JOHN CUNNINGHAM
ON NEW HAMPSHIRE'S
NEW LLC ACT

A HANDBOOK FOR NEW HAMPSHIRE LAWYERS, ACCOUNTANTS AND BUSINESS PEOPLE

DECEMBER 2012 EDITION

DEDICATION

This book is dedicated to my wife, my daughters and my grandchildren

ACKNOWLEDGEMENT

I wish to acknowledge the remarkably diligent and astute assistance that Leticia Liggett of the New Hampshire and Massachusetts bars provided to me as I wrote this book. Without her assistance, I could never have written it.

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CHAPTER 1

INTRODUCTION

OVERVIEW

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§ 1.01 THE ENACTMENT AND EFFECTIVE DATES OF THE NEW ACT

1) The New Hampshire Limited Liability Company Act (which I'll refer to in this book as the "Old Act") was originally enacted in 1993 and was significantly amended in 1997. As evidenced by the entity formation statistics in the attached Exhibit 1-1, LLCs are now, by a wide margin, the entities of choice among New Hampshire business people for business start-ups. For example, from January 1, 2012 through May 31, 2012, New Hampshire business people formed more than seven LLCs for every corporation they formed.

2) On June 18, 2012, Governor John Lynch signed into law a comprehensive revision of the Old Act entitled "the New Hampshire Revised Limited Liability Company Act." (In this book, I'll refer to the revised act as the "New Act.")[1] The New Act, which entirely replaces the Old Act, will become effective:

[1] The official version of the Act can be accessed on-line on the New Hampshire General Court website: http://www.gencourt.state.nh.us/legislation/2012/SB0203.html

a) On January 1, 2013 with respect to NH LLCs formed on and after that date; and

b) On January 1, 2014 with respect to LLCs formed on or before December 31, 2012.[2]

3) However, Section 5, II(a) of the New Act provides that New Hampshire LLCs formed on or before January 1, 2013 may elect to be governed by the New Act before January 1, 2014 by unanimous written vote of their members.

§ 1.02 THE BIA DRAFTING PROJECT

1) I am a business lawyer licensed to practice in New Hampshire and Massachusetts. I am of counsel to the law firm of McLane, Graf, Raulerson & Middleton, Professional Association. For the past 20 years, I have devoted most of my professional life to forming LLCs, converting corporations and other non-LLC entities to LLCs, and writing and teaching about LLC law, tax and practice.

2) In the spring of 2008, I published a lengthy article in the New Hampshire Bar Journal entitled "Amending the New Hampshire Limited Liability Company Act to Meet the Needs of Unrepresented LLC Founders and Members."[3] The essential contents of the article were as follows:

   a) New Hampshire business people who form and operate large, well-capitalized LLCs can afford to hire sophisticated LLC lawyers to assist them in these tasks, and these lawyers can tailor these LLCs to meet their clients' needs.

   b) Few New Hampshire business people who form and operate small New Hampshire businesses can afford sophisticated LLC lawyers.

   c) LLC acts should be designed to be useful to all of the LLCs formed under them and the members of all of these LLCs. However, they should be designed primarily to be useful to small businesses.[4]

   d) The Old Act is a reasonably sound statute, and it has served New Hampshire well. However, it has numerous deficiencies, many of which adversely affect New Hampshire small businesses. The most important of these deficiencies are as follows:

      i) Much of the Old Act is written in an awkward legalese, and in many respects, it is poorly organized and formatted. Even for judges and lawyers, this makes it difficult to understand, but particularly for owners of New Hampshire small businesses..

      ii) The Old Act fails to address numerous key LLC business organization law issues,

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[2] The official title of the New Act is set forth in New Act § 1. Its effective dates as to LLCs formed under the Old and the New Acts are set forth in New Act § 5.

[3] This article is archived in http://www.nhbar.org/publications/archives/display-journal-issue.asp?id=401.

[4] The above article does not define the term "New Hampshire small business," and the term is defined neither in the New Act itself nor in its legislative history. However, I propose the following as a reasonable working definition of the term for purposes of this chapter: A New Hampshire small business is a business that has only a few members—in most cases only one or two; that has only modest capital—in many cases, only a few thousand dollars; and whose annual gross revenues are also modest—in many cases, less than $100,000.

including many that are important to New Hampshire small businesses.[5]

iii) In particular, the Old Act contains no clear fiduciary rules, even though these rules are often critical for maintaining harmony among the members of multi-member LLCs.

iv) For many New Hampshire small businesses, a number of key provisions of the Old Act—e. g., those concerning distributions of LLC profits and the removal of bad LLC members and managers—don't work.

v) Sound operating agreements among LLC members about their LLCs are critical in helping to resolve disputes among these members. Many New Hampshire small-business LLCs lack written operating agreements. Thus, solid "off-the-shelf operating agreements" should be provided to them in the terms of the Old Act itself. However, the off-the-shelf operating agreements in the Old Act fail to meet many basic needs of these businesses.

vi) The Old Act fails to provide reasonable protection to LLC members, and especially to the members of small-business LLCs, against judicial orders transferring their membership rights to third parties, including judgment creditors, divorced spouses and trustees in bankruptcy.

vii) The most flexible of all U.S. LLC acts is the Delaware Limited Liability Company Act. The Old Act contains a few of the "flexibility" provisions in that act, but it lacks several of them that are likely to be useful both to large and to small New Hampshire LLCs.

3) Prompted in part by the above article, the New Hampshire Business and Industry Association requested me in December 2010 to form and chair a committee of New Hampshire lawyers to draft a comprehensive revision of the Old Act. I agreed. The members of the BIA Drafting Committee besides myself were John Bentas of the McLane firm, Claire Howard of Devine, Millimet & Branch, Matthew LaPointe of Sheehan, Phinney, Bass & Green, Curt Little of Cook, Little & Rosenblatt, Dwight Sowerby of Drescher & Dokmo, Roy Tilsley of Bernstein Shur, and John Zaremba of Orr & Reno.

4) Before our committee began meeting, I prepared a draft of the Old Act in which I retained all of its provisions but reorganized them in what I believed was a more logical overall structure. To do so, I divided the reorganized Old Act into 26 distinct parts, each with its own number and caption.

5) Our committee (the "BIA Drafting Committee") began drafting its revision of the Old Act in February 2010. During the next 10 months, the committee devoted hundreds of hours to this task and carefully reviewed every provision of the Old Act. In the course of the review, we held about 12 meetings. In preparation for each meeting, each member of the committee was assigned two or more of the above 26 parts; the member was responsible for determining whether each of the provisions in each of these parts was consistent with the needs of New

[5] The phrase "business organization law" and terms containing this phrase are used extensively in this book. As used here, the phrase means the subset of state business law consisting of the statutory and common law governing the formation, management and other non-tax features and procedures (including, for example, procedures for statutory mergers, conversions and dissolutions) of state-law business entities. Examples of state business organization law statutes include corporate statutes, LLC statutes, and general and limited partnership statutes.

Hampshire small businesses, including, especially, New Hampshire small businesses operating as single-member LLCs whose members are individuals; whether it met all other criteria the member thought appropriate; and whether any additional issues should be addressed in the part of the revised act in question. At each meeting, we addressed as many of these parts as time allowed and reached consensus as to how, if at all, each relevant provision in each relevant part should be amended and what provisions should be added to the part.

6) In October 2011, New Hampshire senate and house sponsors submitted to the legislature the draft of the resulting bill, designated Senate Bill 203; in May 2012, both the Senate and the House passed the bill; and, as noted, on June 18, 2012, Governor Lynch signed it into law.

§ 1.03 THE PURPOSE OF THIS BOOK

1) My principal objectives in this book are:
   a) To provide a comprehensive overview of the New Act;
   b) Where useful, to explain why the BIA Drafting Committee drafted the New Act as it did; and
   c) To point out all significant respects in which the New Act differs from the Old Act.
2) I address these objectives in Chapters 2 through 4.
3) I also want to answer in the book several questions that I believe New Hampshire business people and lawyers are likely to have about the New Act other than the questions addressed in the above chapters. These additional questions and the chapters and chapter sections in the book that address them are as follows:
   a) Does the New Act represent a significant improvement of the Old Act? See especially Chapter 2, § 2.01[B].
   b) In light of the improvements effected by the New Act in the off-the-shelf operating agreements contained in the Old Act, to what extent, if at all, do the members of New Hampshire LLCs still need tailored operating agreements specifically drafted for their own LLCs? See Chapter 4.
   c) How should the roughly 51,000 New Hampshire LLCs likely to be active on January 1, 2013—which, as mentioned, is the New Act's effective date—respond to the New Act? See Chapter 5.
   d) What impact is the New Act likely to have:
      i) On "non-tax choice of entity"—i.e., the process of choosing among LLCs and other business organizations for New Hampshire business start-ups; and
      ii) On the drafting of operating agreements for New Hampshire LLCs?

      See Chapters 6, 7 and 8.
   e) For the many businesses that operate both in New Hampshire and in Massachusetts, which LLC act is better—the New Act or the Massachusetts Act? See Chapter 9.

§ 1.04 HOW TO READ THIS BOOK

1) I have written this book for three main types of readers:

a) Lawyers (including both specialists in LLC law and non-specialists);

b) Accountants; and

c) Business people.

2) I've written Chapters 1 through 9 principally for lawyers (including both specialists and non-specialists in LLC law); Chapter 10 for accountants; and Chapter 11 for business people.

3) However, accountants and business people may want to read any of Chapters 1 through 9 whose topics particularly interest them; and I hope that my efforts to write these chapters in relatively non-technical English will make them easy not just for lawyers but also for accountants and business people to understand.

4) In addition, lawyers and business people who are interested in the comparisons in Chapter 10 concerning the tax implications of the Old and New Acts and the financial provisions in the two acts may want to read those chapters.

5) Finally, lawyers and accountants who are interested in seeing concrete illustrations of the legal points in Chapters 1 through 10 may want to read the extensive illustrations presented in Chapter 11.[6]

§ 1.05 THE TEN MAIN CLASSES OF NEW ACT LLCs; THE 28 MAIN LLC TYPES

[A] INTRODUCTION

1) I am the principal author of *Drafting Limited Liability Company Operating Agreements*, an LLC formbook and practice manual first published by Wolters Kluwer Law & Business in 1998 and now in its third edition.[7] As I developed my thinking about LLCs over the years after the initial publication of *Drafting Limited Liability Company Operating Agreements*, I found it necessary, in order to address adequately the book's subject matter, to devise:

   a) A system for classifying LLCs themselves; and

   b) A system for classifying the various types of provisions in LLC statutes.

2) Since I employ both of these systems extensively throughout this book, it will be useful to describe their main elements in this chapter. I suspect that in reading these descriptions, some readers may initially find them to be puzzlingly complex. However, I believe that their essential simplicity and their practical utility will become manifest as I employ them in the subsequent chapters of this book.

[B] THE SYSTEM FOR CLASSIFYING LLCS IN THIS BOOK

1) All LLCs have three main types of structures—an ownership structure, a management structure and a federal tax structure. On the basis of these three structures, LLCs naturally fall into ten broad classes. These ten classes are identified in the attached Exhibit 1-2.

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[6] The views expressed in this book in addressing the above questions are, of course, mine alone and do not necessarily reflect those of any other member of the BIA Drafting Committee. However, I believe that my views are at least generally consistent with those of these other BIA Drafting Committee members.

[7] My co-author is Vernon Proctor, a member of the Delaware Bar and a founder and principal of Proctor & Heymann, LLP, a Wilmington, Delaware business litigation firm.

a) Class 1 consists of single-member LLCs whose members are individuals. Class 1 LLCs may have any of three main management structures and they may be subject to federal income taxation either as sole proprietorships or as S corporations.

b) Class 2 consists of single-member LLCs whose members are entities. Class 2 LLCs, like Class 1 LLCs, may have any of three main management structures. However, almost all of them have the same federal tax structure—namely, that of "disregarded entities."

c) Class 3 consists of multi-member LLCs that are "member-managed"—that is, they are managed directly by their members through a general partnership management structure. Class 3 LLCs are subject to federal income taxation as partnerships under Internal Revenue Code Subchapter K.

d) Class 4 consists of LLCs that have the same ownership structure and management structure as Class 3 LLCs but are subject to federal income taxation under Subchapter S.

e) Class 5 consists of LLCs that have a general partnership management structure and that are taxable under Subchapter K or Subchapter S, but that, because they have relatively numerous members, are managed by management committees.

f) Class 6 consists of multi-member LLCs that are "manager-managed"—that is, they are managed by persons specifically appointed by the members as managers under a limited partnership management structure. Class 6 LLCs are substantially controlled by their members, and they are taxable under Subchapter K.

g) Class 7 consists of multi-member LLCs that have the same ownership structure and management structure as Class 6 LLCs but that are taxable under Subchapter S.

h) Classes 8 and 9 have, in general, the same ownership structure, management structure and tax structure as, respectively, Class 6 and 7 LLCs, but they are substantially controlled by their managers.

i) Class 10 consists of manager-managed multi-member LLCs that may be taxable under any of three possible federal income tax regimens—namely, Subchapters C, K or S—but that have a corporate management structure.

2) However, if one takes into account the various small but obvious differences among LLCs within each of these classes, one finds that there are a total of 28 specific *types* of LLCs. These include, for example, six specific types under Class 1; three under Class 2; and three under Class 3. To illustrate:

a) Type 1.1 consists of LLCs which have a single member; whose managers are individuals but which, for continuity of management, also have a non-member assistant manager; and that are taxable as sole proprietorships; and

b) Type 3.1 consists of LLCs which have two members whose management and financial rights are equal; which have a simple general partnership management structure; and that are taxable as partnerships under Internal Revenue Code Subchapter K.

c) Type 6.1 consists of member-managed multi-member LLCs with two members, one of whom is a manager-member and the other a non-manager member, but in which the manager as such controls only the day-to-day business of the LLC and the members as such have control over all other LLC matters.

3) As readers will observe, the above three types of LLCs are central to the discussion of off-the-shelf operating agreements in Chapter 4.

4) The three structures of each of the above 28 types of LLCs give rise to numerous specific

business organization law issues for their members. These issues are best identified and optimal resolutions for each are best set forth in separate model operating agreements, each specifically tailored for one of these 28 LLC types.

§ 1.06 THE FIVE CLASSES OF LLC STATUTORY PROVISIONS IN THE NEW ACT; THE 300 "LLC FORMATION PROVISIONS" IN THE ACT

1) In order to be able to understand and evaluate the New Act, to compare it with the Old Act and to use it in forming new LLCs and in adapting Old Act LLCs under it, it is not enough to be familiar with the classes and types of LLCs outlined above; you must also be able to identify and understand all of the specific provisions of the New Act that are relevant to these processes. By my count, there are 300 such provisions.

2) Furthermore, as shown in Chapters 3 and 4, in working closely with these provisions in conducting these processes, you will find that each of them falls into one of five distinct statutory classifications and that the specific classification of each determines its proper use in each of these processes. Specifically, each of the above 300 provisions is either:

   a) Definitional,

   b) Default,

   c) Mandatory,

   d) Non-self-enabling permissive, or

   e) Self-enabling permissive.

3) Chapters 3 and 4 contain definitions of each of these classes of statutory provisions of the New Act, and these chapters illustrate the tactical significance of each in handling LLC matters.

§ 1.07 SERIES LLCs AND THE NEW ACT

1) In 1994, Delaware became the first state to authorize the formation under its LLC act of a new kind of LLC called a series LLC. A series LLC is, in essence, an LLC that is authorized under its certificate of formation to "establish" one or more business organizations called "series" and to "associate" with each of these series specified members, managers, lines of business, assets and liabilities. Under series LLC provisions, the members of each series are protected from liabilities of the series itself, and each series is protected from the liabilities of other series established by the series LLC and even of the series LLC itself. In recent years, eight other states have authorized the formation of series LLCs under their LLC acts, and asset protection lawyers in several states are enthusiastically promoting series LLCs as a powerful new asset protection tool.[8]

2) Given these facts, the BIA Drafting Committee felt an obligation during its drafting of the New Act to address the question whether we ought to include series LLC provisions in that act. We decided that we should not. We made this decision for three main reasons:

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[8] The nine U.S. jurisdictions whose LLC acts authorize the formation of series LLCs are Delaware, Illinois, Iowa, Kansas, Nevada, Oklahoma, Tennessee, Texas, and Utah.

a) Even within series states, there are many unanswered questions about the interaction of series business organization law and other areas of law, such as real and personal property law.

b) Although there are presently nine series states, 42 states and the District of Columbia are *not* series LLC jurisdictions. In all of these jurisdictions, there is a serious question whether the liability shields provided by series LLC provisions will be respected.

c) Series LLCs also raise serious questions in various areas of federal law, including federal income tax law and bankruptcy law.

In light of the above uncertainties, we concluded that, even assuming that the New Hampshire Legislature were willing to enact series provisions in the New Act—which, in my view, it would not have been—the use of New Hampshire series LLCs would expose New Hampshire businesses to undue legal and tax risks.

§ 1.08 THE NEW ACT—A PRELIMINARYY EVALUATION

To what extent does the New Act represent a significant improvement of the Old Act? Needless to say, I am biased, and thus perhaps not the right person to answer this question. However, I think the answer is implicit in the list of major differences between the Old Act and the New Act in Chapter 2, § 2.01[B]. On the basis of this list, I think it is fair to say that the New Act represents a major improvement of the Old Act, particularly with respect to New Hampshire small businesses. But only time will tell.

§ 1.09 WHERE DO WE GO FROM HERE?

1) New Hampshire has an unfortunate history of updating its business organization law statutes only very rarely. I hope that in the field of LLC statutory law, we can overcome this history.

   a) The New Act made hundreds of changes in the Old Act, many of which are merely stylistic but more than a few of which are substantive. It is almost inevitable than in coming years, we will discover that we have made both typographical and substantive errors in effecting these changes. We should correct these errors as soon as we discover them.

   b) In many respects, the New Act is far easier to understand and use than the Old Act. However, despite the best efforts of the BIA Drafting Committee, the New Act still reflects the cumbersome and difficult-to-use formatting of the Old Act rather than, for example, the clear and highly user-friend formatting of the New Hampshire Business Corporation Act. For the sake of all of the New Hampshire businesses, but particularly for New Hampshire small businesses, we should as soon as possible convert the New Act from the former format to the latter.

   c) We should monitor the evolution of LLC legislation in other states and, whenever we discover useful innovations in this legislation, we should amend the New Act to include them.

2) However, in order to address the above challenges, much help will be needed from New Hampshire business people and lawyers, including the readers of this book.

EXHIBIT 1-1

NEW HAMPSHIRE ENTITY FORMATION STATISTICS AS OF DECEMBER 3, 2012

Preliminary note. The statistics in the table below were provided to John Cunningham by the Corporation Division of the New Hampshire Secretary of State on December 3, 2012.

TYPE OF ENTITY	NUMBER FORMED IN CALENDAR YEAR 2010	NUMBER FORMED IN CALENDAR YEAR 2011	NUMBER FORMED IN CALENDAR YEAR 2012 THROUGH Dec 3, 2012	TOTAL FORMED IN ALL YEARS AND NOT ADMINISTRATIVELY DISSOLVED -- THROUGH Dec 3, 2012
1. Business corporations	1079	996	2067	18,129
2. Limited partnerships	32	21	50	2832
3. LLCs	5972	6736	7688	46,174
4. LLPs	56	48	66	234
5. New Hampshire investment trusts	9	14	2	54
6. Non-profit corporations and associations	568	580	510	10,036
7. PLLCs	129	153	171	1,224
8. Professional corporations	21	19	29	978

EXHIBIT 1-2

THE TEN CLASSES OF LLCs

TYPE NUMBER	BRIEF DESCRIPTION
1.	SINGLE-MEMBER LLC WHOSE MEMBER IS AN INDIVIDUAL, TAXABLE AS SOLE PROPRIETORSHIP OR S CORPORATION
2.	SINGLE-MEMBER LLC WHOSE MEMBER IS AN ENTITY, TAXABLE AS DISREGARDED ENTITY
3.	MULTI-MEMBER LLC WITH SIMPLE GENERAL PARTNERSHIP MANAGEMENT STRUCTURE (i.e., NO MANAGING MEMBER OR MANAGEMENT COMMITTEE)—TAXABLE UNDER SUBCHAPTER K
4.	MULTI-MEMBER LLC WITH SIMPLE GENERAL PARTNERSHIP MANAGEMENT STRUCTURE (i.e., NO MANAGING MEMBER OR MANAGEMENT COMMITTEE)—TAXABLE UNDER SUBCHAPTER S
5.	MULTI-MEMBER LLC WITH COMPLEX GENERAL PARTNERSHIP MANAGEMENT STRUCTURE (MANAGING MEMBER AND/OR MANAGEMENT COMMITTEE)—TAXABLE UNDER SUBCHAPTER K OR S
6.	MULTI-MEMBER LLC WITH MEMBER-CONTROLLED LIMITED PARTNERSHIP MANAGEMENT STRUCTURE——TAXABLE UNDER SUBCHAPTER K
7.	MULTI-MEMBER LLC WITH MEMBER- CONTROLLED LIMITED PARTNERSHIP MANAGEMENT STRUCTURE—TAXABLE UNDER SUBCHAPTER S
8.	MULTI-MEMBER LLC WITH MANAGER-CONTROLLED LIMITED PARTNERSHIP MANAGEMENT STRUCTURE—TAXABLE UNDER SUBCHAPTER K
9.	MULTI-MEMBER LLC WITH MANAGER-CONTROLLED LIMITED PARTNERSHIP MANAGEMENT STRUCTURE—TAXABLE UNDER SUBCHAPTER S
10.	MULTI-MEMBER LLC WITH CORPORATE MANAGEMENT STRUCTURE (INCLUDING A BOARD OF DIRECTORS AND OFFICERS)

EXHIBIT 1-3

THE 28 MAIN TYPES OF LLCs AND THEIR MODEL OPERATING AGREEMENTS

Table 1: TABLE OF MODEL LLC AGREEMENTS FOR CLASS 1 LLCs (SINGLE-MEMBER LLCs OWNED BY ONE INDIVIDUAL)

MODEL LLC AGREEMENT NUMBER	MANAGEMENT STRUCTURE	FEDERAL INCOME TAX REGIMEN	FREQUENCY OF USE BY PRACTITIONERS
Form 1.1	Member-managed. The LLC's member is also its manager and there is no assistant manager.	Disregarded entity	Somewhat frequent
Form 1.2	Manager-managed. The LLC's member is its manager, but the LLC also has one or more assistant managers.	Disregarded entity	Frequent
Form 1.3	Manager-managed. The LLC's member is a non-manager, and it is managed by a non-member manager.	Disregarded entity	Somewhat frequent
Form 1.4	Member-managed. The LLC's member is also its manager and there is no assistant manager	Subchapter S	Somewhat frequent
Form 1.5	Manager-managed. The LLC's member is its manager, but the LLC also has one or more assistant managers.	Subchapter S	Frequent
Form 1.6	Manager-managed. The LLC's member is a non-manager, and it is managed by a non-member manager.	Subchapter S	Somewhat frequent
Total number of Type 1 model LLC agreements			6

Table 2: TABLE OF MODEL LLC AGREEMENTS FOR CLASS 2 LLCs (SINGLE-MEMBER LLCs OWNED BY ONE ENTITY)

MODEL LLC AGREEMENT NUMBER	MANAGEMENT STRUCTURE	FEDERAL INCOME TAX CLASSIFICATION	FREQUENCY OF USE BY PRACTITIONERS
Form 2.1	Managed by a single non-member manager	Disregarded entity	Frequent
Form 2.2	Managed by two or more non-member managers	Disregarded entity	Somewhat frequent
Form 2.3	Managed by an internal board of directors and by officers who are non-member managers	Disregarded entity	Infrequent
Total number of Type 2 model LLC agreements			3

TABLE 3: TABLE OF MODEL LLC AGREEMENTS FOR CLASS 3 LLCS (MULTI-MEMBER LLCS—SIMPLE GENERAL PARTNERSHIP MANAGEMENT STRUCTURE—TAXABLE UNDER SUBCHAPTER K

MODEL LLC AGREEMENT NUMBER	NUMBER AND RELATIONSHIP OF MEMBERS	FREQUENCY OF USE BY PRACTITIONERS
Form 3.1	Two members with equal management rights	Frequent
Form 3.2	Two members with unequal management rights	Somewhat frequent
Form 3.3	Three or more members	Frequent
Total number of Type 3 model LLC agreements		3

Table 4: TABLE OF MODEL LLC AGREEMENTS FOR CLASS 4 LLCs (MULTI-MEMBER LLCs—SIMPLE GENERAL PARTNERSHIP MANAGEMENT STRUCTURE—TAXABLE UNDER SUBCHAPTER S)

MODEL LLC AGREEMENT NUMBER	NUMBER AND RELATIONSHIP OF MEMBERS	FREQUENCY OF USE BY PRACTITIONERS
Form 4.1	Two members with equal management rights	Frequent
Form 4.2	Two members with unequal management rights	Somewhat frequent
Form 4.3	Three or more members	Frequent
Total number of Type 4 model LLC agreements		3

Table 5: TABLE OF MODEL LLC AGREEMENTS FOR CLASS 5 LLCs (MULTI-MEMBER LLCs—COMPLEX GENERAL PARTNERSHIP MANAGEMENT STRUCTURE—TAXABLE UNDER SUBCHAPTER K OR S)

MODEL LLC AGREEMENT NUMBER	NUMBER AND RELATIONSHIP OF MEMBERS	FEDERAL INCOME TAX REGIMEN	FREQUENCY OF USE BY PRACTITIONERS
Form 5.1	Three or more members	Subchapter K (without Prop. Reg. provisions)	Frequent
Form 5.2	Three or more members	Subchapter S	Occasional
Total number of Type 5 model LLC agreements			2

Table 6: TABLE OF MODEL LLC AGREEMENTS FOR CLASS 6 LLCs (MULTI-MEMBER LLCs—SIMPLE LIMITED PARTNERSHIP MANAGEMENT STRUCTURE—MEMBER-MANAGER—MEMBER-CONTROLLED—TAXABLE UNDER SUBCHAPTER K)

MODEL LLC AGREEMENT NUMBER	NUMBER AND RELATIONSHIP OF MEMBERS	FREQUENCY OF USE BY PRACTITIONERS
Form 6.1	Two members	Somewhat frequent
Form 6.2	Three or more members	Frequent
Total number of Type 6 model LLC agreements		2

Table 7: TABLE OF MODEL LLC AGREEMENTS FOR CLASS 7 LLCs (MULTI-MEMBER LLCs—SIMPLE LIMITED PARTNERSHIP MANAGEMENT STRUCTURE—MEMBER-MANAGER—MEMBER-CONTROLLED—TAXABLE UNDER SUBCHAPTER S)

MODEL LLC AGREEMENT NUMBER	NUMBER AND RELATIONSHIP OF MEMBERS	FREQUENCY OF USE BY PRACTITIONERS
Form 7.1	Two members	Somewhat frequent
Form 7.2	Three or more members	Frequent
Total number of Type 7 model LLC agreements		2

Table 8: TABLE OF MODEL LLC AGREEMENTS FOR CLASS 8 LLCs (MULTI-MEMBER LLCs--SIMPLE LIMITED PARTNERSHIP MANAGEMENT STRUCTURE—MEMBER-MANAGER—MANAGER-CONTROLLED—TAXABLE UNDER SUBCHAPTER K)

MODEL LLC AGREEMENT NUMBER	NUMBER AND RELATIONSHIP OF MEMBERS	FREQUENCY OF USE BY PRACTITIONERS
Form 8.1	Two members	Frequent
Form 8.2	Three or more members	Frequent
Total number of Type 8 model LLC agreements		2

Table 9: TABLE OF MODEL LLC AGREEMENTS FOR CLASS 9 LLCs (MULTI-MEMBER LLCs--SIMPLE LIMITED PARTNERSHIP MANAGEMENT STRUCTURE—MEMBER-MANAGER—MANAGER-CONTROLLED—TAXABLE UNDER SUBCHAPTER S)

MODEL LLC AGREEMENT NUMBER	NUMBER AND RELATIONSHIP OF MEMBERS	FREQUENCY OF USE BY PRACTITIONERS
Form 9.1	Two members	Frequent
Form 9.2	Three or more members	Frequent
Total number of Type 9 model LLC agreements		2

TABLE 10: TABLE OF MODEL LLC AGREEMENTS FOR CLASS 10 LLCs (MULTI-MEMBER LLCs—CORPORATE MANAGEMENT STRUCTURE—MANAGERS MAY BE EITHER MEMBER-MANAGERS OR NON-MEMBER MANAGERS—TAXABLE UNDER SUBCHAPTER C, K OR S)

MODEL LLC AGREEMENT NUMBER	NUMBER AND RELATIONSHIP OF MEMBERS	FEDERAL INCOME TAX REGIMEN	FREQUENCY OF USE BY PRACTITIONERS
Form 10.1	Three or more members	Subchapter C	Infrequent
Form 10.2	Three or more members	Subchapter K provisions	Infrequent
Form 10.3	Three or more members	Subchapter S	Infrequent
Total number of Type 10 model LLC agreements			3

CHAPTER 2

SIMILARITIES AND DIFFERENCES BETWEEN THE OLD AND THE NEW ACTS—OVERVIEW

OVERVIEW

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§ 2.01 INTRODUCTION

[A] SIMILARITIES AND DIFFERENCES--INTRODUCTION

1) The New Act contains, although often in a different format and prose style, at least 95% of the substantive content of the Old Act.

2) For example:

   a) All of the provisions in the Old Act concerning procedures for LLC formations, mergers, conversions, dissenters' rights, dissolutions, foreign LLCs, and miscellaneous matters concerning administrative fees and annual reports are also contained in the New Act; and

   b) The substantive contents of these provisions are identical in the two acts.

3) Furthermore, there is only one significant mandatory rule in the Old Act that is not contained also in the New Act—namely, the rule in Old Act § 1, VII that provides, in effect, that operating agreements shall not be valid unless in writing.

4) However, as shown in the overview immediately below, the New Act differs from the Old Act in many major respects.

[B] SIGNIFICANT DIFFERENCES BETWEEN THE OLD AND NEW ACTS--OVERVIEW

The paragraphs below identify the 13 significant differences between the Old and New Acts; they briefly state the practical impact of these differences; they indicate whether these 13 differences are addressed in greater detail in the sections of this chapter or elsewhere in this book; and if so, where.

1) Legislative intent. The Old Act has no clearly stated legislative intent. The preamble of the New Act states that the primary intent of the New Act is to meet the needs of New Hampshire small businesses and that its secondary intent is to provide LLC members with maximum flexibility in tailoring their operating agreements to meet their needs.

   a) Impact. The statement of legislative intent set forth in the preamble of the New Act will facilitate the task of judges, lawyers and business people in interpreting the provisions of the New Act, particularly as applicable in unusual factual situations.

   b) Further discussion. None.

2) Term for the totality of a member's membership rights. The Old Act has no term denoting the totality of the rights of LLC members. The New Act defines these rights as the members' membership rights.

   a) Impact of change. The BIA Drafting Committee believes that the inclusion of the above decision in the New Act will help to prevent misunderstandings among LLC members and between them and third parties in discussing LLC matters and engaging in LLC transactions. For example, LLC members sometimes misleadingly state that they have sold or would like to sell their "LLC interests." However, under Old Act § 1, VII and New Act § 12, the term "LLC interest" merely means the members' rights to allocations and distributions. Since the members normally want to sell—and buyers want to buy—not only the members' LLC interests but also all of their other membership rights, including their right to vote, to attend meetings, to obtain LLC information, to assert fiduciary rights and to invoke LLC dispute resolution procedures, in the above statement they obviously should use the term "membership rights," not "LLC interest."

   b) Further discussion. None.

3) Addressing of key LLC business organization law issues—in general. The Old Act fails to address many important LLC business organization law issues that it ought to address. The New Act addresses all of these issues.

   a) Impact of change. All of the above failures could result in serious disputes among LLC members. The New Act's addressing of the above issues will reduce the risk of these disputes.

   b) Further discussion. See § 2.02 of this chapter.

4) Old Act's lack of clear fiduciary duties. The Old Act contains no clear fiduciary duties. The New Act provides comprehensive fiduciary duties.

   a) Impact of change. See discussion below in § 2.03.

   b) Further discussion. See discussion below in § 2.03.

5) Old Act default rules that fail the "plurality" test. The Old Act contains several important

default rules that fail the plurality test. In the New Act, all of these rules have been amended to meet that test.

a) Impact of change. The above default rules, as set forth in the Old Act, may well defeat reasonable expectations of members of Old Act LLCs. The revisions of these rules in the New Act increase the likelihood that members' reasonable expectations will be met.

b) Further discussion. §2.04 of this chapter.

6) Oral and implied operating agreements under the Old Act. Under the Old Act, only written operating agreements are valid. Under the New Act, not only written operating agreements but also oral and implied operating agreements are valid.

a) Impact of change. In providing for the validity of oral and implied operating agreements in the New Act, the BIA Drafting Committee was aware that this change could introduce uncertainty concerning operating agreement terms. However, we also believed that to the extent that New Hampshire LLC members, and especially members of NH small businesses, do not have written operating agreements but *do* have oral or implied agreements whose terms they can prove, these terms should be respected and enforced.

b) Further discussion. None.

7) Statutory protection of the membership rights of LLC members from possibility of judicial orders transferring these rights to third parties. The pick-your-partner provisions and charging order provisions of the Old Act provide LLC members with only limited protection against the risk that the courts will transfer their membership rights to judgment creditors or other third parties. These statutory protections are far stronger under the New Act.

a) Impact of change. See discussion in Chapter 3.

b) Further discussion. See discussion in Chapter 3.

8) Rules governing single-member LLCs whose members are individuals. The rules in the Old Act governing single-member LLCs whose members are individuals are deficient in various respects. The New Act corrects these deficiencies.

a) Impact of change. See discussion in § 2.05.

b) Further discussion. See discussion in § 2.05.

9) Statutory flexibility. The Old Act lacks a number of permissive provisions in the Delaware Limited Liability Company Act potentially beneficial to the members of New Hampshire LLCs. The New Act includes all of these provisions except those that are clearly inappropriate under New Hampshire LLC law.

a) Impact of change. See discussion in § 2.06.

b) Further discussion. See discussion in § 2.06.

10) "Off-the-shelf operating agreements." The off-the-shelf operating agreements in the Old Act are inadequate in many respects for New Hampshire LLCs that lack tailored operating agreements. The off-the-shelf operating agreements in the New Act meet the needs of New Hampshire LLC members to the fullest possible extent.

a) Impact of change. See discussion in Chapter 4.

b) Further discussion. See discussion in Chapter 4.

11) Grouping of relating provisions; captions for these groups. The Old Act has no specific

groupings and captions for provisions relating to basic LLC statutory characteristics, operating agreements, member meetings, member voting, contributions, allocations, distributions, dissociations, grants, redemptions and transfers of membership rights, charging orders, and single-member LLCs.

a) Impact. The inclusion of these groupings and captions in the New Act should make it easier for LLC members, lawyers and others to find specific provisions in the New Act than in the Old Act on issues that concern them.

b) Further discussion. None.

12) Definitions of key statutory terms. There are many key statutory terms in the Old Act that the Old Act does not define. The New Act defines these terms.

a) Impact of change. The inclusion of the above defined terms in the New Act will make the act significantly more intelligible to judges, lawyers and business people who have occasion to read it.

b) Further discussion. §2.07 of this chapter.

13) Legalese. Many provisions of the Old Act are written in dense legalese. All of the provisions of the New Act are written in plain English.

a) Impact of change. The BIA Drafting Committee believes that the replacement of legalese with plain English in the New Act will make it significantly more intelligible to judges, lawyers and business people who have occasion to read it.

b) Further discussion. §2.08 of this chapter.

§ 2.02 PROVISIONS OF THE NEW ACT ADDRESSING SIGNIFICANT LLC BUSINESS ORGANIZATION LAW ISSUES ADDRESSED INADEQUATELY OR NOT AT ALL IN THE OLD ACT

The New Act addresses 19 significant "statutory gap issues" in the Old Act—i.e., significant business organization law issues that should be addressed in an LLC act but that the Old Act does not address.

STATUTORY GAP ISSUE IN OLD ACT	PROVISION ADDRESSING GAP IN THE NEW ACT
1. Definitions. Many important terms in the Old Act whose meaning is not self-evident are not defined in the Old Act. See § 2.07 of this chapter.	The terms that are defined in the New Act but not in the Old Act are identified in § 2.04 of this chapter.
2. Ambiguity about whether the statute of frauds applies to operating agreements. The Old Act is unclear about whether the statute of frauds applies to operating agreements.	Section 44 of the New Act provides that the statute of frauds does not apply to operating agreements.
3. No statement of legislative intent. The Old Act has no statement of legislative intent.	The preamble to the New Act provides a detailed statement of the bill's intent.

STATUTORY GAP ISSUE IN OLD ACT	PROVISION ADDRESSING GAP IN THE NEW ACT
4. Ambiguity about whether members may receive interim distributions from the LLC. The Old Act appears to imply that the members may not receive interim distributions of profits from the LLC (i.e., distributions other than in liquidation of the LLC) unless the operating agreement so provides.	Section 94 of the New Act provides provide that an LLC may make interim distributions upon the majority vote of the members of a member-managed multi-member LLC and upon the majority vote of the managers of a manager-managed multi-member LLC.
5. No statement as to responsibilities of managers. The Old Act does not define the responsibilities of LLC managers.	Section 49, II of the New Act provides that unless the operating agreement provides otherwise, managers have general responsibility for managing the LLC.
6. No clear authorization to members to remove managers. The Old Act is silent as to whether members may remove a manager with whom they are dissatisfied.	Section 50, II of the New Act provides that managers may be removed upon the majority vote of the members.
7. No clear fiduciary rules. The Old Act has no clear fiduciary rules.	Part 15 of the New Act contains comprehensive fiduciary rules.
8. No provision for member lawsuits to obtain LLC information. The Old Act does not provide clear and comprehensive rule for lawsuits in which members may seek information about possible mismanagement and about other matters that concern them as members.	Section 56 of the New Act provides for a specific type of lawsuit available to LLC members to seek information from their LLCs.
9. Silence about key charging order issues. Section 47 of the Old Act fails to address several important issues concerning charging orders, including the issue whether they are exclusive and whether they apply to single-member LLCs.	Section 126 of the New Act addresses comprehensively all significant issues relating to charging orders.
10. Arguable ambiguity about nature of statutory conversions. The New Hampshire Department of Revenue Administration appears to take the position that the Old Act is ambiguous as to whether two or more entities can participate in a statutory conversion and as to whether these conversions can result in transfers of real property.	Section 147 of the New Act comprehensively addresses all significant issues about statutory conversions, including the questions of whether they involve only a single entity and whether they can trigger transfers of property.
11. Ambiguity about whether members may bring "direct actions." The Old Act is ambiguous about whether members who believe that other members or managers have breached their duties may bring lawsuits in their own name to challenge these breaches, or whether, instead, they must bring their claims as "derivative actions" (which are subject to complex procedural rules).	Section 190 of the New Act provides that a member has the option to bring an action against another member, a manager or the LLC either by direct action, or, if the member meets applicable statutory requirements, by a derivative action.

STATUTORY GAP ISSUE IN OLD ACT	PROVISION ADDRESSING GAP IN THE NEW ACT
12. Ambiguity as to whether LLCs may issue certificates of membership, etc. Section 46,III of the Old Act provides that the LLC agreement may provide that an LLC may issue a certificate of limited liability company interest, but the Old Act does not provide for certifications of membership.	Section 57 of the New Act provides that operating agreement may authorize LLCs to issue certificates of membership and other certificates concerning members' rights as members.
13. Ambiguity about the types of matters members of manager-managed multi-member LLCs may be decided by member vote. The Old Act is unclear as to the types of matters that may be decided by vote of the members of manager-managed multi-member LLCs.	Section 66, II of the New Act identifies all of these types of issues.
14. Ambiguity as to member voting requirements. The Old Act is unclear as to whether certain types of matters that members may decide by vote must be decided by majority vote of the members or by unanimous vote.	Section 67 of the New Act clarifies which types of member matters must be decided by unanimous vote and which types may be decided by majority vote.
15. Ambiguity regarding elimination, etc. of fiduciary duties. The Old Act is unclear as to whether an operating agreement may expand, restrict or eliminate the fiduciary and other duties of members and managers.	Section 107 of the New Act provides permits LLC agreements to do these things.
16. Ambiguity about exculpations. The Old Act is unclear as to whether an operating agreement may restrict or eliminate ("exculpate") the personal liability of members and managers for breaches of the agreement.	Section 115 of the New Act provides, following DLLC Act § 18-1101(b), permits LLC agreements to do these things.
17. Lack of provisions permitting waivers of liability shields. The Old Act contains no provision permitting members to waive their liability shield.	Section 23 of the New Act provides this right. A waiver may be useful to, among other things, enable members to include their shares of LLC debt in their outside basis under Internal Revenue Code § 752.
18. Ambiguity about pledges of membership rights. The Old Act is unclear as to whether members may pledge their membership rights as collateral for loans.	Section 121(I) of the New Act provides that members may make these pledges only upon the unanimous vote of the other members.
19. Ambiguity as to continuity of life of single-member LLCs. The Old Act is unclear whether a single-member LLC whose members is an individual will continue to existence after the member's death.	Section 153 of the New Act provides, in essence, that unless the operating agreement provides otherwise, upon the death of an individual who is the member of a single-member LLC, the member's successor shall become a substituted member.

§ 2.03 THE FIDUCIARY RULES IN THE OLD AND NEW ACTS

1) Under the common law, persons who agree to manage the property or personal affairs of other persons automatically become subject to a variety of fiduciary rules unless the parties

agree otherwise; and breaches of these rules can subject them to serious legal and equitable remedies, including dismissal from their positions of trust, disgorgement of profits, and personal liability for money damages. In an LLC, fiduciary rules constitute, in effect, the LLC's "team spirit" and ethical code." To the extent that the members are aware of them and comply with them, these rules can make a major contribution to the success of the LLC and to the personal satisfaction of the members in working for them. However, to the extent that members breach them, whether knowingly or not, these breaches can cause the LLC serious or fatal harm.

2) However, as I have discussed at length in the Franklin Pierce Law Review article noted in Chapter 1, the Old Act contains no clear fiduciary rules. Part 15 of the New Act includes comprehensive fiduciary rules. These rules include, above all:

   a) A duty of care whose standard is the standard of reasonableness is set forth in the current version of the American Bar Association Revised Model Business Corporation Act; and

   b) A duty of loyalty, defined as a duty to act in a manner they reasonably believe to be in the best interest of the LLC.

3) In addition, the New Act also includes a statutory business judgment rule reflecting current New Hampshire case law; and it includes the eight duties subsidiary to the general duty of loyalty. These include, for example:

   a) A duty, absent the consent of the other members, not to compete against the LLC,

   b) A duty not to engage in self-interested transactions,

   c) A duty not to usurp business opportunities,

   d) A duty of disclosure,

   e) A duty to use LLC property only for LLC purposes,

   f) A duty to avoid improper personal benefits,

   g) A duty of confidentiality, and

   h) A duty to act in fiduciary good faith.

4) Finally, Part 15 imposes on LLC managers and members a duty to comply with the implied contractual covenant of good faith and fair dealing, and it defines this duty in a manner that, the BIA Drafting Committee hopes, will make it difficult to evade.

§ 2.04 NEW ACT REVISIONS OF DEFAULT RULES IN THE OPERATING AGREEMENT THAT FAIL THE "PLURALITY" TEST

The following table identifies the principal default rules of the New Act that differ in their content from the corresponding rules in the Old Act.

CITATION AND SUMMARY OR QUOTATION OF RULE IN OLD ACT	CITATION AND SUMMARY OR QUOTATION OF RULE IN THE NEW ACT; COMMENTS
1. Dissociations upon bankruptcy. Section 27, I(d) of the Old Act provides that members shall be dissociated upon becoming bankrupt.	Section 151 of the New Act provides that individuals who are members of single-member LLCs will be dissociated only upon their death or resignation.
2. Member removals. Section 27, IV of the Old Act provides, in essence, that a member may be removed for inability or unwillingness to exercise management responsibilities, for unauthorized actions and for fraud and illegal conduct.	Section 105 of the New Act permits members to sue to obtain the removal of other members, but it also provides broad protections for members sought to be removed.
3. Standard of care. Section 31,VI(a) (first clause) of the Old Act appears to imply that the duty of care of members and managers is merely to avoid gross negligence and willful misconduct.	Section 108 of the New Act provides for a standard of care of reasonableness.
4. Liability for breaches of duty of care. Section 31,VI(a) (second clause) of the Old Act appears to provide that members and managers shall be personally liable to the LLC and the members only for gross negligence and willful misconduct.	The New Act does not specifically address the liability of LLC members and managers for personal damages. However, various New Act provisions clearly imply that they will have this liability if they breach their fiduciary or other duties. See, e.g., section 115, which provides that they will have no such liability if the operating agreement exculpates them from liability.
5. Formula for allocations of profits and losses. Section 38 (second sentence). This section provides that the LLC shall allocate its profits and losses among the members in proportion to their respective contributions that "have not been returned."	In Section 90, II of the New Act ("Formula for Allocations of Profits and Losses"), the quoted phrase is deleted.
6. Members' right to interim distributions. Section 40 of the Old Act appears to provide that the members of LLCs shall have no right to interim distributions unless the operating agreement so provides.	Section 94 of the New Act provides that unless the operating agreement provides otherwise, (i) in member-managed multi-member LLCs, the members by majority vote may decide from time to time whether the LLC shall make interim distributions to the members; (ii) in manager-managed multi-member LLCs, this decision may be made by majority vote of the managers.
7. Dissociation upon transfer of LLC interest. Section 46, II(b) of the Old Act provides that a member will be dissociated upon transferring the member's entire limited liability company interest.	In the New Act, the provision contained in § 46, II(b) of the Old Act has been deleted.

§ 2.05 PROVISIONS UNDER THE OLD AND NEW ACTS FOR SINGLE-MEMBER LLCS WHOSE MEMBERS ARE INDIVIDUALS

1) IRS filing statistics suggest that as many as half of all New Hampshire LLCs currently in existence are single-member LLCs whose members are individuals. The Old Act contains a number of provisions that are favorable to these individuals; but it also contains a number that are not.

2) A major priority of the BIA Drafting Committee was to identify all LLC statutory business organization law issues likely to be relevant to individuals who are members of single-member LLCs; to retain in the New Act any Old Act provisions favorable to these individuals; to change any that were unfavorable to them; and to address in their favor any of these issues on which the Old Act is silent. The results are summarized in the table set forth in Exhibit 2-1 of this chapter.

3) The main similarities between the two acts with respect to dissociations of individuals who are members of single-member LLCs are as follows:

   a) Dissociation of member upon his or her death. Both § 27, I(a) of the Old Act and §§ 100, V and § 151 of the New Act provide that, unless the operating agreement provides otherwise, the death of an individual who is a member of a single-member LLC will dissociate the member. However, both acts also provide that upon the death of these individuals, their membership rights will pass automatically to their successors and there will be no termination of the LLC's legal existence nor any dissolution, winding-up or liquidation of their LLC.

   b) No dissociation of member under Old Act upon adjudication of incompetence. Under Old Act §27, I(e)(2), an individual who is a member of a single-member LLC will not be dissociated as a member if a court adjudicates that the member is incompetent to manage the member's property or person. Furthermore, § 46, I of the Old Act provides that upon such an adjudication, the member's guardian may exercise the member's membership rights. Under New Act § 151, unless the operating agreement provides otherwise, an individual who is a member of a single-member LLC will be not be dissociated upon the member being adjudicated to be incompetent. Thus, upon this adjudication, the LLC will continue in existence and will not be dissolved, although it seems clear that, upon the adjudication, the member's guardian may exercise the member's membership rights under general principles of guardianship law.

4) There are, however, two key differences between the dissociation provisions of the Old Act as applicable to individuals who are members of single-member LLCs; and comments on the significance of these differences.

   a) Bankruptcy. The Old Act provides that unless the operating agreement provides otherwise their operating agreement provides otherwise, individuals who are members of single-member LLCs will be dissociated if they become bankrupt. Under § 151 of the New Act, they will not be dissociated from their LLCs.

      (1) Comment. If individuals who are members of single-members LLC under the Old Act become dissociated, their LLCs LLC will automatically become dissolved under the Old Act. This dissolution may prevent these members from using their LLCs to emerge from bankruptcy or may legally invalidate the actions of the LLC during the dissolution. These problems cannot occur

for individuals who are members of single-member LLCs, since their bankruptcy will not cause their dissociation.

b) Transfers of LLC interests. The Old Act provides that if individuals who are members of single-member LLCs transfer their entire LLC interest to other persons, the legal existence of their LLCs will automatically terminate. The New Act provides that unless the operating agreement provides otherwise, members' transferring their entire LLC interest will not cause their dissociation or, accordingly, the termination of the existence of their LLCs.

(1) Comment. It is possible that for estate planning reasons or otherwise, individuals who are members of single-member LLCs may want to transfer their entire LLC interest. However, many of these individuals may not know that their doing so will terminate the existence of their LLC. Unknowingly operating a business organization that is no longer an LLC and thus no longer has a liability shield or other legal benefits of being an LLC may cause serious legal issues for such an individual. These issues cannot arise for individuals who are members of New Act single-member LLCs.

5) Finally, there are potentially very importance differences between the pick-your-partner provisions and charging order provisions of the Old Act and the New Act:

a) Protection of membership rights of individuals who are members of single-member LLCs under Old Act § 46, I (second sentence). While the matter is unclear, it appears that under Old Act § 46, I (second sentence), if a creditor obtains an unsatisfied judgment against an individual who is a member of a single-member LLC, no provision of the Old Act will prevent the creditor from levying on the member's membership rights. See, e.g., § 49, I (second sentence), which probably must be construed to protect members of multi-member LLCs from levies by judgment creditors on their membership rights, but not members of single-member LLCs.

b) Old Act § 46, I (second sentence). Protection of LLC interests of individuals who are members of single-member LLCs under Old Act § 47. While the matter is unclear, Old Act § 47 probably should be construed to provide that judgment creditors of individuals who are members of single-member LLCs may either (i) obtain charging orders against the LLC interests of those members or (ii) may levy on those LLC interests.

c) Protection of membership rights of individuals who are members of single-member LLCs under New Act § 126. Under New Act § 126, a judgment creditor of an individual who is a member of a single-member LLC can levy on the membership rights of the individual only if distributions to the creditor under a charging order under that section are unlikely to pay the judgment within a reasonable time.

§ 2.06 PROVISIONS IN THE OLD AND NEW ACTS PROVIDING FOR STATUTORY FLEXIBILITY

The Delaware Limited Liability Company Act (the "DLLC Act") contains 20 principal permissive provisions that provide flexibility to LLC members to tailor their LLCs to meet member needs and interests. All of them are listed in the table below. Many of these provisions are contained in the Old Act, but several are not. In the New Act, the Legislature included all flexibility provisions in the Old Act and all other DLLC Act

flexibility provisions except those few that were clearly inappropriate for New Hampshire—namely, those identified in Rows 3 and 6 through 8 of the table. The New Act contains, in all, seven DLLC Act flexibility provisions not contained in the Old Act—namely, those listed in Rows 1, 2, 12, 16, 19, and 20 in the table (all of which are shaded in the table).

FLEXIBILITY PROVISION IN DLLC ACT	IS THIS PROVISION INCLUDED IN THE OLD ACT?	IS THIS PROVISION INCLUDED IN THE NEW ACT?
1. "Any person" rights in operating agreements. Operating agreements may provide rights to "any person." DLLC Act § 18-101(7).	No.	Yes. New Act §45 (Operating Agreements May Provide Rights to Any Persons, Including Non-Parties).
2. Non-signers of operating agreements as LLC members. Persons may be admitted as LLC members even if they do not sign the LLC agreement. DLLC Act § 18-101(7)(b).	No.	Yes. New Act § 46, II (Admissions of Members under Operating agreements without Signatures).
3. Unrestricted indemnifications. The members may indemnify any person from any and all claims whatsoever. DLLC Act § 18-108.	No.	No.
4. Mergers. LLCs may merge into other LLCs or into non-LLC entities. DLLC Act § 18-209.	Yes. Old Act§ 18 (Mergers).	Yes. New Act § 155 (Mergers of Limited Liability Companies With Other Business Entities—In General).
5. Appraisal rights. LLC agreements may provide appraisal rights in connection with amendments of the LLC agreement, mergers, consolidations, statutory conversions, transfers, domestications, and sales of all or substantially all assets. DLLC Act § 18-210	Yes. Old Act § 22-a *et seq*.	Yes. New Act § 160 *et. seq*.
6. "Domestications." Non-US entities may become "domesticated" as Delaware entities if applicable non-U.S. law permits. DLLC Act § 18-212	No.	No.
7. "Transfers." A Delaware LLC may constitute itself a non-U.S. entity in any non-U.S. jurisdiction whose laws permit. DLLC Act § 18-213	No.	No.
8. Series LLCs. Delaware non-series LLCs may become series LLCs. DLLC Act § 18-215	No.	No.

FLEXIBILITY PROVISION IN DLLC ACT	IS THIS PROVISION INCLUDED IN THE OLD ACT?	IS THIS PROVISION INCLUDED IN THE NEW ACT?
9. Statutory conversions of non-LLC entities to LLCs. Non-LLC entities may make statutory conversions into LLCs. DLLC Act § 18-214	Yes. Old Act § 17-a, I (Conversion of Other Business Entities to Limited Liability Companies).	Yes. New Act § 149, I (Statutory Conversions of Other Business Entities to Limited Liability Companies).
10. Statutory conversions of LLCs to non-LLC entities. LLCs may make statutory conversions to non-LLC entities. DLLC Act § 216(a)	Yes. Old Act § 17(B), I (Approval of Conversion of a Limited Liability Company).	Yes. New Act § 150, I (Approvals of Statutory Conversions of Limited Liability Companies to Other Business Entities).
11. Non-contributing members. Persons may become LLC members and may receive limited liability company interests without making contributions to the LLC. DLLC Act 18-301(d) (first sentence)	Yes. Old Act § 23, III (Admission of Members).	Yes. New Act § 53, III (Admissions of Members).
12. Creations of new classes of members, etc. An LLC agreement may provide for the taking of specified actions, including the creation of new classes of limited liability company interests and amendments of the LLC agreement. DLLC Act § 18-302(a)	No.	Yes. New Act § 54 (Classes of Members, Etc.).
13. Non-voting members. LLC agreements may provide for non-voting members. DLLC Act § 18-302(a) (third sentence)	Yes. Old Act § 24, II (Classes, Meetings, and Voting of Members).	Yes. New Act § 54, II (Classes of Members, Etc.).
14. Manager discretion with regard to LLC information. LLCs may exercise broad discretion to keep LLC information confidential from the members if, among other things, the managers "believe in good faith" that non-disclosure is in the best interest of the LLC or could damage the LLC. DLLC Act § 18-305(c)	Yes. Old Act § 28, III (Access to and Confidentiality of Information; Records).	Yes. New Act § 55, IV(a-c) (Members' and Managers' Rights to Limited Liability Company Information).

FLEXIBILITY PROVISION IN DLLC ACT	IS THIS PROVISION INCLUDED IN THE OLD ACT?	IS THIS PROVISION INCLUDED IN THE NEW ACT?
15. Penalties against members. An LLC agreement may impose penalties on members upon their breaching the agreement or upon the occurrence of other events specified in the agreement. DLLC Act § 18-306	Yes. Old Act § 29, I-II (Remedies for Breaches of Operating Agreements by Members); § 37, IV (Liability for Contribution).	Yes. New Act § 87, VII (Liability of Members for Promised Contributions); § 88, I-II (Remedies for Breaches of Operating Agreements by Members).
16. Manager actions without member votes. An LLC agreement may provide for an LLC's taking specified actions without the vote of any manager, including the creation of new classes of limited liability company interests and amendments of the LLC agreement. DLLC Act 18-404(a) (second sentence)	No.	Yes. New Act § 77 (Permissibility of Manager Actions Not Requiring Manager Votes).
17. Penalties against managers. An LLC agreement may provide for the imposition of penalties on managers for breaches of the agreement or upon the occurrence of other events specified in the agreement. DLLC Act § 18-405	Yes. Old Act § 34, I-II (Remedies for Breaches of Operating Agreement by Managers).	Yes. New Act § 114, I-II (Remedies for Breaches of Operating Agreements by Managers).
18. Contractual freedom. The policy of the DLLC Act is to give the maximum effect to the principle of freedom of contract and to the enforceability of LLC agreements. DLLC Act § 18-1101(b)	Yes. Old Act § 78 (Construction and Application of Chapter and Limited Liability Company Agreement).	Yes. New Act §2 (The Policy of this Act).
19. Elimination, etc., of duties. An LLC agreement may expand, restrict or eliminate the duties of members, managers and other persons except for those arising under the implied covenant of good faith and fair dealing. DLLC Act § 18-1101(c)	No.	Yes. New Act § 107 (Expansion, Restriction and Elimination of Duties).
20. Exculpations. An LLC agreement may limit or eliminate the liability of members, managers and other persons for breaches of contract and other breaches of duties except those arising under the implied covenant of good faith and fair dealing. DLLC Act § 1101(e)	No.	Yes. New Act § 115 (Exculpations—in General).

§ 2.07 STATUTORY TERMS NOT DEFINED IN THE OLD ACT BUT DEFINED IN THE NEW ACT

1) "Membership rights." The Old Act contains no term for the totality of a member's rights as a member. The New Act defines the totality of a member's rights as the member's "membership rights." New Act § 15 (Membership Rights—definition). This term can be useful in many contexts, but especially in connection with the sale or other transfer of the totality of a member's rights as a member and in defining creditors' rights against LLC member-debtors.

2) Other terms. The following 13 terms that are used in the Old Act but not defined in it are defined in the New Act.

   (1) "Allocation" (New Act § 89 Allocations--definition);

   (2) "Distribution" (New Act § 9, I (Distributions, etc.—definitions);

   (3) "Interim distribution" (New Act § 91, I (Distributions, etc.—definitions);

   (4) "Liquidating distribution" (New Act § 91, I (Distributions, etc.—definitions);

   (5) "Dissociation (of a member)" (New Act § 98 (Disassociation--definition);

   (6) "Vote" (New Act § 64, I (Vote—definition);

   (7) "Majority vote of the members" (New Act § 64, I (Majority Vote of Members—definition);

   (8) "Majority vote of the other members" (New Act § 64, III (Majority Vote of Other Members—definition);

   (9) "Disinterested member" (New Act § 64, IV (Disinterested Member--definition);

   (10) "Transfer" (of membership rights or limited liability company interests) (New Act § 118, I-II (Transfers—Etc.—definition);

   (11) "Dissolution" (of an LLC) (New Act § 128, I (Dissolution--definition);

   (12) "Winding up" (of an LLC) (New Act § 128, II (Winding-up--definition); and

   (13) "Liquidation" (of an LLC) (New Act § 128, III (Liquidation—definition).

§ 2.08 THE ELIMINATION OF OLD ACT "LEGALESE" IN THE NEW ACT

The word "legalese" is often used to describe a distinctive prose style, too often found in the writings of lawyers, with the following chief characteristics:

- Run-on sentences;
- Run-on paragraphs;
- A preference for complex, unfamiliar and pompous words, including foreign words, over familiar English words;
- A preference for the passive voice over the active voice; and
- The frequent use of two or more words where one will suffice.

In revising the Old Act, the BIA Drafting Committee made a major effort to avoid legalese and, instead, to write the New Act in plain English. It did so in order to make the provisions of the New Act as intelligible as possible for judges, lawyers and the occasional business owners, including owners of New Hampshire small businesses, who have the occasion to read them. Among other things, it sought to identify all run-on sentences and to break them up into shorter sentences; it sought to identify all run-on paragraphs and break them up into two or more short paragraphs; and wherever the context permitted, it provided captions for New Act sections and subsections.

Finally, it made the following changes in specific terms of the Old Act:

1) Active voice. It substituted the active voice for the passive voice wherever possible.

2) "Consent, etc." The Old Act uses, more or less interchangeably, the terms "consent," "approval" and "vote" for the same concept. To prevent disputes about whether there may be some subtle legal distinction among these terms, the BIA Drafting Committee changed the words "consent" and "approval" and words with the same roots as these words to the word "vote" (and words with a similar root) through the New Act.

3) "Consummation." It changed the pompous word "consummation" to "completion."

4) "Execute." It changed the ambiguous legalism "execute" to "sign."

5) "Heretofore, etc." It removed all words such as "heretofore," "thereof," and "thenceforth."

6) "Pursuant to" and "in accordance with." It replaced the legalisms "pursuant to" and "in accordance with" with the plain English term "under."

7) "Transfer." It used the word "transfer" and words with the same root as "transfer" for the specialized LLC term of art "assign" and terms with the same root as "assign."

8) Sexism. It eliminated all sexist terminology in the Old Act, such as the Old Act's reference to the state treasurer as "he."[1]

[1] [1] To my embarrassment, I am compelled to admit that in revising the provisions of the Old Act in the New Act, the BIA Drafting Committee somehow overlooked the ancient French legal term "choses in action," which appeared in Old Act § 17-a, VIII(b) ("Conversion of Other Business Entities to Limited Liability Companies" and Old Act § 22, IV ("Effects of Merger"). However, during its review of the New Act, the House Ways and Means noticed this term and changed it to the plain English term "related claims."

TABLE 2-1

LLC STATUTORY BUSINESS ORGANIZATION LAW ISSUES RELEVANT TO INDIVIDUALS WHO ARE MEMBERS OF SINGLE-MEMBER LLCS; OLD AND NEW ACT PROVISIONS ADDRESSING THESE ISSUES

ISSUE	OLD ACT	NEW ACT
1. Are the operating agreements of single-member LLCs enforceable?	Yes. Section 1, VI.	Yes. "An operating agreement of a single-member LLC shall not be unenforceable on the ground that there is only one party to the operating agreement." Section 43.
2. Will a member of a single-member LLC be dissociated if a court adjudicates that the member lacks capacity to manage the member's person or estate?	No, under § 27, I(e)(2).	No, unless the operating agreement provides otherwise. Section 100.
3. What events will cause the dissociation of an individual who is the member of a single-member LLC.	A member of a single-member LLC will be dissociated (i) if the member withdraws from the LLC (Section 27, I (a); (ii) unless the operating agreement provides otherwise, the member becomes bankrupt (Section 27, I(b); (iii) unless the operating agreement provides otherwise, the member assigns the member's entire LLC interest (Section 46, II (b)).	Unless the operating agreement provides otherwise, the member will be dissociated only upon the member's withdrawal under Section 152 or death (Section 100, V). See generally, § 151, which provides that "individuals who are members of single-member LLCs shall, unless the operating agreement provides otherwise, be dissociated upon their withdrawal or death."
4. If a member of a single-member LLC withdraws from the LLC, will the LLC be dissolved, wound up and liquidated?	Yes. Section 27, I(a).	Yes, unless the operating agreement provides otherwise. Section 152
5. Will death cause the member to be dissociated?	Yes. Section 27, I(e)(1).	Yes. Section 151.
6. What will happen to the member's membership upon the member's death?	It will pass to the member's successor. Section 23, II(c); Section 48, I(c).	Unless the operating agreement provides otherwise, upon the death of an individual who is the only member of an LLC, the individual's membership shall pass to the individual's estate and the LLC shall not be dissolved. Section 131, I.
7. Will bankruptcy cause the member to be dissociated?	Yes (unless the operating agreement provides otherwise).	No, unless the operating agreement provides otherwise.
8. Will resignation cause the member to be dissociated	Yes.	Yes.

ISSUE	OLD ACT	NEW ACT
9. Will the member's death cause the LLC to be dissolved?	No.	No. Under § 131, the member's membership will pass automatically to the member's estate and the LLC shall not be dissolved.
10. Will the member's death cause the LLC to cease to exist as a legal entity?	No.	No.
11. Can a judgment creditor of the member of a single-member LLC succeed to the member's membership?	Yes.	Yes, if the creditor purchases the member's membership rights in an execution sale, the creditor shall become the sole member of the limited liability company. Section 126, VII
12. Will the legal representative of a deceased member have the right to exercise the member's membership rights upon the member's death?	Yes. Section 49 (first sentence)	Unless the operating agreement provides otherwise, upon a member's death, the member's legal representative may exercise the member's membership rights for the purpose of settling the member's estate. Section 105-A, I.
13. Will an individual who is a member of a single-member LLC and whom a court declares to be incapacitated be dissociated from the LLC when the judge issues that order?	No, under § 27, I(e)(2). "A person ceases to be a member of a limited liability company upon the occurrence of one or more of the following events: (e) unless the operating agreement provides otherwise, except in the case of a single-member LLC, the entry of an order by a court of competent jurisdiction adjudicated the member incompetent to manage the member's person or estate."	No, under § 100, VI.
14. Will the legal representative of a deceased member have the right to exercise the member's membership rights if a court determines that the member is incapacitated?	Yes, under § 49 (first sentence).	Yes. Under § 151, the member's incapacitation will not cause the member to be dissociated. The New Act does not address the issue of who may exercise the member's membership rights if the member becomes incapacitated, but presumably under New Hampshire guardianship law, the member's guardian will be entitled to exercise the member's membership rights.

Chapter 3

PROTECTING THE MEMBERSHIP RIGHTS OF LLC MEMBERS FROM THIRD PARTIES—THE "PICK-YOUR-PARTNER" PROVISIONS AND CHARGING ORDER PROVISIONS OF THE OLD AND NEW ACTS

OVERVIEW

TABLE OF EXHIBITS

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§3.01 INTRODUCTION

[A] THE IMPORTANCE TO NEW HAMPSHIRE LLC MEMBERS OF PROTECTING THEIR LLC MEMBERSHIP RIGHTS FROM THIRD PARTIES

1) For many New Hampshire LLC members, and especially for those who are members of relatively small LLCs in which they play active management roles, protecting their LLC membership rights from the risk that a court may order the transfer of these rights to creditors or other third parties (such as former spouses in divorce actions or trustees in bankruptcy) is a crucial matter. This is so not only because the LLC membership rights of these members are often a major source of income for them; it is also because their participation in the business and internal affairs of their LLCs often provides them with important professional, social and personal meaning.

2) Two types of LLC statutory provisions in the Old and New Acts—often described by LLC lawyers as, respectively, "pick-your-partner" provisions and "charging order" provisions—protect LLC members from the above risk. The purpose of this chapter is to explain these provisions and to compare them as they appear in the Old and the New Acts. As the chapter will demonstrate, both the pick-your-partner provisions and the charging order provisions of the New Act provide members with substantially stronger protections from the above risk than the corresponding provisions of the Old Act.

3) The superiority of the New Act pick-your-partner provisions and charging order provisions over those of the Old Act will, of course, be of great importance to LLC members if they ever become defendants in collection suits by judgment creditors or other third-party claimants. However, even apart from these suits, the superiority of these provisions of the New Act is important:

   a) To the members of Old Act single-member and multi-member LLCs in deciding whether to make elections under New Act § 5 to be subject to the New Act before the January 1, 2014 date on which that act will automatically apply to them; and

   b) To New Hampshire business founders, for whom, as will be shown, the New Act pick-your-partner provisions and charging order provisions provide stronger non-tax reasons than the provisions of the Old Act for choosing to conduct their businesses, whether they are single-owner or multi-owner businesses, as LLCs rather than as corporations.

[B] KEY DEFINITIONS—"MEMBERSHIP RIGHTS," "ALLOCATIONS OF PROFITS AND LOSSES," ETC.

Before proceeding to a discussion of the pick-your-partner provisions and charging order provisions of the Old and New Acts as such, it will be useful to define nine key LLC terms of art basic to that discussion.

1) Membership rights. The Old Act contains no definition of the term "membership rights." New Act § 15 defines the term as follows:

   "Membership rights" means the totality of the member's rights as a member under this act, including both economic rights, such as the member's limited liability company interest, and non-economic rights, such as the member's voting rights, if any.

2) Allocation of profits and losses. The Old Act contains no definition of the term "allocation of profits and losses." New Act § 89 defines the term as follows:

   Unless the operating agreement provides otherwise, an allocation by the limited liability company to its members of its profits and losses shall mean an apportionment to the members of their respective shares of these profits and losses on the books of the limited liability company.

3) Limited liability company interest. Old Act § 2, VII defines the term "limited liability company interest" as follows:

   "Limited liability company interest" means a member's share of the profits and losses of a limited liability company and a member's right to receive distributions of the limited liability company's assets.

In the New Act, the definition of the term "limited liability company interest" (for which I'll use the abbreviated term "LLC interest" in the rest of this chapter) is essentially the same as in the Old Act. Under New Act § 12:

> *"Limited liability company interest" means the right of a member to receive allocations of the profits or losses of a limited liability company and to receive distributions of the limited liability company's cash and other assets.*

4) Distribution. The Old Act contains no definition of the general term "distribution" or of the subsidiary terms "interim distribution," and "liquidating distribution." New Act § 91, I defines "distribution" as follows:

> *Unless the operating agreement provides otherwise, the following terms shall have the following meanings:*
>
> *I. Distribution. A distribution by the limited liability company to a member shall mean any transfer of its cash or other assets to the member except:*
>
> > *(a) Payments to a member relating to a transaction between the limited liability company and a member acting in a capacity other than as a member;*
> >
> > *(b) Payments to a member made without regard to the limited liability company's profit or loss for services to or for the limited liability company or for the limited liability company's use of the member's capital; and*
> >
> > *(c) Payments to a member under a limited liability company's indemnification obligations as referenced in RSA 304-C:116 or a limited liability company's obligation to advance expenses as referenced in RSA 304-C:117.*

5) Interim distribution. The Old Act does not define the term "interim distribution." New Act § 91, II defines "interim distribution" as follows:

> *II. Interim Distribution. An interim distribution to a member shall mean any distribution except a liquidating distribution, as defined in paragraph III.*

6) Liquidating distribution. The Old Act does not define the term "liquidating distribution." New Act § 91, III defines liquidating distribution as follows:

> *III. Liquidating Distribution. A liquidating distribution shall mean a distribution in connection with:*
>
> > *(a) The limited liability company's partial or complete redemption of a member's membership rights; or*
> >
> > *(b) The limited liability company's dissolution and liquidation.*

7) Foreclosure, levy, execution and attachment. A foreclosure order in an LLC charging order case means an order by a court requiring the sale of the debtor-member's LLC interest to a creditor or other third party. Under the laws of many states, including New Hampshire, the meaning of the terms "levy," "execution" and "attachment" is, for charging order purposes, the same in practice as that of the term "foreclosure."

8) Assignment. Under the Old Act, the term "assignment" is not defined, but the use of the term in that act makes clear that it means a transfer of an LLC interest by an LLC member or other

holder to another person. The New Act does not use the term "assignment"; rather, for simplicity, it uses the term "transfer" to refer to transfers of both "management" rights and LLC interests.

9) "Management rights." The term "management rights" is not used in either the Old or the New Act, but it is widely used by LLC lawyers and legal scholars to describe the type of rights that LLC statutory pick-your-partner provisions protect. Unfortunately, the term is misleading, since, as discussed below, under both the Old and the New Act, many of these rights are *not* management rights in any conventional sense of the term. In deference to its wide use, I will use the term "management rights" in this chapter from time to time. However, to emphasize its misleading character, in using the term in this chapter I'll put the word "management" in quotes.

[C] THE LLC BUSINESS ORGANIZATION LAW "PARTNER COMPATIBILITY" POLICY

The legislative policy at the heart of LLC statutory law in the Old Act, the New Act and, indeed, in all U.S. LLC acts is the "partner compatibility" policy (referred to in this chapter, for brevity, as the "pick-your-partner" policy). Under this policy, the compatibility of the members of multi-member LLCs in participating in the management and affairs of their LLCs is viewed both by legislatures and by the courts:

1) As critical to the success and even the survival of LLCs; and thus

2) As warranting not only an expectation but also indeed a fundamental legal right in favor of the members to be able to choose their co-members without the interference of third parties.

§3.02 THE PICK-YOUR-PARTNER PROVISIONS OF THE OLD AND NEW ACTS AS APPLICABLE TO GRANTS AND TRANSFERS OF MEMBERSHIP RIGHTS—OVERVIEW

1) The concern of the New Hampshire Legislature to ensure the compatibility of LLC members when it originally enacted the Old Act in 1993 is reflected in two principal provisions of that act—namely, Old Act § 23, II and Old Act § 46, I (third sentence).

   a) Old Act § 23, II provides in effect that unless the operating agreement provides otherwise, a multi-member LLC after its formation may not grant admission to a person as a new member except with the consent of all existing members. Old Act § 23, II appears by its terms to bar LLCs from granting *either* "management" rights *or* LLC interests to third parties except with this consent.

      Old Act § 23, II(a) provides as follows:

      II. After the formation of a limited liability company, a person acquiring a limited liability company interest is admitted as a member of the limited liability company:

      (a) In the case of a person acquiring a limited liability company interest directly from the limited liability company, at the time provided in and upon compliance with the limited liability company agreement or, if the limited liability company agreement does not so provide, upon the consent of all members and when the person's admission is reflected in the records of the limited

liability company. . .

b) The third sentence of Old Act § 46, I provides in effect that unless the operating agreement provides otherwise, a member of an LLC may not transfer to another person the member's "right to participate in the management and affairs of a limited liability company" except with the unanimous consent of the other members. Old Act § 48, I(a) is to the same effect.

Old Act § 46,I provides in its entirety as follows:

§ 304-C:46. ***ASSIGNMENT OF LIMITED LIABILITY COMPANY INTEREST***

I. A limited liability company interest is assignable in whole or in part, except as provided in a limited liability company agreement. Except as otherwise provided in paragraphs I and II, or as provided in RSA 304-C:48 and RSA 304-C:49, the assignee of a member's limited liability company interest shall not be entitled to participate in the management and affairs of a limited liability company, or to exercise any rights or powers of a member. However, an assignee of a member's limited liability company interest may exercise the rights and powers of a member either:

(a) Upon the approval of all of the members of the limited liability company other than the member assigning the limited liability company interest; or

(b) To the extent provided in the limited liability company agreement, and upon compliance with any procedure provided for in the limited liability company agreement.

2) However, presumably because the Legislature in 1993 viewed members' LLC interests as less important than "management" rights in ensuring member compatibility under the pick-your-partner policy, the first sentence of Old Act § 56, I, as set forth above, provides that members of multi-member LLCs may transfer these LLC interests to other persons *without* the consent of other members.

3) Like Old Act § 23, II, New Act § 120 provides that multi-member LLCs after their formation may not grant membership rights to existing or new members except with the unanimous consent of all existing members. New Act § 120 provides in its entirety as follows:

304-C:120 ***LIMITED LIABILITY COMPANY GRANTS OF MEMBERSHIP RIGHTS.***

Unless the operating agreement provides otherwise, after the formation of the limited liability company, the limited liability company shall not grant membership rights to a third party or additional membership rights to an existing member, except upon a unanimous vote of the members.

4) In addition, New Act § 121, I provides in effect that unless the operating agreement provides otherwise, members of multi-member LLCs may transfer their membership rights, with the exception of their LLC interests, only upon the unanimous consent the other members; while

New Act § 123, I provides that unless the operating agreement provides otherwise, the members of multi-member LLCs may transfer their LLC interests to other persons *without* the consent of any other members.

New Act § 121, I provides as follows:

> *304-C:121* ***TRANSFERS OF MEMBERSHIP RIGHTS.***
>
> *Unless the operating agreement provides otherwise, or as provided in RSA 304-C:123:*
>
> *I. No member shall transfer all or any part of the member's membership rights to any transferee except upon a unanimous vote of the other members. . .*

New Act § 123, I provides as follows:

> *304-C:123* ***TRANSFERS OR PLEDGES OF LIMITED LIABILITY COMPANY INTERESTS.***
>
> *I. Unless the operating agreement provides otherwise, a member may transfer or pledge a limited liability company interest, in whole or in part, without the vote of any other member.*

5) However, the manner of *defining the concept* of "management" rights for purposes of the statutory provisions governing transfers of management and non-management rights differs significantly as between the Old and the New Acts. Briefly:

   a) Although both acts provide for a bifurcation as between LLC interests and other LLC membership rights, neither act expressly uses the term "management rights."

   b) As noted above, Old Act § 46, I provides that unless the operating agreement provides otherwise, members may not, without the consent of all other members, transfer their "*right to participate in the management and affairs of a limited liability company*." However, the Old Act is unclear as to:

      i) Whether this "right to participate" implies a *narrow* definition of the rights to which the phrase refers—a definition, for example, that includes only agency rights and member and manager voting rights; or

      ii) Whether, instead, it implies a *broad* definition.

      Broadly defined, Old Act § 46 might be understood, for example, to include the right to obtain LLC information, the right to attend member meetings, and even rights to compensation from the LLC for services to or for it, redemption rights, cross-purchase rights and rights to use LLC property. (These "use" rights can be of substantial value to members of, for example, the many New Hampshire LLCs whose purpose is to hold and manage "family compounds").

   c) By contrast, while the New Act, like the Old Act, contains no express reference to the term "management rights," New Act § 24, II provides that "unless the operating agreement provides otherwise, membership rights, excluding LLC interests, shall be nontransferable except as provided in [§] 121"; while New Act § 121, in turn, provides, as noted above, that members of multi-member LLCs may transfer their LLC interests without the consent of any other members.

   d) Thus, read together, New Act §§ 24 and 121 would appear to provide that unless the

operating agreement provides otherwise, members may transfer *none* of their membership rights *except* their LLC interests unless they first obtain the unanimous consent of the other members.

6) Both the Old and the New Act are silent as to the right of members of *single*-member LLCs to transfer either their "management" rights or their other rights to other persons. However, it would be ludicrous to suggest that any statutory restrictions whatsoever apply to these transfers, since, by definition, the members of single-member LLCs have complete control of their LLCs; and no case or other authority, including any secondary authority, suggests otherwise.

7) Indeed, in light of the clear inapplicability of the pick-your-partner policy to single-member LLCs, the courts have had no hesitation in non-New Hampshire cases to order the members of single-member LLCs to transfer to judgment creditors their membership rights, including both their "management" rights and their other membership rights, in satisfaction of claims against them. See, e.g., *In re Albright*, 291 B.R. 538; 2003 Bankr. LEXIS 291; 50 Collier Bank. Cas. 2d (MB) 1 (Bankr. D. Colo., April 4, 2003). But see discussion below concerning New Act § 126, V(b).

§3.03 THE IMPACT OF OLD AND NEW ACT "MANAGEMENT" RIGHTS TRANSFER PROVISIONS IN COLLECTION ACTIONS AGAINST LLC MEMBERS

1) By their terms, the "management" rights transfer provisions of the Old and New Acts bind only *LLC members* who want to make transfers of these rights; they make no reference to *the courts* as potentially subject to their terms.

2) However, in numerous cases in which creditors holding unsatisfied judgments against the members of multi-member LLCs have petitioned the courts to transfer the members' "management" rights to the creditors, the courts, because of the pick-your-partner policy, have denied these petitions. *Weddell v. H20, Inc*., 271 P.3d 743 (Nev. 2012); *In re LaHood (Heartland Bank and Trust Company v. Covey*), No. 07-81727, slip op. (Bankr.C.D. Ill. July 16, 2009); *Brant v. Krilich*, 835 N.E.2d 582 (Ind.Ct.App. 2005). In other words, the courts in these cases have routinely viewed the pick-your-partner policy as applying not only to LLCs and their members but also to the courts themselves.

3) There appears to be no reported New Hampshire case involving the above type of petition, but there can be little doubt that, whether such a petition were to be brought under the Old or the New Act, the courts of New Hampshire in deciding it would apply the pick-your-partner policy in the same manner as the non-New Hampshire courts in the cases cited above.

4) Rather, any difference in the outcome of such an action under the two acts would presumably arise only from the difference in the implicit meaning of the concept of "management" rights under these acts. Under the Old Act, application of the pick-your-partner policy might well protect from creditors only a narrow range of membership rights, such as voting and agency rights; under the New Act, a far broader range of membership rights might well be protected.

5) Finally, since the rationale for LLC statutory pick-your-partner provisions is the partner compatibility policy, it is clear that the pick-your-partner provisions of either the Old Act or the New Act will protect the "management" rights of Old or New Act LLCs from levies by third parties. However, as discussed in greater detail below, it is also clear that New Act § 126, V(b) protects from levies by judgment creditors of members of New Act single-member LLCs on the "management" rights of these members except in situations in which distributions received by these creditors under charging orders against the LLC interests of

these members will not pay the relevant judgments in a reasonable time.

§3.04 THE IMPACT OF OLD AND NEW ACT CHARGING ORDER PROVISIONS ON TRANSFERS OF LLC INTERESTS TO CREDITORS

As noted, the pick-your-partner provisions of the Old and New Acts apply only to grants and transfers of "management" rights, including judicial transfers of these rights in collection actions. The provisions of these acts that govern judicial transfers of LLC member-debtors' *LLC interests*, including their rights to distributions from their LLC, are the charging order provisions of the two acts under, respectively Old Act § 47 and New Act § 126. The full texts of these two sections are set forth in the attached Exhibits 3-1 and 3-2. The chief similarities and differences of these provisions may be summarized as follows:

1) Both Old Act § 47 (first sentence) and New Act § 126, I provide that creditors who hold unsatisfied judgments against members of LLCs, including both single-member and multi-member LLCs, may apply to a court to obtain a "charging order" against the LLC interest of the member-debtor in question. Under both sections, if the court grants this order, the LLC in question must pay to the creditor, to the extent of the debt plus interest, any amounts it would otherwise have distributed to the member.

2) In addition, it is clear that under both sections, creditors obtaining charging orders obtain only the *distribution* rights of holders of LLC interests in the LLC and not any other membership rights. Furthermore, it is clear that these distribution rights do not include distributions *in general*, but rather, only distributions *that would otherwise be made to the member-debtors in question*. Old Act § 47 (second sentence); New Act § 126, I(b). Thus, under Old Act § 47 and New Act § 126, judgment creditors cannot obtain any "management" rights (as differently defined under the two acts); and New Act § 126, II expressly so provides.

3) However, it is unclear under Old Act § 47 whether a creditor may use any procedure *other* than a claim under that section to obtain the right to the above distributions—e.g., a mechanics lien or other non-charging order lien. By contrast, New Act § 126, IV makes it clear that the *only* type of remedy available under the New Act to a judgment credit of an LLC member-debtor-in-default with respect to these distributions is a charging order.[1]

4) More importantly, while it is unclear from the terms themselves of Old Act § 47 whether a creditor of an LLC member, in seeking satisfaction of its debt, has the right to foreclose on the LLC interest of the member, the clear answer is that it does have this right. This is because, in a 1997 case entitled *Baybank v. Catamount Construction Company, Inc.*, 141 NH 780, 693 A. 2d 1163 (New Hampshire 1997), the New Hampshire Supreme Court, interpreting a charging order provision under the

[1] LLC lawyers sometimes refer to LLC charging order provisions under which charging orders are the exclusive remedy of judgment creditors with respect to distributions payable to member-debtors and to those under which they are *not* the exclusive remedy as, respectively, "exclusive" and "non-exclusive" charging order provisions. Obviously, under this nomenclature, the Old Act charging order provisions are non-exclusive while those of the New Act are exclusive.

New Hampshire Limited Partnership Act essentially identical to Old Act § 47, held that such a foreclosure was available to the judgment creditor in question. The holding of the *Baybank* case unquestionably applies in construing Old Act § 47. By contrast, New Act § 126, V(a) expressly *bars* creditors of LLC member-debtors-in-default from foreclosing on the LLC interests of members of multi-member LLCs.

5) Furthermore, it is unclear whether Old Act § 47 protects from judgment creditors LLC interests held by persons who have received transfers of LLC interests from LLC members (e.g., by gift, will or sale). (As noted above, the Old Act and a number of other LLC acts refer to these transferees as "assignees" of LLC interests.) It is clear under § 126, IV (second sentence) that the New Act does *not* protect these transferees.

6) Finally, although it is also unclear whether Old Act § 47 protects from transfers to judgment creditors LLC interests held by members of single-member LLCs, cases such as the above *Albright* case strongly suggest that it does not. By contrast, the rules governing the application of the provisions of New Act § 126 to members of single-member LLCs are very clear in that section:

   a) In general, judgment creditors may not foreclose either on LLC interests held by members of single-member LLCs *or on any other membership rights held by these members*. New Act § 126, V(b).

   b) However, if these creditors can show that charging orders will not satisfy their judgments "within a reasonable time," a court may order an "execution sale" of *both* the member's LLC interest *and* the member's other membership rights. New Act § 126, VI(a). Furthermore, in a purchase under such an order, the purchaser will obtain not only the member's LLC interest but also all of the other membership rights of the member and will become the new member of the LLC. New Act § 126, VII(a-b).

§3.05 THE IMPACT OF NEW ACT § 126 ON THE DECISION OF OLD ACT LLCS WHETHER TO MAKE ELECTIONS UNDER NEW ACT § 5

1) As discussed in Chapter 3, New Act § 5 provides, in general, that the New Act will not govern Old Act LLCs until January 1, 2014; but that if all of the members of an Old Act LLC make a written election to be subject to the New Act, they and their LLC will become subject to the New Act on any earlier date on or after January 1, 2013 (the effective date of the New Act for LLCs formed under the New Act).

2) As indicated above:

   a) The definition of the concept of "management" rights in the New Act is arguably much broader than under the Old Act. Thus, assuming that in declining to transfer the "management" rights of a member of a New Hampshire LLC to a judgment creditor of the member, the courts adopt a broad interpretation of those rights, the "management" rights transfer provisions in New Act § 121, II and § 123, II will provide the member with substantially greater protection of the member's membership rights than the "management" rights transfer provision in Old Act § 46, I.

b) In addition, New Act § 126, I(b) ensures that the sole means by which judgment creditors of New Act LLC member-debtors can reach distributions otherwise payable to these members is a charging order; and New Act § 126, II(c) ensures that these judgment creditors may not foreclose on the LLC interests of these members.

c) Finally, New Act § 126, VI(a) makes clear:

i) That as long as the distributions made available to judgment debtors under New Act § 126(a) are sufficient to repay the relevant debt "within a reasonable time," judgment debtors may use no means except charging orders to reach distributions from New Hampshire single-member LLCs or other membership rights of the members of these LLCs; and

ii) That these creditors may not foreclose on the LLC interests of the members of single-member LLCs or their other membership rights.

As discussed above, it is doubtful that Old Act § 47 provides any protections whatsoever to members of single-member LLCs.

3) The superiority of New Act § 126 over Old Act § 47 in protecting the membership rights of LLC members from judgment creditors is likely to constitute, for the members of many Old Act LLCs, including members of both single-member and multi-member LLCs, a strong reason to make an election under New Act § 5 to be subject to the New Act before January 1, 2014.

§3.06 THE IMPACT OF NEW ACT § 126 ON NON-TAX CHOICE OF ENTITY

1) As discussed in Chapter 6, the New Hampshire Business Corporation Act (the "BCA") does not contain pick-your-partner provisions or charging order provisions. For many New Hampshire business founders, the BCA's lack of these provisions has always constituted a strong non-tax ground to choose to conduct their businesses as New Hampshire LLCs rather than as New Hampshire business corporations.

2) However, New Act § 126 will provide an even stronger basis than Old Act § 47 for business founders to make this choice.

§3.07 THE EFFECT OF THE PICK-YOUR-PARTNER PROVISIONS AND CHARGING ORDER PROVISIONS OF THE OLD AND NEW ACTS IN DIVORCES AND BANKRUPTCIES

1) A detailed discussion of the impact of the pick-your-partner provisions and charging order provisions of the Old and New Acts in divorce and bankruptcy proceedings involving LLC members is beyond the scope of this chapter. However, the following brief comments may be useful to readers with respect to these issues. See generally, *Bonneville v. Bonneville,* 152 N.H. 325, 438 (1997); Depuy, David, Prac. Guide Divorce New Hampshire §§ 8.3.3 and 8.4.4; Goldberg, Barth, Valuation of Divorce Assets, Rev. Ed., § 15.113; *O'Brien v. O'Brien*, 489 N.E.2d 712 (N.Y. 1985).

2) In general, divorce courts, like courts in creditors' remedies actions, are likely to decline on the basis of the pick-your-partner policy to award the shares of one divorced spouse to another in property settlements in which the first spouse owns shares in a corporation that has

multiple shareholders. It seems likely that at least with respect to the "management" rights of LLC members, a divorce court would apply the pick-your-partner policy in the same way. However, it is possible that the court would be willing to issue a charging order to the other spouse; and under the Old Act, the court might be willing to permit a spouse to foreclose on the LLC interest of the other spouse.

3) In general, federal bankruptcy courts are likely to include all of the membership rights of a bankrupt LLC member in the bankruptcy estate unless the other members oppose this inclusion under § 365(a) and (c) on the ground that the bankrupt member provides unique management capabilities to the LLC that the trustee in bankruptcy cannot provide. See generally, *In re Baldwin*, 463 B.R. 142 (10th Cir. BAP (Okla.), July 11, 2006) (limited partnership case); *Movitz v. Fiesta Investments, LLC (In re Ehmann)*, 319 B.R. 200 (Bankr. D. Ariz., January 13, 2005).

4) However, while I'm aware of no relevant authority, it seems clear that the pick-your-partner provisions and charging order provisions of neither the Old Act nor the New Act are likely to protect the LLC interests or the other membership rights of members of either Old Act or New Act single-member LLCs from divorced spouses or trustees in bankruptcy.

EXHIBIT 3-1

THE TEXT OF § 47 OF THE OLD ACT

§ 304-C:47**. RIGHTS OF JUDGMENT CREDITOR**

On application to a court of competent jurisdiction by any judgment creditor of a member, the court may charge the limited liability company interest of the member with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of the limited liability company interest. This chapter does not deprive any member of the benefit of any exemption laws applicable to the member's limited liability company interest.

EXHIBIT 3-2

THE TEXT OF § 126 OF THE OLD ACT

304-C:126 **CHARGING ORDERS.**

I. On application to a court of competent jurisdiction by any judgment creditor of (a) a member of a limited liability company (the "debtor- member") or (b) a transferee of all or any part of a member's limited liability company interest (a "transferee"), the court may enter a charging order against the limited liability company in respect of the limited liability company interest of the debtor-member or the transferee for the unsatisfied amount of the judgment plus interest.

II.(a) A charging order constitutes a lien on a debtor-member's or transferee's limited liability company interest.

(b) Under a charging order, a judgment creditor has only the right to receive distributions to which the debtor-member or transferee would otherwise have been entitled from the limited liability company, and only to the extent of the judgment, including interest.

(c) A judgment debtor that obtains a charging order does not thereby become the holder of the debtor-member's or transferee's limited liability company interest.

III. This section does not deprive any judgment debtor of the benefit of any exemption law applicable to the judgment debtor's membership rights.

IV. Except as provided in paragraphs VI and VII, a charging order is the sole and exclusive remedy by which a judgment creditor of a debtor-member may satisfy a judgment from a debtor-member's membership rights or from the assets of a limited liability company. This section is not exclusive as to the rights of creditors with respect to the limited liability company interests of transferees.

V.(a) The remedy of execution upon a debtor-member's membership rights shall be unavailable to a judgment creditor attempting to satisfy a judgment against a debtor-member of a multi-member limited liability company.

(b) Except as provided in paragraph VI, the remedy of execution upon a debtor-member's membership rights shall be unavailable to a judgment creditor attempting to satisfy a judgment against a debtor-member of a single-member limited liability company.

VI.(a) If a judgment creditor shows to the satisfaction of a court of competent jurisdiction that distributions under a charging order in respect of the limited liability company interest of a debtor-member of a single-member limited liability company will not satisfy the judgment within a reasonable time, a charging order shall not be the sole and exclusive remedy by which the judgment creditor may satisfy the judgment against the member.

(b) Upon such a showing, the court may order the sale of the debtor-member's membership rights under an execution sale.

(c) A judgment creditor may make a showing to the court under subparagraph VI(a) that distributions under a charging order will not satisfy a judgment either (1) when the judgment creditor applies for the entry of a charging order under a member of a single-member limited liability company or (2) at any time thereafter.

VII. If, under paragraph VI, a court orders an execution sale of the membership rights of a debtor-member that is the member of a single-member limited liability company:

> (a) The purchaser shall obtain all of the member's membership rights and not merely the rights of an transferee;

(b) The purchaser shall become the member of the limited liability company; and

(c) The debtor-member whose membership rights have been sold shall cease to be a member.

VIII. Nothing in this section shall limit:

(a) The rights of a creditor that has been granted a consensual security interest in the limited liability company interest or other membership rights of a member to pursue the remedies available to the secured creditor under other law applicable to secured creditors;

(b) The principles of law and equity which affect fraudulent transfers;

(c) The availability of the equitable principles of veil-piercing, equitable lien, or constructive trust, or other equitable principles not inconsistent with this section; or

(d) The continuing jurisdiction of the court to enforce its charging order in a manner consistent with this section.

IX. In any action in a court of this state in which a judgment creditor seeks a charging order against a member or transferee of a foreign limited liability company, this section shall apply.

CHAPTER 4

THE "OFF-THE-SHELF OPERATING AGREEMENTS" IN THE NEW ACT—THEIR SIGNIFICANCE FOR NEW HAMPSHIRE SMALL-BUSINESS LLCs AND FOR LLC FORMATION LAWYERS

OVERVIEW

§ 4.01 INTRODUCTION

[A] THE PURPOSE OF THIS CHAPTER; BACKGROUND CONCEPTS FROM OTHER CHAPTERS

1) The purpose of this chapter is to define and explain the "off-the-shelf operating agreements" embedded in the definitional, default, mandatory and self-enabling permissive provisions of the New Act.[1][2] As discussed below, these agreements are critically important elements of the New Act for New Hampshire small businesses. Indeed, the usefulness of the New Act to these businesses depends to a large extent on the adequacy of its off-the-shelf operating agreements.

2) However, the better you understand the off-the-shelf operating agreements in the New Act, the better you will understand not only their indispensable value to New Hampshire small businesses but also their unavoidable inadequacies in meeting the needs of these businesses. In so doing, you may more fully appreciate the importance even for New Hampshire small-businesses of *tailored* operating agreements. By tailored operating agreements, I mean:

   a) Written operating agreements;

   b) Prepared by LLC lawyers;

   c) Designed to meet all significant legal and tax needs and interest of the members of particular LLCs.[3]

3) It will be useful to begin this chapter with a brief review of several key concepts in Chapter 1:

   a) Classes and types of LLCs. Under the LLC classification system outlined in Chapter 1, there are 10 broad classes of LLCs and 28 main LLC types.

   b) The five classes of LLC statutory provisions. Chapter 1 also identifies the five main classes of statutory provisions in LLC acts—namely, definitional, default, mandatory, non-self-enabling permissive and self-enabling permissive provisions; it proposes that

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[1] Exclusion of non-self-enabling permissive provisions. The only LLC statutory provisions that are not elements in the off-the-shelf operating agreements in the New Act are the non-self-enabling permissive provisions of the act. This is because, by definition, these provisions are not included in LLC operating agreements unless the members specifically adopt them in these agreements.

[2] Secondary literature and case law on off-the-shelf operating agreements. For a discussion of the concept of off-the-shelf operating agreements in LLC secondary literature and case law, see, e.g., Allan Donn *et al*., *State Limited Liability Company & Limited Liability Partnership Laws*, PGLLC-40.2, (2010-4 Supplement); 2 Alan R. Bromberg and Larry E. Ribstein, *Bromberg and Ribstein on Partnership* § 7.01(c) at 7:15 (2012-1 Supp.); Barrett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 Va. L. Rev. 821, 825 and n. 21 (1992); *Spires v. Casterlin*e, 4 Miscellaneous 3D, 428, 435-436, 778 NYS 2d 259 (NY Supreme Court—Monroe Cty, 2004). I am indebted to Allan Donn for providing me with the above and other citations concerning off-the-shelf operating agreements.

[3] Written vs. oral and implied operating agreements. Under § 1,VI of the Old Act, only written operating agreements are valid. Under § 40 of the New Act, not only written operating agreements but also oral and implied agreements are valid. However, to avoid potentially difficult problems of proof as to the contents of operating agreements, the tailored operating agreements referred to in this chapter should always be in writing, and they should always expressly provide that amendment of them shall be valid only if in writing.

there are a total of 300 of these provisions in the New Act that are relevant to the drafting of tailored operating agreements (which are sometimes described collectively in this book as "LLC Formation Provisions"); and it explains that, in general, the purpose of these LLC Formation Provisions is:

i) To identify and resolve LLC business organization law issues likely to be important to members of New Hampshire single-member and multi-member LLCs; and thus,

ii) To provide off-the-shelf operating agreements to LLCs that lack tailored operating agreements.

c) Multiple off-the-shelf operating agreements; superiority of New Act off-the-shelf operating agreements. Not just one off-the-shelf operating agreement is embedded in the above provisions of the Old and the New Act. Rather, these provisions contain off-the-shelf operating agreements for *all* of the 28 types of LLCs that may be identified under the above Chapter 1 LLC classification system.[4] However, because of its inclusion of comprehensive fiduciary provisions and numerous non-fiduciary provisions not contained in the Old Act and for other important reasons, the off-the-shelf operating agreements in the New Act are substantially better than those in the Old Act.

d) The provisions of the off-the-shelf operating agreements in the Old and New Acts are dispersed through these acts. As explained in Chapter 1, the off-the-shelf operating agreements are not organized and denominated *as such* in the Old or the New Act. Rather, in both the Old and the New Act, each of them is contained *implicitly* in the act and consists of the specific subset of LLC Formation Provisions specifically relevant to their members. However, because the organizational structure of LLC acts is necessarily very different from that of tailored operating agreements, these provisions are dispersed throughout the New Act and can be assembled in the form of off-the-shelf operating agreements only on the basis of hard work and substantial LLC expertise.

[B] NEW HAMPSHIRE SMALL-BUSINESS LLCS NEED OPERATING AGREEMENTS, BUT MANY LACK THEM

1) My experience as a New Hampshire LLC lawyer and my discussions with other New Hampshire LLC lawyers and business people make clear that a very high percentage of New Hampshire LLCs—perhaps as much as 70%—lack written operating agreements. Furthermore, my experience suggests that the written operating agreements of many New Hampshire LLCs that *do* possess these agreements fail to address at least a few LLC business organization law issues likely to be critical to the LLC's members. These issues often include, for example, in the case of multi-member LLCs, interim distribution issues, member dissociation issues, fiduciary issues, buy-sell issues and dispute resolution issues.

2) Furthermore, my practice experience suggests that many of the New Hampshire LLCs that lack adequate tailored operating agreements or that lack these agreements altogether are New Hampshire small-business LLCs.

3) In my experience, there are two main reasons why so many New Hampshire small-business

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[4] Types of LLCs for which Old and New Acts do not provide off-the-shelf operating agreements. The types of LLCs under the above classification system for which the Old and New Acts do *not* provide off-the-shelf operating agreements are Types 1.2, 1.3, 2.1 through 2.3, 5, 8, 9 and 10. These types of LLCs require specialized management provisions which would unduly complicate these acts and add unduly to their length.

LLCs lack adequate tailored operating agreements or lack them altogether:

a) First, many individuals who form New Hampshire small-business LLCs to conduct their businesses are unaware of the importance of these agreements.

b) Second, many individuals who are members of New Hampshire small-business LLCs and who *are* aware of the importance of tailored operating agreements are unwilling or unable to pay lawyers to assist them in creating these agreements for them or can't find lawyers who can provide this assistance.

4) As emphasized in Chapter 1, the principal purpose of the BIA Drafting Committee in drafting the New Act was to make it as user-friendly as possible for New Hampshire small businesses. In light of the above discussion, this meant, above all, that the BIA Drafting Committee had a duty to ensure, to the extent possible in an LLC act, that the New Act would identify and resolve *all of the LLC business organization law issues likely to be important to the members of New Hampshire small-business LLCs*.

5) In short, in order to meet the needs of New Hampshire small businesses, the New Act, to the extent possible to an LLC act, must contain, in its various LLC Formation Provisions, *off-the-shelf* operating agreements that can substitute for the *tailored* operating agreements that so many New Hampshire small-business LLCs lack.

[C] THREE KEY QUESTIONS THE BIA DRAFTING COMMITTEE HAD TO ADDRESS IN DRAFTING THE OFF-THE-SHELF OPERATING AGREEMENTS OF THE NEW ACT

1) I was the member of the BIA Drafting Committee who took primary responsibility for the task of ensuring that the New Act would meet the above requirement of providing adequate off-the-shelf operating agreements for New Hampshire small-business LLCs that lacked tailored operating agreements. In order to perform this task, I had to address and resolve three principal questions:

a) First, for what specific types of New Hampshire small-business LLCs, among the 28 main types outlined in Chapter 1, should the New Act provide off-the-shelf operating agreements?

b) Second, which specific LLC business organization law issues should each of these off-the-shelf operating agreements address?

c) Third, what criterion should the BIA Drafting Committee apply in seeking to resolve each of these issues appropriately?

2) The analysis necessary to resolve the above three questions is complex and depends to a certain degree on speculation. However, in my view, the following are the best available answers to these questions:

a) There are two types of LLCs that, by a wide margin, are used with greatest frequency by New Hampshire business people to conduct small businesses.

i) The first is single-member LLCs whose members are individuals and which are "member-managed" LLCs—i.e., they are managed directly by their members. These LLCs are identified under the LLC classification system in Chapter 1 as "Type 1.1" LLCs.

ii) The second is multi-member LLCs which have two individuals as members and whose members have equal economic and management rights. These LLCs are

identified under the Chapter 1 LLC classification system as "Type 3.1" LLCs.[5]

b) However, a small but significant number of small-business single-member and multi-member LLCs are "manager-managed" LLCs; that is, only specific persons agreed upon by the members have the title of manager and the right to sign LLC contracts and decide LLC business matters; the other members are *non*-manager members. This type of LLC is classified in Chapter 1 as a "Type 6.1" LLC.

c) In order to meet the needs of New Hampshire small businesses, the LLC Formation Provisions of the New Act must address all of the New Hampshire business organization law issues likely to be important to the members of each of above three types of LLCs—namely, Types 1.1, 3.1 and 6.1.

d) In order to identify these issues, the BIA Drafting Committee needed either to create checklists of the relevant issues for each of these LLC types or to locate existing checklists adequate for that purpose. The checklists that I used were the tables of contents of the model operating agreement I had developed over the years for these three types of LLCs for inclusion in *Drafting Limited Liability Company Operating Agreements*. In order to identify the LLC business organization law issues that these model operating agreements should address, I had reviewed over the years all 51 U.S. LLC acts; all model operating agreements I could find in LLC treatise, handbooks and formbooks; and numerous operating agreements by other lawyers I had occasion to review in handling LLC formations and disputes.

e) There may, of course, be relevant LLC business organization law issues that the model operating agreements in *Drafting Limited Liability Company Operating Agreements* fail to identify. However, I am unaware of any, and I was unable to find any satisfactory source for comprehensively identifying the relevant issues *except* these agreements.

f) It was clear to me that the resolution of each of the above LLC business organization law issues in the off-the-shelf operating agreements for Type 1.1, 3.1 and 6.1 LLCs in the New Act should be a "*plurality*" resolution—that is, a resolution that, after careful consideration, at least a plurality of the members of New Hampshire small-business LLCs would themselves adopt.

3) For the reasons outlined above with respect to the model operating agreements in *Drafting Limited Liability Company Operating Agreements*, I am reasonably confident that the off-the-shelf operating agreements in the New Act for Type 1.1, Type 3.1 and Type 6.1 LLCs in fact identify most or all of the relevant LLC business organization law issues that an LLC act can reasonably be expected to address. I am also reasonably confident that the resolutions of these issues meet the above plurality test.

4) Obviously, only time will tell whether I am right. However, I know that not only the BIA Drafting Committee but also the Legislature will be grateful for any suggestions from the readers of this book or from New Hampshire lawyers, legislators or businesses people on how to improve these agreements.

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[5] IRS filing statistics. IRS statistics concerning the filing of S corporation federal income tax returns and other considerations suggest that about 50% of all New Hampshire LLCs are single-member LLCs; about 40% have two members; about 7% have three members; and that the remaining 3% have four or more members. See, e.g., http://www.irs.gov/taxstats/bustaxstats/article/0,,id=96405,00.html. The records of the Corporation Division of the New Hampshire Secretary of State suggest that a substantial majority of both single-member and multi-member New Hampshire LLCs are member-managed.

[D] SECTIONS 4.02 THROUGH 4.06 OF THIS CHAPTER

In §§ 4.02 through 4.04 of this chapter, I will provide overviews of the off-the-shelf operating agreements in the New Act for Type 1.1, 3.1 and 6.1 LLCs. In § 4.05, I will identify the various key functions that only *tailored* operating agreements can provide for members of New Hampshire LLCs. In § 4.06, I will address a concern about the default provisions in the New Act raised by a member of the New Hampshire House of Representatives during the legislative review of the bill (namely, Senate Bill 203) that became the New Act.

§ 4.02 THE OFF-THE-SHELF OPERATING AGREEMENT IN THE NEW ACT FOR TYPE 1.1 LLCS—OVERVIEW

1) Definitional provisions. The Type 1.1 off-the-shelf operating agreement includes 20 of the 31 definitional provisions of the New Act potentially relevant in LLC formations. The main types of New Act definitional provisions excluded from the Type 1.1 agreement are those dealing with managers (since the members of Type 1.1 LLCs are also, by statute, managers of these LLCs); member voting (since, as noted, all Type 1.1 decisions are made unilaterally by their members); and fiduciary provisions (since, obviously, the members of Type 1.1 LLCs have no fiduciary duties to themselves).

2) Default provisions. The Type 1.1 off-the-shelf operating agreement includes 22 of the 107 default provisions potentially relevant in LLC formations. Excluded are the pick-your-partner provisions in §§24, and 121 and 123 of the New Act and the provisions of the New Act relating to:

   a) Managers;

   b) Member meetings;

   c) Member voting;

   d) Penalties for failure to make promised contributions;

   e) Allocations and distributions;

   f) Member dissociations, except, of course, for the provisions of the New Act specifically addressing dissociations by members of single-member LLCs;

   g) Single-member LLCs whose members are entities; and

   h) Fiduciary matters.

3) Mandatory provisions. The Type 1.1 off-the-shelf operating agreement includes 73 of the 96 mandatory provisions of the New Act potentially relevant in LLC formations. The Type 1.1 agreement does not include New Act mandatory provisions relating to mangers, member meetings and fiduciary matters.

4) Self-enabling permissive provisions. The Type 1.1 off-the-shelf operating agreement includes 73 of the 96 mandatory provisions of the New Act potentially relevant in LLC formations. It does not include self-enabling provisions relating to:

   a) Dissenters' rights;

   b) Managers;

c) Penalties and remedies for member withdrawals;

d) Indemnifications; and

e) Methods of dispute resolution.

§ 4.03 THE OFF-THE-SHELF OPERATING AGREEMENT IN THE NEW ACT FOR TYPE 3.1 LLCS—OVERVIEW

1) Definitional provisions. The Type 3.1 off-the-shelf operating agreements contains 27 of the 31 definitional provisions of the New Act, excluding only those, such as the definition of foreign LLC, that are clearly irrelevant to Type 3.1 LLCs. Since I believe that all of the above 27 definitions appear to me to be non-controversial I will address none of them here.

2) Default provisions. The Type 3.1 off-the-shelf operating agreement contains 83 of the 107 in the New Act. The main provisions in the New Act that Type 3.1 off-the-shelf operating agreement does not address are those specifically relating to manager-managed multi-member LLCs. These include, for example, provisions addressing the appointment and removal of managers, the types of issues reserved to them, and manager meetings and voting. Among the most important default provisions in the Type 3.1 off-the-shelf agreement are these:

   (1) Management of LLC. Section 47, I provides that the LLC shall be managed by its members.

   (2) Members' agency authority. Section 52, I provides that each member is an agent of the LLC. This is consistent with the general partnership management that the BIA Drafting Committee believes is the preferred management format for a substantial majority of two-member New Hampshire LLCs.

   (3) Members' voting power. Section 65, II provides that each member's share of member votes is the same as the member's share of total contributions to the LLC. Section 65 reflects what the Senate Commerce committee decided was the best rule for Type 3.1 LLCs during its review of the BIA Drafting Committee's draft of the New Act.

   (4) Matters on which members may vote. Section 66, I provides that each member of a Type 3.1 LLC has the right to vote on all matters relating to that LLC. Section 66, I, like the above two sections, is intended to reflect a general partnership management format.

   (5) Number of votes required to decide matters on which members may vote. Section 66, II provides, with a few stated exceptions, that matters on which the members may vote shall be decided by majority vote of the members.

   (6) Formula for allocation of LLC profits between the members. Section 90, I provides that LLCs shall allocate their profits among the members in accordance with their shares of total contributions to the LLC. The experience of the BIA Drafting Committee is that this rule is the one most commonly chosen by small New Hampshire LLCs that consider the matter.

   (7) LLC admissions of additional members. Section 121 provides that a Type 3.1 LLC may not admit an additional member except upon the unanimous vote of the existing members. Section 121 reflects the "pick-your-partner" philosophy that lies at the heart of both partnership business organization law and the business organization law

governing Type 3.1 LLCs.

(8) Authority for interim distributions. Section 94, I provides that the LLC must make interim distributions of its profits to the members (i.e., "operating" distributions, as opposed distributions in liquidation of members' membership rights or of the LLC) upon a majority vote of the members.

(9) Allocations of interim distributions. Section 95, II provides that the LLC must allocate interim distributions among the members in proportion to their shares of total contributions to the LLC.

(10) Events of dissociation of the members. Section 100 provides that members who are individuals shall be dissociated from the LLC if they die, are declared by a court to be incapacitated, become bankrupt, resign or are expelled by vote of the other members.

(11) Distributions to members upon their dissociation. Section 105, I and II provides that when members are dissociated, they will be entitled to receive their accrued allocations but not any payment in redemption of their membership rights.

(12) Members' fiduciary duties. Sections 106 through 117 comprehensively address the fiduciary duties of the members.

(13) LLC's admission of additional members. Section 120 provides, in keeping with the above pick-your-partner policy, that after its formation, an LLC may not admit additional members except upon the unanimous vote of the existing members.

(14) Members' transfers of their membership rights. Section 121, I provides, in keeping with the pick-your-partner policy, that the members may not transfer their membership rights to other persons except with the consent of all of the other members.

3) Mandatory provisions. The Type 3.1 off-the-shelf operating agreements contains 91 of the 96 mandatory provisions of the New Act, excluding only clearly irrelevant provisions such as those dealing with foreign LLCs and single-member LLCs. Since all of these provisions are non-controversial and since none of them is counterintuitive, I will not discuss any of them here.

4) Self-enabling permissive provisions. The Type 3.1 off-the-shelf operating agreement contains 29 of the 32 self-enabling permissive provisions of the New Act, excluding only those that apply specifically to manager-managed multi-member LLCs. Again, since all of these provisions are non-controversial and since none of them is counterintuitive, I will not discuss any of them here.

§ 4.04 THE OFF-THE-SHELF OPERATING AGREEMENT IN THE NEW ACT FOR TYPE 6.1 LLCS—OVERVIEW

[A] INTRODUCTION

1) As noted above, Type 6.1 LLCs are manager-managed multi-member LLCs that have two members, one of whom is a member-manager and the other a non-manager member. The off-the-shelf operating agreement for Type 6.1 LLCs is not a "pure" off-the-shelf operating agreement, since its management terms will not apply to any particular LLC unless an LLC's members first specifically agree in a tailored operating agreement that their LLC will be a manager-managed LLC.

2) However, once they so agree, all of the management provisions of the Type 6.1 off-the-shelf operating agreement will apply to their LLC unless their tailored operating agreement provides otherwise; and many of these provisions will apply also to single-member LLCs whose members provide in tailored operating agreements that their LLCs are manager-managed.

[B] PROVISIONS OF THE TYPE 3.1 OFF-THE-SHELF OPERATING AGREEMENT IN THE NEW ACT THAT APPLY ALSO TO TYPE 6.1 LLCS

Most of the provisions in the off-the-shelf operating agreement for Type 6.1 LLCs are essentially identical to the provisions of the off-the-shelf operating agreement for Type 3.1 LLCs. These include, for example, provisions concerning:

1) Contributions;
2) Allocations;
3) Distributions;
4) Events of dissociation;
5) Redemptions and cross-purchases of membership rights;
6) LLC grants of membership rights;
7) Members' transfers of their membership rights;
8) Member meetings;
9) Member voting;
10) Fiduciary provisions applicable to managers and to members participating in management;
11) LLC record keeping;
12) LLC dissolutions; and
13) Claims by the members against other members and against managers.

[C] PROVISIONS IN THE NEW ACT OFF-THE-SHELF OPERATING AGREEMENT FOR TYPE 6.1 LLCS THAT ARE NOT CONTAINED IN THE NEW ACT OFF-THE-SHELF OPERATING AGREEMENT FOR TYPE 3.1 LLCS—IN GENERAL

However, Form 6.1 also contains numerous provisions that specifically address issues relating to managers and that, accordingly, are *not* addressed in Form 3.1. These include provisions concerning::

1) Managers' qualifications;
2) The duration of their terms,
3) Manager appointments, resignations and removals;
4) Their titles;
5) Their authority,
6) Their information rights;
7) Their general responsibilities;
8) Delegations of management authority;

9) Manager functional responsibilities;

10) Managers' time commitments; and

11) Manager compensation and fringe benefits.

[D] PROVISIONS IN THE OFF-THE-SHELF OPERATING AGREEMENT FOR TYPE 6.1 LLCS THAT DETERMINE THE LLC MATTERS THAT THE MEMBERS OF MANAGER-MANAGED MULTI-MEMBER LLCS MAY DECIDE BY MEMBER VOTE

In addition, Section 66, II of the New Act, a default provision that lists 12 specific types of LLC matters which are reserved in that agreement for decision by the members; and Row 21 lists Section 66, III, which reserves to the managers all matters not identified in Section 66, II. Since, in forming any Type 6.1 LLC, the task of deciding whether to delete from or to add to the types of matters included in Section 66, II is likely to be critical in determining the manage structure of the LLC, it will may be useful to list the above 12 default matters here. They comprise:

(1) Whether to compromise a member's promise to make a contribution to the limited liability company;

(2) Whether the limited liability company shall indemnify a member or other person;

(3) Whether the limited liability company shall admit a new member;

(4) Whether a member may transfer or pledge all or any part of the member's membership rights;

(5) Whether the limited liability company interest may grant additional membership rights to a member;

(6) Whether to remove a manager;

(7) Whom to appoint to replace a manager who has ceased to be a manager;

(8) Whether and on what terms the limited liability company may sell all or substantially all of its assets outside the ordinary course of business;

(9) Whether and on what terms the limited liability company may change its business organization form under RSA 304-C:149;

(10) Whether and on what terms the limited liability company may participate in a merger;

(11) Whether and on what terms the limited liability company may be dissolved; and

(12) Whether a member may take an action that breaches the member's duty of loyalty or any duty subsidiary to that duty.

§ 4.05 DO THE OFF-THE-SHELF OPERATING AGREEMENTS IN THE NEW ACT MAKE TAILORED OPERATING AGREEMENTS UNNECESSARY?

[A] INTRODUCTION

1) For the reasons discussed above, off-the-shelf operating agreements are indispensable for the

many New Hampshire small-business LLCs that have inadequately tailored operating agreements or that lack these agreements altogether. However, there are six key functions in constructing operating agreements for particular LLCs that cannot be performed by off-the-shelf operating agreements, but rather, *only* by tailored operating agreements. Each of these functions is briefly discussed below as applicable in forming Type 3.1 LLCs. However, these Type 3.1 functions also apply, with generally minor adaptations, in forming all other types of LLCs.

2) The discussion below is important for LLC lawyers, since the performance of the above six functions for any particular LLC will require substantial LLC expertise under the New Act—an expertise that only New Hampshire LLC lawyers are likely to possess. Thus, for each particular LLC, it is likely to require substantial legal work (and thus may merit significant legal fees).

[B] ONLY TAILORED OPERATING AGREEMENTS CAN ADDRESS THE KEY FACTUAL ISSUES THAT MUST BE ADDRESSED IN LLC OPERATING AGREEMENTS

The provisions of embedded agreements are necessarily of general application, and they obviously cannot provide factual information about any particular LLC. By contrast, a Type 3.1 operating agreement, such as the one set forth in Form 3.1 in *Drafting Limited Liability Company Operating Agreements*, should contain numerous provisions stating factual information specific to the Type 3.1 LLC in question. These include:

1) The date of the agreement (Form 3.1, page 1, first paragraph);

2) The LLC's name (Form 3.1, title of agreement; identification of parties on agreement, page 1; Section 1.1);

3) The address of the LLC's principal place of business (Form 3.1, page 1);

4) The members' names (Form 3.1, page 1; see also Section 1.2);

5) The members' addresses (Form 3.1, page 1);

6) The factual background in the "recitals" (the statement of factual background) in Form 3.1, page 1;

7) The date on which the LLC's certificate of formation was filed or will be filed (Form 3.1, section 1.3);

8) The name of the LLC's registered agent and the address of its registered office (Form 3.1, section 1.9);

9) The name of the LLC's principal tax and accounting advisers (Form 3.1, sections 1.15 and 1.16) ;

10) The name of the LLC's principal legal advisers (Form 3.1, section 1.17);

11) The kind (cash, property or services), the dollar value of the members' contributions to the LLC and any special terms governing those contributions (Form 3.1, section 3.4);

12) The effective dates of the various events of dissociation provided for in Form 3.1, sections 7.4 through 7.9;

13) The price terms and non-price terms of redemptions by the LLC and cross-purchases by the members of the membership rights of dissociated members (Form 3.1, section 9.2 and Exhibit B);

14) The amount of time that each member must commit to the work of the LLC (Form 3.1,

section 15.7);

15) Each member's compensation and fringe benefits for their services to and for the LLC (Form 3.1, section 15.8);

16) Each member's specific functional responsibilities for the LLC (Form 3.1, section 15.9); and

17) The date of expiration of the duty of the members to maintain the confidentiality of LLC records and information (Form 3.1, section 19.4).

[C] ONLY TAILORED OPERATING AGREEMENTS CAN ALTER THE DEFAULT PROVISIONS OF THE NEW ACT THAT DON'T WORK FOR PARTICULAR LLCS

1) As noted above, the default provisions of the New Act are intended to comply with the plurality rule, and, in my view, most or all of them do so. However, every LLC has at least a few unusual features, and, for many LLCs, one or more default rules of the New Act, reflecting, as they do, plurality rules, won't work.

2) To illustrate: Section 65 of the New Act provides that unless the operating agreement provides otherwise, the share of aggregate votes to which each member of an LLC will be entitled on each matter on which the members may vote will be proportionate to their contributions to the LLC. However, the members of a significant number of LLCs allocate the LLC's income among the members not only on the basis of their contributions to the LLC but also on the basis of the value of their services to the LLC; and they want the members' voting power to reflect these services. In the tailored operating agreements of these LLCs, LLC lawyers must override Section 65 to the extent appropriate to reflect this intent.

[D] ONLY TAILORED OPERATING AGREEMENTS CAN ALTER THE SELF-ENABLING PERMISSIVE PROVISIONS OF THE NEW ACT THAT DON'T WORK FOR PARTICULAR LLCS

1) As discussed in Chapter 1, the self-enabling permissive provisions in the New Act function like default provisions. That is, unless the operating agreement provides otherwise, the legal arrangements contained in these provisions automatically govern LLCs. However, like the default provisions of the New Act, one or more of the self-enabling permissive provisions of the New Act may not work for particular LLCs.

2) To illustrate: Section 40 of the New Act provides that not only written operating agreements but also oral and implied agreements will be valid as among the members and thus will bind the members. However, the contents of oral and implied agreements are often difficult to prove. To avoid these difficulties, the members of many LLCs formed under the New Act may want to override Section 40 in their tailored operating agreements and to provide in these agreements that, as among the members, only written amendments of the agreements will be valid.

[E] ONLY TAILORED OPERATING AGREEMENTS CAN INCLUDE IN THE OPERATING AGREEMENTS OF LLCS THAT NEED THEM THE NON-SELF-ENABLING PERMISSIVE PROVISIONS THESE LLCS NEED

1) As discussed in Chapter 1, non-self-enabling permissive provisions also function like default provisions. That is, unless the operating agreement of an LLC specifically adopts the

arrangements provided for in them, these arrangements will not be available to the LLC except by amendment of the agreement.

2) To illustrate: Section 115 of the New Act provides that an operating agreement may limit or eliminate the liability of members, manager and others for breaches of contract and breaches of duties, including fiduciary duties. Founders of New Hampshire multi-member LLCs who intend to manage these LLCs but who want to protect themselves from any risk that dissident members will make claims against them for money damages for alleged breaches of their contractual or other duties may want to eliminate the possibility of these damages. However, they can do so only by overriding Section 115 in their operating agreement.

[F] ONLY TAILORED OPERATING AGREEMENTS CAN INCLUDE IN THE OPERATING AGREEMENTS OF LLCS THAT NEED THEM THE LLC BUSINESS ORGANIZATION LAW PROVISIONS THAT THESE LLCS NEED BUT THAT THE NEW ACT DOES NOT INCLUDE

The tailored operating agreement of a Type 3.1 agreement should often contain numerous provisions addressing important LLC business organization law issues that, because of space limitations or for other reasons, the New Act does not contain. These may include:

1) A provision stating the date on which each member will be bound by the agreement and the effective date of the agreement (Form 3.1, section 2.1);

2) A provision stating that the members accept the terms of the certificate of formation (Form 3.1, section 2.1);

3) A provision stating that contributions include only those actually made by the members and not returned to them as returns of contributions (Form 3.1, section 3.12);

4) A provision stating that a member may be dissociated if the member becomes disabled (Form 3.1, section 7.8);

5) A provision defining the term “disability” for the above purpose (Form 3.1, section 7.8);

6) A provision stating that the members may expel a member upon a majority vote for any of the reasons stated in the agreement (Form 3.1, section 7.10);

7) A provision providing that the LLC and the members will be entitled to puts and calls of members’ membership rights only as provided in the agreement (Form 3.1, section 9.1);

8) A provision setting a deadline for the member’s exercises of the options in the agreement permitting the LLC to redeem and the members to cross-purchase the membership rights of dissociated members (Form 3.1, section 9.4);

9) A provision stating that the choice as to whether the LLC will redeem or the other members will cross-purchase the membership rights of a dissociated member will be made at the time of the dissociation (Form 3.1, section 9.5);

10) A provision providing the members with unlimited access to LLC records and information (Form 3.1, section 14.1);

11) A provision stating that the members have joint responsibility for the LLC’s management (Form 3.1, section 15.2);

12) A provision requiring each member to consult with the other before taking any material action relating to the LLC (Form 3.1, section 15.5);

13) A provision setting forth members’ representations in connection with their becoming

members (Form 3.1, section 21.1);

14) A provision setting forth representations by members that are entities (e.g., concerning their good standing) in connection with their becoming members (Form 3.1, section 21.2);

15) A provision setting forth the effective date of any dissolution of the LLC by member vote (Form 3.1, section 23.3); and

16) A provision requiring the members to consult with the LLC's legal and tax advisers in connection with any dissolution of the LLC (Form 3.1, section 23.10).

[G] ONLY TAILORED OPERATING AGREEMENTS CAN ADDRESS THE FEDERAL INCOME TAX ISSUES AND OTHER NON-BUSINESS ORGANIZATION LAW ISSUES IMPORTANT TO PARTICULAR LLCS

1) Introduction. The provisions of the New Act necessarily address only LLC business organization law issues; if they were to address any other types of issues, such as federal or state tax issues, this would confuse users of the act and could have made the enactment of the act difficult or impossible. By contrast, Type 3.1 operating agreements must contain numerous provisions addressing non-business organization law issues that are critical to the LLC and the members, including, above all, federal tax issues.

2) Federal tax provisions. Federal tax provisions that the tailored operating agreements of Type 3.1 LLCs must contain include:

   a) A provision providing that the federal income tax regimen of the LLC shall be Subchapter K (Form 3.1, section 1.12);

   b) A provision providing that the items allocated among the members will be computed as federal income tax items (Form 3.1, section 1.12);

   c) A provision providing that distributions to the members will be subject to a "qualified income offset" as defined in applicable U.S. Treasury regulations (Form 3.1, section 5.9);

   d) Provisions providing that the LLC will maintain capital accounts for the members in accordance with applicable U.S. Treasury regulations (Form 3.1, section 6).

2) State contract law provisions. Type 3.1 operating agreements must also contain provisions addressing numerous issues of state contract law, including:

   a) Provisions stating the term and providing for the termination of the operating agreement (Form 3.1, section 24);

   b) A provision providing that the survival of members' rights and duties under the agreement after the termination of the agreement (Form 3.1, section 24.3);

   c) Contract boiler plate provisions, including:

      i) An integration provision (Form 3.1, section 28.1);

      ii) A provision governing amendments of the agreement (Form 3.1, section 28.2);

      iii) A notice provision (Form 3.1, section 28.9);

      iv) A provision governing the construction of the agreement (Form 3.1, section 28.11);

      v) A provision validating counterpart agreements (Form 3.1, section 28.16);

      vi) A severability provision (Form 3.1, section 28.15); and

vii) A provision validating faxed signatures (Form 3.1, section 28.19).

3) Dispute resolution provisions. The operating agreements of many Type 3.1 LLCs should contain detailed provisions concerning methods of resolving internal LLC disputes. These should often include:

   a) General provisions governing member claims in LLC internal disputes (Form 3.1, Section 25);

   b) Mediation provisions (Form 3.1, Section 26); and

   c) Arbitration provisions (Form 3.1, Section 27).

4) Miscellaneous business organization law and non-business organization law provisions. Type 3.1 operating agreements should also contain provisions addressing several types of non-business organization law issues other than those identified above, including:

   a) A provision providing that the members must ensure that property they contribute to the LLC is unencumbered and that the contributions do not violate fraudulent transfer law (Form 3.1, Section 3.10);

   b) A provision providing that the LLC must reimburse expenses that the members reasonably occur for the LLC (Form 3.1, 5.13);

   c) A provision providing that the LLC and the members may not grant or transfer membership rights except after consulting with a securities lawyer (Form 3.1, Section 8.9);

   d) A provision addressing the issue whether the lawyer drafting the agreement has done so in a joint representation (Form 3.1, Section 28.21).

§ 4.06 DO THE OFF-THE-SHELF OPERATING AGREEMENTS IN THE NEW ACT NEEDLESSLY COMPLICATE THE LLC FORMATION PROCESS?

1) During the legislative review of the draft of the New Act produced by the BIA Drafting Committee, a member of the New Hampshire House of Representatives with whom I discussed the draft objected to its passage on the ground that it contained too many default provisions. The member (whom I'll call "Representative X") is a lawyer who from time to time assists his clients in forming LLCs. He said that in working with his clients in forming these LLCs, he feels an obligation to review each of the default provisions of the governing LLC act and to ask the client whether the rule contained in the provision is acceptable to the client. Obviously, the greater the number of default rules in the New Act, the longer and the more expensive the LLC formation process will be for Rep. X's LLC formation clients.

2) Rep. X's objection to the New Act deserves a careful response. However, for the following reasons, I think that his objection is invalid:

   a) The logic of Rep. X's argument would appear to imply that LLC acts should contain few or no default provisions. However, all U.S. LLC acts currently in effect, including the Old Act, contain dozens of these provisions; most or all of these acts have been drafted by committees of highly competent LLC lawyers; and all of them, by definition, have been approved by state legislatures, often after extensive legislative reviews. These facts alone are enough to suggest that Rep. X's argument is invalid.

   b) As discussed in Chapter 1, the purpose of the default provisions of LLC acts and also of

the non-self-enabling and self-enabling provisions in these acts is to provide LLC members with off-the-shelf operating agreements to the extent that LLC business organization law issues important to them are not addressed in tailored operating agreements. For the reasons discussed above in this chapter, there can be no question that the New Act *must* contain these off-the-shelf operating agreements; above all, it must contain them because so many New Hampshire small businesses need them.

c) It is true that to review with an LLC formation client each of the default rules in the governing LLC act (not to mention its non-self-enabling and self-enabling permissive provisions) would be unduly time-consuming and expensive for the client. However, such a review is by no means necessary in connection with an LLC formation; indeed, because of its length and cost, lawyers should *never* conduct such a review.

Rather, in handling these formations, they should simply review with their clients, without any reference to the governing act, the various LLC business organization law issues specifically relevant to members of the type of LLC in question, and they should determine with their clients how to resolve each of these issues in the clients' best interests. For each relevant type of LLC, these issues are clearly identified in, among other sources, the tables of contents of the relevant model operating agreements in *Drafting Limited Liability Company Operating Agreements* and in many other LLC formbooks.

CHAPTER 5

SHOULD THE MEMBERS OF OLD ACT LLCS ELECT TO BE GOVERNED BY THE NEW ACT?

OVERVIEW

TABLE OF EXHIBITS

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§ 5.01 INTRODUCTION

1) The purpose of this chapter is to advise the members of Old Act LLCs on whether they and their LLCs should make an election under New Act § 5, discussed in detail below, to be governed by the New Act during calendar year 2013.

2) Whether or not to make the election will be an important decision for many New Hampshire business people:

   a) As of June 1, 2012, New Hampshire Secretary of State statistics indicated that there were 47,593 active New Hampshire LLCs. These statistics suggest that by January 1, 2013, the effective date of the New Act, this number will have increased to about 51,000.

   b) In addition, IRS filing statistics indicate that as of June 1, 2012, very roughly 75,000 New Hampshire residents were members of Old Act LLCs and that by January 1, 2013, this number will have increased to about 78,000.

§ 5.02 SECTION 5 OF THE NEW ACT—THE NEW ACT TRANSITIONAL PROVISIONS

1) The transitional provisions of the New Act provision are set forth in New Act § 5. This section provides in its entirety as follows:

   304-C:5 ***TRANSITIONAL PROVISIONS.***

   I. This act shall govern domestic limited liability companies formed on and after January 1, 2013 and all foreign limited liability companies as of the effective date of this act.

   II. Domestic limited liability companies formed on or before December 31, 2012 shall be governed by the New Hampshire limited liability company act until January 1, 2014. On and after January 1, 2014, this act shall govern all limited liability companies. However:

      (a) If all of the members of any domestic limited liability company formed on or before December 31, 2012 elect, in writing, to be governed by this act as in effect on January 1, 2013, the domestic limited liability company shall be governed by this act as in effect on the effective date of the election.

      (b) Notwithstanding any other provision of this section, a domestic limited liability company formed on or before December 31, 2012 shall be governed by its operating agreement, whether written, oral, or implied, to the extent that this operating agreement overrides any nonmandatory provision of the New Hampshire limited liability company act or of this act.

2) The rules of New Act § 5 that specifically apply to Old Act LLCs may be summarized as follows:

a) In general, from January 1, 2013 to January 1, 2014, LLCs formed before January 1, 2013 (i.e., Old Act LLCs) will be governed exclusively by the Old Act except to the extent that any written, oral or implied operating agreement to which the members have agreed validly overrides any provision of the New Act.

b) However, at any time before or during calendar year 2013, the members of Old Act LLCs may elect in writing to be governed, to the extent provided in their election, by the provisions of the New Act. This election will also automatically cause their LLC to be governed by the New Act as of the effective date of the election.

c) On and after January 1, 2014, Old Act LLCs whose members have not already elected that they and their LLCs be governed by the New Act will automatically be governed by that act, along with their members, except to the extent that their operating agreements (whether written, oral or implied) validly override any provisions of the New Act.

3) In the above written elections, the members should, among other things:

a) Certify that they are all of the members of the LLC in question;

b) State the date of formation of the LLC (which, obviously will be a date before January 1, 2013);

c) Identify any written operating agreement among the members relating to the LLC and state that, on and after the effective date of their election, the terms of this agreement will override any conflicting provisions of the New Act; and

d) State the effective date of the election.

4) Attached to this chapter (as Exhibits 5-1 through 5-3) are model "certificates of election" that I suggest for use by members of single-member and multi-member Old Act LLCs in making the above elections.

5) Neither New Act § 5 nor any other provision of the New Act requires that Old Act LLCs file documents with the Secretary of State evidencing the above elections. However, members of these LLCs that believe it will be useful to provide notice to third parties about their elections may wish to make these filings.

§ 5.03 SHOULD THE MEMBERS OF OLD ACT LLCs MAKE A § 5 ELECTION IF THEY DECIDE NOT TO HIRE A LAWYER TO ADVISE THEM WHETHER TO MAKE IT?

1) As indicated above, § 5 of the Old Act effectively forces Old Act LLC members to decide whether or not to make the above election.

2) Since the members of Old Act LLCs cannot know with certainty which of these two choices is best without a careful comparison of the impact on them of the Old Act and the New Act during calendar year 2013, the best way for them to make the above choice is with the assistance of an LLC lawyer. However, as discussed in §§ 5.05 through 5.10 of this chapter, the legal work necessary to make this choice correctly may often be complex and may result in significant legal fees.

3) Obviously, if the financial or personal stakes for the members of an Old Act LLC are substantial and if they can afford expert legal assistance, they should hire lawyers to assist them in making the choice.

4) But what choice should they make if their LLC financial or personal stakes are not substantial or if they are unable or unwilling to hire lawyers to assist them in the choice?

5) I would suggest, with one qualification, that they *should* make the election. My analysis is somewhat different for, on the one hand, single-member Old Act LLCs and, on the other, those with two or more members.

6) If the Old Act LLC in question is a single-member LLC:

   a) First, and most importantly, Chapter 3 makes clear that the "pick-your-partner provisions" and charging order provisions of the New Act will provide the members of Old Act single-member LLCs with far greater protection against the risk of losing their membership rights to third parties than the corresponding provisions of the Old Act.

   b) Second, as discussed in Chapter 2, making the election will make available to the members of that LLC during calendar year 2013 the dissociation provisions of the New Act. As discussed in Chapter 2, for most single-member LLCs, these provisions are likely to be substantially more favorable than the Old Act dissociation provisions.

7) If the Old Act LLC in question is a multi-member LLC, many New Act provisions discussed in Chapters 2 through 4 may be better for them than the provisions of the Old Act during calendar year 2013.

   a) Obviously, however, the members of these LLCs, like those of single-member LLCs, may particularly benefit from the fact that the pick-your-partner provisions and charging order provisions of the New Act are stronger than those of the Old Act.

   b) In addition, these members are likely to benefit from the fact that the New Act provides comprehensive fiduciary rules, while the Old Act effectively provides none.

8) However, without a comprehensive legal review, it is obvious that neither I nor any other LLC lawyer can guarantee that during calendar year 2013, the members of any single-member and multi-member Old Act LLCs will not be adversely affected by at least one New Act provision—and conceivably, by many.

§ 5.04 THE CONFLICT-OF-INTEREST ISSUE FOR MEMBERS OF OLD ACT LLCs IN RETAINING LAWYERS TO ASSIST THEM IN RESPONDING TO THE NEW ACT

1) As will be evident from the discussions in §§ 5.05 through 5.10, many of the provisions of the New Act are likely to be advantageous for one or more members or managers of a particular Old Act LLC but disadvantageous for one or more others. Thus, before the members of an Old Act LLC ask a lawyer who is an expert in the Old and New Acts to assist them in deciding how to adapt to the New Act, they should first decide whom they want the lawyer to represent. There are three main options:

   a) The lawyer can represent some or all of the members jointly. However, many New Hampshire lawyers will not want to engage in such a joint representation, since the applicable New Hampshire ethical rules require that, before doing so, a lawyer should make relatively comprehensive disclosures to the members about the disadvantages to them of joint representations. New Hampshire Rules of Professional Conduct, Rule 1.7.

   b) The lawyer can represent only one of the members.

   c) The lawyer can represent only the LLC itself and not any of the members. Under this

arrangement, the members may well want to request the lawyer to advise them as to how each of the relevant provisions impacts each relevant member and to suggest how best to accommodate any conflicts, and the lawyer may be willing to do so; but they should also be aware, and the lawyer is likely to advise them in no uncertain terms, that if they want to protect their own individual interests as members or managers, each must hire his or her own lawyer.

2) I suggest that for most Old Act LLCs, the best arrangements with the lawyer who assists them will be the third of the arrangements outlined above.

§ 5.05 THE SIX-STEP METHOD THAT MEMBERS OF OLD ACT MULTI-MEMBER LLCs SHOULD USE IF THEY RETAIN A LAWYER TO ASSIST THEM IN RESPONDING TO THE NEW ACT

The process that the members of an Old Act LLC should generally follow if they decide to retain an LLC lawyer to assist them in deciding on how to respond to the New Act should normally comprise six main steps. These steps are set forth in general terms immediately below, and Step 4 is explained in detail and illustrated in §§ 5.06 through 5.10.

1) Step 1—determine relevant LLC business organization law issues. First, the members, with the help of their lawyer, should develop a checklist or use an existing checklist that will identify all of the LLC business organization law issues likely to be important to the class and type of LLC to which they belong. Checklists for this purpose are available in the tables of contents of the 28 model operating agreements in *Drafting Limited Liability Company Operating Agreements*, but they may also be available from many other sources in the LLC legal literature.

2) Step 2—negotiate and record the terms of a written operating agreement among the members. Second, the members should, with the assistance of their lawyer, address all of the issues in the above checklist and agree on how to resolve them; and, to avoid uncertainty and possible future disputes about these resolutions, they should record them in a written operating agreement. This agreement should provide that it alone defines the terms of the operating agreement among the members and that these terms do not include oral or implied terms.

3) Step 3—ensure consistency of certificate of formation with relevant model operating agreement. Third, the members, with the assistance of their lawyer, should review the terms of their LLC's certificate of formation as filed with the New Hampshire Secretary of State and should ensure the consistency of this certificate with the above tailored operating agreement.

4) Step 4—ensure consistency of written operating agreement with relevant definitional and mandatory LLC Formation Provisions of New Act. Fourth, with the assistance of their lawyer, the members should ensure that the above tailored operating agreement deals appropriately with the definitional, default, mandatory and self-enabling permissive provisions of the New Act and, to the extent of it fails to do so, they should amend their agreement to correct this failure.

5) Step 5—identify issues in the relevant default, non-self-enabling and self-enabling LLC Formation Provisions of the New Act that are not addressed in their written operating agreement and resolve those issues. Fifth, with the help of their lawyer, the members should

determine whether to adopt in their tailored operating agreement any of the non-self-enabling permissive provisions of the New Act.

6) Step 6—sign the operating agreement. Once the members have agreed to all of the terms of a final written operating agreement among them, they should sign that agreement.

§ 5.06 DETERMINING THE IMPACT OF NEW ACT DEFINITIONAL PROVISIONS ON OLD ACT MULTI-MEMBER LLCs

[A] INTRODUCTION

1) As noted in Chapter 1, the definitional provisions of the New Act are those that define specific terms used in the act. By my count, there are 31 definitional provisions in the New Act. Most all of these provisions address standard LLC business organization law terms used in most or all other LLC acts, and they define them in accordance with standard business organization law practice.

2) As discussed in Chapter 2, the only unusually defined term used in the New Act is the term "membership rights." Section 15 of the New Act defines this term as referring to "the totality of [a] member's rights as a member under this act, including both economic rights, such as the member's limited liability company interest, and non-economic rights, such as the member's voting rights, if any." The term can be important in, among many other situations, grants of membership rights by an LLC to existing or new members and the sale of membership rights by members to other persons. In this situation, most LLC acts have no term for the concept of the totality of a member's rights as a member; yet that is normally what LLCs grant in admitting new members and what LLC members and their transferees intend to transfer in sales and other transfers of member's membership rights.

3) Nevertheless, many operating agreements, purchase-and-sale agreements and other legal documents of New Hampshire and other LLCs misleadingly refer to the totality of the rights of LLC members covered by these documents as the members' "LLC interests" rather than as their membership rights. This reference is inconsistent with the definitional provisions of many LLC acts, including the New Act, which generally define LLC interests as comprising only the right of members to receive allocations of LLC profits and losses and to receive distributions of LLC assets. These definitions thus implicitly *exclude* from the definition of LLC interest any other kinds of rights, such as voting, information and fiduciary rights.

4) In assisting the members of Old Act multi-member LLCs to respond to the New Act, LLC lawyers should ensure that all of the terms used in their operating agreements to refer to specific LLC concepts are consistent with the definitions of these concepts in the New Act. Otherwise, ambiguities may arise in construing these agreements, and these ambiguities may result in disputes among the members.

[B] ILLUSTRATION

1) XYZ, LLC ("XYZ") is an Old Act LLC with three members. XYZ has a written operating agreement. This agreement provides for redemptions by XYZ of its members' membership rights upon their death or disability. However, the agreement refers to the membership rights subject to these buy-outs as "LLC interests."

2) In reviewing the definitional provisions of the New Act, the lawyer whom XYZ has retained

to assist it in responding to the New Act changes the term "LLC interests" in the buy-out provisions of XYZ's operating agreement to "membership rights."

§ 5.07 DETERMINING THE IMPACT OF NEW ACT DEFAULT PROVISIONS ON OLD ACT MULTI-MEMBER LLCs

[A] INTRODUCTION

1) As indicated in Chapter 1, the default provisions of the New Act are those that, by their terms, permit members to validly override in their operating agreements the rules set forth in these provisions. However, if a default rule in the New Act is not overruled in an operating agreement, it becomes, in effect, a mandatory rule when all of the parties to the operating agreement have signed the agreement. By my count, there are 105 default provisions in the New Act relevant to LLC formations.

2) Examples of New Act default provisions potentially relevant to Type 3.1 LLCs are the following:

   a) Section 65, II, which provides in effect that unless the operating agreement provides otherwise, each member's share of total member votes will be the same as the member's share of total contributions to the LLC; and

   b) Section 90, II, which provides in effect that unless the operating agreement provides otherwise, LLCs shall allocate their profits and losses among the members in proportion to their respective shares of total contributions to the LLC.

3) With the assistance of their lawyers, members of Old Act LLCs who retain these lawyers must do the following in addressing the default provisions of the New Act:

   a) They must determine whether the issue addressed in each of these provisions of the New Act is addressed in their LLC's operating agreement.

   b) If the issue addressed in any of these provisions is *not* addressed in the member's LLC's written operating agreement, they must determine whether the rule contained in the provision is advantageous or disadvantageous to them.

   c) If the rule is advantageous to them, they can safely ignore it, since, when the members have signed the LLC's written operating agreement, the rule will, as indicated, automatically become a mandatory rule with respect to the LLC.

   d) If the rule is disadvantageous to them, they must seek to persuade the other members to override the rule in the LLC's written operating agreement before they sign that agreement.

[B] ILLUSTRATION

1) John Doe is both a member and the manager of ABC, LLC ("ABC"). Section 108, II of the New Act provides that unless the operating agreement provides otherwise, the standard of care to which managers are subject is a "reasonableness" standard. John is concerned that this standard may make it too easy for other members to claim that he has breached his duty of care as ABC's manager.

2) Thus, John seeks persuade the other members to override § 108, II in ABC's written

operating agreement to provide that his standard of care shall be to avoid gross negligence.

§ 5.08 DETERMINING THE IMPACT OF NEW ACT MANDATORY PROVISIONS ON OLD ACT MULTI-MEMBER LLCs

[A] INTRODUCTION

1) As noted in Chapter 1, the mandatory provisions of the New Act are those that LLC members may not validly alter in their operating agreements. My table of New Act mandatory terms contains 96 mandatory provisions.

2) Examples of New Act mandatory provisions include:

   a) Section 87, I, which provides that creditors that extend credit to an LLC in reliance on a member's obligation to make a contribution to an LLC may enforce the obligation even if the members amend or waive the obligation;

   b) Section 55, which provides various mandatory rights to members to inspect and copy various types of LLC records.

3) In responding to the New Act, members of Old Act LLCs that are using the help of LLC lawyers must review each of the mandatory provisions of the New Act in order to ensure that none of the terms of their operating agreements conflict with these provisions. For if any such conflict exists, the relevant term in the operating agreement will be legally invalid both as to third parties and even among the members to the extent that any member challenges it.

[B] ILLUSTRATION

1) MNO, LLC ("MNO") is a multi-member Old Act LLC. Mary Roe is its manager. Mary is familiar with § 18-108 of the Delaware Limited Liability Company Act, which provides, among other things, that an operating agreement may provide for the indemnification of managers against any claims whatsoever. Mary has persuaded the members of MNO to include in MNO's operating agreement an indemnification whose terms are identical to those of DLLC Act § 18-108.

2) However, New Act §§ 116, II(a) and (b) provide in effect that LLCs may not indemnify managers for breaches of their duty of loyalty in connection with derivation actions in which they have been judged liable to the LLC or in connection with any other proceeding in which the manager has been adjudged liable for a breach of the duty of loyalty.

3) The above section in MNO's operating agreement is invalid to the extent it is inconsistent with New Act §§ 116, II(a) and (b).

§ 5.09 DETERMINING THE IMPACT OF NEW ACT SELF-ENABLING PERMISSIVE PROVISIONS ON OLD ACT MULTI-MEMBER LLCs

[A] INTRODUCTION

1) As noted in Chapter 1, the self-enabling permissive provisions of the New Act are those that an LLC may implement through a vote of its members or managers even without any enabling provision in the operating agreement. My table of the self-enabling permissive LLC Formation Provisions of the New Act includes 32 provisions.

2) The following are examples of self-enabling LLC Formation Provisions in the New Act potentially important to Type 3.1 LLCs:

   a) Section 40, which provides that an operating agreement may be written, oral or implied; and

   b) Section 116, which provides, in effect, that the members, by majority vote, may indemnify members, managers and others for the types of liabilities specified in the section.

[B] ILLUSTRATION

1) TUV, LLC ("TUV") is a multi-member Old Act LLC. It has a written operating agreement. TUV's members want to avoid the possibility that any member or other person will claim that in addition to being bound by that agreement, the members are bound by certain oral or implied operating agreement provisions.

2) Thus, they include in TUV's written operating agreement a provision stating that no agreements among the members relating to TUV shall be valid unless in writing.

§ 5.10 DETERMINING THE IMPACT OF NEW ACT NON-SELF-ENABLING PERMISSIVE PROVISIONS ON OLD ACT MULTI-MEMBER LLCs

[A] INTRODUCTION

1) As noted in Chapter 1, the non-self-enabling permissive provisions of the New Act are those that permit and validate the legal arrangements described in them only if these arrangements are adopted in an operating agreement or in a related document.

2) The following are examples of non-self-enabling provisions of the New Act potentially relevant to Type 3.1 LLCs:

   a) Section 107, which provides, among other things, that an operating agreement may eliminate the duties of members and managers except duties arising under the implied contractual covenant of good faith and fair dealing; and

   b) Section 115, which provides that an operating agreement may provide that specified members, managers and others shall have no personal liability for the breach of any duty to the LLC or the members except duties arising under the implied contractual covenant of good faith and fair dealing.

3) Each of the members of an Old Act LLC who wants to do a thorough New Act Adaptation Analysis must follow essentially the same procedures as with respect to the default LLC Formation Provisions of the New Act. In other words:

   a) The member must determine whether the business organization law issue addressed in each of the non-self-enabling LLC Formation Provisions of the New Act is addressed in the member's LLC's written operating agreement.

   b) If the issue addressed in any of these provisions is not addressed in the LLC's written operating agreement, the member must determine whether the rule contained in the provision is advantageous or disadvantageous to the member.

   c) If the rule is advantageous to the member, the member can safely remain silent about it, since, when the members sign the LLC's written operating agreement, the rule will, as indicated above, automatically become a mandatory rule with respect to the LLC.

   d) If the rule is disadvantageous to the member, the member must seek to persuade the other members to override the rule in the LLC's written operating agreement.

[B] ILLUSTRATION

1) GHI, LLC ("GHI") is a multi-member Old Act LLC. It has a non-member manager named Arthur Able. Arthur wants to avoid any risk that he will be subject to claims by the members that he has breached his duties of care or loyalty.

2) Thus, in reliance on the above New Act § 107, he successfully negotiates with the GHI's members to include in GHI's operating agreement a provision providing that he is not subject to those duties.

§ 5.11 HOW SHOULD THE MEMBERS OF OLD ACT SINGLE-MEMBER LLCs RESPOND TO THE NEW ACT?

1) As noted on the first page of this chapter, about half of all New Hampshire LLCs are single-member LLCs. Although no relevant statistics are available, it is probable that the members of the vast majority of these single-member LLCs are individuals and that only a few are entities.

2) How should single-member LLCs formed under the Old Act respond to the New Act? A key consideration is that the provisions of the New Act concerning the dissociation of members of single-member LLCs and that the New Act pick-your-partner provisions and charging order provisions are very likely to be substantially more favorable to these LLCs than those under the Old Act. Thus, if the financial and personal stakes of the members of single-member LLCs formed under the Old Act are not substantial and are unlikely to become substantial, the members of these LLCs should simply make written elections under New Act § 5 without any expenditure of time or legal fees.

3) However, if the members of any of these single-member LLCs believe that their financial or personal stakes in them are substantial or are likely to become substantial, they should retain LLC lawyers to assist them in determining how to respond to the New Act, and these lawyers should lead them through the six-step method outlined in § 5.05.

4) As readers will know, the above method involves, among other things, the planning and drafting of a written operating agreement. Since, by definition, the members of single-member LLCs totally control their LLCs, some readers may question whether it makes sense

for the members of single-member LLCs to develop and sign these agreements, since these same members can freely amend them at any time. However, there are four strong reasons supporting the use of these agreements:

a) First, the members of single-member LLCs can fully understand structures and operations of their LLCs only on the basis of a document that comprehensively describes these structures and operations. The best form of document in which to set forth these descriptions is a written operating agreement.

b) Second, the very existence of a written operating agreement provides evidence of the separateness of a single-member LLC and its member, and to the extent that the member complies with the provisions of the agreement, both the existence of the agreement and this compliance may help defeat veil-piercing claims by third parties against the LLC—i.e., claims that the courts should hold the members liable for claims against single-member LLCs because the members dominate them.

c) Third, written operating agreements are often useful in providing evidence to third parties that have a right to basic information about the single-member LLCs that are parties to them—e. g., banks that have a right to know the identities of persons authorized to sign loan documents to which single-member LLCs are parties.

d) Finally, under most or all LLC acts, including the New Act, there are likely to be one or more default provisions that are contrary to the interests of the members of single-member LLCs. The best way to override those provisions is in written operating agreements.

5) To illustrate the above point:

a) Section 47, II of the New Act provides that "unless the operating agreement provides otherwise, a limited liability company shall be managed by its members." However, a basic question for any individual who is the member of a single-member LLC is how to ensure the proper management of the LLC when, because of illness, absence or otherwise, the member is unable to manage it. Thus, most single-member LLCs whose members are individuals should have written operating agreements that appoint one or more non-members as assistant managers of these LLCs and that specify the circumstances in which these assistant managers may decide LLC matters, sign LLC contracts and otherwise exercise LLC management rights.

b) Most single-member LLCs whose members are entities should also override in written operating agreements the default member-management structure imposed by § 47, II to reduce the risk that the members will be held personally liable for claims against these LLCs; indeed, the principal purpose of these LLCs is to prevent this result. In general:

i) The written operating agreements of relatively small single-member LLCs whose members are entities should provide for management by a single individual;

ii) Those of relatively larger single-member LLCs whose members are entities should provide for management by two or more individuals, who should generally have duties and responsibilities generally similar to those of corporate officers; and

iii) Those of large single-member LLCs with substantial assets and complex operations should generally have a corporate management structure with internal boards of directors and two or more officers.

6) Obviously, all of the above management structures for both single-member LLCs whose members are individuals and for those whose members are entities require the appointment of specifically named individuals as managers and also require the addressing of fiduciary issues

and other LLC business organization law issues that need tailored treatment in the case of each single-member LLC.

EXHIBIT 5-1

CERTIFICATE OF ELECTION

1. The individual identified in the signature block below (the "member") hereby certifies that on the effective date of this Certification of Election, the member will be the only member of _____, LLC (the "LLC"), a single-member limited liability company formed and existing under the New Hampshire Limited Liability Company Act (the "LLC Act").
2. The LLC's date of formation was _____.
3. Under Section 5, II(a) of the Revised New Hampshire Limited Liability Company Act (the "Revised LLC Act"), the member hereby elects that except as the member may validly alter the provisions of the Revised Act in the LLC's operating agreement, the member will be governed by the Revised LLC Act on and after the later of (i) the Effective Date; and (ii) January 1, 2013.
4. The effective date of the above election (the "Effective Date") will be the date on which the member signs and dates this Certificate of Election.
5. The member hereby acknowledges that on and after the later of (i) the Effective Date and (ii) January 1, 2013, the LLC will no longer be governed by the LLC Act and that, except as validly provided in the LLC's operating agreement, it will be governed by the Revised LLC Act.

SIGNED:

_____

[NAME OF MEMBER] (Date)

CERTIFICATE OF NOTARIAL ACT

STATE OF NEW HAMPSHIRE

COUNTY OF _____

I, _____, am a notary public commissioned by the State of New Hampshire. My commission expires on _____. I hereby certify that I personally know the person whose name and signatures are set forth above and that I have witnessed this person this Certificate of Election on today's date.

_____

[NAME OF NOTARY] (Date)

[SEAL]

EXHIBIT 5-2

CERTIFICATE OF ELECTION

1. The entity identified in the signature block below (the "member") hereby certifies that on the effective date of this Certification of Election, the member will be the only member of _____, LLC (the "LLC"), a single-member limited liability company formed and existing under the New Hampshire Limited Liability Company Act (the "LLC Act").
2. The LLC's date of formation was _____.
3. Under Section 5, II(a) of the Revised New Hampshire Limited Liability Company Act (the "Revised LLC Act"), the member hereby elects that except as the member may validly alter the provisions of the Revised Act in the LLC's operating agreement, the member will be governed by the Revised LLC Act on and after the later of (i) the Effective Date; and (ii) January 1, 2013.
4. The effective date of the above election (the "Effective Date") will be the date on which the member signs and dates this Certificate of Election.
5. The member hereby acknowledges that on and after the later of (i) the Effective Date and (ii) January 1, 2013, the LLC will no longer be governed by the LLC Act and that, except as validly provided in the LLC's operating agreement, it will be governed by the Revised LLC Act.

SIGNED:

[ENTITY NAME]

By: _____
[NAME OF AUTHORIZED INDIVIDUAL SIGNER (Date)
[TITLE OF SIGNER]

CERTIFICATE OF NOTARIAL ACT

STATE OF NEW HAMPSHIRE

COUNTY OF _____

I, _____, am a notary public commissioned by the State of New Hampshire. My commission expires on _____. I hereby certify that I personally know the person whose name and signatures are set forth above and that I have witnessed this person sign this Certificate of Election on the indicated date.

_____
[NAME OF NOTARY] (Date)

[SEAL]

EXHIBIT 5-3

CERTIFICATE OF ELECTION

1. The persons identified in the signature blocks below (the "members") hereby certify that on the effective date of this Certification of Election, the members will be the only members of _____, LLC (the "LLC"), a multi-member limited liability company formed and existing under the New Hampshire Limited Liability Company Act (the "LLC Act").
2. The LLC's date of formation was _____.
3. Under Section 5, II(a) of the Revised New Hampshire Limited Liability Company Act (the "Revised LLC Act"), the member hereby elects that except as the members may validly alter the provisions of the Revised Act in the LLC's operating agreement, the members will be governed by the Revised LLC Act on and after the later of (i) the Effective Date; and (ii) January 1, 2013.
4. The effective date of the above election (the "Effective Date") will be the date on which the last of the members to sign and date this Certificate of Election shall have done so.
5. The members hereby acknowledge that on and after the later of (i) the Effective Date and (ii) January 1, 2013, the LLC will no longer be governed by the LLC Act and that, except as validly provided in its operating agreement, it will be governed by the Revised LLC Act.

SIGNED:

_____

[NAME OF MEMBER] (Date)

_____

[NAME OF MEMBER] (Date)

CERTIFICATE OF NOTARIAL ACT

STATE OF NEW HAMPSHIRE

COUNTY OF _____

I, _____, am a notary public commissioned by the State of New Hampshire. My commission expires on _____. I hereby certify that I personally know each of the persons whose names and signatures are set forth above and that I have witnessed each of these persons sign this Certificate of Election on the indicated date.

_____

[NAME OF NOTARY] (Date)

[SEAL]

CHAPTER 6

THE IMPACT OF THE NEW ACT ON NEW HAMPSHIRE LLC FORMATION PRACTICE—INTRODUCTION

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1) A key issue for LLC lawyers under the New Act is whether the process of forming New Hampshire LLCs is different under that act than under the Old Act.

2) Forming New Hampshire LLCs is a complex, multi-step process. However, in addressing the LLC business organization law issues that are the subject of this book, the two most important steps lawyers must handle are, in the following order:

   a) Non-tax choice of entity—that is, determining under New Hampshire business organization law which type of New Hampshire business organization will be best for the business of one's clients on non-tax grounds; and, assuming that the best business organization for the clients is an LLC,

   b) Planning, negotiating and drafting an operating agreement for their LLC.

3) In order to perform the latter task:

   a) You must identify all of the LLC business organization law issues likely to be important to your clients and you must determine with them the resolution of each of these issues that is likely to be in their best interest. However, in my experience, these issues and their resolution are unlikely to be affected by the LLC act that happens to govern the LLC deal in question. Thus, they are unlikely to be affected by the fact that you are forming a New Hampshire Act under the Old Act or under the New Act.

   b) Secondly, after you have made the above determinations and have formalized them in a draft operating agreement, you must review the definitional, default, mandatory, non-self-enabling permissive and self-enabling permissive provisions of the governing LLC act to ensure that the draft agreement addresses each of these provisions in the operating agreement in a manner consistent with your clients' best interests. Obviously, the list of provisions in Exhibit 1-4 will facilitate this task under the New Act.

4) In order to perform non-tax choice of entity:

   a) You must first identify all of the business organization law characteristics of each relevant type of business organization that are relevant in comparing that type of business organization with other relevant types. Then, on the basis of these characteristics, you must compare each relevant business organization with each other relevant business organization, and, on this basis, you must make a non-tax choice of entity.

   b) Chapter 7 of this book identifies the statutory characteristics of LLCs under the Old and New Acts that, in my view, are likely to be relevant for non-tax choice of entity purposes, and Chapter 8 describes the non-tax choice of entity process in which these characteristics are applied.

5) However, as Chapter 7 makes clear, while there are differences in *degree* as to the characteristics of New Hampshire LLCs under the Old and the New Acts that are relevant to non-tax choice of entity, there are no differences in *kind*.

6) Thus, for example, although, as discussed in Chapter 2, the New Act contains a number of "flexibility" provisions not contained in the Old Act, both acts provide very substantial

contractual flexibility to LLC founders to tailor their LLCs to meet member needs and interests.

7) Similarly, although the pick-your-partner provisions and charging order provisions of the New Act provide much stronger protections to LLC members against the possibility that courts will order the transfer of their membership rights to third-party claimants, both acts provide LLC members with far greater protections of this kind than corporations.

8) Accordingly, although, because of its intrinsic importance in the New Hampshire LLC formation process, I will discuss the non-tax choice of entity process in considerable detail in Chapter 7, the main result of the discussion will be to show, as indicated, that the process is essentially identical under the Old and New Acts.

CHAPTER 7

THE CHIEF STATUTORY CHARACTERISTICS OF OLD AND NEW ACT LLCs RELEVANT TO NON-TAX CHOICE OF ENTITY

OVERVIEW

LLCs under both the Old Act and the New Act have ten chief statutory characteristics generally relevant in making non-tax choice of entity analyses.

Characteristic 1. ENTITY STATUS

New Act LLCs are entities. As provided in New Act § 19, I, "[a] limited liability company formed under this act shall be a legal entity separate and distinct from its members." Old Act § 12 is to the same effect.[1]

COMMENT

The critical importance of entity status in non-tax choice of entity is discussed in Chapter 8.

Characteristic 2. LIMITED LIABILITY

LLC members and managers as such have no personal liability for the obligations of their LLCs. New Act § 23;[2] Old Act § 25 is to the same effect.

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[1] Section 12, IV provides that "[a] limited liability company formed under this [act] shall be a separate legal entity, the existence of which as a separate legal entity shall continue until the cancellation of the limited liability company's certificate of formation."

[2] Section 23, I provides as follows:

> I. Except as provided in RSA 304-C:144, IV(b) [concerning third-party claims for certain assets distributed in LLC liquidations] and paragraph II [concerning members' voluntary waivers of limited liability]:

COMMENT

The paramount importance of limited liability to the members of Old and New Act LLCs is self-evident. Its importance in non-tax choice of entity is discussed in Chapter 8.

Characteristic 3. THE "ONE-MEMBER" RULE

New Act LLCs may have any number of members but must have at least one. New Act § 20.[3] Old Act § 1, V is to the same effect.[4] Old Act § 1 provides that "[l]imited liability company". . . mean[s] a limited liability company formed under the laws of New Hampshire and having one or more members."

COMMENT

The New Act one-member rule distinguishes New Act LLCs from New Hampshire business corporations, which can be validly formed even if they have *no* owners (i.e., no shareholders) at the time of their formation. However, since the admission and identity of the member of a New Hampshire single-member LLC and the members of a New Hampshire multi-member LLC will almost always be clear from circumstantial evidence at the time of its formation, the rule will rarely have any practical significance in non-tax choice of entity or otherwise.[5]

Characteristic 4. BROAD PERMISSIBILITY AS TO TYPES OF MEMBERS

There are no limits under either the New Act or the Old Act as to the types of persons that may be LLC members. For example, these persons may be U.S. or foreign individuals, they may be entities and they may be revocable or irrevocable trusts.

COMMENT

Like the one-member rule, the above rule as to permissible types of members is self-evidently important in defining the LLC business organization form under the New Act from a theoretical viewpoint. However, it, like the above one-member rules, will rarely have any practical importance for LLCs or their members in non-tax choice of entity or otherwise.

Characteristic 5. CONTRACTUAL FLEXIBILITY—IN GENERAL

1) Section 4 of the preamble of the New Act makes clear that its second most important purpose

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> (a) The debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, shall be solely the debts, obligations, and liabilities of the limited liability company; and
>
> (b) No member or manager of a limited liability company shall be obligated personally for any such debt, obligation, or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.

[3] Section 20 provides that "[a] limited liability company must have at least one member but may any greater number of members." [John: is something missing here or are the double "s intentional?]

[4] Old Act § 1 provides that "[l]imited liability company". . . mean[s] a limited liability company formed under the laws of New Hampshire and having one or more members."

[5] For example, in the case of many New Act LLCs, the very signature on the certificate of formation whose filing creates the LLC will often provide useful evidence as to its compliance with the one-member rule.

was to increase the flexibility of New Hampshire LLCs.[6] Under the New Act, LLC members have maximum freedom of contract in tailoring their LLCs under their LLC agreements to meet member needs and interests, and the courts must give maximum effect to the enforceability of these agreements. This contractual freedom and enforceability are reflected above all in New Act § 2.[7] They are also reflected in the fact that virtually all of the provisions of the New Act governing the internal affairs of LLCs are default provisions, non-self-enabling permissive provisions or self-enabling permissive provisions; only a very few are mandatory.[8]

2) Under Old Act § 78, II, , as under § 2 of the New Act, LLC founders have sweeping statutory flexibility in tailoring their LLCs to meet their needs and interests. Indeed, the terms of Old Act § 78, II are identical to those of New Act § 2. However, as discussed in Chapter 2, the New Act contains several "flexibility provisions" that the Old Act does not contain, including, for example, provisions permitting the elimination of fiduciary duties and the exculpation of members, managers and others from liability for breaches of these duties. Furthermore, it is by no means clear that the courts would permit the degree of elimination of fiduciary duties and exculpation of liabilities under the Old Act.[9]

3) Thus, it is clear that the New Act provides substantially greater flexibility than the Old Act.

COMMENTS

1) Most LLCs have at least a few unusual features, and many of them have many such features. The above provisions of the New Act provide LLC members, managers and their lawyers with virtually unlimited flexibility in tailoring LLCs to meet unusual needs and interests.

2) However, few prospective members or managers of LLCs are likely to be able to identify with any comprehensiveness the features of their LLCs that are unusual, much less to know how to take advantage of the flexibility available under the New Act to address these features. Indeed, in my experience, the ability to discern unusual LLC features and the ability to address them properly in operating agreements are rare among LLC lawyers—but they are among the most important qualities that these lawyers should possess.

Characteristic 6. CONTRACTUAL FLEXIBITY WITH REGARD TO MANAGEMENT STRUCTURES

1) The default management structure of LLCs is management by the members. New Act § 47,

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[6] For example, the first sentence of the section states that "[t]his bill also contains a number of new provisions that will increase the flexibility of the act and thus will enhance the ability of both small and large New Hampshire businesses to tailor their LLCs to meet members' and managers' needs and interests."

[7] Section 2 provides as follows: "It is the policy of this act to give the maximum effect to the principle of freedom of contract and to the enforceability of operating agreements."

[8] Once such mandatory provision is set forth in New Act § 87, VI, which requires the vote of all of the members to compromise member promises to make contributions to the LLC.

[9] See, e.g., David Johnston Development, LLC v. Lakes Region Gaming, LLC (Merrimack Cty Superior Court NO. 217-2006-EQ-112), decided April 4, 2011, in which Judge McNamara ruled that the fiduciary duties of members and managers are the very strict duties imposed under Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928). It may be questions whether, merely on the basis of § 78, II of the Old Act, Judge McNamara would permit the limitations of fiduciary duties and the exculpations permitted under the above provisions of the New Act.

II.10 However, consistent with the general New Act policy of maximum flexibility, section 47, II, provides that LLCs may also be "manager-managed"—that is, they may be managed by persons, who may be either members or non-members, appointed as managers under their operating agreement. Section 31, II of the Old Act is to the same effect.

2) In addition, under the broad freedom-of-contract provisions of New Act § 2 and under various other New Act permissive provisions, LLCs may adopt a corporate management structure with a board of directors and officers, bylaws and other corporate features; but, under Old Act § 78, II and other Old Act provisions, Old Act LLCs, too, may have corporate management structures.

Characteristic 7. CENTRAL IMPORTANCE OF WRITTEN OPERATING AGREEMENTS

1) As noted in Chapter 4, the operating agreements of single-member LLCs are agreements among the members and their LLCs about the legal and tax structure and the administration of these LLCs. As discussed in Chapter 4, the operating agreements of single-member LLCs are important in providing members with an understanding of their LLCs, in evidencing the separateness of these LLCs and thus in resisting veil-piercing claims; in altering default rules of the governing act that are inappropriate for these LLCs; and in providing a basis for responding to third-party inquiries about them.

2) As discussed in Chapter 4, the operating agreements of multi-member LLCs are agreements among these LLCs, their members and their managers concerning their legal and tax structures and the respective rights and duties of the members and managers. The operating agreements of multi-member LLCs are important above all:

   a) In providing prospective members of these LLCs with a basis for deciding whether to become actual members; and

   b) In resolving disputes among the members and managers about the LLC after its formation.

3) As discussed in Chapter 4 (concerning the "off-the-shelf" operating agreements in the New Act), there are numerous specific issues, including both business organization law issues and issues in other areas of law, that are important for the members of both single-member and multi-member LLCs but that LLC statutes cannot address, whether because solutions of these issues require significant tailoring or for other reasons. These include, for examples, issues concerning buy-outs of dissociated members, dispute resolution issues and federal and state tax issues. To address these issues properly, LLCs need a written operating agreement.

COMMENT

As discussed in Chapter 8, written operating agreements among the members of New Act LLCs are often more important than written shareholder agreements among the owners of corporations. However, the drafting of operating agreements under the New Act, as under the Old Act, can require significant skill and experience, and these qualities don't come cheap. This may sometimes mean that the proper documentation of a New Act LLC may require significantly higher legal fees than that of a corporation.

[10] Section 47, II provides as follows: "Unless the operating agreement provides otherwise, a limited liability company shall be managed by its members."

Characteristic 8. STATUTORY INFORMALITY

The provisions of the New Hampshire Business Corporation Act impose numerous formalities on corporations with respect to their formation and internal governance, and many of these formalities—e.g., those regarding shareholder meetings—are complex. By contrast, neither the Old Act nor the New Act imposes any such formalities except that of maintaining specified types of records. New Act § 55; Old Act § 28. Furthermore, this formality is hardly burdensome, since all of the relevant records are those that LLCs would be likely to maintain or could readily construct in any event.

COMMENT

The importance of statutory informality for non-tax choice of entity purposes is discussed in Chapter 8.

Characteristic 9. PROTECTION OF MEMBERSHIP RIGHTS—"PICK-YOUR-PARTNER" PROVISIONS AND CHARGING ORDER PROVISIONS

As discussed in detail in Chapter 3:

- The New Act contains "pick-your-partner" provisions and charging order provisions that provide New Act LLC members with strong protection of their membership rights against third-party claims.
- The Old Act also contains pick-your-partner provisions and charging order provisions, but these provisions provide members with far less protection than those of the New Act, particularly in the case of members of single-member LLCs.

COMMENT

The importance of the New Act pick-your-partner provisions and charging order provisions in non-tax choice of entity is discussed in Chapter 8.

Characteristic 10. RELATIVE EASE OF TRANSFORMATION OF NON-LLC ENTITIES INTO LLCS AND VICE VERSA

Under the "statutory conversion" provisions and "interspecies merger" provisions of the New Act, non-LLC entities may be readily transformed into LLCs and LLCs may be readily transformed into non-LLC entities.[11] New Act § 147 *et seq.* (statutory conversions); New Act § 155 *et seq.* (interspecies mergers). Similar provisions are contained in, respectively, §§ 17-a and 18 of the Old Act. Corresponding provisions may be found in all other major New Hampshire business organization statutes.

COMMENT

The ease of transformation of non-LLC entities into New Act LLCs and vice versa is not normally a significant factor in non-tax choice of entity, but it can be important to individual LLCs in certain situations. For example:

[11] Statutory conversions are statutory procedures under which business entities change their business organization form—e.g., from the corporate to the LLC form—while remaining the same entity. Interspecies mergers are statutory procedures in which a business entity with one business organization form—e.g., the LLC form—merges into another business entity with another business organization—e.g., the corporate form.

1) A statutory conversion of an entity formed as a New Hampshire corporation to an LLC can make it possible to protect the owners of the entity from the New Hampshire Interest and Dividends Tax—a tax these owners cannot avoid as long as the entity they own is a corporation.

2) A statutory conversion of an entity formed as a New Hampshire LLC to a corporation may facilitate a public offering of interests in the entity.

CHAPTER 8

NON-TAX CHOICE OF ENTITY UNDER THE OLD AND NEW ACTS

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§ 8.01 INTRODUCTION

[A] THE PURPOSE OF THIS CHAPTER

The purpose of this chapter is to provide lawyers with the legal and practical knowledge and the practice tools they will need in order to competently and efficiently do non-tax choice of entity under New Hampshire law. Since the Old Act will be in effect for LLC formations until January 1, 2013, the chapter will address both Old Act and New Act non-tax choice of entity issues. The non-tax choice of entity practice tools in the chapter are set forth in Exhibits 8-1 through 8-5.[1]

[B] DEFINITIONS; NON-TAX CHOICE OF ENTITY AS PRIMARILY A MATTER OF STATE LAW

1) Non-tax choice of entity—definition. Non-tax choice of entity is the analytical process by which lawyers choose on non-tax grounds the type of business organization (e.g., a New Hampshire business corporation or an Old or New Act LLC) that will be best for a particular business.[2] For many businesses, this choice can have critical legal and other consequences.

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[1] Bibliography. In preparing this chapter, I have made an online search of works by other authors on the subject of non-tax choice of entity. Two useful CLE chapters on the subject are Mezzullo, Louis A., *Choice of Family Business Entity for Estate Planning Purposes*, SG020 ALI-ABA 243 (ALI-ABA Course of Study, July 5-7-2002); and Martin, Alson R., *Choice of Business Entity: Business, Tax and Other Non-Fringe Benefit Considerations*, SE66 ALI-ABA 525 (ALI-ABA Course of Study, February 17, 2000). There are also two relatively comprehensive handbooks on the subject—namely, Ely and Grissom, *Choice of Entity: An Overview of Tax and Non-Tax Considerations* (BNA Portfolio 1550), and Keatinge and Connaway, *Keatinge and Conaway on Choice of Business Entity* (Thompson West 2006).

However:

- None of the above writings provides comprehensive non-tax choice of entity practice tools;
- None makes clear the critical fact (discussed further below) that default statutory rules are irrelevant in entity formations in which competent business lawyers are involved (since these lawyers can alter these rules in entity constitutive documents to meet client needs); and
- None makes clear the importance of the concept of "entity" in understanding and applying business organization law factors in non-tax choice of entity (also discussed further below).

[2] "Organization" and "business organization"—definitions. For purposes of this chapter:

EXAMPLE. ABC is a single-owner business that will be owned by Mary Jones. ABC will have three non-owner employees and will manufacture explosives. If Mary forms ABC as a sole proprietorship, she will have no liability shield—which means that a single negligent act by any of her employees may put all of her personal assets at risk. However, if Mary forms ABC as a single-shareholder business corporation or as a single-member LLC, she will have a liability shield for claims against her business. This shield will protect her personal assets from any such claim unless the basis for the claim is her own misconduct.

2) Primacy of New Hampshire law in non-tax choice-of-entity analyses for New Hampshire business start-ups. Business organizations are creatures of the law of the jurisdiction in which they are formed—which, in almost all cases, is state law. Most New Hampshire non-tax choice-of-entity analyses can be made largely or entirely on the basis of New Hampshire business organization law.

3) Business organization law—definition; main types of New Hampshire business organization statutes. The term "business organization law" is used frequently in this chapter. As noted in Chapter 1, business organization law is the area of state statutory and common law that deals with the formation and chief legal characteristics of business organizations. The New Hampshire business organization law governing sole proprietorships and divisions consists exclusively of case law. The principal types of New Hampshire business organization law statutes are those for general and limited partnerships, business corporations and LLCs.

4) The two types of grounds for non-tax choice of entity. There are two principal types of grounds for making non-tax choice-of-entity decisions—namely, (i) business organization law grounds; and (ii) "miscellaneous" grounds.

   a) Business organization law factor—limited liability. A typical business organization law factor in determining whether a particular type of business organization is best for a start-up business is whether that organization provides the owners of the business with a strong limited liability shield.

   b) "Miscellaneous" factor—legal fees. A typical "miscellaneous" factor in determining whether a particular type of business organization will be best for a business start-up is whether the formation of that organization will necessitate significant legal fees.

- "Organization" means a person or group of persons organized for a particular purpose; and
- "Business organization" means an organization organized primarily to conduct a trade, business or profession.

Business organizations include the types of organizations identified in Section 8.02 and 8.04 of this chapter. Each of these types of business organizations is subject to a particular set of business organization law rules under the governing business organization statutory or case law of the state of formation. The term "business organization law" is defined in the text of this chapter.

[C] THE FOUR STEPS IN THE NON-TAX CHOICE-OF-ENTITY PROCESS—OVERVIEW

Most non-tax choice-of-entity analyses can be handled with relative ease on the basis of the four steps summarized below. These steps are also set forth in the attached Exhibit 8-1.

1) Determine the ownership structure of the business in question. First, determine whether the business organization in question will be owned (i) by one individual; (ii) by one entity; or (iii) by multiple owners.

2) Determine which types of business organizations are available to businesses with that ownership structure. Second, determine the principal types of business organizations that are available to businesses with that ownership structure. These organizations are identified and briefly discussed in §§ 8.02 and 8.03 of this chapter. The specific types of business organizations likely to be relevant to (i) single-owner businesses whose owners will be individuals, (ii) single-owner businesses whose owners will be entities and (iii) multi-owner businesses are listed in Exhibit 8-1, Step 3.

3) Determine which types of non-tax choice-of-entity factors are important to the business. Third, determine which non-tax choice-of-entity factors are likely to be important to the business organization. These factors are identified and briefly explained in § 8.04 of this chapter. There are a total of ten main business organization law factors and four main "miscellaneous" factors relevant in making non-tax choice of entity analyses. These factors are listed in Exhibit 8-2.

4) Determine which type of business organization available to the business will best provide the relevant non-tax benefits. Fourth, on the basis of Exhibit 8-3 (for single-owner businesses whose owners are individuals), Exhibit 8-4 (for single-owner businesses whose owners are entities) or Exhibit 8-5 (for multi-owner businesses), determine on a net basis which of the types of business organizations available to the business will best provide the business with the business organization law advantages and "miscellaneous" advantages that it needs. The process of making this determination is illustrated in the hypothetical examples in § 8.05 of this chapter.

[D] THE CRITICAL IMPORTANCE OF DOING NON-TAX CHOICE-OF-ENTITY AND TAX CHOICE-OF-ENTITY ANALYSES INDEPENDENTLY OF ONE ANOTHER

Tax choice of entity is the analytical process by which tax professionals choose the best federal income tax regimen for a business on federal income and Social Security Tax grounds. Lawyers and other professionals forming businesses sometimes attempt to do non-tax choice-of-entity analyses and tax choice-of-entity analyses simultaneously; in doing so, they mix non-tax and tax factors indiscriminately. However, the factors that are significant in non-tax choice-of-entity analyses are completely different from those significant in tax choice-of-entity analyses. Thus, you should always do the two types of analyses completely independently of one another. If, once you've finished both analyses, you find that their outcomes conflict, you should seek to reconcile them.

> EXAMPLE. From a non-tax choice-of-entity viewpoint, XYZ, a start-up company, should arguably be formed as a business corporation because of its need for the protections available to its passive owners under a corporate management structure. From a tax choice-of-entity viewpoint, XYZ should be taxable as a partnership. However, under the relevant U.S. Treasury regulations—i.e., the "Entity Classification Regulations" (often referred to informally as the "Check-the-Box Regulations")—LLCs are eligible for partnership tax treatment but business corporations are not. To reconcile this conflict between non-tax choice of entity and tax choice of entity, XYZ's lawyers

should form XYZ as an LLC but, in its operating agreement, they should provide it with a corporate management structure.

[E] IN NEW HAMPSHIRE NON-TAX CHOICE-OF-ENTITY ANALYSES, THE CHOICE WILL BE OFTEN BE BETWEEN NEW HAMPSHIRE LLCS AND NEW HAMPSHIRE BUSINESS CORPORATIONS

1) LLCs v. business corporations in non-tax choice of entity. Although, as noted, this chapter focuses on six main types of New Hampshire business organizations for non-tax choice-of-entity purposes:

   a) Most New Hampshire business founders will find that they must choose between just *two* types of business organizations—namely, New Hampshire business corporations and New Hampshire LLCs.

   b) In a substantial majority of cases, the better of these types of business organizations from a non-tax choice-of-entity viewpoint will be a New Hampshire LLC. Briefly, this is because:

      i) For single-owner New Hampshire businesses, LLCs are generally better than business corporations from a business organization law viewpoint because their management structure is simpler and because they provide a stronger liability shield.

      ii) For multi-owner New Hampshire businesses, LLCs are generally better than business corporations from a business organization law viewpoint because of the above reasons and also because they provide charging order protections (which business corporations do not).

2) New Hampshire state entity formation statistics. Mainly because of the above factors, a substantial majority of New Hampshire business entities formed each year are LLCs, and year after year, New Hampshire business corporations account for an ever smaller portion of these formations.[3]

3) Business corporations are usually mistakes. Indeed, in my experience, the business organization law advantages of LLCs over business corporations are so great for most business start-ups that it is safe to say that under the laws of most states, *most corporate formations are mistakes.*

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[3] IACA entity formation statistics; Chrisman article. See, e.g., the state entity formation statistics compiled by the International Association of Commercial Administrators ("IACA") and published in IACA's website at http://www.iaca.org/downloads/AnnualReports/2007_IACA_AR.pdf. On the basis of these statistics and his own research, Rodney Chrisman, a law professor at Liberty University, in an article entitled "LLCs Are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations and LPs Formed in the United States Between 2004-2007 and How LLCs were Taxed for Tax Years 2002-2006," has provided an extensive survey and analysis of U.S. formations of LLCs, corporations and limited partnerships from 2002 through 2007. The article is published in 15 Fordham J. Corporate & Fin. L. 459 (2010). An important conclusion of the article is that in all but four states—namely, California, Florida, Illinois and New York—LLCs are now the most commonly formed type of business organizations, and, in many of these statutes, outnumber corporations on an aggregate basis. In Connecticut, for example, LLC formations outnumber formations of corporations by almost 12 to one; in Wisconsin by more than six to one.

[F] THE ASSUMPTION IN THIS CHAPTER THAT NEW HAMPSHIRE BUSINESS OWNERS WILL HAVE THE ASSISTANCE OF COMPETENT LAWYERS IN FORMING BUSINESS ENTITIES

1) All New Hampshire business organization law statutes consist of a combination of definitional, mandatory, default, non-self-enabling permissive and self-enabling permissive provisions.[4] Business founders who choose to form their businesses under a particular business organization law statute but do not make use of a lawyer to address these provisions in the constitutive documents of their business in order to meet their needs will necessarily be bound by the default provisions and the self-enabling permissive provisions of the governing statute. In some situations, the default or permissive provisions of a business organization law statute for one type of entity may be substantially better for a business founder than those of another business organization law statute.

2) Thus, for example, if a business owner wants the ownership interests in his or her business to be freely transferable, the default provisions of a corporate statute will be preferable to the owner than those of a partnership or LLC statute even if, in general, the LLC provisions are far preferable to the owner as compared to those of the corporate statute.

3) Since this chapter is intended primarily for lawyers assisting clients in forming new businesses, I will assume for purposes of the chapter that in choosing a particular type of business entity for their business start-ups, business founders will be able to afford the assistance of competent attorneys:

   a) To alter the default statutory provisions governing that type of entity to meet the founders' needs;

   b) To take advantage of non-self-enabling permissive provisions potentially useful to their clients; and

   c) To avoid the impact of potentially unfavorable self-enabling permissive provisions.

4) However, on the chance that it may be useful to at least a few readers, the following are key considerations of which business start-up clients should be aware in forming New Hampshire business corporations rather than LLCs to conduct their businesses:

   a) The New Act has detailed statutory fiduciary provisions. The Business Corporation Act has only very basic fiduciary provisions, and many key BCA fiduciary issues are addressed only in case law.

   b) Both Old and New Act LLCs provide for simple default and elective management structures. The default tripartite shareholder/director/officer management structure of business corporations under the BCA is complex.

   c) Old and New Act LLCs and New Hampshire business corporations provide owners with strong statutory liability shields. However, business corporations are prone to veil-piercing if shareholders fail to comply with start-up and post-formation statutory formalities. The Old and New Acts impose no such formalities.

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[4] These statutory classifications are defined in Chapter 1, and their practical importance is discussed in various chapters.

§ 8.02 THE PRINCIPAL TYPES OF NEW HAMPSHIRE BUSINESS ORGANIZATIONS RELEVANT TO NON-TAX CHOICE OF ENTITY

[A] THE ELEVEN MAIN TYPES OF NEW HAMPSHIRE BUSINESS ORGANIZATIONS THEORETICALLY RELEVANT IN NON-TAX CHOICE OF ENTITY

1) The eleven main types of New Hampshire business organizations. It is useful to think of New Hampshire business organization law as providing for eleven main types of business organizations potentially useful to business start-ups from a non-tax viewpoint. These are:

   i) Sole proprietorships;

   ii) Divisions (i.e., administrative units of entities);

   iii) "Simple" general partnerships under RSA 304-A —i.e., general partnerships (a) which have not registered with their state of formation as limited liability partnerships ("LLPs") and (b) in which one or more of the partners are not limited liability entities;

   iv) General partnerships that file registrations under RSA 304-A:44 and thus become "limited liability partnerships" ("LLPs");

   v) General partnerships in which all of the partners are limited liability entities;

   vi) "Simple" limited partnerships—i.e., limited partnerships under RSA 304-B:

      (1) Which have not registered as limited liability limited partnerships ("LLLPs") and

      (2) Whose general partners are not limited liability entities;

   vii) Limited partnerships that have registered as LLLPs under RSA 304-A:44;

   viii) Limited partnerships whose general partners are limited liability entities;

   ix) Business corporations that have *not* elected to adopt a partnership structure under RSA 293-A:7.32;[5]

   x) Business corporation that *have* made the above election; and

   xi) LLCs.

2) New Hampshire law also provides for professional corporations under RSA 294-A; for professional LLCs under RSA 304-D; for non-profit corporations and associations under RSA 292; and for New Hampshire investment trusts under RSA 292. However, these entities are used only in specialized circumstances and will not be discussed in this chapter.

[B] THE FIVE TYPES OF BUSINESS ORGANIZATIONS THAT SHOULD NORMALLY BE EXCLUDED FROM CONSIDERATION IN NEW HAMPSHIRE NON-TAX CHOICE-OF-ENTITY ANALYSES

In my view, the following six of the above eleven types of New Hampshire business organizations should be excluded from consideration in most non-tax choice-of-entity analyses for the following reasons:

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[5] BCA § 7.32. BCA § 7.32 provides, in general, that business corporations formed under the BCA may elect to adopt a partnership structure under which, among other things, these corporations have no board of directors or officers but rather are managed directly by their shareholders.

1) Simple general partnerships. Simple general partnerships should be excluded because, under the mandatory provisions of the general partnership statutes of all states, all of the partners of these partnerships have unlimited personal liability for claims against their partnership and its partners.

2) General partnerships in which all of the partners are limited liability entities. Even though, by definition, general partnerships in which all of the partners are limited liability entities provide liability shields to all partners, these partnerships should be excluded because, for most business organizations, the cost of creating such a partnership structure and the complexity and administrative burdens of implementing it are excessive.

3) Simple limited partnerships. Simple limited partnerships should be excluded because, by definition, the general partners of these entities have unlimited personal liability for partnership debts. Because of this liability exposure, few individuals or entities that are legally sophisticated will be willing to serve as the general partners of simple limited partnerships.

4) LLLPs. LLLPs should be excluded because:

   a) Under RSA 304-B, LLLPs, like LLPs, have only a partial liability shield; and

   b) Only about twenty-two states authorize LLLPs. In all other states, the general partners of limited partnerships have no liability shield.[6]

5) Business corporations that elect partnership business organization law structures. Business corporations that elect to adopt partnership business organization law structures under BCA § 7.32 should be excluded because (a) there is little case law defining the ramifications of these elections; and (ii) the business organization law flexibility available to business corporations and their shareholders under § 7.32 are far more readily available to LLCs and their members under the Old and New Acts.

[C] THE TYPES OF NEW HAMPSHIRE BUSINESS ENTITIES THAT SHOULD NORMALLY BE CONSIDERED IN NON-TAX CHOICE-OF-ENTITY ANALYSES FOR SINGLE- AND MULTI-OWNER NEW HAMPSHIRE BUSINESSES

On the basis of the exclusion of the above six types of business organizations from consideration in this chapter:

1) Single-owner businesses whose owners are individuals. The remaining types of business organizations potentially useful to single-owner businesses whose owners are individuals are:

   a) Sole proprietorships;

   b) Single-shareholder business corporations; and

   c) Single-member LLCs.

2) Single-owner businesses whose owners are entities. The remaining types of business organizations potentially useful to single-owner businesses whose owners are entities are:

   a) Divisions;

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[6] LLLP states. According to the latest information I have been able to obtain, the following twenty-two states provide for LLLPs: Alaska, Arizona, Arkansas, Colorado, Delaware, Florida, Georgia, Hawaii, Idaho, Iowa, Kentucky, Maryland, Minnesota, Missouri, Nevada, New Hampshire, North Carolina, North Dakota, Pennsylvania, South Dakota, Texas and Virginia.

b) Single-shareholder business corporations; and

c) Single-member LLCs.

3) Multi-owner businesses. The remaining types of business organizations potentially useful to multi-owner businesses are:

a) LLPs;[7]

b) Limited partnerships whose general partners are limited liability entities;

c) Multi-shareholder business corporations; and

d) Multi-member LLCs.

§ 8.03 THE SIX MAIN TYPES OF NEW HAMPSHIRE BUSINESS ORGANIZATIONS RELEVANT TO NON-TAX CHOICE OF ENTITY—DEFINITIONS; BASIC DESCRIPTIONS FROM A NON-TAX CHOICE-OF-ENTITY VIEWPOINT

1) Sole proprietorships

a) A sole proprietorship is a business organization owned by one individual.

b) Sole proprietorships come into existence simply because the individuals who conduct them engage in this conduct. Their formation does not require the filing of any document with a state agency and normally involves no initial or annual state taxes or fees.

c) The formation of sole proprietorships normally requires no legal fees for business organization law services.

d) Sole proprietorships do not provide their owners with limited liability or with pick-your-partner or charging order protections.

e) Sole proprietorships have simple and highly user-friendly management structures.

f) Sole proprietorships are not entities.

2) Divisions

a) Divisions are administrative units of business corporations and other entities. Entities may form them by simple administrative action without any state filing.

b) The formation of divisions requires no legal fees for business organization law services.

c) Divisions do not provide their owners with limited liability or with pick-your-partner or charging order protections.

d) Divisions have simple and thus user-friendly management structures.

e) Divisions are not entities.

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[7] However, under RSA 304-A:15, II, New Hampshire LLPs provide only a partial liability shield—in essence, a shield against certain types of tort claims—and the same is true for LLPs formed in other states. For this reason, LLPs should rarely, if ever, be used to conduct New Hampshire businesses. In my experience, their main usefulness is in providing liability shields to partners of general partnerships who are unwilling to spend the time and money necessary to convert their partners to LLCs.

3) LLPs

   a) LLPs are general partnerships that register as LLPs with the state in which they are formed. By virtue of this registration, all of the partners of the general partnership have statutory limited liability.

   b) Because they are general partnerships, LLPs provide their partners with statutory charging order protections.

   c) The competent formation of LLPs often requires significant legal fees for business organization law services. However, merely registering a New Hampshire general partnership as an LLP is quick and inexpensive.

   d) All states provide for LLPs. However, under the laws of ten of these states, including New Hampshire, the LLP statutory liability shield is only a "partial" rather than a full shield; i.e., in general, it protects partners only from tort claims but not from any other type of claims, such as contract claims and bankruptcy claims.[8]

   e) Under the laws of most states, LLPs are entities.

4) Limited partnerships whose general partners are limited liability entities

   a) Limited partnerships are partnerships in which the limited partners have liability shields but the general partners do not.

   b) In limited partnerships whose general partners are limited liability entities, all of the partners have liability shields.

   c) Because they are limited partnerships, limited partnerships whose general partners are limited liability entities provide for statutory pick-your-partner and charging order protections.

   d) Because they are limited partnerships, limited partnerships whose general partners are limited liability entities are entities.

   e) The competent formation of limited partnerships whose general partners are limited liability entities requires substantial legal fees for business organization law services.

5) LLCs

   a) LLCs are organizations formed under state LLC statutes.

   b) These statutes provide LLC members with limited liability and they provide members and LLCs with statutory pick-your-partner and charging order protections.

   c) LLCs are entities.

   d) The competent formation of LLCs requires significant legal fees for business organization law services (and, in particular, for the planning, negotiation and drafting of operating agreements).

6) Business corporations

   a) Business corporations are organizations formed under state corporate statutes. In order to form a business corporation, an organizer must file a certificate of incorporation or other

[8] Partial-shield LLP states. According to the latest information I have been able to obtain, the ten partial-shield LLP states are Kentucky, Louisiana, Michigan, Nevada, New Hampshire, Pennsylvania, South Carolina, Tennessee, Utah and West Virginia.

appropriate document with the secretary of state or other appropriate state officer.

b) All of the shareholders of a business corporation have statutory liability shields.

c) The only state corporate statute that provides business corporations with charging order protections is that of Nevada. The BCA does not provide business corporations with pick-your-partner protections.

d) Business corporations are entities.

e) The proper formation of business corporations often involves significant legal fees for the drafting of shareholder agreements. However, because the BCA provides substantially less flexibility to shareholders in tailoring corporations to meet their needs and interests, these fees are often less than those required for the drafting of comprehensive operating agreements.

§ 8.04 THE PRINCIPAL FACTORS RELEVANT TO NON-TAX CHOICE OF ENTITY

[A] INTRODUCTION

1) Non-tax factors in choice of entity—overview. As noted above, it is convenient to divide the factors relevant in non-tax choice-of-entity analyses into two categories—namely, business organization law factors and "miscellaneous" factors. As also noted, and as shown in Exhibit B, there are ten main business organization law factors and four main "miscellaneous" factors relevant to non-tax choice of entity.

2) The critical importance of entity status. However, as discussed immediately below, many of these factors depend directly on whether, under the applicable state law, a particular business organization is or is not an "entity." Business organizations that are entities possess eight main business organization law advantages that business organizations that are not entities do not possess. These include five important business organization law advantages and three important "miscellaneous" advantages. These advantages are outlined immediately below.

3) The implication of references in this chapter to business organizations as entities. Whenever this chapter identifies any type of business organization as an entity, you can assume that the organization possesses all eight of the above advantages.

[B] THE CRITICAL IMPORTANCE OF ENTITY STATUS IN NON-TAX CHOICE OF ENTITY

1) "Entity"—definition. For business organization law purposes, an entity means a business organization that is a legal person separate from its owners. Under the laws of most or all states, whether a business organization is an entity is determined by statutory law. Under the laws of most or all states, the principal types of business organizations that are entities are general and limited partnerships, business corporations and LLCs. Under the applicable common law in all states, neither sole proprietorships nor divisions are entities.

2) The powers of entities. Under most or all state business organization law statutes, entities have the legal power to acquire, own and dispose of property, to enter into contracts, to be plaintiffs or defendants in lawsuits, and to do all other things that natural persons may do in conducting businesses.

3) The six business organization law advantages that business organizations possess by reason of being entities. Under the business organization statutes of most or all states, business

organizations that are entities have, by reason of their entity status, most or all of the following six types of business organization law advantages not possessed by sole proprietorships or divisions:

a) Perpetual duration. The relevant state statutes generally provide that business organizations on which these statutes confer entity status have "perpetual duration"—i.e., they provide that these organizations will continue in existence as legal persons until, in general, either:

   i) Their owners vote to dissolve them; or

   ii) A court orders their dissolution; or

   iii) They are dissolved for failure to comply with state administrative requirements such as a requirement to pay an annual registration fee.[9]

b) Continuity of life. Because entities have perpetual duration, they will, in general, continue in existence even upon the death or dissolution of all of their owners.

c) Continuity of management. Because entities have perpetual duration, the death or dissolution of their owners will not, in general, affect their continuity of management.

d) Ease in transferring assets. Because entities own all of their assets in their own name, the owners of these entities may transfer all of these assets in a single sale or other transfer (e.g., a transfer under a will or trust) by transferring all of the ownership interests in them. By contrast:

   (1) Sole proprietorships may transfer their assets only on an asset-by-asset basis; and

   (2) Since, under the governing common law, the entities that own divisions are also by definition the owners of all of the assets of their divisions, these assets, too, may be transferred only on an asset-by-asset basis.

e) Ease in selling businesses as units. Because entities own all of their assets in their own name, the owners of entities may sell or otherwise transfer the ownership of these entities as a unit by transferring all ownership interests in them. By contrast:

   i) Sole proprietorships may transfer their businesses as a unit only by transferring each asset of the business individually; and

   ii) Owners of divisions may sell their divisions as a unit only by transferring the assets of the division from ownership in the owners' names to ownership in the names of the transferees.

f) Ease in admitting additional entity owners. The relevant state statutes also provide that individuals and entities may hold ownership interests in entities and that their owners may cause these entities to redeem these interests (i.e., to buy them back from their owners) or to issue additional interests to existing owners or to third parties (who thus become additional owners).

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[9] Other circumstances in which entities will cease to exist as legal persons. In addition, under the governing statutes of most states, LLCs cease to exist as legal persons unless they have at least one member; general partnerships cease to exist as legal persons unless they have at least two partners; and limited partnerships cease to exist as legal persons unless they have at least one general partner and one limited partner.

[C] BUSINESS ORGANIZATION LAW FEATURES NOT ARISING FROM ENTITY STATUS BUT LIKELY TO BE IMPORTANT IN NON-TAX CHOICE-OF-ENTITY ANALYSES

1) Limited liability

   a) Definition and effect. Limited liability is a protection conferred by statute on:

      i) All of the shareholders of business corporations;

      ii) All of the members of LLCs (unless the relevant statute permits them to waive limited liability and they waive it);

      iii) All of the partners of LLPs; and

      iv) All of the limited partners (but not the general partners) of limited partnerships.

      The personal assets of the owners of business organizations that provide their owners with statutory limited liability are not at risk for claims against these organizations. Rather, the only assets of these owners that are at risk for these claims are assets they have contributed to these entities.

   b) Whom does limited liability *not* protect? As noted above, liability shields do not protect business owners from liabilities arising from their personal negligence or from other personal misconduct in conducting their business.

   c) For whom can liability shields be useful? Limited liability can be useful to the owners of any single-owner or multi-owner business organizations:

      i) That have one or more non-owner employees; or

      ii) That use independent contractors to conduct hazardous business activities; or

      iii) That are able to obtain lease arrangements or other contractual arrangements for which the owners are not personal guarantors.

   d) The practical superiority of LLC liability shield over corporate liability shield from a veil-piercing viewpoint. The shareholders of business corporations are potentially liable to veil-piercing claims if they fail to comply with corporate statutory formalities.[10] Under most LLC states, LLCs are subject to very few such formalities. This means that LLCs are far less vulnerable than business corporations to veil-piercing arguments on the basis of their failure to comply with statutory formalities.

2) "Pick-your-partner" and charging order protections. LLC pick-your-partner provisions and charging order provisions are discussed in detail in Chapter 3 of this book, and that chapter provides an extensive comparison between the pick-your-partner provisions and charging order provisions of, respectively the Old and New Acts. Briefly:

   a) The pick-your-partner provisions of both the Old and the New Act provide no protections to the members of single-member LLCs against third parties seeking to execute on their "management" rights.

   b) The pick-your-partner provisions of both the Old and the New Act provide substantial protections to the members of multi-member LLCs, but the protections provided by the New Act are stronger than those of the Old Act.

   c) The charging order provisions of the New Act are substantially stronger than those of the

[10] Veil-piercing is an equitable doctrine under which the courts impose personal liability for entity debts on entity owners who would otherwise be protected from liability for these debts by statutory liability shields.

Old Act in protecting the LLC interests of members of multi-member LLCs from third-party claims.

d) The charging order provisions of the Old Act provide no such protections to the members of single-member LLCs. The charging order provisions of the New Act provide substantial protections to the members of single-member LLCs as long as these members can show that distributions to creditors under charging orders will pay the creditors' claims within a "reasonable time."

3) Corporate "pick-your-partner" arrangements in shareholder agreements. It is true that shareholders of NH business corporations can obtain somewhat similar protections of their membership rights under provisions in shareholder agreements that provide for redemptions or cross-purchases of the shares of business corporation shareholders. However, these provisions impose potentially serious financial burdens on buyers (whether the buyers are business corporations in redemptions or other shareholders in cross-purchases).

4) User-friendly management structures. The management structure of a business organization means the rules that determine:

a) Who may decide matters relating to the organization; and

b) Who may exercise agency authority on its behalf (i.e., authority to sign contracts on behalf of the organization and to make representations that bind it).

c) The management structure of sole proprietorships. Individuals who own businesses that are sole proprietorships decide business matters simply by their mental acts and, in general, they have no need under applicable law to consult with other persons about these decisions or to make written records of them. In addition, these individuals may sign valid contracts on behalf of their businesses without any act or formality except the application of their signatures. Thus, from the viewpoint both of decision-making and agency considerations, the sole proprietorship management structure is easy for sole proprietorship owners to understand and to implement in a legally valid manner. Accordingly, the management structure of sole proprietorships is highly user-friendly.

d) The management structure of single-member LLCs whose members are individuals. Under the LLC statutory default rules of most or all LLC acts and the provisions of well-drafted operating agreements, it is easy to provide single-member LLCs whose members are individuals with a management structure essentially the same as that of a sole proprietorship. However, in general, these operating agreements should expressly provide for specified non-member assistant managers to provide for continuity of management if, by reason of death, illness, absence or otherwise, member-managers are unable to perform their management functions.

e) The management structure of single-member LLCs whose members are entities. Under the LLC statutory default rules of most LLC acts and the provisions of well-drafted operating agreements, it is easy to provide single-member LLCs whose members are entities with a management structure essentially the same as that of a single-member LLC whose member is an individual.

f) The management structure of New Hampshire general partnerships (including LLPs). Under the relevant provisions of most or all New Hampshire general partnership statutes, all partners of general partnerships, including LLPs, have agency authority and the right to vote on all partnership matters. General partnership statutes do not impose formalities on partner voting and agency. Thus, under applicable general partnership statutory law, the default management structure of general partnerships is likely to be intuitively simple

and user-friendly for most general partnerships, and especially for those with relatively few partners.

g) The management structure of limited partnerships. Under the relevant provisions of most or all New Hampshire limited partnership statutes, the general partner has very substantial authority to decide limited partnership matters and to act as the agent of the limited partnership. This statutory structure may pose risks of general partnership misconduct, but fiduciary provisions in the limited partnership agreement can go far to prevent this misconduct. In general, the default statutory management structure of limited partnerships is likely to be intelligible and user-friendly both to general and to limited partners.

h) Business corporations—in general. The tripartite management structure imposed by the default statutory corporate rules of all states is relatively complex and can be difficult for business owners to understand and to comply with. However, non-compliance can facilitate corporate veil-piercing.

i) When are corporate management structures superior to non-corporate structures? However, a corporate management structure may be useful for a business organization that has one or more owners who:

i) Do not want to participate in the management of the organization, but rather,

ii) Do want one or more representatives—called "directors" in traditional corporate law—to act on their behalf to make major decisions affecting the organization and to monitor the activities of the individuals—i.e., the officers—conducting the organization's day-to-day business.

5) Flexibility in altering the management structure and other elements of the legal structures of business organizations

a) Under the statutory and common law of most or all jurisdictions, it is easy for sole proprietorships and other non-corporate business organizations to alter their management structures and other aspects of their legal structures to meet owner needs.

b) Under corporate statutory and common law, the above alterations are often difficult because of mandatory statutory or common law rules or because of inherent legal complexities (e.g., the procedural and other complexities often involved in amending corporate bylaws).

[D] "MISCELLANEOUS" NON-TAX CHOICE OF ENTITY FACTORS

1) The Cost of Business Organization Legal Services in Business Formations as a "Miscellaneous" Factor in Non-Tax Choice of Entity

a) No business organization law legal fees for sole proprietorships. As indicated above, individuals who form and maintain their businesses as sole proprietorships do so simply by conducting them. These individuals do not need to hire lawyers or to incur business organization legal fees in connection with these formations. For very large numbers of individuals forming new businesses, this avoidance of legal fees is a major factor in choosing whether to form their businesses as sole proprietorships or as entities. Generally similar fee considerations apply to entities in deciding whether to conduct their operations through divisions rather than through single-owner entities.

b) The need of entities for business organization law services. By contrast, in connection with the formation of an entity, it is always useful and may often be indispensable for

business founders to hire business lawyers to assist them in planning, negotiating and drafting business organization "constitutive documents" for their businesses. For business corporations, these documents will normally consist of articles of incorporation or similar official documents, including bylaws, organizational resolutions, share certificates, and shareholder agreements. For LLCs, they will normally consist of articles of organization or similar official documents, and operating agreements (called "limited liability company agreements" under some LLC acts and "regulations" under the LLC act of Texas). For LLPs, they will normally consist of LLP registrations and LLP agreements. For LLLPs, they will normally consist of certificates of limited partnerships or similar state filings, state registration statements and LLLP agreements.[11]

c) Business entity fees for business organization services. The greater the number of owners and the larger the financial stakes in an entity formation, the larger are likely to be the legal fees for handling business organization law services in connection with the formation. At a minimum, these fees may amount to several hundred dollars. For larger entities, they can easily amount to tens of thousands of dollars.

2) Marketing effectiveness. By definition, sole proprietorships are entirely dependent on the good health and the productivity of the individuals who own them as the basis for their providing products and services to their customers. Thus, the conduct of a business as a sole proprietorship may sometimes be less efficacious than its conduct as an entity in persuading potential customers to purchase products and services from the business.

3) Attractiveness to potential investors. For essentially the same reasons as stated immediately above, potential investors may view sole proprietorships as substantially less attractive than single-stockholder business corporations and single-member LLCs as investment opportunities.

4) Usefulness in estate planning. Because of their various business organization law advantages, business organizations are also generally better suited than sole proprietorships for use by individuals who are business owners in their estate planning. For example, business organizations that are entities can be useful in providing for the unified administration of multiple personal assets of these individuals and in providing for valuation discounts.

[E] THE CASE LAW FACTOR

During the first few years after the emergence of the LLC business organization form, some lawyers routinely advised their clients against the use of the form because of the absence of a significant body of LLC case law. However, in recent years, the number of LLC cases has grown rapidly, and today, the adequacy of governing case law is, in most cases, no longer a relevant factor in non-tax choice of entity. Accordingly, this factor does not appear in Exhibits 8-3 through 8-5 of this chapter.

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[11] Matters that should typically be addressed in LLC operating agreements of multi-member LLCs include allocations and distributions of profits and losses; the dissociation of members (i.e., the termination of their memberships upon their death or other triggering events); cross-purchases and redemption of the membership rights of dissociated members; fiduciary issues; and methods of dispute resolution. Similar matters should normally be addressed also in shareholder agreements and in agreements among the partners of general and limited partnerships.

§ 8.05 NON-TAX CHOICE-OF-ENTITY ANALYSES—EXAMPLES BASED ON HYPOTHETICAL FACTS

[A] HYPOTHETICALS INVOLVING SINGLE-OWNER BUSINESS ORGANIZATIONS WHOSE MEMBERS WILL BE INDIVIDUALS

1) Ann Able's nanny business

   a) Facts. Ann Able decides to set up a nanny business in which she will be the sole nanny.

   b) Non-tax choice-of-entity analysis on the basis of Exhibit 8-3

      i) Ann may form her business as a sole proprietorship, a "standard" single-shareholder business corporation or a non-series single-member LLC.

      ii) If Ann engages in negligence or other misconduct in her nannying activities, she may face a substantial litigation risk. However, since she will be the only person conducting these activities, a statutory liability shield will not be useful to her. Furthermore, even assuming that it may benefit her to form her business as a single-shareholder business corporation or a single-member LLC, she may not be able to afford the legal fees necessary to form such an entity properly and will probably not want to pay these fees.

      iii) Thus, Ann should form her business as a sole proprietorship.

2) Mary Jones's solo immigration law practice—Fact Pattern # 1

   a) Facts. Mary Jones is a lawyer specializing in immigration law. She plans to form an immigration law firm in which, at least for the foreseeable future, she will be the only lawyer and will have no secretary or other non-professional staff. She will operate her firm from an office in her home. What will be the best type of entity for her firm?

   b) Non-tax choice-of-entity analysis on the basis of Exhibit 8-3

      i) Mary may form her business as a sole proprietorship, a "standard" single-shareholder business corporation or a non-series single-member LLC.

      ii) Because Mary will be the only person conducting the activities of her law firm, a liability shield will not protect her from claims of malpractice or other misconduct.

      iii) However, it may be useful to Mary to conduct her practice as a single-shareholder business corporation or a non-series single-member LLC for marketing purposes.

      iv) However, if this is so, Mary should not form her practice as a single-shareholder business corporation, since the corporate management structure will be needlessly complex for her. Rather, she should form it as a non-series single-member LLC.

3) Mary Jones's solo immigration law practice—Fact Pattern # 2

   a) Facts. Same facts as above, except that Mary wants to lease an office for use by her law firm, and in the current real estate market in her town, she will be able to obtain a lease without having to personally guarantee the lease.

   b) Non-tax choice-of-entity analysis on the basis of Exhibit 8-3

      i) Mary should form her firm as a single-shareholder business corporation or as a single-member LLC so that her business corporation or LLC can be the lessee of her office. If she does so and if, at some point after the formation of her firm, her firm defaults on the lease for any reason, she will not be personally liable for the default.

ii) Because a single-member LLC has a simpler management structure than a single-shareholder business corporation, Mary should form a single-member LLC to conduct her practice, and this single-member LLC should be the lessee of her office.

4) Bob Baker's auto repair shop—Fact Pattern # 1

a) Facts. Bob Baker intends to form a new auto repair business. He will be the sole owner of this business, but even when he first forms it, he will have at least one employee assisting him in providing auto repair services.

b) Non-tax choice-of-entity analysis on the basis of Exhibit 8-3

i) Bob may form his business as a sole proprietorship, a single-shareholder business corporation or a non-series single-member LLC.

ii) Bob will need a liability shield to protect him if his employee engages in negligence or other misconduct. Thus, Bob should form his business as a single-shareholder business corporation or a single-member LLC.

iii) However, because of the complexity of the corporate management structure, Bob should not form his business as a business corporation. Rather, he should form it as a single-member LLC.

5) Bob Baker's auto repair shop—Fact Pattern # 2

a) Facts. Same facts as above, except that even when he first forms his business, the business will own tools, equipment and vehicles with a current fair market value of $150,000.

b) Non-tax choice-of-entity analysis on the basis of Exhibit 8-3

i) Because of the value of his business assets, Bob can benefit from charging order protections. However, he cannot obtain these protections from a sole proprietorship, a single-shareholder business corporation or a single-member LLC. LLPs, limited partnerships with general partners that are limited liability entities and multi-member LLCs provide charging order protections.

ii) However, two-member LLCs provide full-shield limited liability in more states than LLPs and they have a simpler management structure than general partnerships whose general partners are limited liability entities. Thus, Bob should consider forming a two-member LLC with his wife (or another appropriate person) as a co-member; holding his business assets in this LLC; and leasing them from the LLC to his operating company, which should also be an LLC.

[B] HYPOTHETICALS INVOLVING SINGLE-OWNER BUSINESS ORGANIZATIONS WHOSE MEMBERS WILL BE ENTITIES

1) ABC, Inc.'s internal accounting operations

a) Facts. ABC, Inc. is a large widget manufacturer. Its employees include thirty accountants; these accountants provide accounting services to its marketing, manufacturing and shipping operations. What type of business organization should ABC use to conduct its accounting operations?

b) Non-tax choice-of-entity analysis on the basis of Exhibit 8-4

i) The types of business organizations available to ABC for use in its accounting operations are a division, a single-shareholder business corporation and a non-series

single-member LLC.

ii) ABC's accounting operations have no need for a liability shield, charging order protections or the other benefits potentially available from a single-shareholder business corporation or a single-member LLC. Accordingly, ABC should conduct these operations in a division.

2) ABC, Inc.'s manufacturing operations

a) Facts. ABC faces a significant risk of claims for negligence and other misconduct in designing and manufacturing its widgets. What type of business organization should ABC use to conduct its operations of designing and manufacturing widgets?

b) Non-tax choice-of-entity analysis on the basis of Exhibit 8-4

i) The types of business organizations available for use by ABC's manufacturing operations are a division, a single-shareholder business corporation and a single-member LLC.

ii) ABC needs a liability shield to protect it from possible liability for its manufacturing operations. Thus, ABC should not conduct these operations through a division, but rather, through a single-shareholder business corporation or a single-member LLC.

iii) The management structure of single-member LLCs is substantially simpler than that of single-shareholder business corporations. Thus, ABC should conduct its manufacturing operations through a single-member LLC.

[C] HYPOTHETICALS INVOLVING MULTI-OWNER BUSINESS ORGANIZATIONS

1) The law firm of John Jones and Mary Smith

a) Facts. John Jones and Mary Smith are trial lawyers. They decide to leave the large law firm for which they work and to form their own two-lawyer litigation boutique.

c) Non-tax choice-of-entity analysis on the basis of Exhibit 8-5

i) Because malpractice or other misconduct by either of them may result in claims against the other, John and Mary need liability shields. In addition, they will need these shields in order to protect themselves from claims by third-party employees of their firm. However, all three of the types of business organizations available to John and Mary in forming their firm—namely, a two-partner LLP, a two-shareholder business corporation and a two-member LLC—will provide them with this shield.

ii) Because of the complexity of the default statutory corporate management structure, John and Mary should not form their firm as a business corporation.

iii) Thus, assuming that the LLP provisions in the general partnership statute of the state where they will form their firm provide full-shield limited liability, the types of business organizations available to them are an LLP and an LLC.

iv) In some states, general partnerships that are LLPs may offer marketing benefits to professionals that LLCs do not offer. Assuming that is the case in their state, John and Mary may lean toward forming their new firm as an LLP rather than as an LLC.

v) However, as noted above, LLC liability shields are full shields in all U.S. jurisdictions, while, in some states, LLP shields are only partial shields. Thus, if John and Mary believe there is any significant possibility that their firm or they as lawyers in their firm will be sued in jurisdictions in which LLP liability shields are partial shields, they should form their firm as an LLC.

2) Jones Family Company

a) Facts. John and Mary Jones are a wealthy married couple with three children. They own, in their own names as individuals or jointly, numerous commercial buildings, securities, paintings, automobiles and other valuable assets. In order to provide for unified administration of these assets and for valuation discounts, their estate planner advises them:

i) To form an entity of which John, Mary and their children will all be owners but which John and Mary will control; and

ii) To contribute the above assets to this entity.

b) Non-tax choice-of-entity analysis on the basis of Exhibit 8-5

i) John and Mary will need liability shields in managing the entity; they will need charging order protections for it; and the entity must be suitable for their estate planning purposes.

ii) Business corporations do not provide charging order protections. Thus, the types of business organizations available to John and Mary for their estate planning entity will be an LLP, a limited partnership whose partners are entities, and a limited liability company.

iii) However, under the relevant statutory law in their state, each partner of an LLP has agency authority—i.e., authority to sign contracts that bind the partnership. Thus, since John and Mary want to reserve control of their estate planning entity, they cannot use an LLP for that purpose.

iv) Furthermore, John and Mary want to avoid the costs and administrative complexities of holding general partner interests in a limited partnership through limited liability entities. Thus, they choose an LLC as their estate planning entity.

EXHIBIT 8-1

THE FOUR STEPS IN THE NEW HAMPSHIRE NON-TAX CHOICE-OF-ENTITY PROCESS

1) Determine the ownership structure of the business in question. The relevant ownership structures are (i) ownership by a single owner who is an individual; (ii) ownership by a single owner who is an entity; and (iii) ownership by multiple owners.

2) Determine which types of business organizations are available to the business. These are:

    a) For single-owner businesses owned by individuals, (i) sole proprietorships, (ii) single-shareholder business corporations and (iii) single-member LLCs;

    b) For single-owner businesses owned by entities, (i) divisions, (ii) single-shareholder business corporations and (iii) single-member LLCs; and

    c) For multi-ownership businesses, (i) LLPs, (ii) limited partnerships whose general partners are limited liability entities, (iii) multi-shareholder business corporations and (iv) multi-member LLCs.

3) Determine which types of non-tax choice-of-entity factors are important to the business. All of these factors are listed in Exhibit 8-2 of this chapter.

4) Determine which type of business organization available to the business will best provide the relevant non-tax benefits.

    a) For single-owner businesses owned by individuals, use Exhibit 8-3.

    b) For single-owner businesses owned by entities, use Exhibit 8-4.

    c) For multi-owner businesses, use Exhibit 8-5.

EXHIBIT 8-2

THE TEN MAIN BUSINESS ORGANIZATION LAW ADVANTAGES AND THE FOUR MAIN "MISCELLANEOUS" ADVANTAGES RELEVANT IN NEW HAMPSHIRE NON-TAX CHOICE-OF-ENTITY

BUSINESS ORGANIZATION LAW FEATURES

1) Statutory limited liability
2) Charging order protections
3) Perpetual duration
4) Continuity of life
5) Continuity of management
6) User-friendly management structure
7) Ease in transferring the business as a single unit
8) Ease in transferring all assets in a single transaction
9) Ease in admitting additional members
10) Ease in altering to meet evolving owner needs

"MISCELLANEOUS" FEATURES

1) Minimal legal fees for business organization law services in connection with formation
2) Marketing effectiveness
3) Attractiveness to investors
4) Usefulness in estate planning

EXHIBIT 8-3

NON-TAX CHOICE OF ENTITY FOR NEW HAMPSHIRE SINGLE-OWNER BUSINESSES WHOSE OWNERS ARE INDIVIDUALS

NON-TAX ADVANTAGE	AVAILABLE TO SOLE PROPRIETORSHIP?	AVAILABLE TO SINGLE-SHAREHOLDER BUSINESS CORPORATION?	AVAILABLE TO SINGLE-MEMBER LLC?
I. **BUSINESS ORGANIZATION LAW ADVANTAGE**			
1. Limited liability for owner	No	Yes	Yes
2. Charging order protections	No	No	No
3. Perpetual duration	No	Yes	Yes[12]
4. Continuity of life	No	Yes	Yes[13]
5. Continuity of management	No	Yes	Yes[14]
6. User-friendly management structure	Yes	No	Yes[15]
7. Ease in transferring the business as a unit	No	Yes	Yes
8. Ease in transferring all of the assets of the business in a single transaction	No	Yes	Yes
9. Ease in admitting	No[16]	No[17]	No[18]

[12] Under the LLC acts of most states, single-member LLCs cannot exist unless they have at least one member. However, in operating agreements for single-member LLCs owned by individuals, it is easy to provide for a new member upon the death of the current member.

[13] See footnote 1.

[14] In the operating agreement of a single-member LLC owned by an individual, it is easy to provide for continuity of management upon the death of the member.

[15] See footnote 3.

[16] Upon the admission of a new member, it will be necessary to draft and execute an inter-owner agreement.

additional owners			
10. Ease in altering to meet evolving needs of owner (freedom of contract)	Yes	No	Yes
II. **MISCELLANEOUS ADVANTAGE**			
1. Low fee for business organization legal services in connection with formation	Yes	No	No
2. Marketing effectiveness	No	Yes	Yes
3. Attractiveness to potential equity investors in the business	No	Yes	Yes
4. Estate planning effectiveness	No	Yes	Yes

[17] See footnote 5.

[18] See footnote 5.

EXHIBIT 8-4

NON-TAX CHOICE OF ENTITY FOR NEW HAMPSHIRE SINGLE-OWNER OWNER BUSINESSES WHOSE OWNERS ARE ENTITIES

NON-TAX ADVANTAGE	AVAILABLE TO DIVISION?	AVAILABLE TO SHAREHOLDER OF SINGLE-SHAREHOLDER BUSINESS CORPORATION?	AVAILABLE TO MEMBER OF SINGLE-MEMBER LLC?
I. **BUSINESS ORGANIZATION LAW ADVANTAGE**			
1. Limited liability for owner	No	Yes	Yes
2. Charging order protections	No	No	Yes
3. Perpetual duration	No	Yes	Yes
4. Continuity of life	No	Yes	Yes
5. Continuity of management	Yes	Yes	Yes
6. User-friendly management structure	Yes	No	Yes
7. Ease in transferring the business as a unit	No	Yes	Yes
8. Ease in transferring all of the assets of the business in a single transaction	No	Yes	Yes
9. Ease in admitting additional owners	No	No[19]	No[20]
10. Ease in altering to meet evolving needs of owner (freedom of contract)	Yes	No	Yes

[19] Upon the admission of a new member, it will be necessary to draft and execute an inter-owner agreement.

[20] See footnote 1.

II. **MISCELLANEOUS ADVANTAGE**			
1. Low fee for business organization legal services in connection with formation	Yes	No	No
2. Marketing effectiveness	No	Yes	Yes
3. Attractiveness to potential equity investors in the business	No	Yes	Yes
4. Estate planning effectiveness	Irrelevant	Irrelevant	Irrelevant

EXHIBIT 8-5

NON-TAX CHOICE OF ENTITY FOR NEW HAMPSHIRE MULTI-OWNER BUSINESSES

NON-TAX ADVANTAGE	**AVAILABLE TO LLP AND ITS PARTNERS?**	**AVAILABLE TO LIMITED PARTNERSHIP WHOSE GENERAL PARTNER IS A LIMITED LIABILITY ENTITY?**	**AVAILABLE TO MULTI-SHAREHOLDER BUSINESS CORPORATION?**	**AVAILABLE TO MULTI-MEMBER LLC?**
I. **BUSINESS ORGANIZATION LAW ADVANTAGE**				
1. Limited liability for owner	(Yes, but liability shield will be "partial" in several states)	Yes	Yes	Yes
2. Charging order protections	Yes	Yes	No	Yes
3. Perpetual duration	Yes	Yes	Yes	Yes
4. Continuity of life	Yes	Yes	Yes	Yes
5. Continuity of management	Yes	Yes	Yes	Yes
6. User-friendly management structure	Yes	Yes	No	Yes
7. Ease in transferring the business as a unit	Yes	No	Yes	Yes
8. Ease in transferring all of the assets of the business in a single transaction	Yes	No	Yes	Yes
9. Ease in admitting	Yes	Yes	Yes	Yes

additional owners				
10. Ease in altering to meet evolving needs of owners	Yes	Yes	No	Yes
II. **MISCELLANEOUS ADVANTAGE**				
1. Low fee for business organization legal services in connection with formation	No	No	No	No
2. Marketing effectiveness	Yes	Yes	Yes	Yes
3. Attractiveness to potential equity investors in the business	Yes	Yes	Yes	Yes
4. Estate planning effectiveness	Yes	Yes	Yes	Yes

CHAPTER 9

WHICH LLC ACT IS BETTER FOR BUSINESSES OPERATING IN BOTH NEW HAMPSHIRE AND MASSACHUSETTS—THE NEW ACT OR THE MASSACHUSETTS LLC ACT?

OVERVIEW

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§ 9.01 INTRODUCTION—THE PRACTICAL IMPORTANCE OF THE QUESTION WHETHER THE NEW ACT IS A BETTER LLC ACT THAN THE MASSACHUSETTS LLC ACT; THE COMPLEXITY OF THE QUESTION

1) The question whether the New Act is a better LLC act than the Massachusetts LLC Act is important two main circumstances:

   a) Every year, numerous Massachusetts and New Hampshire business founders form new LLCs that will conduct business in both of these states and thus that must be registered in both. All of these business founders must address the question whether their LLCs should be formed under the New Act or the Massachusetts LLC Act.

   b) Furthermore, there are already thousands of Massachusetts business owners that conduct their businesses as Massachusetts LLCs but that do business in both Massachusetts and New Hampshire; and there are thousands of New Hampshire business owners that conduct their businesses as New Hampshire businesses but that do business in both jurisdictions. These Massachusetts business owners must decide whether, because of its potentially superior legal merits, they should convert their Massachusetts LLCs to New Hampshire LLCs; and these New Hampshire business owners must ask the same question about their New Hampshire LLCs.

2) To provide a comprehensive answer to the question whether the New Act is better than the Massachusetts LLC Act from a business organization law viewpoint would require many pages, since each act contains hundreds of provisions, and since, to answer the question comprehensively, each of these provisions in each act would have to be compared with the corresponding provisions in the other act.

3) However, in my view, this kind of comprehensiveness is not necessary, since, as shown below, even a consideration of the seven factors summarized below will suffice to demonstrate the superiority of the New Act over the Massachusetts LLC Act in the above circumstances.

§ 9.02 SEVEN REASONS WHY THE NEW ACT IS BETTER THAN THE MASSACHUSETTS LLC ACT

1) The New Act provides LLC members with greater contractual flexibility than the Massachusetts LLC Act. The New Act provides maximum flexibility to New Hampshire LLC members to tailor their LLCs in their operating agreements to meet member needs. This flexibility is manifest above all in New Act § 2, which provides that "it is the policy of this Act to give the maximum effect to the principle of freedom-of-contract and to the enforceability of operating agreements"; but also in the many other "flexibility provisions" in the New Act identified in Chapter 2 of this book.

   The Massachusetts Act contains no provision similar to New Act § 2. This fact is highly significant in construing the Massachusetts Act, since there are so many provisions in that act that mirror those of the Delaware Limited Liability Company Act (the "DLLC Act"), and which thus make clear that the drafters of the Massachusetts LLC Act had a comprehensive knowledge of the provisions of the DLLC Act. Thus, the fact that the omission of any provision comparable to the above New Act § 2 makes clear that the Massachusetts Legislature specifically chose not to include such a provision in the Massachusetts LLC Act. The Massachusetts Legislature has thus opened the door to the courts' overriding the clear terms of Massachusetts operating agreements whenever, in their opinion, these courts believe these terms are unreasonable or unfair to any parties. No such risk exists under the New Act.

2) The New Act meets the needs of single-member LLCs better than the Massachusetts LLC Act. As discussed in Chapter 2, the New Act contains nine provisions specifically designed to meet the needs of single-member LLCs, including both single-member LLCs whose members are individuals and those whose members are entities. These include provisions ensuring the continuity of life of single-member LLCs upon the death or dissolution of the members and providing that unless the operating agreement provides otherwise, the members of these LLCs will not be subject to dissolution upon the occurrence of any event except death and resignation. The Massachusetts LLC Act contains no such provisions.

3) The New Act has comprehensive fiduciary provisions; the Massachusetts LLC Act has none. Part 15 of the New Act contains comprehensive fiduciary provisions. These provisions can be indispensable in resolving fiduciary disputes among LLC members. The Massachusetts LLC Act has no such provisions, including even provisions imposing basic duties of care and loyalty. Thus, in the event of fiduciary disputes among the members of Massachusetts LLCs, their lawyers can determine the governing fiduciary rules only on the basis of case law—which, in the circumstances in question, may not exist.

4) The charging order provisions of the New Act are better than those of the Massachusetts LLC Act. The protections afforded under New Act § 126 (the New Act "charging order" provision) to members of both single-member and multi-member Act LLCs against claims by judgment creditors and in bankruptcy and divorce proceedings are much stronger than those afforded to members of Massachusetts LLCs under § 40 of the Massachusetts LLC Act. In particular, New Act § 126 provides that the only remedy available to judgment creditors with respect to members' distributions from their LLCs is charging orders and that judgment creditors may not levy on their LLC interests. On these issues, Massachusetts LLC Act § 40 is at best ambiguous.[1]

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[1] Indeed, the superiority of New Act § 126 over Massachusetts LLC Act § 40 is so pronounced and of such great potential importance that some Massachusetts business people conducting their businesses through

5) The definitional provisions of the New Act are far more comprehensive than those of the Massachusetts LLC Act. The New Act specifically defines each of the terms contained in it whose meaning may not be self-evident to business people and to other non-LLC specialists. The Massachusetts LLC Act contains far fewer such definitions, and, in particular, it fails to define basic statutory terms such as "allocation," "interim distribution," and "dissolution."

   The result is that the New Act is much easier for non-LLC specialists to understand than the Massachusetts LLC Act.

6) The New Act provides for member expulsions; the Massachusetts LLC Act does not. Section 104 of the New Act contains specific default provisions enabling members of LLC to expel other members if they can prove that these other members have engaged in conduct that warrants expulsion. The Massachusetts LLC Act contains no such provision.

7) The New Act permits LLC members to bring direct actions against other members and against managers for fiduciary and other breaches; the Massachusetts LLC Act apparently does not. New Act § 188 permits members to bring derivative actions—i.e., actions in the name of the LLC—against other members and against managers for fiduciary and other breaches. However, the procedural rules governing derivative actions are complex and compliance with them can be time-consuming and expensive. Thus, New Act § 190 permits members to also bring these claims as direct actions—i.e., as actions in the members' own names. Massachusetts LLC Act § 56 arguably permits these claims *only* as derivative actions.

§ 9.03 THE MASSACHUSETTS LLC ACT VS. THE OLD ACT

Many of the considerations set forth above relating to the superiority of the New Act over the Massachusetts LLC Act apply also in comparing the Old Act with the Massachusetts LLC Act. Above all, in § 78, II, the Old Act has a freedom-of-contract provision similar to that in New Act § 2. As noted, the Massachusetts LLC Act has no similar provision.

Massachusetts LLCs may want to convert their Massachusetts LLCs to New Act LLCs even though these business people don't transact business in New Hampshire.

CHAPTER 10

WHAT SHOULD NEW HAMPSHIRE AND MASSACHUSETTS ACCOUNTANTS KNOW ABOUT THE NEW ACT?

OVERVIEW

TABLE OF EXHIBITS

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§ 10.01 INTRODUCTION

[A] WHAT ACCOUNTANTS SHOULD KNOW ABOUT THE NEW ACT--OVERVIEW

1) The primary audience I've had in mind in writing Chapters 1 through 9 of this book are New Hampshire lawyers, and I suspect that only these lawyers will find it worth their time to give these chapters a close reading.

2) However, there are many points about the New Act that I believe are likely to be important also to New Hampshire and Massachusetts accountants. These accountants are the "you" in the rest of this chapter.

3) First of all, it's obvious that, if you are a New Hampshire or Massachusetts accountant, you need to know whether the New Act has any federal or state tax implications that are different

from those of the Old Act. §§ 10.03 through 10.04 of this chapter address this issue.

4) However, you also need to know how the financial provisions of the New Act differ from those of the Old Act. (By financial provisions, I mean those that govern members' contributions to their LLC, the LLC's allocations of its profits and losses to the members, the LLC's interim and liquidating distributions to them, and all closely related provisions).

   a) For example, if you are aware that both the Old Act and the New Act, bar LLCs from making distributions to their members that will cause the liabilities of these LLCs to exceed the fair value of their assets, this may enable you to protect clients of yours who conduct their businesses in LLCs from making distributions that could have serious adverse legal consequence for them.

5) Section 10.06 of this chapter addresses the above financial provisions.

6) Finally, since business people sometimes ask accountants legal questions about *non*-financial LLC matters that they might not ask lawyers, I suspect it may be useful for you to be familiar even with the key differences between the Old Act and the New Act relating to these non-financial matters—even though, of course, in responding to your clients' questions about these matters, you will want to make clear that you're not giving legal advice.

7) However, since it's difficult to guess which *specific* LLC business organization law issues are likely to be important to you or your clients, in these sections, I'll addressed, although in very brief terms, *all* of the significant LLC legal issues addressed in Chapters 1 through 9. Sections 10.07 through 10.10 address the non-financial provisions of the Old and New Acts.

8) Here are two examples of possible non-financial LLC questions you might receive:

   a) A client who conducts her business through an Old Act LLC asks you whether you think she should make an election under § 5 of the New Act to be covered by the New Act during calendar year 2013. (Without this election, her LLC would not be covered by the New Act until January 1, 2014. See discussion in § 10.09 of this chapter.)

   b) A client of yours who is starting a business that will operate in both New Hampshire and Massachusetts asks you whether you think she should form her LLC under the Old or New Act or, instead, under the Massachusetts LLC Act. See discussion in § 10.10.

9) As you will have noticed from the table of contents of this book, Chapter 11 of the book addresses questions about the Old and New Acts that I believe may interest New Hampshire and Massachusetts business people. Chapter 11 addresses Old Act and New Act tax and financial provisions only very briefly, and the issues it does addresses are mainly the same as those in this chapter. However, Chapter 11 contains many concrete examples of the practical impact of the New Act on business people; this chapter does not. You may want to read Chapter 11 just for these examples.

[B] THE FIVE CLASSES OF PROVISIONS IN THE OLD AND NEW ACTS

In order to discuss meaningfully the provisions of the Old and New Acts, including both financial and non-financial provisions, it is necessary first of all to classify each of these provisions, since these classifications will critically affect the impact of the provisions on LLC members and their LLCs. The five classes of provisions are these:

1) Definitional. The first are *definitional* provisions—which, as the term makes clear, are provisions in the two acts that define terms used in these acts. An important financial definitional provision in the New Act is § 1, which defines "limited liability company interest" as the right of a member to receive allocations of the profits or losses of a limited

liability company and to receive distributions of the limited liability company's cash and other assets."

2) Default. The second are *default* provisions. These are provisions which, by their terms, will govern LLCs unless the members override them in their operating agreements. In the New Act, default provisions are always marked by the phrase "unless the operating agreement provides otherwise." An important financial default provision in the New Act is § 87, VI, which provides that unless the operating agreement provides otherwise, a compromise of a member's promise to make a contribution to the LLC will be valid only with the consent of all of the members.

3) Mandatory. The third are *mandatory* provisions—i.e., provisions that the members may not validly override in their operating agreements. As noted above, an important financial definitional provision in the New Act is § 97, which prohibits an LLC from making distributions to their members that will cause the LLC to have a negative net worth.

4) Non-self-enabling permissive. The fourth *are non-self-enabling permissive* provisions. These are provisions which permit members to adopt the arrangements contained in the provision, but only if they do so in their operating agreement. An important non-self-enabling permissive provisions in the New Act is § 90, which provides that an LLC may allocate its profits and losses on any basis set forth *in its operating agreement.*

5) Self-enabling permissive. The fifth are *self-enabling permissive provisions*. These are provisions that permit members to implement the arrangements contained in them even *without* adoption in their operating agreements. An important self-enabling permissive provision in the New Act is § 87, which permits an LLC to require a member to contribute cash equal to the value of property or services that the member has failed to contribute.

§ 10.02 THE OLD AND NEW ACTS—GENERAL COMPARISONS

Before I address specific tax or legal issues, it will be useful to provide you with the following general comparisons between the Old and the New Acts:

1) Although, in drafting the New Act, the BIA Drafting Committee consulted the Revised Uniform limited liability company Act and various state acts, including, above all, Delaware Limited Liability Company Act. However, by far the most important basis for the New Act was the Old Act. The committee carried over at least ninety-five percent of the text of the Old Act into the New Act, and virtually all of the provisions of the Old Act are reflected in some form in the New Act.

2) Furthermore, most of the LLC business organization law issues that are likely to be important to LLC members are addressed in the Old Act, and, in my view most of the provisions addressing those issues in the Old Act do so soundly.

3) Thus, in general, the Old Act is a good LLC act. This is why, by a wide margin, LLCs have become the entities of choice in New Hampshire.

4) However, several key provisions of the Old Act are inappropriate for small New Hampshire businesses. The New Act changes all of these provisions.

5) Furthermore, there are several LLC business organization law issues likely to be important for New Hampshire businesses, and especially for New Hampshire small businesses, that the

Old Act does not address. The New Act addresses all of these issues.

§ 10.03 THE FEDERAL TAX IMPACT OF THE NEW ACT

Although, as Chapters 1 through 8 of this book make clear, the New Act is in many ways a radical revision of the Old Act, LLCs under the New Act, like those under the Old Act, are "unincorporated business entities" under the U.S. Treasury Entity Classification Regulations (also known as the "Check-the-Box Regulations"). Thus:

1) Federal tax classification of single-member LLCs whose members are individuals. Under the Entity Classification Regulations, the default federal tax classification of New Act single-member LLCs whose members are individuals, like those formed under the Old Act, is that of disregarded entities. However, the members of these LLCs may elect under the Entity Classification Regulations to have them taxable for federal tax purposes under Subchapter C, and, if these LLCs meet Subchapter S eligibility requirements, under Subchapter S.

2) Federal tax classification of single-member LLCs whose members are entities. Under the Entity Classification Regulations, the default federal tax classification of New Act single-member LLCs whose members are entities is also that of disregarded entities. However, the Entity Classification Regulations, the members of these LLCs may elect to have them taxable for federal tax purposes under Subchapter C.

3) Federal tax classification of multi-member LLCs. Under the Entity Classification Regulations, the default federal tax classification of multi-member LLCs under the New Act, like that of multi-member LLCs under the Old Act, is that of partnerships. However, the members of these LLCs may elect under the Entity Classification Regulations to have them taxable for federal tax purposes under Subchapter C and, if these LLCs meet Subchapter S eligibility requirements, under Subchapter S.

   Obviously, however, only very rarely, if ever, will the members of either single-member or multi-member New Act LLCs want their LLCs to be taxable under Subchapter C.

§ 10.04 THE IMPACT OF THE NEW ACT ON NEW HAMPSHIRE TAXATION OF LLCs AND THEIR MEMBERS

1) The New Hampshire Interest and Dividends Tax. No provision of the New Act will affect the New Hampshire Interest and Dividends Tax liability of members of New Act LLCs that reside in New Hampshire any differently than the provisions of the Old Act. In essence, the members of New Act LLCs, like those of Old Act LLCs, will be able to avoid this tax only if:

   a) In the case of single-member LLCs, their operating agreements provide that upon any transfer of their membership rights, these LLCs will be dissolved; and

   b) In the case of multi-member LLCs, their operating agreements provide either:

      i) That upon any transfer of their membership rights, these LLCs will be dissolved; or

      ii) That no member may transfer all or any part of the member's membership rights except with the consent of at least one other member.

2) The New Hampshire Business Profits Tax and Business Enterprise Tax. No provisions of the New Act will affect the liability of LLCs under the New Hampshire Business Profits Tax or Business Enterprise Tax.

3) The New Hampshire Real Estate Transfer Tax as applicable to statutory conversions of New Hampshire corporations to LLCs.

   a) Why should New Hampshire corporations convert to LLCs? There are two main reasons why it is often in the best interest of the shareholders of many New Hampshire business corporations to make statutory conversions to New Hampshire LLCs:

      i) First, to protect their New Hampshire members from the I&D Tax; and

      ii) Second, to obtain the charging order protections and other business organization law advantages available to LLCs but not to corporations.

   b) Statutory conversions under the New Act. The first of these reasons applies equally to Old Act and New Act LLCs. However, the business organization law reasons to make statutory conversions of New Hampshire business corporations to New Hampshire LLCs are substantially stronger under the New Act than under the Old Act. See discussion in Chapter 3 of this book.

   c) The Real Estate Transfer Tax issue in converting New Hampshire corporations to LLCs. However, under the New Hampshire Real Estate Transfer Tax (the "RETT"), there is a significant problem with the statutory conversion to LLCs of New Hampshire corporations that own New Hampshire real property. This is because the New Hampshire Department of Revenue Administration (the "DRA") has long taken the position that these statutory conversions trigger the RETT.

   d) Statutory conversions don't involve transfers. In my view, the above DRA position is clearly wrong, since, by definition, an entity that is a corporation and that makes statutory conversions to an LLC merely change their business organization form; they remain the same entity after the conversion as before. Accordingly, these conversions can involve no transfers and thus no liability for the RETT. But corporations that make statutory conversions and that own real property could be certain that the DRA would assess the RETT against them on the basis of the conversion.

   e) The deletion of the New Act "no transfer" provisions by the House. In SB 203, the bill that became the New Act, the BIA Drafting Committee sought to eliminate the above RETT issue by expressly providing that statutory conversions do not involve transfers. Unfortunately, however, on the ground (a dubious one in my view) that these "no transfer" provisions could result in a substantial revenue loss, the DRA was able to persuade the House to delete these provisions. Thus, the RETT audit risk for corporations that own New Hampshire real property and make statutory conversions to LLCs remains strong; and the legislative history of the above deletions arguably lends additional strength to the DRA's position in these audits.

§ 10.05 THE IMPACT OF THE NEW ACT ON MASSACHUSETTS TAXATION OF LLCs AND THEIR MEMBERS

The enactment of the New Act will have no impact on the liability of New Hampshire LLCs and their members for any Massachusetts state tax.

§ 10.06 WHAT ACCOUNTANTS SHOULD KNOW ABOUT THE FINANCIAL PROVISIONS OF THE NEW ACT AS COMPARED WITH THOSE OF THE OLD ACT

Exhibit 10-1 identifies all of the 31 financial issues addressed in the Old and New Acts, and it summarizes the provisions in these acts that address these issues.

1) Key financial provisions that are similar in Old Act and New Act. As will be clear to you Exhibit 10-1, most of the key provisions on financial matters in the Old Act are essentially the same in the New Act.

   a) Permitted types of contributions. Both under § 36 of the Old Act (a self-enabling provision) and § 85 of the New Act (also a self-enabling provision), LLC members may contribute to their LLC cash, property, services or promissory notes for cash property or services.

   b) Basis for allocations of LLC profits and losses. Both under § 38 (second sentence) of the Old Act (a default provision) and under § 95, I of the New Act (also a default provision), each member's share of LLC allocations (i.e., accruals to the member of the member's share of LLC profits on the LLC's books) is the same as the member's share of the total value of contributions to the LLC.

   c) Basis for LLC allocations of interim distributions. Both under both § 39 (first sentence) of the Old Act (a default provision) and under § 95, I of the New Act (also a default provision),[1] an LLC must allocate its interim distributions among the members on the basis of the value of their contributions

   d) Right of dissociated members to receive distributions of amounts allocated to them before their dissociations. Under both Old Act § 41 (first sentence, first clause) (mandatory provision) and under New Act §105, I (same rule, but § 105, I is a default provision), dissociated members, upon their dissociation, must receive distributions of amounts allocated to them.

   e) No right of dissociated members to redemptions. Under both Old Act, § 41 (first sentence, second clause) (a default provision) and New Act, § 105, II (also a default provision), dissociated members have no right to receive the value of their LLC interests (i.e., to have these interests redeemed) upon their dissociation.

   f) Right of dissociated members to ongoing allocations and distributions in respect of their LLC interests. Both under § 41 (second sentence) of the Old Act (a mandatory provision) and § 105, III (also a mandatory provision) under the New Act, if dissociated members receive no payment for their LLC interest upon their dissociation, they will be entitled after their dissociation to continuing allocations and distributions in respect of their LLC interest as long as they retain these interests.

   g) Right of members to receive distributions in liquidation of the LLC. Both under Old Act

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[1] Allocations of distributions are, of course, quite different from allocations of profits and losses. Example: At the end of calendar year 2014, XYZ, LLC, a member-managed multi-member LLC with two equal members, X and Y, has profits of $100,000. Unless the operating agreement provides otherwise, it must allocate $50,000 of these profits to X and $50,000 to Y. X and Y vote to distribute $20,000 of these profits to themselves as members. Unless the operating agreement provides otherwise, XY must allocation $10,000 of this distribution to X and $10,000 to Y.

§§ 58, I and I (default provisions) and New Act 141, II (also a default provision), upon an LLC's liquidation and after it obtains a certificate of dissolution from the New Hampshire Department of Revenue Administration and has paid its creditors:

i) The LLC must make distributions to the members of allocations accrued to them; and

ii) It must distribute any remaining assets to them in accordance with their LLC interests.

2) Authorization of interim distributions. However, there is one critically important difference between the financial provisions of the Old Act and the New Act:

a) Under § 40 of the Old Act (a mandatory provision), members may receive interim distributions from their LLCs *only if the operating agreement so provides*. This means that if the operating agreement is silent about these distributions, the members may *not* receive them unless the operating agreement is amended to permit them. In most cases, this amendment will require a unanimous vote of the members.

b) However, under, respectively, §§ 94, I and II of the New Act, unless the operating agreement provides otherwise:

i) Member-managed multi-member LLCs shall make interim distributions to their members upon majority vote of the members;

ii) Manager-managed multi-member LLCs shall make interim distributions to their members upon majority vote of the managers.

§ 10.07 WHAT ACCOUNTANTS SHOULD KNOW ABOUT THE NON-FINANCIAL PROVISIONS OF THE NEW ACT AS COMPARED WITH THOSE IN THE OLD ACT

There are ten main points that, as a New Hampshire or Massachusetts accountant, you should know about LLC business organization which may interest you yourself and about which your clients may ask you questions. All of these points are addressed in previous chapters of this book, but it will useful to useful to catalogue them here in a single comprehensive list.

1) The fiduciary provisions in the New Act.

a) The fiduciary duties that govern the members of an LLC constitute, in effect, the LLC's code of ethics and its team spirit. In addition, these fiduciary duties have teeth: members who breach them may incur serious money damages and other sanctions.

b) The Old Act contains no clear fiduciary provisions. The fiduciary provisions of that are set forth in Part 15 of the New Act, §§ 106 through 117, are comprehensive. This means that LLC members whose LLCs are subject to the New Act will be likely to face a significantly lesser risk of serious fiduciary disputes that members whose LLCs are subject to the Old Act.

c) The main fiduciary duties to which LLC members are subject under the above sections of the New Act consist principally of:

i) Their duty to conduct the LLC's business carefully;

ii) Their duty to be loyal to one another and the LLCs (and thus, for example, not to compete against the LLC or to take other actions that will involve conflicts of interest);

iii) Their duty to act fairly and in good faith toward the LLC.

2) Member bankruptcies under the New Act. Under the default rules of the Old Act, members of single-member LLCs who become bankrupt will be "dissociated" from their LLCs—that is, they will cease being members; and their bankruptcies will cause their LLCs to cease to exist as legal entities, thus potentially crippling the efforts of their members to *escape* from bankruptcy. Old Act §§ 27, I(d) and 1, IV. Members of New Act single-member LLCs who become bankrupt will not cease to be members of their LLCs, and their bankruptcies will have no effect on the existence of their LLCs. New Act, § 151.

3) The validity of oral and implied operating agreements under the New Act. Under the Old Act, only written operating agreements are valid. This means that any oral or "handshake" or implied agreements among the members of an LLC of Old Act LLCs about their LLCs will be invalid even if all of the members agree to them unambiguously. Old Act, § 1, VI. Under the New Act, oral and implied terms in operating agreements are valid and thus are respected by the law and enforceable in court. New Act, § 40.

4) The statutory definitions in the New Act.

   a) The Old Act contains many statutory terms whose meanings are likely to be unclear to business people, accountants and even lawyers; but which are not defined in the act.

   b) In the New Act, all significant statutory terms are expressly and clearly defined. Chapter 2, § 2.07 comprehensively lists the LLC statutory terms of art that are not defined in the Old Act but are expressly defined in the New Act.

5) The protection of members' membership rights from third parties under the New Act.

   a) LLC statutes generally contain two types of provisions—referred to by LLC lawyers as "pick-your-partner provisions" and "charging order provisions"—that, together, provide LLC members with protection from the risk that the courts will order the transfer of their membership rights to judgment creditors, former spouses or trustees in bankruptcy.

   b) The pick-your-partner provisions and charging order provisions in the New Act offer LLC members far stronger risks against these transfers than those of the Old Act, especially for members of single-member LLCs. The relevant provisions of the Old Act are in §§ 46, I (third sentence) and 47. The relevant New Act provisions are in §§ 121, I and 126.

6) The right of members to remove members who engage in serious misconduct or who prove to be incompatible. The Old Act provisions permitting members to remove other members for misconduct or incompatibility focus principally on the removal of members for engaging in incompetent or dishonest management activities. Old Act, § 27, IV. The corresponding provisions in the New Act are comprehensive—they address every possible legitimate reason for member removals. However, they also strike a careful balance between the rights of members seeking to remove other members and the rights of these other members. New Act, § 104.

7) The right of members to remove managers who are incompetent or engage in serious misconduct. The Old Act contains no clear rules permitting members to remove managers who are incompetent or who engage in serious misconduct, and § 31, I (fourth sentence) of the Old Act can be read to provide that these managers *cannot* be removed. The default

provisions of the New Act permit the members to effect these removals by member majority vote. New Act, § 50, II.

8) Contractual flexibility under the New Act. LLC members often want the contractual flexibility to tailor their LLCs under their operating agreements to meet member needs and interests—e.g., the interest of LLC founders in sharing the profits of their LLCs with family members without the risk of fiduciary challenges by these members. The New Act provides LLC members with substantially greater freedom of contract than the Old Act. See detailed discussion in Chapter 2, § 2.06.

9) Plain English in the New Act. Much of the Old Act is written in an annoying and obscure legalese. The New Act is written in plain English. Thus, not only to lawyers and judges but also to any accountants and business people who may want to review its provisions, the New Act is much easier to understand.

10) The organization of the New Act. In many respects, the Old Act is confusingly organized and formatted, and it is often difficult not only for business people and accountants but even for LLC lawyers to find specific provisions in it. The provisions of the New Act are organized into 26 distinct parts, and each part has a distinctive caption. It is thus much easier not only for lawyers but also for accountants and business people to find specific provisions in the New Act than in the Old Act.

§ 10.08 WHAT ACCOUNTANTS SHOULD KNOW ABOUT THE "OFF-THE-SHELF OPERATING AGREEMENTS" IN THE NEW ACT AS COMPARED WITH THOSE IN THE OLD ACT

1) In drafting both the Old Act, the drafters were aware that the members of many New Hampshire LLCs would not have written operating agreements (which I'll refer to here as "tailored operating agreements") that addressed the issues likely to be important to their particular LLCs; and the drafters of the New Act were also aware of this fact.[2]

2) Thus, in undertaking this drafting, the drafters sought to include in both acts "off-the-shelf operating agreements"—i.e., operating agreements implicit in provisions of these acts that would address to the extent possible all of the issues likely to be important to LLC members who lack tailored operating agreements. These off-the-shelf operating agreements are not set off in separate captioned divisions of the Old or New Act; rather, the provisions constituting them are dispersed throughout these acts. However, if you pull all of these provisions together, you'll find that they provide decent basic operating agreements for at least the more common types of both single-member and multi-member LLCs.

3) However, two key points must be made about these off-the-shelf operating agreements:

   a) First, as discussed in detail in Chapters 2 through 4, the off-the-shelf operating agreements in the New Act are substantially better than those in the Old Act.

   b) Second, there are many key functions that tailored operating agreements do perform that even the best off-the-shelf operating agreements *cannot* perform. Briefly:

      i) Factual issues. There are numerous factual issues critical to any LLC—e.g.,

[2] I can speak with certainty about this issue, since I've been deeply involved in the drafting of the original New Hampshire LLC Act, its 1997 amendments, and the New Act.

the names of the members, their contributions, and buy-sell arrangements among them—that, obviously, no off-the-shelf operating agreement can address; they can be addressed only in tailored operating agreements.

ii) Inappropriate default provisions. For virtually all LLCs, there are at least a few default provisions of both the Old and the New Act that won't work. The only way to alter these provisions for any particular LLC is in a tailored operating agreement.

iii) Tax issues, etc. All LLC deals involve not only LLC business organization law issues but also federal and state tax issues and contract law issues, and many of them involve yet additional issues, such as securities law issues. Neither the Old nor the New Act can address any of these non-LLC business organization law issues; only tailored operating agreements can address them.

iv) Format. As I've noted, the provisions of off-the-shelf operating agreements in the Old and New Acts are dispersed throughout these acts. This means that it can be difficult—and may require substantial assistance by LLC lawyers—to piece them together in order, for example, to resolve disputes among LLC members about their LLCs. By contrast, all of the provisions in tailored operating agreements are, by definition, set forth in the texts of those agreements, where all of them may be readily located and, in well-drafted tailored operating agreements, readily understood.

4) Thus, if a client of yours happens to be aware of the off-the-shelf operating agreements in the Old or New Acts and asks you whether these agreements can substitute for tailored operating agreements, you should tell them that, in many critical ways, they cannot—and thus, that if they are willing and able to hire LLC lawyers to draft tailored operating agreements for their LLCs, they should do so.

§ 10.09 WHAT ACCOUNTANTS SHOULD TELL TELL THEIR CLIENTS WHO ARE MEMBERS OF OLD ACT LLCs ABOUT WHETHER TO MAKE ELECTIONS TO BE GOVERNED BY THE NEW ACT

Governor Lynch signed the New Act into law on June 18, 2012. It will become effective on January 1, 2013 for LLCs formed on and after that date. However, it will not apply to LLCs formed under the Old Act until January 1, 2014 unless the members of these LLCs elect in writing to be covered by the New Act during calendar year 2013. Obviously, as an accountant, you cannot give legal advice as such to clients who are members of Old Act LLCs about whether to make these elections. However, I suggest that they can usefully tell these clients that, subject to the advice of their lawyers, they should follow the guidelines below concerning these elections:

1) As indicated above, the New Act differs in many major ways from the Old Act. If the members of any Old Act LLCs elect to be governed by the New Act during 2013 without first consulting with lawyers expert in both the Old Act and the New Act, they may find that some of the provisions to which they will thus become subject may affect them adversely.

2) However, it may well require LLC lawyers at least a few hours of careful analysis in order to

give competent advice to the members of an Old Act LLC whether to make the above election, and the legal fee for this advice may be significant.

3) Furthermore, as indicated in the discussion above, the provisions of the New Act outlined above are likely to provide many Old Act LLCs with numerous legal advantages—including, for example, "pick-your-partner" and charging order advantages—that the Old Act does not provide,

4) Finally, for many Old Act LLCs, none of the provisions of the New Act are likely to be disadvantageous.

5) Thus, members of Old Act LLCs who are unwilling or unable to hire lawyers to advise them as to whether to make § 5 elections and who are willing to run the generally minor risk of adverse results from the election should make these elections even *before* January 1, 2013 (although the elections will not actually be effective *until* that date). However, they should realize that while it is unlikely, it is nonetheless possible that the election will result in unexpected adverse consequences for them.

6) Whether or not they are willing to hire lawyers, the same advice applies with even greater force to members of Old Act LLCs who do not have significant financial or personal stakes in their LLCs.

§ 10.10 WHAT ACCOUNTANTS SHOULD TELL THEIR CLIENTS WHO DO BUSINESS IN BOTH NEW HAMPSHIRE AND MASSACHUSETTS AS TO WHETHER THEY SHOULD FORM THEIR LLCs UNDER THE NEW ACT OR THE MASSACHUSETTS ACT?

1) Business people who intend to do business in both New Hampshire and Massachusetts must form their LLCs under the LLC act of one of these states and register it as a "foreign LLC" under the LLC act of the other.

2) As outlined in Chapter 9, the New Act offers LLC members many LLC business organization law advantages that the Massachusetts LLC Act does not offer. For example:

   a) The New Act provides far greater protection of LLC members' membership rights against transfers to third parties than the Massachusetts LLC Act.

   b) The New Act provides far greater contractual flexibility than the Massachusetts Act.

   c) The provisions in the New Act concerning the removal of bad managers and concerning the making of interim distributions are much better than those in the Old Act.

3) Thus, most business people who have to choose between forming their LLCs under either the New Act or the Massachusetts LLC Act should form them under the New Act.

EXHIBIT 10-1

TABLE COMPARING THE FINANCIAL PROVISIONS OF THE OLD ACT AND THE NEW ACT

ISSUE	OLD ACT	NEW ACT	COMMENT
1. What is a member's "LLC interest"?	A member's LLC interest is the member's right to allocations of the LLC's profits and losses and to receive distributions of its assets. Old Act, § 1, VII (definitional provision)	Same. New Act, § 12 (definitional provision)	The definition of "LLC interest" in both the Old and New Acts can be confusing, because it two quite distinct (though closely related) economic rights in the same term.
2. What is the meaning of the phrase "allocation of an LLC's profits and losses"?	The Old Act does not define this term.	"Unless the operating agreement provides otherwise, an allocation by the limited liability company to its members of its profits and losses shall mean an apportionment to the members of their respective shares of these profits and losses on the books of the limited liability company." New Act, § 89 (default provision)	Many lawyers and business people are unlikely to know the meaning of the LLC statutory term "allocation of profits and losses." The failure of the Old Act to define the term is a significant flaw in the Old Act.
3. What is a "distribution"?	The Old Act does not define this term.	In general, a distribution means a transfer by an LLC to a member in the member's capacity as a member. New Act, § 91, I (default provision).	See comment in Row 2 about the term "allocation of profits and losses." Same criticism applies with respect to the term "distributions."
4. What is an "interim distribution"?	The Old Act does not define this term.	An interim distribution is any distribution except a liquidating distribution. New Act, § 91, II (default provision).	See comment in Row 3.

ISSUE	OLD ACT	NEW ACT	COMMENT
5. What is a "liquidating distribution"?	The Old Act does not define this term.	A liquidating distribution means a distribution: • In redemption of a member's membership rights; or • In liquidation of the LLC. New Act, § 91, III (default provision)	See comment in Row 3.
6. What forms of contribution may members make to LLCs	Contributions may be of cash, property, services or promissory note for cash, property or services. Old Act, § 36, I (self-enabling permissive provision)	Same. New Act, § 85 (self-enabling permissive provision)	
7. What is the duty of the LLC's managers when a member makes a non-cash contribution or no contribution at all?	The managers must state a dollar value for the contribution or that there was no contribution. Old Act, § 36, II (mandatory provision)	Same. New Act, § 86 (mandatory provision)	The duty to value non-cash contributions in these provisions applies not only to managers of manager-managed multi-member LLCs but also to members of member-managed multi-member LLCs. The duty to "state" in these sections should be construed to mean "state in *writing*."
8. When is a promise to contribute enforceable?	Only when it is in writing signed by the member. Old Act, § 37, I (mandatory provision)	Under New Act, § 87, I, same rule, except in a default provision.	
9. Must a member make a promised contribution even if the member is unable to do so because of death, disability or any other reason?	Yes, unless the operating agreement provides otherwise. Old Act, § 37, II (first sentence). (default provision)	Same. New Act, § 87, II (default provision),	These sections refer only to members, but it is obvious that they impose duties also on the members' successors as members.

ISSUE	OLD ACT	NEW ACT	COMMENT
10. What must the member do if the member does not make a required contribution of property or services?	At the LLC's option, the member must contribute cash equal to the agreed value of the property or services. Old Act, § 37, II (second sentence). (self-enabling permissive provision)	Same. New Act, § 87, III (self-enabling permissive provision as to the LLC; mandatory as to defaulting members)	
11. Under what circumstances may a promise to contribute be compromised?	Unless the operating agreement provides otherwise, only with the consent of all of the members. Old Act, § 37, III (default provision)	Same. § 87, VI (default provision)	
12. If there is such a compromise, what rights do creditors have with respect to the contribution?	Creditors who rely on the promise may enforce the original obligation to contribute. Old Act, § 37, III (second sentence) (self-enabling permissive provision)	Same. New Act, § 87, VI (self-enabling permissive provision)	
13. May an operating agreement impose penalties on the interests of members for failure to make promised contributions?	Yes. Old Act, § 37, IV (first sentence) (non-self-enabling permissive provision)	Same. New Act, § 87, VII (non-self-enabling permissive provision)	
14. What types of penalties may be imposed under § 37, IV (first sentence)	A wide variety of penalties are permitted. Old Act, § 37, IV (second sentence) (default provision)	Same. New Act, § 87, VIII (default provision)	New Act, § 87 should arguably be amended to permit the forfeiture not merely of a member's "interest" but of some or all of the member's *membership rights*.
15. On what basis may the profits and losses of an LLC be allocated among the members?	On any basis provided in an operating agreement. Old Act, § 38 (first sentence) (non-self-enabling permissive provision)	Same. New Act, § 90, I (non-self-enabling permissive provision)	

ISSUE	OLD ACT	NEW ACT	COMMENT
16. If the operating agreement is silent, how must above profits and losses be allocated?	On the basis of the value of each member's contribution to the extent they have been received by the LLC and not returned. Old Act, § 38 (second sentence) (default provision)	Same, except that § 90, II does not contain the phrase "and not returned"). New Act, § 90, II (default provision)	The BIA Drafting Committee omitted the phrase "and not returned" because they felt it was ambiguous as to whether returns were limited to returns of contributions treated as such or could also mean interim distributions or compensation. However, the more obvious construction is "returns of contributions treated as such."
17. How must an LLC allocate distributions among the members?	In any manner provided in the operating agreement. Old Act, § 39 (first sentence) (non-self-enabling permissive provision)	Same. New Act, § 95, I (non-self-enabling permissive provision)	
18. If the operating agreement is silent, how must distributions be allocated?	On the same basis as allocations of profits and losses under Old Act, § 38 (second sentence) (default provision)	Same. New Act, § 95, II (default provision)	
19. When is a member entitled to receive interim distributions before the member's dissociation and the LLC's dissolution?	Only as provided in the operating agreement. Old Act, § 40 (first sentence) (mandatory provision)	• Unless the operating agreement provides otherwise, a member-managed multi-member LLC must make interim distributions upon the majority vote of the members. New Act, § 94, I (default provision) • Unless the operating agreement provides otherwise, a manager-managed multi-member LLC must make interim distributions upon the majority vote of the members. New Act, § 94, II (default provision)	

ISSUE	OLD ACT	NEW ACT	COMMENT
20. To what distribution is a member entitled upon the member's dissociation?	The member is entitled to the distribution of amounts allocated to the member before the dissociation. Old Act, § 41 (first sentence, first clause) (mandatory provision)	Under New Act § 105, I, the rule is the same as under the Old Act, except that, in the New Act, it is a default rule.	
21. Is a dissociation member entitled to a payment for the value of member's LLC interest on the basis of his right to share in LLC distributions?	No. Old Act, § 41 (first sentence, second clause) (default provision)	Same. New Act, § 105, II (default provision)	
22. What rights does a dissociated member retain if he receives no payment for the value of his LLC interest?	The member retains the right to allocations and distributions in respect of the member's LLC interest. Old Act, § 41 (second sentence) (mandatory provision)	Same. New Act, § 105, III (mandatory provision)	Arguably, New Act § 105 should be amended to be a default provision.
23. Does a member have a right to demand and receive distributions other than cash?	Unless the operating agreement provides otherwise, no. Old Act, § 42 (first sentence) (default provision)	Same. New Act, § 96, I (default provision)	
24. May the LLC compel a member to accept a distribution in kind?	Only to the extent that the percentage of the asset distributed to the member exceeds a percentage of the asset that is equal to the percentage in which the member shares in distributions for the LLC. Old Act, § 42 (second sentence) (mandatory provision)	Same. New Act, § 96, II (default provision)	
25. What is the status of a member who is entitled to receive a distribution?	Unless the operating agreement provides otherwise, the member has the status of a creditor. Old Act, § 43 (first sentence) (default provision)	Same. New Act, § 92 (default provision)	

ISSUE	OLD ACT	NEW ACT	COMMENT
26. May an operating agreement provide for the establishing of a record date with respect to allocations and distributions?	Yes. Old Act, § 43 (second sentence). (Non-self-enabling permissive provision.)	Same. New Act, § 97, I (non-self-enabling permissive provision)	
27. May an LLC make a distribution if, after the distribution, the LLC's liabilities will exceed the fair value of its assets?	No. § Old Act, 44, I (mandatory provision)	Same. New Act, § 93, I (mandatory provision)	
28. What will be the liability of a member who knowingly accepts a distribution in violation of Old Act, § 44, I?	The members will be liable to the LLC for the amount of the amount of the distribution. Old Act, § 44, II (first sentence) (mandatory provision)	Same. New Act, § 93, III(a) (mandatory provision)	
29. What is the liability of a member who received the above distribution but did not know it violated Old Act, § 44, I?	The member will not be liable for the distribution. § 44, II (second sentence) (mandatory provision)	Same. New Act, § 93, III(b) (mandatory provision)	

ISSUE	OLD ACT	NEW ACT	COMMENT
30. What rights do LLC members have to distributions after its winding-up?	Upon the LLC's winding up, the LLC may make no distributions until it obtains a certificate of dissolution from the New Hampshire Department of Revenue Administration (mandatory provision); it must then must pay its creditors (mandatory provision); unless the operating agreement provides otherwise, it must then make distributions to the members in satisfaction of liabilities for distributions under second edition 40 and 41 default provision); and unless the operating agreement provides otherwise, it must make distributions to members first of their contributions and second in respect to their distribution rights (default provision). Old Act, § 58, I and II.	Same. New Act, § 141, II (same combination of mandatory and default rules as in Old Act, § 58)	

CHAPTER 11

WHAT SHOULD NEW HAMPSHIRE AND MASSACHUSETTS BUSINESS PEOPLE KNOW ABOUT NEW HAMPSHIRE'S NEW LLC ACT?

OVERVIEW

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§ 11.01 INTRODUCTION

1) On June 18, 2012, Governor Lynch signed into law a new New Hampshire LLC act entitled the "Revised New Hampshire Limited Liability Company Act" (the "New Act").

2) The New Act will govern all New Hampshire LLCs formed on and after January 1, 2013 ("New Act LLCs"). In general, it will *not* govern LLCs ("Old Act LLCs") formed *before* January 1, 2013 until January 1, 2014. However, Old Act LLCs will be governed by the New Act during calendar year 2013 if all of them vote to be governed by the New Act.

3) The New Act will have no impact whatsoever on the federal or state tax liabilities of New Hampshire LLCs or their members. However, the New Act differs from the Old Act from a *legal* viewpoint in many major respects. This chapter points out each of these differences in non-technical language, and it illustrates the practical importance of each with concrete examples.

§ 11.02 THE FIDUCIARY PROVISIONS OF THE NEW ACT

[A] EXPLANATION

1) Fiduciary duties constitute, in effect, an LLC's code of ethics and its team spirit. In addition, fiduciary duties have teeth: members who breach them may incur serious money damages and other serious penalties.

2) The Old Act contains no clear fiduciary provisions. By contrast, Part 15 of the New Act contains comprehensive fiduciary duties, although all of these duties may be reduced or eliminated by the members in their operating agreement or by member vote. The fiduciary duties in the New Act reduce the risk of fiduciary disputes among LLC members and they can greatly facilitate the resolution of these disputes.

3) The main fiduciary duties under the New Act are a duty to exercise reasonable care in managing the LLC; to act fairly toward the members; and to be loyal to them. The duty of loyalty includes:

   a) A duty not to compete against the LLC;

   b) A duty not to engage in transactions with the LLC that involve conflicts of interest;

   c) A duty to share business opportunities with the LLC;

   d) A duty to maintain the confidentiality of confidential LLC information;

   e) A duty to act in good faith toward the LLC and the members—i.e., not to engage in any action that the member intends or knows will cause them harm;

   f) A duty to use LLC property only for LLC purposes;

   g) A duty to promptly disclose to the other members any information of which the member becomes aware that may be significant for the LLC.

[B] CONCRETE ILLUSTRATIONS

1) <u>Illustration under the Old Act</u>

   a) Arthur Able and Bill Baker are the members of AB, LLC, a New Hampshire Old Act LLC (i.e., an LLC formed under the Old Act) that provides electrical services in central New Hampshire. A customer calls Able and asks him to perform major electrical services. Able does not tell Baker about this work. He performs the work by himself in the evening and on weekends over a period of several weeks and earns $50,000 for it. Baker finds out about the work; he sharply criticizes Baker for it; and he tells Able that if he doesn't share the $50,000 equally with him, he will sue Able for this amount.

   b) Baker consults a lawyer, who tells him that nothing in the Old Act prohibits a member of an LLC from competing against the LLC, particularly if the competition occurs outside of normal work hours; and that nothing in the Old Act requires a member to disclose the member's competitive activities to other members.

2) <u>Illustration under the New Act</u>

   a) Same facts as above, except Able and Baker have formed AB, LLC under the New Act.

   b) When Baker sees a lawyer about the above dispute, the lawyer tells him that the fiduciary provisions of the New Act prohibit him from competing with AB not only during normal working hours but also at all other times; that these provisions require him to disclose any

such activity to Baker; and that if Baker sues him for his share of the above $50,000, Baker will almost certainly win. See New Act, §§ 110, I and II, §§ 110, III(a) and (e).

§ 11.03 MEMBER BANKRUPTCIES UNDER THE NEW ACT

[A] EXPLANATION

1) Under the default rules of the Old Act, members of single-member LLCs who become bankrupt will be "dissociated" from their LLCs—that is, they will cease being members; and their bankruptcies will cause their LLCs to cease to exist as legal entities, thus potentially crippling the efforts of their members to *escape* from bankruptcy.

2) By contrast, members of New Act single-member LLCs who become bankrupt will not cease to be members of their LLCs, and their bankruptcies will have no effect on the existence of their LLCs.

[B] CONCRETE ILLUSTRATIONS

1) Illustration under the Old Act

   a) John Doe is the member of JD, LLC, a successful single-member LLC that renovates single-family homes. Because of family medical expenses, John declared bankruptcy several years ago, but through hard work, he paid his creditors and was eventually able to acquire substantial new personal assets.

   b) John is unaware that under § 27, (d) of the Old Act, his bankruptcy caused him to be "dissociated" from his LLC—i.e., the bankruptcy caused him to cease being a member of the LLC; and that, because, under the Old Act, LLCs must have at least one member, his dissociation terminated the existence of the LLC. Old Act § 1, VI.

   c) Several years after John has recovered from his bankruptcy, one of his employees, contrary to his express instructions, negligently leaves a ladder leaning against a home on which John's LLC is doing work. The ladder falls on a Mary Roe, a pedestrian and seriously injures her.

   d) John's lawyer argues that while John's LLC is liable for Mary's claim, John, because, as a member of an LLC, he has a statutory liability shield and thus is not personally liable for the claim.

   e) However, Mary's lawyer discovers that John became bankrupt before the claim arose; that he is thus no longer a member of his LLC; and that his LLC no longer exists as a legal entity.

   f) On the above basis, the court holds John personally liable for Mary's claim.

2) Illustration under the New Act

   a) Same facts as above, except that John has formed his LLC under the New Act and Mary is injured after the LLC's formation.

   b) Under the New Act, members of single-member LLCs who become bankrupt are *not* dissociated from their LLCs. Thus, John is not personally liable for Mary's claim.

§ 11.04 THE STATUTORY DEFINITIONS IN THE NEW ACT

[A] EXPLANATION

1) The Old Act contains many statutory terms whose meanings are likely to be unclear to business people, accountants and even lawyers, but which are not defined in the act.

2) In the New Act, all significant statutory terms are expressly and clearly defined.

[B] CONCRETE ILLUSTRATIONS

1) Illustration under the Old Act

   a) ABC, LLC is a multi-member LLC formed under the Old Act. A dispute arises among the members about their right to share in LLC profits, distributions they have received from the LLC in the past, and their right to receive allocations and distributions of LLC profits in connection with its dissolution, winding-up and liquidation. In an effort to resolve their dispute without having to consult a lawyer, the members review their own the relevant provisions of the Old Act.

   b) However, because the meaning of the key statutory terms "allocation," "interim distribution," "liquidating distribution," "dissolution," "winding-up" and "liquidation" are not defined in the Old Act, the members are unable to understand the above provisions and thus must hire a lawyer to interpret them. The lawyer charges them a substantial legal fee to do so.

2) Illustration under the New Act. All of the above statutory terms are expressly defined in the New Act. As a result, ABC's members are able to interpret the above statutory terms and to resolve their dispute on the basis of those terms. In doing so, they do not need the help of a lawyer.

§ 11.05 LAWSUITS BY MEMBERS AGAINST OTHER MEMBERS AND AGAINST MANAGERS UNDER THE NEW ACT

[A] EXPLANATION

1) The Old Act provides in effect that members of New Hampshire LLCs who believe that managers or other members have engaged in misconduct may sue these persons only through a complex and expensive type of legal proceeding called a "derivative suit."

2) Under the New Act, members may bring these claims in "direct actions" that will generally be much simpler than any derivative suit is likely to be.

[B] CONCRETE ILLUSTRATIONS

1) Illustration under the Old Act

   a) Able, Baker and Charlie are members of ABC, LLC, an LLC formed under the Old Act. Able believes that Baker has engaged in serious misconduct in participating in ABC's management, and he brings suit against Baker to obtain money damages for this misconduct.

b) In bringing his suit, Baker fails to comply with the requirement of § 76, I(c) of the Old Act, which requires that complaints filed in suits such as Baker's "set forth with particularity the effort of the plaintiff to secure initiation of the action by a manager or member or the reasons for not making the effort."

c) Because of this failure, the court dismisses Bakers' suit.

2) Illustration under the New Act. As permitted by § 190 of the New Act, Able brings his suit as a direct action against Baker. His suit is not dismissed, and it results in his winning substantial damages from Baker.

§ 11.06 THE PROTECTION OF MEMBERS' MEMBERSHIP RIGHTS FROM THIRD PARTIES UNDER THE NEW ACT

[A] EXPLANATION

1) LLC statutes generally contain two types of provisions—referred to by LLC lawyers as "pick-your-partner provisions" and "charging order provisions"—that, together, provide LLC members with protection from the risk that the courts will order the transfer of their membership rights to judgment creditors, former spouses or trustees in bankruptcy.

2) The pick-your-partner provisions and charging order provisions in the New Act offer LLC members far stronger risks against these transfers than those of the Old Act, especially for members of single-member LLCs.

[B] CONCRETE ILLUSTRATIONS

1) Illustration under the Old Act

a) Mary Roe is the only member of MR, LLC, an Old Act single-member LLC. She incurs a substantial liability to John Smith when, while driving her car on personal business, she accidentally but negligently collides with his car and seriously injuries him. Her automobile insurance is insufficient to cover the resulting damage award. . John Smith brings a collection action in a New Hampshire court to levy on her MR membership rights.

b) No provision of the Old Act protects the membership rights of members of single-member or multi-member LLCs formed under that act. Thus, the court orders the sale of Mary's membership rights and John Smith acquires it in partial satisfaction of his unsatisfied judgment against Mary.

2) Illustration under the New Act.

a) Same facts as above except that Mary forms her LLC under the New Act and the above accident occurs after she does so.

b) Under § 126 of the New Act, Mary will be able to retain ownership of her MR membership rights as long as she can prove that she will be able to satisfy John Smith's judgment against her within a reasonable time.

§ 11.07 THE RIGHT OF MEMBERS UNDER THE NEW ACT TO REMOVE MEMBERS WHO ENGAGE IN SERIOUS MISCONDUCT OR WHO PROVE TO BE INCOMPATIBLE

[A] EXPLANATION

1) Section 27, IV of the Old Act permits the members of an LLC to remove a member only for mismanagement; for breach of the LLC's operating agreement; and for fraud and other serious misconduct relating to the LLC

2) The member removal provisions of § 104 of the New Act are comprehensive; they address every possible legitimate reason for member removals. But they also strike a careful balance between the rights of members seeking to remove other members and the rights of these other members. In particular, they provide the courts with broad discretion to determine the buy-out terms in any member removal.

[B] CONCRETE ILLUSTRATIONS

1) Illustration under the Old Act

   a) Mrs. Able, Mrs. Baker and Mrs. Charlie are the members of ABC, LLC, a three-member LLC formed under the Old Act.

   b) Initially, the relationship between ABC's members is positive and productive. However, three years after ABC's formation, a serious personal conflict arises between, on the one hand, Mrs. Able, and, on the other Mrs. Baker and Mrs. Charlie, which makes it impossible for Mrs. Baker and Mrs. Charlie to work with Mrs. Able in conducting ABC's business. This inability creates a serious risk that ABC will fail.

   c) Under § 27, IV of the Old Act, Mrs. Baker and Mrs. Charlie will have no basis for voting for the removal of Mrs. Able.

2) Illustration under the New Act

   a) Under § 104, II(d) of the New Act, Mrs. Baker and Mrs. Charlie may petition a court to remove Mrs. Able as a member of ABC if the court finds that her conduct make it "not reasonably practicable to carry on the activities of [ABC] with [Mrs. Able] as a member."

   b) Under § 104, II(d) of the New Act, Mrs. Baker and Mrs. Charlie bring a suit in the Superior Court to obtain the removal of Mrs. Able as a member of ABC and they obtain a removal order.

   c) However, under § 104, III, which gives the courts broad discretion to determine the terms of a member's removal under § 104, II, the court in the ABC case requires Mrs. Baker and Mrs. Charlie to make a membership termination payment to Mrs. Able that will adequately compensate her for any future income of ABC reasonably attributable to ABC's goodwill that is reasonably attributable to her.

§ 11.08 THE RIGHT OF MEMBERS UNDER THE NEW ACT TO REMOVE MANAGERS WHO ARE INCOMPETENT OR WHO ENGAGE IN SERIOUS MISCONDUCT

[A] EXPLANATION

1) Old Act Section 31, I (fourth sentence) provides that "[a] manager shall cease to be a manager as provided in a limited liability company agreement." The Old Act provides no standards for manager removals, and § 31 can be read to provide that if an operating agreement does not provide these standards, the members cannot remove a manager. "

2) New Act § 50 provides that unless the operating agreement provides otherwise, the members may remove a manager by majority vote of the members at any time and for any reason or no reason.

[B] CONCRETE ILLUSTRATIONS

1) Illustration under the Old Act

   a) Smith is a not a member of XYZ, LLC, an Old Act LLC whose members are individuals. X, Y and Z, hire Smith to manage XYZ, and Smith negotiates a substantial salary for his management services.

   b) During his first year as XYZ's manager, Smith proves to be seriously incompetent in managing XYZ, and X, Y and Z vote unanimously to terminate him and to cease paying his salary.

   c) Smith sues X, Y and Z and XYZ for breaching § 31, I (fourth sentence) and demands the indefinite continuation of his salary.

   d) X, Y and Z are advised by their lawyer that because of Old Act § 31, I, there is a significant risk that Smith will prevail in his suit. On the basis of this advice, X, Y and Z settle the suit on terms highly favorable to Smith.

2) Illustration under the New Act

   a) Same facts as above, except that X, Y and Z form XYZ under the New Act; they hire Smith as its manager after the formation; and when he proves to be incompetent, they vote unanimously to remove under New Act § 51.

   b) Smith's lawyer advises him that the New Act provides him with no effective defense against his termination by XYZ and that there is no basis for his negotiating a favorable termination settlement agreement.

§ 11.09 CONTRACTUAL FLEXIBILITY UNDER THE NEW ACT

[A] EXPLANATION

1) LLC members often want the contractual flexibility to tailor their LLCs under their operating agreements to meet member needs and interests—e.g., the interest of LLC founders in sharing the profits of their LLCs with family members without the risk of fiduciary challenges by these members.

2) Section 78, II of the Old Act provides that "it is the policy of this Act to give the maximum effect to the principle of freedom of contract and to the enforceability of the limited liability company agreement," and a few provisions of the Old Act apply this principle with respect to specific LLCs matters such as mergers and statutory conversions. However, no provisions of the Old Act apply the principle to key management issues such as the reduction or elimination of management fiduciary and other duties and the exculpation of managers from personal liability for breaches of these duties.

3) The New Act provides LLC members and managers with substantially greater freedom of contract than the Old Act. In particular, it permits them to provide in their operating agreements under New Act § 107 for the complete elimination of fiduciary and other duties and, under New Act § 115, for complete exculpation from damages for breaches of these duties.

[B] CONCRETE ILLUSTRATIONS

1) Illustration under the Old Act

   a) Individual A is an inventor and entrepreneur. He invents a new kind of solar panel, patents it, forms ABCD, LLC, an LLC under the Old Act to commercialize the patent, and invites three friends, individuals B, C and D, each of whom has management skills he lacks, to become members of ABCD.

   b) To provide himself with maximum entrepreneurial freedom, his lawyer includes in ABCD's operating agreement provisions providing that he will not be subject to any fiduciary of care or loyalty or to any other fiduciary duty and that, if he is found to have breached any such duty, he will not be personally liable to ABCD or the other members for damages.

   c) Some years after ABCD's formation, John decides to begin promoting the sales of his solar panels in China, and he devotes most of his time and most of ABCD's resources to doing so. His three co-members deeply disagree with this strategy and they so inform John. Nevertheless, John continues with his China strategy. The strategy totally fails and results in ABCD's having to terminate all of its other business activities worldwide.

   d) B, C and D sue A for breach of his fiduciary duties of care and loyalty and seek a multi-million dollar damage judgment against him.

   e) The trial lawyer whom A retains to represent him in defending himself against the suit by B, C and D advises him that while § 78, II of the Old Act provides him with a significant defense in the suit, there is a significant question whether the court hearing the case will view that section as an adequate basis for the elimination of fiduciary duties in ABCD's operating agreement or for the exculpation clause in that agreement. As a result, he advises A to offer to B, C and D to settle the suit by paying 50% of the amount claimed. A makes this offer and B, C and D accept it.

2) Illustration under the New Act.

a) Same facts as above, except that A forms ABCD under the New Act and the claim against him by B, C and D arises after the formation.

b) The lawyer representing B, C and D with respect to the claim of fiduciary breach and damages they are considering against A advises them that in light of New Act §§ 107 and 115, they have no grounds for making the above claims. On this basis, they decide not to make them.

§ 11.10 THE "OFF-THE-SHELF OPERATING AGREEMENTS" IN THE NEW ACT

[A] EXPLANATION

1) The provisions of the Old Act are organized in a sequence typical of LLC statutes. However, the provisions in them can be reorganized so as to address specifically and comprehensively the LLC business organization law issues that concern various specific types of LLCs. These "off-the-shelf operating agreements," embedded in the provisions of the Old Act, can, at least to a degree, substitute for written operating agreements specifically developed for particular single-member and multi-member LLCs (referred to in this chapter as "tailored operating agreements"). But above all, they can be useful to the many LLCs that lack tailored operating agreements altogether.

2) However, the off-the-shelf operating agreements in the Old Act fail to address many of the LLC business organization law issues likely to be important to LLC members who lack tailored operating agreements; and some of the provisions in them that do address these issues do so in a manner that, for many of these members, won't work.

3) By contrast, the provisions in the off-the-shelf operating agreements in the New Act address *comprehensively* the LLC business organization law issues likely to be important to LLC members who lack tailored operating agreements; and all of them do so in a manner that meets a "plurality" rule—that is, they work for more LLCs than any alternative provisions would work.

[B] CONCRETE ILLUSTRATION

1) Illustration under the Old Act

a) Under the Old Act, individuals S, T and U in 2000 form STU, LLC, a three-member LLC, to manufacture and sell widgets. They do not adopt any written operating agreement. STU as an LLC and S, T and U as its members are thus governed by the default and self-enabling permissive provisions of the Old Act.

b) In 2010, STU earns substantial profits. Because of medical and educational expenses incurred by his family, S proposes to T and U that STU make distribution a substantial portion of those profits to S, T and U in early 2011. T agrees to these distributions, but U opposes them on the ground that if STU invests them in its business, it can realize major growth in 2011.

c) Old Act § 40 (first sentence) provides in essence that members may receive distributions from an LLC only as "specified in the limited liability company agreement." STU's lawyer advises S and T that under § 40, STU cannot make an interim distribution to its

members (i.e., a distribution other than in redemption of a member's membership or the liquidation of the LLC) even if a majority of the members vote to approve it. On this basis, STU makes no distribution to any of its members in 2011.

2) Illustration under the New Act

   a) Same facts as above, except that S, T and U form STU under the New Act and S requests the above interim distribution from STU after the formation.

   b) Section 94, I of the New Act provides that unless the operating agreement provides otherwise, the members of a member-managed multi-member LLC may require by majority vote that the LLC make an interim distribution to the members. Under § 94, I, upon a vote by S and T, STU must make the interim distribution requested by S even if U opposes the distribution.

§ 11.11 DO THE "OFF-THE-SHELF OPERATING AGREEMENTS" OF THE NEW ACT MAKE TAILORED OPERATING AGREEMENTS UNNECESSARY?

[A] EXPLANATION

1) As noted, the off-the-shelf operating agreements in the New Act are substantially better than those in the Old Act. However, they cannot fully substitute for tailored operating agreements.

2) In particular:

   a) Factual issues. Every LLC deal involves unique facts that, by definition, no LLC statute can address but that are critical to the deal. These include, for example, the identity of the LLC members; the kind and amount of their contributions to the LLC; and the terms of any buy-out to which they will be entitled upon their death or disability. Tailored operating agreements address all of these facts.

   b) Non-business organization law issues. The New Act addresses only LLC business organization law issues. However, in every LLC deal, not only LLC business organization law issues but also many other kinds of issues—e.g., federal and state tax issues, contract law issues or securities law issues—are likely to be critical. Only tailored operating agreements can address these issues.

   c) Default provisions that don't work for particular LLCs. For virtually every LLC, at least a few of the default provisions of the New Act won't work. For example, § 90 of the New Act provides that an LLC shall allocate its profits among the members in proportion to their respective contributions to the LLC. However, in numerous LLCs, the members intend that the profit sharing percentage of one or more members shall be based on their services, not their contributions. Tailored operating agreements are necessary to effectively alter § 90 for these LLCs.

   d) Non-self-enabling permissive provisions. The New Act contains numerous "non-self-enabling permissive provisions"—i.e., provisions that may be useful to LLCs but that won't apply to them unless their operating agreements expressly so provide. For example, New Act § 107 provides that an operating agreement may reduce or eliminate fiduciary and other duties of LLC members and managers. Provisions implementing § 107 may be indispensable for LLC members who are concerned that one or more other members may eventually make baseless fiduciary claims against them. Tailored operating agreements are necessary in order to ensure that LLCs for whom § 107 and

other non-self-enabling permissive provisions in the New Act will be useful are implemented in a legally binding manner.

3) Furthermore, the provisions of each off-the-shelf operating agreement in any LLC statute are dispersed throughout that statute; they can be comprehensively assembled for presentation to prospective or actual LLC members in a form that will be of practical value to them only by diligent and time-consuming legal work. The provisions of any well-drafted tailored operating agreement can be readily reviewed, evaluated and applied by prospective and actual LLC members—e.g., by prospective members in deciding whether to join LLCs; and by actual members in resolving disputes about their LLCs.

4) Thus, if they are willing and able to pay the necessary legal fees, LLC members who have significant financial or personal stakes in their LLCs should hire lawyers to address with them the LLC business organization law issues, tax issues and other issues relevant to their LLCs and to formalize the resolution of these issues in writing in comprehensive tailored operating agreements.

[B] CONCRETE ILLUSTRATIONS

All of the above advantages of tailored operating agreements are available under both the Old Act and the New Act.

§ 11.12 SHOULD NEW HAMPSHIRE BUSINESS PEOPLE WHO ARE MEMBERS OF OLD ACT LLCs MAKE ELECTIONS TO BE GOVERNED BY THE NEW ACT DURING CALENDAR YEAR 2013?

[A] EXPLANATION

As noted above, the New Act will not apply to Old Act LLCs until January 1, 2014 unless the members of these LLCs elect in writing to be covered by the New Act during calendar year 2013. Obviously, accountants cannot give legal advice to their clients who are members of Old Act LLCs about whether to make these elections. However, I suggest that they can usefully tell these clients that, subject to the advice of their lawyers, they should follow the guidelines below concerning these elections:

1) As indicated above, the New Act differs in many major ways from the Old Act, and if the members of any Old Act LLCs elect to be governed by the New Act during 2013 without first consulting with lawyers expert in both the Old Act and the New Act, they may find that some of the provisions to which they will thus become subject may have an adverse effect on them.

2) However, it may well require LLC lawyers at least a few hours of careful analysis in order to give competent advice to the members of an Old Act LLC whether to make the above election; and the legal fee for this advice may be significant.

3) Furthermore, as indicated in the discussion above, the provisions of the New Act outlined above are likely to provide many Old Act LLCs with numerous legal advantages—including, for example, “pick-your-partner” and charging order advantages—that the Old Act does not provide; and, for many Old Act LLCs, none of the provisions of the New Act will be disadvantageous.

4) Thus, members of Old Act LLCs who are unwilling or unable to hire lawyers to advise them as to whether to make § 5 elections and who are willing to run the generally minor risk of adverse results from the election should make these elections even *before* January 1, 2013 (although the elections will not actually be effective *until* that date). However, they should realize that while it is unlikely, it is nonetheless possible that the election will result in unexpected adverse consequences for them.

5) Whether or not they are willing to hire lawyers, the same advice applies with even greater force to members of Old Act LLCs who do not have significant financial or personal stakes in their LLCs.

[B] CONCRETE ILLUSTRATIONS

1) Illustration if Old Act LLC makes no election

   a) In 2010, individuals John Smith, Frank Smith and Mary Smith form JSM, LLC under the Old Act to purchase Blackacre, a lakeside property for the benefit of their family. Under the operating agreement of JSM, John, Frank, Mary, their spouses and their children have the right to use the property for any recreational purpose.

   b) In 2012, John Smith and his wife Betty are divorced. On December 1, 2012, Betty asks the judge in the divorce court proceeding to award her John's right to use Blackacre. At that time, JSM has not made an election under New Act § 5 to be governed by the New Act during calendar year 2013.

   c) John's lawyer argues to the judge that the judge should not order the transfer of John's right to use Blackacre to Mary because Old Act § 49, (fourth sentence) provides that LLC members may not transfer to other persons their "right to participate in the management and affairs of the limited liability company." John's lawyer acknowledges that John's LLC interest in JSM is subject to transfer to Mary, but he argues that all of John's other rights as a member are not.

   d) Mary's lawyer argues that the rights that John may protect from transfer under Old Act § 46, I (third sentence) must be narrowly construed; that they include only any agency rights John may have as a manager of Blackacre and any voting rights, information rights, fiduciary rights and dispute resolution rights he has as a manager, but that they do not include any rights he has to use Blackacre.

   e) The judge accepts Mary's lawyer's argument and awards Mary the right to use Blackacre. In addition, the judge rules that since, on the date on which Mary sought an order transferring this right to her, the Old Act governed JSM, and any election by JSM to be governed by the New Act during 2013 would be ineffective to bar this transfer.

2) Illustration if Old Act LLC makes election

   a) Under New Act § 126, it is clear that except for his LLC interest, John may not transfer any of his rights to any person except with the consent of all other members. These rights clearly include John's right to use Blackacre. Accordingly, the judge in his divorce court proceeding declines to transfer this right to Mary.

§ 11.13 SHOULD NEW HAMPSHIRE AND MASSACHUSETTS BUSINESS PEOPLE WHO DO BUSINESS IN BOTH

STATES FORM THEIR LLCs UNDER THE NEW ACT OR UNDER THE MASSACHUSETTS ACT?

[A] EXPLANATION

1) Business people who intend to do business in both New Hampshire and Massachusetts must form their LLCs in one of these states and must register it as a "foreign LLC" in the other.

2) As outlined in Chapter 9, the New Act offers LLC members many LLC business organization law advantages that the Massachusetts LLC Act does not offer. Above all:

   a) The New Act provides far greater protection of LLC members' membership rights against transfers to third parties than the Massachusetts LLC Act.

   b) The New Act provides far greater contractual flexibility than the Massachusetts Act.

3) Thus, while business people considering under which of the two acts they should form their LLCs should retain lawyers to advise them on this issue if their financial or personal stakes in their LLCs are substantial, it is likely that in most cases, the advice of a lawyer will be to form their LLC under New Act; and for business people who want to make the choice without legal advice, the New Act will probably be the best choice in any event.

[B] CONCRETE ILLUSTRATIONS

The concrete illustrations set forth above in this chapter that make clear the LLC business organization law advantages of the New Act over the Old Act apply also in comparing the New Act and the Massachusetts LLC Act.

§ 11.14 SHOULD BUSINESS PEOPLE WHO CONDUCT THEIR BUSINESSES THROUGH CORPORATIONS CONVERT THEIR CORPORATIONS TO NEW ACT LLCs?

[A] EXPLANATION

1) In 1997, the Old Act was amended to permit New Hampshire corporations and other non-LLC entities to make "statutory conversions" of their corporations. In a statutory conversion, the converting entity changes from one business organization form to another—for example, it changes from a corporation to an LLC—but it remains the same legal entity after the conversion as before, and thus has the same owners, assets, rights and liabilities.

2) There have always been three powerful reasons for New Hampshire corporations to make statutory conversions to LLCs:

   a) First, New Hampshire residents who own shares of corporations and receive dividends from these corporations must pay the 5% New Hampshire Interest and Dividends Tax on these dividends regardless of the structure of the corporation. However, if the corporation makes a statutory conversion to an LLC and the LLC has "nontransferable shares," the shareholders—who are now LLC members—do not have to pay the I&D Tax.

      i) In general, single-member LLCs have nontransferable shares if their operating agreements provide that upon any transfer of membership rights in them, they must dissolve. Multi-member LLCs have nontransferable shares if their operating

agreements provide that no members may transfer any membership rights except with the consent of another member.

b) Second, corporation statutes provide no protection to shareholders against the risk that courts will transfer their shares to third parties in divorces, bankruptcies and debt collection lawsuits. The Old Act provides significant protections against this risk.

c) Third, the Old Act also provides various other legal advantages to LLC members that corporation statutes do not provide, such as much simpler management structures.

3) The above reasons explain why, over the past several years, roughly 900 New Hampshire corporations have made statutory conversions to LLCs.

4) All of these reasons apply also under the New Act. However, as discussed in detail in Chapter 3 of this book, the New Act provides far greater protection against the transfer of members' membership rights to third parties, particularly in the case of single-member LLCs.

[B] CONCRETE EXAMPLES

1) Joe Jones, a New Hampshire resident, is the only shareholder of XYZ, Inc., a New Hampshire corporation. XYZ never pays dividends, so Joe is not concerned about avoiding the I&D Tax. Furthermore, although Joe would like to protect himself from the risk that a court will transfer his shares to a third party in a lawsuit. However, he knows that the Old Act won't protect him from this risk; so he doesn't make a statutory conversion of XYZ to an LLC.

2) However, if Joe waits until the effective date of the New Act—namely, January 1, 2013, he will obtain powerful protection against the above risk even though his LLC will be a single-member LLC.

3) Same facts as above, but to obtain the above protections, he gives half of his XYZ shares to his wife. If he makes a statutory conversion of XYZ to an LLC, he will obtain significant protection against the above risk even under the Old Act. However, as discussed in Chapter 3, he will receive far greater protection under the New Act.