ARTICLES

TREATMENT OF MEMBERS UPON THEIR DEATH AND WITHDRAWAL FROM A LIMITED LIABILITY COMPANY: THE CASE FOR A UNIFORM PARADIGM

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Continuing an international trend,[1] Wyoming initiated a national movement in 1977 by adopting the first limited liability company act in the United States.[2] The movement began slowly,[3] as the Internal Revenue Service (Service) took more than ten years to announce that a Wyoming limited liability company would be taxed like a partnership.[4] Since that time, a total of forty-seven states and

1. *See* CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 1.01[1] n.1 (1994).

2. 1977 Wyo. Sess. Laws 158 (codified as amended at WYO. STAT. §§ 17-15-101 to -143 (1989 & Supp. 1995)).

3. Florida adopted similar legislation in 1982. 1982 Fla. Laws ch. 177 (codified as amended at FLA. STAT. §§ 608.401–.514 (1993)).

4. Rev. Rul. 88-76, 1988-2 C.B. 360. The ruling was issued only after a difficult beginning for limited liability companies. The Service initially expressed confusion regarding the tax classification of Wyoming limited liability companies as partnerships or corporations. *Compare* Priv. Ltr. Rul. 81-06-082 (Nov. 18, 1980) (partnership) *with* Gen. Couns. Mem. 38,281 (Feb. 15, 1980) (corporation). At the same time, an amendment was proposed to the tax classification regulations that would have classified all unincorporated organizations with owner limited liability as corporations. Prop. Treas. Reg. § 301.7701-2, 45 Fed. Reg. 75,709 (1980). Before the amendment was withdrawn in 1983, *see* 48 Fed. Reg. 14,389 (1983), the Service determined that a Florida limited liability company was classified as a corporation. Priv. Ltr. Rul. 83-04-138 (Oct. 29, 1982). Following the withdrawal of the proposed regulation amendment, the Service launched a study to determine how unincorporated organizations with owner limited liability should

the District of Columbia adopted limited liability company legislation[5] and the National Conference of Commissioners on Uniform State Laws (Conference) adopted the Uniform Limited Liability Company Act (ULLCA).[6]

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be classified. Announcement 83-4, 1983-2 I.R.B. 31. The study concluded that an unincorporated organization should not be classified as a corporation merely because it possessed the corporate limited liability characteristic. Announcement 88-118, 1988-38 I.R.B. 26. The Service released Revenue Ruling 88-76 as part of the conclusion of the study. Since then, the Service has released numerous private letter rulings and 17 additional revenue rulings all classifying limited liability companies as partnerships. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶¶ 2.03[1], 2.12 (Table 2.1); *see also infra* note 17.

5. State enactments in 1990 include: COLO. REV. STAT. ANN. §§ 7-80-101 to -913 (West Supp. 1994) and KAN. STAT. ANN. §§ 17-7601 to -7651 (Supp. 1993). State enactments in 1991 include: NEV. REV. STAT. ANN. §§ 86.010–.571 (Michie 1994); TEX. REV. CIV. STAT. ANN. Art. 1528n, arts. 1.01–11.07 (West Supp. 1995); UTAH CODE ANN. §§ 48-2b-101 to -158 (1994 & Supp. 1994); and VA. CODE ANN. §§ 13.1-1000 to -1123 (Michie 1993 & Supp. 1995). State enactments in 1992 include: ARIZ. REV. STAT. ANN. §§ 29-601 to -857 (Supp. 1994); DEL. CODE ANN. tit. 6, §§ 18-101 to -1107 (1993); ILL. ANN. STAT. ch. 805, para. 180 (Smith-Hurd Supp. 1995); IOWA CODE ANN. §§ 490A.100–.1601 (West Supp. 1995); LA. REV. STAT. ANN. §§ 12:1301–:1369 (West 1994); MD. CODE ANN., CORPS. & ASS'NS §§ 4A-101 to -1103 (1993 & Supp. 1994); MINN. STAT. ANN. §§ 322B.01–.960 (West 1995); OKLA. STAT. ANN. tit. 18, §§ 2000–2060 (West Supp. 1995); R.I. GEN. LAWS §§ 7-16-1 to -75 (1992 & Supp. 1994); and W. VA. CODE §§ 31-1A-1 to -69 (Supp. 1994). State enactments in 1993 include: ALA. CODE §§ 10-12-1 to -61 (Supp. 1993); ARK. CODE ANN. §§ 4-32-101 to -1314 (Michie Supp. 1993); CONN. GEN. STAT. ANN. §§ 34-100 to -242 (West Supp. 1995); GA. CODE ANN. §§ 14-11-100 to -1109 (1994 & Supp. 1995); IDAHO CODE §§ 53-601 to -672 (1994 & Supp. 1995); IND. CODE ANN. §§ 23-18-1-1 to -13-1 (West 1994 & Supp. 1994); MICH. COMP. LAWS ANN. §§ 450.4101–.5200 (West Supp. 1995); MO. ANN. STAT. §§ 347.010–.187 (Vernon Supp. 1995); MONT. CODE ANN. §§ 35-8-101 to -1307 (1994); NEB. REV. STAT. §§ 21-2601 to -2653 (Supp. 1994); N.H. REV. STAT. §§ 304-C:1 to :85, 421-B:17 (Supp. 1994); N.J. STAT. ANN. §§ 42:2B-1 to -70 (West Supp. 1995); N.M. STAT. ANN. §§ 53-19-1 to -74 (Michie Supp. 1994); N.C. GEN. STAT. §§ 57C-1-01 to -10-07 (1993 & Supp. 1994); N.D. CENT. CODE §§ 10-32-01 to -155 (Supp. 1993); OR. REV. STAT. ANN. §§ 63.001–.990 (Supp. 1994); S.D. CODIFIED LAWS ANN. §§ 47-34-1 to -59 (Supp. 1995); WIS. STAT. ANN. §§ 183.0102–.1305 (West Supp. 1994). State enactments in 1994 include: ALASKA STAT. §§ 10.50.010–.995 (Supp. 1994); CAL. CORP. CODE §§ 17000–17705 (West Supp. 1995); D.C. CODE ANN. §§ 29-1301 to -1378 (Supp. 1995); KY. REV. STAT. ANN. §§ 275.001–.455 (Michie/Bobbs-Merrill Supp. 1994); ME. REV. STAT. ANN. tit. 31, §§ 601–762 (West Supp. 1994); MISS. CODE ANN. §§ 79-29-101 to -1201 (Supp. 1994); N.Y. LTD. LIAB. CO. LAW §§ 101–1403 (McKinney Supp. 1995); OHIO REV. CODE ANN. §§ 1705.01–.58 (Anderson Supp. 1994); 15 PA. CONS. STAT. ANN. §§ 8901–9507 (Supp. 1995); S.C. CODE ANN. §§ 33-43-101 to -1409 (Supp. 1995); TENN. CODE ANN. §§ 48-246-101 to -602, 48-248-101 to -606 (Supp. 1994) and WASH. REV. CODE ANN. §§ 25.15.005–.902 (West Supp. 1995). At the end of August, 1995, only Hawaii, Massachusetts and Vermont had not adopted limited liability company legislation.

6. The UNIF. LTD. LIAB. CO. ACT (1994), *reprinted in* 25 STETSON L. REV. 463 (1995), was adopted by the Conference at its annual meeting in Chicago, Illinois, in August 1994. Because of a subsequent change in federal tax law, the Conference's Executive Committee adopted an amendment to section 801 of the Act in January 1995. *See* Rev. Proc. 95-10, § 5.01(1), 1995-3 I.R.B. 20, 23. The ULLCA amendment provides that

The allure of the limited liability company is a unique statutory structure that combines the two most critical features of all of the other business organizations in a single business organization — a corporate-styled liability shield and the pass-through tax benefits of a partnership.[7] General and limited partnerships do not extend their partners a corporate-styled liability shield.[8] Corporations, including those having made a Subchapter S election, do not provide their shareholders all the pass-through tax benefits of a partnership.[9] All

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only specified dissociations of a member who is also a manager of manager-managed at-will and term limited liability companies threaten dissolution of the organization. *See* ULLCA § 801(b)(3). The amendment will encourage the formation of manager-managed limited liability companies (and new management elections by member-managed companies) because they are now more stable business entities than member-managed companies. Generally, in order for a limited liability company to be characterized as manager-managed, members who are not also managers must lack contractual authority to bind the company as agents in their capacity as members. *See* Treas. Reg. § 301.7701-2(c)(4) (as amended in 1993). The structure of many state limited liability company acts may impede this development because of the lack of clear statutory rules regarding the situs of apparent agency power in member-managed and manager-managed companies. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶¶ 7.06[2][b][v] to [vi].

7. Other partnership tax benefits are also applicable to limited liability companies. For example, general partners are subject to a self-employment tax on their distributive share of partnership income or loss while limited partners normally are not. Subject to special qualifications, non-managing members of manager-managed companies are not subject to the tax while all other members of member-managed and manager-managed companies are subject to the tax. For a complete discussion, see BISHOP & KLEINBERGER, *supra* note 1, ¶¶ 1.04[2], 12.04[4], and Current Events (First Supplement); Robert R. Keatinge & Risa L. Wolf-Smith, *Proposed Self-Employment Tax Regulations Enhance the Use of LLCs*, 1 J. LTD. LIAB. COS. 170 (1995).

8. Under the REVISED UNIF. PARTNERSHIP ACT (1994) (RUPA), 6 U.L.A. 280 (Supp. 1995), general partners are jointly and severally liable for all obligations of a general partnership. RUPA § 306. Under the REVISED UNIF. LTD. PARTNERSHIP ACT (1985) (RULPA), 6 U.L.A. 407 (Supp. 1995), limited partners are not liable for obligations of a limited partnership unless they participate in the control of the business, but general partners remain personally liable for the obligations as if the partnership were a general partnership. RULPA §§ 303, 403(b). Control-based liability of a limited partner must not be based solely on conduct that is within defined "protected" categories of behavior. Also, liability must be based on a reasonable belief that a limited partner is a general partner. Together, these two limitations severely curtail, but do not eliminate, control-based liability of a limited partner. *See* ALAN R. BROMBERG & LARRY E. RIBSTEIN, PARTNERSHIP § 15.14(i)–(k) (1988). Because of the severity, complexity, and confusion regarding these limitations, Georgia has statutorily eliminated limited partner control-based liability entirely. GA. CODE ANN. § 14-9-303 (1994).

9. Regular corporations are generally subject to double taxation on their earnings — at the corporate level when earned and at the shareholder level when distributed in the form of a dividend. A Subchapter S election mitigates this effect by avoiding the corporate level tax by taxing the corporate earnings to shareholders when earned. However, the Subchapter S election is available only to certain defined small business corpo-

state limited liability company acts contain provisions to assure the presence of a corporate-like liability shield and partnership tax status.[10] Generally, a limited liability company will be taxed like a partnership unless it possesses three or more[11] of the four corporate characteristics including continuity of life,[12] centralized management,[13] limited liability,[14] and free transferability of interests.[15] Since most limited liability companies possess limited liability,[16]

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rations and does not offer all the advantages of partnership tax advantages. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶¶ 4.01–.16. The Service has recommended that Congress consider a new Subchapter S tax system that would eliminate most, if not all, of these differences. *See The Treasury Proposes a New Approach to Helping S Corporations*, WALL ST. J., July 26, 1995, at A1.

10. Many first generation state acts were designed to assure that partnership tax classification was "bullet proof" for limited liability companies organized under those statutes. This system eliminated drafting flexibility with regard to the critical corporate characteristics of free transferability of interests and continuity of life. Members could not alter this outcome by private agreement. A limited liability company formed under such statutes lacked (1) free transferability of interests because a transferee of a member's membership interest could not be admitted as a member without the consent of all the remaining members, and (2) continuity of life because the dissociation of a member caused the dissolution of the company unless all the remaining members agreed, within 90 days after the dissociation, to continue the business of the company. *See, e.g.*, COLO. REV. STAT. ANN. § 7-80-702(1) (West Supp. 1994) (transferability); WYO. STAT. § 17-15-123(a)(iii) (1989) (dissolution). However, newer state acts permit flexibility on all corporate characteristics. A limited liability company formed under such statutes may lack: (1) free transferability of interests because a transferee of a member's membership interest may not be admitted as a member without the consent of a "majority in interest" of the remaining members; (2) continuity of life because the dissociation of a member will cause the dissolution of the company only if a "majority in interest" of all the remaining members agree, within 90 days after the dissociation, to continue the business of the company; (3) centralized management because the members possess the apparent authority to bind the company; and (4) limited liability because at least one member is personally liable for the obligations of the company simply in the capacity as a member. *See, e.g.*, N.Y. LTD. LIAB. CO. LAW §§ 604(a) (transferability), 701(d)(2) (dissolution), 412(a) (management), 609(b) (liability shield) (McKinney Supp. 1995). See also *infra* note 52 for a discussion of the majority in interest terms.

11. Treas. Reg. § 301.7701-2(a)(3) (as amended in 1993).

12. *Id*. § 301.7701-2(b).

13. *Id*. § 301.7701-2(c).

14. *Id*. § 301.7701-2(d).

15. *Id*. § 301.7701-2(e).

16. A limited liability company ordinarily possesses the corporate characteristic of limited liability because, as with a corporation, its members are not personally liable for the company's debts and obligations merely because they are the owners of the company. *See* Treas. Reg. § 301.7701-2(d)(1) (as amended in 1993); *see also* BISHOP & KLEINBERGER, *supra* note 1, ¶ 2.04[2]. However, the release of Rev. Proc. 95-10, 1995-3 I.R.B. 20, may alter this landscape. Section 5.04 of Revenue Procedure 95-10 provides that a manager-managed limited liability company lacks limited liability when at least

they are classified as partnerships because they lack at least two of the remaining three characteristics — generally, continuity of life and free transferability of interests.[17]

Despite the commonality of the liability shield and partnership tax themes, state acts reflect a dazzling array of diversity. Unfortunately, this lack of uniformity manifests itself in basic but fundamentally important questions.[18] Arguably, the most important issue relates to the treatment of dissociated members.[19] State laws accord vastly different treatment to the effect of member dissociation on the dissociating member (purchase of interest and management rights) and its separate effect on the business continuity of the limited liability company (dissolution). Because each state act is an amalgam of general and limited partnership and corporate laws, the results are far from uniform. Shareholder events such as death, bankruptcy, retirement or resignation of employment, incapacity,[20]

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one member is personally liable for all the obligations of the company pursuant to express authority granted in the controlling statute and also possesses a net worth equal to 10% of the total contributions to the company. This aspect of the release analogizes a limited liability company to a limited partnership with a general partner personally liable for all partnership obligations. For a complete discussion, see BISHOP & KLEINBERGER, *supra* note 1, ¶ 2.04 and Current Events (First Supplement); Barbara C. Spudis & Susan Pace Hamill, *Ruling Standards for LLCs Clarified by* Rev. Proc. *95-10*, 1 J. LTD. LIAB. COS. 147 (1995). Most state acts do not permit owners to be liable for the entity's obligations. ULLCA permits this flexibility, provided owner liability is acknowledged by a provision in the articles of organization and the written consent of affected members. *See* ULLCA § 303(c); N.Y. LTD. LIAB. CO. LAW § 609(b) (McKinney Supp. 1995); *see also infra* note 118.

17. Most limited liability companies are classified as partnerships for federal tax purposes because they lack continuity of life and free transferability of interests. *See* Rev. Rul. 88-76, 1988-2 C.B. 360 (Wyo.); Rev. Rul. 93-5, 1993-1 C.B. 227 (Va.); Rev. Rul. 93-6, 1993-1 C.B. 229 (Colo.); Rev. Rul. 93-30, 1993-1 C.B. 231 (Nev.); Rev. Rul. 93-38, 1993-1 C.B. 233 (Del.-Situation 1); Rev. Rul. 93-49, 1993-2 C.B. 308 (Ill.); Rev. Rul. 93-50, 1993-2 C.B. 310 (W. Va.); Rev. Rul. 93-53, 1993-2 C.B. 312 (Fla.); Rev. Rul. 93-81, 1993-2 C.B. 314 (R.I.); Rev. Rul. 93-91, 1993-2 C.B. 316 (Utah); Rev. Rul. 93-92, 1993-2 C.B. 318 (Okla.); Rev. Rul. 93-93, 1993-2 C.B. 321 (Ariz.); Rev. Rul. 94-5, 1994-1 C.B. 312 (La.); Rev. Rul. 94-6, 1994-1 C.B. 314 (Ala.); Rev. Rul. 94-30, 1994-1 C.B. 316 (Kan.); Rev. Rul. 94-51, 1994-32 I.R.B. 11 (N.J.); Rev. Rul. 94-79, 1994-51 I.R.B. 7 (Conn.); and Rev. Rul. 95-9, 1995-3 I.R.B. 17 (S.D.).

18. *See* ULLCA Prefatory Note.

19. *See* Harry J. Haynsworth, *At-Will and Term LLCs Are Treated Differently Under Uniform Act*, 2 J. LTD. LIAB. COS. 12 (1995). Dean Haynsworth argues the stated distinction is the most important and controversial aspect of ULLCA. *Id.* at 12.

20. The Model Business Corporation Act does not specify any default rules for a company purchase of a shareholder's interest in the company because of an event of dissociation of the shareholder. *See* REVISED MODEL BUSINESS CORP. ACT (1984). However, a shareholder in a company governed by the Close Corporation Supplement may

and share transfers[21] generally do not require the company to purchase the dissociated shareholder's interest absent an agreement to the contrary. Also, these events do not affect the corporation's perpetual business continuity.

Partnership law is different. A dissociating partner is usually entitled to either force the partnership to liquidate or to purchase that partner's interest. Most state limited liability company acts are designed to have the entity taxed like a partnership because it lacks the corporate characteristics of continuity of life and free transferability of interests. Therefore, in most respects the acts adopt the partnership rather than the corporate paradigm regarding the effect of member dissociation on that member's right to be bought out by the company and to cause a liquidation of the entity. Unfortunately, because of the Service's view on specific aspects of its tax classification regulations, important details of these state laws are extremely varied and inconsistent as state legislatures cope with how much uncertainty their limited liability law should tolerate.[22] The Service itself has publicly recognized these limitations and endorses radical change in its tax classification regulations that should ultimately stabilize state legislation.[23] Widely divergent rules on the effects of

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require the company to purchase all of that shareholder's shares on death. *See* MODEL STATUTORY CLOSE CORP. SUPP. §§ 14–17.

21. Corporate shares are ordinarily freely transferrable. However, transfer restrictions exist if the company is governed by the Close Corporation Supplement. *See* MODEL STATUTORY CLOSE CORP. SUPP. § 11. A company is entitled to a first right of refusal on a proposed transfer to an outsider. *Id*. § 12. A transfer violating the restriction is ineffective. *Id*. § 13.

22. See *supra* note 10 regarding bullet proof state laws. This externality of the tax regulations is unfortunate. The regulations are the driving force behind many details of the state acts. Statutory decisions are based on vague interpretations of regulations that were adopted in 1960 for a completely different purpose — to prevent professional partnerships from being taxed like corporations. The application of the regulations today is largely unjustified from a tax policy perspective. Since 1987, publicly traded partnerships have been taxed as corporations under I.R.C. § 7704 (1988) notwithstanding their partnership classification under the regulations. This effect essentially should moot all classification issues for non-publicly traded entities. Steps in this direction have already been adopted by the Subchapter S rules. Under this view, all publicly traded entities would be taxed like corporations regardless of business form. Likewise, all non-publicly traded entities should be taxed like partnerships. This is largely the result when the effects of I.R.C. § 7704, Subchapter S rules, and the classification rules are combined. By not reflecting this position, the tax treatment of non-publicly traded unincorporated business organizations suffers from the excessive influence of vague perspectives not fully developed under the tax regulations.

23. *See generally* BISHOP & KLEINBERGER, *supra* note 1, at Current Events (First

Supplement); Daniel Shefter, *Check the Box Partnership Classification Action: A Legitimate Exercise in Tax Simplification*, 67 TAX NOTES 279 (1995); *see also supra* note 9. In Notice 95-14, 1995-14 I.R.B. 7, the Service announced that it is considering scrapping the current four-factor classification system in favor of a "check-the-box" system. Under the system, newly formed unincorporated business organizations with two or more members would simply elect to be treated as either a partnership or a corporation by filing the appropriate tax return unless another Internal Revenue Code provision prohibits the chosen classification (e.g., section 7704 publicly-traded partnership provisions). The system will apply prospectively and once an election is made changes would be permitted only with the consent of all owners. Presently incorporated organizations would not be permitted to use the election as the corporate formation choice is itself an election of corporate tax status. Since the release covers unincorporated organizations, it would govern the classification of all limited liability companies and limited liability partnerships.

Notice 95-14 signals the first step in the eventual decline of the importance of the four-factor classification tests outlined in sections 301.7701-2 and 301.7701-3 of the tax classification regulations. Because the current regulations draw artificial lines, a revision is impossible without a governing paradigm. After considerable study, the Service has recognized the impossibility of developing such a paradigm.

The ultimate effect will encourage states to amend their limited liability company laws to provide infinite flexibility. A corporate-styled liability shield for owners will survive as will flexible management structures that permit owners to specify either member- or manager-management. The remaining two criteria have caused more statutory dislocation and are far more likely to be revisited in the redrafting process. Specifically, free transferability provisions may see less revision than continuity of life provisions.

Free transferability revisions may now contemplate different management structures. For example, as with a centrally managed corporation and subject to the publicly-traded partnership provisions, non-manager member interests in manager-managed limited liability companies may now be freely transferable. Since these members do not directly participate in management other than through the election of managers, there are few non-tax reasons for restricting the transfer of their interests. However, ownership interests in member-managed limited liability companies and essentially all limited liability partnerships convey a more direct management participation and therefore these owners may wish to continue the current rules which permit the members to "pick their partners by subjecting transfers to a member consent procedure." Both rules should be structured as default rules to permit owners to agree otherwise. Notwithstanding new flexibility, these default rule modifications are not certain to occur. For example, even after the release of Rev. Proc. 95-10, ULLCA drafters rejected a modification of the pick-your-partner rule that would have permitted a majority-in-interest of the member-managers to admit transferees of a current member as a member. *See* ULLCA §§ 503(a), 103(b) (all members must agree to admit a transferee as a member unless otherwise provided in the operating agreement). The release may also signal the welcome end of the rules that provide the death of a member terminates the decedent's management rights where death does not dissolve the company. Under this rule, the decedent's heirs take only the decedent's economic rights. See *infra* note 46 and accompanying text for a discussion of this topic. Again, any default rule modification may well conform to the organization's management structure in order to preserve the pick-your-partner rule.

Continuity of life revisions may now contemplate severing the current tax-mandated relationship between owner dissociation and organization dissolution. This revi-

member dissociation will ultimately create confusion and inhibit the development of uniform case law. As a result, case law will have little precedential value from state to state.[24]

State adoption of ULLCA will foster certainty and predictability and increase the precedential value of case law developed state by state.[25] ULLCA stabilizes the effects of member dissociation on the member's buyout rights and the effect on the business continuity of the company. In essence, ULLCA continues the trend of the other uniform partnership acts by characterizing the nature of an owner's interest in relation to the entity's expected duration as agreed to by all members. Where the members agree that the duration of the entity should be for a specified term, ULLCA locks in the interest of members who withdraw, die, or otherwise "dissociate"[26] before the end of the term. Where the members have not agreed that the duration of the entity should be for a specified term, the company will be

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sion would make the organization more like a corporation. At the same time, the introduction of this corporate similarity promises a new look at the lock-in effect applicable to corporate shareholders. Organizations with a perpetual existence, no fixed term, and no established market for owner interests face minority and passive owner protection issues which in turn may be addressed through a combination of enhanced judicial dissolution statutes and statutory buyout rights triggered by specified events ranging from mere owner dissociation to control misconduct. These statutory buyout provisions in effect substitute for private buy-sell agreements which are very expensive and complex to draft (which helps explain why few corporations actually have such agreements).

It is difficult to predict whether Notice 95-14 will be the progenitor of significant state law development and modification, other than simply to create more flexibility and adjust current default rules. Sophisticated tax analysis has already had a noticeable effect on state law. Ultimately, if only minor changes occur, it would support the interpretation that, in the final analysis, the Service has made little true concession while promoting sound tax policy — greater tax classification uncertainty.

24. Nearly every state considering the adoption of ULLCA will already have adopted its own act. ULLCA sets forth several transition rules to govern this occasion. First, all new limited liability companies formed after the ULLCA effective date will be governed by ULLCA. ULLCA § 1205(a)(1). Companies already in existence on the effective date may elect at any time to be governed by ULLCA. *Id*. § 1205(a)(2). Where no election is made, a company will nevertheless be governed by ULLCA after the expiration of a specified transition period. *Id*. § 1205(b). The last rule assures that after some period of time all companies will be governed by one set of laws. This rule may cause some alteration in the rights of members of some preexisting companies and therefore alter expectations. However, the transition period provides adequate time for a reexamination of these issues.

25. For a more thorough discussion of the advantages of uniformity, see generally Fred H. Miller, *The Future of Uniform State Legislation in the Private Law Area*, 79 MINN. L. REV. 861 (1995).

26. For a discussion of the term "dissociation," see *infra* notes 30–33 and accompanying text.

an "at-will company" from which members may withdraw, die, or dissociate at any time and require the company to purchase their interest at that time. Also, ULLCA continues the partnership feature regarding the use of business continuation agreements by making it easier for less than all the remaining members in a member-managed company to agree to continue the business of a company in the event of a dissociation. In a manager-managed company, only a dissociation of a member-manager threatens dissolution which, in turn, may be avoided by less than all the remaining members.

The ULLCA at-will concept is not expressly recognized in any state limited liability company act. However, every state limited liability company act provides that the articles of organization must set forth some variation of a duration specification,[27] but the nature of the duration provision and its relationship to mandatory dissolution at the end of that duration are unclear. While the articles designating a duration must be filed with the Secretary of State, that filing office may routinely fail to police the adequacy of the duration designation. Even where the duration is appropriately set forth in the articles, the Secretary of State's office cannot be expected to police whether members continue the company beyond the specified duration. In both cases, the limited liability company would presumably operate as an at-will company in concept, yet state law does not concern itself with the issue. Also, even though state acts universally create what ULLCA defines as a "term company,"[28] the rights accorded to members of those companies do not always parallel the rights accorded to term partnership entities. In many cases, member rights are more similar to withdrawal and distribution rights accorded to at-will partnership members. For all these reasons, ULLCA treats and considers both types of entities under a single organizational umbrella.[29]

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27. Some states permit a perpetual designation. Since this designation does not express any finite or determinable duration, it should also be regarded as an at-will designation.

28. ULLCA § 101(19).

29. Presumably, the fact that ULLCA sets forth two types of organizations under one act will not negatively affect the estate valuation issues applicable to membership interests under I.R.C. § 2704 (Supp. V 1993). Since persons may elect to form either a general or limited partnership with dramatically different estate valuation results, it should not matter that the same result can be achieved by simply designating that a company will be a term company in the articles. The term designation is no more than a business entity choice and should not therefore be considered an applicable restriction

The first, second, and third sections of this Article discuss the treatment of members upon dissociation by death or withdrawal under ULLCA, other business organization forms, and current state laws. The conclusion adopts the view that a uniform default rule substantially advances predictability for limited liability companies while substantially continuing pre-existing accepted partnership rules.

I. THE UNIFORM LIMITED LIABILITY COMPANY ACT

The term "dissociation" is used in ULLCA to refer to the change in relationships among members and a limited liability company caused by a member ceasing to be associated in the carrying-on of the company's business for any reason.[30] Withdrawal[31] and death[32] are specific examples of member dissociation.[33] The effect of dissociation on both the member's financial and management interests and on the continuation of the company's business depends upon the duration and management structure of the company.

At a company's formation,[34] its articles of organization must designate its duration status as either at-will or term[35] and define its management structure.[36] Member dissociation has different ef

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for purposes of § 2704. In that event, a decedent member's interest would presumably be valued as if an at-will company designation existed. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶ 8.04.

30. ULLCA § 601 cmt. The primary source for ULLCA's dissociation concept is RUPA § 601.

31. ULLCA § 601(1). A member is dissociated from a company when the company has "notice" of that member's express will to withdraw. The withdrawal is effective the earlier of the date of the notice or on a later date specified by the member. *Id.*; *see also id.* § 102(b), (d), (e).

32. *Id.* § 601(8)(i).

33. ULLCA lists 11 separate events which result in a member's dissociation. *Id.* § 601(1)–(11). All dissociation events are merely default rules that may be eliminated or modified in the operating agreement. *Id.* § 103(b).

34. A limited liability company's legal existence begins when the articles are filed by (rather than delivered to) the Secretary of State. *Id.* § 202(b).

35. *Id.* § 203(a)(5). Unless the articles set forth that the company will be a term company and the duration of the term, the company will be an at-will company. Thus, the default duration is at will.

36. *Id.* § 203(a)(6). Unless the articles set forth that the company is to be "manager-managed," it will be "member-managed." *Id.* Thus, the default management structure is member-management. Those terms are defined to distinguish management structure solely by the location of the agency power of members. In a member-managed company, the members are agents of the company with the apparent authority to bind the compa-

fects under both designations and combinations thereof. The duration designation primarily affects the timing of the company's required purchase of a dissociated member's interest and, to a lesser degree, also affects dissolution. The management structure designation primarily affects whether the dissociation threatens dissolution by triggering a vote to continue the company's business. Since a member's interest is in effect purchased[37] by the company if the member's dissociation results in the company's dissolution and liquidation, the single most important aspect of dissociation is whether it results in the dissolution of the company. If not, the critical focus shifts to whether the dissociation forces an immediate or merely a deferred purchase of the dissociated member's interest in the company. Finally, although a company may be formed, operated, or continued with only one member, these effects are of primary importance where there are two or more members.[38]

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ny in the ordinary course of the company's business. *Id*. §§ 101(10), 301(a). In a manager-managed company, the managers are agents of the company with the apparent authority to bind the company in the ordinary course of the company's business. Members do not have any power simply as members to bind the company. *Id*. §§ 101(10), 301(b). Because of the extreme difficulties of precisely defining manager-management when the members exercise diverse responsibilities regardless of titles, the definition of a manager-managed company is specifically related to the simple and bright-line test as to whether the company is so designated in its articles. In fact, neither the definition nor the reference to the articles actually substantively “define” the characteristics of a manager-managed company. However, interpreting the term in its context requires that a manager-managed company have the following characteristics: (1) it has at least one manager who need not also be a member, (2) the manager is vested with agency authority, and (3) no member is vested with agency authority simply because that person is a member.

37. If the company's business is sold to outsiders for a cash purchase, the dissociated member will receive a share of the value of company goodwill. The presumption is that liquidating distributions will be paid in money unless the members otherwise agree. *Id*. § 806(a).

38. See BISHOP & KLEINBERGER, *supra* note 1, ¶¶ 2.08, 5.04[5], and Current Events (First Supplement) for a discussion of the tax classification and statutory issues associated with a one-member limited liability company. *See also* Marshall B. Paul & Stuart Levine, *One-Member LLCs Pose Often-Overlooked State Law Issues*, 1 J. LTD. LIAB. COS. 162 (1995); Jerry S. Williford & Donald H. Standley, Jr., *How Should Single-Member LLCs Be Classified for Federal Tax Purposes?*, 2 J. LTD. LIAB. COS. 27 (1995) (discussing the likely effect of Rev. Proc. 95-10, 1995-3 I.R.B. 20). In Revenue Procedure 95-10, the Service indicated that it would not rule that a one-member limited liability company is taxed like a partnership and that a favorable partnership ruling issued to a company with more than one member would lapse if the company subsequently had only one member. Rev. Proc. 95-10, § 4.01, 1995-3 I.R.B. 20, 21–22.

A. Duration of a Company

Unless the articles specify that the duration of a company is for a specified term (term company),[39] its duration is at-will (at-will company).[40] Under the at-will default rule, a company must ordinarily purchase a dissociated member's interest sooner than in a term company.[41] A member has the power to dissociate by voluntarily withdrawing unless that power is removed by the operating agreement.[42] Other important effects of member dissociation include a termination of the dissociated member's (1) power to bind the company,[43] (2) duties of care and loyalty, except as to company transac-

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39. ULLCA § 203(a)(5). A term company is defined as a company in which the members have agreed to remain members until the expiration of a term specified in the articles. *Id*. § 101(19). The specification must set forth a specific and final date for the dissolution of the company. Specification of a particular undertaking is too indefinite and will fail unless contained within a longer fixed date. *See id*. § 203 cmt. The specificity requirement avoids the indefinite time problems associated with a specific undertaking. *See, e.g.*, RUPA § 101(6).

40. ULLCA § 203(a)(5). An at-will company is defined as any company other than a term company. *Id*. § 101(2). As with management structure definitions, this definitional approach makes clear that there are only two possible company duration categories. Even where the articles fail to provide that a company is to be a term company and which results in an at-will company, the members could agree that the company will be regarded as a term company. The designation in the articles is controlling to third parties who rely on the designation, but not to the members. *Compare* ULLCA § 203(c)(1) *with* § 203(c)(2). Presumably, this paradox would be rare since the members could simply specify a duration in the articles if they so desired.

41. The ULLCA default rules were chosen primarily to represent the Drafting Committee's best sense of the reasonable expectations of small informal companies. For a general analysis of various default rule paradigms, see Lisa Bernstein, *Social Norms and Default Rules Analysis*, 3 S. CAL. INTERDIS. L.J. 59 (1993). The members must elect to be a term company which possesses greater business continuity than an at-will company. Even though the term specification in the articles may be well known, its consequences may be obscure. Nevertheless, the inherent lock-in results associated with a term company only exist if the articles expressly create a term. Even then, the members could override the effect of the term designation by a provision in the operating agreement, which need not be in writing, setting forth that the company will be regarded as an at-will company. *See* discussion *supra* note 40.

42. *See* ULLCA §§ 103(b), 602(a). Since the power to dissociate is not listed as a nonwaivable provision, even the power to dissociate may be eliminated. This is reinforced by the introductory clause in section 602(a): "Unless otherwise provided in the operating agreement . . . ." This is a rare statutory expression of the drafting paradigm created by section 103(b). *See infra* note 48; *see also* ULLCA § 602 cmt.

43. The dissociated member's lingering apparent authority to bind the company continues only for two years if the third party reasonably believed the dissociated member was a member and did not have notice of the dissociation. *See id*. §§ 703 (power to bind), 102 (notice defined). However, a company may earlier terminate the dissociated member's power to bind by filing a statement of dissociation. *Id*. § 704(a). The filed

tions that continue to exist after the dissociation,[44] and (3) rights to participate in the management and conduct of the company's business, except to participate in the winding-up of the company's business if the company dissolves and the dissociation was rightful.[45] If the company does not dissolve and the company does not purchase the dissociated member's interest, the dissociated member ceases to be a member and is treated as a transferee.[46]

1. At-Will Company

Depending on the management structure,[47] and unless otherwise provided in an operating agreement,[48] member dissociation in a

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statement is valid even against persons without notice or knowledge of the dissociation and is effective 90 days after filing. *Id*. § 704(b).

44. Members and managers are only subject to a duty of care based on a gross negligence standard. *Id*. § 409(c), (h); *see* Sandra K. Miller, *What Standards of Conduct Should Apply to Members and Managers of Limited Liability Companies?*, 68 ST. JOHN'S L. REV. 21 (1994).

45. ULLCA § 603(b).

46. *Id*. § 603(b)(1). A transferee, unless admitted as a member by all the other members, is not entitled to participate in management, have access to information concerning company transactions, or inspect or copy any company records. *Id*. § 503(d). A transferee is entitled to receive only the distributions to which the transferor would otherwise have been entitled, to receive a limited statement of account, and to seek a judicial determination that it is equitable to wind up the company's business. *Id*. § 503(e). In cases where the members have allocated voting power according to financial contributions, this effect will result in a proportional shift of voting power from the dissociated member to the remaining members. *See id*. § 801 cmt. For example, if A, B and C own 98%, 1%, and 1%, respectively, of a company and A dies, B and C will together own 100% of the voting power of the continuing company. As a result, A may wish to have the operating agreement provide for a mandatory purchase of A's interest. The purchase price can often be funded by life insurance.

47. See *infra* notes 100–06 and accompanying text regarding the effect of member dissociation in manager-managed companies. Contrary to the discussed rule for member-managed companies, member dissociations in a manager-managed company do not ordinarily threaten dissolution of the company unless either dissociating member was also a manager or there are no managers who are also members.

48. The rules specified in ULLCA are primarily default rules. The members' operating agreement may modify all the ULLCA statutory rules except those set forth in a short statutory list. *See* ULLCA § 103(a), (b). This drafting paradigm means that ULLCA is very flexible, subject to freedom of contract among the members. Of course, the operating agreement is a mere contract and would itself be subject to all contract challenges relating to both formation and enforcement defenses. *See id*. § 104(a). Moreover, given the informality of many small companies, the operating agreement is not required to be in writing and controls among the members even when it is contradicted by the articles. *Id*. §§ 103(a), 203(c)(1). The lack of a writing requirement will ultimately create some uncertainty and lack of predictability as members argue that course of performance

member-managed at-will company has consequences affecting both the continuance of the company and the timing of the company's required purchase of the member's interest at its fair value.[49] Unless the company is manager-managed,[50] member dissociation for any reason[51] will dissolve it unless a specified percentage[52] of remaining members agree within ninety days to avoid the threatened dissolution and continue the business of the company.[53]

If dissolution is not avoided, the company must wind up its business[54] and make liquidating distributions to its members.[55] Accordingly, members may receive payment for the value of their interest by dissociating if the dissociation causes the dissolution of the company.[56] If the dissociation was contrary to the provisions of

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has amended the terms of a written operating agreement. This effect will be mitigated somewhat since the operating agreement may only be amended by all the members unless the agreement provides otherwise. *Id*. § 404(c)(1).

49. The concept of "fair value" is used in ULLCA rather than "fair market value" to, in part, prevent an unfair use of market depression factors to reduce the purchase price of a dissociated member's interest. *See* Haynsworth, *supra* note 19, at 17.

50. *See supra* note 47.

51. ULLCA § 801(b)(3).

52. *Id*. § 801(b)(3)(i). The combined formula vote expressed in § 801(b)(3)(i)(A) and (B) represent an expression of two separate votes capable of exact calculation. Earlier versions of the Act utilized the voting term "majority in interest" but failed to define the term other than by way of reference in the comments to the Service's ambiguous safe harbor definition in Rev. Proc. 94-46, 1994-28 I.R.B. 129. The Drafting Committee therefore opted for certainty and predictability as a default rule. For a more complete discussion of the majority-in-interest standard as defined in Rev. Proc. 94-46, see BISHOP & KLEINBERGER, *supra* note 1, at 1995-1 Supplement (Current Events); Carter G. Bishop, *Conversions to LLCs: Creation of "Majority-In-Interest" Safe Harbor*, 1 J. LTD. LIAB. COS. 78 (1994).

The two formulas seek the vote of those remaining members entitled to a majority of distribution at two separate times: first, at the moment of the dissociation, assuming a liquidation of the company, and secondly, for all future distributions, assuming the company continues. For this purpose, future distributions have a special definition. *See* ULLCA § 801(a). The two-part distribution calculation avoids the unstable reference to profits and capital found in Rev. Proc. 94-46 to achieve greater certainty and to conform to the lack of those terms in the Act. *See* ULLCA § 405 & cmt. In most cases, where the Act's default distribution provisions are utilized, the two vote calculations will be the same.

Notwithstanding the Act's approach, some states use the term "majority-in-interest" without defining the term. Other states use the term but define it more narrowly than in Rev. Proc. 94-46. *See, e.g.*, N.Y. LTD. LIAB. CO. LAW § 102(o) (majority of profits) (McKinney Supp. 1995).

53. See *infra* note 87 for a discussion of business continuation agreements.

54. ULLCA § 802(a).

55. *Id*. § 806.

56. All the members may waive the effects of dissolution but the waiver requires

an operating agreement,[57] thus wrongful, the company may offset its damages against the distribution.[58] Also, the dissociated member retains the right to participate in the winding-up process unless the dissociation was wrongful.[59] All the members, including the dissociated member, may agree before liquidation is complete to retroactively revoke the company's dissolution.[60]

If a vote of a majority of members holding the requisite distribution rights avoids dissolution of a member-managed at-will company, the company must nevertheless purchase the interest of the dissociated member at its fair value determined as of the date of the dissociation.[61] Furthermore, the company must deliver a purchase offer[62] to the dissociated member not later than thirty days after the dissociation.[63] The purchase offer must be accompanied by financial data on the company and a brief explanation of how the purchase price was determined.[64] If the company does not make an offer to purchase the interest within 120 days after the expiration of the thirty-day period, the dissociated member may commence a proceeding within another 120 days to enforce the purchase.[65] In such a proceeding, the court determines the fair value of the dissociated mem-

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the consent of the dissociated member. *Id*. § 802(b). Accordingly, the continuance of the company by the other members may not block the company's payment of the dissociated member's liquidating distribution without that dissociated member's consent.

57. *Id*. § 602(b)(1). Any dissociation from an at-will company will be wrongful only where made specifically wrongful by the operating agreement. However, dissociation by withdrawal is wrongful if made before the expiration of the specified term of a term company. *Id*. § 602(b)(2).

58. Specific provision is made for offset in the context of a company payment to a dissociated member where the company does not dissolve. *Id*. § 701(f). Where the company dissolves, members are entitled to receive only the "surplus" of assets remaining after all other obligations are discharged. *Id*. § 806(b). Payment for a claim of wrongful dissociation could constitute such a claim.

59. *Id*. § 803(a). Of course, the operating agreement could nevertheless restrict the right of a dissociated member to participate in winding up the company. *See id*. § 103(b).

60. *Id*. § 802(b); *see supra* note 56.

61. ULLCA § 701(a)(1). Where agreement is reached, the dissociated member would then be entitled to be bought-out, subject to the terms of that agreement. *See id*. §§ 603(a)(1), 701(a)(1).

62. The price and other terms of the purchase may be determined in an operating agreement. *Id*. § 701(c). Although the parties may modify the purchase right, a provision eliminating it may be unenforceable. *See id*. § 701 cmt.

63. *Id*. § 701(b).

64. *Id*. A simple statement such as "book value" may satisfy the required explanation. *See id*. § 701 cmt.

65. *Id*. § 701(d).

ber's interest, the terms of payment, and enters an order compelling the purchase on those terms.[66] The company may offset damages for wrongful dissociation and all other amounts owing.[67] On the other hand, rather than filing an action to compel purchase, the dissociated member may seek dissolution of the company for its failure to deliver a purchase offer.[68] The dissociated member is entitled to continue to receive an appropriate share of any authorized distribution made after the dissociation but before the first payment is made toward the purchase price.[69] After that date, the dissociated member is treated the same as other company creditors except that the member has the right to petition a court for dissolution if payments do not comply with the terms of the agreement.[70]

Death, as a special form of member dissociation,[71] deserves mention simply because it is involuntary[72] and its effects may be easily remedied through buy-sell agreements funded with life insurance. If the member's death does not result in the dissolution of the company, the decedent's distributional interest must be immediately purchased by an at-will company or at the expiration of the then-specified term by a term company. In a term company, the decedent's estate or heirs may therefore be forced to hold an interest in the company for a significant period of time. During the holding

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66. *Id*. § 701(e).

67. *Id*. § 701(f).

68. *Id*. § 801(b)(5)(iv). The commentary makes clear that the dissolution remedy should only be ordered by the court where no other appropriate remedy exists. Accordingly, a court ordinarily should not order dissolution when it can enforce a company purchase of the applicant's interest under Article 7. *See id*. § 801 cmt.

69. *Id*. §§ 603(b)(1), 702(b).

70. *Id*. §§ 702(c), 801(b)(5)(iv). This important provision protects the dissociated member from relying on nonmarket terms of an agreement for the purpose of settling disputes only to be faced with a default of the purchaser. In such cases, the dissociated member in effect has an election to proceed to enforce the terms of the agreement against the defaulting company or to seek dissolution and receive a different share of the company on liquidation (less previous receipts under the agreement). Purchasers seeking the benefit of their agreements must therefore abide by the payment terms of those agreements or risk that the dissociated member will simply seek the fair value of their interest unencumbered by the agreement through a dissolution proceeding.

71. *Id*. § 601(8)(i).

72. Although an operating agreement may generally make dissociation wrongful and thereby subject the wrongful dissociating member to damages, the enforceability of a provision making death wrongful would be doubtful. Such a provision may be void under contract law as against public policy and therefore illegal. *See id*. §§ 602(b)(2)(i), 104(a). Also, by definition, dissociation by death is not wrongful if from a term company. *Id*. § 602(b)(2).

period, these persons accept the risk of market appreciation or depreciation of the interest since the purchase price is determined at the expiration of the term, not at the date of dissociation. Moreover, the estate or heirs are regarded as transferees of a member's interest with no management or other voting rights.[73] However, for this special purpose, the decedent's successors in interest are regarded as succeeding to the right of a dissociated member to seek judicial dissolution of the company during the remainder of the term to guard against the improper conduct of those in control of the company.[74] Because of these serious limitations,[75] members of a term company may wish to execute an agreement requiring the company to purchase their interests at death. The agreement could be funded by company-purchased life insurance.[76]

2. *Term Company*

In a member-managed term company, member dissociation prior to the expiration of the specified term is less likely to cause the company to dissolve than in an at-will company. Only specific member dissociations threaten dissolution in a term company whereas all member dissociations threaten dissolution in an at-will company.[77] Generally, a member dissociation by voluntary withdrawal in a term company will not force a dissolution vote of the remaining members;[78] however, all such dissociations are wrongful.[79] In addi-

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73. *Id*. § 603(b)(1); *see also id*. § 601 cmt.

74. *See id*. § 801(b)(5). Other transferees of a member's interest are relegated to paragraph (6) to seek judicial dissolution. A transferee of an interest in a term company may not seek dissolution until after the expiration of the term that existed when the transferee acquired the interest. However, a transferee of an interest in an at-will company may seek judicial dissolution at any time. *Id*. § 801(b)(6). Of course, if a term company otherwise dissolves prior to the expiration of the remaining term, a transferee would be able to liquidate its interest. In the meantime, transferees could sell their interests in future distributions, including the purchase rights and liquidating distributions rights. The sale will likely produce deep market discounts because of the lack of liquidity and protective voting rights.

75. *See, e.g.*, Sandra K. Miller, *What Remedies Should Be Made Available to the Dissatisfied Participant in a Limited Liability Company?*, 44 AM. U. L. REV. 464 (1995).

76. *See* ULLCA § 601 cmt.

77. *Id*. § 801(b)(3).

78. *Id*. Other member dissociations that do not trigger a dissolution vote include events specified in an operating agreement and expulsion under an operating agreement or by the vote of the other members or judicial determination. *See id*. § 601(1)–(5).

79. *Id*. § 602(b)(2).

tion, member dissociation prior to the expiration of the specified term determines the same purchase right procedure applicable to an at-will company except that company payment and valuation is postponed until the expiration of the term specified on the date of dissociation.[80] In a term company, the dissociated member bears the risk of loss in value during the remainder of the specified term whereas in an at-will company the member receives immediate payment.[81] From the date of dissociation until the expiration of the specified term, the dissociated member has no right to participate in the management of the company,[82] owes no further fiduciary duties (except with regard to continuing transactions that arose prior to dissociation),[83] and is entitled to receive the distributions that the dissociated member would have been entitled to receive absent a dissociation.[84] Therefore, the dissociated member is generally treated as a transferee of a member who is not admitted as a member.[85]

These rules make clear that the designation of a company as a term company with a specified duration in the articles rather than adopting the default at-will duration has important effects on the consequences of member dissociation. First, member dissociation in a term company is less likely to cause the dissolution of the company because the range of dissociation events that force a dissolution vote is narrower. Secondly, member dissociation in a term company does not trigger a company purchase obligation of the dissociated member's interest until the expiration of the specified term that existed on the date of dissociation.[86] These effects underscore the reason for

80. *Id*. § 701(a)(2).

81. *See id*. § 701 cmt.

82. *Id*. § 603(b)(1).

83. *Id*. § 603(b)(2), (3).

84. *Id*. § 503(e)(1).

85. *Id*. § 603(b)(1). Technically, dissociated members have greater rights than mere transferees who were never members. First, former members have a right of access to the company's books and records for the period of their membership. *Compare id*. § 408(a) (former members) *with id*. § 503(d) (transferees). Also, dissociated members retain broader rights to seek judicial dissolution of the company. *Compare id*. § 801(b)(5) (dissociated members) *with id*. § 801(b)(6) (term company transferees may not seek judicial dissolution until the end of the term but at-will company transferees can seek dissolution any time but on narrower grounds than applicable to dissociated members). See *supra* notes 71–76 and accompanying text for a discussion of death dissociation in a term company.

86. The awkward language is used to clarify the reference to the appropriate speci-

the double duration paradigm — to govern a company organizers need a simple but comprehensive set of default rules that vary rather remarkably depending on the intended duration of the company. A term company is a considerably more stable business entity than an at-will company. Its members can count on a secure capital base with which to operate the business, at least until the expiration of the specified duration.[87]

B. Management Structure

Unless the articles of organization specify[88] that a company is to be "manager-managed,"[89] it will be "member-managed."[90] Thus, the default management structure provides for management by the members. These management structure terms are defined solely by reference to whether members *qua* members are agents of the company and have the power to bind the company and not by reference to the members' decisionmaking authority.[91] The two structures are

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fied term. For example, after a member dissociation, the remaining members of a company that does not dissolve could amend the articles and extend the term or simply not dissolve at the end of the specified term. *See id*. § 411 (term company that continues after the expiration of its specified term continues as an at-will company). In the former case, the company may continue until the expiration of its new specified term but the company must purchase the dissociated member's interest. In the latter case, the dissociated member could seek a judicial dissolution of the company. *Id*. § 801(b)(6)(i).

87. In the past, general partnerships countered the inherent dissolvability of the firm through the use of business continuation agreements. Although the partnership technically dissolved upon the dissociation of any partner, the partnership's business was carried on by the remaining partners. If limited liability companies could use such agreements to deal with the effects of a dissolution, the inclusion of the term company paradigm in ULLCA would have been less justified. Its complexity may then have outweighed its advantages. However, the Service has consistently refused to rule that a limited liability company may use these agreements and still lack the continuity of life characteristic. Due to the obvious negative tax classification effects of this determination, other statutory measures such as term companies are necessary to create more business continuity. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶ 2.06[3][d]; Carter G. Bishop, *Conversions to LLCs: Creation of "Majority-In-Interest" Safe Harbor*, 1 J. LTD. LIAB. CO. 78, 80–81 (1994); Carter G. Bishop & Daniel S. Kleinberger, *Structuring the Minnesota LLC*, BENCH & B. MINN., Nov. 1993, at 23.

88. ULLCA § 203(a)(6).

89. *Id*. § 101(11). See *supra* note 36 for a discussion regarding the management definitions.

90. ULLCA § 101(12).

91. In a member-managed company, each member has equal rights in management and except for specified extraordinary matters, all matters are decided by a majority vote of the members. *Id*. § 404(a), (c). In a manager-managed company, the members have no rights in management and, except for specified extraordinary matters, all matters are

based on the centralized management corporate characteristic under the federal tax classification regulations and permit flexibility in splitting the agency and decisionmaking authority in a single company.[92]

1. Management by Members

In a member-managed company, the members are agents with the authority to bind the company in the ordinary course[93] of its business.[94] In a manager-managed company, the managers are agents with the authority to bind the company in the ordinary course of its business.[95] Members do not have any power to bind the company in their capacity as members in a manager-managed company.[96] In a member-managed company, member dissociation terminates that member's power to bind the company on the earlier of either two years after the dissociation[97] or ninety days after the company files an optional statement of dissociation.[98]

In a member-managed at-will company, the dissociation of any member for any reason[99] will dissolve the company unless a majority of members holding the requisite distribution rights agree within ninety days after the dissociation to avoid dissolution and continue the business of the company.[100] Therefore, the management structure of a member-managed at-will company has no effect on either

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exclusively decided by a majority of the managers. *Id*. § 404(b), (c). These rules are subject to a special voting rule which provides that the dissolution of a company threatened by the dissociation of a member or manager may be avoided by a specified percentage of the remaining members. *Id*. § 801(b)(3)(i). See *supra* note 52 for a discussion of this vote.

92. Treas. Reg. § 301.7701-2(c)(4) (as amended in 1993).

93. The term "ordinary course" is not defined; however, the management provisions imply that only certain matters require unanimous consent. *See* ULLCA § 404(c). All other matters are decided by a majority vote unless otherwise provided in an operating agreement. This paradigm creates a strong inference that only the matters requiring unanimous vote are not in the ordinary course. The term was adapted from RUPA § 301, which was in turn adapted from UNIF. PARTNERSHIP ACT (1914) § 9(1) (UPA), 6 U.L.A. 5 (1969 & Supp. 1995).

94. ULLCA § 301(a).

95. *Id*. §§ 101(10), 301(b).

96. *Id*. § 301(b)(1) (first sentence).

97. *Id*. § 703.

98. *Id*. § 704.

99. *Id*. § 801(b)(3).

100. *Id*. § 801(b)(3)(i).

the dissolution triggers by way of member dissociation, the dissolution vote, or the purchase of a dissociated member's interest discussed under the duration section.[101]

2. Management by Managers

In a manager-managed company, only selected dissociations[102] of a member-manager[103] trigger the dissolution vote.[104] If there are no member-managers, the dissolution rules revert to the discussed rules applicable to at-will and term companies. Therefore, the effect of the manager-management structure considerably narrows the dissociation events that force a dissolution vote to the specified dissociations of managers who also happen to be members.

The effect is most pronounced in a manager-managed at-will company. The dissociation of any member of a member-managed at-will company for any reason forces a dissolution vote, but if the company is manager-managed and at least one member is a manager, the dissociation of members who are not managers does not force a dissolution vote. If there are managers but none are members, once again the dissociation of any member forces a dissolution vote.[105] Even though dissociated members of an at-will company have a right to compel the company to purchase their distributional interests upon dissociation whether member- or manager-managed,[106] the management structure substantially increases the stability of the company by significantly reducing the dissociations that will force a dissolution vote.

The effect is somewhat less dramatic in a manager-managed term company since a term company is less subject to dissolution than an at-will company.[107] Nevertheless, where the dissolution vote

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101. *See supra* notes 47–70 and accompanying text.

102. ULLCA § 801(b)(3).

103. The term "member-manager" is not defined; however, a manager is defined as a person, whether or not a member, with the power to bind a manager-managed company. *Id*. § 101(10). A member-manager is therefore simply a person who is both a member and manager of a manager-managed company. *See id*. § 601 cmt. The term was added to the dissolution section after the release of Rev. Proc. 95-10, 1995-3 I.R.B. 20. *See supra* note 6.

104. ULLCA § 801(b)(3).

105. *Id*.

106. *See supra* text accompanying notes 54–70.

107. *See supra* text accompanying notes 77–87.

is connected to a narrower range of dissociation events in a term company to only member-managers, the stability of the company is significantly increased. The management structure has no effect on the obligation of a term company to purchase a dissociated member's distributional interest at the expiration of the term that existed on the dissociation date.[108] In both at-will and term companies, managers who are not also members do not have the power to dissociate and there is no effect on the company if they leave.[109]

3. Structural Bias to Manager-Management

Designation as a manager-managed company has important effects on the consequences of member dissociation on the dissolution of the company. The manager-managed designation significantly reduces the risk that a member dissociation will force a dissolution vote by providing that only the dissociation of members who are also managers forces the vote. This significantly increases business stability of the company without altering the normative rights of all dissociated members to require the company to purchase their distributional interests if it does not dissolve.

There are other significant advantages to a manager-management designation not expressed in the default statutory structure but permissible if detailed in an operating agreement. First, if the member-managers of a manager-managed company own, in the aggregate, in excess of twenty percent of the total interests in the company, the company will lack the corporate characteristic of centralized management for federal tax purposes even if the company is manager-managed.[110] When applicable, a properly structured

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108. *See supra* text accompanying note 80.

109. *See supra* text accompanying note 30.

110. Rev. Proc. 95-10, § 5.03(2), 1995-3 I.R.B. 20, 23–24 (interpreting Treas. Reg. § 301.7701-2(c)(4) (as amended in 1993) (fifth sentence)). Where the member-managers own in excess of 20% of the interests in the company, the non-managing members do not own "substantially all" the interests in the company within the meaning of Rev. Proc. 89-12, 1989-1 C.B. 798. *See also* Rev. Proc. 92-33, 1992-1 C.B. 782. The questionable rationale is that when the member-managers own in excess of 20% of the company they act in their own self-interest and not solely in a representative capacity. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶ 2.05[5][b]. In order for the rule to prevail, the member-managers must not be subject to periodic elections or substantially unrestricted removal. *See* Rev. Proc. 95-10, § 5.03(2), 1995-3 I.R.B. 20, 23–24 (interpreting Treas. Reg. § 301.7701-2(c)(4) (as amended in 1993) (sixth sentence)); BISHOP & KLEINBERGER, *supra* note 1, ¶ 2.05[5][c].

manager-managed company may elect to possess the corporate characteristic of free transferability of interests and still maintain partnership tax classification status because it lacks the corporate characteristics of centralized management and continuity of life.[111] Second, a manager-managed company will lack free transferability of interests where the necessary consent to transfer more than twenty percent[112] of the interests in the company is to be exercised by only a majority[113] of the member-managers rather than a specified percentage of the remaining members.[114] This flexible feature will encourage the use of limited liability companies rather than limited partnerships. The ULLCA default transfer consent rule provides that all the remaining members must consent to admit a transferee.[115] The operating agreement may modify this rule and provide that the transfer consent may be exercised by the member-manager or, if more than one, by a majority of the member-managers.[116] In the event there are no member-managers at the time of a transfer, a majority of the remaining members would be required to consent under the default rule.[117] Finally, even a limited liability company may lack the characteristic of limited liability where one or more of its members are personally liable for all the debts and obligations of the company and the liability arises under a statute permitting personal liability.[118]

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111. *See supra* notes 10–17 and accompanying text.

112. Rev. Proc. 95-10, § 5.02(1), 1995-3 I.R.B. 20, 23 (interpreting Treas. Reg. § 301.7701-2(e)(1) (as amended in 1993) (first sentence)). The transfer restriction on at least 20% of the interests means that substantially all the interests are not transferable within the meaning of the regulation. As a practical matter, all interests in a company are likely to be encumbered with the same transfer restrictions as some members will not desire to restrict their own interests while freeing the transfer of others. Also, even if member-managers are willing to restrict their own interests as managers while freeing other interests because they are not involved in management, it is unlikely that the managers will own in excess of 20% since they most often expect to receive their interest in the company for services rendered or to be rendered.

113. The majority standard may be satisfied by either a majority of the interests, capital, profits, or persons. Rev. Proc. 95-10, § 5.02(3), 1995-3 I.R.B. 20, 23. This definition should be contrasted to the more vague majority-in-interest standard. *See* Rev. Proc. 94-46, 1994-28 I.R.B. 129.

114. Rev. Proc. 95-10, § 5.02(3), 1995-3 I.R.B. 20, 23.

115. ULLCA §§ 503(a), 404(c)(7).

116. *Id*. § 103.

117. Rev. Proc. 95-10, § 5.02(2), 1995-3 I.R.B. 20, 23.

118. Rev. Proc. 95-10, § 5.04, 1995-3 I.R.B. 20, 24. The local liability rule distinguishes contractual guarantees of company obligations by one or more members from liability imposed under local law. Local law must permit this result. ULLCA permits one

These dramatic effects will encourage all companies to elect manager-management, even those previously organized as member-managed. In the latter case, a pre-existing company may need to amend its articles of organization.

II. OTHER PREVALENT BUSINESS FORMS

ULLCA is an amalgam of provisions borrowed from other business forms and specially tailored provisions all designed to meet its special needs.[119] While its combinations are unique, they are best understood comparatively — in relation to other business organization forms. The most common are general partnerships (including limited liability partnerships), limited partnerships, and corporations.

A. General Partnerships (1914 Act) (UPA)

The effect of partner dissociation and partnership dissolution is less detailed for general partnerships formed under the Uniform Partnership Act of 1914 (UPA) than under ULLCA. In a general partnership, the dissociation of any general partner for any reason causes the immediate dissolution of the partnership notwithstanding any agreement to the contrary.[120] Partner dissociation occurs as a result of the end of an individual partner's ongoing relationship

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or more specified members of a company to be personally liable for some or all of the company's obligations provided the articles permit the result and the members so liable consent in writing. ULLCA § 303(c); *see also id*. § 203(a)(7) (required provision in the articles of organization). These provisions permit, for example, a member-manager of a manager-managed company to accept personal liability for company obligations, allowing the company more flexibility in its business structure while continuing to be taxed like a partnership for federal tax purposes. While ULLCA provisions permit personal liability for some or all of the company obligations, the Revenue Procedure requires liability for all company obligations. Also, the Revenue Procedure requires liable members to maintain a net worth equal to 10% of all capital contributions throughout the duration of the company. Rev. Proc. 95-10, § 5.04, 1995-3 I.R.B. 20, 24. However, the net worth standard may not apply, provided the obligated members are also managers and are not considered to be under the absolute control of the other members (the "dummy" standard). *See* Treas. Reg. § 301.7701-2(d)(2) (as amended in 1993) (first sentence). For a discussion of the regulation "dummy" standard and case law, see BISHOP & KLEINBERGER, *supra* note 1, ¶ 2.04[3]; *see also* discussion *supra* note 16.

119. ULLCA § 101 cmt.

120. UNIF. PARTNERSHIP ACT (1914) § 29 (UPA). *See* Table II, UPA Column.

with fellow partners because of death,[121] bankruptcy,[122] expulsion,[123] or resignation or withdrawal.[124] Dissolution does not end the life of the partnership — it merely indicates the partnership has no proper purpose other than to settle its accounts with third parties and partners.[125]

Under these rules, even a partner dissociation made wrongful by the partnership agreement causes the partnership to dissolve[126] but neither the dissociation or resulting dissolution necessarily terminates the partnership's business. Thus, a partner retains the power to dissociate but the partnership agreement may make the dissociation wrongful.[127] Partnership liquidation only occurs if the partnership agreement does not provide that the business of the old partnership[128] is to continue in a successor partnership notwithstanding the dissolution, winding-up, and termination of the old partnership.[129] Accordingly, partners generally secure business continuity by having the partnership agreement provide that the business will continue in a successor partnership notwithstanding a

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121. *Id*. § 31(4).

122. *Id*. § 31(5).

123. *Id*. § 31(1)(d).

124. *Id*. § 31(1)(b) (by express will when no definite term or particular undertaking is specified), 31(2) (by express will in contravention of partnership agreement).

125. *Id*. §§ 30 (dissolved partnership is not terminated but continues until its winding up), 40 (rules regarding settling accounts among the partnership, third parties, and partners).

126. *Id*. § 31(2) (expressly contemplating dissolution following wrongful dissociation); *see id.* §§ 37, 38.

127. *Id*. § 31(2) (by express will in contravention of partnership agreement if the duration of the partnership is at will; if the duration is for a particular undertaking, the dissociation is wrongful unless otherwise agreed).

128. The partners continuing the business in a new partnership technically wind up the business of the dissolved partnership by settling accounts with the dissociated partner, settling accounts with the creditors of the dissolved partnership which involves either paying off all obligations or having the new partnership assume the obligations of the dissolved partnership, and settling accounts of the partners continuing the business by granting them rights in the new partnership that are the same as in the dissolved partnership. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶ 9.02[1][c].

129. UPA §§ 38(1) (partnership assets liquidated upon dissolution of the partnership unless the dissolution was "in contravention of the partnership agreement" and the partners have "otherwise agreed" to avoid the liquidation), 38(2)(a)(i) (partners who have not caused partnership dissolution "in contravention of the partnership agreement" have all the rights specified in section 38(1), including therefore the right to continue the partnership business through a provision in the partnership agreement that predated the wrongful dissolution); *see* BISHOP & KLEINBERGER, *supra* note 1, ¶ 9.02[1][c].

subsequent dissolution.[130]

Where the business continues, partners who rightfully dissociate are entitled to payment of the value of their partnership interest determined at the time of dissolution, including the value of goodwill.[131] Any delay in payment is therefore only by agreement of all the partners. However, wrongfully dissociating partners[132] are not entitled to immediate payment for the value of their interest if the remaining partners "freeze-in" those partners' investment in the partnership for the duration of any original agreed term of the partnership.[133] In order to defer payment, the remaining partners must agree to continue the business of the partnership,[134] hold the wrongfully dissociated partner harmless from personal liability arising from past or future business operations,[135] and obtain a court-approved bond guaranteeing the eventual payment of the wrongful dissociator's interest at the end of the original agreed term.[136] Even if payment is deferred until the expiration of the original agreed term, the wrongful dissociator's partnership interest is valued at the time of the dissociation and hence dissolution.[137] However, the valuation excludes the value of any goodwill and the deferred payment may be reduced by any damages caused by the wrongful dissociation.[138] Otherwise, the payment is generally protected from post-dissolution losses and does not benefit from post-dissolution appreci-

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130. *Compare* discussion *supra* note 87.

131. UPA §§ 38(1), 42, 40; BROMBERG & RIBSTEIN, *supra* note 8, § 7.13(b); *see* Table I, UPA-GPner Column.

132. Withdrawal from a partnership for a term or a particular undertaking is perforce wrongful because the partners have agreed to enter into an association for a certain period of time. *See* BROMBERG & RIBSTEIN, *supra* note 8, § 7.03(a).

133. UPA § 38(2)(b).

134. The business continuation agreement may be made either before or after the dissolution since UPA does not otherwise prohibit advance agreement. Of course, if the partners make the agreement before dissolution, they (including the wrongful dissociator) advance business continuity since all partners preagree to continue the business. If the agreement is made after dissolution, it excludes the consent of the wrongful dissociator. UPA § 38(2)(b); *see* BISHOP & KLEINBERGER, *supra* note 1, ¶ 9.02[1][d].

135. Compare UPA § 38(2)(b), which merely requires that the partners continuing the business "indemnify" the wrongful dissociator against all present or future partnership liabilities, with § 38(2)(c)(II), which requires the continuing partners to obtain a "release" from all existing liabilities of the partnership. For a brief discussion of this inconsistency, see BROMBERG & RIBSTEIN, *supra* note 8, § 7.13(e).

136. UPA § 38(2)(b).

137. *Id*. ("the value of his interest in the partnership at the dissolution").

138. *Id*. § 38(2)(a)(II) (each partner not wrongfully dissociating has a right to damages against each partner who wrongfully caused dissolution).

ation.[139]

B. General Partnerships (1914 Act) Contrasted with ULLCA

The contrast between the general partnership and ULLCA paradigms is significant. Importantly, members of a limited liability company are not liable for the obligations of the company,[140] while general partners possess personal liability. Beyond liability issues, even though general partnerships with business continuation agreements enjoy slightly greater business continuity than a limited liability company, the ULLCA method of dealing with dissociated members tilts the scale in their favor.

1. Business Continuity

Dissociation of any partner causes an automatic dissolution of a general partnership regardless of the duration or the management structure of the partnership. The effects of the dissolution are left to business continuation agreements. In a limited liability company, the effect of member dissociation critically depends on both the duration[141] and the management structure of the company.[142]

The ability of a company's members to vote to avoid dissolution has invited criticism, since business continuation agreements made before dissolution may cause the company to possess the corporate characteristic of continuity of life.[143] Also, only selected dissociations of members of a term company[144] and only the dissociation of a member-manager of a manager-managed company threaten dissolution,[145] whereas the dissociation of every general partner causes dissolution of a general partnership. The management structure of a general partnership has no impact on the dissociation and dissolution characteristics of a general partnership. Indeed, under the tax classification regulations a general partnership will always be con-

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139. The wrongful dissociator nevertheless elects to receive either interest on the deferred payment or a share of profits until the time of actual settlement. *Id.* § 42; BROMBERG & RIBSTEIN, *supra* note 8, § 7.11(c) n.15.

140. *See* discussion *supra* note 16.

141. *See supra* text accompanying notes 47–87.

142. *See supra* text accompanying notes 88–109; Table II, LLC Columns.

143. *See supra* note 87.

144. *See supra* text accompanying note 77.

145. *See supra* text accompanying notes 102–04.

sidered member-managed, even if management is delegated to a management committee under the partnership agreement.[146] The reason is that all general partners retain the apparent authority to bind the partnership to third parties without notice of the internal delegation of authority.[147] The ineffectiveness of internal agency limitations as to third parties makes the limitations meaningless for tax purposes.

Despite the apparent dissolvability of a general partnership compared to a limited liability company, a general partnership with a business continuation agreement nevertheless has greater business stability than a limited liability company. Once a dissolution-threatening dissociation occurs to either entity, the business continuity of the general partnership is assured because of its agreement, whereas the limited liability company must avoid the dissolution by a vote of a specified percentage of the remaining members. Effectively, this means that some percentage (typically small) of the remaining members may force the liquidation a company's business, whereas all the partners are bound by their business continuation agreement. In the latter case, no group of less than all the remaining partners may breach the business continuation agreement with impunity.

2. *Treatment of Dissociated Owners*

Notwithstanding the slight entity comparison advantage enjoyed by partnerships because of greater business continuity,[148] considering the treatment of dissociated owners under the two business forms, the limited liability company enjoys greater capital utility because of its greater ability to freeze-in a dissociated member's interest beyond the moment of dissociation.

If a partnership does not liquidate, rightfully dissociated partners of at-will and term partnerships and wrongfully dissociated partners of an at-will partnership receive immediate payment of the value of their interest.[149] Payment to wrongfully dissociated partners is reduced by damages and by the value of goodwill.[150] More-

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146. Treas. Reg. § 301.7701-2(c)(4) (as amended in 1993) (third sentence).
147. *Id*. (fourth sentence).
148. *See supra* text accompanying notes 141–47.
149. *See supra* text accompanying note 131.
150. *See supra* text accompanying notes 132–39.

over, payment may be deferred in a term partnership (but not at-will) until the expiration of the original term, but the deferral is only upon satisfaction of stringent conditions necessary to reduce the risk of nonpayment.[151] If a limited liability company does not dissolve, dissociated members of an at-will company are also entitled to immediate payment for the fair value of their interest through a simple voluntary dissociation (which may be made wrongful by agreement). However, dissociated members of a term company are not entitled to payment until the expiration of the term regardless of whether the dissociation is rightful or wrongful, the payment is not secured by a bond, and the payment is subject to the risk of the business during the deferral, since the value of the interest is determined at the end of the term rather than at the time of dissociation. Thus, a dissociated partner of a partnership has greater ownership liquidity than a dissociated member of a term company — at least when viewed from the perspective of a forced put to the entity.

3. Management Structure

Each partner has equal rights in management[152] with management disputes as to ordinary matters resolved by a vote of a simple majority of partners and extraordinary matters resolved by a unanimous vote.[153] Each member has the actual and apparent authority to bind the partnership as to matters necessary to carry on the business of the partnership in the usual way.[154] Although the partnership agreement may limit the actual authority of any member, the authority limitation is only effective as to third persons who have knowledge of the limitation.[155] In contrast, the management rights of members of a limited liability company depend on the management structure of the company. A member-managed company is like a general partnership.[156] However, in a manager-managed company, the members have no authority to bind the company solely because

151. *See supra* text accompanying notes 134–36. Compare Table I, LLC-Members Column.

152. UPA § 18(e).

153. *Id*. § 18(h).

154. *Id*. § 9(1).

155. *Id*.

156. *See supra* text accompanying notes 93–94.

they are members.[157] Only managers have agency authority.[158] Accordingly, a company may use the manager-management designation to more effectively limit the apparent authority of members in a member-managed company to bind the company to persons without notice of the authority limitation. By way of contrast, a partner who exceeds actual authority is liable to the other partners but nevertheless binds the partnership to third parties without actual knowledge of the authority limitation.[159] Accordingly, when authority limitations are important, a limited liability company offers a vastly superior approach to a general partnership — a manager-managed limited liability company relegating owners without intended agency authority to the status of members but not managers.

4. Conclusion

Given that most limited liability companies will elect to be manager-managed term companies, just as most general partnerships have business continuation agreements, the default ULLCA business structure is significantly more favorable to the continuing members than to dissociated members — particularly where the dissociation is rightful. This, coupled with limited liability, means that general partnerships will likely experience declining acceptability compared to limited liability companies.[160]

C. Limited Liability Partnerships Contrasted with ULLCA

Limited liability partnerships, although currently popular,[161]

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157. ULLCA § 301(b)(1) (first sentence).

158. *Id*. § 101(10), 301(b).

159. UPA § 9(a).

160. Of course, a general partnership may still be created without any filing similar to that required for limited liability companies and other liability shield entities. UPA § 7. Therefore, general partnerships will continue to dominate informal and unintended business combinations where the owners are not required to file any organization documents.

161. Limited liability partnerships may often be chosen over limited liability companies for conversions of existing general partnerships to a noncorporate entity with liability shield because it is simpler to create (no need for a new or revised agreement or articles of organization), easier to understand (requires only new knowledge of the na-

will ultimately suffer the same fatal comparative disadvantages of general partnerships. A limited liability partnership is simply a general partnership that files an annual registration statement to acquire some form of a liability shield for its partners.[162] Although it also enjoys partnership tax status and, in some cases, a similar shield to limited liability companies,[163] a limited liability partnership is still a general partnership for all nonliability shield purposes, including dissociation and dissolution characteristics. Therefore, they suffer the same infirmity as general partnerships regarding the buyout rights of dissociated partners. Also, not only is the scope of the liability shield generally inferior to that for limited liability companies,[164] all limited liability partnership liability shields are self effacing. They require annual renewal through an annual registration. The shield does not apply to obligations incurred when the shield is not in effect. Accordingly, if the registra-

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ture and extent of the liability shield), and most importantly, generally does not require a fresh reading of the old partnership agreement and the resulting change negotiations (although contribution and indemnification provisions should be reviewed to make certain the effects of the new liability shield are not waived). For a complete discussion of this topic, see BISHOP & KLEINBERGER, *supra* note 1, ¶ 1.03.

162. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶ 1.03. State enactments include the following 23 statutory provisions: ARIZ. REV. STAT. ANN. §§ 29-244 to -257 (Supp. 1994); CONN. GEN. STAT. ANN. §§ 34-81a to -81Z (West Supp. 1995) (effective Jan. 1, 1996); DEL. CODE ANN. tit. 6, §§ 1544–1547 (1993); D.C. CODE ANN. §§ 14-8-62 to -64 (Supp. 1995); GA. CODE ANN. §§ 14-8-62 to -64 (Supp. 1995); IDAHO CODE §§ 53-343A to -343C (Supp. 1995); ILL. ANN. STAT. ch. 805, para. 205/8.1–8.5 (Smith-Hurd Supp. 1995); IOWA CODE ANN. §§ 486.44–.46 (West Supp. 1995); KAN. STAT. ANN. §§ 56-345 to -347 (1995); KY. REV. STAT. ANN. §§ 362.555–.605 (Michie/Bobbs-Merrill Supp. 1995); LA. REV. STAT. ANN. §§ 9:3431–:3435 (West Supp. 1995); MD. CODE ANN., CORPS. & ASS'NS §§ 9-801 to -805 (Supp. 1994); MICH. COMP. LAWS ANN. §§ 449.44–.48 (West Supp. 1995); MINN. STAT. ANN. §§ 323.44–.47 (West 1995); N.Y. PARTNERSHIP LAW §§ 121-1500 to -1503 (McKinney Supp. 1995); N.C. GEN. STAT. §§ 59-84.2 to -84.3 (Supp. 1994); OHIO REV. CODE ANN. §§ 1775.61–.63 (Anderson Supp. 1994); 15 PA. CONS. STAT. ANN. §§ 8201–8207 (Supp. 1995); S.D. CODIFIED LAWS ANN. §§ 48-7-108 to -111 (Supp. 1995); TEX. REV. CIV. STAT. ANN. Art. 6132b, §§ 45-A to 45-C (West Supp. 1995); UTAH CODE ANN. §§ 48-1-41 to -48 (Supp. 1994); VA. CODE ANN. §§ 50-43.1 to -43.10 (Michie 1994).

163. The nature of state limited liability partnership liability shields differ radically. Early statutes were intended to protect partners from vicarious tort liability emanating from the misconduct of other partners and partnership agent-servants. Later shields were expanded to protect these partners from the same liability sounding in either tort or contract. A few modern statutes now provide a complete corporate-like liability shield. These liability shields offer the same protection as the discussed second generation statutes and in addition protect partners from liability for ordinary partnership obligations unless the shield is waived through a guarantee. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶ 1.03(2).

164. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶ 1.03[2].

tion is not renewed there will be a gap in the liability shield.[165] Therefore, limited liability companies should eventually outpace these entities as well, primarily because of a superior liability shield.[166] An exception may exist for professional service firms unable to practice as a limited liability company.[167]

D. General Partnerships (1994 Act) (RUPA)

Partner dissociation under a general partnership formed under the Revised Uniform Partnership Act of 1994 (RUPA) has different consequences than partner dissociation from a UPA partnership. Specifically, the dissociation of a RUPA partner does not automatically cause a dissolution of the partnership.

Any partner not already dissociated[168] from an at-will partnership may dissociate by giving the partnership notice of an express will to withdraw.[169] The dissociation causes the dissolution of the partnership.[170] The partnership will thereafter be liquidated unless all the partners, including a rightfully withdrawing partner,[171] agree after the dissolution to waive dissolution and continue the partnership's business.[172] Where waiver of dissolution occurs, the partnership resumes carrying on its business as if dissolution had never occurred.[173] Generally, the partnership must purchase every dissociated partner's interest if the partnership does not dissolve and wind up its business.[174] Unless a rightful dissociator waives dissolution as well as the right to be bought out, the partnership must purchase the dissociated partner's interest notwithstanding the dissolution

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165. *Id*.

166. In states with full corporate-like liability shields, the comparison is closer but still favors limited liability companies. This is because the limited liability partnership liability shield remains self-effacing under the annual registration requirement whereas once created, the limited liability company shield is permanent.

167. For example, some states may not permit professional service firms to operate as limited liability companies but may permit operation as limited liability partnerships.

168. RUPA §§ 801(1), 601(2)–(10).

169. *Id.* § 801(1).

170. *Id*.

171. The withdrawing partner's consent is required only if the withdrawal was rightful. *Id*. § 802(b).

172. *Id*. Under such an agreement, although the partnership technically dissolves, the partnership entity continues. *See id*. § 802(b) cmt. 2.

173. *Id*. § 802(b)(1).

174. *Id*. § 701(a).

waiver since the partnership is not wound up.[175] If the partner's withdrawal was wrongful, that partner's consent is not necessary for the remaining partners to continue the business, but the partnership nevertheless must purchase that member's interest.[176] The partnership may reduce the buyout price by the amount of any damages incurred as a result of the wrongful dissociation.[177] The purchase price is equal to the fair value[178] of the interest determined at the date of dissociation with interest payable from the date of dissociation to the date of payment.[179]

If the partnership is for a definite term or particular undertaking, only specified dissociations[180] cause partnership dissolution, and only when a majority in interest of the remaining partners fail to avoid the dissolution.[181] If the partnership continues, it nevertheless must purchase a rightfully dissociating partner's interest.[182] If the dissociation was wrongful, the partnership is not required to purchase that partner's interest until the end of the term or particular undertaking, unless earlier payment will not cause a hardship to the business of the partnership.[183] Dissociation from a term partnership by express will prior to the expiration of the term is wrongful.[184]

E. General Partnerships (1994 Act) Contrasted with ULLCA

The contrast between ULLCA and RUPA is less significant than between ULLCA and UPA.[185] Generally, a limited liability company has slightly greater entity stability than a RUPA partnership, par-

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175. The comments to section 802(b) are silent as to the effect of the dissociated partner's dissolution waiver consent on that partner's buyout right.

176. *Id*. § 701(a).

177. *Id*. § 701(c). Presumably, the partnership's damages will be minimal where the remaining partners consent to waive dissolution and continue the partnership's business under section 802(b)(1). Damages would presumably relate to the cost to the partnership of immediately financing the purchase under the "unexpected" dissociation.

178. *Id*. § 701(b). The actual valuation formula is somewhat more complex than simply fair value.

179. *Id*.

180. Only specified partner dissociations, excluding withdrawal, threaten dissociation. *See id*. §§ 801(2), 601(6)–(10).

181. *Id*. § 801(2)(i).

182. *Id*. § 701(a).

183. *Id*. § 701(h).

184. *Id*. § 602(b)(2).

185. In large part, this is because RUPA served as the drafting model for many of the ULLCA general partnership-like provisions. UPA was ordinarily not consulted.

ticularly where the company is manager-managed.[186]

In an at-will RUPA partnership, the dissociation of any partner by express will causes dissolution unless all the partners waive dissolution.[187] However, the dissolution of a member of a member-managed at-will limited liability company causes dissolution unless a specified percentage of the remaining members agree to avoid dissolution.[188] In a manager-managed at-will limited liability company, only the dissociation of a member who is also a manager threatens dissolution.[189] Accordingly, an at-will limited liability company enjoys greater default rule flexibility than an at-will RUPA partnership to achieve greater business continuity simply by organizing as a manager-managed company (versus a more complex drafting approach).

Comparing member-managed term companies and term RUPA partnerships,[190] the same partner and member dissociations threaten dissolution which may, in both cases, be avoided by similar majoritarian voting concepts.[191] However, RUPA does not contain a concept similar to the ULLCA manager-managed company rules. In the latter case, only the dissociation of a member who is also a manager threatens dissolution.[192] Once again, the flexibility to create a manager-managed limited liability company creates significantly more business continuity than exists in a RUPA partnership.[193]

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186. When comparing a RUPA general partnership and a member-managed limited liability company, the agency authority issues are similar because RUPA served as the drafting model for the comparable ULLCA provisions. *See supra* note 185. However, the ULLCA agency provisions regarding manager-managed companies have no RUPA counterpart. Compare discussion *supra* text accompanying notes 152–59.

187. *See supra* text accompanying notes 168–72.

188. *See supra* text accompanying note 99.

189. *See supra* text accompanying notes 102–04.

190. A limited liability company may not be created for a particular undertaking. *See* ULLCA § 203(a)(5).

191. *Compare* discussion *supra* at notes 180–84 and accompanying text (RUPA) *with* notes 93–101 and accompanying text (member-managed ULLCA).

192. *See supra* text accompanying notes 102–04.

193. Presumably, for the same reason a limited liability company may not utilize a business continuation agreement to enhance business continuity, neither may a RUPA partnership, at least not without burdening the partnership with the corporate continuity of life characteristic. *See* discussion *supra* note 87.

Briefly, this and other concerns may cause some RUPA-based limited liability partnerships to be classified as associations taxable as corporations under the current tax classification regulations. Such a partnership in a state with a full corporate-styled liability shield would possess the corporate limited liability characteristic. *See supra* notes 16 & 163 and accompanying text. The filing of a RUPA statement of authority

F. Limited Partnerships

1. In General

The effects of partner dissociation on the dissolution of a limited partnership depend upon whether the dissociating partner is a limited or general partner and, if the latter, upon the presence of other general partners. The primary method of dissociation is "withdrawal," although that term is not defined. When a general or limited partner exercises a withdrawal power, rightfully or wrongfully, that partner is ordinarily entitled to receive a distribution of the value of the partnership interest. However, unlike in a general partnership, withdrawal will not necessarily dissolve the partnership and thereby entitle the remaining partners to receive the fair value of their partnership interest.

2. General Partner Rules

Although a general partner possesses all the management rights of a limited partnership, limited partners possess very few such rights.[194] A general partner is also liable for all the debts and obligations of the partnership.[195] A general partner may withdraw at any time from a limited partnership but if the withdrawal violates the partnership agreement, the partnership may recover damages and offset them from the amount otherwise due the withdrawing partner.[196] As in a general partnership, a general partner of a lim-

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relating to real estate, *see* RUPA § 303(d), could cause the entity to possess the corporate characteristic of centralized management because of the lack of similar agency power to third persons without notice of the restriction. *See supra* note 6 and text accompanying notes 155–59. Coupled with expressed continuity of life concern, a RUPA LLP could be classified as a corporation because it possessed three of the four requisite corporate criteria. *See supra* note 11 and accompanying text.

Rev. Rul. 95-55, 1995-35 I.R.B. 13 is the first revenue ruling released regarding the tax classification of a UPA general partnership. No rulings have been released regarding a RUPA general partnership. The ruling determined that a New York UPA-styled limited liability partnership was classified as a partnership because it lacked free transferability of interests, centralized management, and continuity of life. The New York law provides a full corporate-styled liability shield so the partnership possessed the corporate limited liability characteristic.

194. *See supra* text accompanying notes 152–53.

195. REVISED UNIF. LTD. PARTNERSHIP ACT (1985) § 403(b) (RULPA).

196. *Id*. § 602.

ited partnership has the power, but not necessarily the right, to withdraw.[197] Unless otherwise provided in the partnership agreement, withdrawing general partners are entitled to receive the fair value of their partnership interest within a reasonable time after withdrawal.[198] The fair value is to be based on the partners' right to share in distributions as of the date of withdrawal.[199] Accordingly, a partnership agreement may make the withdrawal wrongful and alter the terms of the payout but may not negate the power to withdraw.

3. Limited Partner Rules

Generally, limited partners may not participate in the control of the partnership's business without becoming liable for partnership obligations.[200] Also, most limited partners do not possess the broad general partner power to withdraw from the partnership. The statutory language provides that:

> A limited partner may withdraw from a limited partnership at the time or upon the happening of events specified in writing in the partnership agreement. If the agreement does not specify in writing the time or the events upon the happening of which a limited partner may withdraw or a definite time for the dissolution and winding up of the limited partnership, a limited partner may withdraw upon not less than six months' prior written notice to each general partner at his [or her] address on the books of the limited partnership at its office in this State.[201]

The first sentence does not grant a limited partner a default power to withdraw from the partnership. It merely states the obvious — the partnership agreement may state the time or events entitling a limited partner to withdraw and that these circumstances must be in writing. The writing requirement provides a statute of frauds rule and is important since the partnership agreement itself,

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197. *See supra* text accompanying notes 120–30.
198. RULPA § 604.
199. *Id*.
200. *Id*. § 303(b). See *supra* note 8 for a discussion of limited partner control-based liability.
201. *Id*. § 603.

and any amendments, need not be in writing.[202] Without the context of the remainder of the statute, the first sentence in fact neither affirms nor negates a limited partner's default power to withdraw from the partnership. The fact that the sentence provides for positive withdrawal circumstances could mean either that the default power otherwise exists and the sentence is authority for narrowing that power or that no default power exists and the sentence is authority for granting that power if in writing in the partnership agreement.

The second sentence is more instructive. The first conjunctive alternative of the sentence provides that if the partnership agreement does not reflect in writing the circumstances of withdrawal authorized by the first sentence, "a limited partner may withdraw upon not less than six months' prior written notice to each general partner."[203] By itself, this portion of the sentence means that a limited partner has a default power to withdraw from the partnership conditioned only on six-months' written notice. However, the second conjunctive alternative appears to negate that default power: "If the agreement does not specify in writing . . . [first conjunction] . . . a definite time for the dissolution and winding up of the limited partnership, [second conjunction] a limited partner may withdraw upon not less than six months' written notice to each general partner."[204] The second conjunction provides that a limited partner only possesses the default power to withdraw if the partnership "agreement" does not specify a definite term in writing.[205] This requires an analysis of the scope of the partnership agreement.

In order to form a limited partnership, a written certificate of limited partnership must be filed in the office of the Secretary of State.[206] The certificate must set forth, among other things, "the latest date upon which the limited partnership is to dissolve."[207] This certificate provision clearly contemplates a finite life of the partnership, particularly when compared to the 1916 and 1976 certificate requirements.[208] The 1985 amendments to the Uniform Lim-

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202. *Id*. § 101(9).
203. *Id*. § 603.
204. *Id*.
205. *Id*.
206. *Id*. § 201(a).
207. *Id*. § 201(a)(4).
208. *See* BROMBERG & RIBSTEIN, *supra* note 8, § 12.02(g); *compare* UNIF. LTD.

ited Partnership Act were, in part, designed to reduce the importance of the certificate of limited partnership and elevate the partnership agreement as the central document of importance to the partnership and third parties.[209] This evolution is reflected in the minor changes to the limited partner withdrawal statute. Before the 1985 amendments de-emphasizing the importance of the certificate, the statute read as follows:

> A limited partner may withdraw from a limited partnership at the time or upon the happening of events specified in the certificate of limited partnership and in accordance with the partnership agreement. If the certificate does not specify the time or the events upon the happening of which a limited partner may withdraw or a definite time for the dissolution and winding up of the limited partnership, a limited partner may withdraw upon not less than six months' prior written notice to each general partner at his [or her] address on the books of the limited partnership at its office in this State.[210]

The central difference between the 1976 and 1985 versions of the withdrawal statute is that the 1976 version refers to the certificate of limited partnership, whereas the 1985 version deletes this reference and focuses on written provisions of the partnership agreement. The best explanation of this change is that, consistent with the changes to the certificate requirements, the 1985 version intended to elevate the importance of the partnership agreement as the central agreement of the partners. However, the certificate requirement was maintained and there is no indication in either the 1976 or 1985 Act that the provisions actually included in the certificate are to be ignored. Therefore, as long as the partnership complies with the requirements for the certificate of limited partnership and states a definite term in the certificate, it appears that the limited partners will not have a default power to withdraw from the

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PARTNERSHIP ACT § 2(1)(a)(V) (1916) ("The term for which the partnership is to exist") *with* UNIF. LTD. PARTNERSHIP ACT § 201(a)(11) (1976) ("any time at which or events upon the happening of which the limited partnership is to be dissolved and its affairs wound up") *and* RULPA § 201(a)(4) ("the latest date upon which the limited partnership is to dissolve").

209. RULPA § 201 cmt.

210. UNIF. LTD. PARTNERSHIP ACT § 603 (1976).

partnership.[211] If the written terms of the partnership agreement conflict with the certificate and negate a term specified in the certificate or the certificate simply fails to properly state a term and the partnership agreement does not state a written term, presumably the limited partners would have a default power to withdraw.[212] Otherwise, the written and filed stated term provision of the certificate will become part of the partnership agreement. In many, if not most cases, the partnership agreement will repeat the stated term of the partnership and mute the importance of the certificate when the written terms of the partnership agreement are silent. The same result would occur where the written terms of the partnership agreement state a term and the certificate is erroneously silent.

Where a limited partner does have the power to withdraw under this analysis, the limited partner has the same distribution rights as a withdrawing general partner — the right to receive a distribution of the fair value of the interest within a reasonable time after the withdrawal.[213] The partnership agreement may make the withdrawal wrongful and control the terms and timing of the payment.[214] Damages are offset against the distribution.[215]

Unlike a general partnership, a limited partnership is not necessarily dissolved by the exercise of a power to withdraw.[216] Thus, even though withdrawing partners in both general and limited partnerships are generally entitled to receive a distribution of the fair value of their interest within a reasonable time after the withdrawal,[217] limited partnerships have considerably more business continuity than general partnerships because fewer partners have the withdrawal power. Accordingly, a general partnership-styled business continuation agreement is rare in the context of a limited partnership.[218]

The essential limited partnership dissolution provision provides

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211. For inferential support for this interpretation, see RULPA § 801(4) (only the withdrawal of a general partner threatens dissolution of a limited partnership — the withdrawal of a limited partner has no effect on partnership dissolution even if the limited partner has the power to withdraw).

212. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶¶ 8.02[1][b], 9.02[2] n.33.

213. RULPA § 604.

214. *Id*.

215. *Id*.

216. *See supra* text accompanying note 197.

217. *See supra* text accompanying notes 198–99.

218. *See supra* note 87.

that a limited partnership will dissolve and wind up its affairs only upon the withdrawal of a general partner:

> an event of withdrawal of a general partner unless at the time there is at least one other general partner and the written provisions of the partnership agreement permit the business of the limited partnership to be carried on by the remaining general partner and that partner does so, but the limited partnership is not dissolved and is not required to be wound up by reason of any event of withdrawal, if, within 90 days after the withdrawal, all partners agree in writing to continue the business of the limited partnership and to the appointment of one or more additional partners if necessary or desired . . . [219]

The limited partnership dissolution statute[220] makes clear two important points. First, only the withdrawal of a general partner threatens dissolution of the partnership. The withdrawal of a limited partner, even if when permitted in writing in the partnership agreement, does not threaten the dissolution of the partnership.[221] Second, the withdrawal of a general partner merely threatens dissolution, and then only in a specific context: the withdrawal of a general partner will cause the dissolution of the limited partnership unless (1) at least one other general partner remains, the written provisions of the partnership agreement permit that general partner to carry on the partnership's business, and that partner does so; or (2) within ninety days after the withdrawal of the only remaining general partner, all the limited partners agree in writing to continue the partnership's business and to appoint another general partner.[222]

Thus, in order for a limited partnership to dissolve, the last remaining general partner of the partnership must withdraw and at least one limited partner must refuse to consent to continue the

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219. RULPA § 801(4).

220. The statute only deals with nonjudicial dissolution. Judicial dissolution is governed by RULPA § 802.

221. BISHOP & KLEINBERGER, *supra* note 1, ¶ 9.02[2] n.34; *see also* Larry E. Ribstein, *Statutory and Planning Considerations for Withdrawal from an LLC*, 1 J. LTD. LIAB. COS. 64, 65 (1994).

222. The unanimous consent of the limited partners to continue the partnership's business is the progenitor of the limited liability company consent to avoid dissolution. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶ 9.02[2] n.34.

partnership's business. Regardless of whether the partnership dissolves, the withdrawing general partner is entitled to receive, subject to damages for wrongful withdrawal, the fair value of the partnership interest within a reasonable time after the withdrawal unless the partnership agreement provides otherwise.[223]

G. Limited Partnerships Contrasted with ULLCA

Since a limited partnership is managed by a general partner and limited partners generally exercise no management rights, a limited partnership resembles a manager-managed limited liability company. The management rights of limited partners most closely resemble those of non-managing members of a manager-managed limited liability company,[224] but the exit rights of limited partners are similar to those of members of a term company. Since limited partners of a term limited partnership do not have the power to withdraw,[225] they may not force the partnership to distribute the fair value of their partnership interests until the end of the partnership's term, unless the partnership dissolves earlier.[226] Similarly, although members of a term company have the power to dissociate, their dissociation will not force the company to purchase their interest until the expiration of the term (provided the dissociation does not cause a dissolution). In both cases, the specification of a

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223. RULPA § 604.

224. The analogy is less than perfect when the management rights of non-managing members of a manager-managed company and limited partners are compared. In a limited partnership, limited partners have no right to vote on any matter unless the partnership agreement otherwise grants the right. RULPA § 302. Generally, limited partners only have the right to inspect and copy the partnership's required records and to obtain upon reasonable demand (1) "true and full information" regarding the state of the partnership's business and its financial condition, (2) copies of partnership income tax returns, and (3) other "just and reasonable" information regarding the affairs of the partnership. *Id*. § 305. Limited partners also have the right to seek judicial dissolution of the partnership when it is "not reasonably practicable to carry on the business in conformity with the partnership agreement." *Id*. § 802. By way of contrast, a general partner has all the management rights of a general partner in a general partnership. *Id*. § 403(a). A non-managing member of a manager-managed limited liability company has superior rights to a limited partner. In addition to similar rights accorded to limited partners, non-managing members have the right to vote on "extraordinary" matters, vote on the appointment of new managers, and to seek removal of a manager without seeking a dissolution of the company. ULLCA § 404(a)(3), (c). Limited partners are therefore more like transferees of a member's distributional interest. *See id*. § 503(e).

225. *See supra* notes 200–11 and accompanying text.

226. RULPA § 801(4); *see supra* notes 212–19 and accompanying text.

term in the partnership's certificate or agreement or in the company's articles of organization freezes the interest in the entity until the term expires. Also, in the extremely rare case that a limited partnership is "at-will" because of a failure to specify a term in the certificate or in the partnership agreement, the limited partner will have a power to dissociate and will be entitled to receive a distribution of the fair value of the interest within a reasonable time.[227] This is similar to the treatment accorded to members who dissociate from an at-will limited liability company.[228]

As with a manager of a limited partnership, a general partner retains the power to withdraw, although its use may be made wrongful by the partnership agreement. This power may not be eliminated. By contrast, a limited liability company may eliminate the power of a managing-member to dissociate.[229] Only the dissociation of the last remaining general partner of a limited partnership threatens dissolution, whereas the dissociation of any member-manager of a manager-managed limited liability company threatens dissolution. Dissolution of a limited partnership may be avoided only by the written agreement of all the limited partners, whereas dissolution of a limited liability company may be avoided by a vote of a majority of the remaining members holding the requisite distribution rights. These comparisons generally mean that a manager-managed limited liability company with a sole member-manager will possess greater business continuity than a limited partnership with one general partner simply because the quantum of consent to avoid dissolution has been dramatically reduced.

Because of these comparisons, it is unlikely that limited partnerships will continue to flourish and will be largely replaced by term manager-managed limited liability companies with at least one member-manager. These companies possess greater business continuity than a limited partnership. It is easier to freeze-in a dissociating managing member's interest until the end of the term than to freeze-in a withdrawing general partner's interest, and it is no more difficult to freeze-in a dissociating non-managing member's interest than a limited partner's interest. Moreover, although non-managing members have slightly greater voting and management rights than

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227. *See supra* notes 27–28 and accompanying text.
228. *See supra* text accompanying notes 47–70.
229. ULLCA § 103.

limited partners, the former may participate in the business without sacrificing their liability shields.

III. SUMMARY ANALYSIS OF STATE LLC LAW

As reflected in Tables III–IV, state limited liability company laws may be compared and contrasted on the basis of several factors. All comparisons establish enormous diversity regarding fundamental issues concerning whether a member has the power to withdraw, the right to withdraw, the right (if the power exists) to receive any distribution at or near the time of withdrawal for some value of the interest, and the effect of withdrawal on the business continuity of the entity. The comparative data establishes that death of a member has not been universally considered as an event of withdrawal. In some cases, the estate is not thereafter empowered to withdraw, and therefore the decedent's interest may be frozen-in until the limited liability company otherwise dissolves.

By way of a summary, a majority of jurisdictions provide that a member has an optional default power to withdraw from the company unless the operating agreement eliminates this power.[230] Thirteen states provide that a member has the absolute power to withdraw and that the power may not be eliminated.[231] Four states provide that a member does not have the power to withdraw unless that power is granted by the operating agreement.[232] Within these three categories, there are five separate categories that characterize the distribution rights of a member when the power to withdraw is excised. The most common distribution option, that of seventeen states and the District of Columbia, provides that dissociated members are entitled to receive the fair value of their interest less any damages caused by wrongful withdrawal.[233] Eleven states provide that dissociated members simply receive the fair value of their interest if they have the power to withdraw, providing no wrongful dissociation damages.[234] Eight states provide that a dissociated member is not entitled to any distribution prior to dissolution of the entity.[235]

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230. Table III, Column C.
231. Table III, Column B.
232. Table III, Column D.
233. Table III, Row 2 and Columns B & C.
234. Table III, Row 1 and Columns C & D.
235. Table III, Row 4 and Columns C & D.

Seven states provide that a dissociated member is simply entitled to receive a return of contribution.[236] Finally, three states provide that dissociated members receive the liquidation value of their interest upon dissociation.[237]

Tables IV-A to IV-C summarize the effects of death on the right of individual decedent members to receive a distribution for some value of their interest. Table IV-C sets forth the citations to all death-related statutes. First, death is an event of dissociation in all states either through a direct reference in the dissolution statute[238] or through a reference to an external statute, including death as an event of dissociation, withdrawal, resignation, cessation, or termination.[239] Second, the table sets forth the citations that describe whether a distribution occurs in the event death does not cause dissolution.[240] Finally, the table sets forth citation to any statutes describing the right of the estate to exercise some or all of the decedent's member's rights, including the right to withdraw.[241]

Tables IV-A and IV-B display two separate arrangements of the death statutes. Table IV-A primarily reflects whether the decedent's estate is entitled to a distribution of some value of the decedent's interest in the company as a default matter,[242] or only if the operating agreement expressly provides for that right.[243] A variation on this theme is the ability of the estate to affirmatively demand the right to the distribution as the holder of all the decedent's rights as a member solely for the purpose of settling the estate, including the right to resign, withdraw, or dissociate.[244] Most states provide that when the estate receives a distribution, the value of the distribution will be the "fair value" of the decedent member's interest.[245] Table

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236. Table III, Row 5 and Columns B & C.

237. Table III, Row 3 and Column C.

238. Table IV-C, Column B. The states which directly reference death in their dissolution statutes are categorized by a single statutory reference in Column B.

239. Table IV-C, Column B. The states which indirectly reference death in their dissolution statutes are categorized by multiple statutory references in Column B.

240. Table IV-C, Column C.

241. Table IV-C, Column D.

242. Table IV-A, Row 2 and Columns B through E. See Table III-A, Column I for a summary of the precise measure of distribution rights.

243. Table IV-A, Row 1 and Columns B through E.

244. Table IV-A, Row 3 and Column B.

245. Table IV, legend note. In each case, this valuation presumably includes the member's right to vote even though this interest is not transferable. Also, it is not clear whether this is a going concern value or simply a liquidation value.

IV-B arrays the same statutes differently to reflect that in many instances death is simply a default event of dissolution. In fact, seventeen states provide that death will threaten dissolution only if so provided in the operating agreement.[246] The remaining states provide that death is always an event of dissolution which apparently cannot be modified by the operating agreement.[247]

The state laws are thus organized into several groups. In all states, death is at least a default event of dissolution.[248] If death causes dissolution, the decedent's estate and remaining members receive the liquidation value of their interests. If dissolution does not occur, the states differ as to whether and how a decedent's interest is purchased by the company and, if not, as to the rights retained by the estate. The most popular version, that of nineteen states, provides that if an individual member's death does not cause the dissolution of the limited liability company, the decedent's interest is nevertheless purchased by the company.[249] Nine additional states and the District of Columbia provide that, for the purpose of settling the estate, the estate retains all of the decedent's rights as a member, including presumably the right to withdraw or otherwise voluntarily dissociate and receive the value of the interest unless all dissociations are made wrongful in the operating agreement.[250] Therefore, twenty-eight states and the District of Columbia all provide for some default mechanism for the company to purchase the decedent's interest if the company does not otherwise dissolve. On the other hand, eighteen states provide that the company need not purchase a decedent's interest, at least as a default matter.[251] In these states, the interest of the estate and heirs will only be purchased if the operating agreement expressly so provides or the remaining members voluntarily decide to do so. The latter option is not likely since, upon death, the decedent member's right to vote and participate in management also expires. The estate and heirs only maintain the economic rights to future distributions that the decedent possessed. In essence, this amounts to a surprising transfer of voting and man-

246. Table IV-B, Column B.

247. Table IV-B, Column C. It is unclear whether an operating agreement may modify provisions which do not appear to be default provisions.

248. Table IV-B.

249. Table IV-A, Row 1 and Columns B through E.

250. Table IV-A, Row 3 and Column B.

251. Table IV-A, Row 2 and Columns B through E.

agement rights to the remaining members.[252]

IV. CONCLUSION

The default rules regarding the right of members to force the company to purchase their interest for fair value within a reasonable time after a voluntary withdrawal or death vary significantly. The variance is based largely on the fact that the statutes were drafted in different years with different paradigms in mind. The statutes are based in varying degrees on general partner, limited partner, and corporate shareholder models setting forth similar distribution rights associated with withdrawal and death. Even though the internal affairs doctrine suggests that these issues are to be resolved by reference to the law of the state of organization of the limited liability company, variance can create unwarranted problems.

First, members, particularly investing members and their counsel, should not be required to know and understand the law of the state of organization. Requiring this knowledge is unrealistic and inefficient, creating uncertainty and unnecessary expense. Second, the variance destroys the value of precedent. State and federal case law in one jurisdiction will not persuade another jurisdiction because of the differences in statutes.

ULLCA solves these and other concerns[253] by setting forth two separate and independent business organizations under the same limited liability company umbrella. Under this structure, practitioners need understand only whether the company is a term or at-will company to understand the default rules regarding members' rights to force the company to purchase their interest upon voluntary withdrawal or death. These rules are somewhat intuitive since members that have agreed to a specific term forfeit liquidity until the expiration of the agreed term. If occurring in an at-will company, both events constitute events of dissociation[254] which, absent a contrary provision in the operating agreement,[255] require the company to deliver a purchase offer for the fair value[256] of the member's interest

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252. ULLCA § 601 cmt.
253. *See supra* note 25 and accompanying text.
254. ULLCA § 601(1), (8)(i).
255. *Id*. § 103.
256. *Id*. § 701(a)(1).

within thirty days of the dissociation.[257] If occurring in a term company, both events are also events of dissociation,[258] but the company is not, absent a contrary provision in the operating agreement, required to deliver a purchase offer for the fair value of the interest until the expiration of the specified term that existed on the date of dissociation.[259] Also, the term company fair value is not determined until the end of the specified term.[260] These rules are simple. In an at-will company the members may exit the entity with relative ease but the business continuity of the company is fragile as a result. The at-will paradigm is the default rule. The term paradigm only applies if the articles affirmatively designate the company as such.[261]

These two paradigms will greatly simplify practice, promoting certainty, cost savings, and the precedential effect of decisional law. Since both rules maintain great flexibility for contract modification through the operating agreement, they present a forceful argument for the adoption of the Uniform Limited Liability Company Act.

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257. *Id*. § 701(b).
258. *Id*. § 601(1), (8)(i).
259. *Id*. § 701(a)(2).
260. *Id*.
261. *Id*. § 203(a)(5).