The Louisiana Limited Liability Company Law After "Check-the-Box"

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The limited liability company ("LLC") has become a popular form of business organization because it offers investors the type of limited liability that is enjoyed by corporate shareholders and, at the same time, an LLC may be classified as a partnership for federal income tax purposes. An LLC is not always classified as a partnership, however. Until January 1, 1997, an LLC was classified as an association taxable as a corporation rather than as a partnership unless the LLC lacked at least two of the following corporate characteristics: (1) continuity of life, (2) centralized management, (3) limited liability, and (4) free transferability of interests.

The Louisiana LLC Law is a flexible statute that allows the parties to make elections in an LLC's articles of organization and operating agreement (collectively referred to as an LLC's "organizational documents") that affect all aspects of the LLC's structure and governance. Because of the flexibility accorded to the parties under the Louisiana LLC Law, it was possible for a Louisiana LLC to be classified under the former regulations either as an association taxable as a corporation or as a partnership, depending on the provisions contained in the LLC's organizational documents. To the extent that an LLC's organizational documents are silent, the Louisiana LLC law "fills in the gaps" with certain default provisions, many of which are designed to ensure that the LLC would be classified as a partnership under the former classification regulations. Some deviation from the default rules of the Louisiana LLC Law was permissible without causing a Louisiana LLC to be classified as an association taxable as a corporation. The Internal Revenue Service (the "Service") has ruled that a Louisiana LLC whose organizational documents did not meet the default rules of the Louisiana LLC Law was permissible without causing a Louisiana LLC to be classified as a partnership.
not depart too far from the default rules of the Louisiana LLC Law was classified as a partnership for federal income tax purposes under the former regulations.\(^5\)

In December 1996, the Service and the Treasury Department issued regulations (the "check-the-box" regulations)\(^6\) that simplify the classification of an LLC by permitting many LLCs to determine their tax classification by election. Under the check-the-box regulations, the corporate resemblance test of the former classification regulations is relevant no longer. Consequently, the default rules of the Louisiana LLC Law that were written to comply with the rules of the former regulations are necessary no longer. This article discusses the classification of a Louisiana LLC under the former classification regulations and the new check-the-box regulations, and considers whether Louisiana LLC Law should be amended now that the check-the-box regulations permit more flexibility with respect to the organization and operation of an LLC.

Part I of this article discusses the development of the classification regulations and the reasons for their amendment. An understanding of the intricacies of the entity classification analysis under the former regulations is helpful to appreciate the impact of the check-the-box approach and the amendments that should be made to the Louisiana LLC Law now that the new regulations have been issued in final form. Accordingly, Part II explains the classification of a Louisiana LLC under the former regulations and the extent to which deviation from the default rules of the Louisiana LLC Law was permissible without causing an LLC to be classified as an association taxable as a corporation. Part III describes the check-the-box election under the new regulations. Part IV considers whether the default rules of the Louisiana LLC Law should be amended as a result of the new flexibility available under the new regulations and offers several suggestions. If the Louisiana LLC Law is to be amended significantly, it may be advisable for the Louisiana Legislature to consider adopting the Uniform Limited Liability Company Act ("ULLCA") recently issued by the National Conference of Commissioners on Uniform State Laws. While a complete analysis of ULLCA is beyond the scope of this article, Part V raises issues that should be considered in determining whether ULLCA is a suitable statute for Louisiana.

I. BACKGROUND

The former regulations that distinguished a partnership from a corporation sometimes are referred to as the "Kintner" regulations because they were promulgated in response to United States v. Kintner,\(^7\) in which the United States

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7. 216 F.2d 418 (9th Cir. 1954).
Court of Appeals for the Ninth Circuit held that an unincorporated medical association had sufficient corporate characteristics to be classified as a corporation for federal income tax purposes. It was important for the association in *Kintner* to achieve corporate tax status so that the association could establish a qualified pension plan for its “member-doctors.” At the time that *Kintner* was decided, a partnership could not establish a qualified pension plan for its partners.\(^8\) The *Kintner* regulations made it more difficult for an unincorporated business organization to be classified as a corporation for federal tax purposes than the prior regulations did.

After the *Kintner* regulations were issued, professionals who practiced in unincorporated business organizations could not qualify for tax deferral under pension plans that were available to businesses operating in the corporate form. The government failed, however, in its effort to prevent professionals from taking advantage of the corporate provisions of the Internal Revenue Code. Professionals convinced state legislatures to enact laws permitting them to incorporate,\(^9\) courts refused to apply amendments to the regulations that would have denied corporate status to professional corporations,\(^10\) and Congress eventually made the benefits of pension and profit sharing plans available to partners.\(^11\)

Not only did the Treasury Department lose its battle in trying to deny the benefits of corporate taxation to professionals, but the *Kintner* regulations, weighted as they were toward partnership classification, had the unintended effect of ensuring that limited partnership tax shelters would qualify for partnership taxation. Taxation under subchapter K permitted such limited partnerships to pass tax losses through to investors who could then use the losses to offset, or “shelter,” income from other sources. After the government lost two cases in which it attempted to classify limited partnerships as corporations for federal tax purposes,\(^12\) the Treasury Department issued proposed regulations in 1977 that would have amended the *Kintner* regulations to make it more difficult for a business organization to be classified as a partnership for federal tax purposes.\(^13\)

The Treasury Department, however, withdrew the proposed regulations two days

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9. Every state has enacted legislation permitting at least some groups to form professional corporations. For a list of the current statutes, see 4A Zolman Cavitch, Business Organizations § 82.01 (1991).
after they were promulgated, apparently bowing to the protests of both the oil and gas industry and real estate interests.

While the withdrawal of the 1977 proposed regulations made it easier for limited partnerships to qualify for taxation under subchapter K, the issue concerning the tax status of an LLC remained unsettled. In 1980, the Service issued proposed regulations that would have denied partnership classification to a business organization if, under local law, no member of the organization was personally liable for the debts of the organization. The example in the 1980 proposed regulations explained that the rule precluded an LLC from being classified as a partnership for federal income tax purposes. The effective date of the 1980 proposed regulations, however, was delayed. Finally, the Service withdrew the proposals before they ever became effective, announcing that it would undertake a study of the rules for the tax classification of entities "with special focus on the significance of the characteristic of limited liability."

In 1983, the Service announced that it would not issue rulings concerning the tax status of an LLC until it resolved the question. The Service finally decided to issue such rulings in 1988. In Revenue Ruling 88-76, the Service ruled that a Wyoming LLC was classified as a partnership for purposes of federal income taxation. The Service has confirmed this result in a number of other published rulings.

Despite the government's misgivings and despite its continuous study of the Kintner regulations through 1988, the regulations remained unchanged. In the meantime, many of the policy concerns that would require denial of partnership tax status to unincorporated business organizations subsided. Congress had found ways
to attack tax shelters, regardless of whether a business organization is classified as a partnership.

In 1978, Congress reinforced the at risk rules by extending their application to all activities except for certain real estate activities, limiting the ability of taxpayers to deduct losses from activities in which they have not incurred a real financial risk. The passive activity loss rules, enacted in 1986, further limit the ability of taxpayers to use losses from passive investments to shelter income from other sources. The alternative minimum tax also reduces the value of tax shelter losses.

In 1987, Congress enacted section 7704 of the Internal Revenue Code which generally treats a publicly traded partnership as a corporation for purposes of federal income taxation. Thus, if a partnership or an LLC that otherwise qualifies as a partnership is publicly traded, the benefits of pass-through taxation may be denied to its investors. Section 7704 has reduced the fear that the corporate tax base will be eroded by the “disincorporation” of the corporate sector.

As a result of these developments, the Treasury Department and the Service have indicated that their concerns with respect to the partnership tax status of LLCs have subsided. In December of 1994, the Service issued Revenue Procedure 95-10, which provides guidance to taxpayers seeking classification rulings with respect to an LLC under the Kintner regulations. Revenue Procedure 95-10 makes it easier to obtain a favorable ruling (i.e., that an LLC is classified as a partnership) than practitioners previously had thought. In Notice 95-14, the Treasury Department and the Service announced that they were considering simplifying the Kintner regulations to allow taxpayers to choose whether they want an unincorporated business organization to be taxed as a corporation or as a partnership simply by checking a box on an income tax form. Proposed “check-the-box” regulations were issued in May of 1996 and finalized in December of 1996.

24. For a discussion of the at risk rules, see Boris I. Bittker & Lawrence Lokken, Federal Taxation of Income, Estates and Gifts § 25.10 (2d ed. 1989 and Supp.)
26. For a discussion of the passive activity loss rules, see Bittker & Lokken, supra note 24, at § 28 and Supp.

The check-the-box election is available to an entity formed after January 1, 1997, if the entity meets the eligibility requirements of the new regulations. An entity formed before January 1, 1997, (an “existing entity”) will retain its classification as determined under the Kintner regulations, unless the entity is eligible to make a check-the-box election and makes such an election. If an existing entity that was classified as a corporation under the Kintner regulations makes an election to be classified as a partnership under the new regulations, the transaction will be treated for tax purposes as a liquidation of the corporation and a formation of a new partnership. The deemed liquidation of the corporation in many cases will cause gain to be recognized, both by the corporation and by its shareholders. Thus, it may be important for an existing LLC to know whether it was classified as a corporation or as a partnership under the Kintner regulations. A discussion of the classification of a Louisiana LLC under the Kintner regulations also is helpful in understanding the impact of the check-the-box election and the amendments to the Louisiana LLC Law that may be desirable now that the proposed regulations have been issued in final form.

II. CLASSIFICATION OF A LOUISIANA LLC UNDER THE KINTNER REGULATIONS

The Kintner regulations identify six corporate characteristics that distinguish a corporation from another type of business organization: (1) associates, (2) an objective to carry on business and divide the gains therefrom, (3) continuity of life, (4) centralized management, (5) limited liability for investors, and (6) free transferability of interests. Because partnerships, like corporations, have associates and an objective to carry on business for a joint profit, the determination of whether a business organization is to be classified as a partnership or as an association taxable as a corporation depends on whether the organization has continuity of life, centralized management, limited liability, and free transferability of interests. An unincorporated organization will not be classified as a corporation unless it has at least three of these four primary corporate characteristics. In applying the test under the Kintner regulations, equal weight is given to each of the four primary corporate characteristics.

To be classified as a partnership under the Kintner regulations, an LLC must lack at least two of the four primary corporate characteristics. The default

37. I.R.C. § 331(a) (1994) (amounts received by a shareholder in liquidation of a corporation are treated as received in exchange for the shareholder’s stock), § 336(a) (1994) (in general, gain or loss must be recognized by a liquidating corporation on the distribution of its assets).
provisions of the Louisiana LLC Law are designed to ensure that a Louisiana LLC will lack three of these characteristics. Thus, some deviation from the default rules is permissible without jeopardizing the tax status of an LLC under the former classification regulations. Revenue Procedure 95-10 and some of the Service's LLC classification rulings also indicate that some of the default rules of the Louisiana LLC Law are unnecessarily inflexible, even under the Kintner regulations.

A. Continuity of Life

Continuity of life is a characteristic more common to corporations than to traditional partnerships. The withdrawal of a shareholder from a corporation does not affect the corporation's existence. A partnership is more susceptible to dissolution than a corporation. The withdrawal, expulsion, death, or bankruptcy of a general partner dissolves a traditional partnership formed under the Uniform Partnership Act ("UPA") or the Revised Uniform Limited Partnership Act ("RULPA") unless the partnership's business is continued by the remaining partners. A partnership formed under the Revised Uniform Partnership Act ("RUPA") also is more susceptible to dissolution than a corporation. If a partnership formed under RUPA is entered into for a definite term or a particular undertaking, the partnership dissolves upon the death or other dissociation of a partner unless, within ninety days, a majority in interest of the remaining partners, including partners who have rightfully dissociated, agree to continue the partnership. Under RUPA, a partner can cause an at-will partnership to dissolve by providing notice of the partner's express will to withdraw from the partnership.

A Louisiana partnership, like a corporation, generally does not dissolve upon the withdrawal of a partner. Unlike a corporation, however, a Louisiana partnership dissolves if the number of its partners is reduced to one. A Louisiana partnership in commendam more closely resembles a traditional partnership in that the retirement, death, interdiction, or dissolution of the general partner can trigger dissolution. Partners in partnerships formed under any of the uniform acts and partners in a partnership in commendam can avoid the risk of dissolution by including in their partnership agreement a provision permitting the remaining members to agree to continue the partnership after an event that terminates a general partner's interest in the partnership.

42. UPA §§ 29, 31(1)(d), (4), (5) (1914); RULPA §§ 402(3), (6)(i), (4), 301(4) (1985).
43. RUPA § 801(2) (1994).
44. RUPA § 801(1) (1994).
46. Id.
48. UPA § 38(1) (1914); RULPA § 801(4) (1985); La. Civ. Code art. 2825. For the ability of partners to continue a partnership formed under the Uniform Limited Partnership Act, see 2 Alan R. Bromberg & Larry E. Ribstein, Bromberg and Ribstein on Partnership § 7.11(c) (1989).
Under the *Kintner* regulations, a business organization lacks the corporate characteristic of continuity of life if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will cause the organization to dissolve. 49 (Hereinafter the death, insanity, bankruptcy, retirement, resignation, or expulsion of a member will collectively be referred to as the "withdrawal" of a member.) Following the partnership model, the test in the regulations focuses on technical dissolution. Even if an agreement by which an organization is established provides that the business will be continued by the remaining members in the event of the withdrawal of a member, the organization will not have continuity of life if under local law, the withdrawal of any member causes a dissolution of the organization. 50

The default provisions of the Louisiana LLC Law provide that an LLC dissolves upon the death, interdiction, withdrawal, expulsion, bankruptcy, or dissolution of a member or the occurrence of any other event that terminates a member's interest in the LLC unless, within ninety days after the event, the LLC is continued by the unanimous consent of the members and, if the membership in the LLC is reduced to one, the admission of one or more members. 51 These provisions are designed to ensure that a Louisiana LLC will lack continuity of life under the *Kintner* regulations.

In Revenue Ruling 94-5, 52 the Service held that a Louisiana LLC whose articles of organization conformed to the default provisions of the Louisiana LLC Law lacked continuity of life. The LLC's articles of organization provided that the LLC would dissolve upon the occurrence of any event that terminated the continued membership of a member in the LLC, unless within ninety days all the remaining members of the LLC agreed to continue the business. The Service concluded that the continuity of the LLC was not assured because upon the cessation of a member's interest, all of the remaining members would have to agree to continue the business. 53

The default rules of the Louisiana LLC Law concerning the dissolution of an LLC may be altered by a provision in the LLC's articles of organization or the written operating agreement. 54 If an LLC's articles of organization or operating agreement does not alter the default rules for dissolution, under Revenue Ruling 94-5, the LLC should lack the corporate characteristic of continuity of life.

The default rules requiring the dissolution of an LLC upon the withdrawal of any member (unless the remaining members unanimously consent to continue the LLC) can be problematic, especially if an LLC has many members. To prevent dissolution of an LLC governed by the default rules, it is necessary to monitor each of the LLC's members to determine whether some event such as the death,

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52. 1994-1 C.B. 312.
53. *Id.*
interdiction, or bankruptcy of a member has occurred with enough time remaining to obtain the consent of the remaining members to continue the LLC. Upon the withdrawal of a member from an LLC, it may be difficult to locate all of the remaining members in order to obtain their consent to continue the LLC. The default rules also permit one member to dissolve an LLC by refusing to consent to continue the LLC after the withdrawal of a member. Dissolution, of course, can be disruptive to the LLC’s business. When an LLC dissolves, it must wind up its affairs and distribute its assets, first to creditors, and then to each of its members.55

The parties may alter the default rules of the Louisiana LLC Law56 in some ways without causing the LLC to have the corporate characteristic of continuity of life. If an LLC’s articles of organization or written operating agreement deviate too far from these default rules, however, an LLC may have continuity of life under the Kintner regulations. The Service has ruled that an LLC had continuity of life where the LLC’s operating agreement provided that the LLC would continue following the death, retirement, resignation, expulsion, bankruptcy, or dissolution of a member or the occurrence of any other event that terminated the continued membership of a member in the LLC.57

It is not necessary, however, to require the consent of all of the members to continue an LLC following the withdrawal of a member in order for the LLC to lack continuity of life.58 In 1993, the Treasury Department amended the Kintner
regulations to provide that a limited partnership lacks continuity of life if the death, insanity, bankruptcy, retirement, resignation, expulsion, or other event of withdrawal of a general partner cause: the limited partnership to dissolve unless the remaining general partners or a majority in interest of the remaining partners agree to continue the business. In Revenue Ruling 94-5, the Service stated that this regulation applied in determining the tax classification of an LLC. For this purpose, the requirement that a majority in interest of the remaining members agree to continue the LLC after the withdrawal of a member will be satisfied if remaining members owning a majority of the profits interests and a majority of the capital interests owned by all remaining members agree to continue the LLC.

An LLC would be less likely to dissolve if its dissolution could be triggered upon the happening of only one event that terminates the interest of a specified member rather than upon the happening of one of several events terminating a member’s interest to any one of the members. It may be possible to reduce an LLC’s susceptibility to dissolution in this way. The Service has ruled privately that an LLC lacked continuity of life where fewer than all of the statutory dissolution events could trigger dissolution of the LLC and where the withdrawal of only one specified member could cause an LLC to dissolve.

In Revenue Procedure 95-10, the Service explained that it will not rule that an LLC lacks continuity of life where fewer than all of the members are subject to the specified dissolution events unless the LLC is managed by managers who are members of the LLC. In the case of a manager-managed LLC, all of the member-managers must be subject to the dissolution events for continuity of life.

who were also members and a majority in number and in interest of the remaining members); Priv. Ltr. Rul. 92-26-035 (March 26, 1992) (unanimous consent of the LLC’s managers who also were members and a majority of the remaining members).

59. Former Treas. Reg. § 301.7701-2(b)(1) (as amended in 1993). See also Rev. Proc. 92-35, 1992-1 C.B. 790 (“If under local law and the partnership agreement the bankruptcy or removal of a general partner of a limited partnership cause: a dissolution of the partnership unless the remaining general partners or at least a majority in interest of all remaining partners agree to continue the partnership, the Service will not take the position that the limited partnership has the corporate characteristic of continuity of life”). Before the Kintner regulations were amended, they provided that a limited partnership would lack continuity of life if it dissolved upon the retirement, death, or insanity of a general partner unless either the remaining general partners or all of the remaining partners agreed to continue the partnership. Former Treas. Reg. § 301.7701-2(b)(1) (1983). Under the previous regulation, the Service had rules that a Florida LLC had continuity of life where its articles of organization provided that the LLC would dissolve upon the termination of a member’s interest unless the remaining members agreed to continue the LLC by a majority vote of the members. Priv. Ltr. Rul. 90-10-027 (Dec. 7, 1989). Subsequent rulings have been more liberal. See rulings cited supra note 58.

60. 1994-1 C.B. 312. See also Rev. Proc. 95-10 § 5.01(2), 1995-1 C.B. 501.


64. Rev. Proc. 95-10 §5.01(1), (2), 1995-1 C.B. 501.
to be lacking. For example, if the LLC is managed by A, B, and C, it must be provided that a dissolution event with respect to A, B, or C will dissolve the LLC unless a majority in interest of the remaining members continue the LLC. The Service will not rule that the LLC lacks continuity of life if a dissolution event with respect to only one of the named member-managers (i.e., a dissolution event only with respect to A but not B or C) could dissolve the LLC.

Additional requirements must be met to obtain a ruling that an LLC lacks continuity of life where the LLC may dissolve upon a dissolution event with respect to member-managers only. In such a case, the member-managers must satisfy a minimum ownership interest requirement and a minimum capital account balance requirement. The minimum ownership interest and minimum capital account balance requirements are designed to ensure that the managing-members of the LLC have a substantial and continuing membership interest in the LLC.

Under the minimum ownership interest requirement, the member-managers generally must own, in the aggregate, at least a one percent interest in each material item of the LLC's income, gain, loss, deduction, or credit during the entire existence of the LLC. The member-managers of an LLC do not need to meet the one percent minimum ownership interest standard if the LLC has contributions exceeding $50 million. In that case, the member-managers in the aggregate must maintain an interest in each material item of at least one percent divided by the ratio of total contributions to $50 million. For example, if total contributions are $100 million, the member-managers' interest in each material item must be at least .5%, i.e., one percent divided by 100/50. In no event, however, will the minimum ownership interest standard be satisfied, unless the member-managers' aggregate interest in each material item is at least .2%.

Under the minimum capital account balance requirement, the member-managers, in the aggregate, generally must maintain throughout the entire existence of the LLC a minimum capital account balance equal to the lesser of: (1) one percent interest in each material item of the LLC's income, gain, loss, deduction, or credit during the entire existence of the LLC; or (2) one percent divided by the ratio of total contributions to $50 million.

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67. Rev. Proc. 95-10 §4.02, 1995-1 C.B. 501. Required allocations under I.R.C. § 704(b) or § 704(c) causing less than one percent of the LLC's income, gain, loss, deduction, or credit to be allocable to the member-managers will not cause a violation to the minimum ownership interest requirement. Any other temporary allocation that has the same result will cause a violation of the minimum ownership interest requirement unless the LLC clearly establishes in its ruling request that the member-managers have a material interest in net profits and losses over the LLC's anticipated life. For this purpose a profits interest generally will not be considered material unless it substantially exceeds one percent and will be in effect for a substantial period of time during which the LLC reasonably expects to generate profits. An example of a material profits interest provided by Rev. Proc. 95-10 is a 20% interest in profits that begins four years after the LLC's formation and continues for the life of the LLC where the LLC is expected to generate profits for a substantial period of time beyond the initial four-year period.
69. Id. The member-managers must maintain this lesser ownership interest at all times during the existence of the LLC except for temporary allocations or noncompliance as required under I.R.C. § 704(b) or § 704(c) or as permitted by the Service. See supra note 37.
70. Id.
percent of total positive capital account balances or (2) $500,000. Whenever a non-managing member makes a contribution, the member-managers must be obligated under the operating agreement to contribute to the LLC either: (1) capital equal to 1.01% of the non-managing members' capital contributions or (2) a lesser amount that causes the member-managers' capital account balances to equal the lesser of one percent of total capital account balances for the LLC or $500,000.

If no member has a positive capital account balance, then the member-managers need not have a positive capital account balance to satisfy the minimum capital account balance requirement. For purposes of these requirements, capital accounts and the value of contributions are determined under the section 704(b) regulations.

The minimum capital account balance requirement does not need to be satisfied if at least one member-manager has contributed or will contribute substantial services in the capacity as a member, other than services for which guaranteed payments are made. In such a case, however, the LLC's operating agreement must provide that, upon the dissolution and termination of the LLC, the member-managers will contribute capital to the LLC in an amount equal to the lesser of: (1) the aggregate deficit balance, if any, in their capital accounts, or (2) the excess of 1.01% of the total capital contributions of the non-managing members over the aggregate capital previously contributed to the LLC by the member-managers.

Revenue Procedure 95-10 also indicates that an LLC may lack continuity of life where fewer than all of the statutory dissolution events with respect to a member or a member-manager will trigger a dissolution of the LLC without further action by the remaining members. In such a case, however, the Service will not rule that the LLC lacks continuity of life unless the taxpayer clearly establishes in the ruling request that the event or events selected provide a meaningful possibility of dissolution.

If an LLC can lack continuity of life when it dissolves upon the occurrence of only one event, for example, bankruptcy, of only one or a few members, it will be much easier for the LLC to monitor the designated member or members in order

72. Id. In some cases, the requirement will be satisfied even if the member-managers make no contributions to the LLC.
73. Id.
75. Rev. Proc. 95-10 § 4.05, 1995-1 C.B. 501. The term "guaranteed payment" is defined in I.R.C. § 707(c). In determining whether a member-manager's contributed services are performed in a capacity as a member, the Service will closely scrutinize services that do not relate to the day-to-day operations of the LLC's primary business activity, such as services related to the organization and syndication of the LLC, accounting, financial planning, general business planning, and services in the nature of investment management. Id.
78. Id.
to obtain the consent of the remaining members to continue in time to prevent dissolution. When consent of fewer than all of the members is required to continue the business upon such an event, it is even easier to prevent the LLC from dissolving.

The ability of an LLC to avoid dissolution and at the same time lack continuity of life for purposes of tax classification under the Kintner regulations was important. While an LLC only needed to lack two of the four primary corporate characteristics to be classified as a partnership under the Kintner regulations, easing the requirements with respect to lacking continuity of life provided greater flexibility. An LLC that lacked continuity of life only had to lack one other corporate characteristic to be classified as a partnership.

It should be noted that the Kintner regulations, Revenue Procedure 95-10, and the Service's published rulings provide that an LLC lacks continuity of life if it is dissolved upon the withdrawal of a member unless "a majority in interest" of the remaining members vote to continue the LLC. Under the default rules of the Louisiana LLC Law, members vote on the basis of one-person, one-vote, rather than in proportion to their respective interests in the capital, profits, and losses of the LLC.79 The default rules also provide that members of a Louisiana LLC share in its profits and losses equally.80 Both of these default rules may be altered by a provision in the LLC's written operating agreement.81

If an LLC's articles of organization or operating agreement subscribes to both default rules, a vote of a majority of the members of an LLC may be the same as a vote of a majority in interest of the LLC. This conclusion is uncertain, however, because the interests of the members in the capital of an LLC may vary, depending upon the members' contributions to the LLC.82 If the parties wished to depart from the default provisions of the Louisiana LLC Law with respect to dissolution, it was advisable for the LLC's written operating agreement to contain a provision specifying that the LLC would dissolve upon the termination of a member's interest in the LLC unless a majority in interest of the remaining members vote to continue the LLC's business.

Before the promulgation of the check-the-box regulations, some commentators suggested that to prevent an LLC from dissolving, its members should enter into an agreement binding the members to continue the LLC in the event of the termination of a member's interest.83 Under the Kintner regulations, an

82. See La. R.S. 12:1325(C) (Supp. 1997) (a member who withdraws from an LLC is entitled to receive the fair market value of the member's interest as of the date of the member's withdrawal), La. R.S. 12:1337(A)(2) (1994) (upon liquidation of an LLC, members receive a return of their capital contributions after superior claims are satisfied).
agreement providing that the remaining members will continue the business in the event of the death or withdrawal of a member will not cause the organization to have continuity of life if under local law any member has the power to dissolve the organization. Accordingly, commentators suggested that an agreement requiring the remaining members to continue an LLC upon the termination of a member's interest would satisfy this rule if it required monetary damages, rather than specific performance, upon its breach. The Service, however, never reached a conclusion as to the effect of such an anticipatory agreement and informally indicated that the treatment of an agreement of this type was "controversial." Without formal guidance with respect to the consequences of such an agreement, a conservative planner would avoid using one unless the LLC lacked two of the other corporate characteristics.

B. Centralized Management

Centralized management is a corporate characteristic because a corporation generally must have a board of directors that makes management decisions necessary to conduct corporate business. Under the Kintner regulations, a business organization has centralized management if any person, or group of persons that does not include all of the members, has continuing exclusive authority to make the management decisions necessary to conduct the business for which the organization was formed. The regulations explain that centralized management is characteristic of a corporation because the concentration of management powers in a board of directors effectively prevents a shareholder, simply because he or she is a shareholder, from binding the corporation by his or her acts. In contrast, a partnership lacks centralized management because the act of any partner within the scope of partnership business binds the partnership; even if the partners agree among themselves that only a few will have management powers, the agreement will be ineffective against a third party who has no knowledge of it.

The Louisiana LLC Law gives an LLC a choice in structuring its management. Under the default provisions of the Louisiana LLC Law, an LLC is managed by its members. An LLC's articles of organization, however, may alter the default

85. See authorities cited supra note 83.
86. Ribstein and Keatinge, supra note 83, at § 16.14 n.192.
89. Former Treas. Reg. § 301.7701-2(c)(4) (as amended in 1993).
90. La. Civ. Code art. 2814; UPA § 9 (1914); Former Treas. Reg. § 301.7701-2(c)(4) (as amended in 1993).
rules by designating that the LLC will be managed by managers instead of members.92

The default provisions of the Louisiana LLC Law are designed to ensure that a Louisiana LLC will lack centralized management. When an LLC is member-managed, its management structure resembles that of a general partnership because each member of a member-managed LLC is a mandatary of the LLC.93 The Service consistently has ruled that when an LLC’s management was vested in all of its members, the LLC lacked the corporate characteristic of centralized management.94 In Revenue Procedure 95-10,95 the Service explained that it generally will rule that an LLC lacks centralized management if the controlling statute or the LLC’s articles of organization or operating agreement, pursuant to the controlling statute, provides that the LLC is managed by the members exclusively in their membership capacity.96

It may be inconvenient for all of the members of an LLC to manage its day-to-day affairs. A member-managed LLC may prefer to appoint one or a few of the members to make the day-to-day business decisions for the LLC. The existence of an executive committee that manages the day-to-day affairs of a member-managed LLC should not cause the LLC to have the corporate characteristic of centralized management. The Kintner regulations focus on whether the members have the power to make such decisions rather than their actual exercise of that power.97 Under the Kintner regulations, a partnership subject to a statute corresponding to UPA lacks centralized management even if the partners have agreed among themselves that management powers will be exercised exclusively by only a few of the partners because such an agreement is ineffective against an outsider who has no notice of it.98 The default provisions of the Louisiana LLC Law are similar to UPA in this respect. If the members of an LLC informally agree among themselves that only one or a few of the members will manage the LLC’s day-to-day affairs, the agreement will be ineffective against a third party who deals with a member acting with apparent authority.99

In several private letter rulings the Service has ruled that an LLC lacked centralized management where the LLC’s articles of organization vested management of the LLC in its members, but only one of the members managed the

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95. 1995-1 C.B. 501.
LLC’s day-to-day affairs pursuant to a separate management agreement.100 The
Service found centralized management was lacking in each case because,
notwithstanding the separate management agreement, each member had the
authority to bind the LLC. While these rulings are not precedent and do not bind
the Service with respect to any person other than the taxpayer to whom they were
issued,101 they indicate that an LLC could lack centralized management when the
members delegate their management authority to one or more “executive members”
to manage the LLC.102

A member-managed LLC, even one with executive members who manage the
day-to-day affairs of the LLC, presents some risk. The members of a member-
managed LLC remain mandataries of the LLC and can incur obligations that are
binding on the LLC.103 Despite any separate management agreement, members
in a member-managed LLC can bind the LLC in transactions with third parties who
have no knowledge of the agreement.104 The problem can be avoided if the LLC
is managed by managers. Under the Louisiana LLC Law, the parties can alter the
default rule requiring an LLC to be member-managed by including a provision in
the LLC’s articles of organization stating that the LLC shall be managed by
managers.105 When an LLC is manager-managed, the managers, rather than the
members, are mandataries of the LLC and can bind the LLC by acting with
apparent authority.106 If an LLC is managed by managers, however, it could have
the corporate characteristic of centralized management. In Revenue Ruling 94-
5,107 the Service ruled that a Louisiana LLC had centralized management when
three of its twenty-five members were elected as managers in accordance with the
LLC’s articles of organization. The Service consistently has ruled that a manager-
managed LLC has centralized management.108

100. See, e.g., Priv. Ltr. Rul. 93-21-070 (March 3, 1993); Priv. Ltr. Rul. 93-20-045 (Feb. 24,
(member-managed LLC lacked centralized management, notwithstanding the existence of a governing
committee).


102. For such a suggestion, see Kenneth L. Harris and Francis J. Wirtz, Corporate Governance,
Limited Liability Companies and the IRS’s View of Centralized Management, Taxes, Apr. 1993, at
225, 230.


104. Id.


51, 1994-2 C.B. 407; Rev. Rul. 94-30, 1994-1 C.B. 316; Rev. Rul. 94-6, 1994-1 C.B. 314; Rev. Rul. 94-
Service ruled that a Colorado LLC whose management was vested in managers, all of whom were
members, had centralized management, even though all of the members were managers. At the time that
Revenue Ruling 93-6 was issued, the Colorado LLC Act provided that management of an LLC always
was vested in managers. Colo. Rev. Stat. § 70-811-607(1) (amended 1994). Thus, there was no other
In Revenue Procedure 95-10, the Service indicated that it will not always rule that a manager-managed LLC has centralized management. In some respects, managers of an LLC who own membership interests in the LLC can be compared to general partners who own an interest in a limited partnership and who have the exclusive authority to manage the partnership on behalf of the limited partners.

Under the Kintner regulations, a limited partnership subject to a statute corresponding to the Uniform Limited Partnership Act ("ULPA") generally does not have centralized management, notwithstanding the fact that limited partners may not participate in the management of the partnership. Presumably, the lack of centralized management in a limited partnership is attributable to the fact that general partners, unlike corporate shareholders, manage the partnership in their capacity as owners of the partnership. When the general partners do not own a sufficient interest in the partnership, however, a limited partnership will have centralized management. The Kintner regulations explain that a limited partnership has centralized management if "substantially all" the interests in the partnership are owned by limited partners. The Service has interpreted the "substantially all" standard to mean that a limited partnership will have centralized management if the limited partnership interests, excluding those held by general partners, exceed eighty percent of the total interests in the partnership.

The Kintner regulations also explain that if all or a specified group of the limited partners may remove a general partner, all the facts and circumstances must be taken into account to determine whether the partnership has centralized management. A substantially restricted right of the limited partners to remove a general partner, (e.g., in the event of the general partner's gross negligence, self-dealing, or embezzlement) will not itself cause the partnership to have centralized management. When limited partners have the right to remove the general partners without cause, it seems that the general partners are managing the partnership on behalf of the limited partners and not on their own behalf. In such a case, the general partners are like directors of a corporation who manage the corporation on behalf of and at the will of the shareholders.

In Revenue Procedure 95-10, the Service adopted a similar approach for determining whether a manager-managed LLC should be considered to have way that the parties could have provided for the management structure of the LLC. In Revenue Ruling 93-6, the Service explained that a Colorado LLC always had the corporate characteristic of centralized management because members of a Colorado LLC never could manage the LLC in their capacity as members. 1993-1 C.B. at 231. Thus, the member-managers of the LLC were like shareholders in a corporation who serve on the corporation’s board of directors. Such shareholders manage the corporation, not in their capacity as shareholders, but in their capacity as directors.

111. RULPA § 303 (1985); ULPA § 7 (1916).
115. Id.
centralized management. The Service explained that it will not rule that a manager-managed LLC lacks centralized management unless member-managers own at least twenty percent of the total interests in the LLC. However, even if the twenty-percent aggregate ownership requirement is met, the Service will consider all the relevant facts and circumstances including, particularly, member control of the member-managers, in determining whether the LLC lacks centralized management. The Service will not rule that an LLC lacks centralized management if either: (1) the member-managers are subject to periodic elections by the members or (2) the non-managing members have a substantially nonrestricted power to remove the member-managers.

The Louisiana LLC Law does not require periodic elections of the managers of an LLC. A default rule, however, states that any or all of the managers of an LLC may be removed by the members, "with or without cause." This default rule may be altered by a provision in the LLC's articles of organization or an operating agreement. If a Louisiana LLC is managed by managers who own at least a twenty-percent interest in the LLC, it will be necessary for the LLC's articles or operating agreement to provide that the managers may not be removed by the non-managing members without cause in order to obtain a ruling that the LLC lacks centralized management. In such a case, however, the Service still may rule that the LLC has centralized management if all of the facts and circumstances so indicate. Thus, it cannot be assured that the Service will rule that a manager-managed LLC lacks centralized management.

As a general rule, it is easier to establish that a member-managed LLC lacks centralized management. As explained earlier, management by members may be less desirable because all of the members of a member-managed LLC are mandataries of the LLC who can incur debts on behalf of the LLC when acting with apparent authority. Steps can be taken, however, to limit the agency powers of some of the members of a member-managed Louisiana LLC. An LLC's written operating agreement may contain a provision restricting the management powers of certain designated members. If the existence of such a restriction is referenced in the LLC's articles of organization, the Louisiana LLC Law provides that all persons dealing with a member in the LLC will be deemed to have knowledge of the restriction.

117. Id.
118. Id.
119. Id.
120. La. R.S. 12:1313(2) (1994).
122. La. R.S. 12:1305(C)(1), 1317(B) (1994). Notwithstanding such a provision, a member could exceed his or her authority by self-certifying the member's authority to act on behalf of the LLC. La. R.S. 12:1317(C) (1994). The ability of a member to exceed his or her authority by self-certification, however, can be prevented if the LLC's articles of organization designate a certifying officer. La. R.S. 12:1305(C)(5), 1317(C) (1994).
If an LLC's articles of organization and written operating agreement restrict the management authority of some of the members in this way, however, the LLC could be considered to possess the corporate characteristic of centralized management. Under the Kintner regulations, an agreement among the members of a member-managed LLC that only one or a few of the members will manage the LLC will not cause the LLC to have centralized management if the agreement is ineffective against third parties who have no notice of it. By negative implication, such an agreement should cause the LLC to have centralized management if the agreement is effective against third parties with no actual notice of it. The constructive notice provisions of the Louisiana LLC Law ensure that the limitations on a member's agency powers are effective against all third parties. The Kintner regulations explain that a business organization has centralized management "if any person (or group of persons which does not include all the members) has continuing exclusive authority to make the management decisions necessary to the conduct of the business for which the organization was formed." The constructive notice provisions of the Louisiana LLC law may be considered to give continuing exclusive authority to make management decisions on behalf of the LLC to the members whose authority is not restricted. On the other hand, the Service may rule that a member-managed LLC lacks centralized management where the agency powers of eighty percent or fewer of the members are restricted.

Without further guidance, the circumstances under which the Service will rule that a manager-managed LLC lacks centralized management are not entirely certain. It also is uncertain whether centralized management will exist in a member-managed LLC whose articles of organization and written operating agreement restrict the management authority of some of the members. Accordingly, when it was necessary for an LLC to lack centralized management, a conservative planner would include a provision in the LLC's articles of organization stating that the LLC will be managed by its members and would not include a provision restricting the management powers of any of the members that satisfies the requirements of the Louisiana LLC Law for constructive notice. Of course, if the LLC lacks two of the four primary corporate characteristics other than centralized management, the management structure of the LLC will not be important for tax classification purposes under the Kintner regulations. In that case, it may be preferable to specify in the LLC's articles of organization that the LLC will be managed by managers. If a Louisiana LLC is manager-managed, the members cannot bind the LLC by acting with apparent authority.

C. Limited Liability

Limited liability is one of the characteristics most frequently associated with a corporation. A shareholder has limited liability with respect to a corporation's

debts.\textsuperscript{124} In contrast, at least one partner in a partnership has unlimited, personal liability for all partnership obligations.\textsuperscript{125} Under the \textit{Kintner} regulations, a business organization has the corporate characteristic of limited liability if under local law there is no member who is personally liable for the debts or claims against the organization.\textsuperscript{126} For this purpose, "personal liability" means that a creditor of the organization may seek satisfaction from a member of the organization to the extent that the assets of the organization are insufficient to satisfy the creditor's claim.\textsuperscript{127}

The Louisiana LLC Law generally provides that a member of an LLC is not personally liable for the debts, obligations, or liabilities of the LLC.\textsuperscript{128} A member of a Louisiana LLC, however, is liable for fraud, breach of a professional duty, or any other negligent or wrongful act performed by the member.\textsuperscript{129} A member may also be liable for any written promise to contribute property or services to an LLC\textsuperscript{130} and is liable for unlawful distributions that the member receives or approves.\textsuperscript{131} While a member of an LLC may incur some liability with respect to the LLC, a member is not liable for the LLC's debts merely because he or she is a member of the LLC. While it is possible for a court to pierce the veil of an LLC and impose liability for the LLC's obligations upon its members,\textsuperscript{132} the liability of a member of an LLC is no greater than the liability of a shareholder in a corporation in this or any other respect.\textsuperscript{133}

In Revenue Ruling 94-5,\textsuperscript{134} the Service held that a Louisiana LLC has limited liability. Revenue Ruling 94-5 is consistent with the Service's other published rulings on this issue.\textsuperscript{135} In fact, the Service has ruled that an LLC

\textsuperscript{124} La. R.S. 12:93(B) (1994); Revised Model Business Corp. Act § 6.22(b) (1985).
\textsuperscript{125} La. Civ. Code art. 2817; UPA § 15 (1914); RULPA § 403(b) (1985). While a partner in a Louisiana partnership is liable only for the partner's virile share of partnership obligations, the partner is potentially liable for a percentage of an unlimited amount.
\textsuperscript{126} Former Treas. Reg. § 301.7701-2(d)(1) (as amended in 1993).
\textsuperscript{127} \textit{Id.}
\textsuperscript{128} La. R.S. 12:1320(B) (1994).
\textsuperscript{129} La. R.S. 12:1320(D) (1994). See also La. R.S. 12:1314 (1994) (a member in a member-managed LLC may be liable for breach of a fiduciary duty to the LLC or its members unless the LLC's articles of organization or written operating agreement provide for elimination of liability for such a breach or for indemnification); 12:1315(B) (1994) (a member in a member-managed LLC is always liable for the amount of any financial benefit improperly received from the LLC and for any intentional violation of criminal law).
\textsuperscript{130} La. R.S. 12:1322 (1994).
\textsuperscript{131} La. R.S. 12:1328 (1994).
\textsuperscript{132} See \textit{Kalinka, supra} note 1, at § 1.32.
\textsuperscript{133} See id. § 1.31.
\textsuperscript{134} 1994-1 C.B. 312.
providing professional services has limited liability notwithstanding the fact that
a member of such an LLC has personal liability in connection with the
performance of professional services on behalf of the LLC and for the acts
of others under the member's direct supervision and control. A member of an LLC, of course, can become liable for the LLC's debts, for example, by offering a personal guarantee. In general, however, the ability of
a member to incur personal liability for specified debts of an LLC should not be
relevant in determining whether the LLC has the corporate characteristic of
limited liability. A shareholder in a corporation has the same ability to incur
personal liability in this way. The liability that a member incurs with respect to
guaranteed debts is incurred, not in the member's capacity as a member of the
LLC, but in the member's capacity as a guarantor.

The Service has indicated it will rule that an LLC lacks limited liability
under certain circumstances. In Revenue Procedure 95-10, the Service
explained that it generally will not rule that an LLC lacks limited liability unless
at least one member (an "assuming member") validly assumes personal liability
for all (but not less than all) of the LLC's obligations, pursuant to express
authority granted in the controlling statute.

In addition, the Service generally will not rule that an LLC lacks limited
liability unless the assuming member or members have an aggregate net worth
that equals at least ten percent of the contributions to the LLC. If the safe
harbor net worth requirement is not met, the taxpayer must demonstrate that the
assuming members collectively have substantial assets (other than the assuming
members' interests in the LLC) that could be reached by a creditor of the
LLC. The assuming members also must satisfy a minimum ownership interest requirement and a minimum capital account balance require-

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(Colorado LLC); Rev. Rul. 93-5, 1993-1 C.B. 227 (Virginia LLC); Rev. Rul. 88-76, 1988-2 C.B. 360
(Wyoming LLC); Priv. Ltr. Rul. 90-10-027 (Dec. 7, 1989) (LLC formed pursuant to the statute of
an unidentified state).

136. See e.g., Rev. Rul. 94-30, 1994-1 C.B. 316 (Kansas professional LLC); Rev. Rul. 93-93, 1993-
140. Id. The ten percent net worth requirement must be met at the time of the ruling request and
must be expected to continue throughout the life of the LLC. Id.
141. Id. In determining the net worth of the assuming member(s), the principles contained in
Rev. Proc. 92-88 § 4.03, 1992-2 C.B. 496, are to be applied. Under principles contained in § 4.03
of Rev. Proc. 92-88, in determining the net worth of a member, the member's interest in the LLC
is not included and the value of property included in determining the net worth of one assuming
member may not be taken into account in determining the net worth of any other assuming member.
For example, where a parent corporation and a wholly owned subsidiary are assuming members, the
value of the stock held by the parent in the subsidiary is not counted in determining the parent's net
worth.
142. Rev. Proc. 95-10 §§ 4.02, 4.03, 1995-1 C.B. 501, 503. To satisfy the minimum ownership interest standard, the assuming member or members generally must own, in the aggregate, at least
ment in order for the taxpayer to obtain a ruling that the LLC lacks limited liability.

It is unlikely that the Service will rule that a Louisiana LLC lacks limited liability under these standards. Under Revenue Procedure 95-10, the Service will not rule that an LLC lacks limited liability unless at least one member validly assumes personal liability for all of the LLC's obligations, "pursuant to express authority granted in the controlling statute." The Louisiana LLC Law has no provision expressly granting a member the authority to assume personal liability.

Temporary allocations required to maintain an interest at all times during the existence of the LLC in each material item of the greater of: (1) one percent divided by the ratio of total contributions to $50 million or (2) .2%. For example, if total contributions are $200 million, the interest in each material item must be at least .25%, that is, one percent divided by 200/50. Temporary allocations required by § 704(b) or § 704(c) that reduce the assuming members' aggregate interest below the required amount will not cause a violation of the minimum ownership interest requirement. If other temporary allocations reduce the assuming members' interest below the required amount, the LLC must clearly establish that the assuming members have a material interest in net profits and losses over the LLC's anticipated life.

For this purpose, a profits interest generally will not be considered material unless it substantially exceeds one percent and will be in effect for a substantial period of time during which the LLC reasonably expects to generate profits. The assuming members need not meet the one percent standard if the LLC has total contributions exceeding $50 million. In that case, the assuming members in the aggregate must maintain an interest at all times during the existence of the LLC.

Rev. Proc. 95-10 §§ 4.02, 4.05, 1995-1 C.B. 501, 503. If a taxpayer requests a ruling that an LLC lacks limited liability, the assuming members, in the aggregate, generally must maintain throughout the entire existence of the LLC, a minimum capital account balance equal to the lesser of one percent of total positive capital account balances or $500,000. Whenever a non-assuming member makes a capital contribution, the assuming members must be obligated under the express terms of the LLC's operating agreement, to contribute immediately to the LLC capital contributions equal to 1.01% of the non-assuming members' capital contributions or a lesser amount (including zero) that causes the sum of the assuming members' capital account balances to equal the lesser of one percent of total capital account balances for the LLC or $500,000. If no member has a positive capital account balance, then the assuming members need not have a positive capital account balance to satisfy the minimum capital account balance requirement.

Rev. Proc. 95-10 § 4.05, 1995-1 C.B. 501, 503. In that case, the LLC's operating agreement must provide that, upon dissolution and termination of the LLC, the assuming members will contribute capital to the LLC in an amount equal to the lesser of: (1) the aggregate deficit balance, if any, in their capital accounts, or (2) an amount equal to 1.01% of the total contributions of the non-assuming members less the aggregate capital previously contributed to the LLC by the assuming members.

liability for any of the debts or obligations of an LLC. In fact, the law seems to be designed to ensure that the liability of a member of an LLC always will be limited. Section 12:1320(A) of the Louisiana Revised Statutes recites that the liability of members of an LLC "shall at all times be determined solely and exclusively by the provisions of [the Louisiana LLC Law]." Under the Louisiana LLC Law, no member of an LLC is liable in his or her capacity as a member for any debt, obligation, or liability of the LLC.\(^\text{145}\) As if to underscore the limitations on a member's liability to third persons for an LLC's obligations, the Louisiana LLC Law provides that a member of an LLC is not a proper party to a proceeding by or against an LLC except when the object of the proceeding is to enforce the member's rights against or liability to the LLC.\(^\text{146}\)

D. Free Transferability of Interests

Free transferability of interests is the fourth characteristic that distinguishes a corporation from a partnership. Under the Kintner regulations, a business organization has this corporate characteristic if the members owning substantially all of the interests in the organization have the power, without the consent of the other members, to substitute for themselves in the organization a person who is not a member of the organization.\(^\text{147}\) For free transferability of interests to exist, a member must be able, without the consent of the other members, to confer upon his or her substitute all of the attributes of the member's interest in the organization, including not only the right to share in the profits, but also the right to participate in the management of the organization.\(^\text{148}\) Under the default rules of the Louisiana LLC Law, a member's interest in the LLC is assignable in whole or in part.\(^\text{149}\) An assignment of a member's interest entitles the assignee only to receive the distributions, if any, to which the assignor was entitled and share in the profits and losses and allocations of tax items to which the assignor was entitled, to the extent assigned.\(^\text{150}\) An assignee of a member's interest may not become a member or exercise any of the rights and powers of a member unless the other members unanimously consent in writing.\(^\text{151}\)

These default provisions are designed to ensure that a Louisiana LLC will lack the corporate characteristic of free transferability of interests. In Revenue Ruling 94-5,\(^\text{152}\) the Service held that a Louisiana LLC whose articles of organization followed the default rules lacked free transferability of interests.

\(^{145}\) La. R.S. 12:1320(B) (1994).
\(^{146}\) La. R.S. 12:1320(C) (1994).
\(^{147}\) Former Treas. Reg. § 301.7701-2(e)(1) (as amended in 1993).
\(^{148}\) Id.
\(^{149}\) La. R.S. 12:1330(A) (1994).
\(^{150}\) Id.
\(^{152}\) 1994-1 C.B. 312.
Revenue Ruling 94-5 is consistent with other published rulings in which the Service has held that an LLC lacked free transferability of interests where an assignee of a member's interest was permitted to participate in distributions, profits, and/or tax items of an LLC but could not become a member or participate in the management of the LLC unless the nonassigning members unanimously agreed.\(^{153}\)

The default rules of the Louisiana LLC Law that require unanimous consent of the remaining members before an assignee of a member's interest may be admitted as a member follow the partnership model. Under the default rules of the Louisiana Partnership Law, unanimous consent of the partners is required before a new partner may be admitted to the partnership.\(^{154}\) The unanimity requirement prevents the admission of unwanted partners. The requirement is important because each partner is a mandatary of the partnership who may bind the partnership for most obligations incurred in the ordinary course of business\(^{155}\) for which each partner incurs personal liability.\(^{156}\)

The members of a member-managed LLC also may desire to retain the right to veto the admission of a new member because each member of a member-managed LLC is a mandatary of the LLC who may incur obligations on behalf of the LLC.\(^{157}\) Even though the members of an LLC are not personally liable for any of the LLC's obligations, they may wish to prevent the admission of a member whose mismanagement could compromise the success of the LLC's business.

When an LLC is managed by managers, the members may have less concern with respect to the identity of the other members. Members of a manager-managed LLC are not mandataries of the LLC.\(^{158}\) Under the default rules of the Louisiana LLC Law, members of a manager-managed LLC retain the right to vote only on extraordinary matters such as the dissolution and winding up of


154. La. Civ. Code art. 2807. See also La. Civ. Code art. 2812 (a partner may share his interest in the partnership with a third person without the consent of his partners, but he cannot make him a member of the partnership).

155. La. Civ. Code art. 2814. A partner is not a mandatary of the partnership with respect to the alienation, lease, or encumbrance of immovables. Id.

156. Id.


158. Id.
the LLC, the transfer of substantially all of the assets of the LLC, the merger or consolidation of the LLC, transactions with respect to the LLC's immovables, and amendments to the LLC's articles of organization or operating agreement.\textsuperscript{159}

It may be preferable for the members of a manager-managed LLC to have more freedom to transfer their interests than is permitted under the default rules of the Louisiana LLC Law. If an LLC is large, obtaining the consent of all the members to the admission of a new member may be cumbersome. The inability of a member to transfer his or her interest without the consent of all of the other members could make the interest less marketable.

The default rules of the Louisiana LLC Law concerning the assignment of a member's interest may be altered by a provision in the LLC's articles of organization or a written operating agreement.\textsuperscript{160} Altering the default rules, however, could cause an LLC to have free transferability of interests. The Service has ruled that an LLC had free transferability of interests where the LLC agreement provided that the assignee of a member's interest could participate in the management of the LLC and become a member of the LLC upon written notice and without the consent of any of the members.\textsuperscript{161}

However, some flexibility is permissible. It is not necessary for the LLC's documents to require unanimous consent of the nonassigning members before an assignee may become a member. The \textit{Kintner} regulations explain that free transferability exists if a member is able, without the consent of other members, to confer upon the member's assignee all of the attributes of the member's interest in the organization.\textsuperscript{162} By referring to the consent of "other members" rather than the consent of "the other members" or "all of the other members," the regulations imply that free transferability of interests will not exist where the admission of an assignee of a membership interest as a member is conditioned on the consent of fewer than all of the nonassigning members. In several published rulings,\textsuperscript{163} the Service has held that an LLC lacked free transferability of interests where an assignee of a member's interest could not become a member of the LLC unless a majority in interest of the nonassigning members consented.

The Service's unpublished rulings have been even more liberal. In Private Letter Ruling 92-18-078,\textsuperscript{164} the Service held that an LLC lacked free transferability of interests where the transferee of a member's interest had no right to become a substituted member unless the managing member consented or members owning at least two-thirds of the outstanding units (excluding the

\textsuperscript{159} La. R.S. 12:1318(B) (1994).
\textsuperscript{160} La. R.S. 12:1330(A), 1332(A) (1994).
\textsuperscript{161} Rev. Rul. 93-38, 1993-1 C.B. 233 (Situation 2).
\textsuperscript{162} Former Treas. Reg. § 301.7701-2(e)(1) (as amended in 1993).
\textsuperscript{164} (Jan. 31, 1992).
transferred units) consented. In Private Letter Ruling 92-10-019, the Service held that an LLC lacked free transferability of interests where a disposition of an interest in the LLC could not be effected without the consent of the managing member. The consent of the other members was required only if the manager was not a member of the LLC or the manager was the member who transferred the interest. These private letter rulings seem to follow the limited partnership model where requiring the consent of a general partner generally is sufficient for the partnership to lack free transferability of interests. Consistent with this model, the Service held in both private letter rulings that free transferability of interests was lacking where the manager whose consent was required was also a member of the LLC.

In Revenue Procedure 95-10, the Service explained that it generally will rule that a manager-managed LLC lacks free transferability of interests if the LLC’s members do not have the power to confer upon a non-member all of the attributes of the members’ interests in the LLC without the consent of not less than a majority of the non-transferring member-managers of the LLC. For this purpose, consent of a majority includes: (1) a majority of both the capital and profits interests in the LLC; (2) a majority of either the capital or profits interests in the LLC; or (3) a majority determined on a per capita basis.

Where consent to a transfer is required by member-managers, the member-managers must meet a minimum ownership interest requirement and a minimum capital account balance requirement. These requirements are designed to ensure that the member-managers in fact are members of the LLC.

To satisfy the minimum ownership interest requirement, the member-managers, in the aggregate, generally must own at least a one percent interest in each material item of the LLC’s income, gain, loss, deduction, or credit during the entire existence of the LLC. Revenue Procedure 95-10 reduces the

165. (Dec. 6, 1991).
166. See, e.g., Former Treas. Reg. § 301.7701-3(b)(2) Example (1) (as amended in 1993).
170. Rev. Proc. 95-10 § 4.02, 1995-1 C.B. 501. The express terms of the LLC’s operating agreement must provide that the member-managers have at least an aggregate one percent interest in each material item. Id. Allocations required under I.R.C. § 704(b) or § 704(c) that temporarily reduce the member-managers’ aggregate interest in the LLC’s items of income, gain, loss, deduction, or credit below the one percent threshold generally will not be considered to violate the minimum ownership interest requirement. Rev. Proc. 95-10 § 4.02, 1995-1 C.B. 501. Any other temporary allocation causing less than one percent of any material item of the LLC’s income, gain, loss, deduction, or credit to be allocated to member-managers will be considered a violation of the minimum ownership interest requirement unless the LLC clearly establishes that the member-managers have a material interest in net profits and losses over the LLC’s anticipated life. Id. For this purpose, a profits interest generally will not be considered material unless it substantially exceeds one percent and will be in effect for a substantial period of time during which the LLC reasonably expects to generate profits. Id. For example, a twenty percent interest in profits that begins four years after the LLC’s formation and continues for the life of the LLC generally will be considered
minimum ownership interest requirement with respect to LLCs that have contributions in excess of $50 million. In that case, the member-managers in the aggregate must at least maintain an interest in each material item of the greater of: (1) .2% or (2) one percent divided by the ratio of total contributions to $50 million. For example, if total contributions are $200 million, the interest in each material item must be at least .25%, that is, one percent divided by 200/50.

Under the minimum capital account balance requirement, the member-managers, in the aggregate, generally must maintain throughout the entire existence of the LLC a minimum capital account balance equal to the lesser of: (1) one percent of total positive capital account balances or (2) $500,000. The minimum capital account balance requirement does not apply if at least one member-manager has contributed or will contribute substantial services in the capacity as a member, other than services for which guaranteed payments are made. In that case, the requirement will be met if the LLC’s operating agreement expressly provides that, upon dissolution and termination of the LLC, the member-managers will contribute to the LLC capital in an amount equal to the lesser of: (1) the aggregate deficit balance, if any, in their capital accounts, or (2) the amount by which 1.01% of the total capital contributions of the non-managing members exceeds the aggregate capital previously contributed to the LLC by the member-managers.

If an LLC is managed by members or the member-managers do not satisfy the minimum ownership interest and minimum capital account balance requirements, the Service generally will rule that the LLC lacks free transferability of interests if

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172. Id. The LLC’s operating agreement must expressly incorporate at least the computed percentage. Id.
173. Rev. Proc. 95-10 § 4.04, 1995-1 C.B. 501. Whenever a non-managing member makes a capital contribution, the member-managers must be obligated, pursuant to the express terms of the operating agreement, to contribute immediately to the LLC capital equal to 1.01% of the non-managing members’ capital contributions or a lesser amount (including zero) that causes the sum of the member-managers’ capital account balances to equal the lesser of one percent of total capital account balances for the LLC or $500,000. Id. If no member has a positive capital account balance, the member-managers need not have a positive capital account balance to satisfy the minimum capital account balance requirement. Id. For this purpose, capital accounts and the value of contributions are determined under the rules of Tress. Reg. § 1.704-1(b)(2)(iv) (1996). Rev. Proc. 95-10 § 4.04, 1995-1 C.B. 501.
174. Rev. Proc. 95-10 § 4.05, 1995-1 C.B. 501. The Service will closely scrutinize services that do not relate to day-to-day operations in the LLC’s primary business activity to determine if they are in fact substantial services. Id. Suspect services include: services related to the organization and syndication of the LLC, accounting, financial planning, general business planning, and services in the nature of investment management. Id. In making the determination, the Service will consider the nature of the LLC and its activities. Id.
175. Id.
each member does not have the power to confer on a non-member all the attributes of the member's interests in the LLC without the consent of at least a majority of the non-transferring members. For this purpose, consent of a majority includes: (1) a majority of both the capital and profits interests in the LLC; (2) a majority of either the capital or the profits interests in the LLC; or (3) a majority determined on a per capita basis.

Even if all of the requirements are met with respect to an LLC whose interests may be transferred upon the consent of a majority of the nontransferring member-managers, or upon the consent of a majority of the nontransferring members, the Service will not rule that the LLC lacks free transferability of interests unless the power to withhold consent to the transfer constitutes a meaningful restriction on the transfer of the interests. "For example, a power to withhold consent to a transfer is not a meaningful restriction if the consent may not be unreasonably withheld." A restriction on the assignment of all of the interests in the LLC also is not necessary in order for the LLC to lack free transferability of interests. The Kintner regulations explain that an organization has free transferability of interests if the members owning "substantially all" of the interests in the organization have the power, without the consent of other members, to substitute for themselves in the organization a person who is not a member.

In Revenue Procedure 92-33, the Service interpreted the "substantially all" language to require that a partnership agreement must restrict the transferability of partnership interests representing more than twenty percent of all interests in partnership capital, income, gain, loss, deduction, and credit, before the partnership would be considered to lack free transferability of interests. In Revenue Procedure 95-10, the Service explained that the same "more-than-twenty-percent standard" applies to an LLC.

The Kintner regulations provide that even if there is no restriction on the transfer of a member's interest, a business organization nevertheless lacks free transferability of interests if under local law a transfer of a member's interest results in the dissolution of the old organization and the formation of a new organization. Thus, it would seem that an LLC would lack free transferability of interests if its articles of organization or operating agreement provided that the LLC would dissolve upon the transfer of a member's interest. The Service has not applied this provision to an LLC in any of its published rulings.

179. Id.
182. Rev. Proc. 95-10 5 5.02(1), (2), 1995-1 C.B. 501. See, e.g., Priv. Ltr. Rul. 93-06-008 (Nov. 10, 1992), in which the Service held that an LLC lacked free transferability of interests where one of the members, who owned less than eighty percent of all interests in the LLC's capital, income, gain, loss, deduction and credit, could freely transfer the member's interest.
In many cases it will not be advantageous to require an LLC to dissolve upon the transfer of a member’s interest. Upon dissolution of an LLC, its affairs are wound up and its assets are distributed, first to creditors, and then to the members. Even if the remaining members could prevent dissolution by consenting to continue the business upon the transfer of a member’s interest, there always would be the risk that consent might not be given in time to prevent dissolution. Requiring the nontransferring members to consent to the admission of an assignee of a member’s interest accomplishes the same result under the Kintner regulations without exposing an LLC to the risk of dissolution.

In some cases, however, it was advisable to provide that an LLC would dissolve upon the transfer of a member’s interest. When a business organization is owned by related parties, the Service sometimes has taken the position that the organization has free transferability of interests notwithstanding a requirement that the nonassigning members of the organization must consent to the admission of an assignee of a member’s interest. For example, in Revenue Ruling 93-4, a German GmbH, which is a form of business organization similar to an LLC, was owned by two wholly-owned domestic subsidiaries of the same United States corporation. The GmbH’s memorandum of association provided that the interests in the GmbH could not be transferred without the written consent of all of the members. In Revenue Ruling 93-4, the Service held that the GmbH had free transferability of interests because the transfer restriction was not meaningful. Inasmuch as all of the members of the GmbH were commonly controlled, the Service reasoned that the common parent could make all of the transfer decisions and therefore there was no impediment to the transfer of an interest. The Service explained, however, that the GmbH would have lacked free transferability of interests if its memorandum of association had either prohibited the transfer of an interest or provided that the GmbH would dissolve upon the transfer of an interest.

Thus, where an LLC is owned by controlled entities or by an individual and the individual’s wholly-owned corporation, it was advisable for the LLC’s articles of organization or written operating agreement to provide either that the interests in the LLC are not transferable or that the LLC will dissolve upon the transfer of a member’s interest. In several private letter rulings the Service has held that a Louisiana LLC owned by a corporation and the corporation’s wholly-owned subsidiary lacked free transferability of interests where the LLC’s operating agreement provided that no member could assign any or all of his interest in the LLC and that any attempted assignment in violation of the transfer restriction would result in the dissolution of the LLC.

It may be preferable for an LLC’s operating agreement to provide that the LLC will dissolve upon the assignment of an interest rather than to contain an

186. 1993-1 C.B. 225.
absolute restriction on the transfer of an interest in the LLC. An absolute restriction on the transfer of a member’s interest could be invalidated as a violation of the public policy against perpetual restraints on alienability.\(^\text{188}\)

The members of an LLC may desire to permit a member to transfer an interest in the LLC only after first offering the interest to the other members for its fair market value. The \textit{Kintner} regulations provide that a business organization has a modified form of free transferability of interests if its interests are freely transferable, subject to a right of first refusal.\(^\text{189}\) Having a modified form of free transferability of interests would not help an LLC obtain classification as a partnership under the \textit{Kintner} regulations. If an LLC had two of the other corporate characteristics and a modified form of free transferability of interests, it would be classified as an association taxable as a corporation because it had a preponderance of corporate characteristics.\(^\text{190}\) On the other hand, if an LLC lacked two of the other four corporate characteristics and had a modified form of free transferability of interests, it would be classified as a partnership because it lacked a preponderance of corporate characteristics.\(^\text{190}\) Thus, if it was necessary for an LLC to lack free transferability of interests, there had to be some meaningful restriction on the assignment of an interest other than or in addition to a right of first refusal by the nonassigning members.

The LLC Acts of some states permit a member to assign his or her right to participate in the management of the LLC to another person who already is a member, but prohibit an assignment of participation rights to a nonmember unless the nonassigning members unanimously consent in writing.\(^\text{191}\) While the default rules of the Louisiana LLC Law contain no such provision, it seems that the articles of organization or a written operating agreement of a Louisiana LLC could allow for the unrestricted transfer of LLC interests among members without causing the LLC to have free transferability of interests. In Private Letter Ruling 94-25-013,\(^\text{192}\) the Service ruled that an LLC lacked free transferability of interests where members could freely transfer interests among themselves, but could not transfer, without the consent of the other members, their right to participate in the management of the LLC to a person who was not

\(^{188}\) \textit{See}, e.g., \textit{La. Civ. Code art. 1520}; \textit{Female Orphan Society v. Young Men's Christian Ass'n}, 119 La., 278, 44 So. 15 (1907). \textit{But see Priv. Ltr. Rul. 96-06-006} (Feb. 9, 1996) (Louisiana LLC owned by Y and Y's wholly-owned corporation lacked free transferability of interests where the LLC's operating agreement provided that no member could transfer, sell, give, donate, assign, alienate, or otherwise dispose of any of his interest in the LLC and no member could transfer all or any part of his interest by way of security).

\(^{189}\) Former Treas. Reg. § 301.7701-2(c)(2) (as amended in 1993).

\(^{190}\) \textit{See} Former Treas. Reg. § 301.7701-2(a)(3) (as amended in 1993) (an unincorporated organization shall not be classified as a corporation unless the organization has more corporate characteristics than noncorporate characteristics). \textit{See also} Larson \textit{v. Commissioner}, 66 T.C. 159, 185-86 (1976) (each corporate characteristic bears equal weight, except for the modified form of free transferability of interests).


\(^{192}\) (March 23, 1994).
a member. In determining whether a business organization has free transferability of interests, the Kintner regulations focus on the unrestricted power of members to substitute for themselves in the same organization a person who is not a member of the organization.\footnote{Former Treas. Reg. § 301.7701-2(e)(1) (as amended in 1993).}

In some cases, however, members of an LLC may not desire to alter the default rules of the Louisiana LLC Law in this way. If the members of the LLC vote in proportion to their relative capital contributions or in accordance with the number of units each member owns in the LLC, the unrestricted ability of a member to assign participation rights to another member could enable one or several members of the LLC to acquire control of the LLC by purchasing the interests of other members.

On the other hand, the ability of a member to transfer his or her participation rights to another member will not shift control of the LLC if the LLC’s organizational documents do not alter the default rules of the Louisiana LLC Law concerning voting rights. Under the default rules, each member of a Louisiana LLC is entitled to only one vote, regardless of the amount that the member has contributed to the LLC.\footnote{La. R.S. 12:1318(A) (1994).} Thus, the transfer of one member’s interest to another member of such an LLC will not confer upon the transferee any greater voting rights than the transferee had before the transfer. In such a case, it may be preferable to allow the transferor to assign his or her participation rights. As a result of the transfer of a member’s entire interest in the LLC, the transferor would lose his or her voting rights and the right to participate in the management of the LLC. A person who has no financial stake in an LLC generally has little incentive to exercise his or her management rights in the best interests of the LLC. Thus, it might be better to preclude a person who has given up his or her entire financial interest in an LLC from participating in its management.

An interest in a Louisiana LLC is not heritable. If a member dies, the member’s membership in the LLC ceases, and the member’s executor, administrator, or other legal representative is treated as an assignee of the member’s interest.\footnote{La. R.S. 12:1333 (1994).} Presumably, this rule was included in the Louisiana LLC Law to prevent a Louisiana LLC from having the corporate characteristic of free transferability of interests. It may not be necessary, however, to preclude heritability of a member’s interest in order for an LLC to lack free transferability of interests under the Kintner regulations.

In Private Letter Ruling 96-04-014,\footnote{Oct. 26, 1995.} the Service indicated that interests in an LLC may be heritable without causing the LLC to have free transferability of interests. In the private letter ruling, an LLC’s operating agreement provided that persons who received an interest in the LLC by will upon the death of a member or certain member-related persons who received an economic interest...
in the LLC from a member by the law of intestate succession could be admitted as members upon agreeing in writing to be bound by the terms of the operating agreement. Otherwise, the transferee of an economic interest could become a member only with the consent of a majority in interest of the nontransferring members. The Service ruled that the LLC lacked free transferability of interests.

It is not certain whether the parties can alter the rule of the Louisiana LLC Law precluding the heritability of a member's interest. Section 12:1333 of the Revised Statutes provides that the interest of a member ceases when the member dies and that the member's legal representative has only the rights of an assignee. There is no qualification in section 12:1333 allowing for the LLC's articles of organization or an operating agreement to provide otherwise. Nevertheless, section 12:1332(A) permits an LLC's articles of organization or a written operating agreement to alter the default rules that prevent an assignee of a member's interest from becoming a member of the LLC without the unanimous written consent of the nonassigning members. Moreover, the express policy of the Louisiana LLC Law is to give the maximum effect to the principle of freedom of contract. While it is uncertain, it may be possible for an LLC's articles of organization or a written operating agreement to provide that the legal representative of a deceased member may become a member. If such a provision is upheld, it seems that the LLC could still lack free transferability of interests under Private Letter Ruling 960-40-14.

Care should be taken, however, in relying on the private letter ruling. A private letter ruling does not have precedential value and is binding on the Service only with respect to the taxpayer to whom it is issued.

E. Other Factors.

The Kintner regulations state that in addition to the four primary corporate characteristics, other factors may be found in some cases that are significant in classifying an organization as an association taxable as a corporation or as a partnership. No court, however, has considered factors other than the four primary corporate characteristics in determining whether a business organization was taxable as a corporation or as a partnership. In Larson v. Commissioner, both the taxpayer and the Service identified additional factors that caused the limited partnership whose tax status was at issue to resemble either a corporation or a partnership. The Larson court refused to consider the other factors identified by the parties, either because the other factors were within the ambit of the four primary corporate characteristics or because the other factors

198. See supra text accompanying note 196.
201. 66 T.C. 159 (1976).
were irrelevant.\textsuperscript{202} Similarly, in determining the tax classification of a limited partnership in \textit{Zuckman v. United States},\textsuperscript{203} the Court of Claims refused to consider other factors identified by the government because the court already had found that the limited partnership in question lacked all four of the primary corporate characteristics.

In Revenue Ruling 79-106,\textsuperscript{204} the Service acquiesced in \textit{Larson} and listed "other factors" that it would not consider in issuing classification rulings. The list includes the following factors:

(1) the division of limited partnership interests into units or shares and the promotion and marketing of such interests in a manner similar to corporate securities,
(2) the managing partner's right or lack of the discretionary right to retain or distribute profits according to the needs of the business,
(3) the limited partner's right or lack of the right to vote on the removal and election of general partners and the right or lack of the right to vote on the sale of all, or substantially all, of the assets of the partnership,
(4) the limited partnership interests being represented or not being represented by certificates,
(5) the limited partnership's observance or lack of observance of corporate formalities and procedures,
(6) the limited partners being required or not being required to sign the partnership agreement, and
(7) the limited partnership providing a means of pooling investments while limiting the liability of some of the participants.\textsuperscript{205}

The existence or absence of other factors does not seem to be an issue in determining the tax status of an LLC. The Service has not considered any factors other than the four primary corporate characteristics in any of its rulings concerning the classification of an LLC since 1988.

\textbf{F. The Single-Member Limited Liability Company}

The Louisiana LLC Law does not authorize the formation of an LLC with fewer than two members.\textsuperscript{206} If a Louisiana LLC ceases to have at least two members for more than ninety consecutive days, the LLC will dissolve.\textsuperscript{207} The

\begin{itemize}
\item \textsuperscript{202} \textit{Id.} at 184.
\item \textsuperscript{203} 524 F.2d 729, 744 (Ct. Cl. 1975).
\item \textsuperscript{204} 1979-1 C.B. 448.
\item \textsuperscript{205} \textit{Id.}
\item \textsuperscript{206} See La. R.S. 12:1301(A)(10) (1994) (defining the terms "limited liability company" and "domestic limited liability company" to mean an unincorporated association having two or more members); La. R.S. 12:1304 (1994) (requiring two or more persons to form an LLC).
\item \textsuperscript{207} La. R.S. 12:1334(3) (1994).
\end{itemize}
LLC laws of some other states, however, authorize the formation of single-member LLCs. A single-member LLC formed under the laws of a state other than Louisiana should be able to procure a certificate of authority to transact business in Louisiana. Thus, a sole proprietor, who is a resident of Louisiana, could be tempted to form a LLC under the laws of another state in order to limit his or her liability and then register the LLC as a foreign LLC in order to transact business in Louisiana. While such a device might limit the sole proprietor’s liability, it could have adverse tax consequences under the Kintner regulations.

The Service has stated that it will not consider a ruling request that relates to the classification of an LLC as a partnership for federal tax purposes unless the LLC has at least two members. Before the check-the-box regulations were issued, most commentators agreed that a single-member LLC could not be classified as a partnership for purposes of federal income taxation. Under state law, a partnership, whether a general partnership or a limited partnership must have at least two partners. The Internal Revenue Code and the Kintner regulations suggest that the absence of a second member is fatal to partnership classification. The Internal Revenue Code defines the term “partnership” to include a “syndicate, group, pool, joint venture or other unincorporated organization.”

208. See, e.g., Del. Code Ann. tit. 6, § 18-101(6) (1996); N.Y. Limited Liability Company Law § 102(m) (McKinney 1996) (defining the term “limited liability company” as an unincorporated organization of one or more persons having limited liability); Or. Rev. Stat. § 63.001(13) (1995); Tex. Rev. Civ. Stat. Ann. art. 1528n, art. 6.01(A)(4) (West 1995) (requiring as a default rule that a Texas LLC dissolves upon the termination of a member’s interest unless there is at least one remaining member and the LLC is continued by the consent of the remaining members); ULLCA § 202(a) (1995) (one or more persons may organize an LLC consisting of one or more members). Some states, while not specifically authorizing the formation of single-member LLCs, do not prohibit persons from operating a single-member LLC. See statutes cited in Marshall B. Paul & Stuart Levine, One-Member LLCs Pose Often-Overlooked State Law Issues, 1 J. Limited Liability Companies 162, 166 Table 6 (1995).

209. See La. R.S. 12:1342 (1994) (permitting a foreign LLC to obtain a certificate of authority to transact business in Louisiana even if the laws of the jurisdiction under which the foreign LLC was organized differ from the laws of Louisiana).


212. See La. Civ. Code arts. 2801 (defining a partnership as a juridical person created by a contract between two or more persons), 2826 (providing that a general partnership terminates when its membership is reduced to one person), 2837 (defining a partnership in commendum as consisting of one or more general partners and one or more partners in commendum); UPA § 6(1) (1914) (a partnership is an association of two or more persons to carry on as co-owners a business for profit); RULPA § 101(7) (1985) (a “limited partnership” means a partnership formed by two or more persons having one or more general partners and one or more limited partners).

term "other unincorporated organization" could include a sole proprietorship, the
illustrative examples in the statutory definition are all business organizations
comprised of two or more members. The Kintner regulations support this
conclusion by explaining that a partnership, like a corporation ("other than the so-
called one man corporation"), has associates and an objective to carry on business
for joint profit. The provisions of the Internal Revenue Code concerning the
termination of a partnership also indicate that a partnership must have at least two
members at all times. A partnership will terminate for tax purposes if no part of its
business continues to be carried on by any of its partners in a partnership. The
regulations interpreting this provision provide an example of a partnership
termination where two partners in a three-person partnership sell their interests in
the partnership to the third partner.

Some commentators, however, have suggested that a single-member LLC
should be taxed as a sole proprietorship. The check-the-box regulations
create some confusion with respect to the foregoing analysis.

Under the check-the-box regulations, a single-member LLC, in many cases,
may elect to be disregarded as an entity separate from its owner. If an
entity is disregarded, its activities are treated in the same manner as a sole
proprietorship, branch, or division of the owner. Under a grandfather rule,
an entity that: (1) was in existence before the effective date of the check-the-box
regulations (an "existing entity") and (2) is eligible to make a check-the-box
election under the new regulations (an "eligible entity") will have the same
classification that the entity claimed under the Kintner regulations. In the
case of an existing eligible entity with a single owner, the new regulations
provide that if such an entity "claimed to be a partnership under those regulations,
the entity will be disregarded as an entity separate from its owner."

216. Treas. Reg. § 1.708-1(b)(1) (1960). Upon the death or retirement of a partner in a two-
person partnership, the retired partner or a deceased partner's successor in interest is treated as a
partner until the partnership interest of the retired or deceased partner is completely liquidated. Treas.
Reg. § 1.736-1(a)(1)(ii) (as amended in 1965). Thus, a two-person partnership does not terminate
for tax purposes upon the retirement or death of one of the partners until the partnership interest of the
retired or deceased partner is completely liquidated or the interest is purchased by the remaining
partner. See also Treas. Reg. § 1.708-1(b)(1)(i)(a) (1960) (upon the death of one of the partners in
a two-member partnership, the partnership does not terminate if the estate or other successor in
interest of the deceased partner continues to share in the profits or losses of the partnership business).
These rules should apply when one of the members of a two-member LLC dies or retires.
217. Francis J. Wirtz & Kenneth L. Harris, Tax Classification of the One-Member Limited
Liability Company, 59 Tax Notes 1829 (June 28, 1993). See also Williford & Standley, supra note
211, at 33.
218. Treas. Reg. § 301.7701-3(a) (as amended in 1996).
221. Id.
The quoted language indicates that a single-member LLC could claim to be a partnership under the Kintner regulations. This conclusion is not entirely certain, however. The check-the-box regulations explain that an existing entity's claimed classification will be respected for periods prior to their effective date if, *inter alia*, the entity had a reasonable basis (within the meaning of section 6662) for its claimed classification. The reasonable basis standard under section 6662 is a relatively high standard and is not satisfied by a position that is merely arguable or that is merely a colorable claim.

Under prior authority, and in light of the Service’s “no-rule policy” with respect to the classification of single-member LLCs, it seems that it would be difficult for a single-member LLC to have a reasonable basis for claiming that it is a partnership under the Kintner regulations. Prior to the effective date of the check-the-box regulations, a conservative planner would avoid forming a one-person LLC. Steps could be taken, however, to permit a person who could not find or did not desire associates to form an LLC and achieve partnership classification under the Kintner regulations.

Under the Louisiana LLC Law, a sole proprietor could form an LLC with a wholly-owned corporation as the other member of the LLC. Before the check-the-box regulations were issued, it was advisable to organize an LLC owned by a person and that person’s wholly-owned corporation in such a way as to avoid application of the “no separate interests” theory.

Under the “no separate interests” theory, a business organization whose members consist of controlled parties could be denied partnership tax status under the Kintner regulations because the lack of separate interests could cause the organization to have too many corporate characteristics. In *MCA, Inc. v. United States*, the United States District Court for the Central District of California applied a “no separate interests” theory in holding that foreign distribution outlets owned by a commonly controlled corporation and trust were corporations rather than partnerships for federal income tax purposes. The district court explained that because of the lack of separate interests, there was no meaningful possibility that

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222. Treas. Reg. § 301.7701-3(f)(2) (as amended in 1996). In addition, an entity’s claimed classification may not be respected if: (1) the entity or any of its members did not recognize the federal tax consequences of any change in the entity’s classification within the 60 months prior to January 1, 1997 or (2) either the entity or any member was notified in writing on or before May 8, 1996, that the classification of the entity was under examination. Id.


225. 502 F. Supp. 838 (C.D. Cal. 1980), rev’d on other grounds, 685 F.2d 1099 (9th Cir. 1982).
the owners of the outlets would act independently. The court agreed with the government that the outlets had free transferability of interests because if either of the commonly controlled entities that owned the interests in the outlets wished to sell its interest in the outlets, the other would not have objected or interfered. Similarly, the court held that the outlets had continuity of life notwithstanding the fact that they would dissolve upon the death, insanity, retirement, resignation, or expulsion of any member. The court reasoned that if one of the events occurred terminating a member’s interest, no separate interests existed that would demand dissolution of any of the outlets. Because many of the outlets also possessed the corporate characteristic of limited liability, the court held that they were corporations for federal income tax purposes. Similarly, if an LLC whose members consisted of one person and a wholly-owned corporation was considered to have continuity of life and free transferability of interests under the “no separate interests” theory, the LLC would be classified as a corporation under the Kintner regulations because it also would have a third corporate characteristic, limited liability.

The precedential value of the district court’s subscription to the “no separate interests” theory in MCA was uncertain. No other court has adopted this theory. In reversing the district court’s opinion in MCA, the United States Court of Appeals for the Ninth Circuit neither endorsed nor rejected the “no separate interests” theory. Instead, the Ninth Circuit found that the corporation and the trust that owned the interests in the outlets were not in fact controlled by the same interests. Thus, the Ninth Circuit did not have to decide whether the “no separate interests” theory is valid as a matter of law.

For a long time, the Service’s position with respect to the “no separate interests” theory was also uncertain. On several occasions the Service has ruled, without discussing the “no separate interests” theory, that a business organization owned by controlled entities is a partnership for federal income tax purposes.

227. Id. at 846.
228. Id.
229. Id.
230. Id. at 847.
231. 685 F.2d 1099 (9th Cir. 1982).
232. 685 F.2d at 1103-04.
On other occasions, the Service applied the "no separate interests" theory to deny partnership classification to a business organization. In Revenue Ruling 77-214, the Service applied the "no separate interests" theory in holding that a German GmbH whose quotas (interests) were owned by two wholly-owned United States domestic subsidiaries was taxable as a corporation rather than as a partnership. The memorandum of association pursuant to which the GmbH was formed provided that the GmbH would be dissolved by the death, insanity, or bankruptcy of any of the quotaholders and that the quotas were not transferable without the prior written approval of all quotaholders. Despite the GmbH's apparent compliance with the requirements of the Kintner regulations, the Service held that the GmbH possessed the corporate characteristics of continuity of life and free transferability of interests. The Service explained that because both quotaholders were subsidiaries of the same parent, there were no separate interests to compel dissolution if an event of dissolution should occur, assuring that the GmbH would have continuity of life. The Service found that there was free transferability of interests because the controlling parent would make all the transfer decisions for its subsidiaries, regardless of any provision to the contrary in the memorandum of association. The GmbH in question possessed both limited liability and centralized management and, therefore, was classified as a corporation for federal tax purposes.

In Revenue Ruling 93-4, the Service modified and superseded Revenue Ruling 77-214 with respect to the same GmbH. On reconsideration, the Service decided that the presence or absence of separate interests is not relevant to the determination of whether an entity possesses continuity of life and held that the GmbH in question lacked that corporate characteristic because the bankruptcy of either quotaholder, without further action, could cause the GmbH to dissolve. In Revenue Ruling 93-4, the Service reaffirmed its position that the GmbH had free transferability of interests, but explained that the GmbH would have lacked that corporate characteristic if its memorandum of association had either prohibited the transfer of an interest or provided that the GmbH would dissolve upon the transfer of an interest. Because the GmbH had three of the four primary corporate characteristics, it was classified as an association taxable as a corporation.

Thus, it seems that a Louisiana LLC whose members consist of a person and the person's wholly owned corporation could be classified as a partnership under the Kintner regulations, notwithstanding the "no separate interests" theory. Under the default rules of the Louisiana LLC Law, an LLC dissolves, inter alia, upon the

235. 1977-1 C.B. at 409.
236. Id.
237. Id.
238. 1993-1 C.B. 225.
239. Id. at 226.
240. Id.
241. Id.
death, interdiction, withdrawal, expulsion, bankruptcy, or dissolution of a member unless the remaining members consent to continue the LLC. As long as the LLC's articles of organization and operating agreement do not depart from the default rule, the LLC should lack continuity of life under Revenue Ruling 93-4. Under Revenue Ruling 93-4, an LLC that is owned by commonly controlled interests lacks free transferability of interests if its articles of organization or a written operating agreement either prohibit the transfer of a member's interest or provide that the LLC will dissolve upon the transfer of a member's interest. In several private letter rulings the Service held that a Louisiana LLC owned by a corporation and its wholly-owned subsidiary lacked free transferability of interests where the LLC's operating agreement provided that no member of the LLC was permitted to assign all or any part of the member's interest in the LLC and that any attempted assignment in violation of the transfer restriction would cause the LLC to dissolve.

III. THE "CHECK-THE-BOX" REGULATIONS

As Part II of this article indicates, the issue of whether an LLC is classified as a partnership or as an association taxable as a corporation may require a complex analysis under the Kintner regulations. In December of 1996, the Service and the

243. If the LLC also lacks centralized management, the consideration of whether it also lacks free transferability of interests is irrelevant because an LLC needs to lack only two of the four primary corporate characteristics to avoid being taxed as a corporation. There may be some question as to whether an LLC whose interests are owned by commonly controlled parties has the corporate characteristic of centralized management. Under the Kintner regulations, an organization has centralized management where only one person has the continuing exclusive authority to make business decisions on behalf of the organization which do not require ratification by members of the organization. Former Treas. Reg. § 301.7701-2(c)(3) (as amended in 1993). The Service could find that an LLC whose members are an individual and the individual's wholly-owned corporation has centralized management because the individual has continuing exclusive authority to make business decisions on behalf of the LLC.

Notwithstanding the foregoing analysis, in private letter rulings, the Service has held that an LLC owned by an individual and the individual's wholly-owned corporation lacked centralized management because it was member-managed and any member had the authority to bind the LLC. See, e.g., Priv. Ltr. Rul. 93-20-045 (Feb. 24, 1993); Priv. Ltr. Rul. 93-20-019 (Feb. 18, 1993). The Service did not discuss the no separate interests theory in either ruling. A private letter ruling, however, may not be used or cited as precedent and is binding on the Service only with respect to a taxpayer to whom the letter ruling was issued. Rev. Proc. 96-1 § 11.02, 1996-1 I.R.B. 8. Accordingly, a conservative planner who formed such an LLC before the effective date of the check-the-box regulations would want to ensure that the LLC lacked the corporate characteristic of free transferability of interests.

244. See, e.g., Priv. Ltr. Rul. 94-09-016 (Nov. 30, 1993); Priv. Ltr. Rul. 94-09-014 (Nov. 29, 1993); Priv. Ltr. Rul. 94-04-021 (Nov. 1, 1993). See also Priv. Ltr. Rul. 96-06-006 (Feb. 9, 1996) (Louisiana LLC owned by Y and Y's wholly-owned corporation lacked free transferability of interests where LLC's operating agreement provided that no member could transfer, sell, give, donate, assign, alienate or otherwise dispose of any of his interest in the LLC or transfer any or all of his interest in the LLC by way of security).
Treasury Department issued final check-the-box regulations that simplify the classification rules by permitting many LLCs to choose their tax classification by election. This Part discusses the check-the-box regulations and the tests that now apply in determining whether an LLC is classified as a partnership.

The check-the-box regulations were proposed in May of 1996. The Preamble to the proposed regulations explains that the Kintner regulations are based on the historical differences under local law between corporations and partnerships, but the emergence of new forms of business organization has blurred the distinctions. Under the Kintner regulations, taxpayers were able to achieve partnership taxation with respect to business organizations that were virtually indistinguishable from corporations. To accomplish this result, however, taxpayers and the Service had to expend considerable resources in determining the proper classification of unincorporated business organizations. Moreover, small business organizations often lacked the expertise to achieve the tax classification they wanted under the current classification regulations. The elective procedure of the check-the-box regulations is intended to reduce the burdens on both taxpayers and the Service.

The check-the-box election is not available to all business organizations. For example, trusts and corporations are not eligible to make a check-the-box election. Similarly, in many cases, a publicly traded entity will receive no benefit from the check-the-box regulations. Regardless of whether a publicly traded entity is classified as a partnership under the current or proposed regulations, most publicly traded entities are taxed as corporations under section 7704 of the Internal Revenue Code. Where partnership tax status is desired for a non-publicly traded entity, incorporation should be avoided.

248. Id.
249. Treas. Reg. §§ 301.7701-1(b), -2(b), -3(a) (as amended in 1996).
250. Treas. Reg. § 301.7701-2(b)(7) (as amended in 1996). While a publicly traded entity may be classified as a partnership under the current classifications or may be eligible to make a check-the-box election under the proposed regulations, the taxation of such an entity is determined under I.R.C. § 7704. The Service and the Treasury Department do not have the authority to overrule a federal statute. A publicly traded entity, however, may be taxed as a partnership if ninety percent of the partnership’s gross income consists of “qualifying income” for the taxable year and for all preceding taxable years beginning after December 31, 1987. I.R.C. § 7704(c) (1994). For this purpose, qualifying income generally consists of passive-type income, such as interest, dividends, real property rents, gain from the sale or other disposition of real property, capital assets, and income and gains from certain mineral activities. See I.R.C. § 7704(d) (1994). A grandfather rule provides that certain partnerships that were publicly traded on December 17, 1987, will not be classified as corporations until taxable years beginning after December 31, 1997, unless prior to that time, they engage in a substantially new line of business. H.R. Rep. No. 495, 100th Cong., 1st Sess. 950 (1987); IRS Notice 88-75 § 5, 1988-2 C.B. 386. While it is not entirely certain, a publicly traded partnership that converts to an LLC should be able to take advantage of the grandfather rule. Inasmuch as the grandfather rule is about to expire, it should have little relevance for LLCs unless the expiration date is extended.
A. Eligibility

Under the new regulations, only an eligible "entity" may make a check-the-box election.\textsuperscript{251} For this purpose, the issue of whether an organization is an "entity" separate from its owners is a matter of federal tax law and does not depend on whether the organization is an entity under local law.\textsuperscript{252} Thus, it seems that notwithstanding the fact that an LLC is an entity separate from its owners under Louisiana law,\textsuperscript{253} the separate existence of a Louisiana LLC could be disregarded under federal tax law.

A joint venture or other contractual arrangement may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom.\textsuperscript{254} On the other hand, a joint undertaking merely to share expenses does not create a separate entity.\textsuperscript{255} For example, a separate entity exists for federal tax purposes if co-owners of a building lease space and also provide services to the tenants either directly or through an agent, whereas the mere co-ownership of property that is maintained, kept in repair, and rented or leased does not create a separate entity.\textsuperscript{256}

The distinction between a separate entity and a mere co-ownership of property under the check-the-box regulations is similar to the distinction between a partnership and a mere co-ownership of property under the former section 761 regulations.\textsuperscript{257} In Revenue Ruling 75-374,\textsuperscript{258} interpreting the former section 761 regulations, the Service ruled that a mere co-ownership, rather than a partnership, existed where co-owners of an apartment complex furnished customary tenant services such as heat, air conditioning, hot and cold water, unattended parking, normal repairs, trash removal, and cleaning of public areas at no additional charge above the basic rental payments. The analysis in Revenue Ruling 75-374 also should apply in determining whether a separate entity exists under the check-the-box regulations.

The tax consequences to the parties may differ depending on whether an LLC is considered an entity or a mere co-ownership. For example, if an LLC

\textsuperscript{251} Treas. Reg. § 301.7701-3(a) (as amended in 1996).
\textsuperscript{252} Treas. Reg. § 301.7701-1(a)(1) (as amended in 1996).
\textsuperscript{253} See La. R.S. 12:1301(A)(10) (1994) (defining the term "limited liability company" as an "entity" that is an unincorporated association having two or more members that is organized under the Louisiana LLC Law); La. R.S. 12:1329 (1994) (an interest in an LLC is property; a member of an LLC has no interest in the LLC's property); La. Civ. Code art. 2801 (defining the term "partnership" as a "juridical person, distinct from its owners").
\textsuperscript{254} Treas. Reg. § 301.7701-1(a)(2) (as amended in 1996).
\textsuperscript{255} Id.
\textsuperscript{256} Id.
\textsuperscript{257} See Former Treas. Reg. § 1.761-1(a) (as amended in 1972). I.R.C. § 761(a) provides a definition of the term "partnership" that is similar to the definition of that term in I.R.C. § 7701(a)(2). Thus, it is appropriate for the § 7701 regulations to provide interpretative rules similar to those contained in the § 761 regulations.
\textsuperscript{258} 1975-2 C.B. 261.
is an entity taxed as a partnership, most elections that affect the computation of
the LLC's taxable income must be made by the LLC rather than by the
individual members. Such elections include: (1) the choice of the LLC's
taxable year, (2) the LLC's method of accounting, (3) the method to be
used for depreciating the LLC's property, and (4) the election to defer
recognition of casualty gain with respect to the LLC's property. Co-owners,
on the other hand, may make inconsistent elections with respect to their
respective shares of the jointly-owned property. If an LLC is an entity taxed as
a partnership, its items of income, gain, loss, deduction, and credit will flow
through to the members and be reported by each member for the member's
taxable year and within which the LLC's taxable year ends. In contrast,
each co-owner must report his or her share of items of income, gain, loss,
deduction, and credit derived from the jointly-owned property in the year in
which the items are earned, incurred, or accrued, depending on the co-owner's
method of accounting.

A determination that an LLC is an entity rather than a mere co-ownership
also may affect the tax treatment of income and deductions. If an LLC is an
entity, the character of its income is determined at the LLC level. For
example, a sale or exchange of property held for investment by an LLC that is
an entity taxable as a partnership generally will result in capital gain in the hands
of a member even if the member is a dealer in such property. The character
of gain or loss on the sale or exchange of jointly-owned property is determined
separately with respect to each co-owner.

It also may be important to determine whether an LLC is an entity for tax
reporting purposes. If an LLC is an entity taxable as a partnership, the LLC
must file an informational income tax return and furnish a copy of the return to
its members. No such return is required if the relationship of the parties is
mere co-ownership.

259. I.R.C. § 703(b) (1994).
261. See I.R.C. §§ 446, 448 (1994). In some cases, an LLC may not be permitted to use the
cash method of accounting. For a discussion of whether an LLC may use the cash method of
accounting, see Kalinka, supra note 1, § 6.3.
on the sale of property being treated as ordinary income to a non-dealer partner because the
partnership was holding the real estate primarily for sale to customers in the ordinary course of a
business). But see I.R.C. § 734 (1994) (gain or loss with respect to contributed property generally
retains it character, at least for five years after the contribution). For a discussion of I.R.C. § 734,
see Kalinka, supra note 1, § 5.21.
267. I.R.C. § 6031 (1994). Failure to file a partnership return could result in a penalty unless
the participants can prove that the failure was due to reasonable cause. I.R.C. § 6698 (1994).
To be entitled to make a check-the-box election, not only must an LLC be an entity, but it must also be an “eligible” entity. The regulations classify the following business entities as corporations: (1) a business entity organized under a federal or state statute, or a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic; (2) a state-statute authorized joint-stock company or joint-stock association; (3) an insurance company; (4) a state-chartered bank, if any of its deposits are insured under the Federal Deposit Insurance Act or a similar federal statute; (5) a business entity wholly owned by a state or political division of a state; and (6) a business entity, such as a publicly traded partnership, that is taxable as a corporation under a provision of the Internal Revenue Code other than section 7701(a)(3). The check-the-box regulations also provide a list of specified foreign, possession, territory, and commonwealth entities that are classified as corporations. Under a grandfather rule, however, a listed entity is classified as a partnership if: (1) the entity was in existence on May 8, 1996; (2) classification of the entity as a partnership was relevant to any person for federal tax purposes on May 8, 1996; (3) no person (including the entity) for whom the entity’s classification was relevant on May 8, 1996, treats the entity as a corporation for purposes of filing income tax returns, information returns, and withholding documents for the taxable year including May 8, 1996; (4) any change in the entity’s claimed classification within the sixty months preceding May 8, 1996, occurred solely as a result of a change in the entity’s organizational documents, and the entity and all of its members recognized the federal tax consequences of any change in the entity’s classification within the sixty-month period; (5) there was a reasonable basis for claiming partnership classification of the entity on May 8, 1996; and (6) neither the entity nor any member was notified in writing on or before May 8, 1996, that the classification of the entity was under examination. For purposes of the grandfather rule, a foreign entity’s classification is relevant when the entity’s classification affects the liability of

268. Treas. Reg. § 301.7701-3(a) (as amended in 1996).
269. Id.
272. Treas. Reg. § 301.7701-2(d)(1) (as amended in 1996). For this purpose, the issue of whether the entity had a reasonable basis for its claimed classification as a partnership is determined under the principles of I.R.C. § 6662. Id. If a listed entity is formed after May 8, 1996, pursuant to a written binding contract in effect on May 8, 1996, and all times thereafter, in which the parties agreed to engage (directly or indirectly) in an active and substantial business operation in the jurisdiction in which the entity is formed, the grandfather rule also will apply to the entity. Treas. Reg. § 301.7701-2(d)(2) (as amended in 1996).
any person for federal tax or information purposes.\textsuperscript{272} The grandfather rule ceases to apply upon the earliest of the following to occur: (1) the effective date of any election to be treated as an association taxable as a corporation; (2) a termination of the partnership under section 708(b)(1)(B) of the Internal Revenue Code on the sale or exchange of fifty percent or more of the total interests in the entity in capital and profits within a twelve-month period; or (3) a division of the partnership under section 708(b)(2)(B) of the Internal Revenue Code.\textsuperscript{274}

\textbf{B. Consequences of the Election}

Under the check-the-box regulations, an eligible entity may elect its classification for federal tax purposes. An eligible entity with two or more members may elect to be classified as an association (and therefore, taxable as a corporation) or as a partnership.\textsuperscript{275} An eligible entity with a single member may elect to be classified as an association or to be disregarded as an entity separate from its owner.\textsuperscript{276} If a single-member entity elects to be disregarded as a separate entity, it will be taxed as a sole proprietorship or as a branch or division of a corporation, depending on the nature of its single owner.\textsuperscript{277}

The Louisiana LLC Law does not authorize the formation of an LLC with fewer than two members.\textsuperscript{278} Currently, the only way a single-member entity can achieve limited liability under Louisiana law is to incorporate.\textsuperscript{279} Under the new regulations, however, an incorporated entity is not eligible to make a check-the-box election. Now that the check-the-box regulations have been issued in final form, the Louisiana LLC Law should be amended to authorize the formation of a single-member LLC.

\textbf{C. Default Rules}

The check-the-box regulations are designed to provide the most eligible entities with the classification they would choose without requiring them to file an election.\textsuperscript{280} Accordingly, the regulations provide default classification rules

\textsuperscript{272}. Treas. Reg. § 301.7701-3(d)(1) (as amended in 1996).
\textsuperscript{274}. Treas. Reg. § 301.7701-2(d)(3)(i) (as amended in 1996). The grandfather status of a listed entity will not cease where termination of the partnership is caused by a sale or exchange of the interests in the entity to a related person (within the meaning of I.R.C. §§ 267(b) and 707(b)) and occurs twelve months after the date on which the entity was formed. Treas. Reg. § 301.7701-2(d)(3)(ii) (as amended in 1996).
\textsuperscript{275}. Treas. Reg. § 301.7701-3(a) (as amended in 1996).
\textsuperscript{276}. \textit{Id.}
\textsuperscript{277}. Treas. Reg. § 301.7701-2(a) (as amended in 1996).
\textsuperscript{278}. \textit{See La. R.S. 12:1301(A)(10) (1994 & 1996 Supp.)} (defining the term "limited liability company" as an unincorporated association having two or more members).
\textsuperscript{279}. \textit{See La. R.S. 12:93(B) (1994 & 1996 Supp.)} (a shareholder is not personally liable for any debt or liability of the corporation).
that are intended to meet those expectations. Under the check-the-box regulations, a newly formed unincorporated domestic entity automatically will be classified as a partnership if it has two or more members unless it elects to be classified as an association taxable as a corporation.\textsuperscript{281} A newly formed unincorporated domestic entity with a single owner automatically will be disregarded as a separate entity unless it elects to be classified as an association.\textsuperscript{282} Thus, in many cases, an LLC formed after the effective date of the check-the-box regulations will be taxed as a partnership unless it elects to be taxed as a corporation.\textsuperscript{283}

\subsection*{D. Existing Entities}

Under the new regulations, an eligible entity that was in existence before the effective date of the check-the-box regulations (an "existing entity") generally will retain the same classification that it claimed under the current regulations unless the entity elects otherwise.\textsuperscript{284} As explained earlier, an eligible entity with a single owner that claimed to be a partnership under the current regulations will be disregarded as an entity separate from its owner absent an election to the contrary.\textsuperscript{285}

Care should be taken in changing the tax status of an existing entity. If an eligible entity, such as an LLC, was classified as a corporation under the current classification regulations and makes a check-the-box election to be classified as

\begin{footnotesize}

\begin{enumerate}
\item Treas. Reg. § 301.7701-3(b)(1)(i) (as amended in 1996).
\item Treas. Reg. § 301.7701-3(b)(1)(ii) (as amended in 1996).
\item The default rules for classification of a foreign entity that is eligible to make a check-the-box election depend on whether any of the members of the foreign entity have limited liability. If one or more of the members of a foreign eligible entity does not have limited liability, the entity automatically will be classified as a partnership if it has two or more members and will be disregarded as a separate entity if it has only one member, unless the entity elects to be classified as an association. Treas. Reg. § 301.7701-3(b)(2)(i)(A), (C) (as amended in 1996). For this purpose, a member of a foreign eligible entity has limited liability if, pursuant to the law under which the entity is organized, the member has no personal liability for the debts of or claims against the entity by reason of being a member. Treas. Reg. § 301.7701-3(b)(2)(ii) (as amended in 1996). If the law under which the entity is organized allows the entity to specify in its organizational documents whether its members will have limited liability, the organizational documents also may be relevant in determining whether any member has limited liability. \textit{Id.} A person has personal liability for purposes of the check-the-box regulations if the creditors of the entity may seek satisfaction for all or any portion of the debts of or claims against the entity from the member as such, even if the member makes an agreement under which another person assumes the member's liability or agrees to indemnify the member for such liability. \textit{Id.} On the other hand, if all of the members of a foreign eligible entity have limited liability, the default rules provide for classification of the foreign entity as an association. Treas. Reg. § 301.7701-3(b)(2)(ii)(B) (as amended in 1996).
\item Treas. Reg. §§ 301.7701-3(b)(3)(i) (as amended in 1996).
\item \textit{Id.} For this purpose, a foreign eligible entity is considered to be an existing entity only if the entity's classification is relevant to any person for federal tax purposes at any time that includes the date immediately before the effective date of the check-the-box regulations. Treas. Reg. §301.7701-3(b)(3)(ii) (as amended in 1996).
\end{enumerate}

\end{footnotesize}
a partnership, the change in classification will be treated for tax purposes as a liquidation of the corporation. 286 A corporate liquidation may cause both the corporation and the shareholders to recognize gain. 287

A transition rule provides that the Service will respect an existing entity’s claimed classification for all periods prior to the effective date of the check-the-box regulations if: (1) the entity had a reasonable basis (within the meaning of section 6662) for its claimed classification; (2) the entity and all of its members recognized the federal tax consequences of any change in the entity’s classification within the sixty-month period preceding January 1, 1997; and (3) neither the entity nor any member was notified in writing on or before May 8, 1996, that the classification of the entity is under investigation. 288 The issue that may cause controversy under the transition rule is whether the entity had a reasonable basis for its claimed classification. Presumably, an existing LLC will satisfy the reasonable basis requirement if its articles of organization and operating agreement satisfied the requirements of the Kintner regulations for the claimed classification. 289

It seems that the members of an existing LLC that was classified as a partnership under the Kintner regulations will be able to amend the LLC’s organizational documents to achieve greater flexibility without jeopardizing the LLC’s tax status. For example, an LLC’s organizational documents could be amended to provide that the LLC will not dissolve upon the termination of a member’s interest, that the LLC is to be managed by managers, and/or that the interests in the LLC are freely transferable. Now that continuity of life, centralized management, limited liability, and free transferability of interests are no longer relevant for tax classification purposes, it should not matter whether an existing LLC takes advantage of the flexibility accorded under the check-the-box approach, as long as the amendments were not effective before January 1, 1997.

E. Making the Election

An eligible entity that does not want the default classification or wishes to change its classification must file an election with the appropriate service

289. The “reasonable basis” standard was added to I.R.C. § 6662 in 1993. According to the legislative history of § 6662, Congress “intended that ‘reasonable basis’ be a relatively high standard . . . , that is, significantly higher than ‘not patently improper.’ This standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim.” H.R. Rep. No. 213, 103d Cong., 1st Sess. 669 (Conf. Rep. 1993). See also Prop. Treas. Reg. § 1.6662-3(b)(3), 60 Fed. Reg. 45,661 (1995) (same; if a return position is reasonably based on one or more of the authorities set forth in § 1.6662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities and subsequent developments), the return position will generally satisfy the reasonable basis standard).
Form 8832 is used to file a check-the-box election. An election will not be accepted unless it provides all of the information, including the entity's taxpayer identifying number, that is required on Form 8832.

The electing entity will be able to specify an effective date for the election that is not more than seventy-five days before the date on which the election is filed or more than twelve months after the date on which the election is filed. If no effective date is specified, the election will be effective on the date when the election is filed. The election must be signed by either: (1) each member of the electing entity who is an owner at the time that the election is filed or (2) any officer, manager, or member of the electing entity who is authorized to make the election and who represents having this authorization under penalties of perjury.

If an election is to be effective for any time prior to the date on which the election is filed, each person who was an owner between the effective date of the election and the date on which it is filed must also sign the election.

The check-the-box regulations do not state whether an election signed by an authorized person will require the unanimous consent of the members. The preamble to the regulations explains that the determination of whether a person is authorized to make an election is based on local law.

Under the default rules of the Louisiana LLC Law, it seems that a majority of the members must consent to a check-the-box election.
A special rule applies to eligible entities that are exempt from taxation. In many cases, a tax-exempt entity will be classified as a trust or will be a nonprofit corporation. If a tax-exempt entity is an eligible entity, however, the check-the-box regulations treat the entity as having made an election to be classified as an association. The deemed election of a tax-exempt entity will be effective as of the first date for which exemption is claimed or determined to apply and will remain in effect unless an election is made to change the entity's classification after the claim for exempt status is withdrawn or rejected or the determination of exempt status is revoked.

Similarly, an eligible entity that files an election to be treated as a real estate investment trust (a "REIT") is treated as having made an election to be classified as an association taxable as a corporation. The deemed election is effective as of the first day the entity is treated as a REIT.

There is a limitation on the number of times that an entity can change its classification within a short period of time. Once an entity elects to change its classification, it generally may not make another election to change its classification during the sixty months following the election. However, an existing entity that makes an election to change its classification as of the effective date of the check-the-box regulations may elect to change its classification within the sixty-month period.

IV. WHAT TO DO AFTER CHECK-THE-BOX

Now that the check-the-box regulations are effective, the four-factor corporate resemblance test of the Kintner regulations is no longer relevant in determining the tax classification of a newly-formed LLC. LLCs formed before the effective date of the check-the-box regulations may alter their organizational documents without having to comply with the requirements for partnership classification under the Kintner regulations. Accordingly, the Louisiana Legislature can amend the Louisiana LLC Law without jeopardizing the tax status of a Louisiana LLC. Any amendments to the Louisiana LLC Law, however, should be prospective only, to avoid upsetting previously existing relationships and contracts. If the parties desire the amendments to apply to a previously existing LLC, they can amend the LLC's articles of organization.

300. Id.
302. Id.
304. Id.
305. See La. R.S. 12:1367(C) (1994 and Supp. 1996) (neither the Louisiana LLC Law nor any amendment thereto is to be construed so as to impair the obligations of any contract or to affect any action or proceedings begun or right accrued before the LLC Law or any amendment thereto takes effect).
or written operating agreement to so provide. This Part explores several possibilities for amending the Louisiana LLC Law and offers some suggestions.

A. Single-Member LLCs

First, there is no need for the Louisiana Legislature to make any changes to the LLC Law to help Louisiana residents form LLCs that can be classified as partnerships under the check-the-box regulations. Failure to amend the law, however, especially with respect to the prohibition against single-member LLCs, could cause significant inconvenience. If the Louisiana LLC Law does not permit the formation of an LLC with only one member, taxpayers in Louisiana will be tempted to form a single-member LLC in a jurisdiction that authorizes such LLCs and register the foreign LLC to transact business in Louisiana. This circuitous procedure requires two filings, one in the state of organization, and another in Louisiana. A Louisiana resident who wishes to do business as a single-member LLC will incur additional expenses for the double filing and could subject the LLC and/or its member to taxation by more than one state.

There is no policy reason for disallowing the formation of a single-member LLC. The not-fewer-than-two-members requirement probably was designed

306. See La. R.S. 12:1301(A)(10) (1994 and Supp. 1996) (defining the term "limited liability company" as an unincorporated association having two or more members), 12:1304(A) (1994 and Supp. 1996) (requiring two or more persons to form an LLC), 12:1334(3) (1994 and Supp. 1996) (default rule requiring dissolution of an LLC on the occurrence of any event that terminates the continued membership of a member unless the LLC is continued by the unanimous consent of the remaining members, and if membership is reduced to one, the admission of one or more members).

307. One commentator, however, does not think that a single-member LLC is such a good idea. Professor Larry E. Ribstein is concerned that statutes that allow single-member LLCs "may invite such firms into a world of trouble and uncertainty." Larry E. Ribstein, The Loneliest Number: The Unincorporated Limited Liability Sole Proprietorship, J. of Asset Protection May/June 1996, at 46, 47. Professor Ribstein’s concerns are based largely on the fact that the default rules of most LLC statutes, including rules relating to allocation of management power among members and managers, sharing of profits and distributions, fiduciary duties of members and managers, and dissolution and buy-out upon dissociation of a member, are designed for two or more owners. Id. This author does not share Professor Ribstein’s fears. Corporate statutes, like LLC statutes, contain default provisions designed for corporations having two or more members. Nevertheless, there has been little difficulty in applying these statutes to single-owner corporations. Professor Ribstein is concerned, however, that many LLC statutes permit the default rules to be altered only by an LLC’s operating agreement. Id. He reasons that an operating agreement requires an agreement between or among members, an impossibility if an LLC has only one member. Id. In contrast, a corporation’s articles of incorporation or bylaws may alter the default rules of corporate statutes. La. R.S. 12:24(C), 28(B) (1994 and Supp. 1996); Rev. Model Business Corp. Act §§ 2.02(b)(2), (3), (4), (5), 2.06. It seems that Professor Ribstein has overlooked the possibility of altering the default provisions of an LLC statute in the LLC’s articles of organization, which do not require an agreement among the members. Moreover, as Robert Keatinge has observed, there is no reason why the sole member of an LLC may not enter into an operating agreement with the LLC to alter the default rules of the LLC statute. Robert R. Keatinge, The Single-Member LLC: Operating Agreement Questions and Other Issues,
only to ensure a Louisiana LLC would be classified as a partnership for purposes of federal income taxation. On the other hand, if the Louisiana Legislature permits a single-owner business to be organized as an LLC, taxpayers who own sole proprietorships in Louisiana will be able to limit their liability and achieve a simple method of pass-through taxation that cannot be achieved under subchapter S. Additionally, corporations will be able to limit their liability for branch operations without having to form a more complicated two-member entity.

In many cases, better tax results can be achieved if a business is taxed as a sole proprietorship rather than as an S corporation. For example, where the business is leveraged, a sole proprietor may be able to deduct a larger portion of business losses than a subchapter S shareholder. A subchapter S shareholder may deduct his or her share of the corporation's losses only to the extent of the basis of the shareholder's stock and the basis of any indebtedness of the corporation to the shareholder. For this purpose, a subchapter S shareholder generally may not include in basis any of the corporation's debts or liabilities, even if the shareholder is personally liable for repayment of corporate debts, for example, as a result of a personal guarantee. In contrast, a sole proprietor, who is considered to be the obligor of debts incurred by the business, may deduct expenses that are paid with borrowed funds.

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3 J. of Limited Liability Companies 87, 88 (1996). Professor Ribstein suggests that a new statute should be enacted, designed for single-member limited liability entities. Ribstein, supra at 49. Such a statute is not necessary. The existing LLC statutes, if amended to authorize the formation of a single-member LLC, are adequate to meet the needs of such entities. Promulgation of new laws designed for single-member entities is inefficient because it will require courts, practitioners, and entrepreneurs to master the rules of the new law. Moreover, Professor Ribstein has suggested no solution to the problems that may arise if another member is admitted to a single-member entity that is governed by the special statute.

Before the proposed check-the-box regulations were issued, most commentators agreed that an LLC with fewer than two members would not be classified as a partnership. See supra note 211 and accompanying text. In fact, the Service has stated that it will not rule that an LLC with fewer than two members may be classified as a partnership. Rev. Proc. 95-10 § 4.01, 1995-1 C.B. 501.

I.R.C. § 1336(d)(1) (1994). Losses that are disallowed under this rule may be carried forward indefinitely until the basis of the shareholder's stock or the basis in any indebtedness of the corporation to the shareholder increases. I.R.C. § 1366(d)(2) (1994). The time value of money, however, makes a current deduction of such losses more valuable to a shareholder than the deferred deduction.

See, e.g., Harris v. United States, 902 F.2d 439 (5th Cir. 1990); Estate of Leavitt v. Commissioner, 875 F.2d 420 (4th Cir. 1989), aff'd 90 T.C. 206 (1988); Brown v. Commissioner, 706 F.2d 755 (6th Cir. 1983). But see Selfe v. United States, 778 F.2d 769 (11th Cir. 1985) (indicating that a subchapter S shareholder may include corporate debts in basis if the creditor looks primarily to the shareholder, rather than to the corporation, for repayment of the debt).

A sole proprietor includes a debt in the basis of property purchased with the borrowed funds and may claim depreciation deductions that are computed with respect to the full basis of the property even if the sole proprietor is not personally liable for repayment of the debt. Crane v. Commissioner, 331 U.S. 1, 67 S. Ct. 1047 (1947); Commissioner v. Tufts, 461 U.S. 300, 103 S. Ct. 1826 (1983).
Property can be retired from business operations less expensively if a business is taxed as a sole proprietorship rather than as an S corporation. The distribution of property from an S corporation to its shareholder often will trigger gain recognition. The retirement of property from business use by a sole proprietor generally is a non-taxable event unless the property is sold or exchanged.

The ability to form a single-member LLC also may be advantageous to a corporation. While pass-through taxation may be available to a corporation that files a consolidated return with its subsidiary for federal income tax purposes, the Louisiana tax law has no provision allowing a corporation and a subsidiary to combine their income and losses for state income tax purposes. Currently, a Louisiana corporation that wishes to limit its liability and achieve pass-through taxation for state income tax purposes with respect to branch operations must form an LLC that has at least two members. Authorizing the formation of a single-member LLC would simplify the transaction.

The prohibition against a single-member LLC also can cause problems under state law. Under the default rules of the Louisiana LLC Law, an LLC dissolves upon the death, interdiction, withdrawal, expulsion, bankruptcy, or dissolution of a member or the occurrence of any other event that terminates the continued membership of a member unless, within ninety days after the event, the LLC is continued by the unanimous consent of the remaining members. To avoid dissolution after the termination of a member’s interest in a two-member LLC, the remaining member also must admit one or more members to the LLC within the ninety day-period. Even if the articles of organization

312. On a distribution of appreciated property to a shareholder, an S corporation must recognize gain. I.R.C. § 311(b) (1994). The gain recognized by the corporation flows through to the shareholder and increases the adjusted basis of the shareholder’s stock. I.R.C. §§1366(a), 1367(a) (1994). The shareholder may be required to recognize additional gain if the fair market value of the distributed property exceeds the adjusted basis of the shareholder’s stock, determined after the stock basis is increased to account for the shareholder’s pro rata share of all of the corporations items of income and deduction, including the gain recognized by the corporation on the distribution of the property. I.R.C. § 1368(b), (c), (d) (1994).

313. See I.R.C. § 1001(a) (1994) (gain or loss must be recognized on the sale or exchange of property unless otherwise provided). A sole proprietor may recognize gain in some cases, however, even if business property is not sold or exchanged, if the property withdrawn from business use was expensed under I.R.C. § 179 or if the property was listed property for which accelerated depreciation was claimed. See I.R.C. § 179(d)(10) (1994) (requiring recapture of deductions allowed under I.R.C. § 179(a) with respect to property that is not used primarily in a trade or business in a subsequent year), § 280F(b)(2) (1994) (requiring recapture of accelerated depreciation deductions with respect to listed property that is not used primarily in a trade or business in a subsequent year).


315. For a discussion of some of the state-law problems that may arise in jurisdictions requiring an LLC to have at least two members and some planning suggestions, see Paul & Levine, supra note 208, at 162.


317. Id.
or a written operating agreement of a two-member Louisiana LLC alters the default rules to provide that the LLC does not dissolve on the termination of a member's interest, it is likely that the LLC will dissolve if its membership is reduced by one. By definition, a Louisiana LLC may not have fewer than two members.\textsuperscript{318}

An unsophisticated member of a two-member LLC may not be aware of the consequences of failing to admit another member to the LLC after the termination of the other member's interest. Even if the remaining member has sought the advice of counsel in forming the LLC, he or she may not consider it important to seek the advice of counsel within ninety days after the other member's interest has terminated. Moreover, it may be difficult for the remaining member of a two-member LLC to find an appropriate business associate within the requisite period to avoid dissolution of the LLC. As explained earlier, dissolution of an LLC can be disruptive, accelerating debt payment obligations and requiring distributions to members and former members in liquidation of the LLC.\textsuperscript{319} Valuable contract rights of the LLC may be extinguished as well. To the extent that the remaining member of a former two-member LLC receives sufficient business assets on liquidation of the LLC and decides to continue the business, the remaining member will be exposed to personal liability for business debts and obligations unless the remaining member incorporates the business. In that case, the only way for the remaining member to achieve flow-through taxation is to make a subchapter S election. These problems could be avoided if the Louisiana Legislature were to authorize the formation of single-member LLCs.\textsuperscript{320}

\section*{B. Other Amendments}

Any amendment to the Louisiana LLC Law other than the authorization of single-member LLCs is not as compelling. Most of the other provisions of the Louisiana LLC Law that are designed to ensure partnership tax status under the \textit{Kintner} regulations are default rules.\textsuperscript{321} Persons forming an LLC after the effective date of the check-the-box regulations may enjoy the flexibility accorded under the new classification rules by including provisions in the LLC's articles of organization or in a written operating agreement altering the default rules.

\begin{footnotes}
\item[320.] There is at least one potential problem in forming a single-member LLC. One commentator has cautioned that a single-member LLC that conducts a multi-state business may face personal liability for the LLC's obligations arising in states that do not recognize single-member LLCs. William E. Sider, \textit{Check-the-Box Proposed Regulations Make LLCs Even More Appealing}, 3 J. of Limited Liability Companies 51, 59 (1996). This concern, however, will diminish as more states, encouraged by the check-the-box regulations, amend their statutes to allow the formation of single-member LLCs.
\item[321.] The prohibition against single-member LLCs, however, is not a default rule. See \textit{La. R.S. 12:1301(A)(10), 1334(3)} (1994 and Supp. 1996).
\end{footnotes}
Moreover, any change to the Louisiana LLC Law should be considered carefully. Many of the restrictions imposed by the default rules primarily for tax status purposes may be desirable or important to the members of an LLC. On the other hand, some of the default rules of the Louisiana LLC Law that were designed to ensure that a Louisiana LLC would be classified as a partnership are cumbersome and may not be desirable for any non-tax business reason. A few of the default rules also may create traps for the unwary. The Louisiana LLC Law should be accessible to small entrepreneurs who do not have the benefit of counsel. Accordingly, the default rules should be drafted with such persons in mind.

The check-the-box regulations make the LLC form of business less cumbersome for ventures with many investors. Under the check-the-box rules, there is no longer a need to include provisions in an LLC’s articles of organization or operating agreement that can create problems for widely-held businesses. For example, it is no longer necessary to trigger dissolution of an LLC on the termination of any member’s interest in order to ensure that an LLC lacks continuity of life. Managers of a manager-managed LLC no longer have to satisfy minimum ownership and minimum capital account requirements in order to take advantage of the more flexible provisions of Revenue Procedure 95-10 to ensure that an LLC lacks centralized management. As long as interests in an LLC are not publicly traded, the check-the-box regulations permit an LLC to be classified as a partnership even if its interests are freely transferable. While it might seem appropriate to amend the Louisiana LLC Law with the interests of widely-held concerns in mind, the default rules nevertheless should be fashioned to meet the needs of small, informal businesses. Those desiring to enter into more sophisticated agreements may modify the default rules by so providing in an LLC’s articles of organization or an operating agreement.

The remainder of this Part discusses the default rules of the LLC Law that are designed to ensure partnership tax status for a Louisiana LLC and suggests that some, but not all, of the rules should be changed. The rules are discussed in order of the four corporate characteristics identified by the Kintner regulations to distinguish an association taxable as a corporation from a partnership.

C. Continuity of Life

Unless otherwise provided in an LLC’s articles of organization or a written operating agreement, a Louisiana LLC dissolves upon the death, interdiction, withdrawal, expulsion, bankruptcy, or dissolution of a member or the occurrence of any other event that terminates the continued membership of a member in the LLC, unless within ninety days after the event, the LLC is continued by the
unanimous consent of the remaining members. As explained earlier, this rule, designed to ensure that a Louisiana LLC will lack continuity of life for tax classification purposes, can be cumbersome and disruptive. When an LLC dissolves, its affairs must be wound up, and its assets must be distributed, first to creditors, and then to members and former members. Even if a new LLC is formed by the remaining members, valuable contract rights of the former LLC may be lost as a result of the dissolution. To avoid dissolution under the default rule, each member must be monitored to determine whether the member's membership interest has terminated, and, in the event of a membership termination, all of the members must be contacted so that the necessary consent to continue can be obtained within the ninety-day period.

Under check-the-box regulations, the issue of whether an LLC lacks continuity of life is no longer important for tax classification purposes. Accordingly, the Louisiana Legislature can repeal the rules triggering dissolution of an LLC on the termination of a member's interest without the possibility of causing adverse tax consequences to an LLC or its members. While it may be desirable in some cases for a closely-held LLC to dissolve on the inability of a key member or a manager to serve, there is no need to retain the default rules of the Louisiana LLC Law on this issue. The default rules of the Louisiana LLC Law are too broadly written even with such LLCs in mind. Under the Louisiana LLC Law, dissolution of an LLC is not triggered on the termination of an interest of one or more specified members; dissolution is triggered on the termination of any member's interest. Moreover, it is not necessary for the law to provide that an LLC dissolves upon the termination of the interest of one or more specified members even if the LLC has one or more members who are essential to the LLC's business. If the termination of a member's interest makes it impracticable to continue an LLC's business, the remaining members can dissolve the LLC by consent or a member may bring an action for judicial dissolution.

It is better to leave the decision to dissolve an LLC to the discretion of the remaining members than to require automatic dissolution on the termination of any member's interest. Persons who form an LLC probably will not want the LLC to be as susceptible to dissolution as is required under the default rules of the Louisiana LLC Law. The rule triggering dissolution of an LLC upon the termination of a member's interest should be repealed.

If the rule is repealed, other provisions of the Louisiana LLC Law also should be amended. Dissolution of an LLC on the termination of a member's interest, in some cases, may serve an important function in protecting the

325. See supra note 55 and accompanying text.
interests of a member or the successor of a member whose interest in an LLC has terminated. In many cases, dissolution of an LLC is the only means by which a member whose interest in the LLC has terminated may receive a return on the member’s investment in the LLC. When an LLC dissolves, its affairs are wound up and its assets are distributed. Any assets remaining after paying or providing for payment to a dissolved LLC’s creditors are distributed to members and former members in satisfaction of liabilities for distributions, for a return of their capital contributions, and in proportion to their sharing ratio for distributions. Thus, distributions on liquidation of an LLC generally will return to each member his or her capital contribution and share of the LLC’s profits.

Absent a dissolution, a member whose interest in an LLC has terminated may not be able to receive the benefit of the member’s contributions to the LLC. A member whose interest is terminated is entitled to receive a payment from an LLC only if the member voluntarily withdraws from an LLC. Under the default rules of the Louisiana LLC Law, a member who withdraws from an LLC is entitled to receive a distribution in an amount equal to the fair market value of the member’s interest at the time of the withdrawal. Such withdrawal rights protect the interests of the individual members and probably reflect the intent of small entrepreneurs who enter into a business together. As long as the parties can agree on business matters, they generally will want to retain their investment in the business. In many cases, the parties will want to have the option to withdraw their investment from an LLC in the event that they reach an insurmountable disagreement with respect to the conduct of the LLC or its affairs. The required distribution to a withdrawing member accommodates this understanding.

There is no provision in the Louisiana LLC Law requiring a distribution on any event that terminates a member’s interest in an LLC other than the voluntary withdrawal of a member. Thus, for example, if a member dies, is adjudicated incompetent, becomes bankrupt, or dissolves, the member’s interest in the LLC terminates, but the member or the member’s legal representative or successor is not entitled to receive a distribution from the LLC in liquidation of the interest in the LLC unless the termination of the member’s interest triggers a dissolution of the LLC.

When a member of a Louisiana LLC dies or is adjudicated incompetent, the member’s legal representative is treated as an assignee of the member’s

334. If the business faces a downturn, the parties may agree to discontinue the business before their entire investment is lost. The Louisiana LLC Law permits the members to dissolve an LLC by consent. See La. R.S. 12:1318(B)(1), 1334(2) (1994).
interest.335 The legal representative or successor of a member that has dissolved or terminated also is treated as an assignee.336 The Louisiana LLC Law is silent with respect to the rights of a trustee in bankruptcy of a bankrupt member, probably because the rights of a trustee in bankruptcy has with respect to an interest in an LLC are a matter of federal, rather than state law.337

336. Id.
337. The Bankruptcy Code supersedes both state law and any provisions in an LLC’s operating agreement. See, e.g., In re Safren, 65 B.R. 566, 568 (Bankr. C.D. Cal. 1986); In re Rittenhouse Carpet, Inc., 56 B.R. 131, 133 (Bankr. E.D. Pa. 1985). Like the interest of a member of an LLC, a general partner’s interest in a partnership terminates upon the bankruptcy of a partner. La. Civ. Code art. 2818; RUPA §601(6)(i) (1994); UPA §§ 31(5), 35(3)(b) (1914); RULPA § 402(4) (1985). The courts do not agree as to whether a trustee in bankruptcy may avoid termination of a general partner’s interest in a partnership, notwithstanding state partnership law. Compare In re Phillips, 966 F.2d 926 (5th Cir. 1992) (partner who was a Chapter 11 debtor did not have authority to file Chapter 11 petition for the partnership; federal bankruptcy law did not supersede state law on this issue); In re Catron, 158 B.R. 624, 627 (Bankr. E.D. Va. 1992), aff’d, 25 F.3d 1038 (4th Cir. 1993) (“Fundamentally, a partnership is based upon the personal trust and confidence of the partners”, because of this relationship, “the agreement or contract governing the partnership is essentially a contract for personal services, which renders it nondelegable and nonassignable); In re Minton Group, Inc., 27 B.R. 385, 390 (Bankr. S.D. N.Y. 1983), aff’d, 46 B.R. 222 (S.D. N.Y. 1985) (Chapter 11 filing by a general partner of a limited partnership dissolves the partnership) and In re Harms, 10 B.R. 817 (Bankr. D. Colo. 1981) (bankruptcy of a general partner dissolves the partnership and terminates the debtor partner’s interest in the partnership) with In re LeRoux, Nos. 94-11251-DPW, 94-11252-DPW 1995 WL 447800 (D. Mass. Oct. 20, 1994), aff’d 167 B.R. 318 (Bankr. D. Mass. 1994) (bankruptcy of general partners did not terminate their status as general partners notwithstanding state law and partnership agreement provisions to the contrary); In re Cardinal Industries, Inc., 116 B.R. 964 (Bankr. D. Ohio 1990) (trustee could assume partnership agreement notwithstanding partnership law and the contractual agreements to the contrary); In re Hawkins, 113 B.R. 315, 316 (Bankr. N.D. Tex. 1990) (personal bankruptcy of general partner did not automatically cause dissolution of the partnership, notwithstanding partnership agreement to the contrary); In re B C & K Cattle Co., 84 B.R. 69, 71 (Bankr. N.D. Tex. 1988) (general partner which had itself filed for Chapter 11 relief retained authority to file involuntary petition against the partnership, notwithstanding state law to the contrary); In re Safren, 65 B.R. 566 (Bankr. C.D. Cal. 1986) (bankruptcy of a general partner does not dissolve the partnership; estate of the debtor is substituted as a partner); In re Rittenhouse Carpet, Inc., 56 B.R. 131 (Bankr. E.D. Pa. 1985) (debtor partner may not be removed as a partner on the filing of a petition in bankruptcy, notwithstanding provisions of state law to the contrary); In re Fidelity Mortgage Co., 10 B.R. 781 (Bankr. E.D. Pa. 1981) (debtor partner may not be removed as a partner on the filing of a bankruptcy petition, notwithstanding provisions of the partnership agreement to the contrary). For a discussion of the issue of whether a trustee in bankruptcy can avoid termination of a partner’s interest in a partnership, see John C. Ale, Substantive Law and Special Problems of General and Limited Partnerships, A.L.I.-A.B.A. Resource Materials, Partnerships: UPA, ULPA, Securities, Taxation, and Bankruptcy 120-21 (9th ed. 1990); Lawrence D. Cherkes, The Effect On a Partnership of the Bankruptcy of a General Partner, 368 PLI/Real 23 (1991); Lewis R. Kaster & Jeffrey K. Cymbler, The Impact of a General Partner’s Bankruptcy Upon the Remaining Partners, 21 Real Prop. Prob. & Trust J. 539, 548-51 (1986); Gerald K. Smith, Issues in Partnership and Partner Bankruptcy Cases and Reorganisation of Partnership Debtors, A.L.I.-A.B.A. Course of Study 639, 651-90 (May 1996). A similar issue exists with respect to whether a trustee in bankruptcy may avoid the termination of a member’s interest in an LLC. As with respect to partnership law, the courts are split on the issue of whether bankruptcy terminates a member’s
As an assignee of a former member’s interest, the member’s successor or legal representative may not become a member or exercise any of the rights or powers of a member unless and until the successor or legal representative is admitted as a member by the unanimous, written consent of the remaining members. Thus, a member’s successor or legal representative may not participate in the management of the LLC, may not vote on LLC matters, and may not even inspect the LLC’s records unless the LLC’s articles of organization or an operating agreement provides otherwise. Without the right to vote or inspect records, a member’s successor or legal representative will have little ability to protect the rights of the member or the member’s estate or heirs with respect to the member’s interest in the LLC.

As an assignee of a former member’s interest, however, the member’s successor or legal representative is entitled to receive distributions to which the member was entitled. Thus, where an LLC is making interim distributions to its members, a member’s successor or a legal representative may participate in such distributions. However, if an LLC is closely held, it is likely that the LLC will distribute its profits in the form of salaries paid to owner-employers rather than as distributions. In such a case, it is unlikely that a member’s successor or legal representative will receive any amounts from the LLC. On the other hand, if an LLC dissolves on the termination of a member’s interest, the member’s successor or legal representative will be entitled to receive a distribution on liquidation of the LLC to the extent that the former member of an LLC would have been entitled.

In some cases, however, the distribution rights on dissolution of an LLC accorded to a member’s successor or legal representative may be inadequate to compensate the member or the member’s successor for the terminated interest in the LLC. Under the default rules of the Louisiana LLC Law, dissolution of

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341. See La. R.S. 12:1319(B) (1994) (providing the right to members to inspect an LLC’s records).
an LLC may be avoided after the termination of a member’s interest by the consent of the remaining members. Often, the remaining members will consent to continue an LLC after a member’s interest has terminated. If the LLC is regularly making distributions to its members, the successor or legal representative of a member whose interest in the LLC has terminated should be entitled to receive a share of the distributions. In some cases, however, the remaining members of an LLC will not want to share the LLC’s profits with an outsider such as a former member’s successor or legal representative. As explained above, the remaining members may be able to achieve this result either by causing the LLC to retain its profits or by withdrawing profits from the LLC in the form of salaries or other payments that do not require distributions. A Louisiana LLC is required to make nonliquidating distributions only as required by an operating agreement or as authorized by the members. As an assignee, a member’s successor or legal representative has no right to vote to authorize distributions or even to inspect the LLC’s records to determine whether a distribution is required under an operating agreement. In such a case, it may be difficult for the successor or legal representative of the member whose interest has terminated to receive any distribution from the LLC.

In an abusive case, the successor or legal representative may be able to apply for a judicial dissolution of the LLC. The Louisiana LLC Law authorizes a court to decree dissolution of an LLC “on application by or for a member.” Arguably, the “for a member” language authorizes a suit by a former member’s successor or legal representative. Even if a successor or legal representative can apply for a judicial dissolution of an LLC, however, it is unlikely that he or she will prevail. The only statutory ground for judicial dissolution of a Louisiana LLC is that it is “not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement.” Unless an LLC’s articles of organization or operating agreement requires payments or distributions to be made on the termination of a member’s interest, it will be difficult for a former member’s successor or legal representative to show such impracticability, especially if the only reason for the suit is to obtain payment for a former member’s interest.

Moreover, dissolution is an extreme remedy for the successor or legal representative of a member whose interest in an LLC has terminated. As explained earlier, dissolution of an LLC may be disruptive to the LLC’s business, especially if it accelerates debt or compromises existing contracts that are favorable to the LLC. A better remedy, and one that probably would reflect the intentions of the parties, would be to require a purchase of a member’s interest when the member’s membership in the LLC terminates.

346. Id.
A person who becomes a member of a closely-held LLC probably does not intend for the rights of his or her estate or other successor to be as restricted as they are under the default rules of the Louisiana LLC Law. It is likely that there will be no market for an interest in a closely-held LLC, especially if the purchaser of the interest will have no right to participate in the management of the LLC's business, no voting rights, and no right to inspect the LLC's records. Where an interest in an LLC is the member's primary asset, the LLC interest will represent a large portion of the member's estate. Limiting the rights of a deceased or incompetent member's legal representative could frustrate the member's desire to provide for himself or herself or for the member's family in the event of the member's disability or death.

The rules of the Louisiana LLC Law restricting the management rights of an assignee apply, regardless of the size of the member's interest that has terminated. Thus, for example, the legal representative of a member who has made a large contribution to the LLC's capital and who owned a controlling interest in the LLC will not be able to compel the LLC to make distributions to the member's estate or heirs. Moreover, the legal representative will not be able to exercise the member's right to withdraw and receive distributions from the LLC in liquidation of the member's interest and will not even be able to inspect the LLC's books and records to ascertain whether the LLC's business is conducted in a way to maximize the amount that may be distributed to the heirs on a later liquidation of the LLC. A buy-out provision could protect the interests of a member in providing for his or her heirs.

On the other hand, requiring an LLC to purchase a member's interest on the death, interdiction, withdrawal, expulsion, bankruptcy, or dissolution of a member could place a significant burden on the LLC and its remaining members. A buy-out obligation could rob the LLC of cash flow needed to finance the LLC's business. If the LLC does not have sufficient cash to purchase the member's interest, the LLC may have to borrow from a third party to finance the purchase. Incurring such a debt could compromise the LLC's ability to borrow more money to finance the needs of its business. Where the LLC does not have sufficient credit, the remaining members may be required to expose themselves to personal liability by guaranteeing a debt incurred to purchase a member's interest. If the LLC and the remaining members do not have sufficient credit to finance the purchase, the LLC may be required to sell important business assets to meet its buy-out obligation. Indeed, a buy-out requirement could trigger a liquidation of the LLC. In that case, the buy-out remedy would have the same results as a dissolution of the LLC on the termination of a member's interest.

While a buy-out requirement can be funded with proceeds of a life insurance policy, such proceeds will not be available if the termination of a member's interest results from an event other than death. Moreover, life insurance may be unavailable or too expensive if the members are old or ill. Furthermore,

unsophisticated members of a small LLC may not have had the foresight to purchase life insurance for this purpose.

As an alternative to a buy-out requirement, the Louisiana LLC Law could be amended to provide that the successor or legal representative of a member whose interest has terminated will have full membership rights with respect to the interest. In many cases, however, such an amendment will not be desirable for a closely-held LLC. Giving full membership rights to a member’s successor or legal representative could force the remaining members to continue the business with an unwanted associate who may be unfamiliar with the LLC’s business and operations. Conferring full membership rights on a successor or legal representative could be disruptive, especially if an LLC is managed by its members, as will be the case for many closely-held LLCs. Under the default rules of the Louisiana LLC Law, every member of a member-managed LLC is a mandatary of the LLC who may incur debts and obligations on behalf of the LLC when acting in the ordinary course of the LLC’s business. The remaining members probably will not want a member’s successor or legal representative to have such agency powers with respect to the LLC.

To mitigate the problem, the Louisiana LLC Law could be amended to require the LLC or its members to purchase a member’s interest on the termination of the member’s membership in the LLC, but to permit the payments to be made in installments, with interest, over a reasonable period of time. The default rules of ULLCA adopt this approach, requiring the buy-out of a “dissociated” member’s interest and giving a court discretion to specify the terms of the purchase, including, if appropriate, terms for installment payments in actions brought because the parties cannot reach an agreement concerning the purchase of the member’s interest. Under ULLCA, a member is dissociated from an LLC upon the

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348. La. R.S. 12:1317(A) (1994). A member of a member-managed LLC, however, is not a mandatary of the LLC for matters concerning the alienation, lease, or encumbrance of the LLC’s immovables. Id.

349. See Robert W. Hillman, The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Performance of Partnerships and Close Corporations, 67 Minn. L. Rev. 1, 83 (1982) (suggesting a similar remedy for a minority shareholder in a close corporation). As Professor Hillman observes, the remaining members could employ manipulative tactics, such as increasing expenses, including salaries, to avoid the installment payment obligation by relying on statutory limitations on distributions of funds to members. Id. To prevent such manipulation, Professor Hillman suggests that the withdrawing shareholder (or member, in the case of an LLC) should be entitled to an immediate decree of dissolution of the enterprise if there is a default in the installment payments. Id. ULLCA adopts a similar approach in permitting a member to obtain judicial dissolution of an LLC upon the failure of the LLC to purchase a dissociated member’s interest. ULLCA § 801(b)(5)(iv) (1995). It is not certain, however, whether ULLCA extends this right to a successor or legal representative of a dissociated member. See infra notes 353-354 and accompanying text.


351. ULLCA § 702(a)(2) (1995). ULLCA leaves the terms of the installment obligation to the discretion of the court, presumably because the need for installment payments and the length of time that should be allotted to such payments will vary from case to case. One commentator has observed
occurrence of certain events, including the member's death, interdiction, withdrawal, bankruptcy, expulsion, dissolution, or termination.\textsuperscript{352} ULLCA, however, gives the right to seek judicial enforcement of the purchase requirement only to the dissociated member.\textsuperscript{353} While the official comments to ULLCA suggest that the right also is accorded to a transferee of a member's interest,\textsuperscript{354} the statute does not clearly support this conclusion. An argument could be made that the successor or legal representative of a dissociated member could bring an action under ULLCA to enforce the purchase of the member's interest because the suit is brought on behalf of the member. Nevertheless, it would be better if the statute, by its terms, gave enforcement powers to a successor or legal representative. A similar rule should be adopted for Louisiana LLCs.

If payment for a former member's interest is to be required under the Louisiana LLC Law, it will be necessary to establish the appropriate price. Under the default rules of the Louisiana LLC Law, a member who withdraws from an LLC is entitled to receive the fair market value of the member's interest as of the date of the withdrawal.\textsuperscript{355} A member's successor or legal representative should be entitled to receive the same amount for the interest as the member would have been entitled to receive if the member had exercised his or her withdrawal rights. Requiring an LLC to pay the fair market value of a member's interest, however, regardless of whether the termination of a member's interest is voluntary or involuntary, could cause hardship to a minority member or the member's successor.

The Louisiana Partnership Law contains a similar provision, requiring a partnership to pay to a former partner, the partner's successors, or a creditor who seizes the partner's interest, the "value" of the partner's interest in the partnership at the time that the partner's membership ceased.\textsuperscript{356} In \textit{Shopf v. Marina Del Ray Partnership},\textsuperscript{357} the Louisiana Supreme Court applied a minority discount in determining the value of a partner's interest under this provision. Lower courts are likely to assume that similar discounts should be applied in determining the value of a member's interest in an LLC.

The application of a minority discount in \textit{Shopf} has been criticized.\textsuperscript{358} As Professor Glenn G. Morris has explained, to the extent that a minority discount "is an 'illiquidity' discount, reflecting merely the difficulty of turning the investment

\textsuperscript{352} ULLCA § 601 (1995).
\textsuperscript{353} ULLCA § 701(d) (1995).
\textsuperscript{354} ULLCA § 702 cmt. (1995).
\textsuperscript{355} La. R.S. 12:1325(C) (Supp. 1997).
\textsuperscript{357} 549 So. 2d 833 (La. 1989).
involved into cash, ... the discount ignores the very purpose of the mandatory buy-out rule: to provide a cash buyer where none would be available in the market." The application of a minority discount in a buy-out of a partner's interest also may encourage a partner owning a minority interest to argue that the buy-out actually constituted a liquidation of the partnership in which a partner is entitled to a proportionate amount of partnership assets remaining after creditors' claims have been satisfied. Such an argument may require litigation of a largely unnecessary new legal issue. The argument may be even more compelling with respect to the buy-out of a member's interest in an LLC, where withdrawal of a member may cause the LLC to dissolve. In fact, since a buy-out of a partnership interest or a member's interest in an LLC often is an alternative to dissolving the business entity, it is appropriate to pay the retiring partner or member the value of the interest determined by reference to a proportionate share of the value of the entity's assets, without any discount.

Others have criticized the application of a minority discount in determining the valuation of an investor's interest in a closely-held corporation. Such a discount imposes a penalty on a person who owns a minority interest in a firm simply because he or she lacks control. A discount also provides unjust enrichment to those who already enjoy a controlling interest in the firm. Courts in jurisdictions other than Louisiana have rejected the application of a minority discount.

359. Id. at 224.
360. Id. at 225.
361. Id.
362. Professor Morris also observes that application of a minority discount in valuing the interest of a retiring partner becomes circular: to the extent that courts apply minority discounts in valuing the interests of departing partners, minority interests are worth less in the marketplace. If no judicial discount were applied, a potential purchaser of a minority interest would pay more for an interest for which the purchaser could receive an undiscounted amount in liquidation of the interest. Id. at 227-29. As Professor Morris observes, any purchaser of a partnership interest (or an LLC interest) will only have the rights to share in the financial rights attributable to the interest unless the purchaser is admitted a member of the partnership (or LLC). Id. at 225 n.32. However, to the extent that the restricted rights of a purchaser of an interest in a partnership or LLC would diminish the "market" price of the interest, an appropriate discount for nontransferability should be included only if market prices truly are to control. Id.
363. See, e.g., American Law Institute, Principles of Corporate Governance: Analysis and Recommendations § 7.22 cmt. (e) (1994) (criticizing the application of a minority discount in valuing the stock of a shareholder who dissents to a corporate merger); Steven C. Bahls, Resolving Shareholder Dissent: Selection of the Appropriate Equitable Remedy, 15 J. of Corp. L. 285, 302 (1990) (arguing that courts should not apply a minority discount in most cases involving shareholders who purchased the stock at its original issue and their heirs or estates because the discount will frustrate the reasonable expectations of the minority shareholders); Charles W. Murdock, The Evolution of Effective Remedies for Minority Shareholders and Its Impact Upon Valuation of Minority Shares, 65 Notre Dame L. Rev. 425 (1990) (arguing that a minority discount is inaccurate because the equitable remedies developed by courts and legislatures imposing fiduciary duties on controlling shareholders and permitting minority shareholders to receive payment for their shares in the even of majority oppression have enhanced the value of minority shares).
364. American Law Institute, supra note 363, at § 7.22 cmt. (e); Bahls, supra note 363, at 302.
discount in valuing the stock of a dissenting shareholder in a closely-held corporation.365

On the other hand, the withdrawal of a member and his or her capital from
an LLC can be disruptive to the LLC’s business and may cause harm to innocent
members, especially if a buy-out is required in every case in which a member
seeks to withdraw. When a member withdraws from an LLC without good
cause, the amount to be paid to the withdrawing member should be reduced
by any damages caused by the withdrawal.

RUPA, which requires a buy-out of a partner’s interest when the partner
dissociates from the partnership, takes these considerations into account in
determining the amount that must be paid for a dissociated partner’s interest.
Under RUPA, the buy-out price is the amount that would be received by the
dissociated partner if the partnership dissolved, wound up its affairs, and
liquidated its assets.366 Thus, RUPA focuses on the value of the partnership’s
assets, rather than the value of the individual partner’s interest, in determining
the buy-out price. The official comments to RUPA explain that the value of the
assets is based on the sale price that would be received on a sale of the
partnership’s entire business as a going concern, and minority discounts are
inappropriate.367 Under RUPA the buy-out price is reduced by damages for
wrongful dissociation and all other amounts owing from the dissociated partner
to the partnership.368

365. See, e.g., Rigel Corp. v. Cutchall, 311 N.W.2d 519 (Neb. 1994); MT Properties, Inc. v. CMC
Real Estate Corp., 481 N.W.2d 383 (Minn. 1992); Charland v. Country View Golf Club, Inc., 588 A.2d
609 (R.I. 1991); Cavalier Oil Corp. v. Harnett, 564 A.2d 1137 (Del. 1989); In re Valuation of Common
Stock of McLoon Oil Co., 565 A.2d 997 (Me. 1989); Hunter v. Mitek Indus., 721 F. Supp. 1102 (E.D.
Mo. 1989); In re Friedman v. Beway Realty Corp., 661 N.E.2d 972 (N.Y. App. 1995); Robblee v.
Robblee, 841 P.2d 1289 (Wash. App. 1992); Walter S. Cheeseman Realty Co. v. Moore, 770 P.2d 1308
(Or. App. 1988); Brown v. Allied Corrugated Box Co., 154 Cal. Rptr. 170 (1979); Woodward v.
Quigley, 133 N.W.2d 38, modified on other grounds, 136 N.W.2d 280 (Iowa 1965).

366. RUPA § 701(b) (1994). The amount to be paid to a dissociated partner is reduced by
various offsets, including damages for wrongful dissociation and amounts owing (presently or in the
future) by the dissociated partner. RUPA § 701(c) (1994).

367. RUPA § 701(b) cmt. 3 (1994). Liquidation value is not intended to mean distress sale
value. Id. The official comment explains, however, that other discounts, such as for lack of
marketability or the loss of a key partner, may be appropriate. Id. Presumably, the discount would
apply where the assets of the business lack marketability, and not where the interest to be purchased
lacks marketability. Professor Hillman argues that in an analogous situation, a minority shareholder
who is entitled to a buy-out of his or her stock should receive no more than the amount that would
be realized on liquidation of the company, assuming that a substantial portion of the going concern
value of the corporation would be realized. Hillman, supra note 349, at 82 and n.256. On the other
hand, as Professor Murdock has demonstrated, most corporate liquidations involve a purchase of the
corporate business as a going concern, either by the other shareholders or a third party who will
continue operating business, and therefore, a minority shareholder or owner should receive a pro rata
share of the value of the corporation as a going concern. Murdock, supra note 363, at 441-43.

368. RUPA § 701(c) (1994).
ULLCA is similar to RUPA in that it requires an LLC to purchase the interest of a dissociated member. The default provisions of ULLCA require the member's interest to be purchased for its "fair value," offset by damages for wrongful dissociation and all other amounts owing by the dissociated member to the LLC. The official comment to this provision explains that a "fair market value" standard is not used because it is "too narrow, often inappropriate, and assumes a fact not contemplated by [the buy-out provisions]—a willing buyer and a willing seller." Thus, ULLCA is sensitive to the fact that it is impossible to determine the fair "market" value of a minority interest in a closely-held firm for which no market actually exists.

Nevertheless, the phrase "fair value" as it appears in the ULLCA buy-out provision could be interpreted to mean "fair market value." As explained earlier, the Louisiana Supreme Court has interpreted the Louisiana Partnership Law, which requires the payment of an amount equal to the "value" of a retiring partner's interest in a partnership to require a payment equal to the "fair market value" of the interest and has applied a minority discount in valuing a partnership interest. To prevent misinterpretation, the Louisiana Legislature should adopt a provision similar to the RUPA provision determining the buy-out price for a partner's interest. Inasmuch as a statutory buy-out requirement and a statutorily determined buy-out price would be enacted as default rules only, the parties would be free to negotiate these issues and alter the rules by a provision in the LLC's articles of organization or operating agreement.

A buy-out requirement may not sufficiently protect the interests of a former member or the member's successor unless the party to be paid has sufficient information to determine whether the price offered by the LLC is fair. As an assignee of the member's interest, under the Louisiana LLC Law, the successor or legal representative of a member whose interest in the LLC has terminated may not inspect or copy the LLC's records. The rule is necessary to prevent third parties from meddling in the LLC's affairs. The privacy and smooth functioning of an LLC could be destroyed if the LLC were required to respond to disclosure demands of third parties, and valuable trade information could be lost. Nevertheless, an assignee should have access to sufficient information to protect the assignee's rights to distributions from the LLC.

ULLCA requires an LLC to furnish to a dissociated member: (1) a statement of the LLC's assets and liabilities as of the date that the value of the member's interest was to be determined; (2) the latest available balance sheet and

370. ULLCA § 701(a), (f) (1995).
income statement, if any; and (3) an explanation of how the estimated amount of the payment was calculated. While ULLCA does not require this much information to be furnished to the legal representative of a deceased or incompetent member, an LLC must provide to such a person information concerning the LLC's business affairs "reasonably required for the proper exercise of the member's rights and performance of the member's duties under the operating agreement or [ULLCA]." The Louisiana LLC Law should require similar information to be furnished to a former member's successor or legal representative.

In some cases, it may not be suitable to require an LLC to purchase a former member's interest, especially if the LLC is entered into for a term (a "term LLC"). Sometimes the parties will form a term LLC in order to complete a specific project. It may be important for a term LLC to retain its capital in order to complete its objectives on time. Withdrawal of a member's capital from a term LLC may damage the LLC's business and prejudice the interests of the remaining members. Accordingly, the Louisiana LLC Law restricts the rights of a member seeking to withdraw from a term LLC.

Under the Louisiana LLC Law, a member may withdraw from a term LLC prior to the expiration of the LLC's term if the other members consent or the member seeking to withdraw has just cause arising from the failure of another member to fulfill an obligation. The statutory language implies that a member of a term LLC may not withdraw prematurely unless the other members consent or there is just cause for withdrawal. The successor or legal representative of a member's whose interest has terminated should have no greater right to receive distributions from a term LLC prior to the expiration of the LLC's term than the former member had.

The rules concerning term LLCs, however, can create special problems for the successor of a member whose interest in a term LLC has terminated, and for a person whose membership has not terminated, but owns a minority interest in the LLC. Such a person easily may become "trapped" in an illiquid investment in much the same way that a minority shareholder may become trapped in a close corporation. In contrast, the majority members of a term LLC have the power to "withdraw" from the LLC at any time by voting to dissolve the LLC.

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375. ULLCA § 701(b) (1995). See also RUPA § 701(g)(1)-(3).
376. ULLCA § 408(b)(1) (1995). The information must be supplied to the member's legal representative without demand. Id. The LLC also is required to furnish the member's legal representative "other information concerning the company's business or affairs, except to the extent the demand or the information demanded is unreasonable or otherwise improper under the circumstances." ULLCA § 408(b)(2) (1995). For example, a demand for information that would reveal trade secrets probably would be unreasonable under this provision.
Under the Louisiana LLC Law, it may not even be certain whether an LLC has been entered into for a term. While an LLC’s articles of organization may establish an LLC’s term by setting forth the latest date upon which the LLC is to dissolve, there is no requirement for an LLC’s term to be established only in the LLC’s articles of organization or in a written agreement. No court in Louisiana has considered the issue of whether an LLC or partnership may be entered into for a term without a written agreement. Courts in other jurisdictions, however, have been willing to infer that a partnership was entered into for a term, notwithstanding the lack of any writing designating the existence of a term.

In many cases, however, members of a term LLC will know the nature of the LLC and the length of its term. When a person becomes a member of a term LLC, that person and his or her successor normally should expect to have to wait until the LLC’s term expires before receiving any payments in liquidation of his or her membership interest.

Nevertheless, the inability of a member or the successor of a member to liquidate an interest in a term LLC could tempt the majority to engage in oppressive behavior. For example, the majority may “squeeze out” a minority member or the member’s successor from participation in the LLC’s profits by refusing to authorize distributions or by refusing to extend the minority member’s employment contract with the LLC. In such a case, the minority member may be subject to a tax liability for which no funds have been received. If an LLC is classified as a partnership, each member is liable for the tax on his or her distributive share of the LLC’s taxable income, regardless of whether the income is distributed. Thus, a minority member of an LLC, who is liable for the tax on the member’s distributive

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381. Under the Uniform Partnership Act (“UPA”), a member may withdraw from a term partnership before the expiration of its term, but may be liable for wrongful dissolution of the partnership resulting from the premature withdrawal. UPA § 31(b), (2) (1914). Damages for wrongful dissolution can be avoided if the partner who seeks to withdraw can obtain an equitable decree of dissolution of the partnership. UPA §§ 31, 32(1) (1914). Under these provisions, a number of courts have been willing to infer that a partnership formed under the UPA was entered into for a term and that the term has lasted for a significant amount of time. See, e.g., Bates v. McTammany, 76 P.2d 513, 515 (Cal. 1938) (partnership formed for the purpose of operating a radio station, the operation of which depended upon its holding a federal license, was entered into for a term that lasted “for so long as the federal license therefor could be procured”). See also cases cited in Hillman, supra note 349, at 20-33 and nn.60, 77-79. Some of the early LLC statutes provided that an LLC’s term expired after 30 years. See, e.g., Colo. Rev. Stat. Ann. § 7-80-204(1)(b) (Repealed); Fla. Stat. Ann. § 608.407(1)(b) (Repealed); Kan. Stat. Ann. § 17-7607(a)(2) (Repealed); Nev. Rev. Stat. § 86.161(1)(b); Tex. Rev. Civ. Stat. Ann. art. 1528(a), art. 3.02(A)(2) (Repealed); Wyo. Stat. § 17-15-107(a)(ii) (1996). The mandatory term limit apparently was designed to prevent an LLC from having the corporate characteristic of continuity of life for tax classification purposes. When it became clear that an LLC did not have to be entered into for a term in order to lack continuity of life, many states repealed these statutes. For a discussion of the lack of necessity of a term limit for an LLC for tax classification purposes, see Thomas E. Rutledge, It Just Doesn’t Matter, or Why You Don’t Need A Definite Date of Dissolution, 2 Ltd. Liab. Co. Rep. 94-407 (1994).
share of the LLC’s income, may not receive sufficient distributions from the LLC to pay the tax liability attributable to the interest in the LLC. A minority member of a term LLC or a member’s successor who is subject to majority oppression may have to wait a long time before the LLC’s term expires in order to leave a business relationship that has become burdensome. The LLC’s articles of organization or operating agreement may provide for a lengthy term or a court may infer that the parties have agreed to a long term.  

In cases involving majority oppression, it may be important to provide protection to a member’s successor or a member owning a minority interest in a term LLC. Most persons who become members of an LLC, regardless of whether the LLC is constituted for a term, expect that they will be able to agree with the other members with respect to the conduct of the LLC’s business and that they will be treated fairly. If there is a dispute after the LLC has been formed, however, a member owning a minority interest in a term LLC may be subject to oppression at the hands of the majority. In contrast, the ability of a minority member of an LLC that is not entered into for a term (an “at-will LLC”) to withdraw and receive a distribution from the LLC in an amount equal to the fair market value of the member’s interest at the time of the withdrawal gives a minority member an opportunity either to sever a cumbersome relationship and receive a return on the member’s capital investment in the LLC or to negotiate with the majority from a stronger bargaining position if there is a dispute.

While other default provisions of the Louisiana LLC Law offer some protection to members of a term LLC from abuse at the hands of other members, it may be difficult for a minority member to obtain relief under these provisions. For example, the default rules of the Louisiana LLC Law provide that members of a member-managed LLC and managers of a manager-managed LLC have fiduciary duties to the LLC and its members. These fiduciary duties must be discharged in good faith. However, the statute does not define what constitutes “good faith.” It may be difficult to establish that the majority have not acted in good faith in determining that a minority member should be discharged from employment with the LLC, especially if the minority does not agree with majority decisions concerning the operation of the LLC’s business. Similarly, the majority may have used good business judgment in deciding that profits should be retained for investment in the LLC’s business.

In some cases, the majority may not even have fiduciary duties with respect to minority members. For example, in the case of a manager-managed LLC, the

383. Cf. Bates v. McTammany, 76 P.2d 513, 515 (Cal. 1938) (partnership formed to operate a radio station was entered into for a term that lasted “for so long as the federal license therefor could be procured”). For a discussion of other cases in which courts have found lengthy terms implied in partnership agreements, see Hillman, supra note 349, at 20-24.
387. Id.
managers, rather than the members, have fiduciary duties under the Louisiana LLC Law. While a court could infer fiduciary duties in an abusive case where the majority have directed the activity of the managers, this result is not certain. Moreover, the Louisiana LLC Law does not provide any specific remedies for dissent or deadlock.

The Louisiana LLC Law also provides some protection to a person owning a minority interest in an LLC by authorizing judicial dissolution of an LLC under certain circumstances. However, as explained earlier, the only statutory ground upon which a judicial dissolution may be obtained is that "it is not reasonably practicable to carry on the [LLC's] business in conformity with the articles of organization or operating agreement." It may be very difficult for a minority member to prove such impracticability, especially where the majority have agreed as to the course of conducting the LLC's business.

Moreover, requiring a term LLC to dissolve before the LLC's term has expired is an extreme remedy and defeats the purpose of forming a term LLC to ensure the stability of the LLC's business. While it is important to effectuate the reasonable expectations of a minority member of a term LLC, it also is important to consider the reasonable expectations of all of the parties in fashioning relief for a dissenting member. The majority may have exercised good business judgment in taking a course of action that was not favorable to the dissenting minority member. Furthermore, the premature dissolution of a term LLC may be detrimental both to the majority and to the minority member because a premature sale of the LLC's assets could result in a lower price than could be obtained on the sale of its assets at a later date. It has been suggested that courts have been reluctant to order dissolution of a corporation even in cases involving oppressive conduct by majority shareholders because dissolution is such a drastic remedy.

Professor Sandra K. Miller has suggested that a range of remedies should be available whenever managers or those in control of an LLC have acted or will act in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial. Suggested remedies, based on remedies available to oppressed shareholders under

388. Id.
390. Id.
391. Hillman, supra note 349, at 51-55.
392. See, e.g., Report of the Committee on Corporate Laws, Section of Corporation, Banking and Business Law, American Bar Association, reprinted in 37 Bus. Law. 269, 302 (1981) (explaining the reason for expanded relief provided for shareholders under the Proposed Statutory Close Corporation Supplement to the Model Business Corporation Act); Murdock, supra note 363, at 427. Actually, dissolution of a corporation (or an LLC) may not be such a drastic remedy. As Professor Murdock has demonstrated, in most cases where a viable business entity is liquidated pursuant to a decree of dissolution, the business is continued, either by one or more of the shareholders or by a third party who purchases the business as a going concern. Murdock, supra note 363, at 446.
the Model Statutory Close Corporation Supplement to the Revised Model Business Corporation Act,\textsuperscript{394} include:

(1) the performance, prohibition, alteration, or setting aside of any action by the limited liability company or its members or managers;
(2) the cancellation or alteration of any provision in the limited liability company's operating agreement;
(3) the removal of any manager;
(4) the appointment of any individual as a manager;
(5) an accounting with respect to any matter in dispute;
(6) the appointment of a custodian to manage the business and affairs of the limited liability company;
(7) the appointment of a provisional manager (who has the rights, powers and duties of a duly elected manager to serve for the term and under conditions prescribed by the court);
(8) the payment of distributions;
(9) the award of damages to any aggrieved party.\textsuperscript{395}

The suggested remedies may provide a good compromise that takes into account the competing policies of ensuring the stability of an LLC's business and protecting owners of minority interests from oppression at the hands of the majority. On the other hand, a court may be reluctant to become involved in overseeing the day-to-day activities of an LLC as may be required under the suggested remedies. While the suggested intermediate remedies should be available regardless of whether an LLC is entered into for a term, they are particularly suitable for term LLCs. In the case of a term LLC, the duration of judicial oversight will be limited. Moreover, the intermediate remedies are more valuable for a term LLC, where business stability is important. Finally, the list of suggested remedies is optional; in an extreme case, a court still should be able to order dissolution of or a buy-out of a member's interest in a term LLC. If the Louisiana LLC Law were to include such a list of intermediate remedies, a court at least might be more amenable to providing relief to minority members.\textsuperscript{396}

Some commentators have argued that courts should not intervene heavily into the affairs of small businesses, but should instead respect the bargain that

\textsuperscript{394} MSCCS § 41(a) (1988).
\textsuperscript{395} Miller, supra note 393, at 531.
\textsuperscript{396} Professor Miller suggests that in fashioning relief, a court should take into account the following standards:
1) the remedy should maximize the ability of minority shareholders to realize their reasonable expectations;
2) the remedy should minimize the administrative costs associated with resolving the dissention; and
3) the remedy should maximize the value of the economic unit while allowing shareholders to realize value in accordance with their reasonable expectations.
\textit{Id.} at 532 (citing Bahls, supra note 363, at 320).
the parties have struck.\textsuperscript{397} In other words, the terms of an LLC's articles of organization and operating agreement should control in determining the remedies or lack of remedies that are available to minority members of an LLC. Respecting the bargain will encourage efficient contracts.

For example, a minority member who is to be an employee of an LLC should be entitled to bargain for a higher salary or a lower purchase price for his or her interest in the LLC in lieu of a buy-out right.\textsuperscript{398} Nevertheless, most minority members probably would prefer to have a buy-out right as a matter of law that could be the subject of negotiation. If the buy-out right and other remedies suggested in this article were enacted as default provisions, the majority would be forced to include a provision in the LLC's operating agreement reducing members' statutory rights. In that case, the minority would be apprised that their rights were to be diminished and could bargain on fuller disclosure.\textsuperscript{399}

Another solution to the potential problem of majority oppression, at least with respect to existing members, would be to remove the majority's ability to oppress minority members by altering the provisions of the Louisiana LLC Law concerning members' voting rights. Under the default rules of the Louisiana LLC Law, each member generally is entitled to one vote, and a majority vote of the members is necessary to approve any action properly brought before them.\textsuperscript{400} If an LLC is managed by managers, the default rules contemplate that the managers will vote with respect to the day-to-day affairs of the LLC on the basis of a one-manager, one-vote, majority rules basis.\textsuperscript{401} Regardless of whether an LLC is manager-managed, however, the default rules require a majority vote of the members to approve certain extraordinary transactions, including: (1) the dissolution and winding up of the LLC; (2) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the LLC's assets; (3) the merger or consolidation of the LLC; (4) the incurrence of indebtedness by the LLC other than in the ordinary course of its business; (5) the alienation, lease or encumbrance of any of the LLC's immovables; and (6) any amendment to the articles of organization or operating agreement.\textsuperscript{402}

The majority vote requirement for extraordinary matters creates the potential for the freeze-out of minority members of a Louisiana LLC.\textsuperscript{403} For purposes of

\textsuperscript{397} Oesterle, supra note 351.
\textsuperscript{398} \textit{Id.} at 890.
\textsuperscript{399} See \textit{id.} at 920 and n.179 (arguing that legislatures, rather than courts, should provide for such rights as default rules).
\textsuperscript{400} La. R.S. 12:1318(A) (1994). Members elect managers, however, on the basis of a one-member, one-vote, plurality basis. La. R.S. 12:1313(1) (1994). Unanimity is required to consent to the admission of an assignee of a member's interest and to continue an LLC after the termination of a member's interest. La. R.S. 12:1332(a)(1), 1334(3) (1994).
\textsuperscript{401} La. R.S. 12:1316 (1994).
\textsuperscript{402} La. R.S. 12:1318(B) (1994).
\textsuperscript{403} For a discussion of the potential for freeze-outs under most LLC statutes, see Franklin A. Gevurtz, \textit{Squeeze-Outs and Freeze-Outs in Limited Liability Companies}, 73 Wash. U. L. Q. 497 (1995). Professor Gevurtz uses the term "squeeze-out" to refer to the situation where majority owners in a
this article, the term “freeze-out” will refer to the situation in which the majority uses legal compulsion to force an unwilling minority to sell out its interest in a business organization, usually at a bargain price.\footnote{Id. at 498.} There are several methods by which the majority of the members of a Louisiana LLC could attempt a freeze-out of the minority. For example, the majority could vote to dissolve the LLC under a plan whereby a new LLC owned solely by the majority acquires the operating assets.\footnote{Professor Gevurtz explains, however, that most courts have been hostile to such attempts in the corporate area. \textit{Id.} at 522 and nn.140, 141.} Even though the minority might receive cash in such a transaction, the liquidation proceeds distributed to the minority might not take into consideration the value of intangibles, such as goodwill, that the new LLC may continue to enjoy.

Alternatively, the majority could sell all of the LLC’s assets for a bargain price to another business organization owned solely by the majority. If the LLC receives only a promissory note in exchange for its assets, the minority will be harmed by the discounted price paid for the LLC’s assets and will be entitled to receive little on the initial sale.

The freeze-out technique most commonly employed by corporate shareholders is effected through a cash-out merger in which the corporation’s assets are transferred to a newly-formed business organization, the majority receive interests in the new organization, and the minority receive cash.\footnote{Id. at 523.} A similar transaction could be accomplished by merging an LLC with another business organization owned solely by the majority.

While a freeze-out may be challenged by a minority member as a breach of the majority’s fiduciary duties,\footnote{A Louisiana LLC may merge with one or more LLCs, partnerships, partnerships in commendam, or corporations. \textit{La. R.S.} 12:1357, 1362(A) (1994). Louisiana law also permits the merger of other forms of business organization with one or more LLCs. \textit{See La. R.S.} 9:3442, 12:117 (1994 and Supp. 1997).} the majority may be able to convince a court that it had good business reasons for the transaction under consideration. Given the difficulty in appraising the value of a business’ assets, the majority also may be able to prove that the amount received by the minority was a fair price. Moreover, it may be difficult for the minority to prove that a transaction that has been approved by the majority of an LLC’s members was improper. The potential for freeze-out could be avoided if the Louisiana LLC Law were to adopt, at least as a default rule, the partnership provision requiring the unanimous agreement of the partners to approve extraordinary matters.\footnote{For the fiduciary duties of members and managers of an LLC, see \textit{La. F.S.} 12:1314 (1994).} While unanimity might not be
necessary to approve transactions involving an LLC's immovables in cases where
the immovables do not constitute substantially all of the LLC's assets, the other
extraordinary matters listed in the LLC statute should be subject to unanimous
approval by the members.

The default rules of the Louisiana LLC Law should at least be amended to
require the unanimous consent of the members to amend an LLC's articles of
organization or operating agreement. The articles of organization and operating
agreement constitute a contract among all the members of an LLC; where
amendment of a contract is sought, all parties to the contract should be included in
any decision to alter or modify it. Moreover, requiring the unanimous consent of
the members to amend the articles of organization or operating agreement might
deter majority members from squeezing out the minority from participation in the LLC's profits, for example, by terminating the employ-
ment of a minority member and refusing to authorize distributions. In such a case,
a minority member might be able to convince a court that the member's employ-
ment with the LLC was authorized by an oral operating agreement, and termination
of his or her employment constituted an amendment to the operating agreement.
Under the Louisiana LLC Law, an operating agreement does not need to be in
writing to be enforceable.410

If the Louisiana Legislature amends the Louisiana LLC Law to provide greater
protection to minority members of an LLC, the value of an LLC as a choice of
entity for an estate plan will be diminished.411 Federal estate and gift taxes are
imposed on the value of property transferred by gift, devise, or inheritance.412
For this purpose, the value of property so transferred is its fair market value,
defined as "the price at which the property would change hands between a willing
buyer and a willing seller, neither being under any compulsion to buy or sell and
both having reasonable knowledge of relevant facts."413 A willing buyer would
pay less for a minority interest in an LLC under the current provisions of the
Louisiana LLC Law than under the amendments suggested in this article. Thus, if

410. See La. R.S. 12:1301(A)(16) (1994) (defining the term "operating agreement" as any
agreement, written or oral, of the members as to the affairs of an LLC and the conduct of its
business). A provision in an operating agreement that is in conflict with the default rules of the
Louisiana LLC Law, however, usually must be in writing in order to be effective.

411. For a discussion of the use of an LLC in an estate plan, see Kalinka, supra note 1, at §§
3.23-3.31.

412. See I.R.C. §§ 2001(a) (1994) (imposing a tax on the transfer of the taxable estate of every
decedent who is a United States citizen or resident), 2501(a)(1) (1994) (imposing a tax on the transfer
of property by gift).

413. Treas. Reg. §§ 20.2031-1(b) (as amended in 1965), -3 (1994), 25.2512-1 (as amended in
a minority interest in an LLC is transferred by gift or by reason of the death of the transferor, the gift and/or estate tax liability of the transferor would be less under the current provisions of the Louisiana LLC Law than if the suggested amendments are adopted. Where an LLC is wholly owned by one family, the transferor might not object to the impediments imposed by the current LLC law on those receiving minority interests. In fact, where a minority interest is transferred by gift, the donor might prefer the recipient to have fewer rights so that the donor may retain control of the LLC.

Nevertheless, the concerns of estate planners are not as compelling as the concerns of members who form an LLC for purposes of operating a business or investment venture. As explained earlier, the Louisiana LLC Law should be written with the needs of small, unsophisticated entrepreneurs in mind. Most persons who receive a minority interest in an LLC, especially if the interest is received in exchange for capital or services, will expect to have greater rights than are afforded under the current provisions of the Louisiana LLC Law. On the other hand, estate planners have the means and the sophistication to alter the default rules of the Louisiana LLC Law to provide control of an LLC to a donor who gives interests in an LLC to his or her family members.414

As explained earlier, the provisions of the Louisiana LLC Law concerning term LLCs are designed to ensure continuity of the LLC's existence, at least until the expiration of the LLC's term. Nevertheless, under the default rules of the Louisiana LLC Law, even a term LLC dissolves upon the death, interdiction, withdrawal, expulsion, bankruptcy, or dissolution of a member or the occurrence of any other event that terminates the member's interest unless the remaining members unanimously consent to continue the LLC within ninety days after the event terminating the member's interest.415 If the default rule triggering dissolution of an LLC on the termination of a member's interest is repealed, term LLCs will have even greater stability.

If an LLC is entered into for a term, its existence will not last forever because the LLC will dissolve upon the expiration of its term unless the members agree to continue the LLC for a longer or indefinite term. In many cases, a term LLC's articles of organization or a written operating agreement will specify the latest date on which the LLC is to dissolve.416 In that case, the members will have to amend

414. Admittedly, however, if enhanced rights are afforded to minority members of an LLC under the default provisions of the Louisiana LLC Law, estate planners may not be able to obtain all of the valuation discounts that otherwise would be available with respect to the gifted interests. See, e.g., I.R.C. § 2704(b) (1994); Treas. Reg. § 25.2704-2(b) (if there is a transfer of an interest in an LLC to a family member, restrictions on the transferee's ability to liquidate the LLC may be disregarded where the limitation on the transferee's ability to liquidate the entity is more restrictive than the limitations that would apply under the state law generally applicable to the entity in the absence of the restriction).
416. See La. R.S. 12:1305(C)(4) (1994) (LLC's articles of organization may set forth the latest date, if any, on which the LLC is to dissolve), La. R.S. 12:1334(1) (1994) (an LLC dissolves upon the occurrence of events specified in writing in the articles of organization or operating agreement). The parties are likely to state the date on which the LLC is to terminate in writing in order to
the LLC’s articles of organization or written operating agreement if they would like to continue the LLC beyond its stated term.

Members of a small, informal, term LLC are likely to forget that the LLC’s term has expired or that they must amend the LLC’s articles of organization or operating agreement in order to extend the LLC’s term. If they continue to operate the LLC beyond its term, they could be exposed to personal liability for the LLC’s debts and obligations incurred after its term has expired. While a court could apply an estoppel theory to hold that a term LLC has continued beyond its term, this result is not certain. It would be better if the Louisiana LLC Law were amended to include a provision similar to the provision of the Louisiana Partnership Law that permits partners to “expressly or tacitly” continue a partnership when its term expires.

D. Centralized Management

The default rules of the Louisiana LLC Law provide that an LLC is managed by its members unless the LLC’s articles of organization designate that the LLC is to be manager-managed. If an LLC is member-managed, each member of the LLC is a mandatary of the LLC for all matters in the ordinary course of the LLC’s business other than the alienation, lease, or encumbrance of its immovables unless the mandate is restricted or enlarged in the LLC’s articles of organization or unless the member lacks the authority to act on behalf of the LLC and the person with whom the member is dealing has knowledge that the member lacks such authority. As explained earlier, these rules are designed to ensure that an LLC will lack the corporate characteristic of centralized management for tax classification purposes under the Kintner regulations.

The default rule treating all members of a member-managed LLC as mandataries can be problematic because it allows any member to incur obligations for which the LLC is liable. Now that the check-the-box regulations have been preclude arguments that the LLC was not entered into for a term. For example, a member who wishes to withdraw from an LLC without the consent of the other members is likely to argue that the LLC was not entered into for a term.

417. Louisiana courts have applied an estoppel theory to prevent the denial of a corporation’s existence prior to its incorporation. See, e.g., North American Contracting Corp. v. Gibson, 327 So. 2d 444, 451 (La. App. 3d Cir.), writ denied, 332 So. 2d 280 (1975). For a discussion of the conditions under which a Louisiana court will apply an estoppel theory to prevent the denial of a corporation’s existence, see Fritz B. Ziegler, Comment, De Facto Incorporation and Estoppel to Deny Corporate Existence in Louisiana, 37 La. L. Rev. 1121 (1977). A similar analysis could apply to prevent the dissolution of a term LLC after its term has expired.

418. See La. Civ. Code art. 2827 (Louisiana partnership may be expressly or tacitly continued when its term expires).

419. La. R.S. 12:1311 (1994). See also La. R.S. 12:1312(A) (1994) (an LLC’s articles of organization may provide that the business of the LLC is to be managed by or under the authority of one or more managers).

issued in final form, it is no longer important to determine whether an LLC has centralized management. Thus, the Louisiana Legislature can repeal the default rule requiring member-management without the possibility of jeopardizing the tax status of an LLC.

Nevertheless, the default rule requiring member-management should not be repealed. Member-management probably is the management structure that would be intended for most informal, closely-held businesses. A person who invests in a small business is likely to be active in the conduct of the business and should have agency authority to deal with third persons on behalf of the business. Persons dealing with an owner of a closely-held business should be able to rely on the owner’s authority to engage in business transactions.

The default rules of the Louisiana LLC Law are somewhat restrictive with respect to a member’s authority to engage in transactions involving the LLC’s immovables. A similar rule of the Louisiana Partnership Law provides that a partner is a mandatary of the partnership for all matters in the ordinary course of its business other than the alienation, lease, or encumbrance of its immovables. A business organization’s immovables are likely to represent a significant capital investment. The restriction on a member’s authority to dispose of immovables places third persons on notice that they must inquire as to the authority of the member who attempts to engage in real estate transactions on behalf of an LLC.

If it is important to restrict or enlarge the agency authority of any of an LLC’s members, there are several methods to achieve this result under the Louisiana LLC Law. First, an LLC’s articles of organization may contain a provision restricting or enlarging a member’s authority. For example, an LLC’s articles of organization may designate one or more members who have agency authority to lease, encumber, or dispose of the LLC’s immovables, or the articles may state that certain members do not have agency authority to bind the LLC. A restriction on a member’s authority also may be contained in a written operating agreement. If the LLC’s articles of organization contain a statement that there are restrictions on some or all of the members’ agency authority, persons dealing with a member are deemed to have knowledge of any restrictions on the member’s authority contained in the written operating agreement. On the other hand, a member’s authority to act on behalf of an LLC may be expanded if such authority is properly certified. Finally, an LLC’s articles of organization may provide that the LLC

422. See id. cmt. (b).
425. Id.
426. La. R.S. 12:1317(C) (1994). A certificate stating that a member has agency authority may be issued only by a certifying official or officials if such official(s) is (are) named in the LLC’s articles of organization; if no certifying official is named in the LLC’s articles of organization, any member or manager may issue a certificate. Id.
is to be managed by one or more managers.427 In that case, no member has agency authority with respect to the LLC unless the LLC's articles of organization or a certificate expands the member's authority.428

The default rule providing for member-management and agency authority of members works fairly well with respect to small firms and generally should be retained. Under the Louisiana LLC Law, any restriction or expansion of a member's authority must be provided in the LLC's articles of organization or in a written operating agreement referenced in the LLC's articles of organization, and expansion of authority may be accomplished by proper certification. Thus, only proper documentation is sufficient to alter the default rules concerning a member's agency authority.

In some cases, however, the Louisiana LLC Law may impose too much of a burden on persons dealing with an LLC. In other cases, the LLC Law may require too little of such persons. Third parties should be able to ascertain easily whether a person has authority to act on behalf of an LLC. Otherwise, creditors and others will hesitate to engage in transactions with the LLC. On the other hand, members of an LLC need to be protected from the acts of others who might exceed their authority to bind the LLC.

The rule permitting the parties to restrict the agency powers of members and managers by so providing in a written operating agreement, referenced by the LLC's articles of organization, can be problematic. Because of this rule, any person dealing with a member or manager of an LLC must not only review the LLC's articles of organization to determine whether the member or manager has the authority to act on behalf of the LLC, but also must peruse all of the LLC's written operating agreements if the articles of organization state that there is a written operating agreement restricting the authority of members or managers. The Louisiana LLC Law does not seem to require the articles of organization to name the members or managers whose authority is restricted or to state the restrictions that apply. Section 12:1317(B) of the Revised Statutes provides:

Persons dealing with a member, if management is reserved to the members, or manager, if management is vested in one or more managers pursuant to R.S. 12:1312, of the limited liability company shall be deemed to have knowledge of restrictions on the authority of such a member or manager contained in a written operating agreement if the articles of organization of the limited liability company contain a statement that such restrictions exist.

The quoted language is somewhat ambiguous. It could be interpreted to require the statement in the LLC's articles of organization to state the specific restrictions that apply and name the persons whose authority is so restricted. On the other hand, a more natural interpretation of Section 12:1317(B) would require

the LLC's articles of organization merely to state: "The LLC's operating agreement contains certain restrictions on the authority of the members [or managers] to bind the LLC."

The latter interpretation also is more logical. If an LLC's articles of organization contain specific restrictions on the authority of named members, there is no need to repeat the information in a written operating agreement.

It may be difficult for third parties to obtain access to an LLC's written operating agreement containing restrictions on members' or managers' authority. An LLC's written operating agreement is not filed with the secretary of state's office or other government agency and, therefore, is not a matter of public record. While the Louisiana LLC Law requires an LLC's written operating agreement to be kept at the LLC's registered office, there is no specific penalty for failure of any person to maintain an LLC's records at the LLC's registered office. In this regard, the Louisiana LLC Law states that "[f]ailure of the limited liability company to keep or maintain any of the records or information required pursuant to [section 12:1319] shall not be grounds for imposing liability on any person for the debts and obligations of the limited liability company." While sloppy recordkeeping may be grounds for a third party to avoid restrictions on the agency authority of a member or manager, it may require litigation to resolve the issue.

Moreover, an LLC may have more than one written operating agreement. If an LLC's articles of organization contain a statement that there is an operating agreement containing restrictions on the authority of members or managers, a person dealing with an LLC may be required to peruse several documents and to determine whether a new operating agreement has been written restricting the agency authority of a member or manager each time the person deals with the LLC.

Unsophisticated persons who deal with an LLC may not be aware of the ability to limit the agency authority of a member or a manager by means of an unrecorded document. While principles of agency law may protect such persons in some cases, the law of agency will not bind the LLC in all cases in which a member exceeds the authority restrictions contained in a written operating agreement referenced in an LLC's articles of organization.

Where a member or a manager has acted as an agent of an LLC through a course of dealing, a court might find that the member or manager has inherent agency power to bind the LLC under principles of agency law. Section 3000 of the Louisiana Civil Code provides:

Powers granted to persons, who exercise a profession, or fulfill certain functions, or doing any business in the ordinary course of affairs

431. La. R.S. 12:1301(A)(16) (1994) defines the term “operating agreement" as "any agreement, written or oral, of the members as to the affairs of a limited liability company and the conduct of its business." Under this definition, there may be more than one agreement of the members as to the LLC's affairs or the conduct of its business.
to which they are devoted, need not be specified, but are inferred from the functions which those mandataries exercise.

Under this authority, courts in Louisiana have held that a principal may be bound by the act of an agent acting with authority implied by a course of conduct.\(^3\) Thus, for example, where a member whose agency authority is properly restricted in a written operating agreement nevertheless has exceeded the restriction on several occasions with the approval of the other members, a court may hold that the member had implied authority to act on behalf of the LLC. However, there is no guarantee that a court in Louisiana will refuse to enforce a restriction on the agency authority of a member or manager that is contained in a written operating agreement that is properly referenced in the LLC's articles of organization. Moreover, if the member or manager whose authority is so restricted does not usually act on behalf of the LLC, even the law of agency will not infer agency powers.

Any restriction on the authority of a member or a manager of an LLC should be a matter of clear, public record. The Louisiana LLC Law should be amended to provide that any restriction on the agency authority of a member or a manager must be contained in the LLC's articles of organization.

Under the current provisions of the Louisiana LLC Law, the easiest way for a third party to be sure that the LLC will be bound by the acts of a member or a manager is to require the person acting on behalf of the LLC to furnish a certificate establishing his or her agency authority. The Louisiana LLC Law provides that persons dealing with an LLC may rely upon a certificate of any person named in the LLC's articles of organization as a certifying official to establish the membership of any member, the authenticity of any records of the LLC, or the authority of any person to act on behalf of the LLC.\(^3\) If no certifying official is named in an LLC's articles of organization, a certificate of any of the LLC's members or managers is sufficient.\(^3\)

The certification rules serve an important function, especially with respect to transactions involving an LLC's immovables. As explained earlier, unless otherwise provided in an LLC's articles of organization, the apparent authority of a member or manager of an LLC does not extend to the alienation, lease, or encumbrance of an LLC's immovables.\(^3\) Under the default rules of the

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432. See e.g., Security Mut. Casualty Co. v. Smith, 185 So. 679 (La. App. 2d Cir. 1939) (husband bound by terms of a letter written by his wife who frequently was left in charge of the operations of his business while he was away). Cf. Analab, Inc. v. Bank of the South, 271 So. 2d 73 (La. App. 4th Cir. 1972) (president of a bank was acting with apparent authority where the bank permitted the president to conduct personal business activities on its premises; the president did not inform the plaintiff that the services performed by the plaintiff were to be performed for himself personally or for a third party, and this fact was not evident from the nature of the transaction).


Louisiana LLC Law, a majority vote of the members of an LLC is required to approve the alienation, lease, or encumbrance of any of the LLC's immovables, regardless of whether the LLC is member-managed or manager-managed.\textsuperscript{436} A certificate of authority of a member or manager to engage in such transactions relieves a third party of the need to otherwise determine whether the proper approval has been given.

The certification rules, however, may expose the members of an LLC to significant risk. If no certifying official is named in an LLC's articles of organization, any member or manager can certify that he or she (or in fact, any other person) has authority to engage in any transaction on behalf of the LLC, regardless of whether the proper approval of the other members has been obtained. While a member or manager who exceeds his or her authority may be liable to the LLC for any damages resulting from such actions, it may be too late to compensate the other members after the damage is done.

The only way that the parties can protect themselves from a member's or a manager's exceeding his or her agency authority through self-certification is by designating one or more certifying officials in the LLC's articles of organization. Third parties may rely on member-issued or manager-issued certificates only if a certifying official is not named in the LLC's articles of organization.\textsuperscript{437} Unsophisticated, small entrepreneurs for whom the LLC Law should be written are not likely to be aware of the certification rules or the steps that must be taken to prevent members and managers from exceeding their agency authority through self-certification.

While it may be important to allow third persons to rely on certificates establishing the authority of members or managers to act on behalf of an LLC, there is no reason to allow members or managers to certify their own authority or that of any other person. Perhaps the best solution is to permit third persons to rely only on certificates issued by one of the LLC's certifying officials who are named in the LLC's articles of organization. In that case, the number of persons who may issue certificates would be limited and the identity of the certifying official(s) would be a matter of public record. If a third party demands a certificate from a member or manager of an LLC that has no certifying official, the members may amend the LLC's articles of organization to include a statement naming such a person.

\textbf{E. Limited Liability}

The Louisiana LLC Law generally provides that a member is not personally liable, in his or her capacity as a member, for any debt, obligation, or liability of the LLC.\textsuperscript{438} As explained earlier, the limitations on the liability of a member cause a Louisiana LLC to have the corporate characteristic of limited

\textsuperscript{436} La. R.S. 12:1318(B)(5) (1994).
\textsuperscript{437} La. R.S. 12:1317(C) (1994).
\textsuperscript{438} La. R.S. 12:1320(B) (1994).
liability. One of the primary advantages of the LLC form of business is the ability of an LLC to shield investors from liability for business debts and obligations and, at the same time, to offer investors the advantages of flow-through taxation under subchapter K of the Internal Revenue Code. Apparently, the drafters of the Louisiana LLC Law considered limited liability to be such an important factor for an LLC that the provisions limiting the liability of a member of an LLC are not written as default rule, even though limited liability is a corporate characteristic under the Kintner regulations.

In contrast, some states permit members to assume personal liability for some or all of an LLC’s liabilities by so providing in the LLC’s articles of organization, regulations, or a written agreement. Presumably, the rules allowing members to assume personal liability for an LLC’s debts and obligations were designed to permit an LLC to lack limited liability under the Kintner regulations. As a result of the check-the-box regulations, the issue of whether an LLC has limited liability is no longer a concern for tax classification purposes.

Since the personal liability of an LLC’s members may no longer have tax consequences, it is difficult to conceive of a reason for any member to expose himself or herself to unlimited liability for an LLC’s debts or obligations. In many cases, creditors will protect themselves from the limitations on a member’s liability by requiring guarantees of an LLC’s members, in the same way that they protect themselves from the limited liability of corporate shareholders. In an appropriate case, a court may use a veil-piercing theory to hold members of an LLC liable for the LLC’s obligations, especially if the LLC is thinly capitalized or under-insured. The limitations on a member’s liability under the Louisiana LLC Law should be retained.

442. See Rev. Proc. 95-10 § 3.04, 1995-1 C.B. 501 (LLC may lack limited liability if at least one member validly assumes personal liability for all of the LLC’s obligations, pursuant to express authority granted in the controlling statute). See supra notes 138-144 and accompanying text.
443. As Professor Macey has observed, limited liability “reduces exposure to loss, reduces insurance costs, and increases incentives for engaging in potentially profitable risk-taking.” Jonathan R. Macey, The Limited Liability Company: Lessons from Corporate Law, 73 Wash. U. L. Q. 433, 437 (1995). While limited liability may increase the cost of borrowing, investors in an LLC can reduce these costs by providing security for specific debts. Id. There is some question, however, as to whether allowing investors limited liability under all circumstances is optimal for society because limited liability may encourage excessive risk-taking for which tortfeasors may not be responsible. Courts, however, may be able to police excessive and dangerous risk-taking by applying veil-piercing theory. Id. at 447-53. For an economic analysis of the benefits of limited liability for business organizations, see Larry E. Ribstein, The Deregulation of Limited Liability and the Death of Partnership, 70 Wash. U. L. Q. 417 (1992).
444. For a discussion of the cases in which courts in Louisiana have pierced the corporate veil, see Glenn G. Morris, Piercing the Corporate Veil in Louisiana, 52 La. L. Rev. 271 (1991).
F. Free Transferability of Interests

Under the default rules of the Louisiana LLC Law, a member may assign his or her interest in an LLC in whole or in part. The only interest that a member may assign, however, is the member’s financial interest in the LLC. An assignee of a member’s interest is entitled only to receive distributions from the LLC, to share in the LLC’s profits and losses, and to receive allocations of the LLC’s income, gain, loss, deduction, or credit to which the assignor was entitled and to the extent assigned. An assignee of an interest in an LLC may not become a member, may not participate in the management of the LLC, and may not exercise any of the rights and powers of a member unless and until the other members unanimously consent in writing. Under these rules, an assignee who is not admitted as a member of an LLC may not vote on any of the LLC’s affairs and may not inspect the LLC’s books or records. As explained earlier, the limitations on the rights of an assignee of a member’s interest are designed to ensure that an LLC will lack free transferability of interests for tax classification purposes. Now that the check-the-box regulations have been issued in final form, the issue of whether an LLC has free transferability of interests no longer has a potential effect on the tax status of an LLC. Consequently, the Louisiana Legislature can repeal the default rules restricting the transfer of a member’s interest without jeopardizing the tax status of a Louisiana LLC.

Nevertheless, the Louisiana Legislature should retain some default rules imposing restrictions on the rights of an assignee. Most small entrepreneurs will want to restrict the transferability of interests in an LLC, especially if the LLC is member-managed, as is required under the default rules of the Louisiana LLC Law. If an LLC is closely held, the members probably will want to retain veto power over the admission of new members to avoid having to conduct business with unwanted associates. As explained earlier, each member of a member-managed LLC is a mandatary of the LLC for all matters in the ordinary course of the LLC’s business other than the alienation, lease, or encumbrance of the LLC’s immovables, and can incur debts on behalf of the LLC when acting with apparent authority as determined under the Louisiana LLC Law. Limiting a member’s ability to freely assign his or her management rights with respect to a member-managed LLC may be important to prevent the admission of an unwanted member whose mismanagement could compromise the success of the LLC’s business.

446. Id.
447. Id.; La. R.S. 12:1332(A)(1) (1994). An LLC’s articles of organization or a written operating agreement may permit an assignee to become a member with less than or without the unanimous consent of the other members. La. R.S. 12:1332(A)(1) (1994).
448. For the voting rights of members, see La. R.S. 12:1313, 1318 (1994).
449. For the inspection rights of members, see La. R.S. 12:1319(B) (1994).
The same concerns do not exist with respect to manager-managed LLCs because the managers, rather than the members, are mandataries of a manager-managed LLC. Nevertheless, transfer restrictions may be important for manager-managed LLCs as well. As explained earlier, the default rules of the Louisiana LLC Law provide that members of a manager-managed LLC retain the right to vote on certain extraordinary matters. Moreover, the nonmanaging members of a manager-managed LLC may have influence with respect to the daily operations of the LLC because the members elect the LLC’s managers and may remove them at any time, with or without cause. It may be important to prevent the assignment of a member’s interest in a manager-managed LLC to prevent dilution of the non-assigning members’ voting power or to prevent a shift in an existing balance of voting power.

Where free transferability of voting power, management rights, and inspection rights is preferable, the parties may alter the default rules of the Louisiana LLC Law by a provision in the LLC’s articles of organization or a written operating agreement. Free transferability of interests is likely to be desirable for larger, more sophisticated business arrangements in which the parties are likely to seek the advice of counsel. Such persons do not need the benefit of default rules to accomplish their goals.

The default rules with respect to an assignment of a member’s interest, however, are problematic in some respects. For example, under the default rules of the Louisiana LLC Law, a member who assigns his or her entire interest in an LLC remains a member unless and until the assignee becomes a member of the LLC. Thus, a member who has given up his or her entire financial stake in an LLC will continue to participate in the management of the LLC and to vote in LLC matters as the member did before the member’s interest was assigned. A member with no financial stake in an LLC is less likely to exercise his or her management and voting rights in the best interests of the LLC. In many cases, an assigning member is likely to vote at the behest of the assignee, essentially conferring management powers on the assignee, notwithstanding the default rules of the Louisiana LLC Law. Recognizing these concerns, the LLC statutes of several states provide either: (1) that a member ceases to be a member of the LLC on the assignment of his or her entire interest in the LLC or (2) that

452. Id.
the nonassigning members may expel a member who has assigned his or her entire interest.457

The latter rule probably is the better rule. If the termination of a member’s interest in an LLC triggers a buy-out requirement, the nonassigning members should be able to decide whether they would rather co-exist with a voting member who has no financial stake in the LLC or cause the member’s interest to be purchased and the proceeds distributed to the assignee.

The Louisiana LLC Law has two provisions that concern the rights of specific assignees of a member’s interest. The first defines the rights of a judgment creditor of a member,458 and the second defines the rights of the successor or legal representative of a member who has died, been adjudicated incompetent, dissolved, or terminated.459 The provisions concerning the rights of the successor or legal representative of a member whose interest has terminated have been discussed earlier in this article.460 What follows is primarily a discussion of creditors’ rights.

A member of a Louisiana LLC may pledge or grant a security interest in his or her interest in an LLC.461 A pledge of a member’s interest generally is not an assignment of the interest because the pledging member usually does not assign to the creditor his or her right to share in the LLC’s profits and losses or to receive distributions from the LLC. If a member defaults on any payments with respect to a loan secured by the member’s interest in the LLC, the creditor has recourse against the member, but not against the LLC, unless the LLC also is a debtor with respect to the loan. A creditor of a member who is not also a creditor of the LLC cannot demand payment or seize assets from the LLC in satisfaction of the debt. A member has no direct interest in an LLC’s property, therefore, a member individually cannot make an LLC’s property available to his or her creditors.

Under the Louisiana LLC Law, a creditor who has obtained a judgment against a member of an LLC (a “judgment creditor”) may apply for a charging order against the member’s interest.463 The remedy is available to secured and unsecured creditors, as long as a judgment against the member is first obtained. Although a member whose interest is charged retains the benefits of any exemptions applicable under state law,464 the member cannot claim an exemp-

460. See supra notes 335-346 and accompanying text.
464. Id.
tion with respect to specific property of the LLC because the member has no specific interest in the LLC’s property. Nevertheless, a charging creditor who is not also a creditor of the LLC may not seize any of the LLC’s assets for the same reason.

In fact, a charging order may be a useless remedy, especially if the charged interest is an interest in a closely-held LLC. Under the Louisiana LLC Law, a charging creditor has only the rights of an assignee of a member’s interest.465

Thus, a charging creditor only has the right to receive distributions to which the debtor-member was entitled, to the extent of the debt plus interest.466 A charging creditor cannot participate in the management of the LLC, cannot vote to compel the LLC to make a distribution in satisfaction of the debt, cannot inspect the LLC’s records to determine whether distributions are required by the LLC’s operating agreement, and cannot exercise a member’s right to withdraw and receive a distribution in liquidation of the interest. While a charging creditor may try to place pressure on the member to exercise his or her own withdrawal rights in order to obtain satisfaction of the judgment, it is doubtful that a judgment creditor can force a member to exercise these rights.467

If an LLC is closely held and does not make regular distributions, the charging creditor is likely to receive very little under the charging order provisions. Unless an LLC’s written operating agreement requires distributions to be made, the LLC will make distributions only as authorized by the members.468 Members of a closely-held LLC who are able to withdraw profits from the LLC as salary or other payments are unlikely to authorize distributions to accommodate the interests of an outside creditor.

A charging creditor may be able to foreclose on the charged interest and have it sold.469 However, it is unlikely that the charging creditor will receive much at a foreclosure sale if the LLC is closely held. Any purchaser of the interest will have only the rights of an assignee.470 A prospective purchaser is likely to pay little or nothing for an interest in a closely-held LLC in which the purchaser will have no voting rights, no inspection rights, and is likely to receive no distributions from the LLC unless and until the LLC is liquidated.

In contrast, the Louisiana Partnership Law is generous to a partner’s creditors. If a creditor of a partner seizes the partner’s interest in the partnership under a writ of execution and the seized interest is not released within thirty

465. Id.
467. Cf. La. Civ. Code art. 1504 (creditor may not require a forced heir to sue for his or her portion of a succession).
469. The Louisiana LLC Law does not state that the charging order is an exclusive remedy with respect to seizure of a member’s interest in an LLC. See La. Civ. Code art. 3398 (authorizing foreclosure of mortgaged property); La. Code Civ. P. arts. 2631-2783, 3721-3743 (foreclosure procedures).
days, the debtor partner ceases to be a member of the partnership, as of the date of the seizure. 471 If the partnership interest is not released, the seizing creditor is entitled to be paid an amount equal to the value of the seized interest. 472

The charging order provisions of the Louisiana LLC Law are similar to the provisions of most other LLC statutes, 473 and are derived from the Revised Uniform Limited Partnership Act ("RULPA"). 474 The limitation on creditors' rights under the partnership charging order provision is intended to prevent a creditor who has a claim against a partner, but not against the partnership, from disrupting the partnership's business by seizing partnership property to the detriment of the other "innocent" partners. 475 Before legislatures enacted laws limiting the rights of a partner's creditor to a charging order, creditors sometimes were entitled to seize partnership assets to satisfy the non-partnership debts of individual partners. Lord Justice Lindley of the English Court of Appeals described the injustice to the non-debtor partners as follows:

When a creditor obtained a judgment against one partner and he wanted to obtain the benefit of that judgment against the share of that partner

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472. La. Civ. Code arts. 2823, 2824. The value of the interest may be set by the partnership agreement or by separate agreement, or it may be judicially determined. La. Civ. Code art. 2823 cmt. (a). See also La. Civ. Code art. 2825 (authorizing judicial determination of the value of a partner's interest and a judicial order requiring payment for a partner's interest if there is no agreement as to the amount to be paid).
474. RULPA § 703 (1985).
475. For a history of the charging order remedy, see 1 Bromberg & Ribstein, supra note 48, § 3.05(d); Elliot Axelrod, The Charging Order—Rights of a Partner's Creditor, 56 Ark. L. Rev. 81 (1982); J. Gordon Gose, The Charging Order Under the Uniform Partnership Act, 28 Wash. L. Rev. 1 (1953). For a discussion of the charging order remedy and the tax consequences to the seizing creditor and the member whose interest is seized, see Susan Kalinka, Assignment of an Interest in a Limited Liability Company and the Assignment of Income, 64 U. Cin. L. Rev. 443, 481-93, 522-29 (1996).
in the firm, the first thing was to issue a fi. fa., and the sheriff went
down to the partnership place of business, seized everything, stopped
the business, drove the solvent partners wild, and caused the execution
creditor to bring an action in Chancery in order to get an injunction to
take an account and pay over that which was due by execution order.
A more clumsy method of proceeding could hardly have grown up.476

The drafters of the English Partnership Act devised the charging order
remedy to prevent this result.477  UPA, RUPA, and ULPA have similar
charging order provisions.478  Like the charging order provisions of partnership
law, the charging order provisions of the Louisiana LLC Law serve an important
purpose in protecting the interests of the "innocent" nondebtor members of the
LLC.

The provisions of the Louisiana Partnership Law concerning the rights of a
partner's creditors are not as intrusive as the rights granted to creditors under
former common law. Under the Louisiana Partnership Law, a creditor who
seizes a partner's interest in a partnership may not seize partnership assets in
satisfaction of the debt and may not receive more than the value of the debtor
partner's interest. Nevertheless, the rights accorded to a partner's creditor under
the Louisiana Partnership Law can be disruptive. Amounts paid in liquidation
of the partner's interest may significantly reduce the amount of cash available to
fund partnership operations or to distribute cash to the nondebtor partners who
may depend on partnership distributions for their livelihood. If the partnership
does not have sufficient cash on hand to pay the creditor, it may have to borrow
from a third party to satisfy the debt, thereby exposing the general partners to
greater liability. If the partnership or the partners are unable to obtain the
necessary financing, the partnership may have to sell important business assets
to satisfy the obligation.

While the charging order provisions may be desirable because they offer
more protection to an LLC and its nondebtor members than the Louisiana
Partnership Law, they are susceptible to abuse. Indeed, some commentators have
suggested that because of the limited protection afforded to creditors under the
charging order provisions of RULPA, a limited partnership is an excellent
vehicle for protecting an individual's personal assets from the claims of
creditors.479 The most commonly suggested device is to transfer personal

477.  Partnership Act of 1890, 53-54 Victoria ch. 39, § 23, cited in 1 Bromberg & Ribstein,
supra note 48, § 3.05.
478.  UPA § 28 (1914); RUPA § 504 (1994); ULPA § 22 (1916).
Partnerships, Tr. & Est., May 1993, at 35, 41-43; Kathryn G. Henkel, How Family Limited
Perspective—Family Limited Partnerships—Valuation Discounts and Creditor Protection, Partnership
assets to a family-owned limited partnership to prevent creditors from seizing them. Because the charging order provisions of the Louisiana LLC Law mirror the charging order provisions of RULPA, it seems that the same results could be achieved by transferring personal assets to a family-owned LLC.

While this device may be effective, there are limitations on a debtor’s ability to evade the claims of creditors, especially if a transfer of personal assets to a family-owned LLC is intended to defraud creditors. For example, such a transfer may be set aside as a fraudulent transfer. Prescription, however, may bar a claim to set aside a fraudulent transfer. Under Louisiana law, a creditor must bring a revocatory action to invalidate a fraudulent transfer within one year from the time that the creditor learned of the transfer or within three years of the transfer, whichever is the shorter period of time. An action to avoid a fraudulent transfer in a bankruptcy setting must be brought within one year of the transfer.

Nevertheless, in an appropriate case, a court may find a remedy for a judgment creditor even after the statute of limitations has run. The purpose of the charging order provisions is to prevent a creditor of a member who has no claim against an LLC from disrupting the LLC’s business by seizing the LLC’s property and causing harm to the other members. Where a debtor’s personal assets have been transferred to an LLC for no business purpose, a court could allow a creditor to seize the assets, especially if the seizure will not jeopardize the rights of other members or third party creditors. Courts have explained that the charging order provisions “are not intended to protect a debtor partner against [the] claims of his judgment creditors where no legitimate interest of the partnership, or of the remaining . . . partners is to be served.”

A court could use a veil-piercing analysis to disregard the separate existence of an LLC, especially in a case where a member has used the LLC as an alter-ego to hold the member’s personal assets in an attempt to evade creditors’ claims. Veil-piercing has been used to allow a shareholder’s creditors to seize...

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480. For a discussion of several remedies to a creditor of a member who fraudulently has transferred assets to a Louisiana LLC and potential problems resulting from statutes of limitations, see Kalinka, supra note 1, at § 1.43.

481. See La. Civ. Code art. 2036 (a creditor may annul an act of a debtor that causes or increases the debtor’s insolvency); 11 U.S.C. § 548 (1994) (trustee in bankruptcy may avoid fraudulent transfers).


485. Hellman, 284 Cal. Rptr. at 833 (citing Crocker, 255 Cal. Rptr. at 796).
assets transferred by the shareholder to a corporation. At least one court has used a veil-piercing theory to allow a creditor to seize assets transferred to a partnership without first requiring the creditor to charge the member's interest. A similar analysis could apply to permit a judgment creditor of a member to seize assets that the member has transferred to an LLC for the purpose of avoiding creditors' claims.

Alternatively, a court could apply a simulation theory to hold that a member's transfer of assets to an LLC never occurred. Unlike a revocatory action or an action in bankruptcy to avoid a fraudulent transfer, a veil-piercing or a simulation action is not prescribed by the statute of limitations.

Nevertheless, there is no guarantee that a court will pierce the veil of an LLC or apply a simulation theory to allow a creditor to retrieve assets transferred by a debtor to the LLC, especially if the LLC operates bona fide business or investment operations and withdrawing the assets would compromise the legitimate interests of other members or creditors of the LLC. The charging order provisions should provide an easily obtainable remedy to a judgment creditor. Once a creditor has established that its claims against a debtor are legitimate by obtaining a court decree, the creditor should not be subject to further uncertain litigation in order to collect on the judgment merely because the debtor's only significant asset is the debtor's interest in an LLC. A debtor's interest in an LLC is something of value that should be made available to creditors without compromising the rights and interests of other members and third party creditors of the LLC.

RUPA and ULLCA have attempted to reach a compromise in balancing the interests of a member's creditors and the interests of the other members and third party creditors. The charging order provisions under RUPA and ULLCA are virtually identical. For convenience, this article will discuss the ULLCA provisions because they apply to a judgment creditor of a member of an LLC.

487. See, e.g., Grant Investments Fund v. Internal Revenue Service, 91-2 USTC ¶ 50,406 (D. Montana 1991), aff'd, 1 F.3d 1246 (9th Cir. 1993).
488. See, e.g., Oppenheim v. Loovis, 9 La. Ann. 261, 264 (1854) (partner's creditor was permitted to seize assets transferred by a partner to a partnership after the creditor had filed a collection suit against the partner because "the whole partnership [was] a sham, a flimsy device to cover the property of Oppenheim [sic] from the pursuit of his creditors"). For a discussion of the application of a simulation theory in this context, see Kalinka, supra note 1, § 1.43.
489. Courts in Louisiana have declared that veil-piercing is an extraordinary remedy, to be granted only rarely. See cases cited in Morris, supra note 444, at 282 n.37. For a discussion of the circumstances under which a court in Louisiana will pierce the corporate veil, see id. A simulation suit will not annul a transfer to an LLC if it would adversely affect the rights of third party creditors who have extended credit to the LLC believing in good faith that the LLC actually owned the assets it purported to own. La. Civ. Code art. 2028 cmt. (b).
The ULLCA charging order provisions are available not only to a judgment creditor of a member, but also to a judgment creditor of a transferee of a member's interest. While a judgment creditor of an assignee of a member's interest in a Louisiana LLC probably could garnish the rights of the assignee to distributions from the LLC, ULLCA provides greater clarity than the Louisiana LLC Law on this issue. Moreover, the rights granted to a transferee and a creditor under ULLCA are greater than an assignee's rights under the Louisiana LLC Law.

Unlike the Louisiana LLC Law, ULLCA specifically states that a court may order foreclosure of a charged interest. A purchaser at a foreclosure sale has the rights of a transferee of a member's interest. Like an assignee of a member's interest in a Louisiana LLC, a transferee of a member's interest who is not admitted as a member of the LLC under ULLCA may not participate in the management of the LLC, require access to information concerning the LLC's transactions, or inspect its records; a transferee has the right to receive current and liquidating distributions to which the transferor otherwise would be entitled. Unlike the Louisiana LLC Law, however, ULLCA requires an LLC to purchase the "distributional interest" of a member upon foreclosure of the interest. As a transferee of the member's interest, the purchaser at a foreclosure sale (who could be the member's creditor) is entitled to the distribution paid by the LLC for the member's interest.

Moreover, ULLCA also gives the transferee of a member's interest the right to seek a judicial determination that it is "equitable" to dissolve and wind up the LLC's business. In contrast, the Louisiana LLC Law provides that an action for judicial dissolution of an LLC may be brought only "by or for a member." Under ULLCA, a member or a dissociated member may apply for a judicial dissolution of an LLC if the court decrees that:

490. ULLCA § 504(a) (1995). See also RUPA § 504(a) (1994).
491. ULLCA § 504(b) (1995). See also RUPA § 504(b) (1994).
492. Id.
494. See ULLCA § 701(a) (1995) (requiring an LLC to purchase the distributional interest of a member who has dissociated from the LLC), § 601(3) (1995) (including in the events constituting the dissociation of a member a "transfer of all of a member's distributional interest, other than a transfer for security purposes or a court order charging the member's distributional interest which has not been foreclosed"). RUPA does not seem to require the same result. Under RUPA, like ULLCA, a partnership is required to purchase the interest of a dissociated partner. RUPA § 701(a) (1994). The transfer of a partner's entire interest in the partnership, however, is not an event of dissociation unless the other partners unanimously vote to expel the partner. RUPA § 601(4) (ii) (1994). Both the ULLCA and the RUPA provisions, however, are default rules and may be altered by an operating agreement or a partnership agreement. ULLCA § 103 (1995); RUPA § 103 (1994).
495. ULLCA §§ 503(e)(1), 504(b) (1995). See also RUPA §§ 503(b)(1), 504(b) (1994).
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(i) the economic purpose of the company is likely to be unreasonably frustrated;
(ii) another member has engaged in conduct relating to the company’s business that makes it not reasonably practicable to carry on the company’s business with that member;
(iii) it is not otherwise reasonably practicable to carry on the company’s business in conformity with the articles of organization and the operating agreement;
(iv) the company failed to purchase the petitioner’s distributional interest as required [under ULLCA on the member’s dissociation];
(v) the managers or members in control of the company have acted, are acting, or will act in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the petitioner.”

The official comments to ULLCA explain that proof of the existence of one or more of the enumerated circumstances may be the basis of a transferee’s application for judicial dissolution of an LLC. Presumably, a purchaser of a member’s interest at a foreclosure sale could petition a court to dissolve the LLC under the fifth enumerated factor where the managers or members of the LLC have acted in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the purchaser, perhaps by refusing to authorize distributions or to purchase the interest. This result is not certain, however. Under ULLCA, the only person entitled to a buy-out of an interest is a member. While the official comments indicate that a buy-out right also is extended to the successor in interest of a deceased member, nothing in the statute requires this result. Even if a successor in interest has a buy-out right under ULLCA, nothing in the statute or in the official comments extends the right to any other transferee, such as a person who purchases a member’s interest at a foreclosure sale.

Moreover, a judgment creditor may be frustrated under ULLCA if the LLC is a term LLC. ULLCA provides that a dissociated member of a term LLC must wait until the expiration of the LLC’s term before receiving payment for the member’s interest. Thus, a charging creditor, as a transferee of the member’s interest, must wait until the member’s right to receive a liquidating distribution ripens. Alternatively, the members may frustrate would-be creditors by providing in an operating agreement that a member may receive no payment in liquidation of his or her interest in the LLC until a specified date in the future or until the LLC dissolves. Under ULLCA, a member’s buy-out rights also may be eliminated by an operating agreement. In such a case, some remedy should be available to

500. ULLCA § 701(a) (1995).
503. ULLCA § 103(a) (1995).
A judgment creditor of a member. The intermediate remedies suggested earlier in this article\textsuperscript{504} may be appropriate in an abusive case.

Where an LLC is to pay for the interest of a member that has been sold at a foreclosure sale, it may be necessary for the person who purchased the interest at foreclosure to have access to sufficient information to determine whether the price tendered by the LLC is correct. The ULLCA provision concerning the rights of a transferee of a member’s interest denies a transferee the inspection rights of a member. Nevertheless, a transferee should be entitled to obtain enough information to protect his or her rights. While it is not certain, ULLCA may permit this result. ULLCA recites: “Unless displaced by particular provisions of this [Act], the principles of law and equity supplement this [ Act].”\textsuperscript{505} A court could find it equitable to allow a transferee access to sufficient information to assert the transferee’s claims against the LLC, at least through discovery.

ULLCA could be improved, however, if it provided more certainty with respect to the rights of creditors and foreclosure sale purchasers to obtain information. Nevertheless, ULLCA seems to offer a better solution than the Louisiana LLC Law with respect to accommodating the competing policies of allowing a creditor to assert legitimate claims against a debtor who is a member of an LLC and preventing a creditor’s claims from disrupting the LLC’s business to the detriment of innocent, nondebtor members.

Recognizing that a dissolution of an LLC is an extreme remedy, that foreclosure is a cumbersome process, and that a buy-out of the interest may impose hardship on an LLC, ULLCA also permits a member’s interest that has been charged to be redeemed at any time before foreclosure: (1) by the judgment debtor; (2) with property other than the LLC’s property, by one or more of the other members; or (3) with the company’s property, but only if permitted by the operating agreement.\textsuperscript{506}

As explained earlier, the Louisiana LLC Law provides that on the death, interdiction, dissolution, or termination of a member, the member’s membership in the LLC ceases and the member’s legal representative or (in the case of a dissolved or terminated member) the member’s successor is treated as an assignee of the member’s interest.\textsuperscript{507} The limitation on the rights of an assignee under the Louisiana LLC Law may leave a member’s successor trapped in the LLC, at the mercy of the remaining members. Like a charging creditor who forecloses on a member’s interest in an LLC, the legal representative or successor of a member whose interest has terminated should be entitled to receive a payment from the LLC in liquidation of the member’s interest and to receive sufficient information to enforce that right.

\textsuperscript{504} See supra notes 394-395 and accompanying text.
\textsuperscript{505} ULLCA § 104(a) (1995). See also RUPA § 104(a) (1994).
\textsuperscript{506} ULLCA § 504(c) (1995). See also RUPA § 504(c) (1994).
\textsuperscript{507} La. R.S. 12:1333 (1994).
In the case of a term LLC, special considerations might require a creditor or a successor to wait until the expiration of the LLC’s term to receive payment for the interest. In that case, a court should be able to apply intermediate remedies to protect the interests of the creditor or successor. While a buy-out right should not be automatic with respect to an interest in a term LLC, the purchase of a member’s interest should be available as a remedy in an abusive case.

V. SHOULD LOUISIANA ADOPT ULLCA?

If significant amendments are to be made to the Louisiana LLC Law, it is worthwhile to consider whether Louisiana should adopt ULLCA. ULLCA is a flexible statute that allows the parties to provide most of the rules governing the operation of an LLC and its affairs in an LLC’s articles of organization or an operating agreement. At the same time, ULLCA provides default rules intended to meet the needs of small, informal businesses.

Nevertheless, some ULLCA provisions are problematic. This article concludes that the Louisiana Legislature should use ULLCA as a model, adopting the provisions in ULLCA that best meet the needs of Louisiana LLCs.

A. Reasons to Adopt ULLCA

Many of ULLCA’s default rules provide solutions to some of the problems that may arise under the Louisiana LLC Law. For example, ULLCA authorizes

508. Only certain provisions may not be altered under ULLCA. An LLC’s articles of organization or an operating agreement may not: (1) unreasonably restrict a member’s right to information or access to records; (2) eliminate a member or manager’s duty of loyalty; (3) unreasonably reduce a member or manager’s duty of care; (4) eliminate the obligation of good faith and fair dealing; (5) vary the right to expel a member for wrongful conduct, for breach of the operating agreement or breach of a fiduciary duty, or for engaging in conduct relating to the LLC’s business that makes it not reasonably practicable to carry on the business with the member; (6) vary the requirement to wind up the LLC’s business upon the occurrence of an event that makes it unlawful for all or substantially all of the LLC’s business to be continued unless the illegality is cured within ninety days after notice to the LLC of the event; or (7) restrict the rights of a person other than a manager, member, or transferee of a member’s interest. ULLCA §§ 103(b), 203(c) (1995). For a general description of ULLCA, see Carter G. Bishop, The Uniform Limited Liability Company Act: Summary & Analysis, 51 Bus. Law. 51 (1995). See also Harry J. Haynsworth, At-Will and Term LLCs Are Treated Differently Under the Uniform Act, 2 J. Limited Liability Companies 12 (1995); James W. Reynolds & Steven G. Frost, Uniform Act Articles of Organization’s Default Rules Discussed, 1 J. Limited Liability Companies 43 (1994); James W. Reynolds & Steven G. Frost, Uniform Act Summary of the Uniform Act’s Provisions, 1 J. Limited Liability Companies 91 (1994); James W. Reynolds & Steven G. Frost, Uniform Act ULLCA Approved, but Revisions Continue, 1 J. Limited Liability Companies 184 (1995) [hereinafter Revisions]; James W. Reynolds & Steven G Frost, Uniform Act ULLCA and Tax Classification, 2 J. Limited Liability Companies 87 (1995); James W. Reynolds & Steven G. Frost, Uniform Act Rights to Obtain Judicial Dissolution, 2 J. Limited Liability Companies 179 (1996) [hereinafter Judicial Dissolution].

the formation of single-member LLCs. In 1996, ULLCA was amended to eliminate the requirement that an LLC dissolve on the dissociation of a member unless other members consent to continue the LLC. ULLCA also requires the interest of a member whose membership in an LLC has terminated to be purchased and requires the unanimous consent of the members for extraordinary matters, both of which may reduce the potential for oppression of minority members. Under ULLCA, an LLC must furnish sufficient information to a dissociated member and to a member's legal representative to allow the member or the legal representative to exercise his or her rights to distributions from the LLC.

ULLCA provides more clarity than the Louisiana LLC Law with respect to the rights and duties of members of a term LLC. Under ULLCA, an LLC's articles of organization must state whether the LLC is to be a term LLC and, if so, the term must be specified. In contrast, the Louisiana LLC Law makes this provision optional. By requiring an LLC's articles of organization to include this information, ULLCA may be more likely to preclude uncertainty as to whether an LLC is entered into for a term and the length of its term. If an LLC's articles of organization state that the LLC is a term LLC, a member will be apprised that his or her ability to withdraw from the LLC and receive a distribution in liquidation of the member's interest before the expiration of the LLC's term is limited. Third persons who deal with the LLC also will know that the LLC is to dissolve on a specified date.

It is possible under ULLCA for an LLC to have the characteristics of a term LLC even if the parties have not included a statement in the articles of organization designating the LLC as a term LLC. For example, an LLC's oral or written operating agreement may provide that members may not withdraw their capital for a minimum stated period of time or until a particular undertaking is completed. In that case, at least with respect to the ability of a member to withdraw and receive a distribution in liquidation of the member's interest, the LLC essentially is a term LLC. Nevertheless, by requiring an LLC's articles of organization to include information concerning a term LLC, ULLCA makes it more likely than the Louisiana LLC Law that the parties will have notice that they have become members of a term LLC. When it is important to retain

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511. ULLCA § 801 (amended 1996).
512. ULLCA §§ 603(a), 701 (1995).
513. ULLCA § 404(c) (1995).
514. ULLCA § 408(b) (1995).
517. Haynsworth, supra note 508, at 15-16.
518. Id.
519. Under ULLCA, whenever there is a conflict between an LLC's articles of organization and the operating agreement, the operating agreement controls as to members and managers. ULLCA § 203(c)(1) (1995).
members’ capital for a specified period of time or for a particular undertaking, either the articles of organization or a written operating agreement of an LLC formed under ULLCA usually will indicate that the LLC is entered into for a term. If an LLC’s articles do not designate that the LLC is entered into for a specific term, any person attempting to enforce an oral agreement requiring a member to leave his or her capital in the LLC will have the burden of proving that such an agreement existed.

ULLCA also provides rules with respect to the continuation of an LLC beyond its stated term. Unlike the Louisiana LLC Law, ULLCA specifically provides that members may tacitly continue an LLC beyond the expiration of its term.520 In that case, the LLC becomes an at-will LLC, and the rights and duties of the members and managers remain the same, except to the extent that such rights and duties are inconsistent with the rights and duties of members and managers of an at-will LLC.521 Thus, if members tacitly continue an LLC beyond the expiration of its term, they will continue to enjoy limited liability with respect to the debts and obligations of the LLC. The ability to tacitly continue a term LLC also ensures that existing contracts that, by their terms, do not expire on or before the date on which the term LLC was to dissolve will not be compromised. On the other hand, ULLCA permits a member of a term LLC that has been continued without amendment to the LLC’s articles of organization to withdraw and receive payment for his or her interest in the LLC at any time after the expiration of the LLC’s term unless the operating agreement provides otherwise.522

Unlike the Louisiana LLC Law,523 ULLCA permits members to dissociate from a term LLC at any time and for any reason.524 ULLCA, however, makes it difficult for a member to dissociate from a term LLC prematurely. In many cases, dissociation before the expiration of an LLC’s term will be wrongful,525 reducing the amount that the member may receive in liquidation of his or her interest in the LLC by the amount of damages caused by the wrongful dissociation.526 ULLCA also requires a member who dissociates prematurely to leave his or her capital in the LLC until the LLC’s term has expired; a member who dissociates before the expiration of an LLC’s term must wait until the end of the term to receive any payment for the member’s interest.527

521. Id.
523. See La. R.S. 12:1325(A) (1994) (member of a Louisiana LLC that has been entered into for a term may withdraw before the expiration of the LLC’s term only if the other members consent or the member seeking to withdraw has just cause arising out of the failure of another member to perform an obligation).
524. ULLCA § 602(a) (1995).
527. ULLCA § 701(a)(2) (1995). If a member withdraws prematurely from a term LLC formed under ULLCA, the fair value of the interest, which is the starting point for computing the amount
Nevertheless, it may be important for a member of a term LLC to be permitted to withdraw prematurely to avoid a tax liability on an LLC's profits if the LLC is making no distributions. As explained earlier, each member of an LLC that is classified as a partnership is taxable on his or her distributive share of the LLC's taxable income, regardless of whether any of that income is distributed.528

Other reasons for the Louisiana Legislature to adopt ULLCA include the advantages that may be achieved by uniformity.529 While only a few states currently have adopted ULLCA,530 the promulgation of the check-the-box regulations may encourage more states to consider ULLCA. As more states adopt ULLCA, the case for uniformity will become even stronger.

Uniform laws provide an obvious advantage to practitioners who form LLCs that will engage in multi-state operations. While the concern that a state might not respect the limited liability of members and managers of an LLC operating outside its state of organization no longer is an issue,531 there may be some

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530. Hawaii, Illinois, Kansas, South Carolina, and West Virginia have adopted ULLCA.
531. Now that all states have adopted LLC acts, there will be no question that an LLC is an exotic form of business organization that should be treated as a partnership in a state that does not recognize LLCs. See, e.g., Means v. Limpia Royalties, 115 S.W.2d 468 (Tex. Civ. App. 1938) (holding that members of an Oklahoma business trust could be held personally liable for obligations of the trust incurred in Texas, notwithstanding Oklahoma law to the contrary). Before all of the
question as to which state’s law will apply to transactions between an LLC and residents of a state other than the LLC’s state of organization. Most LLC statutes provide that the law of jurisdiction in which an LLC is formed governs the organization, internal affairs, and member liability of a foreign LLC, but do not designate the state law that will govern with respect to other matters. While choice-of-law issues can be resolved by contract clauses, not all parties will anticipate potential conflicts-of-law problems. If uniform law is adopted, many of these issues will not exist.

The adoption of ULLCA also will abate the problem of choosing the proper state of organization where an LLC’s members are residents of different states. Non-uniformity in many cases will require members residing outside an LLC’s state of organization to retain local counsel to review or renegotiate the operating agreement at substantial additional cost.

If Louisiana adopts ULLCA, practitioners will have access to more interpretative material. Not only does ULLCA contain the drafters’ comments, but it is likely that ULLCA will receive substantial attention in treatises, law review articles, and other legal literature. As more states adopt ULLCA, there will also be a greater supply of judicial interpretation of the statute.

Currently, there is very little literature or case law interpreting the Louisiana LLC Law. Unites States and the District of Columbia had adopted LLC statutes, there was concern that the limited liability of members and managers of an LLC would not be respected in a state that did not recognize LLCs. For a discussion of the issue of whether a state that had no LLC legislation would permit members of a foreign LLC to enjoy limited liability with respect to transactions occurring in that state, see J. William Callison, Limited Liability Companies § 11 (1993); Ribstein & Keatinge, supra note 83, §§ 13.01-13.08; Wayne M. Gazur & Neil M. Goff, Assessing the Limited Liability Company, 41 Case Western L. Rev. 387, 430-37 (1991); Robert R. Keatinge et al., The Limited Liability Company: A Study of the Emerging Entity, 47 Bus. Law. 375, 449-56 (1992).


See statutes cited in Ribstein & Keatinge, supra note 83, § 13.03, n.6.

Reynolds & Frost, Revisions, supra note 508, at 185.

Id.


Some commentators have argued that ULLCA should not be adopted because uniform laws inhibit innovation in and experimentation with the LLC form of business by the states.\textsuperscript{538} It is questionable, however, whether innovation and experimentation are necessary in this area of the law. States have had plenty of time to experiment with laws governing other forms of business organization, such as partnerships and corporations, from which most LLC statutes are derived. The benefits of uniformity probably outweigh the costs to practitioners and their clients trying to understand the law governing the LLCs formed in their own state as well as the laws of other states.

B. Problems Under ULLCA

ULLCA may not be suitable for Louisiana, however. The Louisiana LLC Law is derived, in large part, from the Louisiana Business Corporation Law and the Louisiana Partnership Law.\textsuperscript{539} Practitioners in Louisiana are familiar with these laws, and there is a large body of case law and other materials interpreting them. ULLCA, on the other hand, is based largely on RUPA, a statute for which there currently is little interpretative law, and one that Louisiana is unlikely to adopt.

The most important reason to reject ULLCA, however, is that ULLCA is not necessarily the best statute for LLCs.\textsuperscript{540} While a statute-by-statute critique of ULLCA is beyond the scope of this article,\textsuperscript{541} there are some serious flaws in ULLCA that should be considered. This article has already discussed the problems that may arise under ULLCA’s requirement that the price to be paid for a dissociated member’s interest is the “fair value” of the interest\textsuperscript{542} and the problems with respect to the rights of transferees under ULLCA.\textsuperscript{543}

Problems also may arise under ULLCA’s provisions concerning the agency powers of members and managers. ULLCA provides that each member of a member-managed LLC and each manager of a manager-managed LLC is an agent of the LLC, and any act of a member or manager, depending on the LLC’s management structure, for apparently carrying on the ordinary course of the

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Advanced Orthopedics, L.L.C. v. Moon, 656 So. 2d 1103 (La. App. 5th Cir. 1995).


539. For a comparison of the Louisiana LLC Law and the Louisiana Business Corporation and Partnership Laws, see Kalinka, supra note 1, §§ 1.1-1.77.


541. For a statute-by-statute criticism of ULLCA, see Ribstein, supra note 538. See supra notes 531-532 and accompanying text.

542. See supra notes 370-372 and accompanying text.

543. See supra notes 499-505 and accompanying text.
LLC's business or business of the kind carried on by the LLC binds the LLC, unless the member or manager had no authority to act for the company in the particular matter and the person with whom the member was dealing knew or had notice that the member or manager lacked authority.\textsuperscript{544} If an LLC formed under ULLCA is managed by managers, members have no apparent authority in their capacity as members.\textsuperscript{545} Under ULLCA, any member of a member-managed LLC or manager of a manager-managed LLC may sign and deliver any instrument transferring or affecting the LLC's interest in real property unless the articles of organization provide otherwise.\textsuperscript{546}

ULLCA provides more certainty than the Louisiana LLC Law with respect to the agency powers of members and managers of an LLC because any provision concerning agency authority must be included in the LLC's articles of organization, which are a matter of public record.\textsuperscript{547} The official comments to ULLCA explain that "[o]rdinarily, restrictions on authority in an operating agreement do not affect the apparent authority of members and managers to bind the company to third parties without notice of the restriction."\textsuperscript{548}

ULLCA is surprising, however, in that it gives members and managers apparent authority to engage in real estate transactions unless the LLC's articles of organization limit their authority. Under the usual rule of partnership law, with which most practitioners are familiar, partners do not have apparent authority to bind the firm to extraordinary transactions, including most transactions involving real estate.\textsuperscript{549} It is likely that members of small, informal LLCs, for whom ULLCA is intended, will be unaware of the need to include a provision in an LLC's articles of organization restricting the authority of members to engage in transactions with respect to the LLC's real estate. In this respect, ULLCA might create a trap for unwary members of informal LLCs who did not receive expert legal advice about the requirement.\textsuperscript{550}

ULLCA's provisions with respect to the liability of members also may be problematic. Unlike the Louisiana LLC Law, ULLCA permits members of an

\textsuperscript{544} ULLCA § 301(a)(1), (b)(1) (1995).
\textsuperscript{545} ULLCA § 301(b)(1) (1995).
\textsuperscript{546} ULLCA § 301(c) (1995).
\textsuperscript{547} Under ULLCA, an LLC's articles of organization must state whether the LLC is to be managed by managers. ULLCA § 203(a)(6) (1995). Thus, it will be clear to third parties whether members of the LLC have agency authority.
\textsuperscript{548} ULLCA § 301 cmt. (1995).
\textsuperscript{549} See, e.g., La. Civ. Code art. 2814 (each partner is a mandatary of the partnership for all matters in the ordinary course of the partnership's business other than the alienation, lease or encumbrance of its immovables); UPA § 10(1) (1914) (sale by a partner of partnership real property binds the partnership only if the sale is in the ordinary course of the partnership's business); RUPA §§ 301-303 (1994) (transfer of partnership property in the ordinary course of the partnership's business is binding on the partnership unless the partnership files a statement of partnership authority restricting one or more partners' authority to transfer partnership real property in the office for recording transfers of that real property).
\textsuperscript{550} Ribstein & Kobayashi, supra note 540, at 973. See also Ribstein, supra note 538, at 347.
LLC to assume personal liability for all or specified debts of the LLC’s debts if the articles of organization so provide and the member or members assuming such liability consent in writing. As explained earlier, now that the check-the-box election is available, the ability of members to assume personal liability for an LLC’s obligations no longer is important for tax classification purposes. Currently, there is little reason for a member of an LLC to blindly commit himself or herself to personal liability for all of an LLC’s debts and obligations. The ULLCA provision is particularly troubling, however, because it may have the unintended result of calling into question a member’s liability with respect to an LLC’s guaranteed debt if there is no provision in the LLC’s articles of organization authorizing the member’s assumption of the liability. Unwary members and outside creditors may find that member guarantees are invalid under this provision.

Commentators have also found fault with ULLCA’s provisions authorizing judicial dissolution of an LLC. Under ULLCA, three different types of persons may obtain a judicial decree of an LLC: a member, a dissociated member, and a transferee of a member’s interest. The grounds for dissolution differ, depending on the status of the person filing the suit. The following discussion concerns first, the rights of a member and a dissociated member to obtain judicial dissolution of an LLC, and then, the rights of a transferee of a member’s interest.

ULLCA provides five separate grounds upon which a member or a dissociated member may obtain a judicial dissolution of an LLC:

(i) the economic purpose of the company is likely to be unreasonably frustrated;
(ii) another member has engaged in conduct relating to the company’s business that makes it not reasonably practicable to carry on the company’s business with that member;
(iii) it is not otherwise reasonably practicable to carry on the company’s business in conformity with the articles of organization and the operating agreement;
(iv) the company failed to purchase the petitioner’s distributional interest as required by [ULLCA] Section 701; or
(v) the managers or members in control of the company have acted, are acting, or will act in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the petitioner.

551. ULLCA § 303(c) (1995).
552. Ribstein & Kobayashi, supra note 540, at 973. See also Ribstein, supra note 538, at 348-49.
553. See, e.g., Reynolds & Frost, Judicial Dissolution, supra note 508; Ribstein, supra note 538, at 375-77.
The second and third grounds for judicial dissolution of an LLC are not controversial. The first has been criticized because the statutory language is poorly drafted.\textsuperscript{555} The authorization of judicial dissolution of an LLC on the grounds that its "economic purpose" is likely to be frustrated implies that an LLC must have an economic purpose, contrary to section 112(a) of ULLCA under which an LLC may be formed for any lawful purpose.\textsuperscript{556} The words "unreasonably frustrated" are also confusing because they imply that judicial dissolution is appropriate if some person's unreasonable acts or omissions prevent the accomplishment of the LLC's purpose.\textsuperscript{557} If that is the intent of the statute, then the provision is redundant in light of the second and third grounds for judicial dissolution.\textsuperscript{558} If the statute is intended to mean that judicial dissolution is appropriate if the purposes of the LLC cannot reasonably be accomplished, the statute should say so.\textsuperscript{559}

The official comments to ULLCA explain that the first ground for judicial dissolution gives a court discretion to dissolve an LLC if the LLC has a very poor financial record that is not likely to improve, in which case, dissolution is an alternative to placing the LLC in bankruptcy.\textsuperscript{560} The statutory language, however, is not so limited. If the drafters intended this provision to cover only situations where the LLC is operating at a financial loss, they probably should have adopted language similar to UPA, which provides for judicial dissolution of a partnership if "[t]he business of the partnership can only be carried on at a loss."\textsuperscript{561}

The fourth enumerated ground for judicial dissolution, that the LLC has failed to purchase a dissociated member's interest as required by Section 701, may be too drastic. Some critics have suggested that, where an LLC has failed to purchase the interest of a dissociated member, the member should have no greater rights than any other creditor.\textsuperscript{562} On the other hand, authorizing judicial dissolution in such a case may provide additional incentive for an LLC to comply with the buy-out requirement. If the remedy is desirable as a matter of policy, the availability of the remedy should not be restricted to dissociated members.\textsuperscript{563} Often the cause of a member's dissociation will be death, in which case, the member's estate or successor in interest should be able to assert the buy-out right in the same way that a dissociated member may assert the right.\textsuperscript{564} The official comments to ULLCA indicate that a deceased member's

\textsuperscript{555} Reynolds & Frost, Judicial Dissolution, supra note 508, at 180; Ribstein, supra note 538, at 375-76.
\textsuperscript{556} Reynolds & Frost, Judicial Dissolution, supra note 508, at 180.
\textsuperscript{557} Id.
\textsuperscript{558} Id.
\textsuperscript{559} Id.
\textsuperscript{560} ULLCA § 801 cmt. (1995).
\textsuperscript{562} Reynolds & Frost, Judicial Dissolution, supra note 508, at 180.
\textsuperscript{563} Id.
\textsuperscript{564} Id. at 181.
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spouse or estate will be able to assert the buy-out right by applying for judicial dissolution of an LLC, but the statutory language does not support this conclusion. Moreover, if judicial dissolution is to be a remedy for failure to purchase a dissociated member's interest, the statute should specifically state whether the remedy is available to transferees of a dissociated member's interest, including an estate, a surviving spouse, an heir, a charging creditor, a purchaser at a foreclosure sale, and other voluntary and involuntary transferees.

The most controversial ground on which a member may obtain judicial dissolution of an LLC is when the "managers or members in control of the [LLC] have acted, are acting, or will act in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the petitioner." Critics argue this provision gives too much discretion to a court to rewrite an operating agreement to give members exit rights when such rights are not permissible under the agreement and encourages litigation. Some contend that the provision is not necessary because of ULLCA's default rules giving members the right to withdraw and have their interests purchased at fair value.

It may be important, however, to authorize judicial dissolution to protect minority members when the managers or controlling members engage in oppressive conduct. Under ULLCA, the buy-out rights of a member may be eliminated by an operating agreement. The ability of a member to obtain judicial dissolution, however, is nonwaivable. When a minority member lacked bargaining power or did not understand the implications of his or her waiver of ULLCA's buy-out rights, the ability to obtain judicial dissolution may be the only remedy available to a minority member who suffers oppression at the hands of the majority. While ULLCA authorizes suits by members against other members for breach of fiduciary duties, which include a nonwaivable duty of good faith and fair dealing, majority members have no fiduciary duties to the LLC or the other members under ULLCA if an LLC is manager-managed. Thus, a minority member of a manager-managed LLC may have a difficult time enforcing his or her rights without the judicial dissolution remedy. If an LLC is entered into for a term, judicial remedies may be even

566. Id.
568. Ribstein, supra note 538, at 376.
569. Ribstein & Kobayashi, supra note 540, at 966-68.
570. Ribstein, supra note 538, at 376.
573. See Dennis S. Karjala, Planning Problems in the Limited Liability Company, 73 Wash. U. L. Q. 455, 466-74 (1995) (judicial oppression remedies are necessary in LLC statutes affording buyout rights because the parties may draft around the default rules without adequately planning for oppression scenarios).
more important because any buy-out right is not available until after the LLC’s term has expired. In fact, a nonwaivable statutory dissolution remedy may serve as a deterrent to prevent majority members from engaging in oppressive conduct in the first place.

The provision is problematic, however, in that it offers no alternative to judicial dissolution in an oppression suit. As explained earlier, dissolution is an extreme remedy that may not be optimal for any of the members, including the minority member claiming oppression. It would be better if the statute permitted intermediate remedies. The ULLCA provision authorizing judicial dissolution for oppression is similar to section 14.30 of the Model Business Corporation Act (“MBCA”). Some commentators have suggested that ULLCA should temper its judicial dissolution remedy, as does section 14.34 of MBCA, by permitting the firm to buy a member’s interest in lieu of incurring litigation costs when suit is brought to dissolve the LLC for oppression. As explained earlier, the buy-out of a member’s interest also may be a drastic remedy, especially if an LLC is entered into for a term. The intermediate remedies suggested earlier in this article also should be considered.

Under ULLCA, a transferee of a member’s interest may seek judicial dissolution of an LLC if “it is equitable to wind up the company’s business.” This language seems to give judges even broader discretion to decree dissolution when a transferee petitions the court than when a member seeks dissolution. Critics contend that this provision gives unwarranted power to a broad class of transferees, including a bankruptcy trustee, a charging creditor, and a person who purchases a member’s interest. Giving such persons the power to dissolve an LLC because it is “equitable” may encourage unnecessary litigation and may undermine the stability of an LLC’s business because the language is so vague.

Two of ULLCA’s provisions, however, limit the impact of the judicial dissolution remedy afforded to transferees. First, a transferee may obtain judicial dissolution of a term LLC only after the LLC’s term has expired. Second, the parties can eliminate a transferee’s right to judicial dissolution by so providing in an operating agreement.

576. See supra notes 395-396 and accompanying text.
577. See supra notes 391-392 and accompanying text.
579. Reynolds & Frost, Judicial Dissolution, supra note 508, at 182.
580. See supra notes 391-392 and accompanying text.
581. See supra note 395 and accompanying text.
583. Reynolds & Frost, Judicial Dissolution, supra note 508, at 181.
584. Id.
586. See ULLCA § 103(b)(7) (1995) (by negative implication, an operating agreement may restrict the rights of a transferee of a member’s interest). It is not certain, however, whether ULLCA permits an operating agreement to eliminate a transferee’s right to judicial dissolution after the
Permitting a transferee to obtain judicial dissolution may be important, however, especially for the estate or successor in interest of a member of a term LLC who may become trapped in the firm, at the mercy of the other members. Even a member’s creditor, in some cases, should have a remedy that is more effective than the charging order. Nevertheless, a remedy should be available to a transferee that does not cause undue harm to the nontransferring members. Dissolution of an LLC at the behest of a member’s transferee, such as an outside creditor, is an extreme remedy. In some cases, even requiring an LLC to purchase a charged interest may be too harsh. While such remedies may be appropriate in some cases, in other cases an intermediate remedy may be more suitable. If ULLCA were to authorize intermediate remedies in addition to judicial dissolution, the statute might better protect the rights of transferees without jeopardizing the interests of the nontransferring members.

C. Fiduciary Duties

The provisions of ULLCA that have generated the greatest controversy are the provisions concerning the fiduciary duties of members and managers. ULLCA prescribes only two types of fiduciary duties, a duty of loyalty and a duty of care. These duties may be expanded or reasonably restricted by a provision in an operating agreement, but they may not be eliminated.

The duty of loyalty generally requires a member or manager: (1) to account for any profit or benefit derived from the use of the LLC’s property, the conduct of its business, or the winding up of the LLC’s business; (2) to refrain from acting adversely to the interests of the LLC; and (3) to refrain from competing with the LLC. The duty of care requires a member or manager to refrain from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law in the conduct of and winding up of the LLC’s business. All duties are to be discharged and rights are to be exercised consistently with the obligation of good faith and fair dealing.

transferee has acquired the interest but before the transferee has commenced a dissolution action. 
Frost & Reynolds, Judicial Dissolution, supra note 508, at 182.
587. Ribstein, supra note 538, at 375.
591. ULLCA § 409(b), (b)(2) (1995).
592. ULLCA § 409(c), (b)(2) (1995).
593. ULLCA § 409(d) (1995).
The fiduciary duties required under ULLCA apply to members of member-managed LLCs,594 and to managers of manager-managed LLCs.595 A member of a manager-managed LLC has no fiduciary duties unless (1) the member also is a manager or (2) the member, pursuant to the operating agreement, exercises some or all of the rights of a manager in the management of the LLC’s business.596 To the extent that an operating agreement delegates managerial authority to the members, a manager is relieved of liability for violation of fiduciary duties.597

The provisions concerning manager-managed LLCs have been criticized because they do not provide sufficient clarity.598 For example, ULLCA does not clearly distinguish the term “member” from the term “manager” in this context.599 ULLCA defines the term “manager” as one who is “vested with authority under Section 301.”600 The statute is circular, however, because section 301 simply vests authority in one who is a “manager” of a manager-managed LLC.601

ULLCA also fails to describe the circumstances under which a member of a manager-managed LLC exercises some or all of the rights of a manager or is delegated managerial authority under the operating agreement.602 For example, it is not certain under ULLCA whether a member would be exercising the rights of a manager if he or she acts on behalf of the LLC and an operating agreement does not prohibit the conduct.603 It also is not clear under ULLCA whether managers of a manager-managed LLC are relieved of liability for their acts when the authority to act with respect to the matter in question is delegated to members.604 If ULLCA is intended to impose fiduciary duties on members who are not managers of a manager-managed LLC but nevertheless exercise control of the LLC, the statutory language should be clearer.

The fiduciary duties of loyalty and care and the good faith requirement under ULLCA are derived from RUPA.605 The RUPA provisions concerning the fiduciary duties of partners have also been the subject of much controversy.606 The RUPA provisions are intended to replace the common law fiduciary

594. ULLCA § 409(b) (1995).
598. Ribstein, supra note 538, at 358-61.
599. Ribstein, supra note 538, at 360-61.
601. Ribstein, supra note 538, at 361.
602. Id.
603. Id.
604. Id.
duties of partners with the duties required of corporate directors and officers. 607 “Contractarians” are concerned that the fiduciary duty provisions interfere with the parties’ freedom to contract and therefore, preclude efficient contracts that otherwise might be negotiated. 608 “Anti-contractarians,” on the other hand, are concerned that the provisions have abrogated necessary protection afforded to partners under the common law, 609 and remove protection from unsophisticated, inexperienced partners who may bargain away fiduciary duties without realizing the implications of their bargain. While partners and members of LLCs have exit rights that arguably reduce the need for judicial protection from opportunistic behavior, these rights may be waived by members who lack foresight or bargaining power and are nonexistent if a partnership or LLC is entered into for a term. 610 Both the contractarians and the anti-contractarians agree that RUPA

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607 RUPA § 404 cmt. 1 (1994).
609 Vestal, supra note 606, at 546-476. RUPA derived its standards regarding fiduciary duties from corporate law. RUPA § 404 cmt. 1 (1994). There is some disagreement whether partners are held to a higher standard of fiduciary duty under the common law than are corporate directors and officers. The language used in case law recites that partners owe a high level of fiduciary duty to each other. See, e.g., Meinhard v. Salmon, 164 N.E. 545, 546 (1928) (defining partners’ duty to one another as “[n]ot honesty alone, but the punctilio of an honor most sensitive”). Some commentators, however, have argued that existing case law already supports application of the business judgment rule, which relaxes the fiduciary duties of corporate directors and officers, to partnerships. See, e.g., UPA Revision Subcommittee on Partnerships and Unincorporated Business Organizations, Should the Uniform Partnership Act be Revised?, 43 Bus. Law. 121, 151 (1987). Professor Dickerson disagrees, arguing that the cases relied on by the UPA Revision Committee all involve limited partnerships, whose management structure arguably is closer to corporations than general partnerships. Dickerson, supra note 606, at 120 n.44. Professor Dickerson, however, admits that some cases apply the business judgment rule in describing fiduciary duties of partners in general partnerships. Id. at n.45. On the other hand, some courts have held that shareholders in a closely-held corporation owe each other the same high degree of fiduciary duty that partners owe to one another. See, e.g., Donahue v. Rodd Electrotype Co. of New England, 328 N.E.2d 505, 515-16 (Mass. 1975).

RUPA requires partners to disclose information. RUPA § 403(c) (1994). The requirement, however, is not a fiduciary duty; the only fiduciary duties of a partner under RUPA are the duties of loyalty and of care. RUPA § 404(a) (1994). In contrast, the duty to disclose information under ULLCA is imposed on the LLC, and not on the members. See ULLCA § 408 (1995) (Members’ Rights to Information). While it might seem that a member of an LLC formed under ULLCA may engage in self-dealing without disclosing to the other members his or her interest in a transaction between the member and the LLC, ULLCA precludes this result by imposing on a member the duty of loyalty to refrain from dealing with the LLC as an adversary party and to refrain from competing with the company, a duty that may be waived only if the operating agreement either identifies the specific types or categories of activities that do not violate the duty of loyalty or specifies the number or percentage of members that may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty. ULLCA §§ 103(b)(2), 409(b)(2), (3) (1995).

610 Like ULLCA, RUPA provides that a member dissociation from a term partnership prior to the expiration of its term is wrongful. RUPA § 602 (1994). For a discussion of the problems that may be faced by a minority member of a term LLC, see supra notes 382-383 and accompanying text.
is wrong in derogating from the flexibility accorded to courts under the common law.\footnote{Ribstein, supra note 606; Vestal, supra note 606.}

The controversy focuses primarily on the provisions of RUPA, which are identical to the provisions of ULLCA, permitting partners or members of LLCs to limit fiduciary duties by contract. Both RUPA and ULLCA provide that a partnership or operating agreement may not eliminate the fiduciary duty of loyalty, but the agreement (1) may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; and (2) may specify the number or percentage of members or disinterested members that may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty.\footnote{RUPA § 103(b)(3) (1994); ULLCA § 103(b)(2) (1995).}

Under both RUPA and ULLCA, a partnership or operating agreement may not unreasonably reduce the fiduciary duty of care.\footnote{RUPA § 103(b)(4) (1994); ULLCA § 103(b)(3) (1995).} While the obligation of good faith and fair dealing is not listed as a fiduciary duty under RUPA or ULLCA, it is inherent in the fiduciary duties of a partner, member or manager. Under both RUPA and ULLCA, the fiduciary duties of partners, members, and managers must be discharged “consistently with the obligation of good faith and fair dealing.”\footnote{RUPA § 404(d) (1994); ULLCA § 409(d) (1995).} The obligation of good faith and fair dealing may not be eliminated by a partnership or operating agreement, but the agreement may determine the standards by which the performance of the obligation is to be measured if the standards are not manifestly unreasonable.\footnote{RUPA § 103(b)(5) (1994); ULLCA § 103(b)(4) (1995).}

The contractarians are concerned that the vagueness of the terms “unreasonably” and “manifestly unreasonable” gives courts broad discretion to invalidate contracts waiving fiduciary duties.\footnote{Ribstein, supra note 606, at 57-61.} The anti-contractarians, on the other hand, are concerned that the ability to contract away fiduciary duties will limit the parties’ access to the courts in cases involving opportunistic behavior.\footnote{See, e.g., Dickerson, supra note 588.}

The positions of the contractarians and the anti-contractarians are difficult to reconcile because they respond to two irreconcilable and competing objectives: (1) efficiency resulting from the reliability of contracts and (2) individual justice and fairness that can be achieved by judicial oversight.\footnote{Allan W. Vestal, Advancing the Search for Compromise: A Response to Professor Hynes, 58 L. & Contemp. Prob. 55 (1995).} The divergent views of contractarians and anti-contractarians are based on different opinions concerning the nature of a partnership or an LLC. The contractarians view a partnership or an LLC as a creature of contract and therefore, the relationship of the parties should be defined by the contract, with statutory default rules applying.
only to the extent that the parties have not otherwise agreed.\textsuperscript{619} The anti-contractarians, on the other hand, consider a partnership or LLC as something more than a contractual relationship and one that requires fiduciary duties.\textsuperscript{620}

It is not certain under RUPA or ULLCA whether a court will consider a partnership or an LLC to be a contractual or fiduciary relationship of the parties. The determination is likely to depend on how strictly or expansively the courts interpret the nonwaivable aspects of the fiduciary duty provisions.\textsuperscript{621} The drafters purposely left for judicial interpretation the definition of the terms "good faith" and "fair dealing."\textsuperscript{622} Contractarians are concerned that the minimum fiduciary duties under RUPA and ULLCA may permit judicial activism.

Mandatory fiduciary duties for partners under RUPA have been defended as necessary because, unlike absolute adversaries who may enter into contracts, partners are bound by a cooperative, intimate, and highly interdependent relationship.\textsuperscript{623} Each partner is an agent of the partnership who may expose every other partner to unlimited personal liability.\textsuperscript{624} Accordingly, minimum fiduciary standards may be necessary to address the discretion among agents.\textsuperscript{625}

While a similar argument may be made for mandatory fiduciary duties for members and managers of LLCs, there is an important distinction between partnerships and LLCs that may make mandatory fiduciary duties less imperative in the LLC setting. Unlike partners, members of an LLC generally are not personally liable for the debts or obligations of the LLC.\textsuperscript{626} Thus, members of an LLC do not risk as much as partners from the consequences of the actions of other members or managers. Nevertheless, there may be need for statutorily mandated fiduciary duties of members and managers of the small, informal LLCs for which ULLCA is intended. Individuals of such LLCs often enter into highly interdependent relationships. They tend to invest a great deal of their own capital and labor in a single LLC in which management lines are ill-defined.\textsuperscript{627} People who become investors in small LLCs typically place a good deal of trust in one another.\textsuperscript{628} Mandatory fiduciary duties may protect unsophisticated members, members with insufficient resources to retain counsel or enter into

\textsuperscript{619} Hynes, supra note 608, at 38-39. \textit{See also} Ribstein, supra note 538, at 331-32 (discussing mandatory rules under ULLCA as limiting the parties' freedom to contract).

\textsuperscript{620} Hynes, supra note 608, at 39.

\textsuperscript{621} \textit{See} Vestal, supra note 618, at 61-70 (discussing alternative interpretations of the waiver provisions of RUPA).

\textsuperscript{622} RUPA § 404 cmt. 4 (1994). For a discussion of the possible interpretation of the good faith standard, see DeMott, supra note 568.


\textsuperscript{624} Id. at 95. \textit{See also} Dickerson, supra note 606.

\textsuperscript{625} Weidner, supra note 623, at 95.

\textsuperscript{626} ULLCA § 303(a) (1995).

\textsuperscript{627} \textit{See} Weidner, supra note 623, at 84 (describing the type of small partnership for which RUPA is designed).

\textsuperscript{628} Id.
lengthy negotiations, and individuals with insufficient experience to appreciate the problems that may arise if fiduciary duties are waived. 629

On the other hand, mandatory fiduciary duties may not be necessary for members and managers of large LLCs that will have many investors and centralized management, the interests in which often will be part of an investor's diversified portfolio. In many cases, the market will constrain the conduct of such an LLC's managers. It may be more efficient for the parties to be able to enter into contracts reducing or eliminating fiduciary duties of managers of such LLCs.

Professor Allan W. Vestal has suggested a compromise solution with respect to RUPA that may be appropriate to suit the needs of both small, informal partnerships and LLCs as well as to provide flexibility for large, widely-held partnerships and LLCs. Professor Vestal suggests that the concerns of both the contractarians and the anti-contractarians could be accommodated if the default rules of RUPA provided a nonexclusive, broad statement of the partners' fiduciary duties, as has been required under UPA. 630 On the other hand, Professor Vestal suggests that the parties should be able to waive fiduciary duties by agreeing, in writing, to be subject to an exclusive limited statement of the partners' duties without any limitation on the authority of the partners to modify the default rules. 631 The only standards for enforcement of the parties' modification agreements under Professor Vestal's suggestion would be the "applicable contract standards of unconscionability, good faith, and the like." 632

While Professor Vestal's suggestion may be suitable for partnerships and LLCs because it provides protection for most members in small, informal businesses and, at the same time, permits unlimited freedom of contract to larger, more sophisticated ventures, there remains the danger under both schemes that unsophisticated, inexperienced members of small partnerships and LLCs may waive fiduciary duties without foreseeing the consequences of their agreement. To prevent confusion, Professor Vestal would have business organizations that opt into the contractarian regime designated as "statutory joint ventures." 633 Nevertheless, it is unlikely that unsophisticated, inexperienced persons will appreciate the consequences of becoming members of a statutory joint venture.

629. Vestal, supra note 606, at 541.
630. Vestal, supra note 618, at 78. Professor Vestal also suggests that these fiduciary duties should apply from the pre-partnership phase through winding up of the partnership. Professor Vestal also would permit fiduciary duties to be waived "only by written agreements, either categorical or specific, either ex ante or ex post, but always with full disclosure of all material facts, and only to the extent not manifestly unfair or unreasonable, either in isolation or in aggregate." Id. The requirement that self-dealing of partners is permissible only if allowed or ratified in writing may be problematic for small, informal partnerships for which the rule is designated, where most agreements are inferred by the partners' course of conduct. Contractarians are likely to object to the "manifestly unfair or unreasonable" language.
631. Id.
632. Id.
633. Id.
In that case, Professor Vestal's suggestion may not provide a solution that accommodates the concerns of the anti-contractarians.

In describing the costs to society if the minimum fiduciary standards under RUPA were waivable, Professor Donald J. Weidner has explained:

[N]o balanced policy of partnership relationships is possible without mandatory minima. Even if particular bargains were free from blemish, it would be far too costly to operate a system that would permit investors to waive all information and other rights necessary to monitor managers and hold them accountable. Contracts that deprive people of all information, remedy, and dignity, and laws that insulate the drafters of such contracts from judicial review are to be prohibited rather than enabled. They offer only abstract benefit to a very limited class, and invite widespread opportunistic behavior with all its individual and social costs. Individuals must bear the cost of avoiding such contracts, and society must bear the cost of picking up the pieces when they fall apart. Certainly they have no place in a default relationship that involves little ability to diversify and joint and several liability for a mutual agency.\[634\]

It is unlikely that Professor Weidner will agree with Professor Vestal's compromise solution. Perhaps there is no solution to the controversy concerning the proper standards for fiduciary duties or the ability of partners or members of an LLC to waive fiduciary duties. In the end, the determination of the scope of fiduciary duties, no matter what the statutory language suggests, may be a matter for the courts to decide. Inasmuch as every contract carries an obligation of "good faith,"\[635\] courts at least will be required to decide whether the parties have acted in good faith under the circumstances. Regardless of the statutory language, courts may apply a restrictive or an expansive interpretation of the good faith requirement.\[636\]

D. Summary

ULLCA offers a number of provisions that may solve problems existing under the Louisiana LLC Law. If Louisiana adopts ULLCA, residents of Louisiana may have the advantages of a uniform statute. On the other hand, it may be better to amend only the troublesome provisions of the Louisiana LLC Law without embracing all of ULLCA. The Louisiana LLC Law contains many provisions that

\[634\] See Weidner, supra note 623, at 103 (footnotes omitted).

\[635\] See, e.g., Restatement (Second) of Contracts § 205 (1979) ("[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement"); UCC § 1-303; La. Civ. Code art. 1759 (good faith governs the conduct of the obligor and the obligee).

are derived from the Louisiana Business Corporation Law and the Louisiana Partnership Law, with which courts and practitioners in Louisiana are familiar and for which there is a firm foundation of interpretative material. Moreover, it is not certain whether ULLCA will be adopted by many states, especially because of its drafting errors and because of some of its controversial provisions. It would be better for the Louisiana Legislature to view ULLCA as a model statute, rather than a uniform statute, adopting the provisions that best suit the needs of LLCs in Louisiana.

VI. CONCLUSION

Now that the check-the-box regulations have been issued in final form, the tax classification of an LLC no longer depends on the number of the LLC’s corporate characteristics under the Kintner regulations. Single-member LLCs also may be eligible to make a check-the-box election. The Louisiana Legislature can amend many of the default rules of the Louisiana LLC Law without the possibility of jeopardizing the tax status of a Louisiana LLC. In fact, the promulgation of the check-the-box regulations provides an excellent opportunity for the Louisiana Legislature to review the LLC Law in its entirety.

If the Louisiana Legislature does not amend the LLC Law, Louisiana LLCs still will be able to obtain partnership tax classification under the check-the-box approach. However, failure to amend the law will give Louisiana residents less flexibility in the organization and operation of an LLC than the check-the-box regulations permit. Because the Louisiana LLC Law does not authorize the formation of a single-member LLC, residents of Louisiana who wish to operate such an LLC will be forced to engage in complex transactions to achieve this result. Accordingly, the Louisiana LLC Law should at least be amended to authorize the formation of a single-member LLC.

Other amendments to the Louisiana LLC Law could offer significant improvements. To provide greater stability to an LLC’s business, the provisions triggering dissolution of an LLC on the termination of a member’s interest should be repealed. At the same time, however, the Louisiana LLC Law should be amended to provide greater protection to minority members and to assignees of members’ interests to prevent abusive behavior on the part of those in control of an LLC. Greater certainty should be provided with respect to the agency powers of members and managers under the Louisiana LLC Law, both to protect the rights of third parties and to protect members from the ability of another member to exceed his or her agency authority.

ULLCA may serve as a good model for some of the amendments. ULLCA, however, should not be adopted in its entirety. While many advantages may be achieved if Louisiana adopts a uniform law governing its LLCs, there are important reasons for Louisiana to avoid embracing all of ULLCA. Not only does the Louisiana LLC Law contain many provisions derived from Louisiana law that will be familiar to practitioners and courts in Louisiana, but ULLCA does not always provide the best rule with respect to the organization and operation of an LLC.