authority of the board of directors, and subject to the oversight, of the board of directors" with very minor limitations).

71. The Internal Revenue Code (or simply the Code, as it is generally known) establishes the rules pursuant to which taxes are imposed. The Code appears at U.S. Code Title 26, and income taxes are covered in I.R.C.§§ 1-1564 (2016).

possessed certain, defined "corporate" characteristics.[72] There were six characteristics utilized in this approach: the presence of associates; a business purpose; continuity of life for the enterprise; centralization of management; limited liability; and free transferability of interests.[73] The presence of associates was required in order to distinguish sole proprietorships (which are disregarded as not involving a separate entity for tax purposes),[74] and the requirement of a business purpose helped rule out organizations classified as trusts. Since both sole proprietorships and trusts are outside the scope of this article, they will not be discussed further here. For multi-owner businesses, however, an organization was taxed as a corporation whenever it had more of the last four characteristics than it lacked, and otherwise it was classified as a tax partnership.[75] Even though this did not correspond directly to the organizational options under state law, which included more than general partnerships and corporations even before the advent of LLCs, LLPs, and LLLPs, those were the only available tax classifications for an enterprise with multiple owners and a business purpose.[76]

In most cases, however, businesses organized as partnerships under state law were classified as tax partnerships, regardless of whether they were general or limited.[77] In either case, the partnership would possess the two characteristics shared by both corporations and partnerships (associates and a business purpose). As for general partnerships, they would generally lack all four of the other corporate characteristics: withdrawal of a general partner at any time could trigger dissolution of that partnership so that there was no continuity of existence; every general partner had at least apparent authority

72. Treasury regulations provided rules to determine the classification of most unincorporated business organizations. Treas. Reg. §§ 301.7701-2(a)-(3) (as amended in 1996). These regulations were also referred to as the *Kintner* regulations, in recognition that they derived in part from language in *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954).

73. Treas. Reg. §§ 301.7701-2(a)-(3) (as amended in 1996); *Kintner*, 216 F.2d at 418.

74. Since sole proprietorships did not have associates, continuity of life, or limited liability, they could not be taxed as corporations and generally did not create much in the way of confusion as to tax status. If a single individual incorporated under state law, the business would have continuity of life, limited liability, centralized management and transferability of interests so that it would be recognized and taxed as a corporation.

75. Treas. Reg. § 301.7701-2(a)(2) (as amended in 1996). Each of the characteristics were to be given equal weight in making the determination. Treas. Reg. § 301.7701-2(a)(1) (as amended in 1996).

76. Excluding certain specialized options available to enterprises such as cooperatives and business trusts, the available tax classifications for multi-owner businesses continue to be: (1) a tax partnership taxed under subchapter K of the Code; (2) an association taxable as a corporation under subchapter C (the "C Corp"); or (3) an association taxable as a corporation under subchapter S (the "S Corp"), as long as a qualifying election is properly made and the business meets the eligibility requirements. I.R.C. §§ 701-61, 301-85; 1371-79; 701-61 (2016).

77. *See* Treas. Reg. § 301.7701-3(2) (as amended in 1996).

to bind the business so the business could not be said to be centrally managed; general partners were personally liable for debts of the partnership; and it took unanimous consent of the general partners to admit anyone as a partner, and in the absence of such consent, only the economic interest in the business was transferable which prevented the general partnership from possessing free transferability of interests.[78]

Even most limited partnerships were characterized as tax partnerships, because they generally did not possess more corporate characteristics than they lacked. State law required the presence of at least one general partner with unlimited personal liability whose withdrawal could trigger dissolution,[79] and the default rule required consent of all partners before anyone new could be admitted as a partner. Because the limited partnership was more successful at blending some corporate attributes into the business, some of such enterprises were carefully scrutinized by the IRS, and some were classified as associations taxable as corporations despite their status as limited partnerships under state law.[80]

On the other hand, businesses incorporated under state law were generally taxed as corporations because they possessed all of the typical corporate characteristics: they would continue to exist regardless of the status of any individual shareholder, management power was vested in a board of directors rather than being retained by shareholders, shareholders were not personally liable for debts of the business under ordinary circumstances, and when shares were sold the purchaser had the right to become a shareholder without the need for any further vote by shareholders or directors.[81] When legal counsel got creative with various other options, the IRS would use the corporate resemblance test to determine the appropriate classification of the enterprise.[82]

78. *See supra* notes 45-55 and accompanying text for a discussion of these attributes associated with the general partnership.

79. "'Limited partnership' and 'domestic limited partnership' mean a partnership formed by two or more persons under the laws of this State and having one or more general partners and one or more limited partners." REVISED UNIF. LTD. P'SHIP ACT § 101(7) (1976), 6B U.L.A. 86 (2008).

80. For a more thorough discussion of the complexities of these tax rules, see 3 ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIPS, § 12:220-12:240 (2014).

81. *See supra* notes 64-70 and accompanying text.

82. The corporate resemblance test, codified in the *Kintner* regulations, was subject to substantial criticism because it was subject to manipulation if the business owners were willing to structure things a little creatively. *Larson v. Commissioner*, 66 T.C. 159 (1976), was often cited as an example of such manipulation. In *Larson*, the Tax Court determined that a limited partnership with a sole corporate general partner was a tax partnership even though the business had been structured so that it did not have much in the way of continuity of life or limited liability. *Larson*, 66 T.C. at 185. For such a discussion, see Thomas M. Hayes, *Checkmate, the Treasury Finally*

D. The LLC and LLP

The very first statute authorizing domestic LLCs was enacted in Wyoming in 1977, as special interest legislation designed to assist a particular mineral concern that explicitly wanted to form a business entity offering limited liability to all equity participants while avoiding imposition of an entity-level tax such as that imposed on corporations.[83] It was not until the IRS acquiesced in the general rule that possessing the traditional "corporate characteristic" of limited liability would not prevent an LLC from obtaining partnership tax status that the LLC phenomenon really took off, with states rushing to enact authorizing legislation.[84]

Surrenders: The Check-the-Box Treasury Regulations and Their Effect of Entity Classification, 54 WASH. & LEE L. REV. 1147, 1157 (1997) ("*Larson v. Commissioner* demonstrates the ease with which taxpayers could manipulate the *Kintner* regulations.").

83. Dale W. Cottam et al., *The 2010 Wyoming Limited Liability Company Act: A Uniform Recipe With Wyoming "Home Cooking"*, 11 WYO. L. REV. 49, 51-55 (2011); *see also* Goforth, *supra* note 6; Richard Johnson, *The Limited Liability Company Act*, 11 FLA. ST. U. L. REV. 387, 387 n.2 (1983). The original citation to the Wyoming LLC Act was Wyo. Stat. §§ 17-15-101 to 136 (1989).

84. Until the IRS acquiesced, only Florida joined Wyoming in enacting LLC legislation, doing so in 1982. *See* Hamill, *supra* note 6, at 1478-1504 (citing Florida Limited Liability Company Act, 1982 Fla. Laws ch. 82-177 (enacted Apr. 21, 1982)). The reason that states were initially slow to act was due in large measure to the IRS's resistance to the notion that such businesses should be taxed as partnerships even though all owners had limited liability. The IRS's original reaction to the initial LLC statute had been less than positive. At the time the first statute was adopted, the IRS had long had the power to classify an unincorporated association as either an association taxable as a corporation or as a partnership for federal tax purposes. Treas. Reg. § 301.7701-2(a)(3) (as amended in 1996). The rules that were then in effect as to whether a particular business organization would be classified as one or the other form for tax purposes could be traced back to the Supreme Court's landmark decision in *Morrissey v. Commissioner*, 296 U.S. 344 (1935), in which the Court established that an association that resembles a corporation is to be taxed as a corporation. The factors that had been set out as determining whether a particular unincorporated association more closely resembled a corporation or a partnership were as follows: continuity of life; centralization of management; limited liability and free transferability of interests. Treas. Reg. § 301.7701-2(a)(1) (as amended in 1996). Under this "corporate resemblance test" an organization was to be taxed as a partnership unless it had more of these characteristics than it lacked. Notwithstanding these regulations, the IRS apparently viewed this new form of entity as a tax dodge, and promptly proposed regulations which would have mandated that any entity providing all members with limited liability be classified as a corporation for tax purposes. Classification of Limited Liability Companies, 45 Fed. Reg. 75709 (proposed 1980). The response from the public to the proposed regulations was intensely critical, and in response the IRS withdrew the proposed regulations, initiating a long-term study to determine how limited liability should be factored into the classification of unincorporated associations. INTERNAL REVENUE SERV., NEWS RELEASE ON PROPOSED REGULATION ON CLASSIFICATION OF LIMITED LIABILITY COMPANIES (1982), 1982 WL 210492. It took six years for the IRS to conclude that limited liability should not be a determinative factor in denying partnership tax status. I.R.S. Notice 88-118, 1988-38 I.R.B. This IRS ruling resulted in a trickle of new legislation which turned into a virtual flood of statutes authorizing the new form of business entity by mid-1994. *See* Goforth, *supra* note 6, at 1202-03.

Perhaps not surprisingly, once the floodgates were opened, some enterprising soul had to ask the question of why it was impossible to form a partnership with limited liability for the partners, when the members in an LLC could be given the benefits of partnership income tax status. The original driving force behind LLP legislation was in fact the perceived unfairness in imposing personal liability on partners in professional partnerships for misconduct of others over whom, as a practical matter, they had neither the ability to supervise nor the power to control.[85] In particular, Texas was motivated to act as a result of the number of suits brought by banking regulators against professionals in larger partnerships who had performed services for financial institutions that later failed.[86] As a result, the original LLP statutes provided general partners with only partial protection against personal liability for entity-level debts, to address the particular problem at hand.[87] However, the LLP quickly morphed from a way to provide "'peace of mind' insurance for innocent partners" to yet another option for business owners seeking fuller protection against personal liability for business debts.[88] Thus, under modern LLP statutes, a general partner in an LLP has the same protection against personal liability that is afforded to shareholders in a corporation or members in an LLC—he or she can be liable for the contributions that have been made or promised, for personal guarantees, for personal misconduct, and for other debts if the veil of limited liability is pierced. However, at heart, the LLP is still a general partnership, with the same management structure, the absolute power in the hands of partners to withdraw at any time, and the resulting problems associated with dissolution that make the traditional general partnership a poor choice for many enterprises.

The limited liability limited partnership, or the LLLP, was the next logical step, at least in some states. If a general partner in a general partnership could achieve limited liability, why should a general partner in a limited partnership be potentially stuck with personal liability for all of the debts of the enterprise? It is, in fact, probably simplest to think of the LLLP as a limited partnership that offers its general partners the same protections from personal liability that would be available to general partners in an LLP.

85. For a description of the genesis of the LLP, see Hamilton, *supra* note 4.

86. *Id.*; *accord* Robert T. Bowsher, *RLLPs Can Limit a Partner's Personal Liability*, 2 J. MULTISTATE TAX'N 232 (1992).

87. For a more complete discussion of the "first generation" LLP statutes, see Hamilton, *supra* note 4, written at a time when a majority of LLP statutes tended to follow this approach.

88. For a discussion of this evolution, see Hamilton, *supra* note 4 at 1087-95. *Accord* Carol Goforth, *Limiting the Liability of General Partners in LLPs: An Analysis of Statutory Alternatives*, 75 OR. L. REV. 1139 (1996).

Limited partners in an LLLP don't require additional protections as they already have limited liability, but without the availability of the LLLP as an organizational option, general partners in limited partnerships would be faced with the potential for personal liability in a way that appears to be increasingly anachronistic in the modern business world. Again, however, the basic structure is that of a limited partnership, except that everyone in the enterprise has the benefit of limited liability (which was traditionally exclusively a corporate characteristic because a traditional limited partnership had to have at least one general partner with unlimited personal liability).

The statutes in question were clearly drafted with an overriding goal of allowing owners to achieve the benefits of avoiding corporate tax status under the corporate resemblance test, while still providing them with limited liability under state law. Choosing the general partnership and limited partnership models as the basis for the default rules for the structure and operation of the business therefore made great sense. The LLC statutes of the time were clearly modeled after the general partnership, with most statutes gradually being amended to allow increasing flexibility as business owners sought to come as close to the line of possessing certain desirable "corporate attributes" as possible without actually crossing those lines.[89]

This resulted in a deluge of private letter ruling requests being submitted to the IRS where businesses, with the assistance of counsel, sent in requests for the IRS to agree that it would take no action to assert that a particular set

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89.

> The very first LLC statutes are generally characterized as 'bulletproof,' in that these statutes provided for minimal flexibility with respect to certain entity characteristics pertinent to the federal tax classification of the LLC and, as those tax classifications regulations were generally interpreted, these statutes would assure partnership classification. There arose a second generation of LLC acts, characterized as 'flexible,' which provided default rules with respect to those tax classification items that would provide for partnership classification. With the flexibility to modify those default rules, however, came the risk of inadvertent failure to meet the requirements for partnership tax classification of an LLC.

Elizabeth S. Miller & Thomas E. Rutledge, *The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations?*, 30 DEL. J. CORP. L. 343, 365 n.82 (2005); *see also* 1 CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY-TAX AND BUSINESS LAW § 1.01(3) (2016) (describing the evolution of the LLC from Wyoming to all fifty states, the District of Columbia, and the Virgin Islands); 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 1:2, (2003) (citing the historical development of LLC in all fifty states); Charles W. Murdock, *Limited Liability Companies in the Decade of the 1990s: Legislative and Case Law Developments and Their Implications for the Future*, 56 BUS. LAW. 499, 499 (2001).

of drafting choices would create an association taxable as a corporation.[90] The stakes were high, because a determination after that fact that a business should have been paying taxes as a corporation could result in surprise tax liabilities as well as interest and penalties that could ruin a burgeoning enterprise. On the other hand, businesses were eager to have operational structures that made sense for the way the businesses needed to run in order to be efficient and competitive. Those that could afford sophisticated legal representation sought to push the boundaries as they attempted to draft around undesirable default rules while preserving partnership tax status and limited liability for all of the owners.

E. The Check-the-Box Rule (or Elective Tax Status for Unincorporated Firms)

These no-action requests placed an incredible burden on the IRS, and on April 3, 1995, the IRS and the Treasury Department jointly issued a notice relating to the classification of business organizations which suggested replacing the corporate resemblance test as a basis for classification of business entities with a less complex alternative.[91] Slightly more than a year later, on May 13, 1996, proposed regulations were published in the Federal Register.[92] The final regulations, which involve a simplified, elective regime,

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90. As the lines between traditional partnerships and corporations became more and more blurred, the burden on the IRS simply became too great. One group of commentators described the situation in 1996 like this:

> [S]ome partnership statutes have been modified to provide that no partner is unconditionally liable for all of the debts of the partnership, and all states have enacted statutes permitting the formation of limited liability companies (LLCs). These entities are designed to provide liability protection for all members and to otherwise resemble corporations. Such entities may still qualify as partnerships for federal tax purposes under the criteria of the current Regulations if their partnership or operating agreements are carefully drafted, and they conduct their operations consistent with such agreements. As a result, the current Regulations have been rendered largely unworkable. The present situation has caused the Service and taxpayers to expend considerable resources on classification issues. For instance, since 1988 the IRS has issued 17 Revenue Rulings analyzing state limited liability company statutes, and several Revenue Procedures and numerous letter rulings regarding classification issues.

Scott E. Grimes, Marilyn K. Wiggan & Steven A. Martin, *Proposed Entity Classifications Regs Greatly Simplify Rules*, 25 TAX'N FOR LAW. 68, 68 (1996).

Another source concluded that "[i]t was the widespread adoption of LLC statutes across the country and the blizzard of requests/demands presented to the IRS for classification guidance and rulings that precipitated the Check-the-Box classification rules and the abandonment of the four factor *Kintner* analysis." Rutledge, *supra* note 9, at 148-49.

91. I.R.S. Notice 95-14, 1995-1 C.B. 297.

92. Simplification of Entity Classification Rules, 61 Fed. Reg. 21989 (proposed May 13, 1996).

took effect on January 1, 1997.[93] Although the regulations are widely known as the "check-the-box" rules,[94] it would be more appropriate to call them the "don't-check-the-box" regulations because they provide that most unincorporated business forms will be taxed as partnerships unless a specific election is made to have them taxed as corporations. Since the preferable result for most small, start-up businesses is to achieve partnership tax status, there is really no need to "check-the-box."

Under the tax regime now in effect, a determination must be made as to whether there is a separate entity for federal tax purposes. This is a matter of federal tax law.[95] If there is no separate entity for federal tax purposes, the check-the-box regulations will not apply. If there is a separate entity, the second determination is whether the entity is a trust or other business entity.[96] If the business entity is not a trust, the next question is whether the business should be taxed as a corporation or a partnership.

The answer to this question first requires a determination of whether the entity has to be automatically classified as a corporation for federal tax purposes.[97] An entity will be automatically classified as a corporation for federal tax purposes if it is any of the following: (i) an entity denominated a corporation under applicable state law; (ii) a joint-stock company; (iii) an insurance company; (iv) a certain type of banking association; (v) a State-owned organization; (vi) any form of business association taxable as a corporation under special provisions of the Internal Revenue Code;[98] or (vii) one of a list of specified organizations formed under the laws of certain

93. Treas. Reg. §§ 301.7701-1 to -3 (1996). In addition to the actual regulations, there are conforming changes to various sections in the Income Tax Regulations and the Procedure and Administration Regulations.

94. *See* Maimonides Med. Ctr. v. United States, 54 F. Supp. 3d 194, 199 (E.D.N.Y. 2014) (identifying Treas. Reg. § 301.7701-1 as the "so-called check-the-Box regulations").

95. The regulations recognize that certain joint undertakings that may not be considered entities under local law may nonetheless constitute separate entities for federal tax purposes while, on the other hand, some entities formed under local law may not be recognized as separate entities for federal tax purposes. Treas. Reg. § 301.7701-1(a) (1967).

96. Generally speaking, the regulations retained prior rules to determine whether a business or trust is involved. Treas. Reg. § 301.7701-4 (1967). Note that the regulations talk about entities which are classified as trusts for tax purposes. Presumably, some entities which are called trusts under state law, like "business or commercial trusts," might nonetheless be business entities for federal tax purposes, and thus subject to the check-the-box regulations.

97. *See* Treas. Reg. § 301.7701-2(b) (1967). For example, this would include "publicly traded partnerships" as defined by I.R.C. § 7704(b) (2016).

98. This provision excludes determinations under I.R.C. § 7701(a)(3) but does not exclude businesses that are "publicly traded partnerships" under I.R.C. § 7704, which are typically required to be treated as corporations under the Code. *Compare* I.R.C. § 7701(a)(3) (2016), *with* I.R.C. § 7704 (2016).

foreign jurisdictions or U.S. possessions, territories or commonwealths.[99] If the entity is not automatically classified as a corporation, the final determination is whether it has two or more members. If it does, the entity will be classified as a partnership unless a specific election to seek corporate tax status has been made.[100] If it does not, the entity will be disregarded as an entity separate from its owner, again unless a specific election to be taxed as a corporation has been made.[101] These rules essentially mean that most privately held general partnerships, LLPs, limited partnerships, LLLPs and multi-owner LLCs organized under state law will be taxed as partnerships under the default rules, although these businesses can elect corporate tax status, while all incorporated enterprises must be taxed as corporations with no possibility of electing partnership tax status.

While much of the experimentation with business forms and options in recent years has been tax-driven, one of the newer options was explicitly designed to address the perceived need to offer an organizational structure that better suited the needs of closely held businesses that were satisfied with (or perhaps resigned to) being taxed as a corporation. This option was the statutory close corporation.

III. THE FAILURE OF THE STATUTORY CLOSE CORPORATION

As mentioned at the outset of this article, a few states have experimented with a statutory option specifically designed to address the needs of closely held corporations.[102] These states enacted special corporate statutes designed to help the corporate form work better for smaller businesses instead of having a single statute more likely to be suited to large, publicly held enterprises.[103] Unfortunately, these efforts appears to have failed, at least based on the fact that so few businesses have acted to accept the supposed

99. Treas. Reg. § 301.7701-2(b) (1967).

100. Treas. Reg. § 301.7701-3(b)(1)(i) (1967).

101. Treas. Reg. § 301.7701-3(b)(1)(ii) (1967). Note that this change addresses what was previously an open issue. Prior to the "check-the-box" regulations, the tax status of a single member LLC was uncertain. The check-the-box regulations now explain how such entities are to be treated for tax purposes. Such enterprises are, however, outside the scope of this article.

102. For a list of states with close corporation statutes, see *supra* note 3.

103. *See infra* notes 121-22 and accompanying text (describing the focus of traditional corporate statutes, which have always been geared towards publicly owned corporations). One commentator listed the following areas in which close corporations were said to need specialized provisions not typically found in general corporation statutes: "(1) managerial division of power; (2) mode of operation; (3) long-term assurance of income or positions for some or all of the participants; (4) restrictions on transfer of shares; and (5) fundamental changes, including mergers, dissolutions, and 'freezeouts' of existing participants." Dennis S. Karjala, *A Second Look at Special Close Corporation Legislation*, 58 TEX. L. REV. 1207, 1213 (1980).

benefits of this special legislation.[104] Since one of the primary theories advanced in this article is that we should learn from this failure in deciding how to proceed with current legislative developments that are also designed to "help" closely held businesses, it is critical that there is a common understanding about what the "statutory" close corporation option involves.

A. *What is a "Statutory" Close Corporation and Why Was it Conceived?*

Cases and secondary authorities contain numerous references to "close corporations," "closely held corporations," and "statutory close corporations."[105] As discussed earlier, the first two phrases generally refer to any corporation with a small number of shareholders, no ready market for shares, some shareholder participation in management, and possibly a geographically concentrated shareholder population.[106] A "statutory close corporation," on the other hand, is a corporation that fulfills specific statutory requirements in order to be eligible for treatment under special rules in the applicable state law.[107] Typically an eligible corporation must make a specific election to be subject to the special provisions.[108] Some statutes have language that applies to all corporations meeting certain limitations (such as a specific number of shareholder or lack of a public market for the shares), even absent a specific election,[109] but this is even less common than statutes allowing a specific election to become a "statutory close corporation." The availability of these kinds of statutory alternatives has generally been held not to change the common-law definition of close or closely held

104. *See infra* Part III.B. of this Article.

105. Gitlin, *supra* note 16.

106. *See supra* Part II.A.

107. For a list of states with special close corporation statutes, see *supra* note 3.

108. Because so few corporations make the election, there are not that many cases discussing the requirements to elect close corporation status. In *Nixon v. Blackwell*, the court specified that the Delaware close corporation statute requires the company to be designated as a close corporation in its certificate of incorporation. 626 A.2d 1366, 1380 (Del. 1993); DEL. CODE ANN. tit. 8, § 342 (1988). In addition, the corporation would need to satisfy the following requirements: (i) having no more than 30 stockholders, (ii) restricting free transferability of all classes of stock, and (iii) never having had a public offering of the corporation's shares. *Nixon*, 626 A.2d at 1380. The Kansas close corporation statute was held in *Hunt v. Data Mgmt. Res.*, 985 P.2d 730, 732 (Kan. Ct. App. 1999), to require articles that identify the corporation as being a close corporation under the statute and, in addition, provide for (i) a specified number of stockholders, not exceeding 30, (ii) one or more restrictions on transfers of stock, and (iii) no public offering of stock. KAN. STAT. ANN. §§ 17–7202(a)(1)-(3), 7203(a) (2005). Maryland's close corporation statute has been found to require a unanimous vote of its stockholders to elect close corporation status, and to impose certain transfer restrictions on the stock. MD. CODE ANN., CORPS & ASS'NS §4-101 (1993); Uninsured Emp'rs Fund v. Lutter, 676 A.2d 51, 55 (Md. 1996).

109. *E.g.*, MINN. STAT. § 302A.011(6)(a) (2011 & Sup. 2016) (defining a close corporation as a corporation which does not have more than 35 stockholders).

corporations, so that failure to elect statutory close corporation status where offered does not generally mean that the corporation is not a "close corporation."[110]

There are sixteen states with specific statutory close corporation codes, but there are also a number of other states that include isolated provisions in their general corporate law granting certain corporations the right to adopt special policies governing how their company is to be operated.[111] One of the most common of these options is the right for qualifying corporations to have unanimous shareholder agreements that vary the "usual" manner of operating the enterprise.[112] Although some of these statutes apply to all companies that are not publicly traded, and therefore might not be seen as provisions specifically geared towards "close corporations," the requirement of unanimity in such agreements tends to limit the usefulness of such provisions to corporations with a very small number of shareholders. Another common provision embedded in general corporate laws is language authorizing corporations to dispense with or limit the authority of a board of directors; most of these statutes provide that this option is only available if there are 50 or fewer shareholders in the corporation,[113] or if there is unanimous agreement by the shareholders.[114]

110. *See, e.g.*, Rexford Rand Corp. v. Ancel, 58 F.3d 1215 (7th Cir. 1995) (applying Illinois law); Hagshenas v. Gaylord, 557 N.E.2d 316 (2d Dist. 1990); Berreman v. West Pub. Co., 615 N.W.2d 362 (Minn. Ct. App. 2000); Hollis v. Hill, 232 F.3d 460, 467 n.17 (5th Cir. 2000) (applying Nevada law).

111. "[R]ecognizing the trend of increasing contractual freedom, but perhaps leery of allowing shareholders to go 'too far,' some states . . . adopted special provisions in their general corporation statutes for closely held corporations (or, more specifically, non-pubic corporations)." Michael K. Molitor, *Eat Your Vegetables (or at Least Understand Why You Should): Can Better Warning and Education of Prospective Minority Owners Reduce Oppression in Closely Held Businesses?*, 14 FORDHAM J. CORP. & FIN. L. 491, 544 (2009) (footnote omitted). For a list of the state provisions authorizing statutory close corporation status, *see supra* note 3.

112. *See supra* note 3. Under these statutes, "unanimous shareholder agreements could result in corporate governance at odds with 'normal' corporate governance. This approach can now be found in the statutes of several states (albeit, in varying degrees), as well as Section 7.32 of the MBCA." Molitor, *supra* note 109, at 546. For examples of such provisions, see N.J. STAT. ANN. § 14A:5-21 (West 2003); N.Y. BUS. CORP. LAW § 620 (McKinney 2003); N.C. GEN. STAT. § 55-7-3(b) (2005).

113. *E.g.*, ARK. CODE ANN. § 4-27-801 (West 1987); IND. CODE ANN. § 23-1-33-1(c) (LexisNexis 2010); KY. REV. STAT. ANN. § 271B.8-010 (LexisNexis 2012); TENN. CODE ANN. § 48-18-101 (LexisNexis 2012). South Carolina does not restrict the ability of a corporation to make such an election so long as it appears in the corporation's articles. S.C. CODE ANN. § 33-8-101 (2006).

114. IOWA CODE ANN. § 490.801 (West 2009); MASS. GEN. LAWS ANN. ch. 156D, § 8.01 (West 2005); N.C. GEN. STAT. § 55-8-01 (2005) (allowing the language in either the articles or a unanimous shareholder agreement, but limitations on authority are only binding if the third party has actual knowledge of the restriction); WASH. REV. CODE ANN. § 23B.08.010 (West 2013). These statutes do not include a specific requirement that there be a limited number of shareholders.

It is obviously impossible to know how many smaller corporations have unanimous shareholder agreements, because those are not generally public documents, but the reality is that any time a shareholder agreement has to be negotiated and drafted, lawyers' fees are likely to go up,[115] or unsophisticated entrepreneurs are likely to seek to minimize expense by "doing it themselves" and avoiding legal assistance all together. It is therefore not implausible to assume that there are a number of closely owned businesses that are either operating with no shareholder agreement even if that would be optimal, or one that has been poorly drafted.[116] It certainly would seem to be simpler to make an election to become a "close corporation" by specifying this in the corporation's articles. This would automatically make the enterprise subject to default rules presumably written with the closely held business in mind. Available evidence, however, suggests that this is not happening in the vast majority of cases, even in states where this option exists.

B. *Underutilization of the Close Corporation Statute*

It is difficult to determine with any degree of certainty how many close corporation filings have been and are being made. Most of the states that have special statutes for close corporations do not keep a searchable record of close corporation filings.[117] It is even more difficult to determine how many new businesses would be eligible to elect to become statutory close corporations but choose not to do so.[118] One source has estimated that at least 90% of newly formed corporations could be statutory close corporations,[119]

115. "The fees charged by the attorney will vary, of course, with the amount of work required. . . . Costs vary considerably . . . in preparing shareholders' agreements. Legal fees can be substantial where there are many . . . shareholders, or where the agreements are heavily negotiated." C. HUGH FRIEDMAN, JAMES F. FOTENOS & EDWARD C. RYBKA, CAL. PRAC. GUIDE CORPORATIONS, § 2:76 (Rutter Group 2016).

116. Presumably, the benefits of obtaining legal advice when drafting complicated transactional documents are sufficiently obvious to readers of law review articles that no extensive citation to authority is needed. In practice, however, "[a]greements among owners of a business or professional practice come in many formats, whether styled as traditional corporate shareholder agreements, LLC operating agreements or partnership agreements. Unfortunately, these instruments are often the result of a poorly conceived 'form' document, with too little attention paid to the specific considerations of each case." Robert T. Smith, *Drafting Shareholder Agreements*, ARK. L., Winter 2008, at 18.

117. F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL AND THOMPSON'S CLOSE CORPORATIONS AND LLCS: LAW AND PRACTICE § 1:29 (rev. 3d ed. 2015).

118. *Id.*

119. *Id.* at § 1:19 (suggesting that "as many as" 10% of all corporations might not be eligible to make the election). Even this, however, fails to consider how many businesses that are not organized as corporations could have elected close corporation status instead of becoming a partnership, LLP, limited partnership, LLP, or LLC instead. Other sources have estimated that family businesses account for as many as 95% of all U.S. business. Steven C. Bahls, *Resolving*

but the available data suggests that only about 5% of such businesses elect to be subject to the rules that were supposedly designed to favor closely held enterprises.[120] This pervasive underutilization of the statutory close corporation option has been discussed by numerous commentators,[121] and has even been mentioned by the courts.[122]

It is certainly not that traditional corporate statutes are a better fit for closely held businesses.[123] General corporate codes were drafted and enacted with the needs and preferences of the public corporation and its directors in mind.[124] This means that there are a number of default and even mandatory rules that do not necessarily suit a smaller, closely held business. Perhaps most obviously, traditional corporation statutes impose a wide range of formalities that are perfectly appropriate when there are concerns about the rights of widely disperse and generally passive shareholders, but which do not typically suit the needs of a business with a small number of shareholders who are often active in the business and who are generally capable of

Shareholder Dissension: Selection of the Appropriate Equitable Remedy, 15 J. CORP. L. 285, 287 (1990) (noting that close corporations constitute the majority of U.S. businesses, and that family businesses represent 95% of total U.S. businesses); *see also* A.B.A. COMM. ON CORP. LAWS, *Managing Closely Held Corporations: A Legal Guidebook*, 58 BUS. LAW. 1073, 1073 (2003) (stating that "the closely held corporation remains the most common form of business organization in the United States").

120. Available statistics "support the general conclusion that only a fraction of the corporations that could use these statutes are electing to do so. Late 20th century data from several states report elections around the 5% mark. The Kansas Secretary of State's office reported less than 5% close corporations and 'probably a lot less,' adding that observations of attorneys and experienced people indicate that the number had been declining." O'NEAL & THOMPSON, *supra* note 117, at § 1:29; *accord* Mike Harris, *Assessing the Utility of Wisconsin's Close Corporation Statute: An Empirical Study*, 1986 WIS. L. REV. 811, 827 (noting that Wisconsin's close corporation statute receives little use, despite prevalence of close corporations in state).

121. "For example, in 1985, approximately 16,684 Delaware corporations had formed under the special incorporation laws; when compared with the 202,115 total Delaware incorporations in 1992, this is equal to roughly eight percent. More recent empirical studies also document this phenomenon." Wortman, *supra* note 3, at 1362-63 (footnote omitted).

122. The Delaware Supreme Court observed that "[s]tatutory close corporations have not found particular favor with practitioners." Nixon v. Blackwell, 626 A.2d 1366, 1380 n.19 (Del. 1993) (en banc).

123. "Rules created for public corporations can have negative and wasteful effects on closely held firms." Wortman, *supra* note 3, at 1375.

124. On the other hand, it is quite clear that prior to the 1930's typical general corporation statutes "were adopted with the publicly held corporation almost exclusively in mind." Henry G. Manne, *Our Two Corporate Systems: Law and Economics,* 53 VA. L. REV. 259, 268, 278 (1967) (also noting that publicly held corporations and close corporations are "extremely dissimilar"); *accord* MODEL BUS. CORP. ACT § 7.32 cmt., at 7-62 (AM. BAR ASS'N, amended 2010) (recognizing that both Model Business Corporation Act and general corporation laws of most states "were designed with an eye towards public companies, where management and share ownership are quite distinct."); Ian Ayers, *Judging Close Corporations in the Age of Statutes*, 70 WASH. U. L.Q. 365 (1992).

attending meetings in person. Even the requirement that there be annual elections of directors, with formal documentation of the actions taken at all meetings of either the shareholders or the directors, is more elaborate and structured than would be ideal for most small businesses.[125] These are precisely the kinds of issues that the close corporation statutes were designed to address.

Why, then, are the close corporation statutes so underutilized? A large number of theories have been advanced to explain this phenomenon. One school of thought is that, despite the theoretical advantages posited by academics, there is really little to be gained through compliance with the requirements of close corporation statutes that could not be achieved with traditional rules.[126] A slightly different way of looking at this is to suggest that close corporation statutes fail to offer a significant advantage over traditional corporate rules because entrepreneurs are already duplicating the benefits of the new rules through the expedient of relatively well understood contractual arrangements, and the new statutes simply add "extra difficulties entailed in meshing the special close corporation default rules with the firms' own agreements and with the standard corporate default terms that continue to apply to closely held firms."[127]

A more plausible explanation for the lack of popularity of close corporation statutes is that the entrepreneurs who are starting these businesses,[128] and, to a regrettable extent probably their lawyers as well,[129]

125. As one commentator noted, "[t]hese requirements are impractical in the case of a close corporation, which would have to interrupt regular operations in order to convene unnecessarily or, in the alternative, waste funds in order to comply with a formality." Wortman, *supra* note 3, at 1376.

126. "A shortcoming of the close corporation statutes is that they seem to lack significant advantages beyond those available under the general corporation statutes." O'NEAL & THOMPSON, *supra* note 117, at § 1:19 (citing Ronald M. Shapiro, *The Statutory Close Corporation: A Critique and a Corporate Planning Alternative*, 36 MD. L. REV. 289 (1976); William J. Carney, *Changes in Corporate Practice Under Georgia's New Business Corporation Code*, 40 MERCER L. REV. 655 (1989) (new code attempts to assure that equal flexibility is available for those corporations not electing special close corporation status under Georgia law)).

127. Larry E. Ribstein & Bruce H. Kobayashia, *Choice of Form and Network Externalities*, 43 WM. & MARY L. REV. 79, 89 (2001).

128. Edwin Bradley argues that minority shareholders are particularly likely to be ill-informed about business options, blaming them for "a naive complacency, an overly trusting nature, bad legal advice or a blunder." Edwin J. Bradley, *An Analysis of The Model Close Corporation Act and a Proposed Legislative Strategy*, 10 J. CORP. L. 817, 839-40 (1985); *see also* 2 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS & LLC MEMBERS § 9:01 (2d ed. 1985) (arguing that minority shareholders fail to inform themselves about options for structuring business relationships).

129. Even before the proliferation of new business alternatives, lawyers were sometimes cautioned about blindly relying on forms and personal past practice without adequately investigating the specific needs of entrepreneurial clients. *See, e.g.*, In re Kuzman, 335 N.E.2d 210, 211 (Ind. 1975) ("It is not unusual for a client untrained in the laws to come into an attorney's office and state

are simply not familiar with the benefits that might be available under the close corporation provisions.[130] The differences between a closely held business and one with publicly traded shares may not be appreciated during the planning phases of business formation.[131] Thus, while it may be true that close corporation statutes do not offer small businesses many advantages that cannot be achieved with careful planning and drafting, it seems more likely that the underutilization is due to the fact that the people organizing new businesses and their advisors simply do not know or care to take the time to fully explore all of the available options.

Even if the founders of a new business are experienced, sophisticated or well-advised enough to have access to information about available alternatives, and they fully understand that they have the ability to hire professionals to help them adapt or modify default rules, a rational cost-benefit analysis may not support choosing anything other than the traditional corporate structure and default rules. It is not irrational to seek to keep the original costs of incorporation to a minimum,[132] and it has been said that "[c]orporate participants may view future management and control clashes as remote contingencies,"[133] in which case it does not make a great deal of

that he wants the attorney to form a corporation for him. If the attorney accedes and completes the forms without first exploring the sole proprietorship and partnership forms of business with the client, and the tax aspects of each, the attorney has failed to give the client the full and disinterested advice to which he was entitled, and which the bar demands be given."). A 1957 study of legal practice in Utah similarly revealed an over-reliance on business forms and past experience. Daniel J. Dykstra, *Molding the Utah Corporation: Survey and Commentary*, 7 UTAH L. REV. 1, 14 (1960). This practice has also been criticized more recently:

> Heavy reliance on precedent and form documents generated by law firms, trade groups, bar association committees, and others is a reality of modern practice. That reliance reflects the need for attorneys to accommodate short timelines for increasingly complex transactions and to keep costs palatable for clients. There is simply not enough time to draft complex agreements from scratch, nor would that be an efficient way to practice. Although reliance on precedent documents has the benefit of harnessing wisdom accumulated over a number of years, extreme and dogmatic adherence to their terms is seldom optimal.

William E. Foster, *Enduring Design for Business Entities*, 2015 UTAH L. REV. 955, 960-61 (2015) (footnotes omitted).

130. As the late Professor Ribstein once explained, "close corporation owners often either lacked the foresight to plan for the breakdown of their relationship, or could not easily figure out how to balance the dangers of freeze-in against the risk that a member would use a power to dissolve the corporation to oust a comember." LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 108 (2010).

131. Harris, *supra* note 118, at 822 n.75 ("[S]pecial management structures may not be drafted because these differences are not perceived and acted upon by the shareholders.").

132. J.A.C. Hetherington & Michael P. Dooley, *Illiquidity & Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 38 (1977).

133. Harris, *supra* note 118, at 822 n.75; *accord* Robert A. Kessler, *Hooray(?) For the Model Act—The 1969 Revision and the Close Corporation*, 38 FORDHAM L. REV. 743, 745 (1970); Manne, *supra* note 122, at 279 n.29; F. Hodge O'Neal & Thomas D. Magill, *California's New Close Corporation Legislation*, 23 UCLA L. REV. 1155, 1166 (1976).

sense to devote meaningful resources to resolve problems perceived as being unlikely to ever arise.[134]

These concerns actually have a common theme. Unless statutory modifications and advancements offer a clear, cost-efficient benefit to business owners, they are not likely to be widely embraced, and statutes that are not likely to be widely utilized are particularly unattractive to business owners and their attorneys. Obviously, there is risk in being among the first to try out a new form of business. How will the new statute work? Will it be understood by business people, bankers, creditors, and even lawyers and accountants? How will the statutes be interpreted in practice? Will there be unintended consequences or unforeseen expenses associated with the new structure and operational rules? While these risks could quickly diminish if the option proves popular, the fewer entrepreneurs who see the benefit from the outset, the more likely it is that the level of uncertainty will remain high.[135] In fact, there is substantial literature pointing to the fact that, when it comes to choosing an operational structure, one critical consideration is the extent to which other entrepreneurs have already adopted that form of business.[136] There are a number of reasons why this might be the case. If

134. In addition, some entrepreneurs may choose to leave provisions vague or incomplete to increase operational flexibility. Edward B. Rock & Michael L. Wachter, *Waiting For the Omelet to Set: Match-Specific Assets and Minority Oppression in Close Corporations*, 24 J. CORP. L. 913, 925 (1999) (arguing shareholders make rational choices not to lock in specific operational rules in order to allow for "self-enforcing, but not legally enforceable, norms [that] emerge to constrain opportunistic behavior."). "Instead of viewing themselves as shareholders, directors and officers, close corporation participants may perceive themselves primarily as businesspeople and work out their business differences by trial and error and compromise." Harris, *supra* note 118 at 822 n.75 (citing Stewart Macaulay, *Non-Contractual Relationships in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963)).

135. Some commentators have spoken about the benefits of not being the first to try out a new statute in the following terms:

> Business associations, including the statutory provisions, cases and forms based on each business association, exhibit some network characteristics that appear only after other people decide to use them. First, courts interpret ambiguous terms in all similar contracts. Second, common practices such as investment banker fairness opinions emerge, implementing contract terms. Third, legal services may be standardized and their cost reduced after parties gain experience in drafting and after books and continuing legal education materials explain contractual terms. These benefits help reduce errors of ambiguity, inconsistency and incompleteness in contract terms. Fourth, wide use of the terms may help the firm in capital markets because of pricing and signaling effects.

Ribstein & Kobayashia, *supra* note 125, at 109-10 (footnote omitted); *accord* Wortman, *supra* note 3, at 1389 ("[C]ommon business practices serve to reduce the uncertainty of both statutory and charter terms. Common usage results in increased information and better interpretation of terms because firms can look to other firms' practices. If a close corporation expects few current and future close corporations to use similar terms, then many of the benefits deriving from common business practices are lost.").

136. Noted scholar Roberto Romano talked about this by relying on the metaphor of law and legal choices as a product. Roberta Romano, *Law as a Product: Some Pieces of the Incorporation*

there are more firms organized in a particular way, this increases the likelihood that ambiguous provisions will be clarified through litigation by other parties.[137] Similarly, if more investors are familiar with the structure, this can decrease their informational costs associated with learning about the structure.[138] These network and familiarity effects of popular statutory frameworks are now well accepted,[139] but simply do not apply when a new option is only rarely adopted.

One thing that has compounded this problem in the context of close corporations is the wide variation that exists in state close corporation acts.[140] While there is substantial agreement in the academic literature about some of the ways in which general corporation laws work poorly for closely held businesses, this does not mean that state legislatures have reacted in the same way to these concerns. For example, it appears to be relatively obvious and widely accepted that traditional corporate statutes impose too many formalities for many smaller businesses, ranging from the requirement that a corporation must adopt bylaws, to the mandates that it must hold annual shareholder meetings and must have meetings of directors, to the obligation to document actions taken by the board in writing or other form capable of being transcribed. Similarly, it seems inappropriate to have a default rule that mandates the management by directors who must be regularly re-elected, and who are then supposed to act as members of a board, even if they are also the sole or majority owners of the business and may be unfamiliar with the notion that they should be routinely disclosing the capacity in which they are acting. Yet despite widespread acceptance among commentators that these rules are

Puzzle, 1 J.L. ECON. & ORG. 225, 225-26 (1985); *accord* Jens Dammann, *Homogeneity Effects in Corporate Law*, 46 ARIZ. ST. L.J. 1103, 1105-06 (2014) (explaining that firms "have reason to care about the extent to which other firms are using the regime in question.").

137. Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 776 (1995).

138. *Id.* at 762.

139. Mark Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 594 (2003) (arguing that network effects make it hard for other states to compete with Delaware); *see* Michal Barzuza, *Price Considerations in the Market for Corporate Law*, 26 CARDOZO L. REV. 127, 142, 146 (2004) (arguing that network effects contribute to Delaware's market power in the charter market); Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 890 (2005) (acknowledging that the network effects on the companies' choices of legal structures are "well recognized"); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1923-24 (1998) (using network theory to explain Delaware's preeminence in the charter market).

140. There is so much variety in the kinds of special close corporations statutes that it is difficult to talk about them in generalities. "Some statutes are aimed solely at the internal governance problem, some solely at the oppression problem, some at both but in varying ways, and at least one, apparently, at neither." Dennis S. Karjala, *An Analysis of Close Corporation Legislation in the United States*, 21 ARIZ. ST. L.J. 663, 683-84 (1989) (footnote omitted).

indeed problematic for many small businesses, this has not translated into any general agreement among state legislatures on the approach to be taken in close corporation statutes.[141] One commentator has explained, in some detail, the lack of incentives for state officials to seek uniformity by pointing out that there is no particular basis for believing that state franchise revenues can be positively affected with such legislation, so that drafting of "close corporation statutes will be determined by the same forces that drive many other types of legislative action: a desire to promote the public welfare, tempered by a willingness, at times, to cater to well-organized private interests."[142] The absence of a persistent interest group lobbying on behalf of closely held businesses diminishes any incentive for legislatures to push for efficient legislation. Professor Ayers opined that, as a result of the lack of financial incentives, state legislators are less likely "to exert themselves in researching, drafting, and passing the optimal legal rules."[143]

Yet another complicating factor is that by the time close corporation statutes were being promulgated, there was already a substantial body of corporate law in place, based upon traditional corporate statutes. General corporation statutes had been in place for more than a hundred years before states began adopting special close corporation provisions.[144] This meant that there were decades upon decades of experience with those statutes by the time that special statutory alternatives for closely held corporations first began to appear. This wealth of experience translated into extensive judicial precedent interpreting and applying the language of the general corporation

141. "[C]lose corporation statutes vary widely not simply in the approach each takes toward meeting the unique needs of close corporations but also in the legislature's perception of what areas of the close corporation merit special treatment. . . . [T]he wide variance among corporate statutes bears testament to great differences among policy-makers on the appropriate legislative response. . . ." JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 14:2 (3d 2015).

142. Ayers, *supra* note 122, at 373.

143. *Id.*

144. "General incorporation statutes that eliminated the need for special chartering were well established in the United States in the early 1800's." Karjala, *supra* note 138, at 664. By the end of the nineteenth century, there was considerable homogeneity in these provisions. *Id.* at 664-65. More than one hundred years after the general corporate code had become prevalent, we began to see legislative responses to the call for special treatment of close corporations. Wortman, *supra* note 3, at 1392. The first state to enact special provisions applicable to close corporations was North Carolina, which added a provision to its general corporate law validating certain unanimous written shareholder agreements in the case of non-public corporations. N.C. GEN. STAT. § 55-73(b) (2015). In 1967, Delaware become one of the first states to enact legislation specifically authorizing the creation of statutory close corporations. DEL. CODE ANN. tit. 8 §§ 341-356 (2011).

codes and a variety of documents drafted under those codes.[145] It also meant that a great many business that would be eligible for the new alternatives were already set up and operating under traditional corporate rules, meaning that future precedents would also be more likely to address traditional language.[146] In addition, not only were there many more judicial explanations and clarifications in place than might be anticipated under the new regime, but businesses and business owners themselves had amassed a high degree of familiarity and experience with the traditional corporation.[147] Parallel to this was the fact that lawyers had become increasingly familiar with traditional corporations as well, meaning that attorney's costs and fees associated with formation of the familiar general corporation had been reduced, while the unfamiliar close corporation provisions would have taken more effort and been more costly.[148]

Finally, it is possible that the advent of the LLC sounded the death knell for the statutory close corporation.[149] The LLC was specifically designed to address the desire of many entrepreneurs to have a more informal option for their business enterprises, and it offered the immediately-obvious benefits of partnership tax status and limited liability for all participants. It is therefore not particularly surprising that the LLC has been popular.

It is, of course, not entirely clear how much of a role each of these explanations plays in the unescapable reality that close corporation statutes,

145. *See* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 776-78 (1995) (suggesting how judicial precedents can reduce uncertainty by addressing ambiguities and procedural safe harbors for compliance with statutory requirements).

146. Wortman, *supra* note 3, at 1387-88.

147. *Id.* at 1391-92 (noting that because businesses were used to working within the traditional corporate form, "developed business practice [has] already evolved").

148. *See supra* note 127 and accompanying text. Moreover, the fact that business persons, attorneys and courts were all familiar with well-established corporate law principles that had been decided and interpreted in the context of publicly-owned corporations meant that there was confusion about whether prior interpretations of similarly worded statutes would apply to the new close corporation option. This meant that if a closely held corporation took a stance in conflict with a provision of the general corporation laws, it might not know whether that modification would be permissible unless the close corporation statute was explicit and unambiguous. In addition, the language attempting to make the modification itself might be misconstrued because until a dispute arises and is resolved, there is no certainty as to how courts will interpret the modification. "[C]ourts have injected an additional element of uncertainty at the initial planning stage of the venture." Sean R. Matt et al., Comment, *Providing a Model Responsive to the Needs of Small Businesses at Formation: A Focus on Ex Ante Flexibility and Predictability*, 71 OR. L. REV. 631, 675 (1992).

149. Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 387, 459-62 (1991) (comparing the LLC with other business options); Susan Kalinka, *The Limited Liability Company and Subchapter S: Classification Issues Revisited*, 60 U. CIN. L. REV. 1083 (1992); Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 386-403 (1992); Marybeth Bosko, *The Best of Both Worlds: The Limited Liability Company*, 54 OHIO ST. L.J. 175, 193-95 (1993).

despite being explicitly drafted with the goal of better suiting the needs of smaller enterprises, have not been terribly successful. In fact, such statutes appear to be a failed experiment in legislative efforts to offer entrepreneurs attractive and efficient alternatives for the structure and operation of closely held businesses.[150] This brings us to the LLC, and the question of whether it is the successful alternative that it could and should be, and, if not, what can be done to remedy any deficiencies in our LLC statutes.

IV. THE LLC AND CURRENT DEFAULT RULES

Every American jurisdiction now authorizes the formation of the LLC. Unfortunately, there is probably more variation in the provisions of state LLC acts than for any other kind of widely available form of business, even the statutory close corporation. One of the reasons for this is that by the time the Uniform Law Commission first promulgated a Uniform LLC Act in 1994, "nearly every state had adopted an LLC statute, and those statutes varied considerably in both form and substance."[151] Since that time, many state LLC statutes have been "substantially amended," often several times, and the "Uniform" LLC Act itself has also been amended, first in 1995 and 1996 "in anticipation of the 'check the box' regulations," then again in 2006, and then, most recently, in 2011 and 2013.[152] As of 2015, eleven states had adopted the ULLCA (2006).[153] One of those subsequently switched to the 2013 version, and three additional states have also enacted a version of ULLCA

150. One commentator humorously characterized this stage in the evolution of statutory options available to closely held businesses as an "adolescent identity crisis." Larry E. Ribstein, *Close Corporation Remedies and the Evolution of the Closely Held Firm*, 33 W. NEW ENG. L. REV. 531, 536 (2011).

151. UNIF. LTD. LIAB. CO. ACT, Prefatory Note, 6B U.L.A. 54 (2008 & Supp. 2016).

152. *Id.* at 54-55; *accord* Bruce H. Kobayashi & Larry E. Ribstein, *Delaware for Small Fry: Jurisdictional Competition for Limited Liability Companies*, 2011 U. ILL. L. REV. 91, 91 (2011) ("Unlike general and limited partnerships, which have been shaped by uniform laws, LLC statutes vary significantly.").

153. The table of jurisdictions where the 2006 version of the ULLCA was enacted lists, as of 2015, Alabama, California, the District of Columbia, Florida, Idaho, Iowa, Minnesota, Nebraska, New Jersey, South Dakota, and Wyoming. UNIF. LTD. LIAB. CO. ACT, Table of Jurisdictions Wherein Act Has Been Adopted, 6B U.L.A. 240 (2016).

(2013).[154] This leaves most states with non-uniform legislation governing this form of business.[155]

Aside from differences in terminology and organization, there are substantial substantive differences in these varied LLC Acts, although there are certainly some points of agreement and commonality.

A. *Points of Commonality in LLC Acts*

With regard to things that are held in common, the internal affairs doctrine generally applies to all LLCs, so that the law of the state of formation will govern the internal relations of members and managers within the LLC.[156] Under those rules, first and foremost, all LLC statutes provide members with limited liability for the debts of the enterprise as a default rule.[157] All LLC statutes also offer a choice between member-management and manager-management, although the default rules in various states

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154. Idaho has now adopted ULLCA (2013), repealing the 2006 version effective in 2017. *See* IDAHO CODE § 30-25 (2013 & Supp. 2016); *see also* IDAHO CODE § 30-6 (2013 & Supp. 2016); S. 1025, 63rd Leg., 1st Reg. Sess. (Idaho 2015) (repealing Chapter 6, Title 30 of the Idaho Code). According to the ULC, North Dakota, Vermont and Washington have all adopted a version of ULLCA (2013). For a list of the applicable state bills, all enacted in 2015, *see* UNIFORM LAWS COMISSION, *Legislation*, http://www.uniformlaws.org/Legislation.aspx (last visited May, 2016).

155. Not all of these other states have completely unique statutes. For example, ten states still have legislation that was originally modeled on the Draft Prototype LLC Act, which was initially prepared by the LLCs, Partnerships & Unincorporated Entities Committee of the American Bar Association Section on Business Law. Those states are Alaska, Arkansas, Connecticut, Indiana, Kentucky, Massachusetts, New Hampshire, New Mexico, Pennsylvania, and Wisconsin. *See* James R. Burkhard, *Resolving LLC Member Disputes in Connecticut, Massachusetts, Pennsylvania, Wisconsin, and the Other States that Enacted the Prototype LLC Act*, 67 BUS. LAW. 405, 407 (2012). For a general description of the draft prototype act, see Revised Prototype Ltd. Liab. Co. Act Editorial Bd., LLCs, P'ships & Unincorporated Entities Comm., ABA Section Bus. Law, *Revised Prototype Limited Liability Company Act*, 67 BUS. LAW. 117 (2011).

156. UNIF. LTD. LIAB. CO. ACT § 104, 6B U.L.A. 71-72 (2008 & Supp. 2016) (noting that "most (if not all) LLC statutes follow the rules stated in this paragraph.").

157. This follows automatically from the LLC's status as an independent legal entity. Agency laws protect agents from vicarious liability undertaken on behalf of disclosed principals, such as LLCs. Stonhard v. Blue Ridge Farms, LLC, 980 N.Y.S. 2d 507, 509 (2014) ("An agent who acts on behalf of a disclosed principal will generally not be liable for a breach of contract." (quoting Matter of Anderson v. PODS, Inc., 896 N.Y.S. 2d 88, 89 (2010)); Selinger Enters., Inc. v. Cassuto, 860 N.Y.S. 2d 533, 535 (2008) (holding that an agent of an LLC is not liable on a contract where the agent signed for the company); *accord* RESTATEMENT (THIRD) OF AGENCY § 6.01 (AM. LAW INST. 2006); *see also* Warren H. Johnson, *Limited Liability Companies (LLC): Is the LLC Liability Shield Holding Up Under Judicial Scrutiny?*, 35 NEW ENG. L. REV. 177, 183 (2000) (tracing the earliest origins of the "limited liability company" back to 1891, in the U.S. Supreme Court decision of *Case Manufacturing Co. v. Soxman*, 138 U.S. 431, 435 (1891)). Johnson notes that limited liability has been a hallmark of this form of business since those earliest days. "While the modern LLC may not be the same business entity as the limited liability company described in Case Manufacturing, the concept of shielding the shareholder (or in the case of an LLC, the member) from the liability of the company remains the same." Johnson, *supra*, at 183.

differ.[158] For purposes of the federal income tax code at least, all LLCs with two or more members are presumed to be taxed as partnerships.[159]

Starting with more basic rules, all LLCs require the filing of an organizational document with a designated state official.[160] While there is some variation in when the document will be deemed effective, all states allow the organizers to choose a deferred effective date.[161] The LLC's name must always include some notice that the LLC form of business has been chosen.[162] Because the LLC is a limited liability entity, it must provide the state with the name and address of a registered agent for service of process,

158. Thomas E. Rutledge, *The Lost Distinction Between Agency and Decisional Authority: Unfortunate Consequences of the Member-Managed Versus Manager-Managed Distinction in the Limited Liability Company*, 93 KY. L.J. 737 (2005) ("The universe of limited liability companies ('LLCs') is bifurcated into two species: LLCs that are member-managed and LLCs that are manager-managed."). Even the terminology of "member managed" and "manager managed" governance for LLCs appears in "the vast majority of existing LLC statutes." Rex Blackburn & Dale G. Higer, *The New LLC Act Preserves Idaho's Traditions*, ADVOCATE, Sept. 2009, at 16, 17 (2009) (noting that only two states (North Dakota and Minnesota) offer alternative default statutory structures that consist of a complicated corporate based "board of managers/governing manager/treasurer"). However, both the North Dakota and Minnesota acts also allow for member management if the members so elect. *See* MINN. STAT. § 322B.606 (West 2011); N.D. CENT. CODE § 10-32-69(a) (2012). Although not mentioned in Blackburn & Higer, *supra*, Tennessee also uses a default corporate governance structure if the members elect "board" management in lieu of member-management. TENN. CODE ANN. § 48-238-101(a)(2) (2012).

159. This is not a matter of state law, but rather the foundation of the check-the-box regulations under the federal tax code. Treas. Reg. §§ 301.7701-1 to -3, (as amended in 2016). As to state law, "[s]ome states impose an entity-level tax on business structures that, for federal tax purposes, are pass-through entities." Ltd. Liab. Co. Subcomm. of the LLCs, P'ships & Unincorporated Entities Comm., ABA Bus. Law Section, *Model Organizational Checklist for A Limited Liability Company*, 69 BUS. LAW. 1251, 1321 (2014) [hereinafter *Checklist*]. The tax status of LLCs under various state taxing regimes is beyond the scope of this Article.

160. "An LLC is a separate legal person that comes into existence through the delivery of a duly executed document—usually called the 'articles of organization'—to a specified public official, whose office then files the document." CARTER BISHOP & DANIEL KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 5.05 (2016) (noting that some statutes refer to "delivery" rather than filing); *see, e.g.*, COLO. REV. STAT. § 7-80-203 (2015); ch. 805 ILL. COMP. STAT. ANN. 180 / 5-1(a) (West 2010). Other statutes refer to filing. *E.g.*, ARIZ. REV. STAT. ANN. § 29-631(A) (2014); CAL. CORP. CODE § 17050(a) (West 2014); FLA. STAT. ANN. § 605.0201 (West 2016); MICH. COMP. LAWS § 450.4202(1) (2011); NY LTD. LIAB. CO. LAW § 203(a) (McKinney 2016). Bishop and Kleinberger, *supra*, also note that not all states use the same label for the form required to organize an LLC, with some states using the term "articles of organization," and others referring to a "certificate." *See also* UNIF. LTD. LIAB. CO. ACT § 206, 6B U.L.A. 107-08 (2008 & sup. 2016).

161. *Checklist, supra* note, 159 at 1321 (stating that "[m]ost if not all, states allow the filing of documents, including articles of organization, with a delayed effective date."). This source cites a number of LLC statutes, including those from Florida, Kentucky, New York, Texas, Virginia and Delaware. *Id.* No other state appears to have an inconsistent provision in its LLC statute.

162. "All the LLC statutes require that the LLC include the term 'L.L.C.,' 'Limited Liability Company,' or 'Limited' in the firm's name to indicate it status as a LLC." ALAN S. GUTTERMAN, BUSINESS TRANSACTIONS SOLUTIONS § 60:18 (2016).

regardless of the state of formation.[163] LLCs are universally allowed to be organized for "business" purposes,[164] although some states go further and allow LLCS to be organized for any "lawful" purpose.

State LLC statutes are generally very flexible, offering organizers substantial freedom of contract in choosing to abandon most of the default and gap-filler rules that appear in LLC statutes.[165] In general, when organizers do wish to change from the default rules, they do so through an operating agreement or similar document,[166] which takes the place of a partnership agreement in the case of partnerships or bylaws in the case of corporations. Absent contrary provisions in such an agreement (or the articles), contributions to an LLC may be made through cash, property, services performed to be performed, or promises to make payments of cash

163. *Checklist, supra* note 159, at 1259 n.10 ("Every LLC act requires the designation by the company of a registered agent.").

164. UNIF. LTD. LIAB. CO. ACT § 108, 6B U.L.A. 88 (2008 & sup. 2016) (noting that some statutes, including ULLCA (2013), are broader than this, permitting any "lawful" purpose, but concluding that all states authorize all business purposes). Outside the context of the LLC acts, however, other state requirements may limit the use of the LLC in certain contexts.

> It is all too easy to take comfort in statutory provisions to the effect that the business at issue may be used for "any lawful business" . . . and assume that purpose limitations are no longer a concern for modem business organizations. That comfort is unjustified. In fact, an array of proper purpose limitations exist, and there are a number of statutes that expressly remind practitioners that these other limitations on proper purpose must be considered.

Checklist, supra note 159, at 1271 n.35.

165. *Checklist, supra* note 159, at 1251 ("Every limited liability company is a unique entity intended to reflect the objectives and agreement of the members (and perhaps other stakeholders) in the business. With few exceptions, there is freedom of contract among those parties to reflect their agreement in the operating agreement."). Professor Sandra Miller has observed that "[p]rivate entrepreneurs have an unparalleled range of choices for structuring LLC relationships. . . ." Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1609-10 (2004); *accord* Victor Peterson & Alison N. Zirn, *Corporate Directors, LLCs and Liability*, 12-6 BUS. L. TODAY 57, 57 (2003) ("State LLC statutes contain relatively few mandatory provisions and instead largely supply default rules, which govern only in the absence of express contractual terms. This gives contracting parties wide discretion in drafting operating agreements to structure LLCs as they wish.").

166. BISHOP & KLEINBERGER, *supra* note 157, at ¶ 5.06. (quoting Abbey v. Fortune Drive Assocs., No. A124684, 2010 L 1553616, at *7 (Cal. Ct. App. Apr. 20, 2010) (calling the operating agreement the "heart and soul of an LLC"); Elf Atochem N. Am., Inc. v. Jaffari, 727 A2d 286, 291 (Del. 1999) (calling it the "cornerstone" of the business)). This does not mean that every LLC must have an operating agreement, although the document is required in some states. In addition, in states where the document is required, there is also considerable variations in what may and what must be in an operating agreement. *See infra* note 178 and accompanying text. In addition, while the document is called an "operating agreement" in most state statutes, a few acts use a different label. In certain states it is referred to as the "company agreement." TEX. BUS. ORGS. CODE ANN. art. 101.001(1) (West 2012). In other statutes it is referred to as the "member control agreement." MINN. STAT. ANN. § 322B.37 (West 2011); N.D. CENT. CODE § 10-32-50 (2012). The Delaware act calls the document the "limited liability company agreement." DEL. CODE ANN. tit. 6, § 18-101(7) (2012).

or property in the future.[167] If the members desire, they have the option under state statutes to authorize the LLC to memorialize the issuance of membership interests with physical certificates.[168] Another generally applicable rule is that members are typically permitted to transfer their membership interest in the LLC, but without consent of other members, the transferee receives only economic rights.[169] LLC statutes provide for judicial dissolution under a range of circumstances, but there is general agreement that this includes situations where "it is not reasonably practicable to carry on the business in conformity with the operating agreement."[170] When the LLC is dissolved and its business is wound up, creditors must be paid off first (and this is not normally something that may be varied in an operating agreement).[171]

B. WHERE THE LLC ACTS DIVERGE

The preceding section might seem to include a lengthy list of issues where there is agreement among the states about how LLCs are to be formed and operated, but the number of significant issues on which the states do not

167. For a sampling of such statutes, *see, e.g.*, UNIF. LTD. LIAB. CO. ACT § 402, 6B U.L.A. 120-21 (2008 & Supp. 2016); FLA. STAT. ANN. § 605.0402 (West 2016); HAW. REV. STAT. § 428-401 (2004); ME. REV. STAT. ANN. tit. 31, § 1552 (2011); NEV. REV. STAT. § 86.321 (2010); S.C. CODE ANN. § 33-44-401 (2006); VA. CODE ANN. § 13.1-1027(A) (2011).

168. *Checklist, supra* note 159, at 1274 n.41 ("Most, if not all, LLC acts expressly permit membership interests to be represented by a physical certificate."). The source does, however, note that the certificate might be limited to a representation of the member's economic rights alone, rather than including any of the management rights that would commonly be understood as being part of a member's interest in the LLC. *See id.* (citing GA. CODE ANN. § 14-11-101(13) (2003); VA. CODE ANN. § 13.1-1002 (2011)).

169. "One of the most fundamental characteristics of LLC law is its fidelity to the 'pick your partner' principle." UNIF. LTD. LIAB. CO. ACT § 502, 6B U.L.A. 151 (2008 & Supp. 2016) (citing Bynum v. Frisby, 311 P.2d 972, 975 (Nev. 1957)). "[U]nless the operating agreement provides otherwise, a new unit holder normally acquires only the 'transferable interest'—the former owner's economic rights." L. Andrew Immerman, *Is There Any Such Thing as an LLC Unit?*, BUS. ENTITIES, July-Aug. 2009, at 20, 26 (describing the impact of identifying membership interests as "units").

170. *Checklist*, *supra* note 159, at 1316 (also noting that that there are many other possible grounds for judicial dissolution in most states, but that the other formulations vary widely). For an example of one state that lists inability to continue the business of the company in conformity with its operational documents as the only grounds for judicial dissolution, consider the following language from the Tennessee LLC Act: "On application by the attorney general and reporter, or by or for a member, the court may decree dissolution, winding up and termination of an LLC whenever it is not reasonably practicable to carry on the business in conformity with the LLC documents." TENN. CODE ANN. § 48-249-617(a) (2012).

171. *Checklist*, *supra* note 159, at 1321 ("LLC acts are similar to each other in their provisions for disposing of assets upon liquidation. Assets must first be applied to discharge obligations to creditors.").

agree is substantially larger.[172] Aside from the substance of the state acts, the basic structure of state LLC statutes varies widely, from extremely detailed versions containing more numerous mandatory provisions, to abbreviated provisions with very little in the way of mandatory rules and structures.[173]

Even when it comes to the question of when an LLC actually comes into existence, the state statutes are not in agreement. Some statutes provide that formation happens upon delivery of the articles or other organizational document,[174] some when the articles are "accepted" by the appropriate state

172. This variation in state statutes may help to explain why the LLC is so much more popular in some jurisdictions than in others. Daniel M. Häusermann, *For A Few Dollars Less: Explaining State to State Variation in Limited Liability Company Popularity*, 20 U. MIAMI BUS. L. REV. 1, 3 (2011) ("Limited liability companies (LLCs) are a much more popular business entity in some states than in others. For instance, people in Connecticut form twelve times as many LLCs than corporations each year. In contrast, more corporations than LLCs are still formed in Illinois, New York, and California.").

173. "Outside of the minority of states that have adopted one of the two uniform statutes, there are significant state-by-state differences. On the one end are states like Minnesota and North Dakota, which have highly detailed mandatory provisions akin to corporation statutes, and on the other end are states like Alaska whose statute is fairly sparse. The laws of commercially large states, like New York and California, differ from each other as well." Michelle M. Harner & Robert J. Rhee*, Teaching LLCs Through a Problem-Based Approach*, 71 WASH. & LEE L. REV. 489, 492 (2014). Note that Minnesota enacted the ULLCA (2006) in 2014, effectively repealing the currently problematic LLC provisions in 2018. *See* MINN. STAT. ANN. § 322B.01 (West 2011 & Supp. 2015) ("Laws 2014, c. 157, art. 1, § 91, repeals this section effective January 1, 2018.").

174. States using "delivery" as the trigger for formation of an LLC word the applicable provisions in a variety of ways. For example, Colorado's statute simply says that "[o]ne or more persons may form a limited liability company by delivering articles of organization to the secretary of state for filing. . . ." COLO. REV. STAT. § 7-80-203(1) (2015). The Arkansas statute says that persons may "form a limited liability company by signing or causing to be signed articles of organization and delivering the signed articles to the Secretary of State of filing." ARK. CODE ANN. § 4-32-201 (2011 & Supp. 2016). Montana provides that normally a document is to be filed when delivery is accepted, although "[i]f the secretary of state is unable to make the determination required for filing by subsection (1) at the time any documents are delivered for filing, the documents are considered to have been filed at the time of delivery if the secretary of state subsequently determines that the documents as delivered conform to the filing provisions. . . ." MONT. CODE ANN. § 35-8-205(2) (2015); *accord* GA. CODE ANN. § 14-11-206(d) (2003). Wyoming's statute says that a "record delivered to the secretary of state for filing under this article shall be effective as provided in W.S. 17-16-123." WYO. STAT. ANN. § 17-29-205(c) (2015). The cross referenced provision in that subsection specifies that the document is effective "[a]s of the time received for filing. . . ." WYO. STAT. ANN. § 17-16-123(a)(i) (2015). Connecticut uses delivery as the trigger for formation, but also requires endorsement, which means that this statute probably effectively requires filing before an LLC comes into existence. CONN. GEN. STAT. ANN. § 34-123(a) (West 2015).

official,[175] some upon filing,[176] some upon filing or acceptance if there is at least substantial compliance with the statute,[177] and some specify that the LLC does not technically come into existence until there is at least one member,[178] or until the articles become "effective."[179]

Some states also require that the members of an LLC have an operating agreement, which may have to be written,[180] although it is not clear whether failure to do so affects the validity of the LLC's existence.[181] If there is an operating agreement, it is not always clear whether an LLC that is not a party to the operating agreement is bound by its terms, although some statutes specify that it is.[182]

175. *See, e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 4A-202(b) (LexisNexis 2014) ("A limited liability company is formed at the time when the Department accepts the articles of organization for record or at a later time specified in the articles, if in either case there has been substantial compliance with this title.").

176. *E.g.*, 15 PA. CONS. STAT. ANN. § 8914(b) (West 2008 & Supp. 2015) ("A limited liability company is organized upon the filing of the certificate of organization in the department or at any later effective time specified in the certificate of organization.").

177. For example, the Maryland statutes speaks in terms of "accepting" the documents, but also adds the requirement that the document be in "substantial compliance" with the LLC statute. MD. CODE ANN., CORPS. & ASS'NS § 4A-202(b) (LexisNexis 2014).

178. UNIF. LTD. LIAB. CO. ACT (amended 2013) § 201(d), 6B U.L.A. 102 (2008 & Supp. 2016) ("A limited liability company is formed when the certificate of organization becomes effective and at least one person has become a member.").

179. "A limited liability company is formed when its articles of organization become effective." COLO. REV. STAT. ANN. § 7-80-207 (2015). Note that Colorado also has a provision stating that the LLC is formed by "delivering" articles of organization. COLO. REV. STAT. § 7-80-203(1) (2015).

180. *See, e.g.*, ARK. CODE ANN. § 4-32-102(11) (West 2011 & Supp. 2016) (defining "operating agreement" to mean "the written agreement which *shall* be entered into among all of the members as to the conduct of the business and affairs of a limited liability company. . . ." DEL. CODE ANN. tit. 6, § 18-201(d) (2013) (emphasis added) (providing that "[a] limited liability company agreement shall be entered into or otherwise existing either before, after or at the time of the filing of a certificate of formation and, whether entered into or otherwise existing before, after or at the time of such filing, may be made effective as of the effective time of such filing or at such other time or date as provided in or reflected by the limited liability company agreement."). Kansas also has a statute mirroring the language from the Delaware LLC Act. KAN. STAT. ANN. § 17-7673b(c) (2007).

181. *Compare, e.g.*, ARK. CODE ANN. § 4-32-102(11) (2011 & Supp. 2016) (where the LLC Act provides that a written operating agreement "shall" be maintained), *with* ARK. CODE ANN. § 4-32-405(d) (2011 & Supp. 2016) (another section of the statute that says although a copy of any effective operating agreement is to be maintained at the company's principal place of business, "[f]ailure of the limited liability company to keep or maintain any of the records or information required pursuant to this section shall not be grounds for imposing liability on any member or manager for the debts and obligations of the limited liability company").

182. *Compare* Elf Atochem North America, Inc. v. Jaffari, 727 A.2d 286 (Del. 1999) (holding that under Delaware law an LLC is bound even if not a party to the operating agreement), *with* Trover v. 419 OCR, Inc., 921 N.E.2d 1249 (Ill. App. Ct. 2010) (finding that non-signatory LLCs are not bound by operating agreements under Illinois law). *See generally* Joan MacLeod

Default rules governing management rights of members in an LLC also vary widely, with some states declining to establish a default rule (requiring the company to specifically elect how it is to be governed),[183] some states using member-management as the default rule,[184] and a few states using a manager-management rule absent agreement to the contrary.[185] How one calculates voting power in a member-managed regime is also treated differently in various states, and "about half of the LLC statutes default to members voting on a per capita (one vote per member) basis, while the other half default to members voting on a pro rata (by financial interest) basis."[186]

In addition, some statutes provide that members have statutory power and apparent authority to manage the business unless an election to be a manager-managed company is made,[187] while a few explicitly reject this approach.[188] The ability of the LLC to expand or limit authority of members through the filing of appropriate statements is also treated differently in

Heminway, *The Ties That Bind: LLC Operating Agreements as Binding Commitments*, 68 SMU L. REV. 811, 816-18 (2015).

183. *See* KY. REV. STAT. ANN. § 275.025(1)(d) (LexisNexis 2012); MONT. CODE ANN. § 35-8-202(1X2) (2015); TEX. BUS. ORGS. CODE ANN. art. 101.251 (West 2012).

184. Most states presume a member-management model. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-402 (2013) (Delware statute); GA. CODE ANN. § 14-11-301 (2003) (Georgia statute); VA. CODE ANN. § 13.1-1021.1(B)(1) (2011 & sup. 2016) (Virginia statute); *see also* Thomas E. Rutledge, *The Lost Distinction Between Agency and Decisional Authority: Unfortunate Consequences of the Member-Managed Versus Manager-Managed Distinction in the Limited Liability Company*, 93 KY. L.J. 737 (2005).

185. At one extreme, Minnesota does not specifically authorize management of the LLC by its members, requiring that each LLC have at least two managers (a chief executive manager and a treasurer) appointed by the LLCs board of governors. MINN. STAT. ANN. § 322B.676 (West 2011). The Minnesota statute does allow members to reserve management control if they enter into a "control agreement." *Id.* § 322B.37. Note that Minnesota enacted the ULLCA (2006) in 2014, effectively repealing the currently problematic LLC provisions in 2018. *See* MINN. STAT. ANN. § 322B.01 (West 2011 Supp. 2016) (stating notice of repeal "Laws 2014, c. 157, art. 1, § 91, repeals this section effective January 1, 2018."). North Dakota also presumes that LLCs will be governed under a board-managed structure where the board consists of one or more governors. N.D. CENT. CODE § 10-32-70 (2012). Members can, however, take any action that the board could take if they act by unanimous vote. N.D. CENT. CODE DEL. CODE ANN. Tit. 6, § 18-1101(c) 10-32-69(2). Members may also remove any of the governors. *Id.* § 10-32-78(3); DEL. CODE ANN. tit. 6, § 18-1101(c) (2013). Members may also remove any of the governors. N.D. CENT. CODE § 10-32-78(3) (2012).

186. Molitor, *supra* note 109, at 530.

187. Rutledge, *supra* note 182, at 737 ("Under most statutory formulations, in a member-managed LLC each member, by reason of their member status, has statutory apparent agency authority to act on behalf of the LLC.").

188. *See* UNIF. LTD. LIAB. CO. ACT § 301, 6B U.L.A. 118 (2008 & Supp. 2016); *see also* Thomas E. Rutledge & Steven G. Frost, *RULLCA Section 301—The Fortunate Consequences (and Continuing Questions) of Distinguishing Apparent Agency and Decisional Authority*, 64 BUS. LAW. 37, 37-38 (2008).

different jurisdictions.[189] Similarly, the fiduciary obligations of members also vary from state to state,[190] both in terms of default rules and the extent to which these obligations may be modified by agreement among the

189. While most LLC Acts do not provide for statements of authority or denial, the most recent version of the ULLCA does so. *See* UNIF. LTD. LIAB. CO. ACT §§ 302-03, 6B U.L.A. (2008 & Supp. 2016).

190. In contrast to fiduciary duties of partners in partnerships and persons who control corporations, which are relatively well understood, duties of members of LLCs "remain unsettled in most jurisdictions." Debra Hatter & Rikiya Thomas, *Swimming in Unsettled Waters: Fiduciary Duties and Limited Liability Companies*, HOUS LAW., July-Aug. 2011, at 22, 23 (2011). These commentators posit that the uncertainty reflects more on the fact that LLCs are relatively new entities, but the underlying statutes also approach the issue of fiduciary obligations differently. *Id.* at 24.

Delaware, for example, does not specify the fiduciary duties of members (or managers), although it does include a provision in its LLC Act allowing the operating agreement to expand, restrict or eliminate fiduciary duties. DEL. CODE ANN. tit. 6, § 18-1101(c) (2013).

The ULLCA (2013) provides that members in a member-managed LLC owe to the company and other members duties of loyalty and care that parallel those owed by general partners in a partnership. *Compare* UNIF. LTD. LIAB. CO. ACT § 409(a)-(d), 6B U.L.A. 141 (2008 & Supp. 2016), *with* UNIF. P'SHIP ACT § 409, 6, pt. II U.L.A. 101-02 (2008 & Supp. 2015). If, however, the LLC is manager-managed, a member owes no duties to the company or other members by reason of being a member. UNIF. LTD. LIAB. CO. ACT § 409(i)(6), 6B U.L.A. 142 (2008 & Supp. 2016). Many states, however, appear to have utilized a corporate law model in drafting provisions relating to fiduciary duties of those in control of LLCs.

Perhaps the most thorough assessment of just how much state treatment of fiduciary obligations varies comes from Professors Callison and Vestal. J. William Callison & Allan W. Vestal, "*They've Created a Lamb with Mandibles of Death": Secrecy, Disclosure, and Fiduciary Duties in Limited Liability Firms*, 76 IND. L.J. 271, 281-86 (2001). In 2001, they reported that nine states adopted the ULLCA model which applies a gross negligence standards to members in a member-managed LLC, nine states ignored fiduciary obligations entirely, twenty state LLC statutes parallel the provisions of the Revised Model Business Corporation Act (RMBCA) calling for that degree of care that "an ordinarily prudent person in a like position would exercise under similar circumstances," and nineteen use the RMBCA language that calls for managing members to act in a manner they "reasonably believe to be in the best interests of the company." Eight additional statutes use a duty of care approach that exonerates behavior unless a specific standard is violated, and four states are identified as outliers, with idiosyncratic provisions. *Id.*

members.[191] There is no consensus on informational rights of members,[192] or on the requirements for a member to be allowed to transfer the right to join

191. There is a similar degree of variation with regard to the power of an operating agreement to modify the default fiduciary obligations of members in an LLC. Callison & Vestal, *supra* note 188, at 285-86. Callison and Vestal noted that 25 states have statutes expressly authorizing members to modify the statutory default duties, while Maine expressly prohibits such modification, and most states fail to address the issue. *Id*. Of those that do permit modification, this right may or may not be absolute. Those statutes following ULLCA (1996) may not "unreasonably reduce" the standards of care. UNIF. LTD. LIAB. CO. ACT § 103(b)(3), 6B U.L.A. 563 (2008). The 2006 and 2013 versions of ULLCA have more complicated rules about the extent to which the duties of care and loyalty may be altered or eliminated. UNIF. LTD. LIAB. CO. ACT § 110(d)(3), 6B U.L.A. 443 (2008); UNIF. LTD. LIAB. CO. ACT § 105(c)(5), 105(d), 6B U.L.A. 72-73 (2008 & Supp. 2016).

A number of jurisdictions have a variety of rules allowing some form of contractual limitation on fiduciary duties in LLCs. Arkansas allows the operating agreement to eliminate liability for damages for breach of any such duty. ARK. COD ANN. § 4-32-404 (2016). Colorado allows any limitation or even elimination of any duty that "is not manifestly unreasonable." COLO. REV. STAT. ANN. §§ 7-80-108 (2015). Delaware allows complete elimination of such duties. DEL. CODE ANN. tit. 6, § 18-1101(c) (2013). The District of Columbia allows alteration of the duties if not "manifestly unreasonable." D.C. CODE § 29-801.07 (2013). Georgia allows elimination of duties except for intentional or knowing misconduct. GA. CODE ANN. § 14-11-305 (2003). Idaho allows alteration of the duty of care or elimination of the duty of loyalty if not manifestly unreasonable. IDAHO CODE § 30-6-110 (2013). Kentucky allows elimination of the duties. KY. REV. STAT. ANN. § 275.180 (LexisNexis 2012). Nebraska allows alteration of the duty of care although not to authorize intentional or knowing misconduct and elimination of the duty of loyalty if not manifestly unreasonable. NEB. REV. STAT. § 21-110 (2012). New Hampshire allows elimination of the duties. N.H. REV. STAT. ANN. §304-C:107 (2015). New Jersey allows alteration of the duty of care or elimination of the duty of loyalty if not manifestly unreasonable. N.J. STAT. ANN. § 42:2C-1-94 (West Supp. 2015). New York allows elimination of liability for damages with certain exceptions. N.Y. LTD. LIAB. CO. LAW § 417 (McKinney 2016). Finally, Utah allows restriction or elimination of the duty of care and the duty of loyalty "if not unconscionable or against public policy." UTAH CODE ANN. § 48-3a-112(4)(c) (LexisNexis 2011).

192. Some LLC Acts give members the right to access records and information during ordinary business hours to the extent the information is material to the member's rights and duties under the operating agreement. *See, e.g.*, FLA. STAT. ANN. § 608.4101(2) (West 2016) (repealed 2015); UNIF. LTD. LIAB. CO. ACT § 410, 6B U.L.A. 138-39 (2008 & Supp. 2016); TEX. BUS. ORGS. CODE ANN. art. 101.502 (West 2012). Other statutes require only that the request be "reasonable," without specifying the purposes for which a request may be made. *See, e.g.*, KY. REV. STAT. ANN. § 275.185(2) (LexisNexis 2012 & Supp. 2015). This right presumably includes, but is not limited to, financial records of the company. Some statutes also provide that the right to information may not be unreasonably restricted. *See, e.g.*, UNIF. LTD. LIAB. CO. ACT § 105(c)(8), 6B U.L.A. 442 (2008 & Supp. 2016).

There is also variation in the extent to which the operating agreement may vary the obligation of the LLC to provide information. *Compare* DEL. CODE ANN. tit. 6, § 18-305(a) (2013 & Supp. 2013) (members of a limited liability company have the right to demand information, subject to reasonable standards "as may be set forth in a limited liability company agreement . . . for any purpose reasonably related to the member's interest as a member of the limited liability company"), *with* KY. REV. STAT. ANN. § 275.185(3) (LexisNexis 2012) (requiring the affirmative delivery of information to members "to the extent the circumstances render it just and reasonable, true and full information of all matters affecting the members to any member").

the LLC as a member[193] (as opposed to merely transferring the economic rights in the business).[194]

The default rules for how profits and losses are allocated and shared also vary widely.[195] Statutes differ in who has authority to declare distributions and in the default rules that fill in the gaps if there is no agreement to the contrary.[196] When it comes to managers, even after it is clear that a particular LLC is to be manager-managed,[197] statutes differ in how managers are to be

193. Some states provide a default rule that a majority-in-interest of members must consent to admission of a new member upon transfer of an existing member's interest. *See, e.g.*, KY. REV. STAT. ANN. § 275.265(1) (LexisNexis 2012) ("[A]n assignee of a limited liability company interest shall become a member only if a majority-in-interest of the members consent."). Other states require "unanimous consent," unless the operating agreement is to the contrary. *E.g.*, MD. CODE ANN., CORPS. & ASS'NS § 4A-604 (LexisNexis 2014); TEX. BUS. ORGS. CODE ANN. art. 101.109(b) (West 2012) ("An assignee of a membership interest in a limited liability company is entitled to become a member of the company on the approval of all of the company's members.").

194. There is general agreement among LLC statutes that economic rights may be transferred, at least absent agreement to the contrary. *See supra* note 167 and accompanying text.

195. LLC acts may have default provisions on the allocation of profits and losses. Some statutes presume sharing on the basis of the value of each member's contributions to the enterprise. *See, e.g.*, KY. REV. STAT. ANN. § 275.205 (LexisNexis 2012) (profits and losses of an LLC "shall be allocated on the basis of the agreed value, as stated in the records of the [LLC] . . . of the contributions made by each member to the extent they have been received by the [LLC] and have not been returned."); TEX. BUS. ORGS. CODE ANN. art. 101.201 (West 2012). Other statutes presume a per capital allocation of profits and losses (i.e., equal among the members). *See, e.g.*, ARK. CODE ANN § 4-32-503 (2001).

196. "Individual LLC acts may have specific requirements for distributions. For example, Rhode Island, R.I. GEN. LAWS § 7-16-28 and Hawaii, HAW. REV. STAT. § 428-404(c)(6) (West 2008) provide a default rule for unanimous approval of the members for an interim distribution. In contrast, under the Revised Prototype LLC Act, the declaration of a distribution is an ordinary course activity requiring the approval of only a majority of the members." *Checklist, supra* note 159, at 1308 n.117.

197. As described *supra* at notes 181-83 and accompanying text, state LLC statutes may require the organizers to choose if the business will be managed by members or managers, may provide for manager management as a default rule, or may offer it as an option only if the members specifically elect to forego the statutory default of member-management.

selected[198] or removed,[199] in how authority is to be allocated among the managers,[200] and the degree of formality that is required in order for them to

198. Consider the differences in how managers are selected, removed, and granted authority as contained in ULLCA (2013), the Arkansas, Delaware, and Minnesota LLC Acts. The ULLCA (2013) provides that the operating agreement may provide for manager-management, and if it does so,

> Except as expressly provided in this [act], any matter relating to the activities and affairs of the company is decided exclusively by the manager, or, if there is more than one manager, by a majority of the managers.
>
> (2) Each manager has equal rights in the management and conduct of the company's activities and affairs.
>
> (3) The affirmative vote or consent of all members is required to:
>
> (A) undertake an act outside the ordinary course of the company's activities and affairs; or
>
> (B) amend the operating agreement.
>
> (4) A manager may be chosen at any time by the affirmative vote or consent of a majority of the members and remains a manager until a successor has been chosen, unless the manager at an earlier time resigns, is removed, or dies, or, in the case of a manager that is not an individual, terminates. A manager may be removed at any time by the affirmative vote or consent of a majority of the members without notice or cause.

UNIF. LTD. LIAB. CO. ACT § 407(c), 6B U.L.A. 127 (2008 & Supp. 2016). In Arkansas, if the company is designated as being manager-managed in its articles,

> Every manager is an agent of the limited liability company for the purpose of its business or affairs, and the act of any manager, including, but not limited to, the execution in the name of the limited liability company of any instrument, for apparently carrying on in the usual way the business or affairs of the limited liability company of which he is a manager binds the limited liability company, unless the manager so acting has, in fact, no authority to act for the limited liability company in the particular matter, and the person with whom the manager is dealing has knowledge of the fact that the manager has no such authority.

ARK. CODE ANN. § 4-32-301(b)(2) (2001). Absent a contrary provision in the operating agreement, managers are to be elected, removed or replaced by a "vote, approval, or consent of more than one-half (1/2) by number of the members." *Id.* § 4-32-401(c)(1). In Delaware,

> if a limited liability company agreement provides for the management, in whole or in part, of a limited liability company by a manager, the management of the limited liability company, to the extent so provided, shall be vested in the manager who shall be chosen in the manner provided in the limited liability company agreement. The manager shall also hold the offices and have the responsibilities accorded to the manager by or in the manner provided in a limited liability company agreement. Subject to § 18-602 of this title, a manager shall cease to be a manager as provided in a limited liability company agreement. A limited liability company may have more than 1 manager. Unless otherwise provided in a limited liability company agreement, each member and manager has the authority to bind the limited liability company.

DEL CODE ANN. tit. 6, § 18-402. (2013).

Minnesota follows a very different approach, using a board of governors as the default managing body for its LLCs. Under that statute, the LLC is also required to have "one or more natural persons exercising the functions of the offices, however designated, of chief manager and treasurer." MINN. STAT. ANN. § 322B.67 (repealed 2014). Individual managers are charged with specific responsibilities, at least absent agreement to the contrary. MINN. STAT. ANN. §§ 322B.673, 1208 (West 2011). Minnesota enacted the ULLCA (2006) in 2014, effectively repealing the currently problematic LLC provisions in 2018. *See* MINN. STAT. ANN. § 322B.01 (West 2011 & sup. 2016) (stating notice of repeal "Laws 2014, c. 157, art. 1, § 91, repeals this section effective January 1, 2018.").

At least one commentator has also complained that because of poor drafting, there are a number of issues that have been created with respect to the extent of managers' authority. Thomas E. Rutledge, *The Lost Distinction Between Agency and Decisional Authority: Unfortunate Consequences of the Member-Managed Versus Manager-Managed Distinction in the Limited*

act.[201] The fiduciary obligations of managers is also described differently in different states,[202] and the statutes are not even consistent in the extent to which such obligations may be changed by agreement.[203] Some statutes explicitly allow indemnification of persons with management authority, while others do not.[204] Some statutes allow members to bring derivative actions if the managers do not act; other statutes are silent.[205]

Liability Company, 93 KY. L.J. 737, 747 (2005) ("In some instances, poor statutory drafting has conveyed to the managers power and authority that was neither properly considered nor intended."). Case law suggests that courts are also uncertain about what falls within the realm of a manager's authority under some statutes. *E.g.*, Apple Glen Crossing, L.L.C. v. Trademark Retail, Inc., 784 N.E.2d 484, 486 (Ind. 2003) (holding that "change orders," not "major decisions," require approval of all of the members); Chase Manhattan Bank v. Iridium African Corp., 197 F. Supp. 2d 120 (D. Del. 2002) (holding that attestation as to proper amendment of the operating agreement not an ordinary matter).

199. While most state statutes are silent on this issue, certain states provide a statutory default rule for the removal of the manager. *See, e.g.*, VA. CODE ANN. § 13.1-1024(F) (2011).

200. Certain statutes expressly provide for differentiation in the authority and duties of various managers. *See*, e.g., VA. CODE ANN. § 13.1-1024(J) (2011). Meanwhile, other statutes do so in a less direct manner. *See*, e.g., KY. REV. STAT. ANN. § 275.165(2) (2012); TEX. BUS. ORGS. CODE ANN. art. 101.252 (West 2012).

201. *See Checklist, supra* note 159, at 1321.

> Generally, LLC acts do not include default provisions for meetings of the members and other formal governance procedures. Rather, those procedures will be determined by the agreement of the members. The absence of standard provisions dealing with member meetings and similar issues is in striking contrast to business corporation laws. However, there are exceptions to this rule, notably Minnesota and North Dakota which, by statute, contain detailed provisions dealing with those procedural matters.

Id. at 1304-05 n.112 (citing MINN. STAT. ANN. §§ 322B.33-.37 (Lexis through 2014 Reg. Sess.; N.D. CENT. CODE §§ 10-32-44 to -50 (2012)); N.Y. LTD. LIAB. CO. LAW §§ 403-407 (McKinney 2016); TENN. CODE ANN §§ 48-222-101(a),48-224-104 (2012); TEX. BUS. ORGS. CODE ANN. art. 6.001-6.053, 101.351-101.359 (West 2012)).

202. In general, fiduciary obligations of managers track those assigned to members in member-managed LLCs in the various states. For a discussion of the wide variety in approaches taken, see *supra* note 188 and accompanying text.

203. *See supra* note 189.

204. A number of states expressly allow derivative suits. *See, e.g.*, FLA. STAT. ANN. § 608.601 (West 2016); DEL. CODE ANN. tit. 6, § 18-1001 (2013); TEX. BUS. ORGS. CODE ANN. art. 101.451-101.463. More states are silent on the issue. New York's highest court found a common law right to bring a derivative action on behalf of an LLC. Tzolis v. Wolff, 884 N.E.2d 1005, 1016 (N.Y. 2008). The Arkansas Supreme Court similarly allowed a derivative suit to proceed in 2014, in a decision not selected for publication in the Southwestern Reporter. Mucchio v. Hunt, No. CV-11-1273, 2014 WL 346929 (Ark. Jan. 30, 2014). For a more detailed discussion of derivative actions in the context of LLCs, see Daniel S. Kleinberger, *Direct Versus Derivative and the Law of Limited Liability Companies*, 58 BAYLOR L. REV. 63 (2006).

205. *Compare* UNIF. LTD. LIAB. CO. ACT (amended 2013) § 802, 6B U.L.A. 178 (2008 & Supp. 2016) (expressly authorizing derivative actions), *with* 1993 Ark. Acts 1003 (codified at ARK. CODE ANN. §§ 4-32-101 to -1401 (2016) (not mentioning derivative claims)). This distinction may be more apparent than real, because courts that have dealt with the issue of whether LLC Acts that do not expressly include the right to sue derivatively nonetheless include that right have generally permitted members to maintain such actions. *See, e.g.*, In re Senior Cottages of America, LLC, 482

Some states allow members to withdraw at will, while others provide that it takes a specific agreement to the contrary before members have this ability.[206] And in addition to those complexities, state statutes also vary as to the consequences of withdrawal when it is allowed.[207] The statutes list different events that can trigger dissolution by act of the members,[208] or by

F.3d 997 (8th Cir. 2007) (applying Minnesota law, and finding that it is likely that Minnesota courts would allow derivative actions even though the Minnesota LLC Act does not expressly authorize them); Bischoff v. Boar's Head Provisions Co., Inc., 436 F. Supp. 2d 626 (S.D.N.Y. 2006) (applying New York law and finding that LLC members have a common-law right to derivative actions); Tzolis v. Wolff, 884 N.E.2d 1005, 1016 (N.Y. 2008) (allowing a derivative action even though there are no provisions governing such suits in the New York LLC Act).

206. "State LLC acts vary with regard to a member's power to withdraw voluntarily from an LLC and receive the financial value of his/her interest. This disparity results from the competing interests between providing some liquidity for LLC members while still protecting the LLC and the remaining members from the disruption caused by dissociation." *See Checklist*, *supra* note 159, at 1321 (citing RIBSTEIN & KEATINGE, *supra* note 89, at § 11:2); CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 8.03[1]. Some states specifically grant the power to dissociate, even in violation of a contractual agreement otherwise. *See, e.g.*, MINN. STAT. ANN. § 322C.0601 (West 2011 & Supp. 2016) ("A person has the power to dissociate as a member at any time, rightfully or wrongfully, by withdrawing as a member by express will."). Some states create a presumption that there is a right to withdraw, but this can be taken away if the parties agree otherwise. MONT. CODE ANN. § 35-8-804 (2015) ("Unless otherwise provided in the operating agreement, a member has the power to dissociate from a limited liability company at any time, rightfully or wrongfully"). Still other states start with the presumption that there is no right to withdraw. ARK. CODE ANN. § 4-32-802 (2016) ("Unless the articles of organization or an operating agreement provides otherwise, a member may not withdraw from a limited liability company prior to the dissolution and winding up of the limited liability company.").

207. BISHOP & KLEINBERGER, *supra* note 206, at ¶ 8.05; *see also Checklist, supra* note 159, at 1292 n.89 ("Some LLC statutes provide for some type of payment to a withdrawing member under various state-specific formulations." (citing RIBSTEIN & KEATINGE, supra note 89 at § 11:3; Thomas E. Rutledge, *You Just Resigned—Now What? Different Paradigms for Withdrawing from a Venture*, J. PASSTHROUGH ENTITIES, Nov.-Dec. 2009, at 43)). Again, to illustrate some of these differences, consider the rule in various statutes. In Montana, members who withdraw from an at-will company have the right to have their distributional interest repurchased within a defined period for a fair value, and if the LLC continues its business to a defined term, the members continue to receive distributions to which they would have been entitled, and have the right to be bought out at the expiration of the term that was specified when the members withdrew. MONT. CODE ANN. § 35-8-805 (2015). In Vermont, while a member has the absolute power to dissociate even if wrongfully, a person who dissociates winds up with the rights of a transferee rather than having a right to be bought out. VT. STAT. ANN, tit. 11 § 4083(a)(3) (Supp. 2016). For a more detailed look at some of the differences in how states treat members upon withdrawal, see Carter G. Bishop, *Treatment of Members Upon Their Death and Withdrawal from a Limited Liability Company: The Case for a Uniform Paradigm*, 25 STETSON L. REV. 255 (1995).

208. Most states allow dissolution as provided in the company's operational documents, or upon approval of the members. However, there is substantial difference in the default rules about what kind of approval of the members is required. Some statutes merely say dissolution occurs "at a time approved by all members." GA CODE ANN. 14-11-602(b) (2003). Some states have a default rule requiring consent to be unanimous and in writing. ARK. CODE ANN. 4-32-901 (2016). Many states appear to require majority approval unless the LLC specifies another number. CONN. GEN. STAT. ANN. § 34-206(2) (West 2015) (providing a default rule that the members may authorize

judicial intervention.[209] States even vary in how assets of the business are to be paid out in the event of dissolution and winding up of the business.[210]

dissolution through "the affirmative vote, approval or consent of at least a majority in interest of the members"). Still other states impose higher levels of formality. For example, Tennessee imposes a requirement that the approval of the members must be at a formal meeting called for the express purpose of considering dissolution. TENN. CODE ANN. § 48-249-603 (2012) (with a default rule requiring a majority vote). Delaware law provides for dissolution "upon the affirmative vote or written consent of the members of the limited liability company . . . by members who own more than 2/3 of the then-current percentage or other interest in the profits of the limited liability company owned by all of the members," unless the limited liability company agreement otherwise provides. DEL. CODE ANN. tit. 6, § 18-801(a)(3) (2013).

209. As noted earlier, there is widespread agreement that a court may order dissolution when it is not reasonably practicable for the business to be carried on in conformity with the LLC's operational documents. *See supra* note 168 and accompanying text. While some states list only that as grounds for judicial intervention (*see, e.g.*, TENN. CODE ANN. § 48-249-617 (2012)), many states include other potential grounds, and those vary widely. *See, e.g.*, CAL. CORP. CODE § 17707.03(b) (West 2014) (including all of the following as possible grounds for a member to seek judicial dissolution: "(3) The business of the limited liability company has been abandoned. (4) The management of the limited liability company is deadlocked or subject to internal dissension. (5) Those in control of the limited liability company have been guilty of, or have knowingly countenanced, persistent and pervasive fraud, mismanagement, or abuse of authority."); 805 ILL. COMP. STAT. ANN. 180 / 35-1(5) (West 2010) (including as a possible event causes dissolution "[o]n application by a transferee of a member's interest, a judicial determination that it is equitable to wind up the company's business."); N.H. REV. STAT. ANN. § 304-C:134(b) (2015) (allowing judicial dissolution if "[a] voting deadlock has occurred among the members and, upon the occurrence of the deadlock, the members have been unable to break the deadlock; and because of the deadlock, either irreparable injury to the limited liability company is threatened or being suffered or the limited liability company's business and internal affairs can no longer be conducted to its advantage."); N.C. GEN. STAT. ANN. § 57D-6-02(2)(ii) (2015) (allowing judicial dissolution if "liquidation of the LLC is necessary to protect the rights and interests of the member."); MONT. CODE ANN. § 35-8-902(1)(e) (2015) (allowing judicial dissolution if the members establish that "the members or managers in control of the company have acted, are acting, or will act in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the petitioner").

210. To a large extent this is not surprising, because statutes also establish differing default rules for how interim distributions are to be shared. *See supra* note 193 and accompanying text. To a large extent, the differences in the default rules governing how liquidating distributions are to be calculated flow from those distinctions, with the usual rule providing that creditors must be paid first, then any unpaid interim distributions must be paid, then members are to receive first the amount of any unreturned contributions, and finally members share whatever is left in proportion to however they shared profits or interim distributions. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-894 (2011); TENN. CODE ANN. § 48-245-1101 (2012). Some states modify this slightly. Kentucky, for example, provides that both members and former members receive their contributions and then share in remaining profits at the same time (rather than treating former members as creditors). KY REV. STAT ANN. § 275.310 (LexisNexis 2012). While sources note that there are widespread differences in state statutes regarding dissolution, it also appears that this is a topic that has not received a great deal of attention in the academic literature. *See* Joan MacLeod Heminway, *The Death of an LLC: What's Trending in LLC Dissolution Law?*, BUS. L. TODAY 1, Jan. 2016, at 1.

C. *Reform Efforts and Further Movement Away from Uniformity*

Commentators have complained that "it is time to clean up the mess created by the proliferation of forms."[211] Ironically, many of those who are unhappy with the lack of uniformity and consistency are also advocating for new ideas or language, or even new forms of business at the same time.[212]

The ULC, in its on-going efforts to improve state LLC Acts and presumptively to aid in achieving a more uniform approach to business organization, is also making choices that seem counter-intuitive if uniformity is the objective.[213] For example, the ULC proposed the ULLCA in 1994, and

211. Larry E. Ribstein, *Making Sense of Entity Rationalization*, 58 BUS. LAW. 1023 (2003) (citing Thomas F. Blackwell, *The Revolution Is Here: The Promise of a Unified Business Entity Code*, 24 J. CORP. L. 333 (1999)). Other sources concerned about the increasingly complex array of organizational options include William H. Clark, Jr., *What the Business World Is Looking for in an Organizational Form: The Pennsylvania Experience*, 32 WAKE FOREST L. REV. 149 (1997); Robert R. Keatinge, *Universal Business Organization Legislation: Will It Happen? Why and When*, 23 DEL. J. CORP. L. 29 (1998); John H. Matheson & Brent A. Olson, *A Call for a Unified Business Organization Law*, 65 GEO. WASH. L. REV. 1 (1996); Dale A. Oesterle & Wayne M. Gazur, *What's in a Name?: An Argument for a Small Business "Limited Liability Entity" Statute (With Three Subsets of Default Rules)*, 32 WAKE FOREST L. REV. 101 (1997); Symposium, *Check-the-Box and Beyond: The Future of Limited Liability Entities,* 52 BUS. LAW. 605, 608 (1997); Daryl B. Robertson et al., *Introduction to Texas Business Organizations Code,* 38 TEX. J. BUS. L. 57 (2002).

212. *See, e.g.*, Oesterle & Gazur, *supra* note 211, at 124 (beginning by noting that most of the newer forms of business have lost their appeal, but then "proposes starting over with one form, the 'limited liability entity.'"). In examining the current landscape in Colorado, these authors count nine different organizational options, including the C and S corporations, the professional corporation and the cooperative, but call the "array of choices" a "false richness." *Id.* at 102.

213. One would presume that this is the intention of the ULC, which has on its home page the slogan "Diversity of Thought, Uniformity of Law." UNI. LAW COMM'N., http://www.uniformlaws.org (last visited Sept. 30, 2016). This home page also specifically claims to be working to bring "clarity and stability to critical areas of state statutory law." *Id.*

then adopted changes to that legislation in 1995 and 1996.[214] It has now produced revised and amended versions in 2006, 2011, and 2013.[215]

At the same time these amendments were being adopted by the Commissioners, they were also at work on a "Uniform Business Organizations Code," which was an effort to "integrate" the "uniform" acts governing general partnerships (and LLPs), limited partnerships (and LLLPs), and LLCs, along with cooperatives, non-profit associations, and statutory trusts, as well as certain model acts designed to govern certain aspects of business organizations law such as the model registered agents act and model entity transactions act.[216] This was an effort to create a "hub and spokes" statute modeled along the same lines as the Uniform Commercial Code.[217] Despite claims by the drafters that "[e]nacting the Code is not difficult," to date only two states have enacted significant portions of the statute.[218]

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214. *See* UNIF. LTD. LIAB. CO. ACT (amended 2013), Prefatory Note, 6B U.L.A. 54 (2008 & Supp. 2016) (noting that the ULLCA "was conceived in 1992 and first adopted by the Conference in 1994."). In 1995, ULLCA was amended to add full shield protection against personal liability; in 1996 the amendments were designed to react to the anticipated changes to the federal tax rules. *Id.* at 55-56. The 2006 amendments made a number of substantive changes to the Act, changing its approach to the operating agreement, fiduciary duties, pre-filing of the certificate of organization, power of members and managers to bind the business, default management structures, charging orders, remedies for oppressive conduct, derivative claims and restructuring of the business through mergers, conversions and domestications. *Id.* at 55. According to the ULC, in the last ten years, no states have acted on the pre-2006 versions of the ULLCA. *See* UNI. LAW COMM'N, *Legislation*, http://www.uniformlaws.org/Legislation.aspx?title=Limited+Liability+Company+(1995)(1996) (last visited May 1, 2016). The 2006 version of the act is noted as having been "superseded by the Revised Uniform Limited Liability Company Act (2006)" in the Committee notes. UNI. LAW COMM'N, *Committees*, http://www.uniformlaws.org/Committee.aspx?title=Limited%20Liability%20Company%20(1995)(1996) (last visited May 1, 2016).

215. The 2011 and 2013 amendments were designed to harmonize unincorporated business law, by removing "shelf-registration," redefining the fiduciary duties (again), and adopting some special rules for single-member LLCs. UNIF. LTD. LIAB. CO. ACT Prefatory Note to 2011 and 2013 Harmonization Amendments (amended 2013), 6B U.L.A. 58 (2008 & Supp. 2016).

216. UNIF. BUS. LIAB. ORG. CODE Prefatory Note, 6 U.L.A. 3 (2015). The note also indicates that the drafters contemplate the inclusion of the MBCA and Model Nonprofit Corporation Act into the statute, but that depends on work from the American Bar Association Business Law Section.

217. *Id.*

218. Two states have adopted the "hub" or general portions of the Uniform Business Organizations Code. IDAHO CODE ANN. §§ 30-21-101 to -901 (2009 & Supp. 2016); WASH. REV. CODE ANN. §§ 23.95.100 to .715 (West 2013). In addition, in 2014, Pennsylvania amended a few of its Associations Code provisions, modeling the new language after parts of the UBOC. *See* 15 PA. STAT. AND CONS. STAT. ANN. § 113, comts. & notes (West 2013 & Supp. 2015) ("Subsections (a) and (b) are patterned after Uniform Business Organizations Code (2011) (Last Amended 2013) § 1-104. Subsection (c) is patterned after Uniform Business Organizations Code (2011) (Last Amended 2013) § 1-212."); *see also* 15 PA. STAT. AND CONS. STAT. ANN. §§ 102, 202, 136, 141-43, 145, 402, 403, 411-19 (West 2013 & Supp. 2015).

In fact, despite all these amendments to the uniform acts and untold hours of labor by the reporters and commissioners, there does not seem to have been a notable increase in uniformity among state LLC Acts. Nor is there widespread agreement among commentators on the "best" language or approach for LLC statutes to take with regard to any number of issues. For example, consider the question of how LLC statutes "should" address the question of fiduciary duties for those with management responsibilities.

The ULLCA (2013) has adopted language that "follows the structure of many LLC acts."[219] It specifically and intentionally deviates from earlier uniform acts by eschewing the attempt to state all managerial duties.[220] The comment to this section takes up more than four pages of the supplement in which it appears, and seeks to explain the language in and intent behind each subsection in the provision.[221] Some of the numerous changes from the earlier versions of the uniform act are intended to bring the provision into line with the Restatement (Third) of Agency,[222] and some are intended to harmonize the language of this act with the uniform partnership statutes.[223] In other places, the effort was to codify or respond to judge-made law generally applicable to business entities.[224] Under these provisions, in a member-managed LLC, a member has a fiduciary duty of loyalty to account to the company as a trustee for the use of certain property of the LLC, to refrain from acting as or on behalf of an adverse party and to refrain from competing with the company prior to its dissolution.[225] There is also a duty of care to refrain from "engaging in grossly negligent of reckless conduct, willful or intentional misconduct, or knowing violation of law."[226] In addition, such a member "shall discharge the duties and obligations under this [act] or under the operating agreement and exercise any rights consistently with the contractual obligation of good faith and fair dealing."[227] These are not identified as the "only" duties owed, and are supplemented by

219. UNIF. LTD. LIAB. CO. ACT § 409 cmt. (amended 2013), 6B U.L.A. 142 (2008 & Supp. 2016) (observing that the section first states the duties in a member-managed company and then uses a "'switching' mechanism" to allocate them in a manager-managed entity).

220. *Id.*

221. *Id.* at 142-46.

222. *See, e.g.*, UNIF. LTD. LIAB. CO. ACT § 409 cmt.(c) (amended 2013), 6B U.L.A. 148 (2008 & Supp. 2016) (stating the decision to stop referring to the "duty of care" as being fiduciary in character, in line with the RESTATEMENT (THIRD) OF AGENCY § 8.02 (2006)).

223. *See, e.g.*, *id.* (noting that the substance of the duty of care was "conformed to the duty of care stated in ULPA (2001) and UPA (1997).").

224. *See, e.g.*, *id.* § 409 cmt.(g) at 145-46 (noting judge-made law allowing "fairness" to be raised as a defense to actions brought alleging a violation of the duty of loyalty).

225. *Id.* § 409(b) at 141.

226. *Id.* § 409(c). This is very carefully not termed a "fiduciary" obligation.

227. *Id.* § 409(d).

provisions allowing members to also act for their own benefit, to obtain ratification for acts that would otherwise violate the standards, and to raise fairness as a defense to any allegation that an action violates the duty of loyalty.[228] These standards may be modified or even eliminated so long as the changes are not "manifestly unreasonable."[229] In a manager-managed LLC, these obligations are "switched" to the manager.[230]

This represents a striking change from the 2006 version of ULLCA, which described the duty of care as being fiduciary in nature, and utilized the business judgment rule to help set the parameters for the default obligations under the statute:

> Subject to the business judgment rule, the duty of care of a member of a member-managed limited liability company in the conduct and winding up of the company's activities is to act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member reasonably believes to be in the best interests of the company. In discharging this duty, a member may rely in good faith upon opinions, reports, statements, or other information provided by another person that the member reasonably believes is a competent and reliable source for the information.[231]

That version of the statute also included the ability to restrict or eliminate this duty, so long as the agreement doing so was not "manifestly unreasonable."[232]

The fiduciary duty provisions in the 2006 version of the ULLCA had been vigorously criticized, as being misdirected, inefficient, convoluted, and profoundly unfair.[233] Nonetheless, it is in effect in ten states and the District

228. *Id.* §§ 409(e)-(g).

229. UNIF. LTD. LIAB. CO. ACT § 105(c)(6) (amended 2013), 6B U.L.A. 73 (2008 & Supp. 2016) (allowing the operating agreement to prescribes standards by which the obligation of good faith and fair dealing is to be judges, if not "manifestly unreasonable."); *id.* § 405(d)(3), at 74 (allowing alteration or elimination of aspects of the duty of loyalty and any other fiduciary duty, so long as not "manifestly unreasonable.").

230. *Id.* § 409(i) at 134.

231. UNIF. LTD. LIAB. CO. ACT § 409, 6B U.L.A 488 (2008).

232. *Id.* § 110(d) at 443.

233. "This overlaying of the 'business judgment rule' on RULLCA's negligence standard of care will be confusing to LLC parties and to courts, which in turn will increase transaction costs and the probability of unexpected and unintended outcomes. Even more importantly, the adoption of a business judgment standard will reduce managers' standard of care to a level that is even more lax and inefficient than the present gross negligence standard that one finds in RUPA, ULPA (2001), and ULLCA." Rutheford B. Campbell, Jr., *The "New" Fiduciary Standards Under the Revised Uniform Limited Liability Company Act: More Bottom Bumping from NCCUS*L, 61 ME. L. REV. 27, 30 (2009). This article also criticizes the fiduciary provisions as being "inefficiently lax and limited," with opt-out provisions that do not facilitate informed bargaining between different constituencies in the closely held enterprise context. *Id.* at 29-30. In fact, some commentators

of Columbia.[234] The earliest version of ULLCA (1996) is also in effect in a handful of jurisdictions,[235] and it, too, has fiduciary duty provisions that have been poorly regarded by at least some commentators.[236] A few commentators urged state legislatures not to adopt the 2006 version of the uniform act because of perceived flaws in the approaches taken by the ULC.[237]

The other model statute that has been proposed is the Prototype LLC Act. A draft prototype act was originally the work product of the Committee on Partnerships and Unincorporated Business Organizations of the American Bar Association Section of Business Law, which began work at the spring 1991 meeting of the committee.[238] A draft of this product was released on November 19, 1992, with the hope that is could serve as a drafting tool.[239] Versions or portions of the draft prototype LLC act were the basis for the

criticized the entire work product. *See, e.g.*, Larry E. Ribstein, *An Analysis of the Revised Uniform Limited Liability Company Act*, 3 VA. L. & BUS. REV. 35, 39 (2008) ("RULLCA imposes enough risks on limited liability companies that state legislators should hesitate to adopt it, and lawyers should consider carefully the pitfalls of advising clients to form LLCs under RULLCA.").

234. The list of jurisdictions where the act has been adopted and is in effect includes Alabama, California Florida, Iowa, Minnesota, Nebraska, New Jersey, South Dakota and Wyoming, in addition to the District of Columbia. The most recent print supplement also includes Idaho, which has now replaced this version of the statute with the 2013 version. *See* UNIF. LTD. LIAB. CO. ACT Table of Jurisdictions Wherein Act Has Been Adopted, 6B U.L.A. 227 (2008 & Supp. 2016).

235. Hawaii, Illinois, Montana, South Carolina and West Virginia are listed as having adopted ULLCA (1996); all of these states having acted in 1996 or 1997. UNI. LAW COMM'N Table of Jurisdictions Wherein Act Has Been Adopted, 6B U.L.A. 227 (2008 & Supp. 2016).)

236. Others also criticized the fiduciary duty provisions of ULLCA, though some ascribed the weaknesses in the Act to other causes. *See, e.g.*, Rutheford B. Campbell, Jr., *Bumping Along the Bottom: Abandoned Principles and Failed Fiduciary Standards in Uniform Partnership and LLC Statutes*, 96 K.Y. L.J. 163, 189-90 (2007-2008); *see also* Larry E. Ribstein, *A Critique of the Uniform Limited Liability Company Act*, 25 STETSON L. REV. 311, 387 (1995) (criticizing ULLCA for incorporating "rules that are inappropriately borrowed from other business forms.").

237. Professor Ribstein, for example, blamed the "dismal failure" of ULLCA (2006) on the fact that "RULLCA was poorly designed to meet firms' needs." Ribstein, *supra* note 233, at 37. He complained that the original uniform act was "not even a suitable model for future LLC legislation. [It] . . . makes many poor policy choices, including terms that are unsuited for informal firms, unnecessary mandatory rules, and rules that are inappropriately borrowed from other business forms. The drafting is often convoluted, complex and otherwise inept." *Id.* Even commentators whose concerns were more limited sometimes advocated adoption of amendments to "fix the problems created by NCCUSL" during the enactment process. Campbell, *supra* note 233, at 53. Many of this issues were specifically considered during the process that led to the promulgation of the current act, which clearly represents the best thinking of a number of experts on the most important issues affecting LLCs.

238. RIBSTEIN & KEATINGE, *supra* note 89, at § 1:7. The committee has since been renamed and is now the "LLCs, Partnerships and Unincorporated Entities Committee."

239. *Id.*

original versions of the Arkansas, Idaho, Indiana, Louisiana, Kentucky, and Montana LLC acts.[240]

Without exception, these states have had multiple issues with the legislation modeled on the original prototype LLC Act. Arkansas has had to amend parts of its statute multiple times in order to address some of the more pressing issues created by the state's reliance on the draft prototype act.[241] Idaho repealed its statute in 2008.[242] Indiana has had to rewrite significant portions of its act to make it better fit the needs of businesses in the state.[243] Kentucky has also needed to substantially revise its LLC statute since it was originally enacted in 1994.[244] Louisiana has amended its act multiple times, as well.[245] Portions of the Montana Act dealing with rights and duties of members, distributions, ownership and transfer of property, admission of members (along with several other sections) were all repealed in 1999,[246] and

240. *Id*. Professor Ribstein added South Carolina to the list. Larry E. Ribstein & Bruce H. Kobayashi, *Uniform Laws, Model Laws and Limited Liability Companies*, 66 U. COLO. L. REV. 947, 984 n.239 (1995). However, since the comment to that statute credits primarily the ULLCA and various other uniform acts, this article does not treat this as a statute "based on" the prototype act. *Id*.

241. *See, e.g.*, S. 479, 81st Gen. Assemb., Reg. Sess. (Ark. 1997); S. 1582, 82nd Gen. Assemb., Reg. Sess. (Ark. 1999); H.R. 1395, 83rd Gen. Assemb., Reg. Sess. (Ark. 2001); H.R. 2392, 86th Gen. Assemb., Reg. Sess. (Ark. 2007); S. 972, 87th Gen. Assemb., Reg. Sess. (Ark. 2009). Commentators have also raised ongoing concerns about the Arkansas act. *See* Carol Goforth, *The Arkansas Limited Liability Company: A Call for Clarification*, 1994 ARK. L. NOTES 19; Mary Elizabeth Matthews, *The Arkansas Limited Liability Company: A New Business Entity Is Born*, 46 K 791, 820 (1994); C. Timothy Spainhour, *Limited Liability Companies in Arkansas: The Knowns and Unknowns*, 16 U.A.L.R. L.J. 27 (1994).

242. Law of 1993, ch. 224, §1, repealed by Idaho S.L. 2008, ch. 176, § 5 (2010).

243. For example, the agency powers of members and managers was significantly revised in 1999. IND. CODE. ANN. § 23-18-2-1 (1993), *amended by* Pub. L. No. 269, §1 (1999). A section dealing with officers, as providing in operating agreements, was added in 2013 and then amended in 2014. IND. CODE ANN. § 23-18-3-2.5 (2013), *amended by* Ind. Pub. L. 63, § 30 (2014). Provisions relating to dissociation of members were amended in 1999 and 2006. IND. CODE ANN. § 23-18-5-5 (1993), *amended by* Ind. Pub. L. 269, §4 (1999); IND. CODE ANN. §23-18-5-5.1 (1999), *amended by* Ind. Pub. L. 40, § 7 (2013).

244. For example, a number of provisions in the Kentucky Act were amended in 1998, 2010, 2011, and 2012. Act of Apr. 7, 1998, ch. 341, 1998 Ky. Acts 1161; Act of Mar. 30, 2010, ch. 51, 2010 Ky. Acts 1261; Act of Apr. 13, 2010, ch. 151, 2010 Ky. Acts 2029; Act of Mar. 15, 2011, ch. 29, 2011 Ky. Acts 115; Act of Apr. 11, 2012, ch. 81, 2012 Ky. Acts 741.

245. The Louisiana LLC Act was originally enacted in 1992. Act of July 27, 1992, No. 780, ch. 22, 1992 La. Acts 2083, 2099-2153. The statute has since been amended numerous times, including by Act of July 9, 1993, No. 475, 1993 La. Acts 1177; Act of July 12, 1999, No. 1253, 1999 La. Acts 3301; Act of June 29, 2001, No. 1186, 2001 La. Acts 2641; Act of June 18, 2003, No. 361, 2003 La. Acts 1692; Act of June 18, 2003, No. 367, 2003 La. Acts 1699; Act of June 21, 2010, No. 417, 2010 La. Acts 1801.

246. *E.g.*, MONT. CODE ANN. §§ 35-8-401 to 35-8-404, repealed by Mont. Laws of 1999, ch. 302, § 56.

other sections had to be amended or repealed in 2007,[247] 2011,[248] and 2013.[249] In addition, the Montana legislature has also consciously attempted to move forward with the ULLCA in this process, stating that "[t]he adoption of ULLCA will provide much needed consistency among the States, with flexible default rules, and multistate recognition of limited liability on the part of company owners. It will also promote the development of precedential case law."[250]

Clearly, the original Prototype LLC Act was not meant to be a final product, and in fact had been utilized by these states while it was only in draft form. It is not surprising, then, that many amendments and adjustments have had to be made. On May 1, 2011, the ABA Committee on Partnerships and Unincorporated Business Organizations, now renamed the Committee on LLCs, Partnerships and Unincorporated Entities of the ABA Section of Business Law, through its Subcommittee on Limited Liability Companies, released a Revised Prototype LLC Act.[251] Moreover, at least one of the principals in the drafting process has commented that prototype act 'is an ongoing project and will be updated from time to time as developments warrant.[252] Because the few states originally relied on the draft version of the prototype act generally had a less than satisfactory experience with the statutory language, and because the "revised" prototype act is promised as an on-going work in progress, it certainly seems unlikely that it will produce significant uniformity among the states.

It is doubtless true that the ULLCA (2013) is not a perfect statute either, with or without the hub-and-spokes structure proposed by the Commissioners as part of UBOC. It is, however, clear that many of the benefits of the LLC format will not be, and realistically cannot be, realized unless and until there is some consistency and constancy with regard to the statutory language among and between the states.[253] Moreover, the more uniform the rules are, the faster that statutory ambiguities can be resolved and the less expensive it

247. *E.g.*, MONT. CODE ANN. §§ 35-8-911, 35-8-1103, *repealed by* Mont. Laws of 2007, ch. 240, §§ 68, 70; MONT. CODE ANN. § 35-8-1103, *repealed by* MONT. LAWS 2007, ch. 240, §§ 68, 70.

248. *E.g.*, MONT. CODE ANN. § 35-8-210, *repealed by* Mont. Laws of 2011, ch. 26, § 36.

249. *E.g.*, MONT. CODE ANN. § 35-8-804 (1999), *amended by* Mont. Laws, ch. 183, § 11 (2013).

250. MONT. CODE ANN. tit. 35, ch. 8, Refs & Annos.

251. RIBSTEIN & KEATINGE, *supra* note 89, at § 1:7. The Revised Prototype LLC Act may be found in Appendix G of Volume 3 of this treatise.

252. RIBSTEIN & KEATINGE, *supra* note 89, at § 1:7.

253. Ribstein & Kobayashi, *supra* note 240, at 947-48 (asserting that "despite their apparent chaos, LLC statutes already have become uniform without NCCUSL's prodding on issues for which uniformity is important.").

will become to obtain reasonable legal advice in connection with creating appropriate documentation for smaller businesses.

Consider the reasons advanced earlier about why close corporation statutes have failed to attract closely held firms:[254] Despite ostensibly being drafted with the needs of smaller businesses in mind, few companies have chosen to become statutory close corporations. This may be because the close corporation statutes offered few benefits that were not available with careful planning under traditional corporate statutes, but more likely was because the benefits were not fully appreciated, too uncertain and risky, or too expensive to fully investigate.[255] However, the more widely language is used, applied and interpreted, the less risky it becomes and therefore more attractive to investors. In addition, the more familiar the rules become, and the better they are understood, working with them becomes less expensive and time-consuming for attorneys, as well as for entrepreneurs and investors.

This article does not advocate for different rules or approaches apart from those now taken by the ULC in the ULLCA (2013). It does not seek to identify where the current version of the ULLCA has improved on prior drafts, or where it could be improved in the future. It certainly does not attempt to illustrate any failures in drafting or where states should make adjustments. What it does do is attempt to demonstrate that while we continue to experiment and revise, innovate and correct, on an on-going and constant basis, we can never realistically hope to achieve uniformity. Perhaps perfect uniformity is not even desirable, but a common framework and general understanding, and a consistent approach to major issues could go a long way to making the LLC a truly user-friendly form of business, rather than being one that a number of attorneys and clients shy away from because the statutes provide rules that shift so rapidly it can be like building on quicksand.

The first thing that probably has to happen is that the ULC has to stop working on substantive revisions to its Uniform Act. States have to be given time to catch up. If one looks at various unincorporated business statutes drafted by the ULC, aside from the rapidly moving ULLCA, it is clear that

254. *See supra* notes 115-47 and accompanying text.

255. *Id.* For a discussion of the impact of the draft prototype LLC Act, see Ribstein & Kobayashi, *supra* note 240, at 984. Professor Ribstein, an outspoken critic of the ULC, argued that the prototype act was as good as the Uniform statute at achieving uniformity, pointing to the fact that Idaho, Arkansas, Montana, and South Carolina had relied on the prototype legislation in their drafting process. Ribstein & Kobayashi, *supra* note 240, at 984. He ignores the fact that at the time these state statutes were enacted that the ULLCA (1994) had not yet been promulgated, so of course it could not have been used as a model. Ribsteian and Kobayashi do acknowledge that the South Carolina Act "explicitly acknowledges that it was derived in part from the PLLCA, as well as from the July 30, 1993 draft of ULLCA." *Id.* at 984 n.135.

state legislatures are generally willing to defer to the substantial expertise and experience of the drafters of the uniform statutes.[256] It is, however, a lot to ask of states to expect them to continuously update and revise their business statutes, and in fact, it is almost certainly unrealistic to expect them to do so.

Instead, if we could settle on a less-then-perfect but far-better-than-chaos alternative, and allow states to enact the legislation over time, we have a realistic possibility of achieving a reasonable proximity of uniformity, with the concomitant benefits of greater understanding, simplicity and ease of use.

V. RECOMMENDATIONS FOR THE FUTURE

The essence of this article is that there have been tremendous changes in the past few years with regard to business alternatives available to closely held enterprises. In fact, there have been so many changes that we are left with a chaotic mix of statutes with a limited number of common attributes (other than the common name of "limited liability company"). To make the LLC a truly economical alternative, with easily obtainable, competent legal assistance, we need to take some time to get used to a common framework. The ULLCA (2013) seems to offer the best hope for this, and if widely adopted could essentially create enough of a network of commonly understood approaches such that the form of business really could be efficient for a wide range of businesses.

Consider the effect of the vast array of conflicting LLC provisions on model forms at the current time. Even a brief foray into the world of online documentation suggests that the plethora of rules and policies, as well as the rapid changes faced by business when LLC statutes are amended repeatedly in a short period of time, have led attorneys to create monstrously lengthy and convoluted documents capable of resolving operational issues that could and should be simply understood without the need for lengthy draft-arounds. Many of these forms are thousands of words long and contain more than a dozen discrete sections, many with multiple subsections.[257] It is no wonder

256. Campbell, *supra* note 233, at 31 (citing widespread adoption of general and limited partnership statutes).

257. *See, e.g.*, ALAN S. GUTTERMAN, BUSINESS TRANSACTION SOLUTIONS § 60:233, Westlaw (database updated September 2016) (27 defined terms, 15 sections almost all of which with multiple subsections, more than 8,000 words long); LISA C. THOMPSON, ARIZONA LEGAL FORMS §§ 7:4.50, 7:6 (3d ed. 2007) (more than 750 words); *id.* at § 7:6 (more than 13,000 words); *see also* 2B ROBERT J. HAFT ET. AL., VENTURE CAPITAL AND SMALL BUSINESS FINANCES § 20:9 (2012) (offering a document containing 10 separate sections with multiple subparts, and more than 14,800 words, although several provisions are drafted in the alternative to cover different operational choices). A sample Florida Operating Agreement that is over 18,000 words in length is reprinted by the same authors, with permission. *Id.* at § 20:5. Billed as a bare-bones "short-form," an operating agreement prepared by Mark A. Sargent and Walter D. Schwidetzky contains more than 600 words. MARK A.

that business people choose to eschew complicating their business with documents of this length and complexity, and not surprising that many attorneys are less than eager to spend the time needed to "get up to speed" on the new business forms. This could all change if states were given some time to catch up, and a common understanding of the LLC was allowed to develop.

SARGENT & WALTER D. SCHWIDETZKY, LIMITED LIABILITY COMPANY HANDBOOK § 8.6 (2015). Their Member-Managed Operating Agreement is 25 single-spaced pages long, plus exhibits. *Id*. at § 8.9. The authors characterize this document as being suitable for "relatively small and straightforward ventures." *Id*. at § 8.8. The Manager-Managed Operating Agreement is 28 single-spaced pages long, plus exhibits. *Id*. at § 8.12. Even checklists can be incredibly convoluted. *See Drafting a Limited Liability Company Operating Agreement*, MOD. CORP. CHECKLISTS § 23:4 (database updated November 2015) (a checklist of 12 questions); *see also* CLIFFORD R. ENNICO, CLOSELY HELD CORPORATIONS § 16:7 (2011) (providing the same list of questions found in Drafting a Limited Liability Company Operating Agreement).